

CAN GOOD GOVERNANCE ENHANCE LOCAL GOVERNMENT PERFORMANCE?

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ABSTRACT

Tujuan pertama dari penelitian ini adalah untuk menguji pengaruh hasil audit pada kinerja pemerintah daerah. Selanjutnya, yang kedua adalah menguji peran moderasi dari good governance pada hubungan antara hasil audit dan kinerja pemerintah daerah. Studi ini memiliki observasi sebanyak 536 data pemerintah daerah yang terdiri dari 134 Pemerintah Daerah di Indonesia dari 2016 hingga 2019. Data yang digunakan untuk hasil audit diekstraksi dari temuan audit dan tindak lanjut audit. Untuk good governance, penelitian ini mengembangkan indeks prinsip good governance dengan memetakan data yang diambil dari evaluasi kinerja pemerintah daerah oleh Kementerian Dalam Negeri RI dengan indikator IGI. Sementara itu, kinerja pemerintah daerah diukur dengan menggunakan total pendapatan asli daerah. Studi ini menggunakan analisis moderasi regresi berganda untuk menjelaskan hubungan antara hasil audit dan good governance pada kinerja pemerintah daerah. Hasil penelitian menunjukkan adanya hubungan yang signifikan pada kedua variabel yang diuji. Penelitian ini juga menemukan interaksi yang signifikan antara hasil audit dan good governance pada pemerintah daerah. Hasil ini menyatakan bahwa good governance dapat meningkatkan kinerja pemerintah daerah agar lebih efektif, dalam menanggapi hasil audit di tahun-tahun berikutnya.

Key words: temuan audit, tindak lanjut audit, good governance, kinerja pemerintah daerah, data panel analisis.

ABSTRAK

The first objective of this study is to examine the effect of audit results on the local government performance. Secondly is examining the moderating role of good governance on the relationship between audit results and local government performance. This study collected 536 local governments data from 134 local authorities in Indonesia from 2016 to 2019. The data employed for audit results were extracted from findings and rectification of audit reports. For the Good Governance, this study develops the Good Governance Principles index by mapping the data taken from Evaluation of Local Government Performance by the Ministry of Home Affairs RI with IGI indicators. Meanwhile, the local government performances were measured using the total local own revenue. This study uses multiple moderated regression analyses to explain the relationship between the audit results and good governance on local government performance. As the result, it has a significant effect on both variables tested. This research also found a significant interaction between audit results and good governance on local government. These results assert that good governance enhances local government to be more effective in responding to audit results to improve their performances in the following years.

Kata kunci: audit finding, audit rectification, good governance, local government performance, panel data analysis.

INTRODUCTION

Local governments are multifunctional organizations that provide a wide scope of services, ranging from education and welfare to firefighting and sanitation services. Therefore, local governments are at the forefront of delivering and providing the core public services citizens rely on in their everyday lives (Diaz, 2017; Hussein et al., 2016). Local governments represent the lower tiers of public administration closest to the general public. Several government programs and activities have been conducted with the aim of improving citizen welfare, such as; (i) Program Keluarga Harapan, a program that provides various health and educational service facilities, (ii) Program Kartu Indonesia Pintar, a program for educational cash assistance to all school-age children (6-21 years) from low-income families, and (iii) Program Bantuan Pangan Non-Tunai, in this program the government provides a non-cash support every month through an electronic account mechanism to buy food ingredients at cooperating food ingredients/e-warung traders.

Despite the many attempts to enhance local government performance, both in developed and developing nations, there are a growing number of concerns about how to improve local government performance. Democratic governance places a high value on performance, and it may be seen as a characteristic of contemporary democracy and a fundamental idea in public administration (Hay and Cordery, 2018). In order to meet the public's desire for improved public services, the public administration must respond quickly, and more people must participate (Umor et al., 2016). Prior research generally agreed that citizens demand comprehensive monitoring in performance reporting to communicate information on accountability of the local governments through government's performance (Reichborn-Kjennerud and Vabo, 2017; Raudla et al., 2016; Akbar et al., 2015). Performance is critical to show publicly how the government conducts monitoring and

control while avoiding concentration of power and improving public administration's learning capability and effectiveness (Mir et al., 2017; Shakya, 2015).

Nevertheless, previous literature showed that local governments' poor performance can be caused by agency problems in Agency Theory (Adriana and Ritonga, 2018). The introduction of Law No. 23 of 2014 about Regional Autonomy has increased the agency problem and expectation gap between local citizens and managers of local governments (Masdiantini and Erawati, 2016; Heriningsih, 2015). In order to reduce asymmetric information between citizens and the government, it is mandatory for local governments to conduct an audit (Din et al., 2017; Umor et al., 2016; Lisic et al., 2015). In Indonesia, every local government is required to publish an annual audit report. The Republic of Indonesia Supreme Audit Board (BPK RI) postulated Government Regulation No. 8 of 2006 about Financial Reporting and Performance of Government Agencies.

It is believed that audit activity will affect the performance of local governments because the quality of information on government financial statements can be trusted and accepted. The purpose of an audit is to verify the fairness of the information from the financial statements that local governments have made, and the function of the audit conducted by the BPK is to monitor from the outside for the financial responsibility of local governments, as their finance and resources mainly come from the tax money of the people (Setyaningrum et al., 2013). The results of the audit exist in the form of generating opinions, providing findings and recommendations for better performance in the future; they act as evidence of whether there are any violations or weaknesses in the internal system in the performance of the local governments' management system.

Moreover, comprehensive monitoring can be in the form of audit activities from an external party (Reichborn-Kjennerud and Vabo, 2015; Amyulianthy et al., 2021).

