

Quality of Financial Reporting in Indonesia Local Government: A Study Literature

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Abstract: The financial statements are the means of delivering information concerning the activities of the organization of government financial management. The financial statements which can transmit the information to the public with accurate, timely, transparent and accountable, then the rate will be high quality financial statements. Periodic financial statements of the local government will be audited by the Audit Board. The results of this audit will be issued opinion by the Supreme Audit Agency. Audit Board's opinion describes the level of fairness of financial statements in accordance with the local authorities the Government Accounting Standards.

This research was conducted in the form of a literature study that examines the commitment of regional heads, government internal control and financial accounting information systems area will affect the quality of the financial statements of local government in Indonesia. With the high commitment of local leaders in following up the previous year audit findings and increase the competence of human resources associated with the financial management of the area so that the level of understanding of the human resources of government accounting standards, the better, internal control systems are getting better government and financial accounting information system area the better it will boost the quality of local government financial reports that are accountable local leaders in the area of financial management.

Key words: commitment; government accounting standards; internal control; quality of local government financial reporting

JEL codes: H11, H83, M41, M48

1. Introduction

1.1 Background

The financial report is information prepared by the head area that shows accountability of regional heads to the stakeholders about the activities carried out by local governments in developing areas, service to the community and efforts to improve the welfare and safety of the community. Statement of Government Accounting Standards number 1 paragraph 9 (Government Regulation No. 10 of 2010) states that the financial statements are structured report on the financial position and transactions undertaken by an entity. The main objective of financial statements is to present information about the financial position, the realization of the budget, cash flow, and the performance of an entity that is useful for users in making and evaluating decisions about the allocation of resources.

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Specifically, the purpose of government financial reporting is to provide information that is useful for decision-making and to demonstrate the accountability of the entity for the resources entrusted to it, to (a) provide information about the position of economic resources, liabilities, and equity of government funds, (b) provide information about changes in the position of economic resources, liabilities, and equity of government funds, (c) provide information about the source, the allocation and use of economic resources, (d) provide information regarding the observance of the realization of the budget, (e) provide information on the way of reporting entities to fund its activities and meet its cash needs, (f) provide information regarding the potential implementation of the government to fund government activities, and (g) provide useful information to evaluate the reporting entity's ability to fund its activities.

Liabilities of preparing of financial statements are the mandate of the agency theory. This theory introduced by Jensen and Meckling (1976). Agency theory to explain the relationship between the principal is a party that gives a mandate for the management of an organization and the management agent that is going to execute the mandate given by the principal. Management is contracted by the principal parties to work in the interests of the principal. The existence of management in a society together selected and given a mandate to run the organization, the management and the need to account for all the work to the principal. The government is in charge of management to govern for the benefit of the principal that is society. All the activities of the government should be oriented to the interests of the principal.

The government elected by the people to run the government through elections or local elections. Mandate given by the people to the government should be able to run properly. Stakeholder forums and the Regional Representatives Council as the representative of the people should be to supervise the running of the government. In addition, periodic activities undertaken by both government agencies will be audited internally and external agencies. The audit carried out these two institutions are operational audits that lead to efficiency, effectiveness and economical. The audit referred to the audit value for money, which means that any government spending should provide added value to the community.

According to Government Regulation No. 10 Year 2010 concerning Governmental Accounting Standards: the conceptual framework of government accounting paragraphs 21 and 22, the financial statements are prepared to provide relevant information about the financial position and all transactions conducted by an entity. Each entity has an obligation to report on the efforts that have been achieved in the implementation of activities in a systematic and structured in a reporting period for the benefit of: (a) Accountability, accountable management of resources and the implementation of policy is entrusted to the unit of government organizations in order to achieve the stated goals periodically, (b) Managerial, provide financial information that is useful for planning and financial management governance and facilitate effective control over all assets, debt, and equity funds, (c) Transparency, provide financial information that is open to the public in order to realize good governance, and (d) the balance between generations (intergeneration equity), assist the user in knowing the adequacy of the government's revenues in the reporting period for cover all the expenses allocated and whether future generations will be assumed to bear the burden of these expenses. In Act number 17 of 2003 on the Governance Financial of article 31 states that financial statements should be presented by the head area at least cover the Budget Realization Report, Balance Sheet, Cash Flow Statement, and Notes to Financial Statements.

