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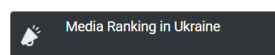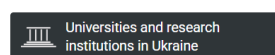
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General

TITLE
NEW PUBLIC MANAGEMENT AND CORRUPTION: EMPIRICAL EVIDENCE OF LOCAL GOVERNMENTS IN INDONESIA

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NEW PUBLIC MANAGEMENT AND CORRUPTION: EMPIRICAL EVIDENCE OF LOCAL GOVERNMENTS IN INDONESIA

Abstract

Corruption in local government is a relevant topic to study because it can disrupt sustainable economic growth and reduce the human development index. This study aims to examine the the impact of New Public Management (NPM) mechanism in the form of fiscal decentralization, quality of financial reporting, and the implementation of independent audits on corruption level. Based on agency theory and fraud triangle theory, this study analyzes the NPM mechanism as measured by fiscal decentralization, quality of financial reports, audit findings, and follow-up audit results on the level of corruption. The sample consisted of 433 local governments in Indonesia for the period 2011-2017. Hypothesis testing was carried out using Partial Least Squares-Structural Equation Modeling (PLS-SEM). The results showed that fiscal decentralization tends to increase the level of corruption. Meanwhile, the quality of financial reports had a negative effect on the level of corruption. The results also showed that audit findings in the form of weaknesses in the internal control system and non-compliance with laws and regulations tend to increase the level of corruption. Meanwhile, follow-up audit results had no significant effect on corruption. The results of this study indicate that the NPM mechanism in the form of fiscal decentralization can actually increase corruption. This implies that fiscal decentralization needs to be balanced with good governance, among others, by improving the quality of financial reports and independent audits.

INTRODUCTION

Based on a survey conducted by the Association of Certified Fraud Examiners (ACFE) published in the Report to the Nation's 2020: Global Study on Occupational Fraud and Abuse, corruption ranks first among fraud schemes that occur in Asia Pacific with a percentage of 51% (ACFE, 2021). Meanwhile, the ACFE Indonesia Chapter in the 2019 Indonesia Fraud Survey

Report also shows that the most common type of fraud in Indonesia is corruption with a percentage of 64.4% of cases (ACFE Indonesia, 2020). Based on the ACFE Indonesia 2020 report, 167 respondents or 69.9% stated that corruption was the most detrimental act in Indonesia. Government organizations are the institutions that suffer the most because of the fraud (ACFE Indonesia, 2020). This data shows that corruption is a significant problem because corruption can cause low economic growth so that it has a negative impact on GDP per capita which in turn results in a low standard of living. In order to overcome the problem of corruption, governments in various countries have carried out public sector reforms known as New Public Management (NPM), including fiscal decentralization, the application of accrual-based financial accounting, and the implementation of independent audits. However, research results indicate that the effectiveness of the NPM mechanism is still a debate and an important research question (Prabowo et al., 2017; Changwony, and Paterson, 2019). The practice of decentralization in Indonesia after 10 years of implementing regional autonomy and fiscal decentralization has caused many problems in the regions, one of which is the occurrence of decentralization of corruption (Prabowo et al., 2017; Boolaky et al., 2018; Harun et al., 2015; Sylvia et al., 2018).

The empirical studies on the effect of fiscal decentralization on corruption have obtained mixed evidence. Studies that provide evidence that fiscal decentralization will reduce the level of corruption include Fisman and Gatti (2002a), Fan et al. (2009), Ivanyna and Shah (2010), and Gurgur and Shah (2014). In contrast, the results of other studies actually provide empirical evidence that there is a positive relationship between fiscal decentralization and the level of corruption (Triesman, 2000; Fisman and Gatti, 2002b; Saputra, 2012; Shon and Cho, 2019; Ulum, et al., 2019). Changwony and Paterson (2019) stated that in order to further explain these mixed findings, it is important for researchers to include other determinants of NPM mechanisms besides fiscal decentralization. Other NPM mechanisms that may reduce corruption include increasing transparency and accountability of government organizations with quality financial reports and the implementation of independent audits (Malagueno, 2010; Liu and Liu, 2012; Atuilik, 2016; Jeppesen 2019; Furqan et al., 2020; Hamed -Shidom et al., 2022; Lino et al., 2022). Therefore, in order to explain the inconsistency of the results of previous studies, this study includes other mechanisms, namely the quality of financial reports and independent audits. This study also offers a financial approach based on agency and fraud triangle theory to fill the existing research gap. In this case the researcher uses the effect of auditing and fiscal decentralization on the level of corruption in a model simultaneously. In

previous research, government external audit was tested for its effect on the level of corruption without involving the influence of fiscal decentralization variables, and vice versa.

1. LITERATURE REVIEW

Jensen and Meckling (1976) define an agency relationship as a contract in which one or more people (principal) ask other people (agents) to do several things for the interests of the principal, which includes delegating some decision-making authority to the agent. Local government in the context of fiscal decentralization is basically the center for a series of contractual relationships between agents and principals (Zimmerman, 1977). This contractual relationship is manifestly embodied in various regulations in the government sector, including in Law Number 32 of 2004 and 33 of 2004. These two laws and their elaboration or regulatory derivatives to the technical level are the basis of legitimacy for fiscal decentralization for local governments in Indonesia.

In the context of public sector reform, Indonesia has sought to develop various NPM mechanisms with the aim of reducing corruption in government organizations by increasing transparency and accountability in budget management. However, after more than 10 years, there are some criticisms between the implementation of NPM in Indonesia. The study of Prabowo et al. (2017) analyze whether public sector reform in Indonesia is consistent with NPM principles. The empirical evidence of Prabowo et al. (2017) show that public sector reform in Indonesia is incompatible with NPM's philosophy of efficiency and effectiveness in the provision of public services. Harun et al. (2020) criticizes that the determinants of NPM adoption, including the budgeting and reporting system in Indonesia, are due to pressure from coercive international financial agencies and the desire to imitate public sector accounting reforms in developed countries. Meanwhile, the internalization of NPM in local governments is a response to a legal obligation imposed by the central government. Several studies also show that the effectiveness of NPM implementation in Indonesia is still limited (Harun and Robinson, 2010; Boolaky et al., 2018; Harun et al., 2015; Sylvia et al., 2018). Therefore, it remains an important research question whether the implementation of NPM can achieve the goals of public sector reform in Indonesia, especially in reducing the occurrence of corruption. This question is mainly because after the implementation of the NPM, the level of corruption problems in local government organizations in Indonesia is relatively high. Based on data from the Corruption Eradication Commission (*Komisi Pemberantasan Korupsi/*KPK), from 2014-2019, there were 97 criminal acts of corruption in local governments in Indonesia. The problem

of corruption has caused significant state losses. Indonesian Corruption Watch (ICW) reports that the value of state financial losses in 2019 reached IDR 8.4 trillion, an increase from 2018 with state financial losses of IDR 5.6 trillion.

In government sector, laws and regulations as well as derivative regulations related to fiscal decentralization, implicitly or explicitly constitute a form of contract between principals and agents. In this contractual relationship, the executive is given the authority to make fiscal decisions by the principal to carry out the actions or activities necessary to fulfill the wishes of the principal (legislative / people). This authority makes executives have discretionary power or freedom of action. Therefore, the activities carried out by the executive (as an agent) cannot always be observed by the legislative / the People (as the principal), resulting in information asymmetry. If both parties in the agency relationship are utility maximizers, then of course there are strong reasons to believe that the agent will not always act in the best interest of the principal (Jensen and Meckling, 1976). Apart from being able to be explained by agency theory, the effect of fiscal decentralization on corruption can also be approached by using the fraud triangle theory. According to Cressey (1953) the fraud triangle consists of three; namely, pressure, opportunity, and rationalization. High political costs resulting in high-cost recovery are a strong pressure to commit corruption. General information and technical skills as conditions for the opportunity are held by regional heads and regional officials who have the authority to prepare and implement regional revenue and expenditure budgets.

In terms of the fraud triangle theory, the opportunistic behavior of the executive and legislative can be explained through three points of view; namely pressure, perceived opportunity, and rationalization (Cressey, 1953). First, the pressure point of view. It is common knowledge that in the context of politics in Indonesia, to become a regional head (regent and mayor) requires high political costs. Therefore, cost recovery by the executive and legislature is a necessity and a strong pressure to commit corruption through the budget. Second, the perspective of perceived opportunity. The regional head and all the bureaucracy have the authority to compile and implement the budget based on laws and regulations governing regional finances in Indonesia. Therefore, executives become very aware (have general information) and also have expertise (technical skills) regarding public sector budgets which are a requirement for perceived opportunities. Two conditions that are parts of the opportunity in the fraud triangle have been fulfilled, so that the opportunity to commit corruption becomes an easy thing. Third, the point of view of rationalization. In the pre-decentralization era, corruption occurred at the

level of the central elite and when fiscal decentralization occurred, the corrupt behavior of the central elite became a justification for the local elites to take the same action. In the end, this corrupt behavior becomes a kind of snowball, which inspires legislators and executive officials in other regions to do the same.

Some researchers argue that decentralization increases the incidence of corruption. Fisman and Gatti (2002b) in the context of federal states in America found a positive relationship between corruption and the proportion of a state's spending through federal transfers. Saputra (2012) and Ulum et al. (2019) research results provide empirical evidence that decentralization will increase the level of corruption in local government in Indonesia. Albornoz and Cabrales (2013) examined the effect of decentralization on corruption in the context of high or low political competition. The results show that decentralization will increase the level of corruption only if the level of political competition is low and vice versa. The findings of Shon and Cho (2019) provide evidence that fiscal decentralization will increase the occurrence of corruption or that there is a positive relationship between fiscal decentralization and corruption in local governments in the United States. The results of research by Maria et al. (2021) shows that regional independence in the financial sector has a positive effect on corruption.

Corruption is an executive opportunist act in local governments that causes harm to the principal (the community), therefore the principal is involved in various forms of supervision of their agents. The literature on delegation of authority identifies four main measures by which principals can limit or reduce agency loss: (1) contract design, (2) screening and selection mechanisms, (3) monitoring and reporting requirements, and (4) institutional checks. Monitoring and reporting force executives to share with the legislature and the public information they may not have obtained. Law Number 32 of 2004 requires regional heads to provide accountability reports to the legislative, which have been audited (examined) by the Audit Board of the Republic of Indonesia (*Badan Pemeriksa Keuangan/BPK*). Monitoring by inspection is carried out by an independent supervisor, which is carried out by government auditors (*BPK*) as mandated by Law Number 15 of 2004 on Audit of the Management and Accountability of State Finances.

One of the important NPM mechanisms in reducing the level of corruption is the transparency and accountability of good financial reporting. Empirical evidence of research at the cross-country level shows that good quality financial statement that have been prepared according to

accounting standards can reduce the level of corruption (Atuilik, 2016; Malagueno et al., 2010; Hameed-Shidom et al., 2022). In Indonesian context, the quality of local government financial statement is reflected in the results of the audit by the *BPK*. If the *BPK* gives an unqualified opinion, the regional government's financial statements show that it is in accordance with government accounting standards and there are no material misstatements. On the other hand, if the financial statements get an adverse opinion, this shows that the financial statements are still not in accordance with the criteria so that public accountability is still a question. In the Indonesian context, Furqan et al. (2021) found that the quality of financial reports as measured by the audit opinion of the *BPK* can improve the quality of public services.

