“Determinant factors on the disclosure level of local government’s financial statements in Indonesia”

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DETERMINANT FACTORS ON THE DISCLOSURE LEVEL OF LOCAL GOVERNMENT'S FINANCIAL STATEMENTS IN INDONESIA

Abstract

Financial reports are required from both the federal and municipal governments to demonstrate and improve governance and raise openness and accountability of government financial management. This study aims to determine how much mandatory disclosure in local government financial reports can be increased by adding variables such as the number of members in the legislative body, debt, and population, as well as a control variable – the age of the municipal authorities. The population of this study comprised all Local Government Financial Statements (LGFS) in Indonesia and the Supreme Audit Agency's financial statement auditing requirements as of 2018. The paper adopted a purposive sample technique; 248 local governments in Indonesia were sampled. This study tested hypotheses using multiple regression analysis with the SPSS Version 25 application. The findings show that the number of members in the legislative body, debt, and total population do not affect the level of LGFS disclosure; however, the level of welfare does. This study should provide information that can help increase LGFS disclosure in a way that is valuable for local governments. Utilization of information technology in meeting social demands more efficiently and effectively is one of the strategies for local governments in carrying out financial statement disclosures.

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INTRODUCTION

According to Government Regulation Number 71 as of 2010, financial reporting aims to give information that can be used to make decisions. SAP is a tool that helps local governments create financial reports that comply with the law. However, this does not fully guarantee that local governments will provide complete information in the LGFS. Furthermore, when compared to private enterprises, the number of research on government financial reporting in terms of disclosure of financial statement (FS) disclosure is still limited.

The results of 397 regional government examinations in the Republic of Indonesia are included in the BPK's Summary of Semester Examination Results II of 2019. Regional Public Service Bodies and Regional Owned Enterprises were examination objects. The results include 238 performance test results and 159 test results for special objectives. The average LGFS disclosure rate in Sumatra is 82.7 percent, according to Marsella and Aswar (2019). From this explanation, it may be stated that the level of LGFS disclosure continues to produce a wide range of ratios.

Furthermore, BPK also provided data on the number of problems in LKPD in 2018. According to the data, LKPD 2018 had a total of 12,117 issues. Compliance issues accounted for 6,259 cases, while internal control system faults accounted for 5,858. In this context, Indonesia provides a unique research setting for studying financial statement disclosures in developing countries. Members of the legislative body, debt, population, and level of welfare are said to have a significant impact on the practice of disclosing financial statements in local governments.

1. LITERATURE REVIEW

An agreement in which one or more people (principal) give orders to others (agent) to provide a service to the principal and give sovereignty to the agent to form the best decision for the agent is called aggression theory (Jensen & Meckling, 1976). The interests of each party (principal and agent) push against each other in agency theory, causing discrepancies in interests between the two parties. According to agency theory, the principal and agent agree that the principal delegated sovereignty to the agent. The principle and the agent agree that the principal entrusts a task to the agent. According to Tricker (1984), agency theory believes that agents are not reliable in making the best decisions for the principal. Kotler and Keller (2000) assert that agency theory can be applied in public institutions based on relationships between the principal and the agent. In agency theory, there are three parties involved in the public sector: the BPK acts as the auditor, the principal is the people represented by the legislative body (DPRD), and the government is the agent. In this case, LGs can act in their own interests rather than in the interests of society.

According to PP No. 71 as of 2010, financial statements are formed to provide related data and transactions within one reporting period. In addition, the disclosure of financial statements in general aims to convey necessary data to achieve the objectives of delivering financial statements and provide services to a number of parties related to the company. Financial reporting is carried out for several purposes, namely accountability, management, transparency, and balance between generations.

