Performance audit in government sector of an emerging market: a case of Indonesia

Parulian Silaen

University of Wollongong, parulian@uow.edu.au

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*) Parulian Silaen, School of Accounting and Finance, University of Wollongong, email: parulian@uow.edu.au
Introduction

Since there is an increasing demand on a better public accountability across nations, particularly in emerging market, the role of performance audit in government sector is becoming popular. The OECD (Organisations for Economic Co-operation and Development) countries have been aware of this need since they have reformed their public management to be more transparent, accountable and provide better service (Leeuw, 1996; Politt, 2003). The OECD countries attempted to advance in this area by having a symposium in Paris on 6-7 June 1995. The countries of emerging market seemingly rushed up to reformed their public management including Indonesia to meet the new demand of the society by compiling performance audit in government sector.

The research on performance audit focuses on various aspects including the qualification of auditors and audit criteria (Smith, et al, 1972; Kitindi, 1992), the measure of efficiency and effectiveness (Leeuw, 1996), and audit expertise in government sector (Gendron, et al., 2007). Leeuw (1996, p.95) found that the goals of performance audit in the Netherlands Court of Audit is the auditing of effectiveness and efficiency. Since the nature of government sector is a non-profit organisation, then the achievement of the government sector will be difficult to be measured quantitatively, and hence efficiency and effectiveness. This characteristic creates a challenge for this study to investigate how the performance audit is used in government sector by taking the case of Indonesia.

The purpose of this study is to investigate how a performance audit is implemented by government audit body in Indonesia. In addition, the study is also investigating the similarities and differences of practice of PA in Indonesia and the OECD countries.

In the next section of this paper, the literature review on performance audit will be presented, followed by a discussion on the types of performance audit practiced by OECD
countries. Then the paper will present the Study which consists of the practice of Performance audit by the Finance and Development Supervisory Agency (BPKP) in Indonesia, followed by a Discussion of the practice and finally will be closed with Conclusion.

Literature review

Performance Audit (PA) may play an important role in managing public sector. In 1971, a CPA firm in New York conducted a management audit on the Long Island Railroad, a government unit (Smith et al, 1972, p. 270). During that early stage, there were many issues were unclear regarding the Performance Audit (PA). Smith et al (1972) conducted a study to investigate the issue of PA to answer the following questions (1) the need for an audit of management [performance audit] by CPAs; (2) the scope of such an audit; and (3) the audit standards required for such an audit. Their survey was conducted to a group of professionals that has a relevant task with auditing by mailing the questionnaire to 108 CPAs (Certified Practicing Accountants), 115 Corporate Controllers, 157 CFAs (Certified Financial Analysts), and 103 Mutual Fund Managers.

The survey on the first question indicated that the CPA group strongly agreed with the PA should be done by CPA qualification, while other groups seemed to oppose it on the ground that PA is much related to the management function by nature (Smith et al, 1972, p.273). Regarding the second question, the study focused on the scope of Performance versus Means by providing three substance to audit (a) Management performance only; (b) the means utilized by management; and (c) both performance and means. The survey indicated that none of the respondents support the idea of an audit of performance or means separately (Smith et al, 1972, p.275). The responses from groups other than CPAs were also interpreted to be relevant to lack of CPAs qualification to perform such audit
(Smith et al, 1972, p.275). The survey on the third question indicated lack of support for the use of Generally Accepted Accounting Principles (GAAP) from the group other than CPAs, which means that a new reporting format need to be developed (Smith et al, 1972, p.281). It can be concluded that their study at early stage of performance audit indicated a need for performance audit, but the auditor should not be limited to CPA qualification, and should not use the GAAP as standard for such audit.

The development in public management has recently increasing which indicated by the adoption of NPM (New Public Management) in the Western Europe (Leeuw, 1996) and some countries of emerging market such as Vanuatu (O’Donnell, 2005) and Malaysia (Siddiquee, 2006). According to Leeuw (1996, pp. 93-94) the NPM needs PA (Performance Audit) on three reasons; firstly, PA can distinguish ambitions and intentions of politician and bureaucrat from realisation or achievement of goals. Secondly, implementing NPM has risk of leading to unintended and undesired consequences, and PA can unravel the intended and unintended consequences, and thirdly, innovations like NPM run the risk of being mimicked, and PA can unravel different aspects of the implementation and adoption of NPM. Leeuw (1996) studied the practice of PA by the Netherlands Court of Audit used the goals of the PA defined by the Budget and Accounting Act (1991) of the country as to audit effectiveness and efficiency includes (Leeuw, 1996, p. 95); (a) auditing the effectiveness and efficiency of management, which includes all possible aspects of the internal management at (departments of) the public service; (b) auditing the effectiveness and efficiency of the (departmental) organisation; and (c) auditing the effectiveness and efficiency of policies (implemented).

