

Good governance and corruption in local governments: The role of internal control and audit

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ARTICLE INFO

Article history:

Received 2025-04-09

Accepted 2025-06-12

Published 2025-06-26

Keywords:

Corruption, internal control, internal audit, audit opinion, capital expenditure.

DOI:

<https://doi.org/10.20885/jaai.vol29.iss1.art1>

ABSTRACT

This study investigates the effects of internal controls, internal audit functions, audit opinions, and capital expenditures on corruption in local governments. Using a panel dataset of 519 local governments over the 2018–2022 period (2,595 observations), the study employs a fixed-effect regression with robust standard errors. The results indicate that internal controls and a more mature internal audit function significantly reduce corruption, while capital expenditure is positively associated with corruption levels. By contrast, audit opinion and lower-level audit capabilities have no significant impact. These findings highlight the importance of strengthening internal governance mechanisms to reduce corruption risk in public sector entities. Policy implications are directed toward local government leaders, auditors, and regulators to enhance internal oversight, professional competence, and qualitative judgment in financial reporting.

Introduction

Globally, including in Indonesia, public sector organisations have recently experienced governance changes. According to Turner et al. (2022), the reform prior to 2010 were marked by the establishment of the Corruption Eradication Commission (KPK) as a powerful organisation for preventing and prosecuting corruption, the affirmation of fiscal decentralisation, and the strengthening of independent institutions, including the Audit Board of Indonesia (BPK) with its Law 15/2004. After 2010, the reforms characterised by the bureaucratic improvement, such as the implementation of a meritocratic career ladder design (Law 5/2014) and a more transparent civil servant recruitment process (Turner et al., 2022). Despite efforts to implement good governance, Indonesia has not yet demonstrated strong commitment to eradicating corruption. Fiscal decentralization in countries with weak accounting practices may actually increase corruption rates (Changwony & Paterson, 2019). KPK (2024a) reported that over the past 20 years, 797 corruption cases occurred or 53% of all corruption in government institutions. Moreover, geographical challenges make it difficult to monitor local government activities, which contributes to persistent corruption. RRI (2023) revealed that there was a fictitious operational ship construction project in the West Seram Regency Government with a state financial loss of Rp5.72 billion. Similarly, Siwalima News (2023) reported a corruption case involving the Head of the Central Maluku Regency Education Office and his staff, who were implicated in mark-ups and fictitious procurement, causing a state financial loss of Rp3.99 billion.

As a first line of defense, internal control plays a critical role in preventing fraud (IIA, 2020). Effective internal control enables organisations to achieve their operational, reporting, and compliance objectives (COSO, 2012). In achieving its objectives, Arens et al. (2017) explained that management is responsible for the adequacy of the design and effectiveness of internal control implementation. Both must be able to provide confidence that internal control can prevent material misstatements, including those resulting from fraud (Arens et al., 2017). Perdana & Prasetyo (2023), Sayang et al. (2023), Wuryandini et al. (2023), and YR and Ariandi (2017) showed that corruption can be prevented through effective internal control. However, the findings of studies by Jalil (2018) and Welly et al. (2024) state that internal control has no effect on preventing corruption.

Although internal controls have been implemented, management has the inherent risk of abusing its authority and committing acts of corruption (Anderson et al., 2017). Therefore, an internal audit function is needed to provide assurance and consultation on fraud prevention measures in an organization. Abdulhussein et al. (2023), Arifin & Hartadi (2020), Asiedu and Deffor (2017), Halbouni (2015), Sayang et al. (2023), and Wicaksono and Prabowo (2022) reveal that the government's internal audit function has an impact on eradicating corruption. In contrast, internal auditors often face pressure and threats from senior management to avoid processing audit

findings (Abdulhussein et al., 2023). Rahmasari and Setiawan (2021), Ramadhan and Arifin (2019), and Rasheed and Jothimuni (2021), internal auditors cannot reduce corruption cases in organizations.