However, monitoring from external parties seems to be costly and only in a limited period of time (Koledoye, 2017). Therefore Zhang (2019) proposes good governance as one of the tools for performance improvement. The study showed that good governance is vital for governments to regain the public trust. Additionally, having good performance is essential for local governments to regain public trust, which is currently deteriorating due to many mismanagement cases reported related to local governments. Said et al. (2016) suggested that in order to improve the performance of local governments, the organization needs to be aware of a clean and authoritarian government mechanism with a governance system for the public sector known as ‘good governance’.

A group of scholars (Heriningsih, 2015; Afiah and Azwari, 2015) suggests that the implementation of good governance can form accountability. It is expected to restore economic, social, and political conditions. The most important, it regulates countermeasures, strengthens organizational transparency, and uphold responsibility and awareness of moral hazards resulting from corrupted behavior and eventually enhances organization performance. Good governance is the mechanism of participation principles, fairness principles, accountability principles, transparency principles, effectiveness principles, and efficiency principles. This prominent issue in the management of public administration was reflected with the intense demands from the public for state officials, both in the government, the legislative council, and the judiciary, to organise good governance (Setyaningrum and Saragih, 2019; Hartanto et al., 2021).

Previous studies (Wardhani et al., 2017; Setyaningrum et al., 2017) tried to determine good governance measurement from elements in, the Evaluation of Local Government Performance required by the Ministry of Home Affairs of the Republic of Indonesia. However, they stated that indicators of the measurement are still weak since they are based on the author’s subjectivity.

Meanwhile, an organization managed by United Nations Development Programme (UNDP) called Kemitraan, promotes the good governance principles known as the Indonesia Governance Index (IGI), with indicators such as participation, fairness, accountability, transparency, efficiency, and effectiveness from the dimensions of government, bureaucracy, civil society, and economic society. The measurement indicator from IGI is considered suitable because IGI was created as an index that can be tracked up as an advocacy tool to promote good governance practices at the local government level. IGI can identify necessary improvements needed for local governments, local parliaments, civil society, and economic community functions (Gismar et al., 2013).

This study uses control variables, namely local government size, local government age, characteristic of head local government, political monitoring, and local government area because these variables in previous studies have been empirically proven to affect local government performance. This study aims to examine the influence of audit results (audit findings and audit rectification) on the local governments performance and specify whether good governance moderates the relationship between audit results (audit findings and audit rectification) and local governments performance. In the future, there is hope that this research will be useful in the more forceful implementation of good governance in order to increase local government performance in Indonesia.

LITERATURE REVIEW

Agency Theory in Public Sector & Hypotheses Development

Agency theory draws up contracts between the owners of economic resources (principals) and agents (Verbeeten and Speklé, 2015). The theory is based on the premise that agents have more information than principals and this causes information asymmetry which adversely results in moral hazard and will affect the principal’s ability

to monitor effectively, and ensure the agents are properly serving their interests. It is also assumed that principals and agents act rationally and that they will use the contracting process to maximize their wealth. In the context of the government, agency theory can also be used in describing the relationship of principal and agent. According to Addink (2019), the modern democratic state is based on a series of principal-agent relationships where public resource managers are agents responsible for using and controlling public resources and are accountable to their principals for the resources provided carry out government programs and services.

Findings from Kostovetsky (2015) suggest that moral hazard and adverse selection problems can be overcome by creating a monitoring system, one of the monitoring tools is financial statements. However, to assure the fairness of financial statements from material misstatements and manipulation, an independent institution is required to conduct an audit of the government's financial statements. Not only to conduct financial report audits but independent audit institutions also conduct performance audits to examine economic aspects and efficiency of activities, including testing compliance with laws, regulations, and internal controls (Umor et al., 2016). In this case, the auditor's role is to act as an independent party that provides the fairness of the report in financial statements and performance reports. Agency relationships could be mitigated by auditors who are independent parties who will assess the fairness of financial statements (Lei et al., 2015). In this study, auditors are referred to as BPK RI, it is a party that can mitigate the agency relationship between the legislature and the executive to conduct effective supervision.

However, according to (Marwan et al., 2022), monitoring is time-consuming and costly. This leads the principals to seek a wage rate that motivates agents and find a level of monitoring that is not too costly and

convinces agents that the risk of being caught shirking is appalling.

Therefore, (Sukmadilaga et al., 2015) suggests that one of the mechanisms that can be used to prevent any deviant action from agents in agency problems is the implementation of good public governance. Supported by Zhang (2019), it is found that good governance allows better monitoring and control so that the agents are more likely to make decisions that are for the best interests of the principals. It also improves principal's protection by minimizing opportunistic behavior of the agents. Thus, the mechanism of good public governance pushes agents to perform better because their policy and decision-making align with the principal's interest and eventually will positively impact the principal's welfare (Setyaningrum et al., 2017).

Audit Results and Local Government Performance

The practice of audit has an important role in ensuring public sector accountability; their main activities are managing the audit of public sector entities' financial statements and assessing probity/compliance, providing advice/recommendation, and undertaking performance audits (Cordery and Hay, 2019). Furthermore, performance of audit by BPK RI will produce audit results comprise of audit findings and audit rectification (Amyulianthy et al., 2021). The audit findings consist of non-compliance with laws/regulations and weakness in an internal control system (Marfiana and Kurniasih, 2013; Sari et al., 2013; Azhar, 2015; Masyitoh et al., 2015; Artha et al., 2015) and audit rectification entail with suggestions for improvement provided by the auditor on weaknesses or errors found during the audit process that are expected to be carried out or acted upon by the auditee (Furqan et al., 2020).

