INDONESIAN LOCAL GOVERNMENT COMPLIANCE OF MANDATORY DISCLOSURE ON GOVERNMENTAL ACCOUNTING STANDARD

A thesis submitted in partial fulfillment of the requirement for the degree of Magister Sains

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I hereby sincerely state that the thesis titled “Indonesian Local Government Compliance of Mandatory Disclosure on Governmental Accounting Standard” is my real masterpiece. The things out of my masterpiece in this thesis are signed by citation and referred in the bibliography.

If later proven that my thesis has discrepancies, I am willing to take the academic sanctions in the form of repealing my thesis and academic degree.

Surakarta, Februari 2011

Stated by,

Umi Pujiyanti
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Umi Pujiyanti
# TABLE OF CONTENT

<table>
<thead>
<tr>
<th>APPROVAL PAGE</th>
<th>ii</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEDICATION PAGE</td>
<td>iii</td>
</tr>
<tr>
<td>PRONOUNCEMENT</td>
<td>iv</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENT</td>
<td>v</td>
</tr>
<tr>
<td>TABLE OF CONTENT</td>
<td>vii</td>
</tr>
<tr>
<td>LIST OF TABLE</td>
<td>xi</td>
</tr>
<tr>
<td>LIST OF APPENDIX</td>
<td>xii</td>
</tr>
<tr>
<td>ABBREVIATION</td>
<td>xiii</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>xiv</td>
</tr>
</tbody>
</table>

## CHAPTER I. INTRODUCTION

- A. Research Background................................................................. 1
- B. Research Questions ................................................................. 7
- C. Research Purposes........................................................................ 8
- D. Significance of the Study......................................................... 8

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CHAPTER II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

A. Theoretical Background ........................................................................ 10

B. Level of Government Agencies and Location of Indonesian Local Government ................................................................. 13

C. Hypothesis Development .................................................................... 16

CHAPTER III. RESEARCH METHODOLOGY .............................................. 20

A. Type Research ..................................................................................... 20

B. Population and Sample ........................................................................ 20

C. Data Source and Data Collection .......................................................... 22

D. The Measurement Issue of Compliance ............................................... 22

E. Technique of Analysis .......................................................................... 26

1. Descriptive statistic .............................................................................. 26

2. Hypothesis testing ............................................................................... 27

CHAPTER IV. DATA ANALYSIS AND DISCUSSION ................................. 29

A. Data Description ................................................................................... 29

1. Sample selection .................................................................................. 29

2. Classical assumption ............................................................................ 31

3. Items of mandatory accounting disclosure ........................................ 31

4. Descriptive statistic .............................................................................. 38
B. Hypothesis Testing

CHAPTER V. CONCLUSIONS, SUGGESTIONS, AND RESEARCH LIMITATION

A. Conclusion
B. Suggestion
C. Research Limitation

BIBLIOGRAPHY

APPENDICES
# LIST OF TABLE

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1</td>
<td>The Scoring System</td>
<td>23</td>
</tr>
<tr>
<td>Table 2</td>
<td>The Scoring System in Nangroe Aceh Darussalam’s Financial Statement</td>
<td>24</td>
</tr>
<tr>
<td>Table 3</td>
<td>Local Governments’ Financial Statements 2007</td>
<td>30</td>
</tr>
<tr>
<td>Table 4</td>
<td>Mandatory Accounting Disclosure Items in Balance Sheet</td>
<td>32</td>
</tr>
<tr>
<td>Table 5</td>
<td>Descriptive Statistics</td>
<td>38</td>
</tr>
<tr>
<td>Table 6</td>
<td>The t-Test Analysis (Independent Sample t-Test) – H₁</td>
<td>40</td>
</tr>
<tr>
<td>Table 7</td>
<td>The t-Test Analysis (Independent Sample t-Test) – H₂</td>
<td>43</td>
</tr>
</tbody>
</table>
## LIST OF APPENDIX

