

FACTORS INFLUENCING THE FINANCIAL DISCLOSURE OF LOCAL GOVERNMENTS IN INDONESIA

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ABSTRACT

This study aims to examine the influence of political competition, legislature size, audit findings, and education level on the financial statements disclosure of local governments. This study used 190 local governments in Indonesia as the samples. The results of this study shows that the higher the level of political competition, legislature size, and education level of community, the higher the disclosure level of financial statement of local governments. Conversely, audit findings measured by the amount of the monetary value audited by the audit board are proven to have no influence on the disclosure level of local financial statement. However, the sensitivity analysis shows a different result. By changing the audit findings proxy with the amount of items findings in the audit findings from the audit board, the analysis proves that the new proxy has a positive influence on the disclosure level of local financial statements. This study has only investigated the disclosure level of local financial statements with the basis of government accounting standards following the government regulation No. 24 of 2005 implementing cash basis toward accrual. Therefore, future studies should aim at that with the basis of government regulation No. 71 of 2010 implementing full accrual basis.

Keywords: Political Competition, Legislature Size, Audit Findings, Education Level, Financial Statement Disclosure, Local Governments.

INTRODUCTION

Since the local autonomy era in Indonesia, local governments including provinces and districts/municipals have been given sole authorities to formulate policies including managing local resources and assets for the prosperity of the area. With that authority, obligation to govern responsibly and accountably arose. One of local government responsibilities for managing local budget is to prepare financial statements. Law No. 17 of 2003 regarding national finance states that government financial statements must be formulated following the government accounting standards by the central government and local governments. The standards manage accounting basis, recognition, measurement, and disclosure to record every transaction or economic event. As a means of accountability, local financial statements are extensively used by concerned parties including the regional representative council, the central government, the audit board, and the public (Budiharseno, 2017; Nugroho et al., 2017).

Therefore, local financial statements should be presented in a complete and qualified form to provide the needed information for all financial statements users. The characteristic of the statements in accordance with the government accounting standards as stipulated in

government regulation No. 71 of 2010 is that financial statements must contain relevant, reliable, comparable, and understandable information. To meet this characteristic, the statements should be presented completely (full disclosure). The disclosure level of local financial statements varies. In general, the disclosure of local financial statements in Indonesia is still low (Hendriyani & Tahar 2015; Suhardjanto & Yulianingtyas 2011; Martani & Lestiani, 2012; Suhardjanto & Lesmana, 2010). One of the distinguishing features is the external motivation on local financial information. Incomplete financial statements will lead to an incorrect interpretation of statements users because they do not receive any other information. This motivation is determined by political competition (Baber, 1983; Rokhmad & Susilo, 2017), legislature size (Suhardjanto & Yulianingtyas, 2011), audit findings (Setyaningrum & Syafitri, 2012), and education level (Martani et al., 2014). This study uses agency theory of Ross (1973) as the basic theory and aims to examine the influence of political competition, legislature size, audit findings, and education level on the financial statements disclosure of local government.

THEORETICAL REVIEW

Agency Theory in Public Accounting

Agency theory explains the relationship between shareholders as principals and management as agents (Kurniawan, 2017; Laupe, 2018). Management is a contracted party to work for shareholders (Wahyuni & Ginting, 2017). Although generally the agency theory is used to describe the interactions within a business organization, agency problems can occur in all organizations (Zimmerman, 1997). In relation to public sector entities in Indonesia with a democratic political system, shareholders can refer to the members of society choosing a leader as a manager to handle national and regional wealth. The President or local leaders are the agents expected to work for the benefit of society. There are many problems in the principal and agent relationship, especially since each party is assumed to be maximizing their own interests; hence agents do not constantly prioritize the interests of principals (Jensen & Meckling, 1976). To minimize these problems, principals can take precautions by giving incentives to agents and intensively monitoring through the supervisory board and external audit, whereas agents can increase the trust of the principal by ensuring transparency including formulating reliable and complete financial statements (Chua et al., 2009). In the context of the local government, agency problems may occur because of the authority given to local leaders to manage regional wealth, in which not all regional wealth management is disclosed, commonly known as moral hazard (Scott, 2014; Attila, 2012). To prevent this issue, local leaders are required to formulate performance responsibility in the form of financial statements. Local financial statements present the local government performance and local wealth. To guarantee the suitability of local financial statements with the government accounting standards, external auditors conduct an audit for financial statements.

