

The Effect of Audit Opinion and Corruption on Local Government Performance

1. Absrak

This study aims to examine the effect of prior year's audit opinion on the performance of local government as well as how the level of corruption affects audit opinion and the performance of local government. The research population was all local governments in Indonesia with total sample of 360 observations in 2012. The result shows that prior year's audit opinion positively affects the performance of local government. Moreover, this study found that the level of corruption weakens the effect of prior year's audit opinion on the performance of local government.

Key word : *prior year's audit opinion, the performance of local government, level of corruption*

2. Introduction

2.1. Research Motivation

Government performance is defined as a result of the government's activities and programs which will be or have been achieved with respect to the use of budget measured with certain quantity and quality (Government Regulation No. 8 of 2006). According to Nordiawan (2010), government performance cannot be seen only in terms of input and output but also in terms of outcomes, benefits and its impacts on the public welfare.

Local government performance is assessed by using *Evaluasi Kinerja Penyelenggaraan Pemerintahan Daerah* (EKPPD). Besides using EKPPD, government performance can also be evaluated from the Human Development Index (HDI). The assessment of government performance using HDI is in accordance with the research of Afonso (2005) and Meurs and Kochut (2013).

In addition to the assessment of performance, government is also responsible to report its performance that has been achieved through financial statements. In accordance with the Government Regulation No. 8 of 2006 on financial reporting and performance of government agencies, financial statements is a form of accountability for a country's or a region's public financial management during one period. Therefore, financial statements may serve as a monitoring tool used by the society in assessing the government performance (Setyaningrum, 2015).

To ensure the fairness of information, government's financial statements must be audited by a competent authority, namely the Audit Board, here in after referred to as BPK (www.bpk.go.id and Government Regulation No. 8 of 2006). BPK, as an independent party, can conduct financial statement audit to reduce agency conflict in government agencies, which is asymmetric information between society, as the principal, and government, as the agent.

After conducting audit for local governments' financial statements, BPK will provide audit opinion as one of the results (www.bpk.go.id). Audit opinion is the result of examining fairness of numbers presented in financial statements which reflect activities and programs in regard to the use of local government's budget. If a local government obtains an unqualified opinion (WTP), it means that the numbers stated in financial statements have been fairly presented. The fairness of those numbers indicates a good performance of local government.

Based on the signaling theory, audit opinion is a form of signal provided by local government to the users of financial statements which shows that local government already fulfilled its obligations mandated by the society. Audit opinion may then attract investors to invest, donors to provide grants, as well as tourists to visit, which will improve local government performance (Puspita and Martani, 2010).

To maintain its credibility, the government will be motivated to improve their public financial management as an effort to enhance its performance. It is consistent with the theory of motivation developed by McClelland and Abraham H Maslow about the need for achievement (Hariandja, 2002). The motivation occurs when government needs to show a good achievement to the society and interested parties. Government will be motivated to maintain its performance if it obtained an unqualified opinion on the prior year. On the other hand, , the government will improve its performance if the prior year's opinion was still bad (other than unqualified opinion). Thus, the prior year's audit opinion will drive the government to obtain a better performance in the future.

Examining the effect of prior year's audit opinion on government performance needs to consider the level of corruption. Rajkumar and Swuroop (2008) found out that the level of corruption can weaken the effect of government spending (allocation of public resources) on the performance. Low levels of corruption show that the government has a good governance. If the government has a good governance, each part of the government will work properly so that the allocation of public resources

can be more effective. It will give a positive effect in improving the government performance.

Rajkumar and Swuroop (2008) also explained that the level of corruption could weaken the effect of prior year's audit opinion on government performance. Government spending is one item of financial statements to be audited by BPK. The fairness of government spending will affect the audit opinion provided for local government financial statements. If the prior year's audit opinion was bad, it will give a signal that the management and accountability of government expenditure is still not quite good.

Therefore, the government will always strive to improve its financial management process and to increase the fairness of its government spending in order to improve the performance. The high level of corruption will be an obstacle for the government in improving the financial management process. Thus, the level of corruption is expected to weaken the effect of prior year's audit opinion on government performance.

This research is important because there is a gap between theories and practices in Indonesia's local government. The number of local governments in Indonesia which obtain unqualified opinion increased considerably every year (IHPS I 2014). On the other hand, the poverty rate has not decreased significantly (www.bps.go.id). This indicates that the performance of local governments is still low and the audit opinion has not yet captured the actual performance of the local governments. This can happen due to the high level of corruption in Indonesia.

2.2. Research Question

Based on this explanation above, therefore, this study will examine the effect of prior year's audit opinion on the performance of local governments as well as how the level of corruption moderates that effect.