BPK states in the State Financial Audit Standards, namely the standards for implementing financial audits, performance, and with certain objectives requiring auditors to: 1) understand and test the internal control system, 2) design audits to detect the occurrence deviation from statutory provisions, fraud, and improperness (abuse). Therefore, the financial audit reporting standards, performance, as well as with certain objectives; the *BPK* will disclose audit findings regarding weaknesses in the internal control system, fraud, deviations from the provisions of laws and regulations as well as impropriety. The auditing standard also requires the examiner to report fraud and deviation from statutory provisions to the competent authority in accordance with the applicable provisions of *BPK*. The *BPK*'s audit report contains audit findings consisting of: 1) weaknesses in the accounting reporting system, and 2) weaknesses in the revenue and expenditure budget control system, 3) weaknesses in the internal control structure.

Audit reports on the internal control system and compliance with laws by the *BPK* are more precisely the findings of an examination of internal control weaknesses and non-compliance with statutory provisions. Therefore, the more findings or detection of irregularities, the greater the incidence of corruption. The most important function of government auditing is to determine whether the process of collecting and spending public funds and other relevant transactions is in line with state laws and regulations, to determine whether there is behavior deviations in the management of public revenues and expenditures, and to expose any irregularities that jeopardize government accountability in audit reports (Malagueno et al., 2010; Liu and Lin, 2012; Jeppesen, 2019; Lino et al., 2022). Liu and Lin's research (2012) on audits conducted in 31 local governments in China shows that irregularities detection has a significant positive effect on corruption. The results of Kurniawati and Pratama (2021) research

also show that audit findings on non-compliance with government regulations have a positive effect on corruption.

The number of irregularities detected in government auditing is a reflection of how many violations there are in the local government bureaucracy. However, an audit report that exposes this impropriety is not effective enough to deter corruption. Therefore, detecting irregularities in government auditing is only the first step that results in several recommendations for improvement by the auditors and a very important second step is to hold local governments accountable for making corrections and implementing improvements as recommended by the auditors (Aikins, 2012; Liu and Lin, 2012).

Corruption is an opportunistic behavior of local government executives, therefore from the perspective of agency theory to reduce this, it is monitored by auditors of *BPK*. The management of the audited entity is responsible for following up on recommendations as well as creating and maintaining an information process and system to monitor the status of follow-up on *BPK*'s recommendations. Based on the findings during the audit of the local government financial statement, the *BPK* will provide suggestions or recommendations for improvement. If the *BPK*'s recommendations or suggestions for improvement are followed up by the executive, it means that weaknesses in the implementation of the internal control system and non-compliance with regulations will be corrected. Therefore, the potential for corruption will decrease.

Government audits will only work as a deterrent to corruption if recommendations for follow-up corrections to abuse in the process of receiving and disbursing funds are carried out entirely (Malagueno et al., 2010; Aikins, 2012; Liu and Lin, 2012; Jeppesen, 2019; Lino et al., 2022). If not done, government audits will be useless. The results of empirical research by Liu and Lin (2012) show that post-audit rectification has a significant negative effect on corruption. The meaning of the results of this study is that if auditees follow up on recommendations based on government audit findings, the level of corruption will decrease. Kurniawati and Pratama (2021) conducted research on provincial local governments in Indonesia and the result was that the follow-up on the results of the examination or audit rectification had a negative effect on the level of corruption.

2. AIMS AND HYPOTHESES

This study aims to provide empirical evidence and analyze the effect of New Public Management (NPM) mechanism in the form of fiscal decentralization, quality of financial reporting, and the implementation of independent audits on corruption level of local government in Indonesia.

Based on the literature review, the following hypotheses are proposed:

H1: Fiscal decentralization has a positive effect on the level of corruption at local governments

H2: Quality of financial reporting has a negative effect on the level of corruption at local governments

H3: The findings of the audit have a positive effect on the level of corruption at local governments

H4: Follow-up on the recommendations of the audit results negatively affects the level of corruption at local governments

3. METHODS

The population in this study were all local governments in Indonesia. Sampling was carried out purposively between 2011 and 2017. The dependent/endogenous variable in this study is the level of corruption that occurs in district/city governments in Indonesia. The measurement of corruption (CORP) in this study refers to the real measurement that has been done (Fisman and Gatti, 2002b; Liu and Lin, 2012). Real corruption is measured by the number of losses caused by corruption in corruption cases that have been decided by the Supreme Court, which has permanent legal force. Therefore, the level of corruption in this study uses real losses due to corruption cases according to the final decision of the court. The formula for measuring the fiscal decentralization (FD) variable is developed into three indicators, namely: (1) Fiscal decentralization (DFORI) = total expenditure budget - special allocation fund, (2) Fiscal decentralization per population (DFPOP) = (total expenditure budget - special allocation fund of a local government)/population, and (3) Fiscal decentralization per area (DFAREA) = (total expenditure budget - special allocation fund of a local government)/area of a local government. Quality of financial reporting is measured by audit opinion from Supreme Audit Agency/BPK on local government's financial statement in Indonesia. The audit opinion is classified into 5 categories, namely the financial statements that receive an unqualified opinion, unqualified with explanatory paragraphs, qualified opinion, adverse, and disclaimer. Audit opinion is

measured by giving weights from 1 to 5, where unqualified opinion is given a score of 1, and disclaimer is given a score of 5.

Audit findings measured by using two indicators, namely the number of cases of findings of weaknesses in the internal control system (*internal control findings*) and the number of rupiah value findings of non-compliance with the law in the audit of district and municipal governments in Indonesia (*noncompliance findings*). Follow-up recommendations for audit results measured by the total rupiah value of findings that have been followed up by the regional government in audits conducted by the BPK for period t and t-1.

Data analysis in this study used a Structural Equation Model (SEM) approach with the Partial Least Square (PLS) method. The software used is Warp PLS 7.0. PLS is one of the methods to implement structural equation models. The reason for using PLS is because the measurement of fiscal decentralization variables uses four formative indicators (Hair et al., 2017; Kock, 2020). By using PLS, it can be obtained the results of simultaneous hypothesis testing simultaneously.

4. RESULTS

The study population consisted of 514 local governments in Indonesia. The final sample consisted of 433 local governments. Table 1 presents descriptive statistics for each research variable. The level of corruption in local governments in Indonesia has various distributions. On average, the value of corruption is at a moderate level with an average loss value of IDR 1,723,966,769.19. Overall, the level of fiscal decentralization in Indonesia is relatively large, as indicated by the average magnitude of the three indicators. Descriptive statistics also show that there are still quite a number of findings of weaknesses in internal control and non-compliance with laws and regulations as well as the audit results of BPK. Meanwhile, the follow-up examination results were still mixed for periods t and t-1. The audit opinion on the financial statements of local governments (untabulated) shows that most are given unqualified (65.6%), qualified (15.8%), unqualified with explanatory paragraphs (6.6%), adverse (0.5%), and disclaimer (11.5%). This shows that there is still a need for improvement in the quality of local government financial reports in Indonesia.

Table 1. Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
Corruption level	2,102,700.00	45,000,000,000.00	1,723,966,769.19	4,989,701,438.54
DF_ORI	289,067,291,956.00	3,960,156,650,321.00	965,018,371,079.14	729,958,726,076.32
DF_POP	687,234.00	18,945,114.00	2,683,763.96	2,717,136.43

DF_AREA	27,014,223.00	23,618,754,997.00	2,101,868,926.50	3,881,701,951.51
Internal control findings	1.00	27.00	9.92	4.24
Noncompliance findings	29,600,000.00	114,143,940,000.00	5,512,408,304.09	10,910,018,763.09
Follow-up audit t	1,840,000.00	7,913,350,000.00	1,169,809,101.80	1,612,806,388.26
Follow up audit t-1	2,030,000.00	38,537,120,000.00	1,634,561,976.74	4,391,932,422.78

This study used unobserved variables and was measured using several indicators. In the SEM-PLS concept, there are two measurement models, namely reflective and formative. This study used all observed variables; a variable which quantitative values can be measured directly and variable indicators in this study using formative indicators. According to Hair et al. (2017) and Kock (2020) for formative constructs, evaluation of the measurement model can be seen from the feasibility of the formative indicator by looking at the significance value of weight and co-linearity (by looking at the VIF value). The result of measurement model using WarpPLS 7.0 in Table 2 shows that p-value for weight significance of all indicators of formative variables <0.001 and co-linearity of all formative indicators shows VIF value <3.3. Therefore, the significance of weight and the VIF value of all indicators used in this study at the evaluation stage of the measurement model have fulfilled rule of thumb required for formative constructs (Hair et al., 2017; Kock 2020).

Table 2. Evaluation of Measurement Model

Indicators	p-value	VIF
DF_ORI	<0.001	1.348
DF_POP	0.004	1.012
DF_AREA	<0.001	1.345
OPN-T	<0.001	1.882
OPN_T-1	<0.001	1.882
IC_T	<0.001	1.006
NC-T	<0.001	1.006
Follow-T	<0.001	1.058
Follow_T-1	<0.001	1.058
CORP	<0.001	0.000

Table 3 presents the goodness of fit for the research model. In Table 3, it can be seen that all fit models are met, therefore it can be concluded that this research model is fit. The size of the fit model is: APC = 0.139, ARS = 0.103, and AARS = 0.083; all significant. AVIF value = 1.655 and AFVIF value = 1.981, which is lower than 3.3 as the minimum criteria limit, therefore the research model has no collinearity problem.

Table 3. Model fit and quality indices

Indicators
Average path coefficient (APC)=0.139, P=0.013
Average R-squared (ARS)=0.103, P=0.039
Average adjusted R-squared (AARS)=0.083, P=0.063
Average block VIF (AVIF)=1.056, acceptable if <= 5, ideally <= 3.3
Average full collinearity VIF (AFVIF)=1.109, acceptable if <= 5, ideally <= 3.3

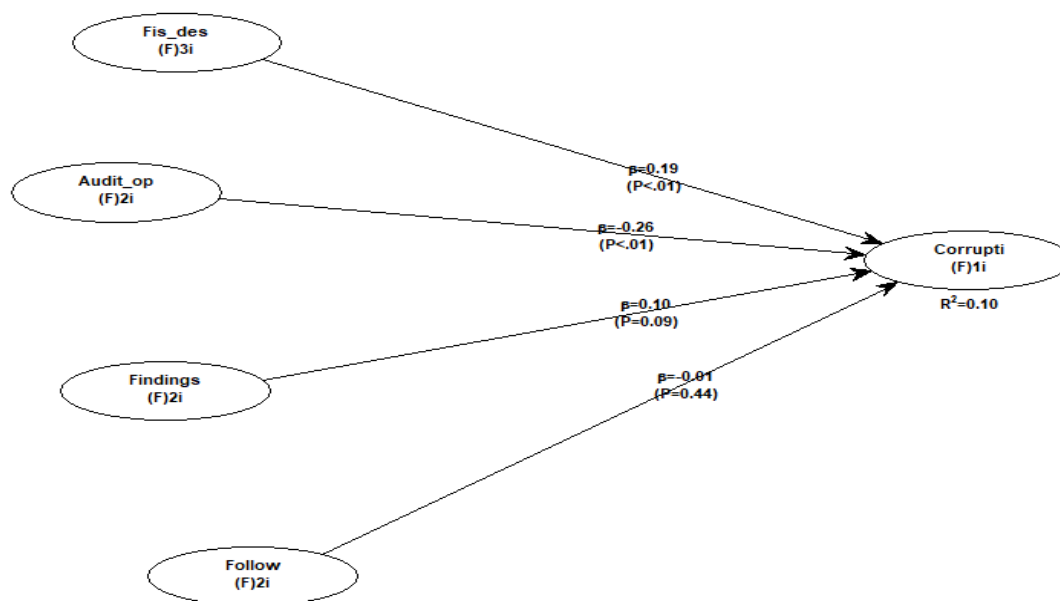Figure 1 presents the WarpPLS 7.0 output for the structural model test results.