Based on research results regarding the measurement of LGFS disclosure levels, such as the study by Bakar (2013), it was discovered that the average disclosure of the financial statements under investigation is 45.9%. Aljifri et al. (2014) investigated disclosure using measurements based on the 317 disclosure items in the International Financial Reporting Standards and items mandated by authorities in the United Arab Emirates. Arifin (2014) also incorporates IGAS PP No. 24 as of 2005. Therefore, there are 57 items in this list that have been corrected. Furthermore, Dewata et al. (2018) based their calculations on Government Regulation No. 71 as of 2010 on SAP, containing 53 elements. Apart from that, Nor et al. (2019) used a binary or dichotomy variable to quantify online disclosure, similar to Verawaty (2015), with 0 for 'unreported' and 1 for 'reported'. Meanwhile, Murdayanti et al. (2014) also employed SAP Regulation No. 24 as of 2005 item indicators in their measurements. Finally, Marsella and Aswar (2019) used the government compliance index to measure the level of disclosure using 50 elements.

A legislative body is an advisory body that is typically elected or authorized to create by popular vote, alter, or abrogate laws enacted by the state or an arm of government with legislative authority (Nurlianto & Aswar, 2020). According to Stigler (1976), the status of members of the legislative assembly can also be said to be individuals who represent the interests of voters and their political parties. Nurlianto and Aswar (2020) conducted research in Java and Sumatra on several components that affect the disclosure level of local governments. The data demonstrate a positive and substantial relationship between the number of legislators and the level of disclosure. Therefore, supervision of local government will increase if there are more legislative members in an area.

The number of members in the legislative body is measured by the number of DPRD members in Indonesia. Zimmerman (1977) shows an *agency problem* in the context of governance, namely problems that occur between local government *(agent)* and society *(principal)*. A difficulty that arises in the public sector is the availability of

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asymmetric information between local governments (agents) with more robust data than the community (principal). Laupe et al. (2018) and Arifin et al. (2015) discovered that the number of legislators who made LGFS disclosures had a beneficial impact. Suhardjanto and Yulianingtyas (2011) found a strong and positive relationship between the number of DPRD members and the level of disclosure.

Debt is an obligation or responsibility to provide financial resources to third parties, demonstrating the government's relationship with third parties (Suwardjono, 2006). The higher the debt, the greater the management responsibility. In the end, the local government will be required to provide better quality disclosure of financial statements (Arifin, 2018). Therefore, to eliminate the suspicion of creditors, local governments usually provide complete information in their financial statements. Patrick (2007) states that the debt variable can be measured based on the total debt ratio to total assets assuming that assets are collateral for debt fulfillment. Ahmed (1995) discovered a positive and significant relationship between debt and level of disclosure. Furthermore, Botosan (1997) and Richardson and Welker (2001) discovered a positive and significant relationship between debt and disclosure level.

According to Dewata et al. (2018), the number of residents in a particular location impacts the services offered by the district and city. In agency theory, the local government *(agent)* will submit financial reports to the public *(principal)* as a form of governmental responsibility. The high public demand for districts and cities to improve their services can be caused by the increasing population of an area. As a result of these expectations, the government will be more encouraged to disclose higher-quality FS as a form of transparency and accountability. The existence of a positive correlation, although not significant to the level of disclosure, is important (Ingram, 1984; Robbins & Austin, 1986). Furthermore, Liestiani (2008) found that FS's population and disclosure level have a positive and significant correlation. In addition, Hilmi and Martani (2012) and Hendriyani and Tahar (2015) found a positive and substantial relationship between population and LKPD disclosure level.

The level of community welfare is described by the gross regional domestic product divided by the population. According to Nor et al. (2019), the degree of welfare does not affect the disclosure of LKPD. However, Martani et al. (2014) found that population welfare positively impacts local governments' disclosure level of financial information. Regions that have a high demand for disclosure of information in financial statements usually have a population with a high level of welfare. The community acts as a principal in agency theory, while the local government acts as an agent. The stronger the political examination and oversight by the people of the government, the higher the per capita income, and the greater the desire to offer public information (Styles & Tennyson, 2007). The quality of audits and the financial management of local governments are affected by the level of community income (Giroux & McLelland, 2003). Furthermore, the amount of community welfare has a positive relationship with the level of LKPD disclosure (Nainggolan & Purwanti, 2016).