Indonesian Government Regulation number 71 of 2010 on leading implementation Government Accounting Standard of accrual accounting for the government, especially the preparation of the financial statements of the government. Accrual basis of Government Accounting Standards is the recognized revenue, expenses, assets, debt,

and equity in the accrual-based financial reporting, as well as recognizing revenue, expenditure, and financing in the reporting of budget implementation on the basis set out in the State Budget/Regional Budget. For the government's financial statements in 2015 must have been using the accrual basis. Component of the government's financial statements comprise the accrual basis of (1) Budget Implementation Report, which consists of Budget Realization Report and Statement of Changes in Balance Budget Surplus and (2) Financial Statements, which consist of the Balance Sheet, Statement of Operations, Statement of Changes in Equity and Cash Flow Statement. The Statements of Operations is prepared to complete the reporting and accrual accounting cycle so that the preparation of statement of operations, Statement of Changes in Equity and Balance Sheet have linkages that can be accounted for, and (3) Notes to Financial Statements.

The financial statements of heads to prioritize areas related to the financial aspects of the area, so that the financial statements are said to be a reflection of the local government in managing local finance. In accordance with Regulation of the Minister of Home Affairs number 13 of 2006 Article 1, Section 6 states that the local finance is all the rights and obligations in the area of regional governance framework that can be valued in money including all forms of wealth associated with the rights and obligations of the area. The success of regional finance manager shows the success of local government in exploring the area and spends financial resources for the benefit of society. The head area and this area gets the mandate of Act number 23 of 2014 on Local Government Article 65 paragraph (1) item a state that the task is to lead the implementation of the regional heads of government affairs under the authority of the area under the provisions of legislation specified and the Local Board Representatives. Thus, the head area and the area is a component of the local government is responsible for the success of the regional administration.

In carrying out the government affairs, the organizers of the regional government get funding from the local budget and national budget. Upon acceptance of the funding, the organizers of the local government shall undertake financial management area as mandated in Law number 23 of 2014 on Local Government Article 280 paragraph (2) states that one of the duties of financial management in an effective, efficient, transparent and accountable. Financial management conducted by the local government will audited by independent parties stipulated that the Law of the Supreme Audit Institutions. The results of tests carried Supreme Audit Institutions will be one of the indicators of the success of local government in the area of financial management. The results of the examination conducted by the Supreme Audit Institutions shown opinions/fairness opinion stating the local government's financial statement presentation. Supreme Audit Institutions examination on local government financial reporting particularly reports of local government in Indonesia 5 years from 2009 to 2013 can be seen in Table 1:

Table 1 Opinion of Local Government Financial Reporting in Indonesia

Opinion	2005	2006	2007	2008	2009	2010	2011	2012	2013
Unqualified	17	4	4	13	15	34	67	119	156
Qualified	311	325	282	323	330	341	352	320	311
Disclaimer	13	27	58	31	48	26	7	6	11
Adverse	22	106	120	118	111	119	97	79	45
Total	363	462	464	485	504	520	523	524	523

Sources: Audited Summary of Supreme Audit Institution, 2014

Table 1 shows in 2005, the financial statements of local governments that received unqualified opinion as

much as 17 local governments, or 5%, and the remaining 95% received non unqualified opinion. In 2006 and 2007, only four local government financial reports are received unqualified opinion or 1% while the other 99% get a non-unqualified opinion. In 2008, there were 13 local governments that received unqualified opinion or only four local governments obtain unqualified opinion or 3% while the other 97% received non unqualified opinion. In the years 2009 to 2013, the number of local government financial statements to obtain unqualified opinion continues to increase from 3%, 7%, 13%, 23% and 30%. Although an increasing number of local government financial statements to obtain unqualified opinion but the numbers are still small. Based above data it can be concluded that the financial statements of local government still has not gained the unqualified opinion of the Audit Supreme Institutions. Unqualified opinion has not been obtained from the Audit Supreme Institutions due to various factors, among others: (a) the weakness of the internal control system, (b) not yet well possessions countries/regions with the order, (c) the incompatibility of the procurement of goods and services with the applicable regulations, (d) the presentation of the financial statements are not in accordance with Government Accounting Standards, (e) the weaknesses in the system of preparation of financial statements, (f) the lack of adequate human resources competencies of financial management in local government.