Figure 1. Results of Structural Model

Table 4 presents a summary of the results of hypothesis testing. The result of this study provides empirical evidence that the hypothesis 1 is supported, with path coefficient 0.19 and p-value 0.004. Hypothesis 2 is supported with path coefficient of quality of financial reporting -0.26 and significant with p-value <0.001. Hypothesis 3 is also supported with path coefficient of audit findings 0.10 and p-value 0.095 (<0.10). Meanwhile hypothesis 4 is not supported due to p-value 0.435 (>0.10).

Table 4. Results of Hypothesis Testing

Path	Hypothesis	Coeff.	p-value	Conclusion
Fiscal decentralization → Corruption	+	0.19	0.004	Supported
Quality of financial report → Corruption	-	-0.26	<0.001	Supported
Audit findings → Corruption	+	0.10	0.095	Supported
Follow-up of audit results→ Corruption	-	-0.01	0.435	Not supported

5. DISCUSSION

The result of this study provides empirical evidence that the hypothesis 1 is supported, it means that the incidence of corruption in Indonesian local governments is increasing along with fiscal decentralization. The test results of hypothesis 1 in this study are in line with the agency theory. This finding also supports Prud'home's (1995) argument that there are great opportunities for corruption at the local level because local politicians and their bureaucrats tend to be pressured to meet demands by certain interest groups. In addition, local decision-makers usually have more discretionary power than national officials, which in turn increases the negative effects of decentralization. Corruption often occurs at the local level rather than the national level, especially in developing countries (Prud'home's, 1995. Local officials live closer to the people, and this closeness allows local interest groups to seek economic rent, which will facilitate higher levels of corruption in a decentralized country.

The study findings also support the theory of the fraud triangle, fiscal decentralization allows local governments to have more authority or autonomy in regional management thereby creating more opportunities for corruption. The results of this study are consistent with a number of previous empirical studies, namely Shon and Cho (2019) and Ulum et al. (2019), Maria et al. (2019), Yanto and Adrison (2020) which provide empirical evidence that there is a positive relationship between fiscal decentralization and corruption. The results of the PLS-SEM test also provide support for hypothesis 2, namely that good quality financial reports will reduce the occurrence of corruption. This finding supports agency theory that financial statements can reduce information asymmetry between principals and agents in organizational management. Furthermore, this finding also supports the fraud triangle theory that fraud can be reduced by limiting opportunities, among others, by practicing transparency and accountability in financial statements that are presented in accordance with accounting standards. The empirical evidence from the results of this study also shows the importance of the role of financial audits, indicated by their negative influence on the level of corruption. The results of this study also support the argument of Liu and Lin (2012) which states that the fundamental purpose of financial auditing is to supervise, guarantee, and support government accountability which is an important institutional part of modern government governance.

The test results show support for hypothesis 3 that the number of audit findings has a positive effect on the level of corruption. The more the financial audit findings in the form of

weaknesses in the internal control system and non-compliance with laws, the greater the level of corruption. These results support the fraud triangle theory argument that weaknesses in internal control is an opportunity factor that can lead to fraud. In addition, this result is consistent with the findings of Liu and Lin (2012) which show that irregularities detection has a significant positive effect on corruption. The results of this study also support Kurniawati and Pratama (2021) which show that audit findings on non-compliance with government regulations have a positive effect on corruption.

The empirical evidence of the results of this study does not show support for hypothesis 4 that the follow-up to financial audit results has a negative effect on the level of corruption in local governments. This is probably due to the low follow-up of examination results as shown in the descriptive statistics. The not yet optimal failure to follow up on the results of financial audits requires evaluation in financial management in Indonesia because as Liu and Lin (2012) argue that financial audits will only work as a deterrent to corruption if recommendations for follow-up corrections to abuse in the process of receiving and disbursing funds are carried out entirely. If not done, financial audits will have little use in government governance.

CONCLUSIONS

The purpose of this study was to examine the effect of NPM mechanism in the form of fiscal decentralization, quality of financial reporting, and the implementation of independent audits on corruption level of local government in Indonesia. The results of this study provide empirical evidence that a greater fiscal decentralization tends to lead to a greater level of corruption in local governments in Indonesia. Financial audits in the form of providing opinions on financial reports have a negative effect on the level of corruption. Meanwhile, weaknesses in the internal control system and non-compliance with laws and regulations tend to increase the level of corruption. These results provide support for the agency theory and the fraud triangle theory. According to the fraud triangle theory, fiscal decentralization provides an opportunity for corruption in local governments in Indonesia. Meanwhile, financial statement and audits act as deterrent factors that reduce opportunities for corruption. Furthermore, the results of this study show that the NPM mechanism in Indonesia in the form of fiscal decentralization can actually increase corruption. The results of this study imply that fiscal decentralization in local governments in Indonesia needs to be controlled by other NPM mechanisms, namely by improving the quality of financial reports and auditing financial management through independent audits.

This study has limitations, among others, the measurement of fiscal decentralization. The use of the size of fiscal decentralization in this study is based on the synthesis of various measurements of decentralization of previous studies that are adapted to the applicable regulations in Indonesia, so that the strength of measuring fiscal decentralization in this study has not been tested in other studies. In future studies, it can be applied the synthesis of the results of the measurement of fiscal decentralization in this study to other countries with adjustments to the regulations within in the country. Corruption is a complex phenomenon that can provide future research opportunities to add variables such as political costs, culture, financial performance, politics variables, and so on. In measuring variables, of course, must consider the availability of data.

AUTHOR CONTRIBUTIONS

Conceptualization: Dwi Ratmono, Darsono Darsono.
Data curation: Dwi Ratmono.
Formal analysis: Dwi Ratmono.
Investigation: Darsono Darsono, Dwi Ratmono
Methodology: Dwi Ratmono, Darsono Darsono
Project administration: Dwi Ratmono.
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Writing – original draft: Dwi Ratmono, Darsono Darsono.
Writing – review & editing: Dwi Ratmono, Darsono Darsono.

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Dear Dwi Ratmono,

Dwi Ratmono has submitted the manuscript NEW PUBLIC MANAGEMENT AND CORRUPTION: EMPIRICAL EVIDENCE OF LOCAL GOVERNMENTS IN INDONESIA to Public and Municipal Finance on 11.04.2022.

Submission form contains the following details:

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to me

Dear Dwi Ratmono,

the manuscript NEW PUBLIC MANAGEMENT AND CORRUPTION: EMPIRICAL
EVIDENCE OF LOCAL GOVERNMENTS IN INDONESIA, submitted
to Public and Municipal Finance Journal, needs to be revised.

Comments:

The author must take a close look at the manuscript requirements. They are not too
rigid, but we recommend to meet them. Therefore, we ask the authors to make every
effort to meet the requirements, as it will provide the quality of their materials and will
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Please, keep in mind that research paper, which is a final report on the finished original experimental study (the structure is Abstract, Introduction, Literature review, Method, Results, Discussion, Conclusion)

Check out what should be in this or that section and correctly distribute the material into sections. Do not introduce new sections. Do not divide sections into small subdivisions, including by introducing subheadings.

The Abstract (its volume is 150-250 words) should contain the following sequence of presentation of the material - relevance, purpose, result, conclusion. The result should be devoted to most of the Abstract volume. You should provide quantitative indicators of the demonstration of the research result.

The purpose of keywords is to provide the insight to the reader into the contents of the paper. They should reflect the area of the research. The number of keywords should be 5-10 in average. There should not be the sentences, but the words or word groups. If the object of the study is not mentioned in the title of the paper (including the country, the region), it should be added to the list of keywords. There is no need to replicate words from the title of the manuscript.

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The literature review also requires revision and consistency of the presentation of the material. It should be subordinated to the purpose of the study and should be completed with a statement of goal. The literature review of the analyzed sources should be 40-50. If you assume hypotheses, then after that, give the hypotheses (all

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Kind regards,

Valeria Matiukhina
Managing Editor
Journal Public and Municipal Finance

RESPONSE PENULIS TERHADAP REVIEW
(BUKTI SUBMIT LAGI DENGAN REVISI ARTIKEL
MENANGGAPI HASIL REVIEW)

Re: MA5813: Notification on Submission ⟩

dwi ratmono <dwi.ratmono2@gmail.com>
to v.matiukhina ▼

Tue, Apr 19, 2022, 3:32 PM

Dear Valeria Matiukhina,

Please find attached manuscript revision. The revision has been highlighted in green.
I've also submitted a follow-up table for each editor's comments.
I've also uploaded the revised manuscript to systems.

Thank you

Best regards,
Dwi Ratmono

Revision Table

Comments	Follow-up (marked with green)
The author must take a close look at the manuscript requirements. They are not too rigid, but we recommend to meet them. Therefore, we ask the authors to make every effort to meet the requirements, as it will provide the quality of their materials and will make it easier for the editorial staff to set the manuscript for publication. https://www.businessperspectives.org/index.php/journals/public-and-municipal-finance#submission-guidelines-for-authors Check out what should be in this or that section and correctly distribute the material into sections. Do not introduce new sections. Do not divide sections into small subdivisions, including by introducing subheadings. Be clear about the purpose of your research.	A revision has been made following the guidelines, so that the paper structure consists of: Abstract, Introduction, Literature review, Aims, Method, Results, Discussion, Conclusion There is no new section in the article and it is not divided into small subdivisions, including by introducing subheadings