2. AIM AND HYPOTHESES

The purpose of this study is to examine the impact of the number of legislative body members, debt, population, and level of welfare on the level of LGFS disclosure in the Indonesian local government. The following hypotheses are suggested based on the literature review:

H1: The number of legislative body members positively and significantly affects the level of LGFS disclosure.

H2: Debt positively and significantly affects the level of LGFS disclosure.

H3: The population positively and significantly affects the level of LGFS disclosure.

H4: The level of welfare positively and significantly affects the level of LGFS disclosure.

3. METHODOLOGY

District and local government agencies are the subjects of this study. Therefore, the study object was derived from the research population, which consisted of the district and municipal administrations across Indonesia during the 2018 fiscal year. Table 1 shows the study's final results after carrying out purposive sampling.

Table 1. Research sample criteria

Description	Total
Population	514
Data inaccessibility	(6)
District/city governments that do not have complete data for all research variables for the 2018 fiscal year	(217)
Samples before exposure to outliers	290
Samples affected by outliers	(42)
Total sample	248

The government compliance index cited by Marsella and Aswar (2019) in PP No. 71 as of 2010 comprises 50 components. The indicator used is the total number of things divided by the most suitable components. Each financial report line item will be examined and coded "1" if yes and "0" if not. Following the Minister of Home Affairs Regulation No. 13 as of 2006, the grading system takes the form of a checklist for SAP. The study carefully analyzed LGFS to better understand the nature and complexity of each local government. This paper uses multiple regression analysis methods. There is a dependent variable metric, namely the level of LGFS disclosure, and four independent variables, namely the number of legislative body members, debt, total population, and level of welfare (Table 2).

4. EMPIRICAL RESULTS AND DISCUSSION

The population is filtered using a purposive sampling technique to obtain the study's final sample. After that, data were analyzed using the SPPS program. Table 3 contains the descriptive statistics for the data.

Table 2. Research variables measurement

Variable	Acronym	Measurement	Source
Number of legislative body members	Numpar	Total legislators	Nurlianto and Aswar (2020)
Debt	LnLiab	Ln total debt	Arifin (2018)
Population	LnPop	Ln total population	Dewata et al. (2018)
Welfare level	Welfel	Per capita income	Nor et al. (2019)
Age of municipal authorities	AGE	Age of local authorities according to the law	Dewata et al. (2018)

Table 3. Descriptive statistics

Variable	N	Min	Max	Mean	Std. deviation
GCI	0.05608	.68	.92	.8031	248
AGE	23,116	5	68	37.08	248
LnLiab	18.07524	27.34922	23.64322	1.55842	248
LnPop	9.53271	15.58039	12.48192	.97978	248
Welfel	10294000	457551000	51261620	58574455	248
Numpar	248	20	50	32.83	9611
NValid	248	–			

Based on Table 2, throughout the 2018 fiscal year, this study used a sample of 248 districts and cities in Indonesia. The descriptive statistics illustrate that the score minimum ranges from 0.68 or about 68%, found in Ngada and West Sumba districts. The maximum value ranges from 0.92 or about 92%. In Indonesia, district/city governments LGFS disclose is at a rate of 0.8031 percent on average (approximately 80.31 percent), with a standard deviation of 0.05608 percent (about 5.608 percent). As a result, complete disclosure is necessary since there are no local governments in Indonesia. In previous studies, the level of mandatory disclosure still varies, such as Marsella and Aswar (2019), which is around 82.7%. Thus, the implementation of Government Regulation No.71 as of 2010 affects this study.

The first hypothesis examines the impact of the number of legislative body members on the level of LGFS disclosure. After the statistical test, T-table = 1.969815 and T-count = 1.138, thus T-count < T-table (1.138 < 1.969815) and has a significant level greater than 0.05, which is 0.256. Thus, Ho is accepted, and Ha is rejected.

