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## **Decentralization and Corruption: Policy and Legal Study on the Effectiveness of Local Financial Oversight**

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### **Abstract**

Decentralization in Indonesia aims to enhance the autonomy and efficiency of local governments in managing finances and public services. However, in practice, decentralization also creates opportunities for budget misappropriation and corruption due to weak oversight systems. This study analyzes the effectiveness of legal policies in local financial oversight using a juridical-normative approach and compares the implementation in regions with high levels of corruption and those with more effective oversight mechanisms. The analysis reveals that although regulations such as Law No. 23 of 2014 on Regional Government and Law No. 17 of 2003 on State Finance establish principles of transparency and accountability, their implementation faces challenges, including weak inter-agency coordination, political interference, and limited human resources. Efforts to enhance transparency through e-budgeting and e-procurement have been introduced but remain partially effective due to technical and infrastructure-related issues. A comparative study with South Korea and Finland demonstrates that the success of local financial oversight relies heavily on the integration of digital systems, the independence of oversight institutions, and a strong culture of

governance integrity. Therefore, Indonesia must strengthen regulatory reforms, optimize the implementation of more transparent and integrated digital technologies, and ensure that decentralization operates in an accountable manner without creating opportunities for corrupt practices that hinder regional development.

**Keywords:** Decentralization, corruption, local financial oversight, legal policy, e-budgeting, blockchain.

## Introduction

Decentralization in Indonesia has been widely implemented since the Reform Era, aiming to provide greater autonomy to local governments in managing their policies and finances.<sup>1</sup> This policy is expected to enhance government efficiency, accelerate regional development, and bring public services closer to the people.<sup>2</sup> However, the reality shows that decentralization also presents serious challenges, particularly in the aspect of local financial oversight.<sup>3</sup>

Corruption cases involving regional leaders indicate that the flexibility in budget management has, in some cases, created opportunities for abuse of power.<sup>4</sup> For instance, in the 2021 sting operation against the Regent of Probolinggo, the regional head and local officials were found guilty of engaging in a job-buying

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<sup>1</sup> Proborini Hastuti, "Desentralisasi Fiskal Dan Stabilitas Politik Dalam Kerangka Pelaksanaan Otonomi Daerah Di Indonesia," *Simposium Nasional Keuangan Negara: Kementerian Keuangan Ri Tahun 2018*, 2018, 784–99.

<sup>2</sup> Rika Santina, "Pengaruh Desentralisasi Dan Otonomi Daerah Terhadap Kesejahteraan Masyarakat Di Indonesia," *Jurnal Review Pendidikan Dan Pengajaran (JRPP)* 7, no. 3 (2024): 9496–9502.

<sup>3</sup> Hilma Lathifah et al., "Transformasi Kebijakan Desentralisasi Di Indonesia Dan Implikasinya Terhadap Stabilitas Pemerintahan Daerah Di Era Globalisasi," *Professional: Jurnal Komunikasi Dan Administrasi Publik* 11, no. 2 (2024): 577–84.

<sup>4</sup> Hendra Karianga, *Carut-Marut Pengelolaan Keuangan Daerah Di Era Otonomi Daerah* (Prenada Media, 2017).

scheme by exploiting loopholes in local financial policies.<sup>5</sup> Similarly, the case of Papua Governor Lukas Enembe involved bribery and money laundering using funds from the regional budget (APBD) that were supposed to be allocated for regional development.<sup>6</sup>

This phenomenon demonstrates that decentralization without strong oversight mechanisms can potentially increase corruption at the regional level.<sup>7</sup> Oversight institutions such as the Supreme Audit Agency (BPK), the Corruption Eradication Commission (KPK), and Regional Inspectorates still face significant challenges in detecting and preventing budget leaks.<sup>8</sup> Legal loopholes, weak policy implementation, and a lack of transparency in regional financial management systems remain critical factors that require deeper analysis.<sup>9</sup>

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<sup>5</sup> Chandra Dewi, "Analisis Kasus Penyalahgunaan Wewenang Dalam Praktik Jual Beli Jabatan Oleh Bupati Probolinggo Puput Tantriana Sari Dan Wakil Ketua Komisi IV DPR Hasan Aminudin.," *Jurnal Ilmu Hukum, Humaniora Dan Politik (JIHHP)* 4, no. 5 (2024).

<sup>6</sup> Huda Saifullah and Aryo Fadlian, "Analisis Praktik Korupsi Gubernur Provinsi Papua Lukas Enembe Dalam Perspektif Undang-Undang Pemberantasan Tindak Pidana Korupsi," *Jurnal Hukum Respublica* 23, no. 02 (2024): 77–88.