Disclosure of Local Financial Statements

Local financial statements are formulated in order to provide information for concerned parties and to prove the accountability and responsibility of the entities to the public. In addition, financial statements reveal the government wealth management in the forms of accounting figures and qualitative information (Hakim, 2017). The government accounting standards require a disclosure of certain information. The disclosure aims to further explain the financial statement

figures and government financial management including the non-figured information in the front page of financial statements (Sukmadilaga et al., 2015). Silvia (2013) describes the variance in the width and types of disclosure of government financial statements caused by the characteristics of users, the binding rules, and the system supervision in each entity. The level of disclosure of government financial statements varies in each entity (Hendriyani & Tahar 2015; Sukmadilaga et al., 2015). This condition is caused by the variance in environment complexity of financial statements in respective local government (Silvia, 2013).

Local Government in Indonesia

Law No. 23 of 2014 regarding local government defines local governance as the performance of governmental affairs by local governments and parliaments following the principles of autonomy and duty of assistance in a broad autonomy system and the principle of the Indonesian Republic in the basic constitution. The definition implies that local governance is run by two parties, local government led by local leaders and the Regional Council (*Dewan Perwakilan Rakyat Daerah/DPRD*). Local leaders act as executives running the local governance, while regional council serves as legislatures legalizing local regulations and supervising local leader performance. In Indonesian political system, local leaders and regional council are directly elected by the people. However, to be a candidate of local leaders, an individual needs a support from a political party having a representative in regional council. This support is needed to approve the draft of local regulations proposed by the local leader and to supervise the implementation of local regulations.

HYPOTHESES

In line with agency theory, political competition has incentive to supervise the leader in charge of a region (Zimmerman, 1977). In addition, Laswad et al. (2005), Rahman et al. (2013) state that high political competition will lead to greater surveillance from political competitors and the public. Political competitors will try to monitor the performance of local government and find weaknesses. Local government competing high politics bear high monitoring costs by providing further information (disclosure) showing the fulfillment of promises during campaign.

H1: Political competition positively influences the disclosure of local financial statements.

The size of regional council (legislature) is different in each region depending on the number of people in the region. Based on Law No. 8 of 2012 regarding the election of the House of Representatives (DPR), the Regional Representative Council (DPD), and the Regional Council (DPRD), the number of provincial legislators is a minimum of 35 and a maximum of 100. The number of regional/city legislators is a minimum of 20 and a maximum of 50. Moreover, Suhardjanto and Yulianingtyas (2011) state that “*regional council has a potential and strategic role in conducting economical, efficient, transparent, and accountable financial supervision*”. Meanwhile, Setyaningrum and Syafitri (2012), Suhardjanto and Yulianingtyas (2011) find that legislature size has a positive influence on the disclosure level of local financial statement. This means that the more the legislatures in a region, the higher the disclosure level.

H2: Legislature size positively influences the disclosure of local financial statements.

Copley (2002) states that “*audit quality will increase the level of disclosure. Because the audit of local financial statements is conducted by one institution (Indonesian Audit Board/BPK)*”, the audit quality among local governments are indistinguishable. In line with this, Martani and Lestiani (2012), Din et al. (2017) use the number of audit findings as a variable to measure the audit quality. The more the number of audit findings, the higher the disclosure level.

H₃: Audit findings have a positive influence on the disclosure of local financial statements.

Suhardjanto and Yulianingtyas (2011) find that education level is one of the variables influencing the disclosure level of financial statements. Belkaoui (1983) states that “*environmental demography including income and education has an influence on the level of financial disclosure in various countries*” (Martani & Lestiani, 2012; Kurniawan, 2017). This variable is one of the variables having a positive relationship with the disclosure of non-financial information about public services through regional and city government websites in Indonesia (Martani et al., 2014; Nugroho et al., 2017; Ghofur & Sulistiyono, 2015). Serrano-Cinca et al. (2009) state “*that there is a positive relationship between education proxied by the average years of schooling and the policy of financial statements openness*”. This is because citizens with a higher education level tend to suppress local governments to publish financial statements. Hermana and Silfianti, (2011) state “*that the success of financial disclosure system through the internet (e-government) is influenced by education level of citizens and civil servants*”. The main assumption underlying the use of this variable is that the higher the education levels of the community, the more critical the community in demanding financial and non-financial information from the government. Further, the demand forces the government to provide more positive and complete information.