Many local governments who have not obtained unqualified opinion, indicates that the financial statements presented by the regional government of inferior quality, because there are a lot of weaknesses. The low quality of financial reporting district/city government accountability is causing the quality of the district/city is still low, in other words not accountable. From the findings of the Audit Supreme Institutions on weaknesses in the local government's financial statement presentation showed that in addition to the weakness of internal controls, as well as the lack of an integrated information system among local governments in Indonesia, and government agencies ranging from the center to the regions do not have a high commitment in the management of finance.

2. Analysis and Discussion

2.1 Head Local Government Commitment to Financial Statements Quality

Commitment is the level of awareness, recognition or identification with the work performed (Robbins, 2000). Commitments linked to the level of concern someone with jobs that are being and will be done. Meyer and Allen (1993) stated that a strong commitment to mean acceptance of the individual against the objectives and values of the organization, and individuals strive and work and have a strong desire to remain in the organization. The commitment of government officials in conducting government then the quality of the resulting reports will be higher. The commitment is a commitment that is owned by government officials in running the government. With the high commitment of the government apparatus, the performance in good will govern. Governance will be associated with the funds used to finance these activities. Sources of funding and expenditures on governance will be reflected in the Center Budget and regional. Realization of state and local budgets will be presented National Financial Statement and Local Government Financial Statement. Good financial performance in governance seen from Audit Supreme Institutions opinion on financial statements prepared by the government. Silviana (2012) found that a high commitment from the government officials, especially heads of regions affects the quality of the financial statements of local governments. In line with the research Syaifullah (2014), also found that the commitment of local government organizations are very supportive and significant impact on the quality of accounting information system applied by the government. Thus, the commitment of heads of local government officials in particular is vital in creating quality accounting information produced by the government.

In addition, the commitment of the head of the viewable area of competence development activities and an increase in human resources related to financial management. The local government must provide adequate budget for education and training of employees of financial management area. With education and training, the new regulations and standards related to financial management would be well understood by the financial management area. Nuryanto research and Nunuy (2013) found that the competence of regional finance managers apparatus positive and significant impact on the quality of local government financial reports. These results are also consistent with research Arsiyanti, Darwanis and Muslim (2008). The high competence of financial management showed a high apparatus quality of local governments in financial management so that the quality of local government financial reports will be higher (Adhi & John, 2013).

According to Head of Financial and Development Regulatory Agency Regulation number PER-1633/K/JF/2011 on Technical Guidelines Increased Capability Government Internal Supervisory Apparatus also stated that the commitment of regional heads is made and signed a chartered audit and budgetary leeway. Audit charter is a guide for Auditor/Internal Controller made head of the region so that the auditor can perform their duties in a professional manner, to obtain audit results in accordance with quality standards, and can be accepted by the various parties, both internal and external. Thus the head of the region to give freedom to the auditors in carrying out the audit function and will provide all the data and information necessary in the process of conducting audits. Allowance intended budget is head of the region provide a budget sufficient to inspectorate to carry out the audit function.

