“Disclosure level of local government’s financial statements in Indonesia: Role of the internal control system”

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Abstract
This study was conducted to examine the factors affecting the level of disclosure of local government financial statements. The study uses the internal control system as a moderating variable. Local government financial reports in Indonesia were the subject of this study’s audit by the Supreme Audit Agency. The number of research samples used was 487 local/city governments in Indonesia for the 2021 period with purposive sampling as a sampling technique. In this study, the Structural Equation Model-Partial Least Square (SEM-PLS) Version 3 data analysis method was employed. Based on the test results, it was found that local government budget expenditures (β = 0.263; p < 0.05) have a significant effect on the level of financial statement disclosure. Meanwhile, financial condition (β = 0.173; p > 0.05) has no significant effect on the level of financial statement disclosures. The internal control system as a moderating variable can moderate the influence of local government budget expenditure (β = 0.263; p < 0.05) on the level of disclosure of financial statements, but cannot moderate the effect of financial condition (β = –0.073; p > 0.05) on the level of disclosure of financial statements. Local governments in Indonesia are expected to be able to further optimize disclosure in accordance with Government Regulations in the future. One of the approaches used by regional governments to execute financial report transparency is the use of information technology to satisfy social expectations more effectively and efficiently.

INTRODUCTION
Mandatory disclosures are disclosures that must be made in accordance with established regulations. Government Accounting Standard (GAS) includes mandatory disclosures with the intention of fostering accountability and openness. The resulting financial reports must therefore adhere to the most recent GAS, specifically PP No. 71 of 2010 (Aswar et al., 2021). There are still a lot of concerns with the degree of government disclosure that do not adhere to the rules or standards that are in place. The 2021 Supreme Audit Board (BPK) Semester Examination Results Summary (IHPS) I, in which the BPK identified 11,622 issues, lends credence to this assertion. This statistic consists of 5,367 (46%) issues with a deficient internal control system and 6,295 (54%) issues with non-compliance with legislative provisions (BPK, 2021). These findings, according to BPK, indicate that some local government financial statements (LKPD) are still not being provided in conformity with rules and guidelines.

Additionally, the 2021 IHPS I reveals that out of the 541 LKPD in 2020, 55 out of those in the first semester of 2021 still have not received un-
qualified opinion, including 25 local governments regarding current assets, 31 local governments regarding fixed assets, 16 local governments regarding other assets, 19 local governments regarding operational spending, and 20 local governments regarding capital spending. Due to a lack of data support, there are still a number of accounts in the financial statements that contravene GAS standards.

As in the study by Aswar et al. (2021), which reveals that the average level of disclosure of district/city government LKPD in Indonesia is only approximately 82.4%, the issue of LKPD disclosure has been the subject of a great deal of prior research. The average district/city LKPD disclosure in Sumatra was then just 84.2% (Hariyani et al. 2022). Another study that supports LKPD disclosure is that of Marsella and Aswar (2019), who found that Sumatra Island has an average LKPD disclosure level of 82.7%. Based on the previous description, which examined the disclosure level, it can be concluded that the local government in Indonesia has not fully implemented LKPD disclosure in accordance with Government Regulation No. 71 of 2010. As a result, Indonesia offers a distinctive research environment for examining financial statement disclosures in developing nations.

1. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Disclosure is defined as providing the public using financial statements with complete information that can be taken into account (Permendagri No. 64, 2013). According to Chen et al. (2016), the general public and stakeholders can evaluate how the government allocates its resources, watch how it behaves, and understand dynamic macro policies and standards through financial disclosure. According to Handoko et al. (2018), the disclosure of the LKPD is divided into two categories: mandatory disclosures and voluntary disclosures. This is done in compliance with Law No. 17 of 2003, which stipulates that every government agency must compile and report its finances (PP No. 71, 2010).

There are various ways to measure local government financial report disclosures. Lesmana (2010) employs a score technique based on the GAS mandated disclosure criteria of 46 items to gauge LKPD disclosures that are required by law. In a separate study, Hardiningsih et al. (2019) looked into LKPD disclosures utilizing a total of 53 disclosure items, or 46 disclosure items in accordance with the Government Accounting Standards Guidelines (GASG) numbers 5 to 9. They also used 7 mandatory disclosure items in CALK. Furthermore, Ryan et al. (2002) employed two key techniques: text analysis and the LGA Index as a gauge of disclosure. In assessing LKPD disclosure with the GCI (Government Compliance Index), Aswar et al. (2022) used contrasting LKPD disclosure and a total of 50 items reported. The checklist receives a “1” if a disclosure has been made, and a “0” if it has not.