3. Landasan Teori

3.1. Agency Theory

Jensen and Meckling (1976) states that the agency relationship is a contract between the manager (agent) and the investor (principal) which involves the delegation of authority from the principal to the agent in the decision making. Agency problem arises when there is a conflict of interest between the principal and the agent

which occurs because the agent does not always act in accordance with the interests of the principal. The agency problems will trigger the agency cost.

Eisenhardt (1989) states that the agency theory aims to solve two problems that occur in an agency relationship. First, the agency problem that arises when the principal and the agent have contradictive interests or goals and it is difficult for the principal to verify what the agent does. Second, risk sharing problems that arise when the principal and the agent have different attitudes toward risk.

In the context of government, agency theory can also be used in describing the relationship of principal and agent. Modern democratic state is based on a series of principal-agent relationship (Lane, 2000). According to Streim (1994), there are three types of agency relationships within the government: 1) the electorates-legislature relationship, the relationship between society (voters/taxpayers) as the principal and legislature as the agent, 2) the legislature-government relationship, the relationship between the legislature as the principal and government as the agent, 3) the government-bureaucracy relationship, a relationship between government as the principal and bureaucrats as the agent.

Agency problems at the local government occurs when local government, act as the agent, does not correspond to the interests of society, as the principal. Agency problem arises because people cannot control the actions of government and bureaucrats directly. Meanwhile, governments and bureaucrats have more information about governance, so that it can trigger asymmetric information.

To reduce the asymmetry of information, a monitoring tools are needed to monitor and observe the performance of government and bureaucrats. One of the monitoring tools is financial statements of local governments which consist of budget realization reports and performance reports of local government administration (Setyaningrum, 2015).

To convince that the financial statements are free of misstatements and manipulation, an audit is required to check the efficiency and effectiveness as well as compliance with laws and regulations. This is consistent with Olken (2007) who described that the monitoring of government administration can be done through the audit process. By conducting the audit of local government financial statements, information received by the society will be more accurate which means that the asymmetric information will be reduced.

3.2. Signaling Theory

The signaling theory states that the manager (agent) has more information than external parties and they use measures or certain facilities to imply the quality of the company (Gumanti, 2009). According to Mavlanova et al. (2012), signaling theory helps to explain the behavior of two groups which each has access to different information. Signaling strategy is an action undertaken by the signaler to influence the views and behavior of the receiver. Signaling theory discusses how an entity should give a signal to the users of financial statements (Setyaningrum, 2015).

Signaling theory explains that the government, as the agent of the society, will give a signal to the public and users of financial statements by providing a reliable financial reports. Information from the local government can also attract investors to invest, donors to give grants, and tourists to visit that will ultimately improve the performance of local governments (Puspita and Martani, 2010). Therefore, the more reliable the information presented in the financial statements, the better the audit opinion obtained by the local government. A better audit opinion is a form of signals to users of financial reports that local governments have done its obligations mandated by the society.

3.3. Theory of Motivation

Motivation is factors inside a person that drive and direct his/her behavior to meet certain goals. Many theories discuss motivation, including theory of hierarchy of needs by Abraham H Maslow and theory of needs by David McClelland. According to Abraham Maslow H, quoted from the book of Hariandja (2002; 327), there are five types of needs that tend to be the default: 1) physical needs, 2) safety needs, 3) social needs, 4) the need for recognition, and 5) self-actualization needs. Meanwhile, according to the theory of needs by David McClelland, quoted from the book of Hariandja (2002; 329), there are three types of human needs, namely: 1) needs for achievement, 2) needs for power, and 3) needs for affiliation.

Based on theory of needs by David McClelland and the theory of hierarchy of needs by Abraham H. Maslow, quoted from the book of Hariandja (2002), there is a need for achievement that encourage people to achieve better performance by doing a better job than before. Referring to the theory, this research explains how the prior year's audit opinion, which sends signals of good or poor performance of local governments, motivated local governments to maintain their excellent performance

(WTP or unqualified opinion) and to improve performance by improving public financial management and accountability in local governments.

3.4. Audit of Government Agencies

External audit on government agencies in Indonesia is conducted by BPK or is called Supreme Audit Institutions (SAIS). According to Kayrak (2008), BPK (Supreme Audit Institution) is considered as institution or agency that ensures transparency and accountability of public sectors and is given the legal power to audit all public funds, resources and activities in government. Therefore, good accountability of public financial management will be reflected from audit opinion provided by BPK.

The obligation to conduct an audit for government financial statements is regulated in Law No. 17 of 2003 which states that government financial statements must be audited by the Supreme Audit Agency (BPK) before being submitted to the legislature in accordance with its authority.