2.2 Internal Control of Government and Quality of Financial Statements

According to Government Regulation number 60 of 2008 regarding the Government Internal Control System, stating that government internal control system is organized internal control system as a whole in the central government and local governments. While internal control is the whole process of audit activities, the Review, evaluation, monitoring, and other monitoring activities towards the implementation of the tasks and functions of the organization in order to provide reasonable assurance that the activities have been carried out in accordance with the benchmarks that have been established to effectively and efficiently for the benefit of the leadership in realizing good governance. Officers who perform internal oversight of government are (1) Financial and Development Supervisory Agency is the internal control official government directly responsible to the president, (2) the Inspector General or any other name that is functionally implement internal control is the internal control official government directly responsible to the minister/head of the institution, (3) Provincial Inspectorate is the internal control of government officials who are directly responsible to the governor, and (4) Inspectorate Regency/City is the internal control official of the government who is directly responsible to the regent/mayor. Government internal control system aims to provide reasonable assurance for the achievement of the effectiveness and efficiency of achievement of the objectives of the state government, the reliability of financial reporting, security of state assets, and compliance with laws and regulations. Government internal control system consists of elements (a) control environment, (b) risk assessment, (c) control activities, (d) information and communication, and (e) monitoring of internal control. Application of government internal control system element implemented together and become an integral part of the activities of Government Agencies. Integrated framework of internal control can be seen in Figure 1.

Internal control of the central government and local governments is designed by referring to Government Regulation number 30 of 2008 on government internal control system. Government internal control system has a function to provide reasonable assurance for the achievement of effectiveness and efficiency in the accounting

process, especially in creating the reliability of financial statements. So that the implementation of the internal control system capable of improving reliability, objectivity of information and prevent inconsistencies and facilitate the process of auditing the financial statements. This is in line with research Indriasari (2008) and Hamdani (2011) who obtained results of the internal control system have a significant effect on the quality of the financial statements. The internal control system is a part of system of accounting information. Accounting information system is guided by rules making up the financial statements so that financial reports produced good quality. Yuliani et al. (2010) found that the use of accounting information systems have a significantly to the quality of financial reporting.



Figure 1 Internal Control — Integrated Framework

Sources: COSO, 2002

Government Internal Control System began to be introduced by the Presidential Decree number 15 Year 1983 on Guidelines for Supervision and Presidential Instruction number 1 of 1989 on Guidelines for Supervision Attached, Ministerial of Employees Empowerment Decree Number 30 Year 1994 regarding Implementation Guidelines Monitoring Fitted renewed by Decision Ministerial of Employees Empowerment number KEP/46/M.PAN/2004, has four objectives: (1) an effective and efficient activity, (2) the financial statements are reliable, (3) securing state assets, and (4) adherence against the legislation. Government Internal Control System is an evaluation of Supervision Attached which has eight elements, namely organizing, personnel, policies, plans, procedures, record keeping, reporting, and the Review intern. Furthermore, on August 28, 2008 Government Regulation number 60 of 2008 regarding the Government Internal Control System which is an adaptation of COSO. Elements of Government Internal Control System are the control environment, risk assessment, control activities, information and communication, and monitoring internal control. Government Regulation number 60 of 2008 is a further elaboration of Article 55 paragraph 4 and Article 58 paragraph 1 and 2 of Law number 1 of 2004 on State Treasury.

Pursuant to Article 59 Paragraph 2 of Government Regulation number 60 of 2008, Financial and Development Supervisory Agency expressed as a builder organizing Government Internal Control System has the obligation prepare technical guidelines for the implementation of Government Internal Control System, socialize, conduct education and training, coaching and consultancy Government Internal Control System, as well as to increase the competence of auditors internal control apparatus government. Government Internal Control System government designed to improve the quality of information that will be produced by the government. With the quality of the information presented Accountability will improve the government's performance. Nuryanto and Nunuy (2013) found that the internal control system of government does not have a significant effect on the

quality of the financial statements. It is clear that the weakness of the internal control system of government in an effort to improve the quality of government financial reports. Meanwhile Kurrohman and Regina (2012) found that the professionalism and knowledge of the internal control of government forces positive and significant impact on the quality of local government financial statements. Mahaputra and I Wayan (2014) stated that the government's system of internal control and significant positive effect on the quality of government financial reports. Furthermore Setiawati and Shinta (2014), Susilawati and Dwi (2014) found that the government's internal control positive and significant impact on the financial statements regions. Other research Sadeli (2008) explains that the professionalism of internal functional control apparatus affects the financial accountability of local governments. Widyaningsih et al. (2011) found that the effectiveness of internal control significant effect on the quality of financial accountability. Results of this study indicate that good internal control within a local government will improve the quality of financial management activities and finally increase local governments' financial statements (financial management accountability).