Unlike the private sector, external auditors in the Indonesian government are not limited to providing opinions on the fairness of the presentation of financial statements but also provide conclusions on the effectiveness of internal control and compliance with applicable provisions (Law 15/2004). Thus, the existence of forms of noncompliance, including acts indicating criminal acts of corruption, can be reflected in the auditor's opinion. Amyulianthy et al. (2022), Faidah & Novita (2022), Perdana and Prasetyo (2023), Utami (2020), Vyatra and Payamta (2020), and Wicaksono and Prabowo (2022) show that audit opinions have a negative effect on the number of corruption cases. Whilst, Budiman & Amyar (2021), Dholi et al. (2023), Kurniawati & Pratama (2021) and Rini and Damiati (2017) explain that audit opinions have no effect on the number of corruption cases.

This study investigates the effects of internal control, internal audit function, audit opinion, and capital expenditure level on eradicating corruption. This work is an improvement over earlier studies. We elaborate on the three-line model of governance as IIA (2020) by involving internal control variables as representations of the first and second lines, the internal audit function as the third line, and audit opinion as the external auditor. All local governments in Indonesia throughout the 2018–2022 (5-year) period, including district, city, and province administrations, were included in the sample to provide a more comprehensive view. To reduce bias in the analysis results, corruption cases in this study focus on state financial losses. This is because many corruption crimes, such as bribery, extortion, and gratification, do not directly harm the state. According to Tuanakotta (2018), bribery can harm the public as market participant, but not necessarily the state. The limitation on state financial losses also aims for a more relevant comparison, because internal and external audit functions are granted forensic accounting knowledge in their audit processes. Therefore, the author needs to limit corruption cases to the context of state financial losses.

Literature Review

Agency Theory

Jensen and Meckling (1976) explained that agency theory is a contractual relationship between one or more individuals and another party to delegate authority to make organizational decisions. Instead of making decisions that benefit the principal, agents engage in behavior contrary to the principal's wishes, thus giving rise to agency problems (Jensen & Meckling, 1976). According to Scott (2015), information asymmetry occurs because agents have more internal information about a company's condition and may not share it with the principal.

In the public sector, agency theory has been widely applied to explain accountability relationships between citizens, legislators, and executives (Hughes, 2003; Siddiqui, 2017). Unlike in the private sector, public agency relationships are hierarchical and involve multiple layers of delegation (Siddiqui, 2017). Citizens act as principals by electing legislators, who in turn delegate technical responsibilities to the executive. This layered structure introduces complexity and potential for misalignment of interests across levels of government.

Good Governance

Good governance in the public sector includes policies and procedures used to direct the activities of an organization to provide reasonable assurance that objectives are achieved in an ethical and responsible manner (IIA, 2020). IIA (2020) developed a governance model with The Three Lines Model, a layered protection with management as the first and second lines, internal auditors as the third line, and the role of external auditors as independent external parties in ensuring governance. Management, as the first and second lines, is responsible as the risk owner and manages the implementation of internal control within the scope of its work unit. An internal audit as the third line acts as a supervisor and guarantor of the quality of the adequacy and effectiveness of governance, risk management, and internal control implemented by management. External auditors provide additional assurance services to protect the interests of stakeholders and the legislature. To achieve this role, external auditors conduct audits of financial statements, the results of which will be submitted to stakeholders (IIA, 2020).

Fraud Triangle Theory

Cressey (1953) introduced the Fraud Triangle Theory to explain the underlying causes of fraudulent behavior. According to Albrecht et al. (2012), fraud typically arises from the interaction of three key elements: pressure, opportunity, and rationalization. These three elements will be interrelated to form a fraud triangle. This element of pressure consists of four main groups: financial pressure, bad habits, work, and other pressures. In financial pressure, people will tend to behave fraudulently when their lifestyle does not match the official salary they receive opportunity factors occur due to weak internal control and ineffective internal audit role. In order for internal control to run effectively, it is very important to maintain the control environment. Management and top leaders must

provide a “tone at the top” as an example for their subordinates to behave honestly and ethically. In the rationalization element, the majority of fraudsters must rationalize their actions to justify their fraudulent actions. Fraudsters will seek justification for their actions after the elements of pressure and opportunity have been met.

