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The effect of the quality of local government financial reports on corruption moderated with the audit findings

Abstract. The study examines the effect of the Quality of Local Government Financial Reports (LKPD) on corruption moderated by audit findings. The study was conducted on all provincial governments in Indonesia. Corruption is measured by data on corruption cases in the Attorney General's Office. The audit findings are evaluated using weaknesses in the Information Control System (SPI) and discoveries of non-compliance with laws and regulations. This research use data regression, model testing, hypothesis testing, and coefficient of determination. The results reveal that the LKPD's quality had a negative and significant impact on corruption. This analysis states that if the quality of LKPD increases by 1%, corruption will decrease by 0.80%. The audit findings strengthen the relationship between the quality of LKPD on corruption. This finding supports the agency theory and stewardship theory. Therefore, the provincial government should improve the quality of LKPD to minimize audit findings and corruption.
Keywords: Quality of Financial Reports; Corruption; Financial Audit System; Financial Management
JEL Classification: K20; K23; H11

1. Introduction

Corruption is not a new phenomenon. The issue of corruption is still a hot issue that continues to be discussed globally. Even Indonesia is one of the countries that continue to be the talk of the world when discussing corruption issues. That emerged after reform, but acts of corruption, collusion, and nepotism (KKN) have existed before the reform (Sarwono et al., 2018).

KKN is centralized among the president's family, military leaders, and conglomerates (Nelson & Santoso, 2020). However, the emergence of democracy introduced in the 1998 reform era in Indonesia has made corruption cases easier to identify with the freedom of the media. In Indonesia, the corruption in local governments (including provincial and district/city governments) has increased significantly every year. The average increase in corruption per year is 31 cases or 49%. In 2015 there was an increase in corruption cases by 5, equivalent to 14% from 2014. From 2016 to 2018, there was an increase in corruption cases, every 26 cases or equivalent to 63% in 2016, 15 cases or equivalent to 22% in 2017, and 80 cases or equivalent to 97% in 2018.

One of the efforts that the government can make in eradicating corruption is through quality financial management that refers to/guided by Government Accounting Standards (SAP) (Jaff et al., 2021; Muda et al., 2018; Sujana et al., 2020). Quality financial management will also produce quality government financial reports (McVay & Szerwo, 2021). According to (Arifuddin et al., 2021), quality government financial reports can be measured by audit opinions because audit results are assumed to be complete, accurate, and unbiased (Arakelova, 2020). High-quality financial reports can mitigate the problem of information asymmetry, reduce moral hazard, and increase the efficiency and effectiveness of allocation and utilization of economic resources (Karabayev et al., 2021). On the other hand, incomplete financial statements might result in regional/state losses, revenue loss, and inefficiency (Montoya, 2018).

The leading theory underlies research on the influence of the quality of LKPD on corruption in provincial governments in Indonesia. The agency theory perspective is used to explain audit findings as moderating variables. In an organization, the separation of ownership by principals and control by agents causes agency conflicts between principals and agents (Ferrali, 2020). The agent has a moral obligation to maximize the principal's profits. On the other hand, management is likewise interested in optimizing their well-being, leading to agency issues (Lassou et al., 2021; Frolov & Bosenko, 2020). As a result, local governments must ensure that management complies with all applicable rules and regulations. Monitoring is expected to provide quality of LKPD (PP No. 71/2010). Quality Local Government Financial Reports (LKPD) are accountable for using various resources to minimize information asymmetry.

Article 1, number 11 of Law Number 15 of 2004 examines the Management and Accountability of State Finances as regulated. While the type of opinion for LKPP/LKKL still refers to Law Number 15 of 2004, namely:
1) The definition of opinion is a professional statement as the auditor's conclusion.
2) Unqualified Opinion with Explanatory Paragraph (WTP DPP). In some cases, the examiner may be required to include an explanation paragraph (or another descriptive language) in his audit report. In this case, BPK can provide an unequivocal opinion and a descriptive paragraph. (WTP DPP).
3) Qualified Opinion (WDP) The financial statements present a particular entity's financial position, results of operations, and cash flows fairly in all material respects, following generally accepted accounting principles in Indonesia, except for the effects of matters relating to those excluded, according to the Qualified Opinion.
4). According to the Unfair Opinion, the financial statements as a whole do not adequately portray the financial status, cash flows, and results of operations of various Indonesian businesses following generally accepted accounting principles.
5) The examiner's failure to express an opinion implies that they do not have one on the financial statements. However, if the auditor is unsure or has doubts about the fairness of the financial accounts, an opinion can be expressed. The auditor cannot carry out the audit according to the standard due to the limited. Therefore, the auditor is not independent of the party being audited. In addition, there are significant uncertainties that significantly affect fairness.