Internal control weaknesses in government have resulted in many leaks in the shopping harm the state. A survey conducted in 2013 by one of the institution that is internationally transparency.org, an independent body of 146 countries, 10 countries recorded the data is expressed as the most corrupt country in the world, namely (1) Azerbaijan, (2) Bangladesh, (3) Bolivia, (4) Cameroon, (5) Indonesia, (6) Iraq, (7) Kenya, (8) Nigeria, (9) Pakistan, and (10) Russia. From this list of Indonesia is ranked 5th most corrupt country in the world, but at the level of Asia Pacific, Indonesia is the most corrupt country. Here are 5 of the most corrupt countries in the Asia-Pacific region, namely (1) Indonesia, (2) Cambodia (3) Vietnam, (4) Philippines, and (5) India.

2.3 Accounting Information Systems and Financial Statements Quality

Finance Minister issued Decree number 355/KMK.07/2002 which forms the Working Group with members consisting of the Ministry of Finance, Ministry of Home Affairs and the Financial and Development Supervisory Agency. The Working Group has produced a draft of standards and guidelines for financial accounting system which has been launched in August 2001 and the First Revised Handbook local financial accounting system in January 2002. Then in June 2002, the Minister of the Interior has also issued a Decree of the Ministry Home Affairs number 29 of 2002 Date of June 10, 2002 on Guidelines for Management, Accountability and Oversight Regional Finance and Budgetary Procedures Revenue and Expenditure, Financial Governance Implementation of Regional and Calculation Budget Preparation and Expenditure. Guided by the Decree of the Minister of the Interior number 29/2002 and Local financial accounting system Handbook Working Group results of the Minister of Finance Decree number 355 On June 5, 2001 is to respond to the vacuum of standards required by the local government, in the framework of the preparation of the financial statements as required by government regulation number 105 of 2000.

Implementation of Law number 33 of 2004 on Financial Balance between Central and Local Government mandates the support of the Regional Financial Information System to support the formulation of national fiscal policy and increase transparency and accountability in the implementation of decentralization. Accounting information systems in local government, better known by the name of regional financial information system. This system is a system that documents, administer and process data of financial management as well as other relevant data into information that is presented to the public and as a decision-making in the framework of the planning, execution and reporting accountability of local government (Government Regulation number 65 of 2010). In order to realize the area of financial management practices are fast, precise, and accurate, Financial and Development Supervisory Agency has developed a computer application system that can process data of financial transactions

into the financial statements that can be utilized at any time, namely the Regional Management Information Systeman application-based system technology which was developed to support the achievement of accountability for local governments at both the reporting entity or the entity-level accounting. This application is expected to help local governments in the preparation of planning and budgeting, as well as the implementation and stylist-company budget and budget accountability¹.

According to Government Regulation number 65 of 2010 states that regional financial information system benefits or ease in data processing of financial management and other relevant data into information that is presented to the public and as a basis for decision making in the context of planning, execution, and reporting of local government accountability. This is in line with research Miftahul (2011) who found that regional financial information system has significant effect on the quality of local government financial reports. Thus regional financial information system utilization in the process of preparation of the financial statements will be able to improve the quality of information in the financial statements. The area of financial accounting information system is a system designed by the local government in helping to organize the financial activities in the area concerned. Some basic laws that underlie the development of the Regional Financial Information System, namely (1) of Law number 17 of 2003 on State Finance (State Gazette of the Republic of Indonesia of 2003 number 47, State Gazette of the Republic of Indonesia Number 4286), (2) Law number 1 of 2004 on State Treasury (State Gazette of the Republic of Indonesia of 2004 number 5, Supplement to State Gazette of the Republic of Indonesia Number 4355), (3) Act number 15 of 2004 on the Management and Financial Responsibility (State Gazette of the Republic of Indonesia of 2004 number 66, State Gazette of the Republic of Indonesia number 4400), (4) Government Regulation number 71 of 2010 concerning Governmental Accounting Standards (State Gazette of the Republic of Indonesia of 2005 number 49, Supplement to State Gazette of the Republic of Indonesia number 4503), (5) Government Regulation number 58 of 2005 on Regional Financial Management (State Gazette of the Republic of Indonesia of 2005 number 140, Supplement to State Gazette of the Republic of Indonesia number 4578), (6) of Government Regulation number 8 of 2006 on Financial Statements and Performance of Government Agencies (State Gazette of the Republic of Indonesia of 2006 number 25, Supplement to State Gazette of the Republic of Indonesia Number 4614), (7) Regulation of the Minister of Home Affairs number 13 of 2006 regarding Guidelines for Financial Management and (8) of the Regulation of the Minister of Home Affairs number 59 of 2007 concerning Amendment to the Regulation of the Minister of the Interior number 13 of 2006 on Guidelines for Financial Management.