The influence of debt on the level of LGFS disclosure is demonstrated by testing the second hypothesis. After statistical testing, T-table = 1.969815 and T-count = 0.762, thus T-count < T-table (0.762 < 1.969815) and has a significant level greater than 0.05, namely 0.447, Thus, Ho is accepted, and Ha is rejected.

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Table 4. Regression analysis

Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. error	Beta		
1	(Constant)	.652	.089	–	7.322	.000
	AGE	.000	.000	–.047	–.664	.508
	LnLiab	.002	.002	.048	.762	.447
	LnPop	.006	.009	.099	.661	.510
	Welfel	2.334E-10	.000	.244	3.970	.000
	Numpar	.001	.001	.168	1.138	.256

The effect of population on the level of LGFS disclosure is demonstrated by testing the third hypothesis. After the statistical test, T-table = 1.969815 and T-count = 0.661, thus T-count < T-table (0.661 < 1.969815) and has a significant level greater than 0.05, which is 0.510. Thus, Ho is accepted, and Ha is rejected.

The fourth hypothesis is that the amount of welfare affects the disclosure level of LGFS. After the statistical test, T-table 1= .969815 and T-count = 3.970, thus T-count > T-table (3.970 > 1.969815) and has a significant level less than 0.05, which is 0.000. Thus, Ha is accepted, and Ho is rejected.

The results of the control variable test reveal that the disclosure level of LGFS is affected by the age of the municipal authorities. After the statistical test, T-table = 1.969815 and T-count = –0.664, thus T-count < T-table (–0.664 < 1.969815) and has a significant level greater than 0.05, which is 0.508. Thus, Ho is accepted, and Ha is rejected.

5. DISCUSSION

The number of legislative body members does not affect the level of LGFS disclosure. In addition, the descriptive statistical results show that the number of members in the legislative body has a mean value of 32.83 or greater than the standard deviation value of 9.611, which indicates an unfavorable result. The data used in this study is less varied and cannot describe the actual situation regarding the number of legislative body members. This study is not in line with Suhardjanto and Yulianingtyas (2011), who found that the number of legislative body members affects the LGFS disclosure by examining 100 city financial reports. In addition, they found that local councils have a strategic and potential role in overseeing efficient and transparent financial reporting. Laupe et al. (2018) examined 190 local governments in Indonesia and stated that the number of legislative body members affected the FS disclosure. Gilligan and Matsusaka (2001) researched the state and local fiscal policies in the 20th century. They stated that the number of legislative body members relates to the disclosure of financial statements. It means that with the greater the number of members, it is expected to tighten the financial supervision of local governments where local governments are responsible.

This study is in line with Arifin (2014), who analyzed isomorphism pressures that affect mandatory disclosures in LGFS in Indonesia and did not find a significant relationship with financial statement disclosures. Arifin et al. (2015) examined 40 local governments in Java and 40 local governments outside Java and stated that the number of legislative body members did not affect the disclosure of financial statements. The hypothesis in this study is rejected, indicating that the findings do not support agency theory for various reasons, including the fact that the DPRD, as a representative community institution (principal), has failed to control the government (agent) effectively. In addition, the DRPD, which functions as a channel for public aspirations, is also considered not to be running well so that the submission of financial data reports to local governments has not been adequately disclosed.

Debt has no relationship with the disclosure of LGFS. In addition, the standard deviation value of the debt variable is 1.55842, and the mean is 23.64322, meaning that the data is less varied because the deviation value is smaller than the mean. The findings of this study contradict Ahmed (1995), who discovered a positive and substantial relationship between leverage and

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level of disclosure. Furthermore, Botosan (1997) and Richardson and Welker (2001) also found that debt and disclosure levels are significantly correlated.