Corruption

ACFE (2024) categorizes fraud schemes into three main groups: asset misappropriation, corruption, and financial statement fraud. However, the term “corruption” under Indonesian law differs slightly from the ACFE’s definition. According to Law No. 31/1999 jo. Law No. 20/2001, there are 30 types of corruption, which are grouped into seven main categories. In this study, we focus exclusively on state financial loss from legal perspective as the operational definition of corruption. Referring to Law No. 31/1999 jo. Law No. 20/2001, state financial loss is defined as an act of unlawful enrichment or abuse of authority, committed with intent, resulting in harm to the state’s finances or economy (article 2 and 3). According to Tuanakotta (2018), the definition of state financial loss share similarities with the concept of asset misappropriation as defined by ACFE (2024). Tuanakotta (2018) further explained that examples of state financial loss include cash theft, inventory theft, invoice mark-ups, and fictitious procurement of goods or services.

The use of agency theory, good governance principles, and fraud triangle theory in this study is essential to explain the multilayered nature of corruption risk in local governments. Agency theory provides a foundational understanding of the conflict of interest between public officials (agents) and the public (principals), where the asymmetry of information and weak accountability mechanisms creates opportunities for corrupt behavior. The good governance framework, particularly the Three Lines Model developed by IIA (2020), offers a structural approach to addressing agency problems by delineating the roles of internal controls, internal audits, and external audits. This model helps to position the studied variables within a comprehensive governance system. Meanwhile, the fraud triangle theory explains the behavioral drivers behind corruption, namely pressure, opportunity, and rationalization, highlighting how weaknesses in control and oversight can create conditions for fraud to occur. Thus, these theories jointly support the development of hypotheses and interpretation of findings related to how internal mechanisms and audit functions influence the incidence of corruption in local governments.

Hypothesis Development

Organizations must enforce internal controls to protect organizational assets and encourage compliance with applicable regulations (COSO, 2012). YR and Ariandi (2017) showed that a strict authorization system, adequate transaction documentation, and anti-corruption leadership and culture can increase corruption prevention. This is supported by Perdana and Prasetyo (2023), Sayang et al. (2023), and Wuryandini et al. (2023), who state that internal control in the government can increase corruption prevention. According to Wuryandini et al. (2023), the government implemented a fraud control plan, which is an internal control specifically designed to prevent corruption. Based on the findings of this study, internal controls are expected to reduce the incidence of corruption.

H₁: Internal control has a negative effect on corruption

The internal audit function provides assurance and consultation on the prevention and detection of criminal acts of corruption. The ACFE (2024) stated that 14% of corruption cases in the organizational environment in the world were detected by the internal audit function. This can be explained by the fact that internal auditors have a more comprehensive understanding of business processes because of their position as part of the organization (Halbouni, 2015). Thus, it is not difficult for internal auditors to find any acts of corruption detrimental to the organization. In addition, Abdulhussein et al. (2023) stated that internal audits help produce quality financial reports while reducing the level of corruption. Given its comprehensive role, an effective internal audit function can reduce the incidence of corruption.

H₂: Internal audit function has a negative effect on corruption

As in agency theory, monitoring costs, including external audit costs, arise because of information asymmetry between the principal and agent. BPK is presented as an external party that verifies all financial transactions that have been entrusted to the government. The transaction verification process is conducted through a financial audit that assesses the fairness of the presentation of financial statements. In formulating an audit opinion, Law 15/2004 explains that the BPK also considers aspects of compliance with statutory provisions, including findings related to deviations from the criminal acts of corruption. This is in accordance with the results reported by Amyulianthy et al. (2022), Faidah & Novita (2022), Perdana and Prasetyo (2023), Utami (2020), Vyatra and Payamta (2020), and Wicaksono and Prabowo (2022) state that audit opinions have a negative effect on the number of corruption cases. This indicates that the higher the audit opinion, the more fairly the government’s financial statements are presented, without any material misstatements originating from errors or fraud. Thus, the

public can be confident that corruption in an organization will decrease or even disappear. Thus, audit opinions can reduce the occurrence of corruption.