According to Marfiana and Kurniasih (2013), audit findings are in the form of BPK RI report, as the results of financial statements audit of local governments reveal the

weaknesses of the internal control system and violations of non-compliance with regulations and law provisions. Non-compliance with these regulation statutory provisions, usually in monetary/financial units, where the result can be described as state/regional losses, potential losses to the state/region, lack of revenue, administrative weaknesses, incapacity, inefficiency, and ineffectiveness. Therefore, compliance with laws and regulations can illustrate the quality of the report on the examination of government agencies, and hence reflect the performance of government agencies (Azhar, 2015).

In addition, Masyitoh et al. (2015) explain that the violation and non-compliance of the laws and regulations that have been set show poor governance in the area. Furthermore, Masyitoh et al. (2015) also mention that non-compliance with regulations and legislation can cause regional losses, as well as potentially detrimental to the region, a lack of revenue so as to reduce regional revenues, ineffectiveness, and inefficiency. This is supported by the BPK's summary of audit report (BPK, 2018) that non-compliance cases that can harm the state, such as not optimal in controlling budget execution and supervising the implementation of contracts, or government officials are weak in supervising and controlling regional tax revenue which is their responsibility, will obviously reduce regional revenue in future. Based on the above discussion on the impact of audit findings on local government financial performance, this study proposed the following hypothesis:

H₁: Prior audit findings negatively effects on local government performance.

Moreover, Suhardjanto et al. (2018) finding showed that the follow-up report of the findings and recommendations in the audit report has shown improvement in terms of the quality of the audit report compared to the prior year. The auditor would monitor whether the previous year's recommendation has been made and the process has become more effective. Consistent with Umar et al. (2018) who stated that with the

input of the auditor, the decision maker can stop and prevent the recurrence of errors, irregularities, fraud, and waste. By implementing what has been recommended by the auditor, the local government has sought to correct errors in the accountability of state administration and reflect on the government's financial performance.

Similarly, Setyaningrum et al. (2013) also found that the more recommendations are acted upon, then it will improve financial accountability or similarly increase the results of the audit opinion. Din et al. (2017) stated that the follow-up of financial investigations may help reduce the level of financial losses incurred by the local government. In other words, the implementation of audit recommendations will reduce financial losses, which may then be reflected in increasing local government performances. Therefore, based on the above discussion this study hypothesised that:

H₂: Prior audit rectifications positively effects on local government performance.

Good Governance and Local Government Performance

The importance of good governance as a critical condition for government development can no longer be underestimated. Addink (2019) defined good governance as “a clear and predictable legal framework, accountability, transparency, and information on the management of national affairs”. The United Nations Development Programme (UNDP, 2018) described good governance as “...democratic governance”; meaning respect for human rights, participation in decision making, accountability, poverty eradication, responsiveness, equal treatment, inclusiveness, fairness, impartiality, absence of any discriminatory practices, as well as taking into consideration the needs of future generations.

Various studies exploring the relationship between good governance and local government performance have been done. Wardhani et al. (2017) proved that good governance will be able to improve inef-

iciency in government expenditures that will increase government performance. Rusydi and Rossieta (2015) found that the implementation of good governance will increase the human development index, because good governance's principles will have an impact on the effectiveness and efficiency of government performance.

Setyaningrum et al. (2017) suggest that transparency is the ease of the community in accessing information in a timely, reliable manner in terms of economic, social, and political information in accordance with stakeholder needs. Lack of transparency creates an opportunity for government officials to use public resources for their personal gain (Kolstad and Wiig, 2009). Overall, previous research supports that with practices of principles, good public governance is effective for government performance strategies, even in developing countries. Based on the above discussion on the impact of good governance on local government performance, this study proposed the following hypothesis:

H₃: Good governance (GG) positively effects on local government performance.

Audit Results, Good Governance and Local Government Performance

Audit findings from the BPK contain violations of compliance with the provisions of laws and regulations, which can be in the form of government losses, potential losses, and lack of revenue. It is empirically proven to reduce government assets (BPK, 2018). Moreover, BPK confirmed that the state's losses was that the information system was not yet optimal to meet the needs of the Regional Tax and Retribution Management Unit in monitoring local taxes and levies. Consequently, this can be caused by local revenue from taxes and levies that are still not optimal. Thus, good governance is needed so that accountability for state finances can be more optimal.

Prior studies from Sukmadilaga et al. (2015) and Nofianti and Suseno (2015) have discovered that good governance mecha-

nism may assist monitoring through audit practice to improve local government financial performance. Audit of the public sector is necessary to safeguard public money and help public services achieve value for money. It also plays an essential role in maintaining confidence in the stewardship of public funds and in those to whom the funds are entrusted. In other words, audit is a cornerstone of good governance (Wardhani et al., 2017; Lei et al., 2015).

The auditor's role is supported by governance responsibility of oversight, insight, and foresight. Setyaningrum (2017) suggest that one of the government's accountability consists of financial accountability. Financial accountability is observable from the findings by an auditor, where the higher the findings means lower accountability. This is because the higher the findings means higher non-compliance with laws/regulations and weakness of the internal control system where the governance system is not running well (Marfiana and Kurniasih, 2013).

Therefore, non-compliance with laws/regulations and weakness of the internal control system can lead to a lack of revenue, loss of state, and also administrative irregularities. However, with the implementation of good governance principles, it is believed that government institutions can manage their institutions with more accountability and transparency (Jurnali and Siti-Nabiha, 2015). As such, these arguments have led to the fourth hypothesis proposed as follows:

H₄: Good governance (GG) weakens the relationship between audit findings and local government performance.

Previous research indicates that audit rectification can affect local government performance (Liu and Lin, 2014; Suhardjanto et al., 2018; Din et al., 2017; Furqan et al., 2020). Audit rectification is the number of improvements made by the auditee, in this case the local government, on the audit findings that have been carried out by the auditors (Liu and Lin, 2014). The higher improvements that have been made, it means that the higher repetitive mistakes

that can be stopped in the future so that the performance of local governments will be maximised.