Furthermore, the findings of this study contradict Naim and Rakhman (2000), who found that the leverage ratio has a good link with the disclosure of financial statements. This study aligns with Lesmana (2010) and Waliyyani and Mahmud (2015), who pointed out that debt has no significant impact on the LGFS disclosure. This study hypothesis is rejected, indicating that the results are inconsistent with agency theory for whatever reason, namely, high debt does not make the government more accountable to improve the quality of FS disclosure. Furthermore, the presence of debt also does not demand local governments to produce better quality disclosures in financial statements.

Furthermore, the level of LGFS disclosure is unaffected by the population. In addition, the descriptive statistical results show that the population variable has a mean value of 12.48192 or greater than the standard deviation value of 0.97978. It indicates a poor result because the data used in this study is less varied and cannot describe the actual situation related to the population. The results are consistent with a positive association, although it is not significant to the level of disclosure (Robbins & Austin, 1986; Ingram, 1984). Furthermore, Liestiani (2008) found that the population and the disclosure level of financial statements have a positive and significant correlation. In addition, Hilmi and Martani (2012) and Hendriyani and Tahar (2015) reveal a positive and significant correlation between the population and the level of LGFS disclosure.

This study is in line with Naopal et al. (2017), who found that the number of residents did not have a significant relationship with the disclosure level of LGFS. This study hypothesis is rejected, indicating that it is not consistent with agency theory for the following reason. Despite the high value of a district/city area's population, it is not accompanied by a high degree of disclosure. This finding can be due to the absence of pressure from the society to local governments to improve the quality of the disclosure level of LGFS.

The level of welfare affects the level of LGFS disclosure. Nor et al. (2019) found that the amount of welfare did not affect the disclosure of LGFS, which contradicts this finding. This result is consistent with Giroux and McLelland (2003), who revealed that the degree of community income impacted audit quality and LGFS. This study hypothesis is accepted, thus, consistent with agency theory: the more significant the political oversight, the higher the per capita income and oversight by the individuals in charge of the government, and the greater the desire to disclose information to the public. Citizens are encouraged to pay more attention to government administration because of the high level of benefits. As a result, the government is compelled to release more information. In addition, the value of the standard deviation of the number of Regional Governments variable is 23.116, and the mean is 37.08, meaning that the data is less varied because the deviation value is smaller than the mean. Thus, the age of the municipal authorities is not included as a predictor variable for LGFS disclosure level. The findings are inconsistent with the results of a correlation to the level of disclosure (Arifin, 2014).

CONCLUSION

The purpose of this study is to examine of number legislative body, debt, population, and level of welfare on the level of LGFS disclosure in the Indonesian local government. After the analysis and hypothesis testing, the results showed 80.31 percent of the disclosure level of LGFS of Indonesian district/city administrations, which is better than prior studies. Second, the number of members in the legislative body has no substantial impact on the level of LGFS disclosure. According to the findings, the number of members does not ensure a high level of LGFS disclosure. Third, debt has no significant impact on the degree of LGFS disclosure in Indonesia. This finding may be caused by the fact that debt owned by local governments does not put pressure on the government to increase disclosure of FS. Fourth, the size

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of the population does not affect the level of LGFS disclosure. This finding could be due to the fact that the population does not place emphasis on the government, or there is no demand from the population for the quality of LGFS disclosure from the government. Lastly, the level of welfare impacts the level of LGFS disclosure. This finding may be caused by the fact that the level of per-capita welfare will result in more excellent political supervision and supervision by the people of the government, thereby increasing the level of LGFS disclosure.

Based on the results, the Indonesian government should evaluate potential issues associated with increased government pressure while implementing financial statement disclosures. For future research, it is recommended to broaden the next study strategy to incorporate longitudinal analysis to better detect trends in Indonesian local government mandatory disclosure procedures over time. While this study only looks at financial reports to investigate mandatory disclosure practices, many communication media exist. As a result, future research should look at additional sources of information, such as data from websites.

AUTHOR CONTRIBUTIONS

Conceptualization: Khoirul Aswar, Alvin Yoga Fanany.
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Writing – original draft: Khoirul Aswar, Alvin Yoga Fanany.
Writing – review & editing: Khoirul Aswar.

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