H₃: Audit opinion has a negative effect on corruption

Albrecht et al. (2012) stated that this factor occurs when employees have authority over a particular business process. The results of a study by Maria et al. (2019) explain that the level of capital expenditure opens up opportunities for government officials to commit corruption in the procurement of goods/services. This study is supported by Perdana and Prasetyo (2023), Rahmasari and Setiawan (2021), and Wicaksono and Prabowo (2022), who also stated that capital expenditure has a positive effect on the level of corruption in the government. Based on this, local governments that have large capital expenditure realizations may increase the risk of irregularities or misconduct by government officials, particularly in the procurement processes of goods/services, including fictitious spending and budget mark-ups. Therefore, capital expenditures can increase the number of corruption cases.

H₄: Capital expenditure has a positive effect on corruption

Research Method

The population in this study consisted of all local governments in Indonesia. Considering the limited data, the sample was purposively determined for 519 of the 542 local governments during the period 2018-2022 with a total of 2,595 samples. The dependent variable, corruption, is proxied by the number of corruption cases that occurred in the relevant year. The dependent variable, internal control (ICM), is internal control maturity, the internal audit function (IAF) is the Internal Audit Capability Model (IA-CM), the audit opinion (AUI) is the BPK's opinion on financial statements, and the level of capital expenditure (BM) is Ln (Capital Expenditure Realization). ICM and IAF are from BPKP assessment and measured ordinally by levels 1 to 5; AUI is measured binary, with unqualified opinion (WTP) = 1 and modified opinion = 0. This study also uses fiscal independence (KF) as a control variable proxied by the proportion of local revenue to total local revenue. KF is expected to have a positive effect on corruption; Alfada (2019) and Maria et al. (2021), Paranata (2022), Syarif (2023).

Data were obtained through the official government website, internal control variables and internal audit functions were obtained from the BPKP performance report, audit opinions were obtained from the IHPS BPK RI (2023), capital expenditure levels were obtained from <https://djpk.kemenkeu.go.id/>, and cases of corruption crimes of state financial losses were obtained from the official website of the Indonesian Attorney General's Office at <https://pelayanan.kejaksaan.go.id/layanan/permohonan/perkara-pidsus>. The data were subsequently analyzed using panel data regression, applying k-1 dummy variables as Hair et al. (2019) for the ICM and IAF. Because no local government achieved ICM and IAF at level 4 and 5 during the time series period (2018-2022), we set level 3 as the maximum reference point, as detailed below.

$$CORRUPT_{i,t} = \alpha + \beta_1 ICMlevel2_{i,t} + \beta_2 ICMlevel3_{i,t} + \beta_3 IAFlevel2_{i,t} + \beta_4 IAFlevel3_{i,t} + \beta_5 AUI_{i,t} + \beta_6 BM_{i,t} + \beta_7 KF_{i,t} + \varepsilon_{i,t}$$

Where CORRUPT for corruption, ICM the internal control, IAF is the internal audit function, AUI is the audit opinion, BM is the capital expenditure level, and KF is the fiscal independence.

We performed descriptive statistics and panel data tests, including Chow, Hausman, and Lagrange Multiplier tests. This study uses clustered robust standard error to prevent heteroscedastic and serial correlation problems as Hoechle (2007). Finally, we performed t-tests to test the hypotheses.