<table>
<thead>
<tr>
<th>APPENDIX I</th>
<th>THE NAME OF LOCAL GOVERNMENTS USED AS SAMPLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>APPENDIX II</td>
<td>CLASSICAL ASSUMPTION TEST</td>
</tr>
<tr>
<td>APPENDIX III</td>
<td>THE COMPLIANCE LEVEL OF LOCAL GOVERNMENTS’ FINANCIAL STATEMENT</td>
</tr>
<tr>
<td>APPENDIX IV</td>
<td>SPSS OUTPUT</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
</tr>
<tr>
<td>--------------</td>
<td>-------------</td>
</tr>
<tr>
<td>BPK</td>
<td>Badan Pemeriksa Keuangan (Supreme Audit Committee)</td>
</tr>
<tr>
<td>LKPD</td>
<td>Laporan Keuangan Pemerintah Daerah (Local Government Financial Report)</td>
</tr>
<tr>
<td>NPM</td>
<td>New Public Management</td>
</tr>
<tr>
<td>PAD</td>
<td>Pendapatan Asli Daerah (Local Government Own Revenue)</td>
</tr>
<tr>
<td>SAP</td>
<td>Standar Akuntansi Pemerintahan (Governmental Accounting Standard)</td>
</tr>
<tr>
<td>SKPD</td>
<td>Satuan Kerja Perangkat Daerah</td>
</tr>
<tr>
<td>UU</td>
<td>Undang – Undang (Law)</td>
</tr>
<tr>
<td>UUD 1945</td>
<td>Undang – Undang Dasar 1945 (Indonesian Constitution 1945)</td>
</tr>
</tbody>
</table>
ABSTRACT

This research aims at figuring out the different level of compliance of Indonesian local governments’ financial reports with SAP. The differentiation is based on the different level of governmental agency (municipal/city) and different geographical location (located in Java Island and Non Java Island).

The sample is 102 financial reports (balance sheet) that consists of 22 reports of provinces (4 are from Java and 18 are from Non Java Island) and 80 from municipalities/cities (40 are from Java Island and 40 others are from Non Java Island) with qualified or unqualified opinion. The tests are normality and Independents sample t-test.

The result shows that compliance level of Indonesian financial reports reaches 41.71% (weakly complied). $H_1$ is rejected due to the absent of penalty, lack of example from the higher level of agency and the independency feeling. $H_2$ is also
rejected due to the fact that local governments from outside Java have the same ability to adapt to new regulation.

This research concludes that local governments in Indonesia have the same level of compliance for their financial reports.

This research has a drawback that is only uses balance sheets as the item of analysis.

Keywords: disclosure, compliance, governmental accounting standard (SAP), local governments, level of governmental agency and different geographical location

ABSTRAK

Penelitian ini bertujuan untuk mengetahui ada tidaknya perbedaan antara tingkat kepatuhan laporan keuangan pemerintah daerah di Indonesia terhadap Standar Akuntansi Pemerintahan (SAP) yang didasarkan pada perbedaan level agen pemerintah (provinsi dan kabupaten/ kota) dan letak geografis (berlokasi di Jawa dan Luar Jawa).

Sampel penelitian berjumlah 102 laporan keuangan (neraca/ balance sheet) pemerintahan daerah yang terdiri dari 22 provinsi dan 80 kabupaten/ kota (40 dari Jawa dan 40 lainnya dari Luar Jawa). Laporan keuangan tersebut memiliki opini wajar tanpa pengecualian dan wajar dengan pengecualian. Item Neraca diukur...
dengan menggunakan metode PC unweighted. Data diuji kenormalannya dengan One Sample Kolmogorov-Smirnov dilanjutkan dengan uji-t.

Hasil penelitian menunjukkan bahwa tingkat kepatuhan (item Balance Sheet) laporan keuangan pemerintah daerah di Indonesia adalah 41,71% (kepatuhan rendah). Tingkat kepatuhan pemerintah daerah di tingkat provinsi sama dengan tingkat kepatuhan di tingkat kabupaten/kota; hipotesis 1 tertolak. Hal ini disebabkan oleh tidak adanya sanksi terhadap pelanggaran, kurangnya contoh dari agen pemerintah yang lebih tinggi dan adanya perasaan independen dari pemerintah daerah yang lebih rendah. Hipotesis 2 tertolak karena pemerintah daerah yang berlokasi di Luar Jawa memiliki kemampuan yang sama untuk beradaptasi dengan peraturan pemachtan yang baru.

Penelitian ini menyimpulkan bahwa semua pemerintah daerah di Indonesia memiliki tingkat kepatuhan yang sama meskipun memiliki tingkat agensi dan lokasi geografis yang berbeda.

Keterbatasan penelitian ini terletak pada hanya diambilnya Neraca sebagai bahan penelitian.

Kata kunci: pengungkapan, kepatuhan, standar akuntansi keuangan (SAP), pemegang saham, tingkat agensi, kepatuhan daerah, dan perbedaan letak geografis
CHAPTER I

INTRODUCTION

This research investigates the compliance of Indonesian local governments with SAP where some comparisons are made. This chapter explains the background of the research, the research problems, the purposes of the research and the benefit of the research.