The financial audit agency's (BPK) audit findings are various forms of fraudulent activities discovered in the government's financial accounts during the BPK's audit that breached internal control rules and legislative requirements. According to Law Number 15 of 2004, public finances must be administered in an orderly manner, following rules and regulations, and in an efficient, economical, effective, transparent, and responsible manner with a sense of justice propriety in mind. In addition, the management and accountability of state finances have an audit standard by the Supreme Audit Agency (Kaletnik & Zdyrko, 2021). Therefore, when the State Audit Board audits state financial management and accountability, it is legally protected (Donatella et al., 2019). The financial audit's goal is to provide reasonable assurance that the financial statements are presented fairly in all relevant aspects, either following generally accepted accounting principles or on a

complete basis of accounting in Indonesia that is not following generally accepted accounting principles. In addition, according to (Berková et al., 2019), the financial statements are presented fairly in all material respects, either following generally accepted accounting principles or on a complete basis of accounting in Indonesia that is not following generally accepted accounting principles. There are 30 types of acts, including the category of criminal acts of corruption according to Law No. 20 of 2001. Corruption offenses are classified into seven categories:

1) state financial losses;
2) bribery;
3) office embezzlement;
4) extortion;
5) fraudulent actions;
6) procurement conflicts of interest;
7) gratuities.

In addition, other types of corruption-related criminal acts include:

a) obstructing the investigation of corruption cases;
b) failing to provide information or providing incorrect information;
c) banks refusing to provide information on the suspect's account;
d) witnesses or experts who do not testify or give false testimony;
e) witnesses who reveal the identity of the suspect.

Recently, the Unqualified Opinion (WTP) given by the Supreme Audit Agency (BPK) on local government financial reports has been in the spotlight. Not without reason, the phenomenon that occurs today is that almost all local governments get WTP opinions. However, there are still indications of corruption/bribery committed by officials at the regional agencies (Hung Son et al., 2020). BPK is an independent audit of state finances in line with Law Number 15 of 2004 concerning Audit of State Finance Management and Responsibility. Therefore, the results of the BPK examination should be able to become a benchmark for performance and a medium for an institution that plays a role in reducing fraud and corruption. Testing the relationship and influence between variables is very important to identify the problem being studied accurately. This study aims to investigate the impact of the Quality of Local Government Financial Reports (LKPD) on corruption as moderated by audit findings.

2. Methods

This type of research is descriptive quantitative, which explains the causality between variables. This study aims to test a theory or hypothesis to strengthen or even reject the theory or hypothesis of previous research. The population in this study were all provinces in Indonesia, amounting to 34, spanning the years 2014-2018. The data used in this study is secondary data in the form of panel data, including data on audit findings and corruption data sourced from the Supreme Audit Agency of the Republic of Indonesia and the Indonesian Attorney General's Office in 2014-2018. In addition to data through documents, research data is taken through literature studies from various previous studies of the same type, literature, journals, articles, and knowledge considered relevant to the discussion.

The data in this study are divided into two types: audit opinion data and audit findings from BPK-RI and corruption data from the Attorney General's Office of the Republic of Indonesia. Determine the independent effect on the dependent variable first, and then utilize quantitative analysis methods on panel data. Next, the quantitative analysis method using panel data that combines time-series data and cross-section data is used to determine the effect of the independent variable on the dependent variable. The formula used in measuring the relationship between variables in the study is as follows:

$$KORP_{it} = \alpha + \beta_{1KLKPDit} + \beta_{2TA} + \beta_{3KLKPD*TAit} + \varepsilon_{it} \, , \qquad (1)$$

where:
$KLKPD$ = Quality of Regional Financial Reports;
TA = Audit Finding;
$KORP$ = Corruption;
β = Regression coefficient;
ε = error term;
it = panel data.

3. Result and Discussion

Descriptive statistics summarize the essential things from the existing data for each research variable. The data include, among others, the minimum and maximum values, the average (mean), and standard deviation. The descriptive statistical results in the study can be seen in Table 1.