Results and Discussion

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
CORRUPT	2,595	0.0000	7.0000	0.5295	0.8764
ICM	2,595	1.0000	3.0000	2.4547	0.6973
IAF	2,595	1.0000	3.0000	2.3168	0.6433
AUI	2,595	0.0000	1.0000	0.8879	0.3156
BM	2,595	19.4233	27.9832	2.3260	0.9545
KF	2,595	0.0008	0.8727	0.1399	0.1233

Source: Processed by Authors (2025)

We analyze 519 local governments, including 32 provincial, 85 city, and 402 regency governments. Table 1 shows that CORRUPT has an average number of corruption cases of 0.5295, with a standard deviation of 0.8764. The minimum value of the CORRUPT variable is zero or there are no corruption cases, and the maximum value is seven or there were seven corruption cases that occurred, namely, in the Konawe Regency Government in 2019. The ICM

variable had an average score of 2.4547 and a standard deviation of 0.6973. The minimum value of the ICM variable is 1 or level 1 (preliminary) for 309 out of 2,595 samples, and the maximum value is 3 or level 3 (defined) for 1489 out of 2,595 samples. The number of samples in the IAF variable was 2,595, with an average score of 2.3168 and a standard deviation of 0.6433. The minimum value of the IAF variable is 1 or level 1 (initial) for 256 out of 2,595 samples, and the maximum value is 3 or level 3 (delivered) for 1,078 out of 2,595 samples. For the AUPI variable, the minimum value is 0 or a modified opinion of 291 out of 2,595 samples, and the maximum value is 1 or an unmodified opinion of 2,304 out of 2,595 samples. For the BM variable, the number of samples was 2,595, with an average of 2.3260 and a standard deviation of 0.9545. For the KF variable, the number of samples is 2,595, with an average value of 0.1399 and a standard deviation of 0.1233. The minimum and maximum values of the KF variable were 0.0008 and 0.8727, respectively.

The normality test is conducted using skewness and kurtosis values. Our model has skewness and kurtosis values of 1.991 and 8.019, indicate that the residuals deviate from normality assumption. As [Daniels & Minot \(2020\)](#), normally distributed residual should have skewness = 0 and kurtosis = 3. However, with over 100 observations, regression estimates remain Best Linear Unbiased Estimator (BLUE) despite non-normal residuals ([Daniels & Minot, 2020](#)). Therefore, the normality violation can be considered negligible.

Table 2. Multicollinearity Test

	ICM	IAF	AUPI	BM	KF
ICM	1.0000				
IAF	0.4676	1.0000			
AUPI	0.3702	0.2567	1.0000		
BM	0.0981	0.0470	0.0659	1.0000	
KF	0.3210	0.3013	0.1577	0.4006	1.0000

Source: Processed by Authors (2025)

Multicollinearity problems occurred when the correlation coefficient was ≥ 1 ([Daniels & Minot, 2020](#)). Table 2. shows that there is no correlation between the independent variables ≥ 1 ; therefore, there is no multicollinearity problem in our model. We performed a panel data test and the results showed that the chow test and Hausman test had a Prob > F = 0,0000 and Prob > Chi² = 0,0000, respectively. The fixed effect model is the best model for predicting our hypothesis testing, as presented in Table 3.

Table 3. Hypothesis Testing

	Prediction	Coefficient	t	P > t	Result
ICM					
1. ICMlevel2	(-)	-0.176	-1.700	0.045**	Supported
2. ICMlevel3	(-)	-0.276	-2.320	0.011**	Supported
IAF					
1. IAFlevel2	(-)	-0.071	-0.990	0.163	Not Supported
2. IAFlevel3	(-)	-0.262	-3.040	0.002***	Supported
AUPI					
1. WTP	(-)	-0.080	-0.890	0.186	Not Supported
BM	(+)	0.056	2.050	0.021**	Supported
KF	(+)	-2.751	-3.520	0.000***	Not Supported

Note: *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Source: Processed by Authors (2025)