Referring to the audit findings, the auditor also provides recommendations for improvement. For example, in increasing control of tax revenue, ordering the head of the tax service unit to validate the advertisement tax of regional unit using the applicable tax base value and increasing the control of local tax revenue which is their responsibility (BPK, 2018). The recommendation has been given in order that the local government's wealth in the following year can be increased because the mistakes from the previous year can be stopped. Rossieta et al. (2020) suggest that a government governance is needed as it can increase the compliance of the regional government, so that it is more responsible for the improvements that should be made. Good governance is considered to be a solution because of the principles of good governance, such as efficiency and effectiveness and will prompt local governments to implement the recommendations given by the auditors.

As efficiency of government strives to produce quality public outputs, including services delivered to citizens (OECD, 2014), meaning that the government tries to deliver their best performance to the people. Hence, the shortcomings and mistakes that occurred in the past can be stopped because the recommendations given by the auditor is hoped to improve the performance of the government in the future. In addition, the good governance principle in the form of effectiveness can also help the auditor's recommendations to be worked on because from these recommendations, it is expected that the achievement of government performance objectives will be even better.

Based on the outcome of such research and arguments, the last hypothesis in this study is formulated as follows:

H₅: Good governance (GG) strengthens the relationship between audit rectification and local government performance.

RESEARCH METHODS

This study is a quantitative approach utilising descriptive analysis and verification methods to show systematic and factual facts and the relationships between variables that are traced by collecting data, processing, analysing, and interpreting in statistical tests. This study population is all local governments in Indonesia during 2019, which is 508 local governments were considered as the population for this study (excluding 34 local governments of provinces and districts in DKI Jakarta as the capital city). The sample criteria are: (1) local government, cities, and regencies, listed in the Ministry of Home Affairs' RI during 2017; (2) BPK-RI has audited local Government Financial Reports in from 2015 to 2019; (3) Have complete data related to audit finding and audit rectification of districts/cities throughout Indonesia from 2015 to 2019 which are listed in the BPK RI's Summary Report; and (4) Have complete data regarding the evaluation scores of districts/cities throughout Indonesia from 2016 to 2019 which are listed in the Evaluation of Local Government Performance from Ministry of Home Affairs RI. Based on the purposive sampling, only 134 local governments met the criteria for this study. Figure 1 is formulated in accordance with hypotheses used to test whether there is a relationship between the variables in the context of this study.

The following model is used to examine the factors that influence Local Government Performance:

$$PRFRM_{it} = a - \beta_1 FIND_{it-1} + \beta_2 RECTIF_{it-1} + \beta_3 GG_{it} + \beta_4 GG * FIND_{it-1} + \beta_5 GG * RECTIF_{it-1} + \beta_6 SIZE_{it} + \beta_7 AGE_{it} + \beta_8 HEADLG_{it} + \beta_9 MONITOR_{it} + \beta_{10} AREA_{it} + e$$

The data is obtained from Audit Supreme Board RI Examination Result Reports, the Evaluation of Local Government Performance from Ministry of Home Affairs RI, and Audited Financial Statement Budgeted from Ministry of Finance RI with the observation from 2016 to 2019. The multiple moderated

linear regression analysis methods were processed using STATA software. However, Good Governance variable were applied using SPSS software by mapping good governance principles from the Evaluation of

Local Government Performance Report with IGI indicators. Good governance indexes were obtained forming factor analysis using the Principal Component Analysis. Operationalization variables can be seen in table 1.

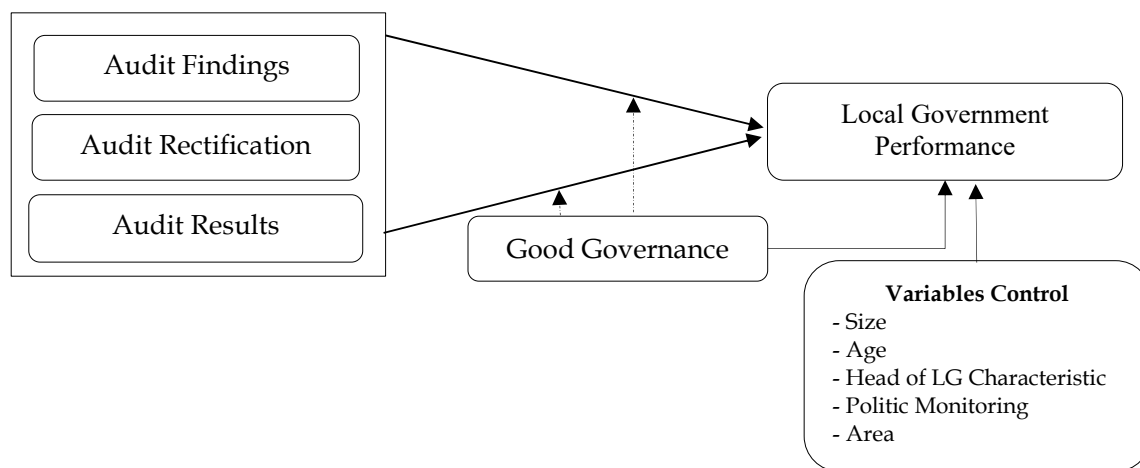


Figure 1
Conceptual Framework

Source: Research Data (Processed)