<sup>7</sup> Dedi Irawan, "Kajian Teoritis Terhadap Praktik Desentralisasi Dan Integrasi Politik Pasca-Orde Baru," *Ilmu Dan Budaya* 37, no. 33 (2013): 3783–3801.

<sup>8</sup> Beni Kurnia Illahi and Haykal Haykal, "Prinsip Dan Dinamika Hukum Keuangan Negara Darurat Dalam Penanggulangan Pandemi Covid-19," *Jurnal Rechts Vinding: Media Pembinaan Hukum Nasional* 10, no. 1 (2021): 1.

<sup>9</sup> Linda Jumame, "Analisis Efisiensi Dan Efektifitas Pengelolaan Keuangan Daerah Kota Sorong," *Jurnal Riset Bisnis Dan Manajemen* 6,

Compared to previous studies, which generally discuss decentralization and corruption in broad terms, this research offers a comprehensive approach by examining the effectiveness of legal policies in local financial oversight. It compares regions with high levels of corruption and those with more effective financial oversight systems to identify key factors that influence the effectiveness of oversight mechanisms in different areas. Additionally, this study evaluates the effectiveness of regulations and policy implementation by questioning whether existing legal frameworks are sufficient to prevent corruption and how their implementation varies across different regions. Another approach explored in this study is the role of technology in enhancing financial transparency at the regional level. It examines how digitalization, such as e-budgeting systems or blockchain technology, can serve as solutions to prevent budget manipulation. Furthermore, a comparative analysis with countries that have successfully reduced corruption within their decentralized systems, such as South Korea and Finland, is conducted to identify alternative strategies that could be applied in Indonesia. By focusing on legal policies, oversight effectiveness, and the utilization of technology, this study aims to provide concrete recommendations for policymakers to improve local financial oversight systems, ensuring that decentralization functions optimally without creating opportunities for corrupt practices.

## Method

This study employs a qualitative approach using the juridical-normative method, focusing on the legal policy analysis related to the effectiveness of local financial oversight within the context of decentralization and corruption.<sup>10</sup> The juridical-normative approach is conducted by examining various laws and regulations governing decentralization, local financial management, and oversight mechanisms, such as Law No. 23 of 2014 on Regional Government, Law No. 17 of 2003 on State Finance, and other relevant regulations.<sup>11</sup> In addition, this study incorporates an empirical approach by analyzing corruption cases at the regional level and evaluating the extent to which existing legal policies have been effective in curbing corrupt practices.<sup>12</sup> Data collection is carried out through document studies, legal decision analysis, reports from oversight institutions such as the Supreme Audit Agency (BPK) and the Corruption Eradication Commission (KPK), as well as interviews with legal experts and public policy analysts to gain deeper insights. The findings of this research are expected to provide concrete recommendations for enhancing the effectiveness of

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<sup>10</sup> Komang Ayu Henny Achjar et al., *Metode Penelitian Kualitatif: Panduan Praktis Untuk Analisis Data Kualitatif Dan Studi Kasus* (PT. Sonpedia Publishing Indonesia, 2023).

<sup>11</sup> Saputra Adiwijaya et al., *Buku Ajar Metode Penelitian Kualitatif* (PT. Sonpedia Publishing Indonesia, 2024).

<sup>12</sup> Jonaedi Efendi and Johnny Ibrahim, "Metode Penelitian Hukum: Normatif Dan Empiris," 2018.

local financial oversight strategies to minimize the risk of corruption within the decentralized governance system.<sup>13</sup>

## **Analysis and Discussion**

### **1. Effectiveness of Legal Policies in Local Financial Oversight**

The effectiveness of legal policies in overseeing local finances in Indonesia still faces various challenges, despite being regulated under several laws, such as Law No. 23 of 2014 on Regional Government, Law No. 17 of 2003 on State Finance, and Law No. 15 of 2004 on the Audit of State Financial Management and Accountability. These regulations mandate transparency and accountability in local financial management and grant oversight authority to institutions such as the Supreme Audit Agency (BPK), the Regional Inspectorate, and the Corruption Eradication Commission (KPK). However, in practice, the effectiveness of financial oversight remains hindered by weak implementation, lack of coordination between oversight institutions, and the high potential for political interference at the regional level.

One of the main issues in local financial oversight is the prevalence of corruption cases involving regional leaders, whether in the form of budget misappropriation, project cost inflation, or bribery related to the management of the Regional Budget (APBD). Cases such as the misallocation of grant funds and social assistance involving several governors and regents

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<sup>13</sup> Zainuddin Ali, *Metode Penelitian Hukum* (Sinar Grafika, 2021).

indicate that legal loopholes are still being exploited for personal or group interests. Moreover, internal oversight systems managed by the Regional Inspectorate often fail to function optimally due to limited human resources and a lack of independence in carrying out their duties.