The study of Leeuw (1996, p.95) found that the Netherlands Court of Audit carried out substantive and systemic PA to audit of effectiveness and efficiency by using the result of
programme evaluation. The substantive PA refers to a functioning and programme of
government activity is analysed by reference to certain standards or benchmarks, while
systemic PA refers to assessment of the adequacy of performance information and its use
(Leeuw, 1996, p. 95). In addition, Leeuw (1996) also found that the Netherlands Court of
Audit carried out government-wide performance audit (GWAs). This type of performance
audit was mentioned as an audit that “...focus on policy instruments, programmes and
activities relevant for all or most of all ministries. These audits are comparative in nature”.
The PA auditor of the Netherlands Court of Audit employed over 30% of its staff having non-
accounting degree, and in addition, the programme evaluations sometimes were done by
the auditors themselves, but more often they are contracted to other social research
institutions (Leeuw, 1996, p. 95). This result indicated that the auditors of PA are not
compulsory professional accountants.

Pollitt (2003) conducted a study on performance audit of Supreme Audit Institution
(SAI) of five Western Europe countries; Finland, France, the Netherlands, Sweden, the UK.
The study indicated that most of the SAIs formally stated that they investigated 3 Es-
economy, efficiency and effectiveness; however in practice the 3 Es were rarely used, rather
to use some notion of good management practice (Pollitt, 2003, p.160). In addition, the
performance auditors’ backgrounds were different across these countries. The performance
auditor in France is likely to be a lawyer; in the UK is accountant, while in Sweden as a social
scientist (Pollitt, 2003, p.161).

Types of Performance audit

In 1995, the OECD (Organisation for Economic Co-operation and Development) held a
symposium on PA (Performance Audit) in government sector, and Barzelay (1995) reviewed
the papers presented at the symposium. Barzelay (1995) identified key differences among
Barzelay (1995) indicated three common types of PA practiced in OECD countries. First type is Efficiency audit which

"...examines organisational functions, processes, and programme elements to evaluate whether inputs are being transformed into outputs in an optimal way, especially with regard to costs" (Barzelay, 1995, p.22).

The second type is Programme effectiveness audit that examines the relationship between programme-level outputs and outcomes (Barzelay, 1995, p.22). The third type is Performance management capacity audits. This type of PA evaluates *whether the auditee has the capacity to manage its processes and programmes in an efficient and effective way* (Barzelay, 1995, p.24).

In addition to the above common types of PA, there are four uncommon types of PA practiced by some of OECD countries (Barzelay, 1995, p.25). The first type in this category is Performance information audit. This type of PA focuses on reviewing non-financial aspect of performance information by validate of attest to its accuracy or reliability. The second type is Best practice review that conducting a review on a large number of organisations to

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**Table 1**

<table>
<thead>
<tr>
<th></th>
<th>Image of government</th>
<th>Meaning of effectiveness</th>
<th>Primary goals of review</th>
<th>Dominant mode of review</th>
<th>Role of reviewer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional auditing</td>
<td>Machine bureaucracy</td>
<td>Transactions and task-performance effectively regulated by systems</td>
<td>Compliance accountability</td>
<td>Auditing</td>
<td>Verify information; Find mismatches between actual local practice and general norms; infer consequences; report findings</td>
</tr>
<tr>
<td>Performance auditing</td>
<td>Input-process-output-boundary spanning among organisations and sectors (plus other NPM ideas)</td>
<td>Organisational and production practices are optimised given a configuration of goals and constraints</td>
<td>Performance accountability</td>
<td>Inspection</td>
<td>Evaluate aspects of program and organisations involved; report finding</td>
</tr>
<tr>
<td>Program evaluation</td>
<td>Government-steered interventions intended to ameliorate collective problems</td>
<td>Programs achieve goals; public policies improve collective well-being</td>
<td>Providing true and useful feedback on policy and program effectiveness</td>
<td>Research</td>
<td>Evaluate effectiveness of interventions of measure impact of disjointed interventions on collective problems.</td>
</tr>
</tbody>
</table>