Table 1
Operationalization Variables

Variables	Measurement	Operationalization	Scale
Local Government Performance (Y)	Wealth (Saraswati, 2019)	Nominal value of Realized Local Own Revenues.	Nominal
Audit Findings (X ₁)	Non-compliance with provisions of laws and regulations (Arifianti et al., 2013; Marfiana and Kurniasih, 2013)	Total sum of monetary value of state losses, potential state losses and lack of state revenue to measure audit finding.	Nominal
Audit Rectification (X ₂)	The ratio of audit recommendations divided by the total number of audit recommendations (Masyitoh et al., 2015; Setyaningrum and Martani, 2018; Din et al., 2017)	Ratio nominal value of audit recommendation follow-up that is in accordance with the audit recommendations compared to the total audit recommendations provided by BPK auditors.	Ratio
Good Governance (M)	Exercise of authority through political and institutional processes that	IGI Matrix; Index of GG from arena of: - Government - Bureaucracy	Ratio

	are consists principles of Participation, Fairness, Accountability, Transparency, Efficiency, and Effectiveness (Addink, 2019; Akerboom, 2018)	- Civil Society - Economic Society	
Size	Local government size	Total assets	Nominal
Age	Local government age	Period since the issuance of the law on the formation of the local government	Nominal
Head of local government characteristic	Head of local government educational background	Dummy variable, 1 = if educational background in economics/accounting/business, 0 = otherwise	Nominal
Political Monitoring	Monitoring which carried out by members of the local parliament (legislative) for local governments	Number of parties that have coalitions in the winning of elections head of local government.	Nominal
Area	Local government's geographical location	Dummy variable, 1 = if local government is on the island of Java, 0 = otherwise.	Nominal

Source: Research Data (Processed)

ANALYSIS AND DISCUSSIONS

This research was conducted on 536 local government in Indonesia from 2016 to 2019 as research samples. Data collected over four (4) years, namely from 2016 and 2019. To answer the research problem, the following data will be analysed on audit finding, audit rectification, good governance and local government performance.

Factor Analysis Result for Good Governance Index

This study makes used of an index to measure the implementation of good governance in local government in Indonesia. Meanwhile, the data set was obtained from several sources, namely Evaluation of Local Government Performance Report (EKPPD), Local Government Financial Statement (LKPD), and Central Bureau of Statistics (BPS) on regencies and cities level of local governments during the 2016-2019 period.

The study applies Factor Analysis using statistical software (i.e SPSS) to develop an index score that measures each principle of

good governance. The index of Good Governance (GG) was developed to represent the measurement of good governance used in the study, based on IGI principle which consists of six (6) principles, namely (a) participation, (b) fairness, (c) accountability, (d) transparency, (e) effectivity, and (f) efficiency.

The principles of good governance (GG) utilised in this research were derived from IGI principle (Gismar et al., 2013). Based on Nurhanifah and Setyaningrum (2021) and Fitriani and Setyaningrum (2018) rationalisation, the indicators are mapped and linked each indication to a specific GG concept. Several data source reports, including the Report of Evaluation Regional Government Administration (EKPPD), Local Government Financial Reports (LKPD), and the Central Bureau of Statistics, were utilised to develop the GG evaluation indicators employed in this research. Some data sources use metrics that aren't categorised according to good governance standards, such as GDP per capita. In order to utilise these reports as a

measuring tool in this study, the indicators must be mapped to the data source reports so that the principles of good governance (GG) may be categorised and recognised.

Indicators that don't apply to local government types of regencies and cities, such as crime and housing, are omitted. Since local governments are used as the unit of analysis in this research, the IGI matrix indicator was adjusted to account for their activities and implementation. As a result, only 42 (forty-two) of the original 89 (eighty-nine) indications were mapped from the entire IGI. All forty-two (42) IGI indicators in the six (6) principles of Good Governance, were used in the Factor Analysis. The Kaiser-Meyer-Olkin (KMO) Measure of Sampling Adequacy and the Bartlett's Test of Sphericity are performed as a pre-requisite prior to conducting Factor Analysis which define the threshold values on the assessment of measure factor analysis that KMO (Kaiser-Meyer-Olkin) value minimum of 0.5 and anti-image matrices a minimum of 0.4. If the result is below 0.5, it should be eliminated from the factor analysis measure until the minimum value of 0.5.

Table 2 presents statistical results on the Factor analysis for Good governance index. In this case, the KMO value is 0.61, which means that it has surpassed the necessary minimum limit of 0.50, and the p-value obtained from the Bartlett's Test is significant at a 1% significance level. Hence, the scoring value of each indicator is considered suitable to be used in forming factor analysis. This

score can be a new index as a of Good Governance measurement. Meanwhile, the value of matrices from six (6) principles (42 indicators) are above 0.4, and the KMO value is 0.616 with chi-square 120.350. The total variance formed three (3) factors, with 23.92%, 19.38% and 17.21% variance and cumulative of 60.534%. It can conclude that all six (6) indicators are correlated and suitable for structure detection to measure the good governance using factor analysis. So, to create the new total score can be formulated as below

$$\text{Total Score} = \left(\frac{\% \text{ Variance}}{\text{Cumulative \%}} \right) \times \text{Factor}$$

$$\text{Total Score of GG} = \left(\frac{23.92}{60.53} \right) \times \text{Factor 1} + \left(\frac{19.38}{60.53} \right) \times \text{Factor 2} + \left(\frac{17.21}{60.53} \right) \times \text{Factor 3}$$

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Table 2
KMO and Bartlett's Test of Good Governance Constructs

Good Governance		Matrices	KMO & Barlett's Test				Total Variance Explained		
No	Component		KMO	χ ²	df	Sig.	Total	% Var	Cum %
1	Participation	0.628 ^a	0.616	120.350	15	0.000	1.436	23.929	23.929
2	Fairness	0.623 ^a							
3	Accountability	0.610 ^a							
4	Transparency	0.643 ^a							
5	Efficiency	0.453 ^a							
6	Effectiveness	0.615 ^a							

Source: Research Data (Processed)