Please, keep in mind that research paper, which is a final report on the finished original experimental study (the structure is Abstract, Introduction, Literature review, Method, Results, Discussion, Conclusion) Check out what should be in this or that section and correctly distribute the material into sections. Do not introduce new sections. Do not divide sections into small subdivisions, including by introducing subheadings.	
The Abstract (its volume is 150-250 words) should contain the following sequence of presentation of the material - relevance, purpose, result, conclusion. The result should be devoted to most of the Abstract volume. You should provide quantitative indicators of the demonstration of the research result.	A revision has been made so that the number of words in the abstract is 246 words. Sequence presentation has been followed covering relevance, purpose, results, and conclusion. The results have been shown more thoroughly with quantitative results in the form of path coefficients and p-value according to the PLS-SEM test.
The purpose of keywords is to provide the insight to the reader into the contents of the paper. They should reflect the area of the research. The number of keywords should be 5-10 in average. There should not be the sentences, but the words or word groups. If the object of the study is not mentioned in the title of the paper (including the country, the region), it should be added to the list of keywords. There is no need to replicate words from the title of the manuscript.	A revision has been made so that the number of keywords is 6, namely fiscal decentralization, financial reporting, audit, corruption level, agency theory, fraud triangle
Please clarify JEL codes. (double-digit) If earlier the author was not aware of this classification system, he/she should attentively look through it in order to have a common understanding of all the areas defined in it http://www.aeaweb.org/jel/jel_class_system.php. The codes, indicated by the author should clearly reflect the research area. The author is welcome to use the codes from two or three areas, if they are covered in the research.	A revision has been made so that the JEL codes in this paper consist of H72: State and Local Budget and Expenditures; H83: Public Administration • Public Sector Accounting and Audits; M41: Accounting

The Introduction (this is half a page-page of text) should be devoted to the relevance of the research topic and the formulation of the problem in general. Do not turn it to the Literature review.	It has been revised so that the Introduction section contains the formulation of the problem, namely the high number of corruption cases in government organizations and the inconsistency of previous research results. In addition, the relevance of the research is described, namely: this study is relevant and important by using a comprehensive theoretical model to explain the problem of corruption in government organizations. The Introduction has been reduced, focusing on the relevance of the topic and the formulation of the problem in general.
The literature review also requires revision and consistency of the presentation of the material. It should be subordinated to the purpose of the study and should be completed with a statement of goal. The literature review of the analyzed sources should be 40-50. If you assume hypotheses, then after that, give the hypotheses (all together and do not insert text between them). Then the Methods should be presented.	The presentation of literature review material has been revised. There has been an increase in the volume of the literature review supported by 46 relevant reference sources.
The Result section is the main section of the article. Then there should be a Discussion section. There should be a discussion of the study results, comparison with previous ones, a discussion of why the authors have exactly such results, determination of further prospects.	It has been revised so that there is a discussion section containing comparisons with previous research and determination of further prospects.
The Conclusion section is built incorrectly. There should be such logic - point out the purpose of the study, briefly demonstrate the result obtained, point out what conclusions should be drawn from it. The Abstract should not repeat the sentences from the Conclusion.	A revision has been made to the conclusion section logically, namely the purpose of the study, results, and conclusions obtained. The repeating sentence from the abstract has been removed.
The plagiarism report attached. Please remove plagiarism and ABC.	The author has made revisions to remove plagiarism and ABC.

ARTIKEL YANG SUDAH DIREVISI KE-1

Dwi Ratmono (Indonesia), **Darsono Darsono** (Indonesia)

NEW PUBLIC MANAGEMENT AND CORRUPTION: EMPIRICAL EVIDENCE OF LOCAL GOVERNMENTS IN INDONESIA

Abstract

This study is relevant because it examines the determinants of of corruption in local governments that have a negative impact on the success of sustainable development. This study aims to examine the the impact of New Public Management (NPM) mechanism in the form of fiscal decentralization, quality of financial reporting, and independent audits on corruption level. Based on agency theory and fraud triangle theory, this study analyzes the NPM mechanism as measured by fiscal decentralization, quality of financial reporting, audit findings, and follow-up audit on the level of corruption. The sample consisted of 433 local governments in Indonesia for data 2011-2017. Partial Least Squares-Structural Equation Modeling (PLS-SEM) was used as a data analysis technique. The results test show that fiscal decentralization has a positive effect on the of corruption with a path coefficient of 0.19 and a p-value of 0.004. The quality of financial reporting has a negative effect on the level of corruption with a coefficient of -0.26 and p-value <0.001. PLS-SEM test results also show that audit findings have a positive effect on corruption with a coefficient of 0.10 and p-value <0.10. On the other hand, follow-up audit results have no significant effect on corruption with p-value >0.10. This study concludes that the NPM mechanism in the form of fiscal decentralization positively affects corruption. These results implies that fiscal decentralization needs to be balanced with good governance, among others, by increasing the quality of financial reports and independent audits.

Keywords	fiscal decentralization, financial reporting, audit, corruption level, agency theory, fraud triangle

JEL Classification   H72, H83, M41

INTRODUCTION

Based on a survey conducted by the Association of Certified Fraud Examiners (ACFE), corruption ranks first among fraud schemes that occur in Asia Pacific with a percentage of 51% (ACFE, 2021). Meanwhile, the ACFE Indonesia Chapter in the 2019 Indonesia Fraud Survey Report also shows that the most common type of fraud in Indonesia is corruption with a

percentage of 64.4% of cases (ACFE Indonesia, 2020). Based on the ACFE Indonesia 2020 report, 167 respondents or 69.9% stated that corruption was the most detrimental act in Indonesia. Government organizations are the institutions that suffer the most because of the fraud (ACFE Indonesia, 2020). In order to overcome the problem of corruption, governments in various countries have carried out public sector reforms known as New Public Management (NPM), including fiscal decentralization, the application of accrual-based accounting, and the implementation of independent audits. However, research results indicate that the effectiveness of the NPM mechanism is still a debate and an important research question (Changwony, and Paterson, 2019). The practice of decentralization in Indonesia after 15 years of implementing regional autonomy and fiscal decentralization has caused many problems in the regions, one of which is the increasing level of corruption (Boolaky et al., 2018; Sylvia et al., 2018).

The empirical studies on the effect of fiscal decentralization on corruption have obtained mixed evidence. Studies that provide evidence that fiscal decentralization has a negative effect on the level of corruption include include Fisman and Gatti (2002a), Fan et al. (2009), Ivanyna and Shah (2010), and Gurgur and Shah (2014). In contrast, the results of other studies actually provide empirical evidence that fiscal decentralization actually increases corruption (Triesman, 2000; Fisman and Gatti, 2002b; Saputra, 2012; Shon and Cho, 2019; Ulum et al., 2019). In order to explain the inconsistency of previous research, it is important for researchers to analyze other NPM mechanisms besides fiscal decentralization. Other NPM mechanisms that may reduce corruption include increasing transparency and accountability of government organizations with quality financial reports and the implementation of independent audits. Therefore, in order to explain the inconsistency of the results of previous studies, this study includes other NPM mechanisms. In this case the researcher uses the effect of fiscal decentralization, financial reporting, and audit on the level of corruption in a model simultaneously. Therefore, this study is relevant and important by using a comprehensive theoretical model to explain the problem of corruption in government organizations.

1. LITERATURE REVIEW

Agency theory describes a contract between a principal that asks an agent to do work on his behalf which includes the delegation of some decision-making authority to the agent (Jensen and Meckling, 1976). Local government in the context of fiscal decentralization is basically the center for a series of contractual relationships between agents and principals (Zimmerman, 1977). This contractual relationship is manifestly embodied in various regulations in the

government sector, including in Law Number 32 of 2004 and 33 of 2004. These two laws and their elaboration or regulatory derivatives to the technical level are the basis of legitimacy for fiscal decentralization for local governments in Indonesia.

The NPM mechanism is designed to fulfill the principles of good governance in agency relations in government organizations (Fisman and Gatti, 2002a; Fan et al., 2009; Changwony, and Paterson, 2019; Saputra, 2012; Boolaky et al., 2018; Harun et al., 2015; Sylvia et al., 2018; Shon and Cho, 2019; Ulum et al., 2019; Ratmono et al., 2021). The NPM mechanisms include, among others, decentralized budget management, financial reporting, accrual accounting and independent auditing (Changwony, and Paterson, 2019; Jeppesen 2019; Ulum et al., 2019; Ratmono et al., 2021; Furqan et al., 2020; Hamed -Shidom et al., 2022; Lino et al., 2022). In the context of public sector reform, Indonesia has sought to develop various NPM mechanisms with the aim of reducing corruption in government organizations by increasing transparency and accountability in budget management. However, after more than 10 years, there are some criticisms between the implementation of NPM in Indonesia. The study of Prabowo et al. (2017) analyze whether public sector reform in Indonesia is consistent with NPM principles. The empirical evidence of Prabowo et al. (2017) show that public sector reform in Indonesia is incompatible with NPM's philosophy of efficiency and effectiveness in the provision of public services. Harun et al. (2020) criticizes that the determinants of NPM adoption, including the budgeting and reporting system in Indonesia, are due to pressure from coercive international financial agencies and the desire to imitate public sector accounting reforms in developed countries. Meanwhile, the internalization of NPM in local governments is a response to a legal obligation imposed by the central government. Several studies also show that the effectiveness of NPM implementation in Indonesia is still limited (Harun and Robinson, 2010; Boolaky et al., 2018; Harun et al., 2015; Sylvia et al., 2018). Therefore, it remains an important research question whether the implementation of NPM can achieve the goals of public sector reform in Indonesia, especially in reducing the occurrence of corruption. This question is mainly because after the implementation of the NPM, the level of corruption problems in local government organizations in Indonesia is relatively high. Data from the Corruption Eradication Commission (*Komisi Pemberantasan Korupsi/KPK)* and Indonesian Corruption Watch (ICW) show an increase in the number of corruption cases and losses to local governments in Indonesia during 2014-2019 (ICW, 2019; KPK, 2020).

Government regulations related to fiscal decentralization are the legal basis for a contractual relationship between principals and agents (Zimmerman, 1977; Malagueno, 2010; Liu and Liu, 2012; Atuilik, 2016; Jeppesen 2019). In this contractual relationship, the executive is given the authority to make fiscal decisions by the principal to carry out the actions or activities necessary to fulfill the wishes of the principal (legislative / people). This authority makes executives have discretionary power or freedom of action. Therefore, the activities carried out by the executive (as an agent) cannot always be observed by the legislative / the People (as the principal), resulting in information asymmetry. By assuming that both parties will maximize their utility, it can be predicted that the agent will not always behave in the interests of the principal (Jensen and Meckling, 1976).

Apart from being able to be explained by agency theory, the effect of fiscal decentralization on corruption can also be approached by using the fraud triangle theory. According to Cressey (1953) the fraud triangle consists of three; namely, pressure, opportunity, and rationalization. High political costs resulting in high-cost recovery are a strong pressure to commit corruption.

In terms of the fraud triangle theory, the opportunistic behavior of the executive and legislative can be explained through three points of view; namely pressure, perceived opportunity, and rationalization (Cressey, 1953). First, the pressure point of view. It is common knowledge that in the context of politics in Indonesia, to become a regional head (regent and mayor) requires high political costs. Therefore, cost recovery by the executive and legislature is a necessity and a strong pressure to commit corruption through the budget. Second, the perspective of perceived opportunity. The regional head and all the bureaucracy have the authority to compile and implement the budget based on laws and regulations governing regional finances in Indonesia. Therefore, executives become very aware (have general information) and also have expertise (technical skills) regarding public sector budgets which are a requirement for perceived opportunities. Two conditions that are parts of the opportunity in the fraud triangle have been fulfilled, so that the opportunity to commit corruption becomes an easy thing. Third, the point of view of rationalization. In the pre-decentralization era, corruption occurred at the level of the central elite and when fiscal decentralization occurred, the corrupt behavior of the central elite became a justification for the local elites to take the same action. In the end, this corrupt behavior becomes a kind of snowball, which inspires legislators and executive officials in other regions to do the same.

