

# THE EFFECT OF LEGISLATIVE OVERSIGHT, BUDGET TRANSPARENCY, AND INTERNAL AUDITOR QUALITY ON LOCAL GOVERNMENT PERFORMANCE WITH TOTAL ASSET MODERATION: A CASE STUDY IN INDONESIA

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## ABSTRACT

*This study aims to examine the relationship between legislative oversight, budget transparency, and the quality of internal auditors on local government performance. To achieve the research objectives, we observed 264 local governments in the 2018 period. The scope limitation in 2018 was due to budget transparency data using a form on the local government website. This study uses descriptive statistics and multiple regression analysis to assist in data processing the findings in this study, among others. Legislative supervision and internal quality auditors do not affect the local government's performance, and local government financial reports' quality impact on local government performance. However, budget transparency positively affects local government performance and local government financial reports' quality. Another finding is that total assets can moderate by weakening the influence of supervision on local government performance. On the other hand, total assets cannot reconcile the effect of internal auditors' transparency and quality on local government performance. Thus, it is necessary to strengthen regional asset management as a supporting resource to strengthen legislative members' competence and strengthen internal auditors within the provincial government's scope.*

**Keywords:** Legislative Oversight, Budget Transparency, Quality Internally Auditor, Performance

## INTRODUCTION

The government's performance describes the achievements that have been achieved in the realization of the programs, goals, objectives, vision, and mission contained in planning (Negara et al., 2018). Good governance can assist the government in evaluating and monitoring government spending to improve performance. Local governments that have governance better, governance should perform better because of the policies and decisions made to meet the public interest (Ward et al., 2017). In general, an organization wants to present a positive performance achieved even though there are still some errors in the report (Hood, 2011; Moynihan, 2008). The presentation of reports that do not have good reliability will impact the government (Dalton & Dalton, 2005; Van de Walle, Van Roosbroek, & Bouckaert, 2008; Van Ryzin, 2011).

The role of supervision by legislative in the public sector is required to implement governance (good governance) both in the public sector. *IFAC* and *The Chartered*

*Institute of Public Finance and Accountancy (CIPFA) in " International Framework: Good Governance in the Public Sector "* (2014) explain that good governance in the public sector. It requires a separation of power in two forms of control: non - executives (legislative body) and executive (a government agency or other public service agency). Good governance by IFAC and CIPFA requires supervisory functions performed by the legislative against suitable management activities undertaken by the executive in this respect, government institutions, and other public service agencies.

The role of *corporate governance* can create value for the corporation and support transparency (Lamm, 2010). Davey & Eggleton (2011) state a positive relationship between a company's size and its performance. Measurement of the quality variable of legislative supervision in this study is different from Anggraeni & Riduwan (2014); Primayana et al., (2014); Kusuma et al. (2016); and Efendi et al. (2017) with primary data through a questionnaire instrument. Kusumawardani (2012) and Sutaryo & Jakawinarna (2013), Saragih and Setyaningrum (2014) found that legislative size has a positive effect on financial performance. Sesotyaningtyas (2012); Sumarjo (2010); and Gilligan & Matsusaka (2015) use legislative measures for supervision, but the results of the study do not affect the financial performance of local governments. Fernandes (2015) and Anugriani (2013), with primary data, found that legislative oversight affects local government performance. Marhawai (2015) states that the legislative size partially has a fragile negative effect on local governments' financial performance.

The research offers alternative measurements using Follow-up Audit (TLHP) BPK as mandated in Law No. 23 of 2014. The study is also filed as a moderating influence total assets supervision, transparency, and internal quality auditor of local government performance. Total assets have been selected as the availability of resources because their value is more stable than income, several employees, or the entire production.

## LITERATURE REVIEW

Jensen & Meckling (1976) describes an agency relationship as a contract in which one or more principals (*principal*) and their agents. In the context of submitting public organizations' financial statements, the government is an agent who is obliged to present useful financial information to users in its capacity as a principal in assessing accountability and making economic, social, and political decisions. The executive and legislative relationship viewed as a *principal-agent* relationship (Fozzard, 2001; Halim, 2007; Moe, 1984; Smith & Bertozzi, 1998). In this relationship, the regional government as the executive acts as an *agent*, while the Regional House of Representatives (RHR) represents the principal.