H₄: Education level of community positively influences the disclosure of local financial statements.

RESEARCH METHOD

Sampling

The subjects in this study were local governments in Indonesia (Table 1). There were several criteria in selecting the samples. The samples had financial statements of 2014 audited by the Indonesian Audit Board, had the audit findings, had the data of the education level of the community established by the Central Bureau of Statistics, and had the data of the portion of supporting political parties in the previous election.

CRITERIA	AMOUNT
Regional government in Indonesia	513
Unavailable audited financial statements	(52)
The local government that is not a reporting entity	(5)
Unavailable data regarding the supporting legislatures	(266)
Selected samples	190

Research Design

The hypothesis testing was conducted to reveal the relationship between variables. To test the proposed hypotheses, multiple regression analysis was used by examining the influence of independent variables on the dependent variables.

$$DISC = \alpha + \beta_1 POL + \beta_2 LEG + \beta_3 AUD + \beta_4 EDU + \varepsilon$$

In which: DISC=disclosure level of local financial statements, POL=political competition, LEG=amount of legislature representatives, AUD=the result of audit by Indonesian Supreme Audit Agency, ED =education level of the people.

The hypotheses were answered by considering the significance value of coefficient of each variable. A variable is considered significant if the t-value is greater than t-table in the trust level of 5%.

Operational Definition

The variable of financial statements disclosure of local government is the percentage of disclosed items in the financial statements compared to the required disclosure by the government accounting standards. The measurement was using the disclosure checklist with rate 1 for a disclosure, rate zero for an unsuitable disclosure, and unrated for an irrelevant disclosure. The disclosure level the value obtained from the checklist value divided by the maximum expected value. The variable of political competition was measured by the percentage of the number of regional council members from political parties excluding supporting parties of local leaders on the previous election. This variable was calculated by dividing the number of regional council members from political parties excluding supporting parties by the number of total members of regional council. Meanwhile, the variable of legislature size was determined by the total members of the regional council. The variable of the audit findings of the Audit Board was measured by the number of items on the audit findings of local government, while the education level was measured by the number of average years of schooling in each region. The data regarding the education level was obtained from the 2014 Central Bureau of Statistics' data.

RESULTS

Descriptive Statistics

The description of values distribution of each variable is described in Table 2. Among the samples, the disclosure level of local financial statements was more than 50%, yet the maximum level of disclosure was only 85%. This meant that there was no local government meeting the requirements of disclosure in the financial statements as a whole.

Variable	Max	Min	Mean	Std. Dev.
Disclosure	0.85	0.53	0.72	0.6
Politics	0.90	0.17	0.67	0.12
Legislature	50	20	30	9
Audit (in billion Rupiah)	79.087	60.671	6.317	11.228
Education	12.5	5.1	8.6	3.2

Hypothesis Testing

This study examined the influence of independent variables including political competition, legislature size, audit results, and community education level on the disclosure of local financial statements using multiple regression analysis. The results of the testing were as in Table 3.

Variable	Prediction	Coefficient	t-value	Probability
Constant			16.213	0.000*
Politics	+	0.188	2.955	0.004*
Legislature	+	0.389	6.100	0.000*
Audit	+	0.052	0.825	0.410
Education	+	0.244	3.869	0.000*
N			190	
R Square			0.279	
Adjusted R Square			0.263	
F Statistics			17.903	
F Statistics (Prob)			0.000	
* Significance 1%				

The multiple regression analysis shows the value of adjusted $R^2=0.263$, meaning that the variable of political competition, legislature size, audit findings, and education level of had 26.3% influence on the disclosure level of the local financial statements. However, among the tested variables, only 3 variables were proved to have an influence on the disclosure level of local financial statements (political competition, legislature size, and education level of community) indicated by the t-value is greater than t table, $p>0.01$. On the other hand, the variable of audit results was proved to have no influence on the disclosure level of local financial statements with the t-value=0.825, $p=0.410$. The results indicated that in the context of political competition, the greater the percentage of regional council members from the non-supporting party (balancing party), the local policies made by the elected members were likely to favour the people and accountable, including presenting financial statements with adequate disclosure according to government accounting standards. This finding was consistent with Ingram (1984) regarding the influence of economic and political factors with different variations in the disclosure of government accounting practices in the US states. Ingram (1984) found that the coalitions of voters have a positive and significant influence on the disclosure level of financial statements in the US states.