The influence of internal control on corruption

Based on the research results, internal controls, both at maturity levels 2 and 3, have a negative effect on the number of corruption cases. These findings is consistent with [Perdana & Prasetyo \(2023\)](#) and [Sayang et al. \(2023\)](#), [Wuryandini et al. \(2023\)](#), and [YR and Ariandi \(2017\)](#) which stated that internal controls have a negative effect on the level of corruption. However, this study is not in accordance with [Jalil \(2018\)](#) and [Welly et al. \(2024\)](#) which found that internal control does not affect the number of corruption cases. However, maturity level 2 has a lower level of influence than maturity level 3. This is presented in the ICMlevel2 coefficient which only reduces corruption cases by 0.176. The difference in its ability to reduce corruption cases can be observed in its research proxy. BPKP Regulation Number 5/2021 explains that maturity level 2 (developing) has the characteristic that the organization has formulated indicators and performance targets according to its goals. However, organizations are still unable to develop an effective strategy to achieve these goals. In addition, the control activities implemented by the

organization are still limited to document fulfillment and have not been adequately implemented. Although they do not yet have effective control activities, the results of the study indicate that regional leaders provide direction to their subordinates by setting performance targets according to organizational goals. [Albrecht et al. \(2012\)](#) explain the need for a "tone at the top" from organizational leaders to always ensure that internal control is implemented effectively. A strong control environment may partially mitigate the weaknesses of control activities. Thus, internal controls at maturity level 2 can significantly reduce corruption.

At maturity level 3, internal control has a greater effect than level 2 in reducing corruption cases. This is indicated by the ICM level3 variable which has a coefficient of -0.276. This condition is explained in BPKP Regulation Number 5/2021, which states that the organization has determined the goals, performance targets, and strategies for achieving the organization's goals. Level 3 also shows that the organization has designed control activities and assessed risks in every business process and organizational activity; the results of this study indicate that management, as the first and second lines, seems to have carried out its function as a supervisor of the effectiveness of the organization's internal control. The results of the study are also in line with [Albrecht et al. \(2012\)](#) that effective control activities can reduce the opportunity for employees to commit corrupt acts. According to [Perdana & Prasetyo \(2023\)](#), a good internal control system has been designed to prevent and detect organizational risks, including fraud. Thus, the organization can immediately decide on corrective and preventive actions against fraud risk. This suggests that local governments with a defined maturity level (level 3) have a greater capacity to reduce corruption than those at a developing maturity level (level 2) because of their ability to implement control activities more effectively and align them with organizational objectivity.

The influence of internal audit function on corruption

Internal audit functions have no effect on reducing the number of corruption cases at capability level 2 (structured). This finding supports the research of [Rahmasari and Setiawan \(2021\)](#), [Ramadhan and Arifin \(2019\)](#), and [Rasheed and Jothimuni \(2021\)](#) who found that the internal audit function has no effect on reducing corruption cases. This result also support the explanation of IA-CM level 2, as stated in BPKP Regulation No. 8/2021. Although the mandate, HR infrastructure, and professional practices are adequate, organizations with capability level 2 (structured) are still constrained in implementing supervision that does not comply with standards and best practices (BPKP Regulation No. 8/2021). [Ramadhan and Arifin \(2019\)](#) further argue that internal auditors do not have a sufficient understanding of the business processes to carry out their audits. Moreover, the incompetence of internal auditors' can increase the potential for rejecting assignments, even though they have full accessibility to asset records and information. This can have an impact on the activities and quality of supervision provided. Organizational commitment factors also affect the effectiveness of internal audits. [Rasheed and Jothimuni \(2021\)](#) explained that leaders who do not have anti-corruption awareness and culture hinder the supervision process. Thus, the function of an internal auditor with level 2 capability may not be sufficiently effective in reducing the incidence of corruption.