Agency theory to analyze the phenomenon of executive and legislative relations has not been widely used. There is a huge *contingency* factor towards the form and concept of democracy adopted by a country and the nature of the public sector, which is not always related to the personal interests that work in it (Christensen, 1992; Smith & Bertozzi, 1998). According to Lane (2003), this theory can be applied to government agencies as an accountability mechanism to ensure adequate monitoring, auditing, and reporting for the achievement of organizational goals (Cribb, 2006), ethically and profitably (Podrug, 2011).

In Indonesia's context, the oversight function of local government financial management is carried out by the RHR. Syahrudin & Taifur (2002) revealed that RHR plays an essential role in supervising local governments in carrying out their government activities to achieve the

desired performance. Supervision activities aim to ensure that programs proposed by the government and approved by the RHR can run according to the stated objectives. The legislature is obliged to supervise activities carried out by the executive. So, the potential for irregularities that might harm the state minimized as much as possible. Tuasikal (2007) explained that external supervision does not have a significant effect.

Kusumawardani (2012) suggests that legislative size affects the financial performance of local governments. The more members of the legislature who supervise correctly, the greater the motivation for the provincial government's performance to provide services to the community or vice versa. Meanwhile, Pamungkas (2012) argues that the application of public sector financial accounting, supervision, and quality of government financial reports affects government agencies' performance accountability. It shows that the better the government's financial reports and adequate control when government performance is responsible. Will increase Bourdeaux & Chikoto (2008) state that legislative oversight positively affects management performance. Marfiana & Kurniasih (2013) explain that local governments with large legislative sizes should improve their performance.

*H<sub>1</sub>: The quality of legislative oversight affects the performance of local governments.*

Leng & Mansor (2005) examined the dominant personality of the *Chief Executive Officer* (CEO), who is concurrently *chairman* and has a relationship with Malaysia's company performance. On the other hand, Haat et al. (2008) stated that there is no significant difference between companies with good and bad governance on performance regarding *disclosure* and submission of reports on time (*timeliness*) as a *proxy* for transparency. Chin (2015) found a significant relationship between *corporate governance* and company performance using market size (*Tobin's Q Ratio*). The use of accounting measure (ROA) causes a significant effect on only the board of commissioners and ownership concentration.

*H<sub>2</sub>: Budget transparency has a positive effect on the performance of local government.*

Aikins (2011) explains that auditing often leads to an increase in the adequacy and effectiveness of internal controls, thereby contributing to public accountability. Nasir & Oktari (2011) explain that internal control factors give the air a positive contribution to government agencies' performance. Warhana et al. (2015) find the inspectorate's significant characteristics to improved local government implementation performance. Suharyanto & Sutaryo (2016) and Sholeh (2017) state that there is a positive effect on internal government supervision on government performance accountability.

*H<sub>3</sub>: Quality internal audit affects the performance of local government.*

In the context of private organizations, organizational supervision is carried out by the board of commissioners. Implementing corporate governance practices can support the company's survival and increase public and investors' trust. Researchers carried out by Yi, Howard, & Eggleton (2011) state a positive relationship between a company's size and performance. The relationship between the company's size between supervision and its financial performance is that its size functions as a moderator between supervision and its financial performance. The moderating effect captured by supervision and firm value is that investment plays a role in developing the company to gain a competitive advantage (Barney, 1991).

*H4: Total local government assets strengthen the influence of quality supervision on local government performance quality.*

Mustikarini & Fitriarsi (2012) stated that the larger the size of the region, which is assessed by the size of the total assets of the regional government, will encourage the characteristics of the local government to open information on resource management and have an impact on the higher performance of local governments. According to Nugroho and Rohman (2012), the government will build infrastructure and facilities needed by the state, reflected in its capital expenditure.

*H5: Total local government assets strengthen the influence of budget transparency on local government performance.*

Tama & Adi (2018) suggest that government size is a factor that determines local governments' financial performance. There is a tendency that when the government's measure gets bigger, local governments' understanding will get better. However, Nugroho and Prasetyo (2018) and Sari and Mustanda (2019) state that regional governments with large assets tend to be unproductive and unable to support local government performance.