On the other hand, although financial digitalization through e-budgeting and e-procurement has been implemented to enhance transparency, weaknesses remain, particularly in terms of data integration and monitoring financial report manipulation. In several regions, these systems have not been fully implemented, leaving room for corrupt practices. Furthermore, law enforcement against financial mismanagement is often hampered by bureaucratic delays and weak administrative penalties, which fail to prevent minor violations from escalating into corruption cases.

Given these challenges, strengthening legal policies is necessary, not only through normative regulations but also by ensuring stricter implementation via independent oversight, enhanced capacity of auditing institutions, and stricter sanctions for violators. The digitalization of financial management should also be expanded with a more integrated system to close gaps that allow budget misappropriation. Additionally, bureaucratic reforms that promote greater transparency and reduce political interference are crucial aspects of improving the effectiveness of legal policies in local financial oversight in Indonesia.

## 2. Effectiveness of Regulations and Implementation of Local Financial Oversight Policies

The effectiveness of regulations and the implementation of local financial oversight policies in Indonesia still faces various challenges, despite being governed by several legal frameworks, such as Law No. 23 of 2014 on Regional Government, Law No. 17 of 2003 on State Finance, and Government Regulation No. 12 of 2019 on Local Financial Management. These regulations establish principles of transparency, accountability, and the oversight roles of the Supreme Audit Agency (BPK), the Corruption Eradication Commission (KPK), and the Regional Inspectorate in ensuring that budget utilization complies with legal provisions. However, the implementation of these regulations continues to encounter several obstacles that impact the effectiveness of local financial oversight.

One of the primary challenges in implementing financial oversight policies is the weak internal oversight conducted by the Regional Inspectorate. This institution often lacks sufficient independence because it operates under the authority of the regional head, making it vulnerable to political interference. Additionally, the limited human resources and capacity to conduct comprehensive audits often result in oversight that is primarily administrative, failing to detect more complex corruption schemes.

Furthermore, the regulations governing local financial management and oversight are not consistently implemented across all regions. Some areas have adopted digital financial



management systems, such as e-budgeting and e-procurement, to enhance transparency and accountability. However, many regions still struggle with implementing these systems due to infrastructure limitations, lack of data integration between institutions, and insufficient technical capacity in managing digital financial systems. As a result, loopholes for budget manipulation, project cost inflation, and fund misappropriation remain open.

Another significant issue affecting the effectiveness of policy implementation is the weak coordination between oversight institutions at both central and regional levels. The Corruption Eradication Commission, the Supreme Audit Agency, and Regional Inspectorates often operate with different audit mechanisms that are not always integrated, leading to inconsistencies in oversight processes. Moreover, although the Supreme Audit Agency provides audit opinions on regional financial reports, the recommendations given are often not followed by concrete measures to improve local financial governance.

To improve the effectiveness of regulations and the implementation of local financial oversight policies, reforms in the oversight mechanisms must be more integrated and independent. Strengthening the Regional Inspectorate as an internal watchdog should be accompanied by enhanced capacity and independence to ensure it is not easily influenced by regional

leaders. Additionally, expanding and strengthening the digitalization of local financial management systems is crucial to ensuring that financial data becomes more transparent and can be audited in real-time. Legal reforms are also needed to reinforce sanctions against violations in local financial management, covering both administrative misconduct and criminal acts of corruption. With these measures, financial oversight policies are expected to function more effectively in ensuring a clean and accountable decentralization process.

### 3. Digitalization of Financial Management Systems, such as E-Budgeting and Blockchain, as a Solution to Prevent Budget Manipulation

The digitalization of financial management systems, including e-budgeting and blockchain, presents a promising solution for enhancing transparency and accountability in regional financial management while preventing budget manipulation. The implementation of e-budgeting aims to ensure that every stage of budget planning, allocation, and utilization is automatically recorded and well-documented, reducing opportunities for irregularities. Several regions in Indonesia have adopted e-budgeting in hopes of increasing transparency. However, its effectiveness still depends on the commitment of local governments to consistently implement the system and ensure that all budget mechanisms can be digitally monitored.

Although e-budgeting improves efficiency in regional financial management, its implementation faces multiple

challenges. A key issue is the lack of integration between e-budgeting and other financial oversight systems, leaving room for data manipulation at various stages of budgeting. Additionally, human resource capacity in operating and supervising these systems is a crucial factor often overlooked, especially in regions with limited technological infrastructure.