3.5. Local Government Performance

Government Regulation No. 6 of 2008 on Guidelines for Evaluating Local Government Administration explains that the performance of local government administration is the achievement of local government affairs measured by the inputs, processes, outputs, outcomes, benefits and impacts.

The question on how to measure the performance is the most challenging issues in the study of management and performance of the public sector (Brewer & Selden, 2000; Van Thiel & Leeuw, 2000). Performance of public sector is very difficult to be measured because of the absence of techniques or standards on how to do it (Nordiawan, 2010). According to Mardiasmo (2002), performance indicators should be created as a basis for assessing government performance.

Government performance indicators can be seen from two sides: First, EKPPD (Permendagri Nomor 73 Tahun 2009; Wahyuni, 2012, Budianto, 2012; Marfiana, 2013) which is an assessment of the performance from the input, output and outcome. Second, HDI (Afonso, 2005; Rajkumar, 2008; Meurs and Kochut, 2013) which is an assessment from the benefits and impacts on public welfare.

3.6 The Level of Corruption

The Global Economic Crime Survey 2011 conducted by PricewaterhouseCoopes shows that asset misappropriation, accounting fraud, bribery and corruption is forms of cheating that often occurs in public sector organizations. Chetwynd, E, Chetwynd, F & Spector, B (2003) define corruption as the abuse of public officers for personal gain. Similarly, Johnson (1996) and World Bank (1997) define corruption as the abuse of public power for personal gain.

Meanwhile, Mimba, Helden & Tillema (2007) describe that corruption is all behaviors of public sector officials and civil servants to abuse their positions in the decision-making process for their personal interests which give negative impact for public interests. Nabli and Humphreys (2003) in Mimba et al. (2007) stated that the level of corruption in public sector consists of: 1) high-level (grand) corruption, the level of corruption in which the top-level of policy-makers create an unstable government process for their personal financial interests, 2) low-level (bureaucratic) corruption, the level of corruption in which the public sector officials and civil servants ask for some fees from people who expect to receive public goods and services.

4. Previous Research and Hypothesis Development

Virgasari (2009) stated that there is a positive relationship between audit opinion and financial performance of local governments. A better opinion on local government financial statements indicates improving better financial performance of the local government. Angelina (2012) found that there is a very weak negative correlation between audit opinion on the financial statements and financial performance of local governments. Budianto (2012) found that audit opinion has significant positive effect on the performance of local governments. Thereby the better the audit opinion obtained by a local government, it is expected that the performance of local government will be better.

These findings are not consistent with Marfiana and Kurniasih (2013) who found that audit opinion has no significant effect on the financial performance of local governments. This opinion is supported by Rustyaningsih (2014) who also found that audit opinion has no significant effect on the performance of local governments. This is due to the weakness of internal control conducted by the internal audit agency for the government's, or called "inspectorate".

Those previous studies examined the effect of an audit opinion on the performance of the same year and the results are not conclusive. This study will

observe the effect of prior year's audit opinion in encouraging the government to produce a better performance based on signaling theory and theory of motivation in local government.

Audit opinion is the auditor's statement on the fairness of information presented in financial statements. Audit opinion will give confidence to the users of financial statements that the information presented can be used for the decision making. A better audit opinion is a signal from local government to users of financial reports that local government has done their obligations to the society.

Based on the signaling theory, local government will be motivated to maintain its prior year's audit opinion if it is already good and or to improve opinion if it is not quite good in the following year through increasing follow-up of examination results (Setyaningrum, 2015). According to Puspita and Martani (2010), information on local government financial reports may also attract investors to invest, donors to give grants, tourists to visit, which in turn will improve the performance of local governments.

To maintain trusts from the public and interested parties, the government will be motivated to maintain a good financial management or to improve a bad financial management. Referring to the theory of motivation developed by McClelland and Abraham H Maslow in Hariandja (2002), the need for local governments to obtain a good achievement for the public and interested parties will motivate them to maintain their performance if prior year's opinion is good and to improve their performance if prior year's opinion is still not good.

If public financial management of the government is already good and is in accordance with the regulations and laws, it is expected that the performance of local government will increase. Thus, prior year's audit opinion would be able to motivate the government to improve its performance, both in terms of accountability in financial management and services provided to the society. Based on this statement, we expect that prior year's audit opinion will affect the performance of local governments, as developed by following hypothesis:

H1.a: Prior year's audit opinion has a positive effect on the performance of local governments (EKPPD)

H1.b: Prior year's audit opinion has a positive effect on the performance of local government (IPM or Human Development Index)

The level of corruption has a significant effect on the government performance as indicated by the performance of economy and public welfare (Abed and Davoodi, 2000; Chetwynd et al., 2003). An audit of local government financial statements is conducted to reduce corruption. This is consistent with Liu and Lin (2012) who found that audit of government can contribute in reducing the level of corruption.