Several previous studies have shown empirical evidence that fiscal decentralization has a positive effect on corruption. Fisman and Gatti (2002b) in the context of federal states in America found a positive relationship between corruption and the proportion of a state's spending through federal transfers. Saputra (2012) and Ulum et al. (2019) research results provide empirical evidence that decentralization will increase the level of corruption in local government in Indonesia. Albornoz and Cabrales (2013) show that decentralization positively affects the level of corruption. The findings of Shon and Cho (2019) provide empirical evidence that fiscal decentralization has a positive effect on occurrence of corruption in local governments in the United States. In the context of local government in Indonesia, Maria et al. (2021) shows that independence in financial management increases the amount of corruption.

Corruption is an executive opportunist act in local governments that causes harm to the principal (the community), therefore the principal is involved in various forms of supervision of their agents. The literature on delegation of authority identifies four main measures by which principals can limit or reduce agency loss: (1) contract design, (2) screening and selection mechanisms, (3) monitoring and reporting requirements, and (4) institutional checks (Malagueno, 2010; Liu and Liu, 2012; Atuilik, 2016; Jeppesen 2019; Furqan et al., 2020; Hamed -Shidom et al., 2022; Lino et al., 2022). Monitoring and reporting force executives to share with the legislature and the public information they may not have obtained. Law Number 32 of 2004 requires regional heads to provide accountability reports to the legislative, which have been audited (examined) by the Audit Board of the Republic of Indonesia (*Badan Pemeriksa Keuangan/BPK*). Monitoring by inspection is carried out by an independent supervisor, which is carried out by government auditors (*BPK*) as mandated by Law Number 15 of 2004 on Audit of the Management and Accountability of State Finances.

One of the important NPM mechanisms in reducing the level of corruption is the transparency and accountability of good financial reporting. Empirical evidence of research at the cross-country level shows that good quality financial statement that have been prepared according to accounting standards can reduce the level of corruption (Atuilik, 2016; Malagueno et al., 2010; Hameed-Shidom et al., 2022). In Indonesian context, the quality of local government financial statement is reflected in the results of the audit by the *BPK*. If the *BPK* gives an unqualified opinion, the regional government's financial reporting show that it is in comply with accounting standards and there are no material misstatements. On the other hand, if the financial reporting get an adverse opinion, this shows that the financial statements are still not in accordance with

the criteria so that public accountability is still a question. In the Indonesian context, Furqan et al. (2021) found that the quality of financial reporting has a positive impact on the quality of public services.

BPK states in the State Financial Audit Standards, namely the standards for implementing financial audits, performance, and with certain objectives requiring auditors to: 1) understand and test the internal control system, 2) design audits to detect the occurrence deviation from statutory provisions, fraud, and improperness (abuse). Therefore, the financial audit reporting standards, performance, as well as with certain objectives; the *BPK* will disclose audit findings regarding weaknesses in the internal control system, fraud, deviations from the provisions of laws and regulations as well as impropriety. The auditing standard also requires the examiner to report fraud and deviation from statutory provisions to the competent authority in accordance with the applicable provisions of *BPK*.

Audit reports on the internal control system and compliance with laws by the *BPK* are more precisely the findings of an examination of internal control weaknesses and non-compliance with statutory provisions. Therefore, the more findings or detection of irregularities, the greater the incidence of corruption. The main objective in the audit of the local government sector is to test whether budget management is in accordance with regulations and conclude whether there are material misstatements in financial reporting (Malagueno et al., 2010; Liu and Lin, 2012; Jeppesen, 2019; Lino et al., 2022). Liu and Lin's research (2012) on audits conducted in 31 local governments in China shows that irregularities detection has a significant positive effect on corruption. The results of Kurniawati and Pratama (2021) research also show that audit findings on non-compliance with government regulations have a positive effect on corruption.

The number of irregularities detected in government auditing is a reflection of how many violations there are in the local government bureaucracy. However, an audit report that exposes this impropriety is not effective enough to deter corruption. Therefore, detecting irregularities in government auditing is only the first step that results in several recommendations for improvement by the auditors and a very important second step is to hold local governments accountable for making corrections and implementing improvements as recommended by the auditors (Aikins, 2012; Liu and Lin, 2012).

Corruption is an opportunistic behavior of local government executives, therefore from the perspective of agency theory to reduce this, it is monitored by auditors of *BPK*. The auditee is obliged to follow up on the recommendations as stated in the management letter. Furthermore, they are also responsible for reporting on the status of the follow-up to the recommendations from the BPK audit results. Based on the findings during the audit of the local government financial statement, the *BPK* will provide suggestions or recommendations for improvement. If the *BPK*'s recommendations or suggestions for improvement are followed up by the executive, it means that weaknesses in the implementation of the internal control system and non-compliance with regulations will be corrected. Therefore, the potential for corruption will decrease.

Government audits will only work as a deterrent to corruption if recommendations for follow-up corrections to abuse in the process of receiving and disbursing funds are carried out entirely (Malagueno et al., 2010; Aikins, 2012; Liu and Lin, 2012; Jeppesen, 2019; Lino et al., 2022). If not done, government audits will be useless. The results of empirical research by Liu and Lin (2012) show that post-audit rectification has a significant negative effect on corruption. The meaning of the results of this study is that if auditees follow up on recommendations based on government audit findings, the level of corruption will decrease. Kurniawati and Pratama (2021) conducted research on provincial local governments in Indonesia and the result was that audit rectification had a negative impact on corruption.

2. AIMS

This study aims to analyze the effect of New Public Management (NPM) mechanism in the form of fiscal decentralization, financial reporting, and the implementation of independent audits on corruption level of Indonesian local government.

Based on the literature review, this study proposed hypotheses:

H1: Fiscal decentralization has a positive effect on the level of corruption at local governments

H2: Quality of financial reporting has a negative effect on the level of corruption at local governments

H3: The findings of the audit have a positive effect on the level of corruption at local governments

H4: Follow-up on the recommendations of the audit results negatively affects the level of corruption at local governments

3. <mark>METHOD</mark>

The population in this study were all local governments in Indonesia. Sampling was carried out purposively between 2011 and 2017. The dependent/endogenous variable in this study is the level of corruption that occurs in local governments in Indonesia. The measurement of corruption (CORP) in this study refers to the real measurement that has been done (Fisman and Gatti, 2002b; Liu and Lin, 2012). Real corruption is measured by the number of losses caused by corruption in corruption cases that have been decided by the Supreme Court, which has permanent legal force. Therefore, the level of corruption in this study uses real losses due to corruption cases according to the final decision of the court. The formula for measuring the fiscal decentralization (FD) variable is developed into three indicators, namely: (1) Fiscal decentralization (DFORI) = total expenditure budget - special allocation fund, (2) Fiscal decentralization per population (DFPOP) = (total expenditure budget - special allocation fund of a local government)/population, and (3) Fiscal decentralization per area (DFAREA) = (total expenditure budget - special allocation fund of a local government)/area of a local government.

Quality of financial reporting is measured by audit opinion from Supreme Audit Agency/BPK on local government's financial statement in Indonesia. The audit opinion is classified into 5 categories, namely the financial statements that receive an unqualified opinion, unqualified with explanatory paragraphs, qualified opinion, adverse, and disclaimer. Audit opinion is measured by giving weights from 1 to 5, where unqualified opinion is given a score of 1, and disclaimer is given a score of 5.

Audit findings measured by using two indicators, namely the number of cases of findings of weaknesses in the internal control system (*internal control findings*) and the number of rupiah value findings of non-compliance with the law in the audit of district and municipal governments in Indonesia (*noncompliance findings*). Follow-up recommendations for audit results measured by the total rupiah value of findings that have been followed up by the regional government in audits conducted by the BPK for period t and t-1.

<mark>Data analysis in this study used a Partial Least Square Structural Equation Model (PLS-SEM) approach. The software used is Warp PLS 7.0 (Kock, 2020). This study used PLS-SEM</mark>

4. RESULTS

The study population consisted of 514 local governments in Indonesia. The final sample consisted of 433 local governments. Table 1 presents descriptive statistics for each research variable. The level of corruption in local governments in Indonesia has various distributions. On average, the value of corruption is at a moderate level with an average loss value of IDR 1,723,966,769.19. Overall, the level of fiscal decentralization in Indonesia is relatively large, as indicated by the average magnitude of the three indicators. Descriptive statistics also show that there are still quite a number of findings of weaknesses in internal control and non-compliance with laws and regulations as well as the audit results of BPK. Meanwhile, the follow-up examination results were still mixed for periods t and t-1. The audit opinion on the financial statements of local governments (untabulated) shows that most are given unqualified (65.6%), qualified (15.8%), unqualified with explanatory paragraphs (6.6%), adverse (0.5%), and disclaimer (11.5%). This shows that there is still a need for improvement in the quality of local government financial reports in Indonesia.

Table 1. Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
Corruption level	2,102,700.00	45,000,000,000.00	1,723,966,769.19	4,989,701,438.54
DF_ORI	289,067,291,956.00	3,960,156,650,321.00	965,018,371,079.14	729,958,726,076.32
DF_POP	687,234.00	18,945,114.00	2,683,763.96	2,717,136.43
DF_AREA	27,014,223.00	23,618,754,997.00	2,101,868,926.50	3,881,701,951.51
Internal control findings	1.00	27.00	9.92	4.24
Noncompliance findings	29,600,000.00	114,143,940,000.00	5,512,408,304.09	10,910,018,763.09
Follow-up audit t	1,840,000.00	7,913,350,000.00	1,169,809,101.80	1,612,806,388.26
Follow up audit t-1	2,030,000.00	38,537,120,000.00	1,634,561,976.74	4,391,932,422.78

This study used latent/unobserved variables and was measured using formative/index indicators. Analysis of the measurement model can be utilized from the feasibility of the formative indicator by looking at the significance value of weight and co-linearity (*variance inflation factor/VIF* The result of measurement model using WarpPLS 7.0 in Table 2 shows that p-value for weight significance of all indicators of formative variables <0.001 and co-linearity of all formative indicators shows VIF value <3.3. Thus, measurement model has fulfilled the criteria for formative constructs.

Table 2. Evaluation of Measurement Model

Indicators	p-value	VIF
DF_ORI	<0.001	1.348
DF_POP	0.004	1.012
DF_AREA	<0.001	1.345
OPN-T	<0.001	1.882
OPN_T-1	<0.001	1.882
IC_T	<0.001	1.006
NC-T	<0.001	1.006
Follow-T	<0.001	1.058
Follow_T-1	<0.001	1.058
CORP	<0.001	0.000

Table 3 presents the goodness of fit for the research model. The test results show that all goodness of fit criteria for PLS-SEM have been met. Therefore, the structural model data analysis can be continued with hypothesis testing.