*H6: Total local government assets moderate the effect of internal audit quality on local government performance.*

## Research Design

The data in this study is in the form of *cross-section* data taken from the results of audits of regional (city and district) government financial reports throughout Indonesia conducted by BPK, city, and district government websites as well as Government Agency Performance Accountability scores (AKIP). The criteria for local government financial reports used are as follows:

1. This study's financial statements consist of district and city governments' financial reports during the 2017-2018 period.
2. District and city governments have official websites that are actively updated, which contain information on both activities and data that can be consumed by the public.
3. The total sample results from 264 Local Governments (LG) consisting of 56 city governments and 208 district governments (districts) in 2018.

Research model are as follows:

$$KPD = a + b_1 \cdot MPA + b_2 \cdot TRA + b_3 \cdot KIA + b_4 \cdot (MPA * TA) + b_5 \cdot (TRA * TA) + b_6 \cdot (KIA * TA) + b_7 \cdot TA + b_8 \cdot PAD + b_9 \cdot POP + b_{10} \cdot GRDP + b_{11} \cdot MANDIRI + b_{12} \cdot CAPITA + e$$

Information:

|       |   |
|-------|---|
| KPD   | = Local Government Performance                        |
| KLKPD | = Quality of Local Government Financial Reports       |
| $b_x$ | = Regression Coefficient                              |
| KPL   | = Quality of Legislative Oversight                    |
| TRA   | = Budget Transparency                                 |
| KIA   | = Quality of Internal Audit                           |
| TA    | = Total Assets  |
| PAD   | = Regional Original Income                            |
| POP   | = Population (total population in natural logarithms) |
| GRDP  | = Gross Regional Domestic Product                     |

MANDIRI = Level of Regional Independence  
 PERKAPITA = Income per capita  
 e = Error

## RESULT

Descriptive analyzes carried out on 264 local government (LG) are composed of 56 municipal authorities and 208 district governments (district.) In 2018. Table 1 contains detailed descriptive statistics of variables empirically in this.

| Table 1<br>DESCRIPTIVE STATISTICS |     |             |                |                  |                   |
|-----------------------------------|-----|-------------|----------------|------------------|-------------------|
|                                   | N   | Minimum     | Maximum        | Mean             | Std. Deviation    |
| Supervision                       | 264 | 0.04        | 1.00           | 0.9351           | 0.14969           |
| Transparency                      | 264 | 1           | 20             | 4.73             | 3.913             |
| TotalAsset                        | 264 | 44990196925 | 32835917510688 | 3621877965824.60 | 3755719549125.134 |
| PADasli                           | 264 | 8452772191  | 2872568512687  | 277560016417.16  | 387620570508.258  |
| Population                        | 264 | 33978       | 5715009        | 635827.20        | 694337.727        |
| Independent                       | 264 | 0.01        | 0.86           | 0.1392           | 0.10156           |
| GRDP                              | 264 | 27          | 33             | 30.06            | 1.097             |
| Percapita                         | 264 | 15.70       | 25.67          | 17.2781          | 1.13760           |
| Valid N (listwise)                | 264 |             |                |                  |                   |

On average, TLHP is high at 0.935 or 93.50 %. Thus the general government follows up on the findings of the BPK audit results. Blitar district government is the local government with the smallest TLHP, while 150 other local governments have 100% TLHP. The average disclosure of as much as 4.73 informational content with 3.9135 standard distribution so that the transparency of local government financial information on the website is low.

The majority of local government internal auditors used in this study are at level 2 with 211 local governments (79.9 %). There are 52 local governments (19.7%) at Level 1, and only one regional government has Level 3 internal audit quality.

The regression model has fulfilled all the classical assumptions required. The regression results presented in Table 2 show that transparency has a significant positive effect on local government performance. In contrast, total asset moderation on the impact of supervision on performance has a significant negative impact on local government performance. Other independent variables do not have a substantial effect on the quality of local government performance variables. Overall, the independent variable has a significant impact on local government performance with a significance level of 28, 9 %, and 0 000.