The second hypothesis stating that legislature size has a positive influence on the disclosure of local financial statements was accepted. This meant that the greater the legislature size, the greater the disclosure level of local financial statements. The number of regional council members is not same in each region depending on population in the region. This finding supported the findings of Setyaningsum and Syafitri (2012), Suhardjanto and Yulianingtyas (2011) stating that legislature size has a positive and significant influence on the compliance level of financial statements disclosure. Likewise, this result was in accordance with the study result of Gilligan and Matsusaka (2001) finding that legislature size has a positive influence on the policies of revenues and expenditures of local government. However, this study contradicted with the study of Khasanah and Siddiq (2014) stating that there was no relationship between legislature size and the compliance level of financial statements disclosure of local government.

Audit findings proxied by the finding value of the report of the audit board had no influence on the disclosure level of local financial statements. The analysis result was in line with Lestiani Martani (2012). However, this study was contradicted with the study of Hendriyani and Tahar (2015) revealing that the deviation level of compliance had an influence on the disclosure of local financial statements. The inconsistency in the study of audit findings was probably caused by the use of unsuitable proxy. The value of audit findings proxy was unable to explain the relevance of audit findings to the financial statements formulation by local governments because each region had a different thought regarding the value of audit findings.

Finally, the results showed that the education level of community had a positive influence on the disclosure level of local financial statements. This meant that the higher the education level of the community, the local government was likely to be more urged to improve the disclosure level of financial statements. The result was in line with Suhardjanto and Yulianingtyas (2011) stating that education level of community had a positive and significant influence on the disclosure level of financial statements. This study was also based on the assumption that higher education level causes the community to be more critical in demanding trustworthy information. In contrast, the community with lower education level tended to be more apathetic and unconcerned to the amount of information in everyday lives.

Sensitivity Analysis

This study applied sensitivity analysis to test the sensitivity of hypothesis testing results by changing the proxy with the amount of finding items in the report of audit board. The independent variables were reexamined resulting in Table 4.

Variable	Prediction	Coefficient	t-value	Probability
Constant			16.305	0.000*
Politics	+	0.196	3.129	0.002*
Legislature	+	0.347	5.364	0.000*
Audit	+	0.180	2.699	0.008*
Education	+	0.193	2.984	0.003*
N			190	
R Square			0.279	
Adjusted R Square			0.263	
F Statistics			17.903	
F Statistics (Prob)			0.000	

* Significance 1%

The results sensitivity analysis with multiple regression showed that variables of political competition, legislature size, and education level remained to have a positive influence on the disclosure level of local financial statements. Moreover, in this analysis, the variable of audit findings with the proxy of the amount of finding items influenced the disclosure of local financial statements. This was indicated with the t-value =2.699 and $p > 0.01$. The result showed that audit findings had a positive and significant influence on the disclosure of local financial statements. This was in line with Martani and Lestiani (2012) stating that the more audit findings, local governments were likely to be more urged to improve the disclosure of financial statements in the following year. There are two main reasons for the execution of audit. Theoretically, financial statements are unreliable without being audited by professional and

independent auditors. Moreover, audit board is authorized to audit financial statements of local governments in accordance with national provisions.

CONCLUSION

The results of this study show that the higher the level of political competition, legislature size, and education level of community, the higher the disclosure level of financial statement of local governments. Conversely, audit findings measured by the amount of the monetary value audited by the audit board are proven to have no influence on the disclosure level of local financial statement. However, the sensitivity analysis shows a different result. By changing the audit findings proxy with the amount of items findings in the audit findings from the audit board, the analysis proves that the new proxy has a positive influence on the disclosure level of local financial statements. This study has only investigated the disclosure level of local financial statements with the basis of government accounting standards following the government regulation No. 24 of 2005 implementing cash basis toward accrual. Therefore, future studies should aim at that with the basis of government regulation No. 71 of 2010 implementing full accrual basis. More broadly, research is also needed to investigate factors influencing the disclosure level of local financial statements, expanding the time series in order to obtain more reliable results regarding the issue.

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