Table 3. Model fit and quality indices

Indicators
Average path coefficient (APC)=0.139, P=0.013
Average R-squared (ARS)=0.103, P=0.039
Average adjusted R-squared (AARS)=0.083, P=0.063
Average block VIF (AVIF)=1.056, acceptable if <= 5, ideally <= 3.3
Average full collinearity VIF (AFVIF)=1.109, acceptable if <= 5, ideally <= 3.3

Figure 1 presents the WarpPLS 7.0 output for the structural model test results.
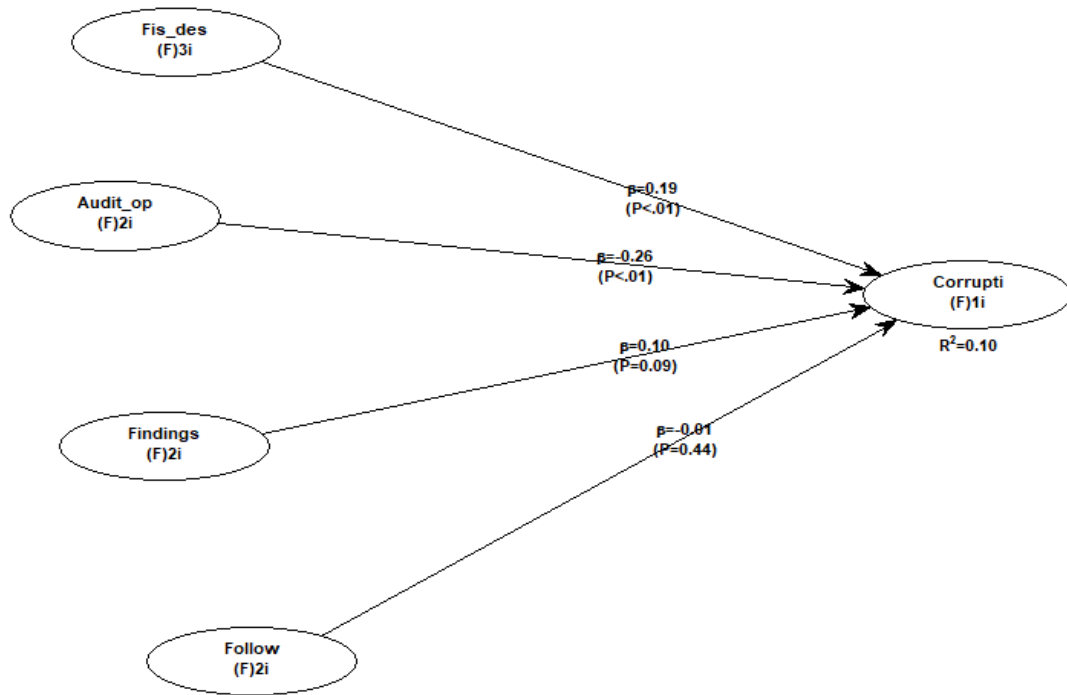
Figure 1. Results of Structural Model

Table 4 presents a summary of the results of hypothesis testing. The result of this study provides empirical evidence that the hypothesis 1 is supported, with path coefficient 0.19 and p-value 0.004. Hypothesis 2 is supported with path coefficient of quality of financial reporting -0.26 and significant with p-value <0.001. Hypothesis 3 is also supported with path coefficient of audit findings 0.10 and p-value 0.095 (<0.10). Meanwhile hypothesis 4 is not supported due to p-value 0.435 (>0.10).

Table 4. Results of Hypothesis Testing

Path	Hypothesis	Coeff.	p-value	Conclusion
Fiscal decentralization → Corruption	+	0.19	0.004	Supported
Quality of financial report → Corruption	-	-0.26	<0.001	Supported
Audit findings → Corruption	+	0.10	0.095	Supported
Follow-up of audit results→ Corruption	-	-0.01	0.435	Not supported

5. DISCUSSION

The result of this study provides empirical evidence that the hypothesis 1 is supported, fiscal decentralization has a positive effect on the level of corruption at local governments. The test results of hypothesis 1 in this study are in line with the agency theory. This finding also supports

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Prud'home's (1995) argument that there are great opportunities for corruption at the local level because local politicians and their bureaucrats tend to be pressured to meet demands by certain interest groups. In addition, local decision-makers usually have more discretionary power than national officials, which in turn increases the negative effects of decentralization. Corruption often occurs at the local level rather than the national level, especially in developing countries (Prud'home's, 1995. Local officials live closer to the people, and this closeness allows local interest groups to seek economic rent, which will facilitate higher levels of corruption in a decentralized government.

The study findings also support the theory of the fraud triangle, fiscal decentralization allows local governments to have more authority or autonomy in regional management thereby creating more opportunities for corruption. The results of this study support Shon and Cho (2019) and Ulum et al. (2019), Maria et al. (2019), Yanto and Adrison (2020), and Ratmono et al. (2021) which provide empirical evidence fiscal decentralization positively affects corruption. The results of the PLS-SEM test also provide support for hypothesis 2, namely that good quality financial statements will reduce the occurrence of corruption. This finding supports agency theory that financial statements can reduce information asymmetry between principals and agents in organizational management. This finding supports previous research, including Atuilik (2016), Malagueno et al. (2010) and Hameed-Shidom et al. (2022) which shows that the high quality of government financial reports can reduce the level of corruption.

Furthermore, this finding also supports the fraud triangle theory that fraud can be reduced by limiting opportunities, among others, by practicing transparency and accountability in financial statements that are presented in accordance with accounting standards. The empirical evidence from the results of this study also shows the importance of the role of financial audits, indicated by their negative influence on the level of corruption. The results of this study also support the argument of Liu and Lin (2012) which states that the fundamental purpose of financial auditing is to supervise, guarantee, and support government accountability which is an important institutional part of modern government governance.

The test results show support for hypothesis 3 that the number of audit findings has a positive effect on the level of corruption. The more the financial audit findings in the form of weaknesses in the internal control system and non-compliance with laws, the greater the level of corruption. These results support the fraud triangle theory argument that weaknesses in internal control is an opportunity factor that can lead to fraud. In addition, this result is consistent with the findings of Liu and Lin (2012) which show that irregularities detection has

a significant positive effect on corruption. The results of this study also support Kurniawati and Pratama (2021) which show that audit findings on non-compliance with government regulations have a positive effect on corruption.

The empirical evidence of the results of this study does not show support for hypothesis 4 that the follow-up to financial audit results has a negative effect on the level of corruption in local governments. This is probably due to the low follow-up of examination results as shown in the descriptive statistics. The not yet optimal failure to follow up on the results of financial audits requires evaluation in financial management in Indonesia because as Liu and Lin (2012) argue that financial audits will only work as a deterrent to corruption if recommendations for follow-up corrections to abuse in the process of receiving and disbursing funds are carried out entirely. If not done, financial audits will have little use in government governance. Future research can further explore the optimization of follow-up audit results and their effect on corruption in government organizations.

CONCLUSION

The purpose of this study is to examine the impact of the New Public Management variables, namely fiscal decentralization, quality of financial statement, audit findings, and audit follow-up on the level of corruption. The results of this study provide empirical evidence that fiscal decentralization positively affects corruption. Financial audits in the form of providing opinions on financial reports have a negative effect on the level of corruption. Meanwhile, weaknesses in the internal control system and non-compliance with laws and regulations tend to increase the level of corruption. These results provide support for the agency theory and the fraud triangle theory. According to the fraud triangle theory, fiscal decentralization provides an opportunity for corruption in local governments in Indonesia. Meanwhile, financial statement and audits act as deterrent factors that reduce opportunities for corruption. Furthermore, the results of this study show that the NPM mechanism in Indonesia in the form of fiscal decentralization can actually increase corruption. The results of this study imply that fiscal decentralization in local governments in Indonesia needs to be controlled by other NPM mechanisms, namely by improving the quality of financial reports and auditing financial management through independent audits.

This study has limitations in measuring fiscal decentralization and corruption based on various proxies. This study has attempted to measure corruption with the best approach, namely by the total level of losses caused by the fraud. Corruption is a complex phenomenon that can provide

future research opportunities to add variables such as political costs, culture, financial performance, politics variables, and so on. In measuring variables, of course, must consider the availability of data.

AUTHOR CONTRIBUTIONS

Conceptualization: Dwi Ratmono, Darsono Darsono.

Data curation: Dwi Ratmono.

Formal analysis: Dwi Ratmono.

Investigation: Darsono Darsono, Dwi Ratmono

Methodology: Dwi Ratmono, Darsono Darsono

Project administration: Dwi Ratmono.

Software: Dwi Ratmono

Supervision: Dwi Ratmono

Validation: Darsono Darsono, Dwi Ratmono.

Writing – original draft: Dwi Ratmono, Darsono Darsono.

Writing – review & editing: Dwi Ratmono, Darsono Darsono.

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Comments:

Please remove this from the Introduction - "Other NPM mechanisms that may reduce corruption include increasing transparency and accountability of government organizations with quality financial reports and the implementation of independent audits. Therefore, in order to explain the inconsistency of the results of previous studies, this study includes other NPM mechanisms. In this case the researcher uses the effect of fiscal decentralization, financial reporting, and audit on the level of corruption in a model simultaneously. Therefore, this study is relevant and important by using a comprehensive theoretical model to explain the problem of corruption in government organization."

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Best regards,
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ARTIKEL REVISI KE-2

Dwi Ratmono (Indonesia), **Darsono Darsono** (Indonesia)

NEW PUBLIC MANAGEMENT AND CORRUPTION: EMPIRICAL EVIDENCE OF LOCAL GOVERNMENTS IN INDONESIA

Abstract

This study is relevant because it examines the determinants of of corruption in local governments that have a negative impact on the success of sustainable development. This study aims to examine the the effect of New Public Management (NPM) as measured by fiscal decentralization, financial reporting quality, and independent audits on corruption level. The sample consisted of 433 local governments in Indonesia for data 2011-2017. PLS-SEM was used as a data analysis technique. The results test show that decentralization positively affects corruption with a path coefficient of 0.19 and a p-value of 0.004. The quality of financial reporting has a negative effect on the level of corruption with a coefficient of -0.26 and p-value <0.001. Hypotheses test results also show that audit finding positively affects corruption with a coefficient of 0.10 and p-value <0.10. On the other hand, follow-up audit results have no significant effect on corruption with p-value >0.10. This study concludes that the NPM mechanism in the form of fiscal decentralization positively affects corruption. These results implies that fiscal decentralization needs to be balanced with good governance, among others, by increasing the quality of financial reports and independent audits.

INTRODUCTION

Based on a survey conducted by the Association of Certified Fraud Examiners (ACFE), corruption ranks first among fraud schemes that occur in Asia Pacific with a percentage of 51% (ACFE, 2021). Meanwhile, the ACFE Indonesia Chapter in the 2019 Indonesia Fraud Survey Report also shows that the most common type of fraud in Indonesia is corruption with a percentage of 64.4% of cases (ACFE Indonesia, 2020). Based on the ACFE Indonesia 2020 report, 167 respondents or 69.9% stated that corruption was the most detrimental act in Indonesia. Government organizations are the institutions that suffer the most because of the

fraud (ACFE Indonesia, 2020). In order to overcome the problem of corruption, governments in various countries have carried out public sector reforms known as New Public Management (NPM), including fiscal decentralization, the application of accrual-based accounting, and the implementation of independent audits. However, research results indicate that the effectiveness of the NPM mechanism is still a debate and an important research question (Changwony, and Paterson, 2019). The practice of decentralization in Indonesia after 15 years of implementing regional autonomy and fiscal decentralization has caused many problems in the regions, one of which is the increasing level of corruption (Boolaky et al., 2018; Sylvia et al., 2018).