In contrast, the internal audit function at Level 3 (delivered) has a negative effect on reducing the number of corruption cases. This finding supports prior study of [Abdulhussein et al. \(2023\)](#), [Arifin & Hartadi \(2020\)](#), [Asiedu and Deffor \(2017\)](#), [Halbouni \(2015\)](#), [Sayang et al. \(2023\)](#), and [Wicaksono and Prabowo \(2022\)](#) that the internal audit function has a negative effect on the number of corruption cases. The results of this study show that internal audits as a third line (IIA (2020)) have effectively carried out functions in assurance and consultation. Compared to Level 2 (structured) capability, the main differentiating factor is its ability to carry out audit activities. Based on the BPKP Regulation No. 8/2021, Level 3 capability (delivered) indicates that the government's internal audit function has been implemented in accordance with the standards and best practices. As a result, audit recommendations address the 3E principles (effectiveness, efficiency, economy) and provide early warnings regarding non-compliance. Local governments with Level 3 internal auditor capabilities have capabilities in accordance with existing standards. Local governments at this level also demonstrate stronger capabilities in producing quality audit reports. However, auditors may experience pressure, threats, and even rejection from their organization ([Abdulhussein et al. \(2023\)](#)). This problem can be overcome if the internal auditor provides recommendations to effectively fix the root cause of the problem. Over time, organizational leaders may recognize the internal audit function as a strategic partner in efforts to prevent and detect corruption in the organization's environment.

The influence of audit opinion on corruption

Audit opinions have no effect on reducing the number of corruption cases. This finding is consistent with previous studies such as [Budiman and Amyar \(2021\)](#) and [Dholi et al. \(2023\)](#), [Kurniawati and Pratama \(2021\)](#), and [Rini and Damiati \(2017\)](#) which state that audit opinion has no effect on the number of corruption cases. Conversely, the results of this study contradict the studies by [Amyulianthy et al. \(2022\)](#), [Faidah and Novita \(2022\)](#), [Perdana & Prasetyo \(2023\)](#), [Utami \(2020\)](#), [Vyatra and Payamta \(2020\)](#), and [Wicaksono and Prabowo \(2022\)](#), who found that audit opinions have a negative effect on the number of corruption cases.

Based on the agency theory in [Jensen and Meckling \(1976\)](#), the presence of an external auditor represents a form of monitoring cost that must be borne to ensure that the agent acts in accordance with the principal's interests. [IIA \(2020\)](#) further argues that external auditors are external parties outside the three lines of defence models to protect the interests of stakeholders and the legislature. External auditors play a strategic role in ensuring accountability of financial statements. By providing audit opinions, external auditors are expected to detect material findings, including those originating from corruption.

The results of this study also indicate that BPK does not qualitatively consider material misstatements. For example, the 2019 Simeulue Regency Financial Statement showed an unqualified audit opinion. However, there were still two cases of corruption in the Simeulue Regency Government in 2019. The details of the corruption cases are: road-paving project on Simpang Batu Ragi Road - Simpang Patriot Road under the Public Works and Public Housing (PUPR) Department, which resulted in a state financial loss of Rp9 billion ([Detik.com, 2021](#)); and fictitious official travel expenses at DPRK Simeulue Regency Government with a state financial loss of Rp2.8 billion ([BPK RI, 2023](#)). According to Government Accounting Standard (SAP) Technical Bulletin No. 20 ([KSAP, 2015](#)), the state financial loss event is recognized by reclassifying the account items on the balance sheet affected by the shortage of money or goods to other asset items after the audit findings. Meanwhile, in other asset items, regional Compensation Claims (TGR) bills in the Simeulue Regency balance sheet for the 2019 fiscal year only show the final balance position of Rp26,838,000.00, which is sourced from the TGR in the 2015 fiscal year. This indicates that the two misstatements from fraud are not recognized and disclosed adequately in the Simeulue Regency financial statement for the 2019 fiscal year.

Ideally, auditors should also consider qualitative factors as impacts of misstatements ([Messier et al., 2022](#)). These qualitative factors are a more important consideration than the number of misstatements reported, especially if the auditor finds that there is a deliberate misstatement by management, such as an indication of corruption, and is not followed up adequately ([Messier et al., 2022](#)). Thus, the indication of intentional misstatement by management, as indicated by budget misuse, appears to have not been adequately considered in the formulation of the audit opinion.