A. Research Background

During the last decade, accounting and government policy makers in the UK, Australia, New Zealand and other countries have advocated the adoption of accrual accounting system, commonly regarded as “commercial accounting”, for public sector financial management (Hopwood and Tomkins, 1985; Guthrie, 1994; Llewellyn, 1998; Lapsley, 1999; Lawrence, 1999; Llewellyn and Northcott, 2005 in Mir and Rahaman, 2006), known as New Public Management (NPM). Mhina (2008) argues that this movement is started in 1980s and based on public choice and managerial schools of thought, new public management seeks to enhance the efficiency of the public sector and the control that government has over it. The main assumption in the NPM-reforms is that more market orientation in the public sector will lead to greater cost-efficiency for governments, without having negative side effects on other objectives and considerations.

The emergence of New Public Management (NPM) is associated with

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the changed role of the state and the growing demands for good governance practices worldwide (Sharma, 2007: 4).

Good governance then is associated with accountability and transparency. Accountability has become a major topic in the discussion among experts in regards to public sector reform. This issue deals a lot with accountability and transparency on the financial report made by the public sector entities. Accountability may be seen as a channel for ascertaining the use of power by an individual or an organization that has been entrusted with the task of performing prescribed tasks (Premchand in Schiavo-Campo, 1999). Transparency, in the other hand, implies that the procedures and methods of decision making and the disbursement of public funds are open to visible to all (Jayawickrama in Schiavo-Campo, 1999).

The emergence of new public management has started since 1980s, but the development in Indonesia is languished since it started in 1992 with the President Suharto’s Decree 35 1992 (Robinson & Harun, 2004). This Presidential decree assigned responsibility to a newly established Accounting Development Board Centre within the Ministry of Finance with the task of modernizing the cash basis system of accounting inherited from the Dutch (Robinson & Harun, 2004).

After a long process, Governmental Accounting Standard (SAP), as one of the important elements of governmental accounting reform in Indonesia, has finally stipulated by Governmental Decree Number 24 Year 2005 (Peraturan Pemerintah No. 24 Tahun 2005) on June 13, 2005. With the issuance of this Decree, Indonesia
for the first time has Governmental Accounting Standard that is specifically composed to be standardized guidance for the government to compose its financial statement.

However, after a couple years the governmental accounting standard has been implemented, the implementation by local governments is still weak (Nasution, 2008). This is evident by the fact that many local governments are still incapable of devising financial statement in compliance with Generally Accepted Accounting Principle (Misra, 2010), although some regions have managed to devise reliable financial statement and obtained good audit opinion. According to the Supreme Audit Committee (Badan Pemeriksa Keuangan/BPK) investigation among 459 local government financial statements (Laporan Keuangan Pemerintah Daerah/LKPD) in the year 2006, BPK gives unqualified opinion for 3 LKPD (1%), qualified for 326 LKPD (71.02%), adverse for 28 LKPD (6.10%), and disclaimer opinion for 102 LKPD (22.22%) (Nasution, 2008).

From accounting practices as a whole, the degree of accounting practices of Indonesia shown in its compliance level is 72.11% on average (Misra, 2010). This is higher compared to Belgium which is only 62% (Christiaens, 1999). However, in particular, the Government Decree Number 24 about local autonomy may open opportunity for local governments in producing wide-varied financial reports based on their own financial resources. This leads to the opportunity for several local governments to falsify the government deposits and to misuse local governments’ money (Purnomo, 2010).
This research investigates the compliance of local governments’ financial statements with its established official standard, SAP. Particularly the study will compare the level of compliance between different levels of agency and between different levels of location of local governments. The different level of government agency is taken into account as such agency in Indonesia is divided into provinces and municipalities/cities (Indonesian Constitution 1945, second amendment, Chapter VI about Local Government, Article 18, Verse 1).

This different level of agency in Indonesia affects the fund distribution from the central government, namely the intergovernmental revenue. The receipt of intergovernmental revenue has been positively associated with organizational innovativeness (Ingram and De Jong, 1987). State and federal governments provide intergovernmental revenue to local governments; they also regulate the way in which the funds can be used (Patrick in Mandasari, 2009). Recipients must meet the financial statements and auditing standards of grantors (Ingram and De Jong 1987). This means that the local governments who receive the intergovernmental revenue will comply more to the established official standard because they have resources to do so.

Further, this research also compares the compliance of Java local governments with non Java local governments. Indonesia consists of thousand islands with wide ranging geographical condition (www.wikipedia.com). The conditions above may affect the presentation of financial statements of local governments. Java and non-Java differs in its human resources and economic condition (Retnoningsih, 2009).
Human resource quality growth of Java Island is higher than outside Java Island (Bhinadi, 2003) and education and health facilities in Java are far different from those in Non-Java Island. In Australia case of study, geographic location and isolation were important determinants of variations in operating practices in local governments including their annual reports (Kloot and Martin, 2001). Urban area with extensive legislative changes and easy access to other region tends to quickly adapt to new rule compared to rural and remote area. Kloot and Martin also identify that rural and remote community tend to have a strong resource of economy which results in the reluctant to change their annual reports to the new standard. Accountability is continually being socially constructed (Parker and Gould in Kloot and Martin, 2001). This means that the more modern and developed the society in a certain area, the higher level of financial statement compliance they perform (Mandasari, 2009; Retnoningsih, 2009).