| Table 2<br>REGRESSION RESULTS MODEL 3 |              |                             |            |                           |        |       |
|---------------------------------------|--------------|-----------------------------|------------|---------------------------|--------|-------|
| Model 3                               |              | Unstandardized Coefficients |            | Standardized Coefficients | t      | Sig.  |
|                                       |              | B                           | Std. Error | Beta                      |        |       |
| 1                                     | (Constant)   | -6.860                      | 3.461      |                           | -1.982 | 0.049 |
|                                       | Supervision  | -0.223                      | 0.331      | -0.036                    | -0.674 | 0.501 |
|                                       | Transparency | 0.032                       | 0.013      | 0.135                     | 2.474  | 0.014 |
|                                       | KIA          | 0.179                       | 0.125      | 0.078                     | 1.432  | 0.153 |

|                           |        |       |        |        |       |
|---------------------------|--------|-------|--------|--------|-------|
| Supervision_TA            | -0.131 | 0.044 | -0.167 | -2.990 | 0.003 |
| Transparency_TA           | 0.020  | 0.060 | 0.018  | 0.328  | 0.744 |
| KIA_TA                    | -0.073 | 0.081 | -0.056 | -0.895 | 0.372 |
| PAD                       | 0.397  | 0.175 | 0.425  | 2.271  | 0.024 |
| TA                        | -0.267 | 0.134 | -0.195 | -1.988 | 0.048 |
| Population                | -0.042 | 0.130 | -0.043 | -0.321 | 0.748 |
| Independent               | -0.221 | 1.090 | -0.024 | -0.203 | 0.839 |
| GRDP                      | 0.245  | 0.107 | 0.290  | 2.294  | 0.023 |
| Percapita                 | -0.008 | 0.052 | -0.010 | -0.163 | 0.871 |
| <i>R</i>                  |        |       | 0.567  |        |       |
| <i>R-Squares</i>          |        |       | 0.322  |        |       |
| <i>Adjusted R-Squares</i> |        |       | 0.289  |        |       |
| <i>Sig.</i>               |        |       | 0.000  |        |       |

## DISCUSSION

Based on hypothesis 1 note's testing results, legislative oversight does not affect local government performance. Meaning, hypothesis point 1 of this study was rejected. While Local conditions of government performance range in B (44.7%) and CC (30.3%) with the highest criteria A and B. This condition indicates that local governments' performance is quite good (B), but many performances need improvement (CC criteria). In line with agency theory, the delegation of authority to the executive should be balanced with the legislature's oversight to ensure that the executive carries out its duties, vision, and mission to achieve its goals. Thus, the *check-and-balance function* runs well (Kumorotomo, 2007). The element of external supervision (through the legislature) is one factor that influences the improvement of local government performance (Widanarto, 2012).

This study's results align with Saragih and Setyaningrum (2012) findings, where legislative supervision proxied by political competition in the RHR does not significantly affect local government performance. Other studies in line with this study are Renas (2013) and Risma et al. (2015), which found that the BPK audit findings did not significantly affect local government performance. Meanwhile, Sudarsana (2013) found that audit findings harm local government performance. The legislative oversight function is more focused on political oversight, where members of the legislature are more concerned with fulfilling campaign promises to constituents who are the basis for elections (Afriansyah, 2013). The legislative oversight function is fragile, with factors suspected of personal background, political background, and budget management understanding. The findings of this study are in line with a survey conducted by the Indonesian Legal Roundtable (Detik.com, 2017), which found that the oversight function carried out by the RHR was inferior, the performance of the legislature at the national and regional levels related to all uses of House of Representative (HR) / RHR rights was below average.

Hypothesis point two is acceptable that the transparency of local government finance has a positive effect on the local government's performance. Information and communication have a good impact on improving performance because all parties obtain and exchange information needed to carry out operational activities. Werimon et al., (2007) said that the implementation of accountability and transparency causes excellent control of the community, causing government managers to work according to existing provisions to produce good government performance. The application of the principle of transparency in the regional government's administration allows the public to find various information regarding local government

implementation in a correct, honest, and non-discriminatory manner. (best performance) to the community by increasing government goals following the vision and mission (Rahmanurrasjid, 2008).

The result of testing hypothesis 3 shows that internal auditors' quality does not affect local government performance. Thus the research hypothesis is rejected. Internal auditors play a role in improving the accuracy and reliability of financial information to correct internal control deficiencies. Internal auditors help local governments to be accountable to the community by enhancing internal control. It is known that 79.9% of internal auditors' quality is at level 2, which means that the government's internal control system is still weak and has not been appropriately handled. The implementation of internal control practices has been carried out. Still, it is not well documented, and its performance is highly dependent on the individual and has not involved all organizational units. The effectiveness of control has not been evaluated so that many weaknesses have not been adequately addressed.