As a more secure alternative, blockchain technology is being introduced as a solution to enhance transparency and prevent budget manipulation. Blockchain offers advantages in creating a decentralized, immutable record-keeping system that can be audited in real-time by authorized parties. The implementation of blockchain in regional financial management would ensure that every budget transaction is recorded in an open system, making manipulation nearly impossible and reducing the risks of corruption and fund misappropriation.

However, the adoption of blockchain in regional financial management still faces several challenges, particularly in regulatory aspects and technological readiness in Indonesia. The absence of specific regulations governing blockchain use in financial governance is a major obstacle to its implementation. Furthermore, deploying this technology requires adequate digital infrastructure and a strong commitment from the government to build a fully supportive ecosystem for financial digitalization.

To ensure that digital financial management systems effectively prevent budget manipulation, a comprehensive strategy is needed, including regulatory strengthening, human resource capacity development, and the integration of various technology-based financial oversight systems. Additionally, periodic evaluations of e-budgeting implementation and further exploration of blockchain adoption should be conducted to ensure that these systems provide maximum transparency and accountability in regional financial management..

#### 4. Comparative Analysis with Countries That Have Successfully Reduced Corruption in Decentralized Systems, Such as South Korea and Finland, to Identify Alternative Strategies for Indonesia

A comparative analysis of countries that have successfully reduced corruption in decentralized systems, such as South Korea and Finland, provides insights into alternative strategies that could be applied in Indonesia. These two countries have taken different approaches to combating corruption at the regional level but have demonstrated high effectiveness in public financial oversight.

South Korea has successfully curbed corruption in its decentralized system by implementing transparency policies based on technology. One of its key innovations is the OPEN (Online Procedures Enhancement for Civil Applications) system, which allows the public to monitor administrative processes in real time, including the use of public funds. Additionally, the KONEPS (Korea ON-line E-Procurement System) e-procurement

system is used to oversee the procurement of goods and services digitally, reducing opportunities for budget misappropriation. South Korea's success in tackling corruption is also supported by the independence of oversight institutions, such as the Anti-Corruption and Civil Rights Commission (ACRC), which has broad authority in handling corruption cases, including at the regional level.

Meanwhile, Finland adopts a governance-based approach, where the regional government system operates with highly transparent and accountable oversight mechanisms. One of its key successes is the implementation of Integrity-Based Governance, which emphasizes a culture of integrity at every level of government. Finland's regional financial administration is open, allowing financial reports to be widely accessible to the public. Financial oversight is also strictly enforced through independent external audit mechanisms that are not subject to political influence. Additionally, Finland has a strong anti-corruption education system, fostering a public service mentality that upholds high ethical standards in governance.

Compared to Indonesia, several challenges still hinder the effectiveness of regional financial oversight, such as weak coordination among oversight agencies, a lack of transparency in budget management, and significant political interference in regional governance. Therefore, strategies that can be applied in Indonesia include strengthening regional financial digitalization

systems, as implemented by South Korea, by ensuring full integration between e-budgeting, e-procurement, and real-time oversight systems. Additionally, it is essential to reinforce the independence of oversight institutions and build a culture of transparency and integrity in regional financial governance, as practiced in Finland.

Implementing these strategies must be accompanied by regulatory reforms to ensure that every policy genuinely minimizes opportunities for corruption at the regional level. By adapting best practices from South Korea and Finland, Indonesia has a significant opportunity to enhance the effectiveness of regional financial oversight and establish a cleaner and more accountable governance system within its decentralization framework.

### **Conclusion**

The effectiveness of regional financial oversight in Indonesia's decentralized system still faces numerous challenges despite being governed by comprehensive regulations, such as Law No. 23 of 2014 on Regional Government and Law No. 17 of 2003 on State Finance. Weak internal oversight, poor coordination among oversight institutions, and high levels of political interference are key factors contributing to the continued prevalence of corruption in regional financial management. Efforts to digitalize financial oversight through e-budgeting and e-procurement have been implemented in some regions, but challenges persist in terms of infrastructure, system integration, and human resource capacity. As an alternative,

blockchain technology could be used to enhance transparency and prevent budget manipulation, although its implementation is still hindered by regulatory and technological readiness issues.

A comparative study with South Korea and Finland demonstrates that technology-driven transparency, independent oversight institutions, and a governance culture of integrity are crucial in preventing corruption within decentralized systems. Therefore, Indonesia must strengthen regulatory reforms, optimize the integration of digital oversight systems, and ensure that decentralization operates in a transparent and accountable manner to prevent corruption from obstructing regional development and public welfare.

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