Table 3
Descriptive Statistics Test

Variable	Mean	Median	Std. Dev.	Min	Max
Local Government Performance*)	0.234	0.160	0.294	0.015	2.581
Audit Finding*)	0.004	0.001	0.017	0.000	0.289
Audit Rectification	0.539	0.540	0.372	0.000	1.000
Good Governance (GG)	0.509	0.399	0.484	0.001	3.305
Local Government Size*)	3.206	2.464	2.694	0.713	19.122
Local Government Age	45.664	58.000	23.884	6.000	74.000
Political Monitoring	5.171	4.000	4.703	0.000	27.000
Head of Local Government Characteristic (Education Background)			Freq.	Percent	
Non-Economic, Business & Administration			388	72.39	
Economic, Business & Administration			148	27.61	
Total			536	100	
Local Government Area (Near Capital City)			Freq.	Percent	
Non- Java Island			320	59.70	
Java Island			216	40.30	
Total			536	100	

*) in trillions of Rupiah

Source: Research Data (Processed)

Based on Table 2, the six (6) principles used to test, then three (3) factors were formed. These three (3) factors are the strongest factors to be used to form the new continuous variable of Good Governance. However, the results of this calculation cannot distinguish which principle is the strongest in representing the variables forming Good Governance. This is because in forming factor analysis using the Explanatory Factor Analysis method with a principal component analysis (PCA) approach. Nevertheless, it can be concluded from all the principles of Good Governance, the indicators of principles are successful in forming factor analysis for the Good Governance variable. Therefore, it can be continued to the next stage of analysis.

Regression Results

Before testing the hypothesis using moderated linear regression analysis, several assumptions must be met so that the conclusions from the regression are not biased, including test of normality, test of multicollinearity, test of heteroscedasticity, and test of autocorrelation.

The normality test in the statistical calculations using using the Jarque-Bera normality test. The result show that Jarque-Bera normality test as many as 1.762 meanwhile value of χ^2 as many as 0.4144 ($\text{prob} > \chi^2$). Means that we cannot reject H_0 , thus data in this study is considered as normal. Therefore, the data is considered as normal and can be used in the following testing stages. The VIF (Variance Inflation Factor) and Tolerance values show that the tolerance value for each of the variables is greater than 0.1. The Variance Inflation Factor values of all variables is less than 5. Thus, it can be concluded that there are no multicollinearity symptoms occur among the variables. Heteroscedasticity testing in statistical calculations can use the White test as long as the the value of $\text{Prob} > \chi^2$ as many as 0.00 which means less than 5% indicating that the independent variables have no relationship with absolute residuals. From this, it can conclude that there is no heteroscedasticity in the regression model. Because this study uses data panel, not time-series data, the test of autocorrelation is not needed (Biørn, 2017).

In Table 3, this study presents descriptive statistics of the variables used in the study. The discussion are as follows: 1) The research found that local government performance had a minimum value of 0.015 for Pakpak Barat Regency–North Sumatera in 2016 and a maximum value of 2.581 for Bogor Regency–West Java in 2019. Mean and standard deviation both come out to be 0.233. To demonstrate that local government performance in most local governments is already excellent, the mean value shows that local government performance is more than 0.160 of the median value. 2) The audit finding variable's lowest value is 0.000 which are local government of Karimun Regency–Riau Island in 2016, Anambas Island Regency–Riau Island 2016, Kaur Regency–Bengkulu in 2017, Bangka Barat Regency–Bangka Belitung Island in 2018 and Tulungagung Regency–East Java is 2019, and maximum values are and 0.289 which is Riak Regency–Riau in 2016. Average: 0.004, standard deviation: 0.017, both in decimal places. If you look at the median value, the average level of audit results for local governments is below 0.001. 3) Audit rectification variable in this study shows that the minimum value is 0.000 which is for Agam Regency–West Sumatera in 2019. The maximum value is 1 for Pasaman Regency–West Sumatera in 2019. The mean value is 0.539 and standard deviation is 0.372. The mean value shows that more than of local governments have been followed up and implemented auditor's recommendation, where the median value is 0.540. 4) Good governance (GG) variable in this study show that the minimum value is 0.001 for Jember Regency–East Java in 2016 and the maximum value is 3.305 for Meranti Island–Riau in 2018. It can be said that the magnitude of the GG in this study has ranged from 0.001 to 3.305 with 0.509 of mean value and 0.484 of standard deviation. Refer to the mean value show that most of local governments has implementation of good governance where above of where the median value of 0.399. 5) The total assets of the local government are

the factor that determines the size of local government. There is a minimum value of 0.713 in this research: Mamasa Regency–West Sulawesi in 2016 and a maximum value of 19.122 for Kutai Kartanegara Regency–East Kalimantan in 2017. It can be said that the magnitude of the Size in this study has ranged from 0.713 to 19.122 with 3.206 of mean value and 2.694 of standard deviation. Refer to the mean value show that those total assets that proxy of size in most local governments are still low, with the median value 2.464. 6) The local Government Age variable in this study shows that the minimum value is 6 years, which is Kepulauan Meranti–Riau in 2016. The maximum value is 74 years, which is Karawang–West Java in 2019. It can be said that the magnitude of the Age in this study has ranged from 6 to 74 with 45.664 of mean value and 23.884 of standard deviation. Refer to the mean value show that most local governments have long formed in running the government, where the median value is 58.000. 7) The political monitoring variable in this study show that the minimum value is 0.000 for Gresik Regency in the election 2016, and the maximum value is 27 parties for Sarolangun election in 2018. It can be said that the magnitude of the political monitoring in this study has ranged from 0 to 27 with 5.171 of mean value and 4.703 of standard deviation. The mean value shows that the number of parties that have coalitions in the winning of elections mayor/regent as many as 5 parties were above the median value as many as 4.