The influence of capital expenditure level on corruption

Based on the research results, the level of capital expenditure has a positive effect on the number of corruption cases. This finding is consistent with previous studies by [Maria et al. \(2019\)](#), [Perdana & Prasetyo \(2023\)](#), [Rahmasari and Setiawan \(2021\)](#), and [Wicaksono and Prabowo \(2022\)](#) which stated that capital expenditure has a positive effect on the level of corruption in government. Nevertheless, the results of the study contradict to [Rahmawati and Nuruddin \(2021\)](#), who stated that the level of capital expenditure has no effect on corruption in local governments. Corruption is one of the impacts of agency problems as in [Jensen & Meckling \(1976\)](#). This problem arises because of the asymmetry of information received by the principal. Agents, as budget managers, will better understand how the budget management process works in their organizational environment. However, the principal relies only on the accountability report prepared by the agent, which is audited by an independent institution. Thus, agents tend to behave inconsistently in accordance with the wishes of the principal, including committing criminal acts of corruption.

These findings also provide empirical support for fraud triangle theory, which states that opportunity is one of the causes of fraud ([Albrecht et al. \(2012\)](#)). This opportunity factor increases if the organization's leaders are given a large capital expenditure budget authority. The results of a study by [Maria et al. \(2019\)](#) explain that high capital expenditure values increase the opportunity for government officials to commit corruption. This argument is confirmed by corruption cases dominated by the goods/services procurement sector, namely, 339 in the last 20 years ([KPK, 2024b](#)). With their authority, leaders may influence subordinates in ways that facilitate budget misappropriation. Thus, an increase in capital expenditure will increase opportunities for corruption among officials. Consequently, the likelihood of corruption is also expected to increase.

Conclusion

Internal controls, both at level 2 (developing) and level 3 (defined), have a negative effect on reducing the amount of corruption. In other words, the results of the BPKP assessment of SPIP maturity can be used as an internal control to understand and consider the number of samples in substantive tests for internal and external auditors. The internal audit function at Level 2 (structured) has no effect on reducing the number of corruption cases. However, the internal audit function at Level 3 (integrated) has a negative effect on the number of corruption cases. In other words, the results of the BPKP assessment of local government internal auditor capabilities reflect the ability of regional internal auditors to reduce corruption rates. Audit opinions have no effect on reducing the number of corruption cases. This indicates that there has been no qualitative consideration of materiality for misstatements caused by the intentional actions of the organization's leaders, which will then have an impact on audit opinion. The level of capital expenditure had a positive effect on the number of corruption cases. High capital expenditures

can increase the opportunity for government officials to misuse their budgets in the areas of expenditure and assets. Ultimately, this increases corruption.

Based on our findings, we suggest to: Heads of local government regional to strive to be role models and pioneers in enforcing ethics, integrity, and anti-corruption culture in their respective environments to formulate strategies and efforts to achieve goals through strengthening effective control activities and update internal control and organizational risk according to current conditions so that various corruption can be adequately prevented; Head of local government internal auditors to improve auditor competence and the quality of supervision results in order to provide added value effectively to the organization; BPK auditors to consider the materiality of qualitative misstatements in transactions, especially those originating from the intentional intention of the regional government as the auditee that leads to corruption; The Head, management, and auditors within the BPKP Representative environment to provide technical assistance and guidance continuously to local governments as an optimization of preventing corruption; and The Ministry of Finance and the Ministry of Home Affairs, to consider adding a policy of sanctions for cutting and/or delaying the distribution of the balanced budget by referring to the number of corruption cases revealed.

This study has several limitations. First, we only involving interest variables and one control variable. There are still other variables that can affect the level of corruption in Indonesia. Second, the use of a quantitative research approach limits the ability to explore deeper behavioural and contextual factors so that there are discussions obtained that need to be further confirmed with different research methodologies. Further researchers are advised to incorporate additional variables, such as local government size, financial distress, or political competition, and to apply qualitative methods, such as interviews with experts and practitioners, to validate and enrich the findings.

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