Rajkumar and Swuroop (2008) found that the level of corruption can weaken the effect of government spending on the government performance. The allocation of public resources (government spending) will be effective and have an impact on improving public welfare if each part of the government is able to function properly. This can happen if the government has a good governance which is characterized by low levels of corruption.

Government spending is one item of financial statements that is audited by BPK. The fairness of government spending will affect audit opinion of the local government. A bad prior year's audit opinion will give a signal that the management and accountability of government expenditure is still not good. Therefore, the government will strive to improve its financial management and to increase the fairness of government spending in order to improve the performance.

To maintain a good audit opinion and to improve a bad audit opinion requires good governance that was shown by the low level of corruption in local government. If the level of corruption is high, it would be difficult for the local government to make improvements of the financial management so that the performance is difficult to be improved. Based on the above explanation, we developed hypothesis as follows:

H2.a: The level of corruption weakens the effect of prior year's audit opinion on the performance of local governments (EKPPD)

H2.b: The level of corruption weakens the effect of prior year's audit opinion on the performance of local governments (IPM of Human Development Index)

5. Research Methods

5.1. Population and Sample

The research population is all local governments in Indonesia (province, regency and city). The sample is chosen by purposive sampling method with the following criteria: 1) Local governments that submit LKPD (local government financial

statements) with complete data to BPK, 2) Local governments that report LPPD (local government administration report) and rated by the Ministry of Home Affairs, 3) Local governments that provide Human Development Index (HDI) data on the website of Indonesia's Central Bureau of Statistics (BPS), 4) Local governments that provide a full biographical data of local government heads on the profile book of local government heads issued by the Ministry of Home Affairs or local government websites, and 5) Local governments which can be accessed by researcher and are willing to provide education background data of the inspectorate's head.

This study used cross section data consisting of Indonesian local governments in 2012. The final sample used in this study is 360 districts/cities. This number is obtained from the process of sample selection as illustrated on Table 4.1:

Table 4.1
Sample Selection

SAMPLE	
Number of local government in 2012	542
Provincial government ^{a)}	(33)
Local government with no EKPPD score	(50)
Local government with no audit opinion	(6)
Local government with no HDI	(2)
Local government with no LKPD	(11)
Incomplete regional head data	(80)
Total Sample	360

Provincial governments are excluded in the sample selection since the corruption case data obtained from *Mahkamah Agung* (Indonesia's Supreme Court) is classified by *Pengadilan Tinggi* (high courts) and *Pengadilan Negeri* (district courts). The number of corruption cases at the high court in each province is the combination of the number of corruption cases in district courts in each district/city in the province.

3.2. Research Model

To determine the effect of audit opinion on the performance and the interaction between audit opinion and the level of corruption on local government performance, this research uses multiple regression analysis with moderating variables. The relationship among variables is shown in the following models:

Model.1

$$KPD_{it} = \gamma_0 + \gamma_1 OA_{it-1} + \gamma_2 Maturity_{KD_{it}} + \gamma_3 Experience_{KD_{it}} + \gamma_4 Education_{KD_{it}} + \gamma_5 Size_{it} + \varepsilon$$

Model 1 is used to test the hypothesis 1(a) and 1(b) with the expectation $\gamma_1 > 0$.

Model.2

$$KPD_{it} = \gamma_0 + \gamma_1 OA_{it-1} + \gamma_2 TK_{it} + \gamma_3 OA_{it-1} * TK_{it} + \gamma_4 Maturity_{KD_{it}} + \gamma_5 Experience_{KD_{it}} + \gamma_6 Education_{KD_{it}} + \gamma_7 Size_{it} + \varepsilon$$

γ : Constant (*Intercept*)

KPD : Local government performance (EKPPD & HDI)

Maturity KD : Maturity of local government heads
Experience KD : Experience of local government heads

Education KD : Education level of local government heads

TK : Level of corruption

Size : Size of Local government

ε : Error

5.3. Description of Variables

a) Dependent Variables

EKPPD Scores: According to Wahyuni (2012) and Masyitoh (2014), the government performance is measured using EKPPD score. EKPPD score used in this study is the score in 2012 which is obtained from Ministerial Decree of the Ministry of Home Affairs No. 120-251 of 2014 with grades is in range of 0-4. The score means 0-1: lower predicate, 1-2: medium predicate, 2-3: high predicate and 3-4: very high predicate.