On the inside of the explanation of Government Regulation number 58 of 2005 (updated to Government Regulation number 65 of 2010 on Regional Financial Information System) stated that for the creation of the implementation of the development process in line with the principles of good governance, and the Central Government Local governments are obliged to develop and exploit advances in information technology to improve the financial management capabilities, and distribute financial information to the public service as a form of accountability for the activities conducted by the government, given that over the years the volume of financial transactions the government shows that the larger the quantity, the more complicated and complex. To the Central Government and Local Government can utilize and leverage advances in information technology, so that the financial statements produced by the local government can meet the criteria required information value. The area of financial accounting information system is a system of grouping, recording, and processing of financial

¹ <http://www.bpkp.go.id>.

activities of local governments into a financial statement as information that can be used by certain parties in decision-making. With advances in information technology evolving so rapidly and the potential for widespread utilization, the management of, and access to financial information areas can be performed more quickly and accurately.

Financial accounting information systems area in principle is a rule that must be followed in the preparation of the financial statements of local government. Rules could include accounting standards, other regulations issued by relevant agencies as well as the software that was created to assist in the preparation of financial statements. Good running of Regions Financial Accounting Information System will produce good financial statements, thereby increasing the accountability of the financial performance of local governments. Mahaputra and I Wayan (2014) are using two indicators related to the accounting information system of local government is the utilization of regional financial information system and the implementation of government accounting standards. The results showed that both variables to describe the area of financial accounting information systems positive and significant impact on the financial statements. Setiawati and Shinta (2014) uses an understanding of accounting as a variable to explain the areas of financial accounting information system and found that understanding of accounting by authorities who manage the finances positive and significant impact on the quality of the financial statements. Hanafi (2013) also found the same thing which the accounting internal control in local government and significant positive effect on the reliability of the value of accounting information. Furthermore Widyaningsih et al. (2011) states that the effectiveness of local financial accounting systems have a significant effect on the quality of financial accountability. But on the other hand Susilawati research and Dwi (2014) found that government accounting standards but not significant positive effect on the quality of the financial statements. This shows that government accounting standards is a standard reference in the preparation of the financial statements becomes a necessity so that a change in this standard did not significantly affect the quality of financial reporting. The change is necessary because the times and the changes concerning additional rules do not change in total.

3. Conclusion

Financial statements have been prepared by each local government. This statement is accountable local leaders in the area of financial management. The financial statements were prepared to be audited by independent parties such as Supreme Audit Institutions. Opinion issued by the Supreme Audit Institutions on the financial statements of local governments is one of the indicators used in assessing the quality of local government financial reports. If the Supreme Audit Institutions issued an unqualified opinion means the local government's financial statements have been presented fairly in accordance with accounting principles generally accepted, the use of methods have been applied consistently and auditors in performing their duties independently.

The quality of the local government's financial statements will be affected by regional heads commitment to follow up all the findings related to the presentation of the financial statements in the previous year and an increase competence of human resources related to financial management, internal control system designed by the local government and the governmental accounting standards own. The high commitment of the head region, the more good internal control system of government and the improving government accounting standards, the financial statements of local governments will also be good.

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