This study also makes use of two dummy variables for Head of Local government characteristic and area of local government. For descriptive characteristics using frequency and percentage. Head of local government characteristic in this study is educational background of mayor/regent. Based on Table 3 can be seen that as many as 388 head of local government or 72% of head local government have no educational background in economics/accounting/business, meanwhile only 148 head of local government or 28% have economics/accounting/

business as educational background. Local government Area in this study is geographical location of local government. Based on Table 3 can be seen that as many as 320 of local government or 60% of local government have geographical location on non-Java Island, meanwhile only 216 of local government or 40% of local government has geographical location on Java Island, which is near the capital city, DKI Jakarta.

The following table 4 is shown the multiple moderated linear regression analysis results.

Table 4 shows that audit findings have a negative significant effect on local government performance at 1%, which is supported in this study. This is in accordance with predictions that the lower the level of non-compliance with rules and laws, the worse the local government's performance, and therefore the lower the capacity of the local government to produce its own income. Next, the results show that audit rectification has a positive significant effect on local

government performance at 1 percent and this is supported in this study. According to predictions, the better the local government does in generating its own income, the more money it will be able to keep. This outcome confirms such predictions. On that note, it shows that the follow-up to correction that has been made can reduce the occurrence of errors in the following year. The local government can improve its performance in generating higher local revenue (Din et al., 2017).

It also indicates a substantial impact on local government performance at 5%, which the model in the research corroborates. A good government environment is created in local government when good governance principles are implemented, demonstrating that the local government's performance is enhanced. This is particularly true when it comes to increasing local income. Essentially this means that the IGI-set standard for good governance has been successfully measured using the index created for this research.

Table 4
Multiple Moderated Linear Regression Analysis

Variables	Exp. Sign	Coef.	Std. Error	p>z
Const		18.9009	1.162	
FIND _{it-1}	(-)	-0.0203	0.008	0.007***
RECTIF _{it-1}	(+)	0.1186	0.028	0.000***
GG _{it}	(+)	0.0231	0.009	0.007***
GG*FIND	(-)	0.0252	0.009	0.004***
GG*RECTIF	(+)	0.0193	0.009	0.026**
SIZE _{it}	(+)	0.2017	0.411	0.000***
AGE _{it}	(+)	0.0160	0.002	0.000***
HEADLG _{it}	(+/-)	-0.0324	0.105	0.379
MONITOR _{it}	(+)	0.0003	0.010	0.499
AREA _{it}	(+)	0.6690	0.117	0.000***
Number of obs		536		
R-square (R ²) overall		63.72		
F-stat		474.42		
p-value		0.000		
Hausman Test (p-value)		0.1150		
BP – LM Test (p-value)		0.0000		

Notes: ***, **, * = p-value significant at 1%, 5%, 10% (one-tail test)

Source: Research Data (Processed)

Table 5
Summary of Finding

H	Hypotheses Statement	Estimate	p-value	Result
H ₁	Prior audit findings negatively effect on the local government performance	-ve	.007 **	Accept
H ₂	Prior audit rectifications positively effect on the local government performance	+ve	.000 ***	Accept
H ₃	Good governance (GG) positively effect on the local government performance	+ve	.007 ***	Accept
H ₄	Good governance (GG) weakens the relationship between audit findings and the local government performance	(Moderate) Weaken	.004 ***	Accept
H ₅	Good governance (GG) strengthens the relationship between audit rectification and the local government performance	(Moderate) Strengthen	.026 **	Accept

Source: Research Data (Processed)

In addition, the interaction of good governance with audit findings shows that the coefficient value of the interaction variable good governance and audit finding shows a positive value, with a significance level at 5%. It concludes that, interaction of good governance with audit finding the results show that good governance has weaken the effect audit finding on local government performance. Meaning that implementation of good governance can establish policies so that incompliance with laws/regulations and internal control system can be strengthen and local government performance can be increased (Sukmadilaga et al., 2015; Setyaningrum et al., 2017).

When good governance and audit rectification interact, as a result, the coefficient values of both models indicate a positive value of 0.019, with a significance level of 5% for the interaction variable good governance. This study find that excellent governance has a stronger impact on local government performance when combined with audit rectification, as seen in both models. Implementing good governance principles provides an environment where law-abiding citizens may thrive and a need for government officials to rectify mistakes. Errors from past periods may be rectified quickly with strong governance implementation, improving local government performance.

For the control variable, the size of local government which proxied by ln of total assets, the results indicate that it has a substantial impact on local government performance at 1%, supported by the model employed in the research. Furthermore, the model used in this study agree that control variables for both age of local government and area of local government also has a significant impact on local government performance at 1%.

In contrast, the dummy variable used to assess the control variable for head of local government characteristics has no significant impact on local government performance. The models in this study support the same findings, which were also found in the study's control variable political monitoring has no significant impact on local government performance.

Moreover, the result show that the number of R² (R-square) as many as 63.72. Meanwhile, the F-stat as shown is 474.42 (p-value is 0.000) and Hausman Test result as 0.1150. The 63.72 percent of local government performance can be predicted using the factors (Audit Findings, Audit Rectification, Good Governance, Local Government Size, Local Government Age, Characteristic of Local Government Area) included in this research model, while 36.28 percent of the performance can be predicted using factors

not included in this research model. Then, the value of F-stat indicates that the Random Effect model, which can be observed via the Hausman Test value of higher than 5%, impacts local government performance when all variables are considered concurrently.