Human Development Index (HDI): In accordance with Afonso (2005), Rajkumar (2008) and Wahyuni (2012), local government performance can also be seen from the HDI. The HDI data used in this study is HDI 2012 which is obtained from BPS catalog. HDI values range is between 0-100, which means lower criteria if the HDI is lower than 50, moderate if the HDI is between 50 and 80 and higher if the HDI is higher than 80.

b) Independent Variables

The independent variable in this study is the audit opinion. According to Adzani (2014), audit opinion in this study will be measured by ordinal scale that indicates the level or opinion ratings ranging from the lowest to the highest, as follows: 1 = Disclaimer of opinion (TMP), 2 = Adverse opinion (TW) 3 = Qualified opinion (WDP), 4 = Unqualified with Explanatory Paragraph (WTP-DPP) 5 = Unqualified opinion (WTP).

c) Moderating Variable

According to Liu and Lin (2012), which measured the level of corruption by calculating the number of corruption cases in each region, and Masyitoh (2014), the level of corruption in this study was measured by the number of corruption cases in each local government that has been ruled by the Supreme Court. Thus, this proxy could reflect the actual level of corruption rather than using the corruption perception index.

d) Control Variables

Maturity: maturity level of local government heads (dummy)

Level of maturity or age of the local government heads is a dummy variable where "1" if the government head is old and "0" if the government head is young (Hambrick and Mason, 1984; Bamber et al., 2010; Prasad, 2014). Age distribution is divided by using the classification from the Ministry of Health (2009) where ages are categorized into 9 levels but only five levels are used in this study: early adulthood 26-35 years, late adulthood 36- 45 years, early elderly 46-55 years old, late elderly 56-65 years, elderly people for more than 65. This study only uses 5 levels of classification because according to the election rules, the age of local government heads are at least 25 years old. Then, this study classifies this age ranges into 2 groups: young (early adulthood and late adulthood): 26-45, older (early elderly and late elderly): 46-above.

Experience: experience of local government heads (dummy)

Experience of local government heads is defined as working experience before becoming the head of local government. In general, the classification of work consists of businessmen, community leaders/educators, members of the DPR/DPRD/MPR and civil servants (PNS). According to Misdi (2015), working experiences of the government heads are divided into two categories, bureaucratic and non-bureaucratic.

Experience of government heads is a dummy variable where "1" if the government head comes from the bureaucratic or government agencies and "0" if they come from an experienced non-bureaucratic agent or other than administrative job (Ricucci, 1995; Sanghee Park, 2014; Misdi, 2015)

Education: educational level of local government heads (dummy)

Educational level of the government heads is a dummy variable where "1" if they hold a minimum of undergraduate degree and "0" if they have no undergraduate degree (Hambrick and Mason, 1984; Finkelstein and Hamrick, 1996; Prasad, 2014).

Size of Local Government

Size of the local government is measured by total assets of local governments and is measured by the natural log (ln) of total assets. Assets of local governments are described as resources that are available for providing services to the society (Hoque & James, 2000; Sumarjo, 2010; Mustikarini, 2012; Marfiana, 2012; Rustiyarningsih, 2014).

6. Results and Discussion

6.1 Analysis of Descriptive Statistics

Table 6.1
Descriptive Statistic

Variable	N	Mean	Std Dev	Min	Max
Dependent Variable					
EKPPD	360	2,2728	0,6657	0,1700	3,35
IPM	360	72,3276	4,2341	49,83	80,24
Independent Variable					
OA	360	2,8861	0,9621	1,0000	5,0000
Moderation Variable					
TK	360	1,9167	4,8606	0,0000	51,0000
Control variable					
Maturity KD	360	0,8056	0,3963	0,0000	1,0000
Experience KD	360	0,3694	0,4833	0,0000	1,0000
Education KD	360	0,9194	0,2725	0,0000	1,0000
Size	360	28,2799	0,6677	26,7411	31,19

Dependent Variable: , EKPPD, IPM=*Indeks Pembangunan Manusia* (HDI);
Independent Variable **Independent:** OA= Audit Opinion; **Moderating Variable:** TK= Level of Corruption; **Control Variable:** *Maturity KD, Experience KD, Education KD* and *Size*.

Table 6.1 shows that performance variable using EKPPD has a mean of 2.2728 with a standard deviation of 0.6657. This indicates that the average EKPPD scores of the local government in this study are high. Meanwhile, performance variable using HDI has an average value of 72.3276 with a standard deviation of 4.2341. The ranges of HDI value from

0 to 100 with a low criteria when HDI is less than 50, moderate if the HDI is between 50 and 80, and high criteria when HDI is more than 80 (www.bps.go.id).