These findings are consistent with research reported by MacRae and Gils (2014). There is more than 90 percent of public sector organizations from all regions (Africa, Asia-Pacific, Europe-Central Asia, Latin America and the Caribbean, Middle East, United States, and Canada, and Western Europe) have scored overall proficiency performance levels at Level 1 (34%) and Level 2 (62%). It is also reported that less than five percent of the public sector's internal audit activity, regardless of region, has achieved higher than Level 2 Infrastructure. Similar to previous research conducted in Malaysia also revealed the same results (Fern, 2015; Haron et al., 2016).

### **The Role of Total Assets In Moderating The Influence of Independent Variables on Local Government Performance**

Total assets as the organization's size have an essential role in achieving organizational performance (Chi, 2004; Vijayakumar & Tamizhekvan, 2010; Abbasi & Malik, 2015). Total asset is a measure acts as a determinant of performance, and its role is also analyzed as an essential moderating variable for the company (Rauch et al., 2009). Based on the results of testing for hypothesis 4, it is known that total assets weaken the effect of supervision on local government performance. These results meet the expectations of the formulation of this research hypothesis, which proposes a statement that total assets moderate (strengthen/weaken) the effect of supervision on local government performance. Thus the research hypothesis is accepted.

Local governments' ability to follow up on BPK audit results is determined by factors of coordination between units in the regions, commitment from leaders, the number of regional government organizations, and the availability of resources (assets). The research found out that regional assets cannot moderate legislative oversight of local government performance resulting from legislative scrutiny of a political nature and resource misuse. In this case, the local assets are more widely abused for legislative interest to serve their constituency constituents.

Based on the results of testing for hypothesis 5, it is known that total assets do not moderate the effect of transparency on local government performance. Thus the research hypothesis is rejected. The provincial government budget's openness is still low due to local governments' capacity to implement transparency through the official website (Purwanti, 2020). This finding is supported by the poor condition of local government asset management, where asset problems include several problems that often arise. Namely inaccurate asset recording, unreliable asset data, unsupported assets with reliable data, non-compliance reporting process, assets not yet optimized, *standard operating procedures* (SOP) have not been prepared,

assets in the form of uncertified land, assets controlled by other parties, and unknown assets. Thus, the inadequate management of local government assets causes assets not to moderate local government performance transparency.

This study explores the total assets' role as an independent variable and moderating variable on local government performance. Local governments that have more considerable total assets have a more extraordinary average performance. Thus, it is hoped that large assets will strengthen and motivate local governments to improve their Internal Auditors' quality. A right but to the contrary is obtained based on the BPK obstacles encountered in upgrading internal auditors' capabilities. These results indicate that the challenges faced in developing internal auditors' quality are the lack of awareness, understanding, and commitment from top management, the governor, regent, and mayor regarding the benefits and roles of APIP.

The absence of top management commitment is the lack of capacity and knowledge of APIP management in managing APIP resources. It impacts the lack of APIP personnel capability and the inadequacy of the assurance and consulting function provided by APIP (BPKP, 2018). The local government leadership commitment's weakness will ultimately impact the use of regional assets to support the internal quality auditor's strengthening. To regional leaders, as the owner does not use local assets, it has to keep auditors' internal resources in governance according to the region. This research shows that total assets do not moderate the internal auditors' quality, caused by the quality of internal auditors' resources being less competent. After all, local governments' investments do not support them due to a lack of regional heads' commitment to internal control.

This study includes total assets, local revenue, GRDP, per capita income, and population. Research by Khasanah and Rahardjo (2015), Maulana and Handayani (2015), Yunara et al. (2016), and Sofyan (2016) found a positive effect of total assets on the disclosure of local government financial statements (LKPD). However, Setyowati (2016) found an influence negative between the asset size and the LKPD disclosure level. Research by Hilmi and Martani (2010), Setyaningrum and Syafitri (2012), Silfia et al. (2015), Feriyanti et al. (2015), and Setyowati (2016) found that regional wealth affects the level of LKPD disclosure. Wenny (2012) PAD has a total effect on the financial performance of local governments. Batubara (2009) PAD is having a significant impact on financial performance. Wenny (2012) and Mustikarini & Ritriasasi (2012) found that Regional Original Income (PAD) affects local government performance.