The majority of the cost of financing regional government is borne by regional revenue and expenditure budgets. Within the framework of the organizational system, local governments are granted the authority to control natural resources and collect taxes. As shown by regional revenues representing their initial capabilities, the majority of areas are only able to collect up to 15% of the APBD value for regional revenues and expenditures (Putri et al. 2020). As a result, in the administration of regional government, the budget refers to the regional budget, which includes all the plans and actions carried out criteria for operational evaluation are issued by the regional administration once a fiscal year in accordance with governmental laws and regulations.

The regional budget is comprised of operational spending, capital spending, unforeseen spending, and transfer spending (Permendagri No. 13, 2006). In order to fulfill the principles, needs, and capacities of the region as well as the community goals outlined in the APBD, regional governments can use their financial resources to allocate monies in accordance with regional expenditures. The local government (agent) has a responsibility to the community (principal) to provide the community with high-quality public services via the APBN because the community has donated a portion of their source of revenue to the regional government.
According to Arifin (2020), LKPD disclosure is significantly positively impacted by the regional government management budget. Aswar et. (2021) showed that local government management budgets have a detrimental impact on LKPD transparency. More local government budget expenditures may lead to less effective public service delivery and less encouragement for the government to publish information in the LKPD, it is thought. However, Kiswanto et al. (2020) found that the capital expenditure has a favorable impact on LKPD disclosure.

The financial condition of the company reveals a lot about its health. Following the creation of the financial statements utilizing the relevant data, the financial status will be displayed. The capacity of local governments to fulfill their duties and offer services to the general public, be ready for unforeseen occurrences, and effectively and efficiently manage their resources is determined by their financial situation (Ritonga et al., 2012). The regional financial condition will be in better shape the more probable it is that the local government would release financial reports. The financial standing of the business can be determined by calculating the quantity of assets (wealth), liabilities (debt), and capital (equity) in the financial statements. This factor is used to assess how well a company is performing (Hariyani et al., 2022). In light of this, it can be claimed that the local government’s performance can be summarized by its financial situation, and that this situation may be advantageous to a number of parties that are in need. According to Giroux and McLelland (2003) and Giroux and Deis (1993), measures of financial sustainability or capacity to deliver services in the future have been proven to have a significant association.

To assess their performance, local governments must make their financial reports public. In particular, in relation to the financing of services and government initiatives, users of financial reports want to know how government monies are spent (Styles & Tennyson, 2007). Styles and Tennyson (2007) examined financial conditions by the primary government’s unconstrained net asset ratio to total spending in earlier study on financial conditions. Giroux and McLelland (2003), Hariyani et al. (2022), Marsella and Aswar (2019), and all utilize the ratio of total debt as a measure of financial health. According to Putri et al. (2022), financial health is determined by dividing total income by total spending. Study by Marsella and Aswar (2019), local governments in sound financial standing will boost financial report disclosure. Financial circumstances appear to positively affect LKPD disclosure, according to study by Hariyani et al. (2022) and Marsella and Aswar (2019).

The internal control system (ICS) – a set of practices used to provide a reasonable level of assurance about the objectives to be attained in terms of the effectiveness and appropriateness of business operations, the accuracy of financial reporting, and compliance with laws and regulations – is frequently influenced by the board of commissioners, management, and other members, corresponding rules (COSO, 1992). ICS is a crucial component of all continuing efforts made by managers and staff to ensure that organizational goals will be met through effective and efficient operations, accurate financial reporting, the protection of state assets, and adherence to laws and regulations. rules (PP No. 60, 2008). The purpose of the internal control system is to provide a reasonable amount of assurance that the financial reporting is accurate.