Source: Barzelay (1995, p.18)
identify organisations which perform the selected function exceptionally well and then analyse why these results are achieved (Barzelay, 1995, p.25). The third type of unusual PA is Risk assessment. This type of PA has future oriented and has its main intent is to identify the precise ways in which an existing programme is liable to break down in the future and to warn the politician and managers accordingly (Barzelay, 1995, p.25). The last type of the unusual PA is General management review that centrally concerned with evaluating performance management capacity to deliver upon its missions and policy mandates.

In order to identify the differences among those types of PA, Barzelay (1995) examines thirteen cases of PA practiced by the OECD countries and separate different types of performance audit (PA) in terms of four features as depicted in table 2 below.

**Table 2**

<table>
<thead>
<tr>
<th>Common types of PA</th>
<th>Type</th>
<th>Unit of Analysis</th>
<th>Mode of review</th>
<th>Scope of evaluation</th>
<th>Focus of effort</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Efficiency Audit</td>
<td>Organisation function, process, or program element</td>
<td>Inspection</td>
<td>Aspects of governmental and “third-party” operation</td>
<td>Identify opportunities to lower budgetary cost of delivering program outputs</td>
</tr>
<tr>
<td></td>
<td>Program effectiveness audit</td>
<td>Policy program, or major program element</td>
<td>Inspection</td>
<td>Selected aspects of program design and operation</td>
<td>Assess impact of public policies, evaluate program effectiveness</td>
</tr>
<tr>
<td></td>
<td>Performance management capacity audit</td>
<td>Organisation</td>
<td>Inspection</td>
<td>That which affects performance of managerial functions</td>
<td>Assess capacity to achieve generic goals of economy, efficiency, and effectiveness</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Uncommon types of PA</th>
<th>Type</th>
<th>Unit of Analysis</th>
<th>Mode of review</th>
<th>Scope of evaluation</th>
<th>Focus of effort</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Performance information audit</td>
<td>Organisation</td>
<td>Audit</td>
<td>Information generated by performance measurement/reporting systems</td>
<td>Validate/attests to accuracy of information provided by organisations</td>
</tr>
<tr>
<td></td>
<td>Risk assessment</td>
<td>Program</td>
<td>Inspection</td>
<td>All aspects of program design and operation</td>
<td>Identify major risks of program breakdown and their sources</td>
</tr>
<tr>
<td></td>
<td>Best practice review</td>
<td>Whole sector, generic process, or common function</td>
<td>Research</td>
<td>All aspects of organisational and program operation</td>
<td>Formulate sector-specific standards of best practice; reveal relative performance of sector participants</td>
</tr>
<tr>
<td></td>
<td>General management review</td>
<td>Organisation</td>
<td>Inspection</td>
<td>Selected aspects of organisational structure, systems, and programs.</td>
<td>Assess capacity of organisation to deliver upon its mission and policy mandates</td>
</tr>
</tbody>
</table>

Source: Barzelay (1995, pp. 23 and 26)
The study

Background

Indonesia is a democratic country that consists of 17,508 islands spread between the Indian Ocean and the Pacific Ocean\(^1\), and had a population of 222 million people in 2006\(^2\). The population consists of at least 500 major ethnic groups with different local languages and cultural backgrounds\(^3\). Before its independency in 1945, Indonesia was colonialized by several countries and has been influenced by at least four countries; Portugal, the Netherlands, Britain, and Japan, in which the Netherland influence is considered the most significant (Sutherland, 1979). After its independence, Indonesia was led by Sukarno as its president.

On 30 September 1965, there was an attempt to coup the country by communist group which make the situation of the country became critical. On 2 October 1965, General Soeharto accepted the task from Soekarno to restore order and security in the country (Ricklefs, 2001, p. 346). On 12 March 1967, the Provisional People’s Consultative Assembly took the power from Soekarno and appointed Soeharto as acting President and finally brings him to be the second president of Indonesia. During the Asian crisis Soeharto was forced by the people to step down from power on 28 May 1998. Soeharto was replaced by the vice president Dr. BJ. Habbibie as the third president until October 1999. Although the Indonesian Democracy Party of Struggle (PDIP) led by Megawati had the highest votes at 1999 election, the People’s Consultative Assembly/Upper House (MPR) led by Amin Rais (a leader of second largest Islamic group) appointed Abdurrahman Wahid (a leader of the largest Islamic group) as the fourth President of Indonesia, and Megawati as the vice president.