Most of the local governments receive qualified opinion (WDP) for their financial statements. It is proven by the mean value of 2.8861 with a standard deviation of 0.9621 which can be seen in Table 4.2. However, there are still many local governments which obtain disclaimer opinion, they are: Kab. Mandailing Natal, Nias Selatan, Padang Lawas, Kota Tanjung Balai, and Tebing Tinggi. The level of corruption, as moderating variable, has the average value of 1.9167. This shows that there are ± 2 cases of corruption in 2012.

6.2 Analysis of the effect of Prior Year's Audit Opinion on EKPPD score and Moderating Effect of Corruption Level

Table 6.2
Test Result of Hypothesis 1(a) and 2(a)

Regression Model					
Direct Effect			Moderating Effect		
$EKPPD_{it} = \gamma_0 + \gamma_1 OA_{it-1} + \gamma_2 Maturity_{KD_{it}} + \gamma_3 Experience_{KD_{it}} + \gamma_4 Education_{KD_{it}} + \gamma_5 Size_{it} + \epsilon_{it}$			$EKPPD_{it} = \gamma_0 + \gamma_1 OA_{it} + \gamma_2 TK_{it} + \gamma_3 OA_{it-1} * TK_{it} + \gamma_4 Maturity_{KD_{it}} + \gamma_5 Experience_{KD_{it}} + \gamma_6 Education_{KD_{it}} + \gamma_7 Size_{it} + \epsilon_{it}$		
Variable	Prediction	Coefficient	p-value	Coefficient	p-value
C		-7,680	0,000***	-7,551	0,000***
OA _{it-1}	+	0,215	0,000***	0,250	0,000***
TK _{it-1}				0,054	0,016**
OA _{it-1} *TK _{it}	-			-0,018	0,012**
Maturity KD _{it}	+	0,095	0,118	0,093	0,123
Experience KD _{it}	+	-0,099	0,068*	-0,076	0,130
Education KD _{it}	+	0,138	0,117	0,131	0,130
Size _{it}	+	0,324	0,000***	0,316	0,000***
<i>R-squared</i>			0,253	0,263	
<i>Adjusted R-squared</i>			0,242	0,249	
<i>R-square change</i>				0,011	
Sig F-statistik			0,000***	0,000***	
<i>Sig F-change</i>				0,079*	
Dependent Variable: EKPPD; Independent Variable: OA= Audit Opinion; Moderating Variable: TK= Corruption Level; Control Variable: Maturity KD, Experience KD, Education KD and Size. *** sig at the level 1%, ** sig at the level 5%, and * sig at the level 10%.					

Based on the results of regression analysis, the direct effect obtained F-statistic of 0.000 which is significant at the level of 1%, while the indirect effect (moderated by levels of corruption) obtained F-statistic of 0.000 which is also significant at the level of 1%. This means that all independent variables, interacting and control variables are able to explain the variation in the dependent variable, either direct or with the moderating variable (the level of corruption). Therefore, model 1 and 2 using the EKPPD as performance measures are acceptable.

Table 6.2 also presents the estimation model coefficients γ_0 (intercept) of -7.680 and γ_1 (slope) of 0.215. The audit opinion has t-statistic value of 6.623 at 1% of significance level. This means that prior year's audit opinion has a significant positive effect on EKPPD scores at the level of 1%.

According to the results above, it can be concluded that these findings support the hypothesis 1 (a). Prior year's audit opinion given by BPK has significant effect on the current year's local government performance. The local government will give their effort to maintain the performance if their prior year's opinion is good. Moreover, a bad prior year's audit opinion could also trigger the local government to improve their financial management activities so that they will achieve a better performance which is demonstrated by the increasing scores of EKPPD. The results support and are more robust than the findings of previous studies which examined the effect of audit opinion on the performance for the same period (Virgasari, 2012; Budianto, 2014).

By having the moderating effect of level of corruption, the estimated coefficients of model γ_0 (intercept) is -7.551 and γ_1 (slope) is 0.250 with a significance level of 1%. This means that by using level of corruption as the moderating variable, prior year's audit opinion gives a significant positive effect on EKPPD scores at the level of 1%. Thus, the effect of prior year's audit opinion on EKPPD scores is constantly positive, either before or after moderating effect of the level of corruption.

Interacting effect is indicated by the changes of R-square from the direct effect to the indirect effect or moderating effect (Syakhroza, 2002). The increase in R-square (r-square change) is equal to 0,011 and is significant at the level of 10%. The value of t-statistic shows that the interacting variable of audit opinion and the level of corruption has a significant t-statistic value of less than 5% and a negative coefficient of -0.018 therefore the results of this

study support the hypothesis 2 (a). This means that the level of corruption is able to weaken the effect of prior year's audit opinion on the EKPPD score. The government efforts to improve financial management due to prior year's audit opinion as the signal will be obstructed if the local government has corruption cases. Thus the moderating effects of corruption in the local government will weaken the effect of prior year's audit opinion on the scores of EKPPD in respective local government.