Previous research on the effect of fiscal decentralization on corruption have obtained mixed evidence. Studies that provide evidence fiscal decentralization has a negative effect on the level of corruption include include Fisman and Gatti (2002a), Fan et al. (2009), Ivanyna and Shah (2010), and Gurgur and Shah (2014). In contrast, the results of other studies actually provide empirical evidence that fiscal decentralization actually increases corruption (Triesman, 2000; Fisman and Gatti, 2002b; Saputra, 2012; Shon and Cho, 2019; Ulum et al., 2019). In order to explain the inconsistency of previous research, it is important for researchers to analyze other NPM mechanisms besides fiscal decentralization.

1. LITERATURE REVIEW

Agency theory describes a contract between a principal that asks an agent to do work on his behalf which includes the giving of some decision-making authority to the agent (Jensen and Meckling, 1976). Local government in the context of fiscal decentralization is basically the contractual relationships between agents and principals (Zimmerman, 1977). This contractual relationship is manifestly embodied in various regulations in the government sector, including in Law Number 32 of 2004 and 33 of 2004. These two laws and their elaboration or regulatory derivatives to the technical level are the basis of legitimacy for fiscal decentralization for local governments in Indonesia.

The NPM mechanism is designed to fulfill the principles of good governance in agency relations in government organizations (Fisman and Gatti, 2002a; Fan et al., 2009; Changwony, and Paterson, 2019; Saputra, 2012; Boolaky et al., 2018; Harun et al., 2015; Sylvia et al., 2018; Shon and Cho, 2019; Ulum et al., 2019; Ratmono et al., 2021). The NPM mechanisms include, among others, decentralized budget management, financial reporting, accrual accounting and independent auditing (Changwony, and Paterson, 2019; Jeppesen 2019; Ulum et al., 2019;

Ratmono et al., 2021; Furqan et al., 2020; Hamed -Shidom et al., 2022; Lino et al., 2022). Indonesian government has developed various NPM mechanisms with the aim of reducing corruption in government organizations by increasing transparency and accountability in budget management. However, after more than 10 years, there are some criticisms between the implementation of NPM in Indonesia. The study of Prabowo et al. (2017) analyze whether public sector reform in Indonesia is consistent with NPM principles. The empirical evidence of Prabowo et al. (2017) show that public sector reform in Indonesia is incompatible with NPM's philosophy. Harun et al. (2020) criticizes that the determinants of NPM adoption, including the budgeting and reporting system in Indonesia, are due to pressure from coercive international financial agencies and the desire to imitate developed countries. Several studies also show that the effectiveness of NPM implementation in Indonesia is still limited (Harun and Robinson, 2010; Boolaky et al., 2018; Harun et al., 2015; Sylvia et al., 2018). Therefore, it remains an important research question whether the implementation of NPM can achieve the goals of public sector reform in Indonesia, especially in reducing the occurrence of corruption. Data from the Corruption Eradication Commission (*Komisi Pemberantasan Korupsi/KPK)* and Indonesian Corruption Watch (ICW) show an increase in the number of corruption cases and losses to local governments in Indonesia during 2014-2019 (ICW, 2019; KPK, 2020).

Government regulations related to fiscal decentralization are the legal basis for a contractual relationship between principals and agents (Zimmerman, 1977; Malagueno, 2010; Liu and Liu, 2012; Atuilik, 2016; Jeppesen 2019). In this contractual relationship, the executive is given the authority to make fiscal decisions by the principal to carry out the actions or activities necessary to fulfill the wishes of the principal (legislative / people). This authority makes executives have discretionary power or freedom of action. Therefore, the activities carried out by the executive cannot always be observed by the legislative / the People (as the principal), resulting in information asymmetry. By assuming that both parties will maximize their utility, it can be predicted that the executive will not always behave in the interests of the principal (Jensen and Meckling, 1976).

Apart from being able to be explained by agency theory, the effect of fiscal decentralization on corruption can also be approached by using the theory of fraud triangle theory (Cressey, 1953), which consists of pressure, opportunity, and rationalization. High political costs resulting in high-cost recovery are a strong pressure to commit corruption.

In terms of the fraud triangle theory, the opportunistic behavior of the executive and legislative can be explained through three points of view; namely pressure, perceived opportunity, and rationalization (Cressey, 1953). First, the pressure point of view. It is common knowledge that in the context of politics in Indonesia, executive requires high political costs. Therefore, cost recovery by the executive and legislature is a necessity and a strong pressure to commit corruption through the budget. Second, the perspective of perceived opportunity. The regional head and all the bureaucracy have the authority to compile and implement the budget based on laws and regulations governing regional finances in Indonesia. Therefore, executives become very aware (have general information) and also have expertise (technical skills) regarding public sector budgets which are a requirement for perceived opportunities. Two conditions that are parts of the opportunity in the fraud triangle have been fulfilled, so that the opportunity to commit corruption becomes an easy thing. Third, the point of view of rationalization. In the pre-decentralization era, corruption occurred at the level of the central elite and when fiscal decentralization occurred, the corrupt behavior of the central elite became a justification for the local elites to take the same action. In the end, this corrupt behavior becomes a kind of snowball, which inspires legislators and executive officials in other regions to do the same.

Several previous studies have shown empirical evidence that fiscal decentralization positively affects corruption. Saputra (2012) and Ulum et al. (2019) research results provide empirical evidence that decentralization will increase the level of corruption in local government in Indonesia. Albornoz and Cabrales (2013) and Shon and Cho (2019) also show that decentralization positively affects the level of corruption. In the sample of local government in Indonesia, Maria et al. (2021) shows that independence in financial management increases the amount of corruption.

Corruption is an executive opportunist act in local governments that causes harm to the principal (the community), therefore the principal is involved in various forms of supervision of their agents. The literature on delegation of authority identifies four main measures by which principals can limit or reduce agency loss: (1) contract design, (2) screening and selection mechanisms, (3) monitoring and reporting requirements, and (4) institutional checks (Malagueno, 2010; Liu and Liu, 2012; Atuilik, 2016; Jeppesen 2019; Furqan et al., 2020; Hamed -Shidom et al., 2022; Lino et al., 2022). Monitoring and reporting force executives to share with the legislature and the public information they may not have obtained. Law Number 32 of 2004 requires regional heads to provide accountability reports to the legislative, which

have been examined by the Audit Board of the Republic of Indonesia (*Badan Pemeriksa Keuangan/BPK*).

The most important NPM mechanisms in reducing the level of corruption is the transparency and accountability of good financial reporting. Empirical evidence of research at the cross-country level shows that good quality financial statement that have been prepared according to accounting standards can reduce the level of corruption (Atuilik, 2016; Malagueno et al., 2010; Hameed-Shidom et al., 2022). In Indonesian context, financial statement qualities of government are reflected in *BPK's* audit opinion. If the *BPK* gives an unqualified opinion, the regional government's financial reporting show that it is in comply with accounting standards and there are no material misstatements. In the Indonesian context, Furqan et al. (2021) provide empirical evidence financial statement quality positively affects public services.

According to the State Financial Audit Standards, auditors must: 1) examine the internal control, 2) design audits program (Ulum et al., 2019). The auditing standard also requires the examiner to report fraud and deviation from statutory provisions to the competent authority in accordance with the applicable provisions of *BPK*.

Audit reports by Supreme Audit Board are more precisely the findings of an examination of financial reporting weaknesses. Therefore, the more findings or detection of irregularities, the greater the incidence of corruption. The main objective in the audit of the local government sector is to test whether budget management is in accordance with regulations and conclude whether there are material misstatements in financial reporting (Malagueno et al., 2010; Liu and Lin, 2012; Jeppesen, 2019; Lino et al., 2022). Liu and Lin's research (2012) and Kurniawati and Pratama (2021) shows that irregularities detection positively affects corruption.

The number of irregularities detected in government auditing is a reflection of how many violations there are in the local government bureaucracy. However, an audit report that exposes this impropriety is not effective enough to deter corruption. Therefore, detecting irregularities in government auditing is only the first step that results in several recommendations for improvement by the auditors and a very important second step is to hold local governments accountable for making corrections and implementing improvements as recommended by the auditors (Aikins, 2012; Liu and Lin, 2012).

Corruption is an opportunistic behavior of local government executives, therefore from the perspective of agency theory to reduce this, it is monitored by auditors of *BPK*. The auditee is

obliged to follow up on the recommendations as stated in the management letter. Furthermore, they are also responsible for reporting on the status of the follow-up to the recommendations from the BPK audit results.

Government audits will only work as a deterrent to corruption if recommendations for follow-up corrections to abuse in the process of receiving and disbursing funds are carried out entirely (Malagueno et al., 2010; Aikins, 2012; Liu and Lin, 2012; Jeppesen, 2019; Lino et al., 2022). If not done, government audits will be useless. The findings of Liu and Lin (2012) show that post-audit rectification positively affects corruption which implies if auditees follow up on recommendations based on government audit findings, the level of corruption will decrease. Kurniawati and Pratama (2021) conducted research on provincial local governments in Indonesia and the result was that audit rectification had a negative impact on corruption.

2. AIMS

This study aims to analyze the effect of New Public Management (NPM) mechanism as measured by fiscal decentralization, financial reporting, and the implementation of independent audits on corruption level of Indonesian local government.

Based on the literature review, this study proposed hypotheses:

H1: Fiscal decentralization positively affects the level of corruption at local governments

H2: Financial reporting quality negatively affects the level of corruption at local governments

H3: The finding of the audit positively affects the level of corruption at local governments

H4: Follow-up on the recommendations of the audit results negatively affects the level of corruption at local governments

3. METHOD

All local governments in Indonesia were population of this research. Sampling was carried out purposively between 2011 and 2017. The dependent/endogenous variable is the level of corruption. The measurement of corruption (CORP) in this study refers to the real measurement that has been done. The corruption level in this study uses real losses due to corruption cases according to the final decision of the court. The formula for measuring the fiscal decentralization (FD) variable is developed into three indicators, namely: (1) Fiscal

decentralization (DFORI) = total expenditure budget - special allocation fund, (2) Fiscal decentralization per population (DFPOP) = (total expenditure budget - special allocation fund of a local government)/population, and (3) Fiscal decentralization per area (DFAREA) = (total expenditure budget - special allocation fund of a local government)/area of a local government.

Financial statement quality is measured by Indonesia Supreme Audit Agency data. Audit findings measured by using two indicators, namely findings of systems weaknesses and the number noncompliance findings. Follow-up recommendations for audit results measured by the total rupiah value of findings that have been followed up by the regional government in audits conducted by the BPK for period t and t-1.

Data analysis in this study used a Partial Least Square Structural Equation Model (PLS-SEM) approach. The software used is Warp PLS 7.0 (Kock, 2020). This study used PLS-SEM because the measurement of fiscal decentralization variables uses four formative indicators (Hair et al., 2017; Kock, 2020). By using PLS, it can be obtained the results of hypothesis testing simultaneously and minimize measurement as well as structural errors (Hair et al., 2017).