\(^1\) Department of Internal Affair, [http://www.indonesia.go.id/home_01.html](http://www.indonesia.go.id/home_01.html), accessed 11-07-05, 17:59.
\(^3\) [http://www.kebudayaan.depdignas.go.id/BudayaOnline](http://www.kebudayaan.depdignas.go.id/BudayaOnline), visit 18-7-2005, 9:45
president. Again in July 2001 the same People’s Consultative Assembly/Upper House (MPR) through a special meeting removed Abdurrahman Wahid from power and replaced him with Megawati as the fifth president. In the election of 2004 Susilo Bambang Yudhoyono won the presidential election as well as in 2009 election he won the election for the second term that make him the sixth president of the country.

**The performance audit in government sector in Indonesia**

Through the government regulation (GR) number 60, 2008, the government of Indonesia put into place an internal control system in government sector including an introduction of performance audit (PA) to be implemented by internal auditors of the government bodies. In the regulation it was mentioned that PA is an audit on the management of public money and the implementation of tasks and functions of government institution that consists of the aspects of economy, efficiency and effectiveness. There are two types of government body in Indonesia; government institution (i.e. ministries, and government agencies), and state government which may consist of two types as provincial and district government. Government institutions are units under the president and have central office in Jakarta. State government are voted directly by the people which is for provincial government is headed by a governor, and district government which is also directly voted by the people and is led by a regent or mayor. As these two government bodies is different there are two audit handbooks issued by BPKP (the Finance and Development Supervisory Agency). The audit handbook used by this study is issued by the Deputy Financial Control of State Government of BPKP year 2009, to be used to audit the performance of state government of year 2008.

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The PA handbook does not specify the qualification of auditor and the requirement of accounting background. Nevertheless, the BPKP (the Finance and Development Supervisory Agency) is a government internal institution that the majority of auditor in this institution had accounting background and certified practicing accountant. From the audit handbook it is indicated that (page 10);

“the primary objective of the PA is to evaluate the service performance and to examine compliance to the rule and regulation and to give recommendation in form of steps to solve the problem”

The PA is focused on five aspects as;

1. Target of achievement of SPM (minimum standard service) as presented in the planning document and in the budget of local government
2. The achievement of minimum standard service (SPM)
3. Planned and budgeted activities that has been executed economically, efficiently, and effectively toward the target.
4. Transparency and accountability of service performance of state government
5. Community satisfaction index

The scope of audit is limited to six services; Education, Health, Utilities, Employment, cooperation, small and medium enterprise, and registry service. The audit method to be used by PA in general is to collect data and information as evidences. These then will be used to assess the compliance of the auditee on the rule and regulations, examine the plan and actual achievement, and to examine that the activities were executed economically, efficiently, and effectively.

The implementation of the PA consists of seven steps. The first step is to examine five components of internal control systems of the auditee (state government unit). The first component is the control environment. The examination on this component is to identify how the head of the unit create an environment encourage the employee to achieve the expected performance. The second component examination on risk assessment set by the auditee. Third is examination on control activities prepared by auditee to anticipate
potential problem. The fourth is examination on how the auditee handles information and how the information is communicated across the hierarchy. The last component is to evaluate how the auditee monitors the implementation of internal audit systems.

The second step is to evaluate compliance to rule and regulations to investigate whether all the plan and target have been documented as required by government regulation. The third step is to audit the achievement of SPM (minimum standard service) by comparing the actual achievement with benchmark specified by the related ministries. There are four objective of this audit; one is to examine achievement plan; two is to convince that the achievement plan is supported by the data collection of the performance; three is to examine the actual achievement of SPM; four is to evaluate service transparency and accountability.

The fourth step is to audit economy, efficiency, and effectiveness of the activities. This step is to ascertain that the activities have been set in the budget and been executed economically, efficiently, and effectively. In this step the economy is measured by comparing the price index with the price per unit used in budget. In addition, the comparison of volume and price on the budget with the actual usage is also used as the measure of economy. The efficiency is measured by comparing input to output, while effectiveness is a measure of relationship between outcome and output.