The degree to which the current ICS ensures sufficient security is described in an internal control system evaluation report. If the system has weaknesses, the information in financial reports might not be accurate (Handoko et al., 2019). The internal control system in local government can be utilized as a tool to prevent fraud or even misappropriation, as well as to give guidance and oversee the use of public funds (Muthaher, 2019). Yosefrinaldi (2008) claims that both the federal government and local governments are involved in overseeing the ICS. A reasonable level of assurance regarding the accuracy of financial reporting is provided by the internal control system. ICS evaluation report details how well this assurance is provided by the current internal control system.

In addition, a robust internal control system can additionally help local government finances by lowering budget savings. Pujiono et al. (2016) demonstrate that enhancing regional financial management necessitates an internal control system that is consistent with the objective of ad-
vancing regional development. Furthermore, the government will not have a lot of trustworthy information to reveal in its financial reports if the current internal control system is unable to do so. A weak internal control structure will therefore prohibit the government from making more extensive disclosures. According to Prismanisa and Sofriyeni (2019), the effect of regional independence on the disclosure level of LKPD can be mitigated by internal control systems.

This study aims to determine whether budget expenditure and financial condition have an impact on the disclosure level in Indonesian local government while using internal control as a moderating factor. The following are the hypotheses for this study, which can be established based on variables that are anticipated to have an effect on the disclosure level for local governments:

H1: Budget spending positively and significantly affects the disclosure level.

H2: Financial condition positively and significantly affects the disclosure level.

H3: The relationship between budget expenditure and disclosure level is moderated by internal control systems.

H4: The relationship between financial condition and disclosure level is moderated by internal control.

2. METHODOLOGY

A fascinating group of people, occasions, or circumstances that the researcher wishes to investigate dominate the population (Sekaran & Bougie, 2016). The portion of the population that will be utilized as the sample is taken as a whole. The local government financial reports that the BPK reviewed in Indonesian provinces and cities in 2020 make up the population of this study. Regarding the degree of LKPD disclosure, the 2021 district/city LKPD in Indonesia that BPK examined was chosen as the sample. Purposive sampling is used in this study’s sample process. The research samples that were obtained based on predetermined criteria are as follows (see Table 1).

The study’s dependent variable is the level of financial report disclosure by local governments (LKPD). LKPD must essentially be disclosed in accordance with the Indonesian GAS in force. According to research by Aswar et al. (2022), which disclosed 50 disclosure items based on PP No. 71 of 2010, measurements conducted by researchers utilizing GCI were adopted.

The regional government budget expenditure is an agreed-upon financial work schedule that specifies the maximum amount that can be used to finance future public interests. In addition to an estimated income that is expected to be received in a certain amount from other parties in a certain period (Kusuma et al., 2021). Utilizing the Arifin (2020) measurement metrics, namely the overall budget for local government.

The capacity of local governments to meet their obligations is a measure of their financial health, provision of services to the general public, readiness for unforeseen events, and effective and efficient management of their resources (Ritonga, 2014). Employing the total debt ratio, which was used as a measurement indicator by Hariyani et al. (2022). Lastly, internal control system using the measuring indicators developed by Prismanisa and Sofriyeni (2019), namely by counting the instances of internal control system flaws on LKPD that BPK reported.

3. EMPIRICAL RESULTS AND DISCUSSION

Descriptive statistical analysis is a common technique for analyzing or describing data acquired in detail. Among the variables in this study for which the descriptive statistics produced the minimum, maximum, mean, and standard deviation values were the disclosure level, budget expendi-

<table>
<thead>
<tr>
<th>Description</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesian Regency/Municipal LKPDs that the 2021 BPK has audited</td>
<td>541</td>
</tr>
<tr>
<td>Provinces will make up the LKPD in 2021. (34)</td>
<td></td>
</tr>
<tr>
<td>Samples taken before removing outliers</td>
<td>507</td>
</tr>
<tr>
<td>samples subject to outliers</td>
<td>(20)</td>
</tr>
<tr>
<td>Final sample</td>
<td>487</td>
</tr>
</tbody>
</table>
ture, financial condition, and internal control system. The standard deviation shows how much the data values range from the average outcome. The data will be heterogeneous if the standard deviation exceeds the mean value. In the opposite case, homogenous data exist when the standard deviation value is less than the mean value (Sekaran & Bougie, 2016). The data that have been gathered for each variable in this study are presented in the following table as descriptive statistics:

Table 2. Descriptive statistics

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>DISC</td>
<td>487</td>
<td>0.84</td>
<td>0.77</td>
<td>0.792</td>
<td>0.023</td>
</tr>
<tr>
<td>BE</td>
<td>487</td>
<td>27.412</td>
<td>28.738</td>
<td>27.933</td>
<td>0.651</td>
</tr>
<tr>
<td>FC</td>
<td>487</td>
<td>0.000</td>
<td>0.231</td>
<td>0.044</td>
<td>0.017</td>
</tr>
<tr>
<td>ICS</td>
<td>487</td>
<td>3.000</td>
<td>25.000</td>
<td>13.142</td>
<td>4.774</td>
</tr>
</tbody>
</table>

The dependent variable in this study is DISC, which stands for the degree of LKPD disclosure. 50 items totaling the LKPD disclosure level (DISC) are measured; these items are broken down into many groups, including financial performance, macroeconomics, accounting principles, municipal budget goals, financial statement elements, and non-financial data (Marsella & Aswar, 2019). The mean result is 0.792, which is higher than the standard deviation value, which is 0.792 > 0.015, according to Table 3 above. This indicates that Indonesia’s district/city local administrations have made the LKPD disclosure required by Government Regulation Number 71 of 2010 available.

T-tests are used for hypothesis testing, with the goal of demonstrating the extent to which the local government budget expenditure and financial condition influence the dependent variable – the level of LKPD disclosure – while using the internal control system as a moderating factor. In this t-test, 0.05 is used as the level of confidence for making decisions. If the significance threshold is less than 0.05 and t-count > t-table, the independent variable partially affects the dependent variable. According to Degree of Freedom (DF) = n-k, where DF = 487 - 3 = 484 and a degree of confidence of 5%, or 0.05 in decimal, the t table value in this study is known to be 1.96506.

Based on the results of hypothesis testing in Table 3, it may be claimed that the amount of LKPD disclosure is significantly influenced by budget expenditure, or H1 is accepted.

Financial position does not have a substantial impact on the level of LKPD disclosure. Thus, H2 is disapproved. Furthermore, H3 is approved since the LKPD disclosure level and budget expenditure can be moderated by the ICS. The relationship between the financial situation and the level of LKPD disclosure cannot be moderated by internal control systems. Thus, H4 is disapproved.

According to the findings of this investigation, the value was 3.578 > 1,965 with a significance number of 0.000 < 0.050. The findings support H1, which states that the degree of LKPD disclosure is negatively associated to the regional government management budget and has a significant impact. As a result, a large government management budget will also result in a higher degree of LKPD disclosure. When it comes to financial information disclosure, specifically the disclosure of LKPD because it relates to the financial openness and accountability of local government to the community, the higher the regional government management budget can demonstrate that the local government can offer quality services to the community (Arifin, 2020).

The study’s results support the institutional hypothesis, which asserts that by demonstrating their capability to responsibly manage their finances and give information transparency through the publication of the LKPD, local governments can gain the trust of the general public, the federal government, and other organizations. This is due
to the community giving up a portion of their revenue to the local government to cover expenses. As a result, a large regional government management budget needs to be accompanied by stronger community services from the local government as well as more government encouragement for information disclosure in LKPD. Yet, because there is a negative correlation, the degree of LKPD disclosure decreases as the local government management budget increases. The findings are in line with Arifin (2020) on 156 Indonesian local governments. This is because high local government management budgets can enable the government to provide more and more public services. well enough to influence the level of LKPD disclosure.

The results demonstrate that the disclosure level of LKPD is not significantly influenced by financial condition (H2). The findings of this study showed that the value was 0.276 < 1.965, the significance level was 0.483 > 0.050. Where this suggests that financial conditions should not be used as a reference for local governments to release information on local government financial reports (Nurhidayati & Rahayu, 2020). Hence, if there is a lack of understanding of the significance of financial information openness, local governments with sound financial situations will not be driven to report LKPD. According to agency theory, the local government’s financial situation can help those who are in need by showing how well it is performing overall. As agents, local governments are required to make their financial reports public in order to be evaluated. Yet, if there is still a lack of public understanding of the value of financial information openness, local governments with sound financial standing will not be encouraged to reveal LKPD for the purpose of creating information asymmetry with the general population.