Table 1:
Test Results

N	Mean	Maximum	Minimum	Std. Dev
Audit Finding	42.72781	289.0000	8.000000	39.04846
Quality of Regional Financial Reports	4.721893	5.000000	2.000000	0.672278
Corruption	3.585799	38.00000	0.000000	2.902484
Valid N (listwise)				

Source: Compiled by the authors

Table 1 explains that the average audit findings are 42.47647 or 42 cases of findings per year, while the standard deviation obtained is 39.07044. Audit findings are various types of fraudulent acts found in the government's financial statements during an audit by the BPK that violate the provisions of internal control and statutory provisions. The lack of good government organizations generally causes fraudulent internal control systems and compliance with the rules. So it can be explained that the average annual fraud case is 42 cases, which is very significant. The maximum value of audit findings during the 2014-2018 period was 289 cases. DKI Jakarta Province for 2017 had the most fraudulent acts found in financial statements, while the minimum value of audit findings was 0 in North Kalimantan province for 2014. Thus, North Kalimantan province has good quality of LKPD. Good Local Government Financial Reports can be seen from financial management by complying with applicable laws and regulations (Pamungkas et al.,2019).

The average quality of Local Government Financial Reports (LKPD) is 4.721893 or equivalent to close to WTP, while the standard deviation obtained is 0.672278. The LKPD is a structured report on a reporting entity's financial situation and transactions based on existing regulations. The average value illustrates that, in general, during the observation period, the quality of LKPD for provincial governments in Indonesia is very high. This outlines preparing and presenting financial statements following Government accounting rules (SAP) (Hudori & Mustikasari, 2020).

The test results using the Chow test explained that the model chosen was the fixed effect model. However, the Hausman and Lagrange multiplier tests confirmed that the chosen models were random-effects models and random effects models, respectively. Thus, the panel data estimation model selected and suitable for use in this study is the random effect model. Table 2 shows the panel data regression model using the random-effects model based on the data processing outcomes.

Table 2:
Hypothesis testing results

Variable	Coefficient	t-Statistic	Prob
C	-2.466107	-0.614798	0.5395
KLKPD	-0.809826	-1.984999	0.0512
KLKPD-TA	-0.030139	-2.147876	0.0319
Adjusted R-squared		0.491933	
Prob F-statistic		0.000892	

Source: Compiled by the authors

Based on the results of the random-effects model in Table 2, the following regression equation is obtained:

$$KORP = \text{-2.466107} - 0.809826\,KLKPD - 0.030139\,KLKPDTA\,. \tag{2}$$

The constant value in the regression equation is -2.466107, which means that if the quality and audit findings are 0, then corruption is -2.4. The LKPD quality regression coefficient value is -0.809826 with a negative direction. Corruption will be reduced by 0.80% if the quality of LKPD improves by 1%. The regression coefficient value of the interaction of audit findings with the quality of LKPD on corruption is 0.030139 with an opposing direction. If corruption increases by 1%, the relationship between the quality of LKPD on corruption will decrease by 0.030%. The results of hypothesis testing with the selected random effects model can be seen in Table 3.

Table 3:
Model Regression Data Panel of the Hypotheses Model Random Effect

No	Variable	Coefficient	t-count	Decision
1	KLKPD	-0.809826	-1.984999	Supported Hypothesis
2	KLKPDTA	-0.030139	-2.147876	Supported Hypothesis

Source: Compiled by the authors

Table 3 explains that all of the proposed research hypotheses are proven and supported where the t value > t table value is -1.984999 or (-1.984999 > -1.66123 or 0.0512 < 0.10) and the coefficient value of the quality of LKPD is - 0.809826. This means that the quality of LKPD has a negative and significant effect on corruption. Thus, hypothesis H1 is accepted. The interaction of moderating variables (audit findings) on the relationship between the quality of Local Government Financial Reports (LKPD) on corruption obtained a t-count value more significant than the t-table value (-2.147876 > -1.66123) with a probability of 0.0319 < 0.10 and a moderating effect value of -0.030139. If the value of t is calculated before the moderated effect is -1.984999 and -2.147876, it has been strengthening. The coefficient values are -0.809826 -0.030139, respectively. This means that the interaction of moderating variables (audit findings) strengthens the relationship between the quality of LKPD and corruption. Thus, hypothesis H2 is accepted.

4. Conclusion

The quality of Local Government Financial Reports (LKPD) has a negative and significant effect on corruption. The better the quality of LKPD, the corruption can be minimized. The audit findings underscore the link between LKPD quality and corruption. Thus, declining audit findings will improve the quality of LKPD and reduce corruption. The results showed a negative effect of LKPD quality on corruption. The audit findings strengthen the negative relationship between LKPD quality and corruption. In addition, the external auditor (BPK-RI) is expected to improve professionalism and integrity in carrying out supervisory duties to reduce corruption in the provincial government. However, the average number of cases of audit findings at the provincial level is still relatively high. It is hoped that the results of this study can motivate the management (government) as a whole to manage state/regional finances based on established rules jointly through various efforts, including providing incentives to management for quality LKPD through government or regional regulations.

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