6.3 Analysis of the Effect of Prior Year's Audit Opinion on the HDI and the Moderating Effect of Corruption Level

Table 6.3
Test Result of Hypothesis 1(b) and 2(b)

Regression model					
Direct effect			Indirect effect		
$IPM_{it} = \gamma_0 + \gamma_1 OA_{it-1} + \gamma_2 Maturity_{it} KD_{it} + \gamma_3 Experience_{it} KD_{it} + \gamma_4 Education_{it} KD_{it} + \gamma_5 Size_{it} + \varepsilon_{it}$			$IPM_{it} = \gamma_0 + \gamma_1 OA_{it-1} + \gamma_2 TK_{it-1} + \gamma_3 OA_{it-1} * TK_{it} + \gamma_4 Maturity_{it} KD_{it} + \gamma_5 Experience_{it} KD_{it} + \gamma_6 Education_{it} KD_{it} + \gamma_7 Size_{it} + \varepsilon_{it}$		
Variable	Prediction	Coefficient	p-value	Coefficient	p-value
C		32,612	0,000***	45,809	0,000***
OA _{it-1}	+	0,944	0,000***	1,007	0,000***
TK _{it-1}				0,288	0,045**
OA _{it-1} *TK _{it}	-			-0,040	0,235
Maturity KD _{it}	+	0,702	0,103	0,804	0,071*
Experience KD _{it}	+	0,067	0,442	-0,105	0,410
Education KD _{it}	+	-1,771	0,014**	-1,853	0,010***
Size _{it}	+	1,345	0,000***	0,862	0,006***
R-squared			0,117		0,150
Adjusted R-squared			0,104		0,134
R-square change					0,034
Sig F-statistic			0,000***		0,001***
Sig F-change					0,000***

Dependent Variable: IPM=Indeks Pembangunan Manusia (HDI); **Independent Variable** Independent: OA= Audit Opinion; **Moderating Variable:** TK= Corruption Level; **Control Variable:** Maturity KD, Experience KD, Education KD and Size. *** sig at the level 1%, ** sig at the level 5%, and * sig at the level 10%.

According to the results of regression analysis (table 6.3), the F-statistic for the direct effect has significance level of 1% while the F-statistic for the indirect effect (moderated by the levels of corruption) also has a significance level of 1%. This means that the independent variables, interaction and control variables are able to explain the variation in the dependent variable, either to influence directly or by moderating effect of the level of corruption. Thus, model 1 and 2 using HDI as the performance measures can be accepted.

In the direct effect, the estimated coefficients of model γ_0 (intercept) is 32.612 and γ_1 (slope) is 0.944. Audit opinion has a t-statistic value of 0.000 ($\alpha < 1\%$). This means that prior year's audit opinion has significant positive effect on human development index in a local government. Based on the results above, it can be concluded that these findings support the hypothesis 1 (b). Prior year's audit opinion given by BPK gives positive effect to increase public welfare as indicated by the HDI. If prior year's audit opinion is not good, the government would try to improve its performance by increasing the number of services provided to the society, so that the value of HDI would increase. If the prior year's opinion has already been good, then the government will strive to maintain its performance.

By having moderating effect of the level of corruption, the model coefficients for γ_0 (intercept) is 45.809 and γ_1 (slope) is 1.007. Audit opinion has t-statistic's significance value at the 1% level. This means that by using moderating effect of the level of corruption, the prior year's audit opinion still gives significant effect on the HDI in the local government. However, the interaction between audit opinion and the level of corruption is not significant, which is 0.235 ($> 10\%$). These results indicate that level of corruption as a moderating variable has not given any evidence that it can weaken the effect of prior year's audit opinion on the performance of local governments measured by HDI. Hence it is concluded that these findings do not support the hypothesis 2 (b).

This hypothesis is not proven since it is probably due to the inappropriate proxy of level of corruption. Future studies are suggested to use the number of audit findings as a proxy. Although audit findings are not necessarily a case of corruption, the amount of loss from audit findings is paid back to the treasury of the state. Hence, it should be allocated for the benefit of society therefore it will have an impact on the public welfare and the increase of human development index.

When we compare two proxies of local government government, EKPPD (table 6.2) and HDI (table 6.3), the effect of prior year's audit opinion on government performance, both direct and indirect, shows the same level of significance. However, the r-square for HDI is less than the ones for EKPPD scores. This means that the independent variables, moderating, and control variables with EKPPD scores as performance measures has less ability to explain the dependent variable than using the HDI.