This study is consistent with those of Hariyani et al. (2022), who used 151 financial reports from local governments in Sumatra in 2021; Marsella and Aswar (2019), who used 151 financial reports from local governments in Sumatra; and Styles and Tennyson (2007), who used 300 middle financial reports from the US. These three studies demonstrate a strong correlation between financial health and the disclosure level of LKPD. However, these findings are in line with a study by Putri et al. (2022) on 68 provincial LKPDs in Indonesia in 2019–2020, which found that strong financial conditions could not be used as a benchmark for the government to disclose LKPDs, therefore they did not significantly alter the level of LKPD disclosures.

The result of H3 revealed the ICS capacity to modify the relationship between budget expenditure and the disclosure level of LKPD. The findings of this investigation showed that the value was 3.402 > 1.965, the significance level was 0.000 < 0.050. This suggests that the budget can be managed effectively and in accordance with legal standards if the ICS is correctly implemented by the government. The internal control system is a technique used to provide a level of confidence over the attainment of organizational goals through effective and efficient operations, according to agency theory. This study is consistent with that of Pujiono et al. (2016), which found that internal control systems must be in line with the objectives of furthering regional development in order to improve regional financial management. To save money and improve the effectiveness of financial management, the ICS must be implemented correctly and thoroughly.

These findings of H4, that the ICS cannot manage the relationship between financial situations and the level of LKPD disclosure. With a significance level of 0.142 > 0.050 and the study’s findings showed that the value was 1,564 < 1,965 in this instance. This suggests that an effective internal control system has no impact on a local government’s financial health and does not likewise influence on the disclosure level of LKPD. According to agency theory, a key element in boosting local government performance effectiveness is the internal control system. To produce high-quality financial reports that adhere to standards and show accountability to the general public, the government, acting as an agent, must put in place an effective internal control system. This study’s findings concur with those of Prismanisa and Sofriyeni (2019), who found that the internal control system had no bearing on the amount of information on LKPD that was released in Sumatra. However, they are different from Kewo and Afiah (2017), who found that ICS structure affects the amount of LKPD disclosure. Hence, a sound ICS does not mitigate how much LKPD disclosure is impacted by financial conditions.
CONCLUSION AND RECOMMENDATIONS

The purpose of this study was to examine the factors influencing the level of disclosure given to local governments, with internal control acting as a moderator, as shown by the Government Accounting Standard Compliance Index 71 of 2010. Based on the findings of the study, the conclusion is that budgetary spending has a significant impact on the disclosure level of LKPD. This demonstrates that the better the services offered by the local government to the community and the greater the government’s motivation to publish LKPD, the larger the regional government management budget must be. Financial condition has no impact on the level of LKPD disclosure. This shows that local governments cannot implement the disclosure of information in local government financial reports using the financial situation as a guide.

The relationship between budget expenditure and disclosure level is moderated by ICS. This shows that the budget can be managed effectively and in compliance with legal standards, provided that the internal control system is correctly implemented by the government to increase the internal control system’s ability to affect the degree of LKPD disclosure with local government management budgets. Meanwhile, the relationship between financial condition and disclosure level of LKPD cannot be moderated by ICS. This shows that it is impossible to determine the financial health of the local government by using the ICS as a yardstick.

According to Government Regulation Number 71 of 2010, it is believed that local governments in Indonesia would eventually be able to further optimize their disclosures. To meet social expectations more effectively and efficiently, regional governments use information technology as one technique of doing financial statement disclosures. It is advised to extend the research term in order to conduct more studies. Then, other variables, including regional income, government size, the number of regional apparatus operating units, and legislative size, are anticipated to be used for further research.

AUTHOR CONTRIBUTIONS

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Supervision: Rheny Afriana Hanif.
Validation: Rheny Afriana Hanif, Sem Paulus Silalahi, Supriono Supriono, Eka Hariyani, Meilda Wiguna.
Visualization: Sem Paulus Silalahi.
Writing – original draft: Rheny Afriana Hanif, Supriono Supriono.
Writing – review & editing: Sem Paulus Silalahi, Eka Hariyani, Meilda Wiguna.

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