The fifth step is to evaluate the role of central and provincial government on the achievement of SPM (minimum standard service) by the district government. This step is implemented only to two sectors; health and education in which the minimum standard service (SPM) of both has been stipulated by the related ministries. The sixth step is to conclude the audit result, preparing the finding and recommendation. The last step is to
prepare a proposal of the minimum standard service (SPM) for related ministries that have not stipulated the minimum standard service (SPM).

Discussion

As indicated by Barzelay (1995) that the primary goals of PA is performance accountability which is mentioned as,

...concerned with establishing and operating a proper relationship between government organisations and their principals so that the latter can enforce responsibility for performance on their agents.

The practice of PA in Indonesia is also indicated to be performance accountability as indicated by the objective of the PA. The regent or the provincial government may be the agent while the principals would be central government, Member of Parliament to represent the public, and the public itself. The practice of PA in Indonesia did not use government accounting standard used by traditional auditing, and the there is no clear indication to say that the auditor of PA has to be a practicing accountant. In addition, regarding the mode of review, it is indicated that the PA in Indonesia did not use auditing mode which is specified by Barzelay (1995, p.19) as;

...to verify information submitted by clients and to detect discrepancies between clients’ financial management systems and transactions, on the one hand, and formal standards, on the other hand.

Rather, the practice of PA in Indonesia is evaluation through inspection and so it is corresponding to the practice of most OECD countries. In relation to the three common types of PA practiced by OECD countries (Barzelay, 1995) the practice of PA in Indonesia seems to involve a combination of efficiency audit and programme effectiveness audit. The practice of efficiency audit is indicated by the third and the fourth step of the PA implementation. The third step is to evaluate the achievement of the auditee in relation to the benchmark stipulated by related ministry. For example, if the audit scope is education
so the benchmark is specified by the ministry of education. If the audit scope is Health, then the benchmark is specified by the ministry of Health. The fourth step of the PA implementation is to measure economy, efficiency and effectiveness of the organisational function or program elements. The measure of economy is using the existing price index, as well as using input to output relationship to measure efficiency, and output with outcome for effectiveness. The practice of programme effectiveness audit by PA in Indonesia is indicated by the scope of audit is limited to six services which is comparable as major program element of Barzelay’s units of analysis, as well as to measure effectiveness as indicated by step four of the PA practiced. It also can be said that the practice of PA in Indonesia may be similar to the one found by Leeuw (1996) as substantive and systemic performance audit.

Conclusion

The practice of PA (performance audit) varies among countries. Barzelay (1995) indicated seven types of PA practiced across the OECD countries. From the seven types three common types of PA are practiced by OECD countries, and four are uncommon. Barzelay (1995) using five features to indicate that performance audit is different from traditional audit and program evaluation. It is also argued that PA is not an audit to verify information; rather it is an evaluation of performance accountability.

Furthermore, Barzelay (1995) also classify those seven types of PA base on four characteristics; unit of analysis, mode of review, scope of evaluation, and focus of effort. The study uses the characteristics of PA practiced by OECD countries to indicate similarities and differences of PA practiced in Indonesia. The PA in Indonesia is on its early stage, and is executed by BPKP (the Finance and Development Supervisory Agency). The PA is practiced
differently across two government bodies; government institution and state government. This study focuses on state government by using the PA handbook specifically to audit the state government unit. The study found that there is no requirement about specific background of auditor to conduct performance audit. The primary objective of PA in Indonesia is to evaluate the performance, compliance, and provide recommendation. The scope of audit is limited to six services or programmes. The implementation of PA consists of seven steps including to measure the achievement and compare it to a benchmark and to audit economy, efficiency, and effectiveness of the state government units and or programmes. The practice of PA in Indonesia using substantive and systemic performance audit (Leeuw, 1996), and the type of PA practiced may be a combination of efficiency audit and programme effectiveness audit (Barzelay, 1995).

The study contributes to the literature by identifying the practice of PA in an emerging market, Indonesia, and compares it to the practice of OECD countries. The finding also indicated that the practice of PA is an evaluation, not verification. The study contribute its finding to support that different countries may practice it differently, as Indonesia may practice a combination of two types of PA practices by OECD countries.

The study is however limited to a single case of BPKP particularly using the data from audit manual. Further study on the how actual practiced of PA through the PA report and or observation on the field would enrich understanding on how really a performance audit is implemented.
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