4. RESULTS

The study population consisted of 514 local governments in Indonesia. The final sample consisted of 433 local governments. Table 1 presents descriptive statistics for each research variable. On average, the value of corruption is at a moderate level with an average loss value of IDR 1,723,966,769.19. Overall, the level of fiscal decentralization in Indonesia is relatively large, as indicated by the average magnitude of the three indicators. Descriptive statistics also show that there are still quite a number of findings of weaknesses in internal control and non-compliance with laws and regulations as well as the audit results of BPK. Meanwhile, the follow-up examination results were still mixed for periods t and t-1. The financial statements of local governments (untabulated) shows that most are given unqualified (65.6%), qualified (15.8%), unqualified with explanatory paragraphs (6.6%), adverse (0.5%), and disclaimer opinion (11.5%).

Table 1. Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
Corruption level	2,102,700.00	45,000,000,000.00	1,723,966,769.19	4,989,701,438.54
DF_ORI	289,067,291,956.00	3,960,156,650,321.00	965,018,371,079.14	729,958,726,076.32
DF_POP	687,234.00	18,945,114.00	2,683,763.96	2,717,136.43
DF_AREA	27,014,223.00	23,618,754,997.00	2,101,868,926.50	3,881,701,951.51
Internal control findings	1.00	27.00	9.92	4.24
Noncompliance findings	29,600,000.00	114,143,940,000.00	5,512,408,304.09	10,910,018,763.09
Follow-up audit t	1,840,000.00	7,913,350,000.00	1,169,809,101.80	1,612,806,388.26
Follow up audit t-1	2,030,000.00	38,537,120,000.00	1,634,561,976.74	4,391,932,422.78

This study used latent/unobserved variables and was measured using formative/index indicators. Analysis of the measurement model can be utilized from the feasibility of the formative indicator by looking at the significance value of weight and co-linearity (*variance inflation factor/VIF* The result of measurement model using WarpPLS 7.0 in Table 2 shows that p-value for weight significance of all indicators of formative variables <0.001 and co-linearity of all formative indicators shows VIF value <3.3. Thus, measurement model has fulfilled the criteria for formative constructs.

Table 2. Evaluation of Measurement Model

Indicators	p-value	VIF
DF_ORI	<0.001	1.348
DF_POP	0.004	1.012
DF_AREA	<0.001	1.345
OPN-T	<0.001	1.882
OPN_T-1	<0.001	1.882
IC_T	<0.001	1.006
NC-T	<0.001	1.006
Follow-T	<0.001	1.058
Follow_T-1	<0.001	1.058
CORP	<0.001	0.000

Figure 1 presents the WarpPLS 7.0 output for the structural model test results.
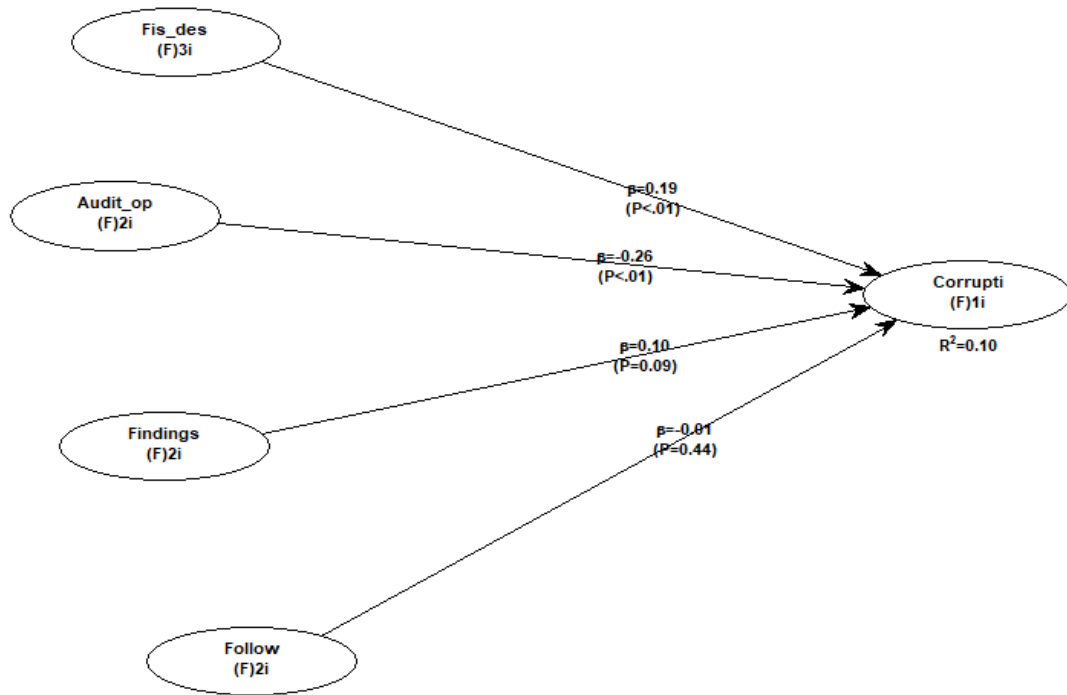
Figure 1. Results of Structural Model

Table 4 shows the hypothesis testing results based on structural model. The result of this study provides empirical evidence that the H1 is accepted, with coefficient 0.19 and p-value 0.004. H2 is accepted with coefficient of quality of financial reporting -0.26 and significant with p-value <0.001. H3 is also accepted with coefficient of audit findings 0.10 and p-value 0.095 (<0.10). Meanwhile H4 is not accepted due to p-value 0.435 (>0.10).

Table 4. Results of Hypothesis Testing

Path	Hypothesis	Coeff.	p-value	Conclusion
Fiscal decentralization → Corruption	+	0.19	0.004	Supported
Quality of financial report → Corruption	-	-0.26	<0.001	Supported
Audit findings → Corruption	+	0.10	0.095	Supported
Follow-up of audit results→ Corruption	-	-0.01	0.435	Not supported

5. DISCUSSION

The result of this study provides empirical evidence that the hypothesis 1 is supported. The test results of hypothesis 1 in this study supports the agency theory. The results of the study support Prud'home's (1995) argument that corruption in developing countries is more common at the local government level than at the national level. This is because executives in local

government are often pressured to comply with the demands of their political groups. With the existence of greater public financial management authority after the era of fiscal decentralization, the behavior of economic rent will increase. The findings of this study also support Cressey's (1953) fraud triangle theory, namely that fiscal decentralization is a fraud risk factor, namely opportunity. Fiscal decentralization provides greater opportunities for executives to engage in corruption in the management of public finances by handing over autonomy from the central government to local governments.

The results of this study support Shon and Cho (2019) and Ulum et al. (2019), Maria et al. (2019), Yanto and Adrison (2020), and Ratmono et al. (2021) which provide empirical evidence fiscal decentralization positively affects corruption. The results of the PLS-SEM test also provide support for hypothesis 2, namely that good quality financial statements will reduce the occurrence of corruption. This finding supports agency theory that financial statements can reduce information asymmetry between principals and agents in organizational management. This finding supports previous research, including Atuilik (2016), Malagueno et al. (2010) and Hameed-Shidom et al. (2022) which shows that the high quality of government financial reports can reduce the level of corruption.

Furthermore, this finding also supports the fraud triangle theory that fraud can be reduced by limiting opportunities, among others, by practicing transparency and accountability in financial statements that are presented in accordance with accounting standards. The empirical evidence from the results of this study also shows the importance of the role of financial audits, indicated by their negative influence on the level of corruption. The results of this study also support the argument of Liu and Lin (2012) which states that the fundamental purpose of financial auditing is to supervise, guarantee, and support government accountability which is an important institutional part of modern government governance.

The test results show support for hypothesis 3 that the number of audit findings has a positive effect on the level of corruption. The more the financial audit findings in the form of weaknesses in the internal control system and non-compliance with laws, the greater the level of corruption. These results support the fraud triangle theory argument that weaknesses in internal control is an opportunity factor that can lead to fraud. In addition, this result supports of Liu and Lin (2012) which show that irregularities detection has a significant positive effect on corruption. The results of this study also support Kurniawati and Pratama (2021) which show that irregularities positively affect corruption.

The empirical evidence of the results of this study does not show support for hypothesis 4 that the follow-up of audit negatively affects corruption in local governments. This finding is probably due to the low follow-up of examination results as shown in the descriptive statistics. The not yet optimal failure to follow up the findings of audits requires evaluation in financial management in Indonesia because as Liu and Lin (2012) argue that financial audits will only work as a deterrent to corruption if recommendations for follow-up corrections to abuse in the process of receiving and disbursing funds are carried out entirely. If not done, financial audits will have little use in government governance. Future research can further explore the optimization of follow-up audit results and their effect on corruption in government organizations.

CONCLUSION

The purpose of this study is to examine the impact of the New Public Management variables, namely fiscal decentralization, quality of financial statement, audit findings, and audit follow-up on the level of corruption. The results of this study provide empirical evidence that fiscal decentralization positively affects corruption. Financial audits in the form of providing opinions on financial reports have a negative effect on the level of corruption. Meanwhile, weaknesses in the internal control system and non-compliance with laws and regulations tend to increase the level of corruption. These results provide support for the agency theory and the fraud triangle theory. According to the fraud triangle theory, fiscal decentralization provides an opportunity for corruption in local governments in Indonesia. Meanwhile, financial statement and audits act as deterrent factors that reduce opportunities for corruption. Furthermore, the results of this study show that the NPM mechanism in Indonesia in the form of fiscal decentralization can actually increase corruption. The results of this study imply that fiscal decentralization in local governments in Indonesia needs to be controlled by other NPM mechanisms, namely by improving the quality of financial reports and auditing financial management through independent audits.

This study has limitations in measuring fiscal decentralization and corruption based on various proxies. This study has attempted to measure corruption with the best approach, namely by the total level of losses caused by the fraud. Corruption is a complex phenomenon that can provide future research opportunities to add variables such as political costs, culture, financial performance, politics variables, and so on. In measuring variables, of course, must consider the availability of data.

AUTHOR CONTRIBUTIONS

Conceptualization: Dwi Ratmono, Darsono Darsono.

Data curation: Dwi Ratmono.

Formal analysis: Dwi Ratmono.

Investigation: Darsono Darsono, Dwi Ratmono

Methodology: Dwi Ratmono, Darsono Darsono

Project administration: Dwi Ratmono.

Software: Dwi Ratmono

Supervision: Dwi Ratmono

Validation: Darsono Darsono, Dwi Ratmono.

Writing – original draft: Dwi Ratmono, Darsono Darsono.

Writing – review & editing: Dwi Ratmono, Darsono Darsono.

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18th of May, 2022

Dwi Ratmono
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Indonesia

ACCEPTANCE LETTER

Dear Dwi Ratmono,

We are pleased to inform you that your manuscript "New public management and corruption: Empirical evidence of local governments in Indonesia" co-authored with Darsono Darsono has been double blind peer-reviewed and accepted for publication in the international journal "Public and Municipal Finance", which is scheduled to be published in Volume 11, Issue 1, 2022.

With cordial regards,
Valeria Matiukhina

Managing Editor
International research journal
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