Maulana & Handayani (2015) found that the local government's size positively affects the LKPD disclosure level. Priharjanto and Wardani (2016) Regional wealth has no significant effect. Sesotyaningtya's (2012) variable *leverage*, legislative size, and *intergovernmental revenue* have no impact on local government financial performance based on performance efficiency ratios. Meanwhile, the local tax revenue variable harms local governments' financial performance based on the performance efficiency ratio.

Anzarsari (2014) states prosperity (*wealth*) and transfers from the central government on the local government's performance. As measured by total revenue, the size of local governments does not affect local government performance. It indicates that the role of local government measures in improving the performance of district/city governments has not been able to function correctly. The regional size does not affect the district/city government's performance because the local government has not been able to properly manage the local government with a considerable measure of *wealth* (PAD) should have a high-performance value. Suppose an LG with a large size and PAD turns out to have a low score. In that case, the Regional Government



must be aware and reflective that its performance means that its performance is lower than a Regional Government with a smaller size and PAD.

It is hoped that the balancing fund will be used by the transfer of funds from the central government to local governments, one of which is by improving existing infrastructure to create development and have an impact on economic activities in the area to enhance the performance of local governments. Sumarjo (2010) found a link between balancing funds and local government financial performance. Kusumawardani (2012) found that legislative size and size variables affect Indonesia's local governments' financial performance. In contrast, prosperity and leverage do not affect the financial performance of local governments in Indonesia. This study indicates that the PAD and the provincial government's size influence local governments' financial performance. Transfers and leverage do not affect the financial performance of local governments.

The next factor that is estimated to affect financial performance is the dependence on funding from the central government, which the central government provided to overcome fiscal imbalances. The central government offers a balanced fund sourced from the National Budget (APBN) allocated to regions to finance regional needs in implementing decentralization. The central government hopes that the greater the intergovernmental revenue, the provincial governments can improve their performance.

## CONCLUSION

This study aims to examine the effect of legislative oversight, budget transparency, and quality of internal auditors on local government performance and the quality of local government financial reports, as well as the moderating role of total assets on the effect of legislative oversight, budget transparency, and quality of internal auditors on local government performance and quality of financial reports for local government.

Legislative oversight does not affect local government performance. The practice of legislative oversight is more oriented towards political supervision than technical supervision. Budget transparency has a positive effect on local government performance. Transparency means more information and communication, which positively impacts performance because all parties obtain and exchange information needed to carry out operational activities. The quality of internal auditors does not affect local government performance. The quality of internal government auditors is still low. It has not been handled correctly, resulting in the implementation of internal control practices that are not well documented. Their performance is highly dependent on individuals and has not involved all organizational units. The effectiveness of control has not been evaluated so that many weaknesses have not been addressed.

Total assets weaken the effect of supervision on local government performance. Local governments' ability to follow up on BPK audit results is determined by factors of coordination between units in the regions, commitment from leaders, the number of regional government organizations, and the availability of resources (assets). As evidenced by the majority of the findings, the unavailability of adequate assets is in the area of asset management. Total assets are not able to moderate the effect of transparency on local government performance. Assets problems include some of the issues that often arise: the recording of assets that are not accurate; the data assets are not reliably; a reliable data reporting process does not support the asset. The assets have not been optimized, *standard operating procedures* (SOP) has not been prepared,

assets in the form of uncertified land, assets controlled by other parties, and assets whose whereabouts are unknown.

Total assets do not moderate the effect of internal auditor quality on local government performance. The overall asset capacity allows the provincial government to develop the capacity/capability of the internal auditor. These results indicate that the obstacles faced in developing internal auditors' quality, the main factor being the lack of awareness, understanding, and commitment from top management, in this case, the governor, regent, and mayor regarding the benefits and roles of APIP.

This study resulted in several findings that showed that legislative oversight did not affect local governments' financial and non-financial performance. The lack of legislative oversight has resulted in minimal control over organizational performance and behavior, resulting in unhealthy regional government administration practices.

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