This is possibly due to several reasons: first, EKPPD score is based on accountability report made by the local government itself, including LPPD, LAKIP and other reports while HDI is assessed based on survey results directly to the public to see the benefits and impacts of governments' programs and activities on public welfare.

Second, by reviewing LKPD from each local government, the proportion of local government expenditure for public welfare is still relatively small compared to other expenses such as expenses for personnel expenditure and spending on goods and services. The ineffective and inefficient use of goods and services causes inefficiency of government spending that would otherwise be allocated to other activities that can improve public welfare. Third, local government's programs and activities for increasing public welfare are not well targeted so that the benefits are less directly obtained by the public.

Based on the analysis above, it can be concluded that government performance cannot only be seen in terms of inputs, outputs and outcomes as described by EKPPD score, but also of the benefits and impact on public welfare as described by the Human Development Index (Nordiawan, 2010).

7. Conclusions, Research Implication dan Research Limitations and Suggestions for Further Research

7.1. Conclusion

This study addresses the issue of local government performance which is measured by using EKPPD and Human Development Index (HDI) score. This study aims to examine the effect of prior year's audit opinion on the performance of local governments and to examine the moderating effect of the level of corruption in the association between the prior year's audit opinion and local government performance.

The test result of hypothesis 1 shows that prior year's audit opinion gives positive effect on the performance of local governments. The subsample testing also confirms that the effect of prior year's audit opinion on EKPPD and HDI score is different if the heads of

local government are older, have a non-bureaucracy experience, and hold an undergraduate degree.

The test result of hypothesis 2 proves that the level of corruption weakens the effect of prior year's audit opinion on the performance of local government measured using EKPPD score, but this is not found in the performance measure using HDI score. Therefore, assessing the performance should not only use EKPPD but also HDI since performance is also correlated with outcome and its impact for the public welfare (Nordiawan, 2010).

7.2. Research Implications

This study has several implications, including:

1. The result of this study provides empirical evidence and a deeper knowledge about the performance of Indonesian local government. This research could become a reference for future studies related to the effect of prior year's audit opinion on the performance of local governments and could contribute to the literature on how the level of corruption moderates the effect of audit opinion on local government performance.
2. Audit opinion has a positive effect on the government performance. Therefore, BPK, as the external auditors for Indonesian government, should maintain or improve the quality of audit opinion since prior year's audit opinion will be used as a guideline for the government agencies to improve the subsequent year's performance.
3. The level of corruption was not proven to weaken the effect of audit opinion on the performance measured by the Human Development Index (HDI). Therefore, the heads of local government and the heads of SKPD have to pay more attention to the internal control system, especially at the budgeting, implementation, and administration stage. Any inaccuracies in the budgeting process will certainly lead to the ineffective absorption of the budget, especially when it is related with capital expenditure that should be utilized for public welfare in the current year. If the capital expenditure has a low realization rate, thus the score of the Human Development Index may be low.
4. In electing the heads of local government, the public should consider several qualities. Those who are older, have experiences in non-bureaucracy sectors, and hold an undergraduate degree could have a higher positive effect on correlation between audit opinion and government performance as well as the moderating effect of the level of corruption.

7.3. Research Limitations and Suggestions for Further Research

There are some limitations of this study, including:

1. This study only examined one fiscal year (cross section data). Future studies are expected to use panel data for several fiscal years so that the results obtained will be better in describing the real condition of local governments performance in Indonesia.
2. The proxy of the level of corruption used in this study is only the number of corruption cases that has been ruled by the Supreme Court; thus, this proxy may not describe the actual level of corruption. It is possible to consider the number of audit findings found by BPK. Although audit findings is not necessarily a case of corruption, the amount of losses that are paid back to the state's treasury will have an impact on public welfare since the amount should be allocated for the interests of society. Therefore, further research is expected to incorporate both proxies to measure the level of corruption.
3. The methodology used in analyzing the effect of prior year's audit opinion on local government performance and the moderating effect of level of corruption in sub samples of different local government qualities is still very weak. Interacting the independent variable, moderating variables and dummy variable of the qualities of local government heads is one alternative to analyze differences of relationship among these variables on the qualities of local government heads. However, there are two interactions between the variables for model number 2 (the moderating effects) which causes a higher multicollinearity. This also complicates the interpretation of results since this study uses a moderating variable and if the test is not separated into sub-sample test and is not incorporated into the model, there will be a double moderating process, hence, this study does not use this method. This study has not found the proper method to test the effect and the correlation between variables for the different sub samples. Thus, the future research may find a better methodology to test the differences in the sub samples.

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