Discussion

The results of testing the first hypothesis (table 5), indicate audit finding is negatively effect on the local government performance. It means incompliance with laws/regulations will cause local governments generate lower local own revenue. This study is in line with prior research (Furqan et al., 2020), which lacks compliance laws and regulation, which leads to a shortage of tax and retribution revenues and late payment of state/regional revenues. Consequently, reducing local own revenue which is proxied of the government's performance in this study. The second hypothesis (table 5) indicate that audit rectification positively effect on the local government performance. This results is consistent with findings of Liu and Lin (2014), that "making correction" is very important in government auditing process. While fraud detection and reporting are essential, it's rectification that keeps the economy and fiscal system running smoothly and promotes government openness. Corrective actions taken after an audit may represent the success of government auditing as a whole, and they are critical in evaluating if the audit system can enhance local government finances. This study also indicates that BPK's auditors' recommendations are empirically proven to increase local own revenue.

Moreover, the third hypotheses (table 5) showed that good governance positively effect on the local government performance. Local governments that adhere to the principles of good governance will also be more transparent, accountable, effective and efficient so that citizen trust the government for the management of state finances that has been carried out. Therefore, the citizen will increasingly comply with laws and regula-

tions related to taxes and levies. Subsequently, local revenues will also increase, reflecting an increase in local government performance. This finding consistent with previous research on an important role of good governance principles on local government performance (Zhang, 2019; Said et al., 2016).

For interaction variable, the fourth hypotheses (table 5) showed that good governance is weakening the relationship between audit findings and the local government performance. This study support Addink (2019) and Rossieta et al (2020) which suggests that a governance system is urgently needed and must be implemented in public sector organozations. By prioritising the principles for the public interest in a proportional and professional manner, so that the complexity of the bureaucracy in public services can be reduced and eliminates corruption of laws and regulations. Therefore, if there were many violations of laws and regulations on previous year, local government will try to improve the last year's poor performance by implementing better governance in current year.

The principle of accountability can actually reduce audit findings because the accountability makes every element of local government comply with the law, whether related to compliance with law, decision-making processes or policy making, as well as program formulation and implementation. The last interaction variable, the fifth hypothesis, supported that good governance strengthens the relationship between audit rectification and local government performance. In line with prior research. Wardhani et al. (2017) contend that effective public governance enhances local governments' ability to fulfill their duties (Lestiawan and Jatmiko, 2016). In addition, also support Trisha (2020) stated that the adoption of good governance strengthens the internal system in local governments, leading to even greater performance.

Recommendations for improvement by auditors such as requesting accountability

reports on the use of funds and increasing supervision and control will be more implemented with the good governance's principle of accountability and transparency. Other recommendations such as developing policies/SOPs as guidelines for carrying out duties and responsibilities will also be strengthened by the good governance's principle of effectiveness and efficiency.

CONCLUSION AND LIMITATION

This study is using agency theory to address the topic of audit results, good governance and local government. Using as many as 134 local government with four (4) years observation, this study show that practice of audit can mitigate the agency problem that occur in public sector. The moral hazard and asymmetry information from agent can be detected by audit results such audit finding and audit recommendation. Hence, in order to improve agent's performance, the practice of audit is needed. The finding of this study also shows that audit results significantly effect on local government performance. As this study investigates the moderating role of good governance (GG) on the relationship between audit result and performance, this study also links agency theory-to the conceptual framework, which deepens the understanding of the effects of such laws on this relationship.

The results of the study will path a way towards enhancing an understanding of a successful of good governance (GG) principles implementation in Indonesia local government, which provide evidence on how to significantly improve performance through the adoption of good governance (GG) techniques. Thus, good governance (GG) principles such as participation, fairness, accountability, transparency, efficiency, and effectiveness would enrich and improved local government performance, especially financial performance.

This study reveals several practical implications as its contribution. First, the adoption of audit practices promotes local

government by helping to improve accountabilities of state finance and monitoring activities for the management of state finances. The advantages of adopting audit practices affects the occurrence of violation of provisions of laws and regulations and the extent to which follow-up efforts improve violation of provisions of laws and regulations on Indonesia local government. Secondly, the principles of good governance (GG) likewise participation, fairness, accountability, transparency, efficiency, and effectiveness have been proven to help trust and provide the certainty and stability needed by local government to improve performance, especially to generate better local own revenue. Also, the principles of transparency and accountability as key factors in planning the management of state finances. Third, the most important implications arising from this research, which affects practitioners concerns the importance of audit and good governance (GG) principles in enhancing local government performance, especially financial performance. The research indicates that audit results for local government to evaluate their activities to oblige with provisions of laws and regulations and to follow-up recommendations for improvement so that errors do not repeat themselves in the future. Finally, the implementation of the principles of good governance (GG) will help local government to be able to channel economic resources that are effective, transparent, and accountable so that inclusive economic development is achieved

This study has several limitations. First, there is a high subjectivity when determining measurement used in each governance indicator. Further research should consider consulting with panel of expert to justify the measurement as well as integrating other governance principle from OECD or IFAC. Second, this research only used quantitative approach in testing the hypothesis where quantitative approach can limit the method and miss a true understanding of the real-world behaviour the comprehensive research might be more relevant than qualita-

tive research. Therefore, next research suggest that as an alternative of traditional, positivist, hypothetical-deductive quantitative research; further research may explore the holistic-inductive qualitative option or the mixed between the two.

This future research could form the aspect of framework, measurements and methodology. First, the framework developed in this study could be adopted by other research to investigate the factor that influence of the certain practices from the perspective of agency theory such as management accounting practices and accounting information system. This framework does not limited to accounting public sector; it also can be attempted to other field of studies such as management and business because agency theory and institutional theory can be apply to broad field of studies. Besides, the replication of this study to other sector would be useful in order to address the question of generalizability and to find out the pattern of the findings. Also, this study only focuses on financial perspective, future research is expected to be able to develop research to be comprehensive by including a non-financial perspective.

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