This research focuses on the mandatory disclosure compliance of balance sheet stated in SAP. Similar research is done by Mandasari (2009) and Retnoningsih (2009). Mandasari (2009) examines the influence of local government characteristics to the mandatory disclosure compliance with SAP. The results show that educational background of regent is the only variable influencing the compliance level. Having economics/accounting background is likely a benefit since the regent will have better knowledge in economics/accounting, also better understanding of the importance of accounting for accountability (Mandasari, 2009). This research also mentions that the average level of disclosure compliance of balance sheet with SAP among 80
municipalities in Indonesia is still low (52.57%). The research by Mandasari (2009) focuses on items of Balance Sheet as the elements of analysis.

In the other hand, Retnoningsih (2009) tries to examine the relation between the characteristics of parliament with the mandatory disclosure. The results show that the compliance level of mandatory accounting disclosure elements in the municipal level is still low (Retnoningsih, 2009). Again, the educational background of person in parliament is the only item influencing the compliance level of mandatory accounting disclosure of a certain municipal (Retnoningsih, 2009). In Retnoningsih (2009), the elements of analysis are items of Budget Realization and Notes on Financial Statement. In this research, Retnoningsih (2009) also discusses in brief the different mandatory disclosure compliance level between Java and Non Java Island where the result identifies that local governments located in Java comply more compared to local government located in Non Java Island. This finding is supported by Bhinadi (2003) which mentions that the quality of human resources in Java Island is higher than those Non Java Island.

Compared to the previous researches mentioned above, this research focuses on the comparison of the mandatory disclosure compliance level between province and municipal/city and between local government located in Java Island and located in Non Java Island.

The balance sheet is chosen since it describes financial position of asset, liability and fund equity of local government in certain date (Mursyidi 2009). Balance sheet also shows the accountability level of government in its resources management.
and accountability level in managing assets and liabilities admitted in financial statement (Bastian 2006). The preparation of a balance sheet will enable the organization to manage its asset more effectively, increase the organizations ability to evaluate debt/equity funding, and allocate accountability for specific asset and liabilities (Churchill, 1992). Moreover, balance sheet is also made to increase the comparability from period to period and local government to local government (Bastian 2006). In order to attain the purpose of comparability, accounting standard obligates financial statement to present in accrual bases.

B. Research Questions

As mentioned above, the main discussion of this research is the compliance level of Indonesian’s Local Governments with SAP. The compliance level will consider the local governments’ structure (province and city/ municipality) and local governments’ geographical location (within Java Island or Non Java Island). The different structure of local government will impact on the fund distribution/ intergovernmental revenue which come to the assumption that the local government receiving bigger amount of fund distribution will comply more with the SAP compared to others who receive smaller number of intergovernmental revenue (Pugh, Hickson, Hinings, Turner, 1969; Ingram and De Jong, 1987). Further, local governments located in Java Island will comply more with SAP compared to those in
Non-Java Island due to the human resource and economic condition (Bhinadi, 2003; Retoningsih, 2009).

The issuance of SAP in 2005 aims at reforming the Indonesian public sector (NPM) by standardizing the form and the essence of the governmental agencies’ financial reports (Robinson & Harun 2004). However, the varied nature of Indonesian local governments—whether it is in a form of different level of governmental agencies or different geographical location—may impact on the SAP application in field. Is the original purpose of SAP issuance reached by the Indonesian provinces and Indonesian cities/ municipalities? How is the compliance level of local government located in Java Island compared to those located in non-Java Island? Are they same or not? The questions above are the important discussion in this research.

C. Research Purposes

The purpose of this research is to figure out the local governments’ financial report compliance level with SAP based on comparisons: (1) between provinces and cities/ municipalities, and (2) between local governments located in Java Island and local governments located in non-Java Island.

D. Significance of the Study

Several studies have been done in the Indonesian local governments. Mandasari (2009) studies the influence of local government characteristics on mandatory

However, none of those researches investigates the comparison among different level of local governments that Indonesia has. Mandasari and Retnoningsih investigate only in the level of city/ municipalities (2009). Further, the researches above also ignore the varied geographical locations of Indonesian local governments that may affect the level of compliance on SAP. This research gives explanations on the difference level of compliance of financial reports between provinces and cities/ municipalities and between local governments located in Java Island and non-Java Island.
CHAPTER II

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

This chapter is about literature review and the development of hypotheses the research has. This chapter elaborate theories used in the previous researches in discussing the subject, level of agency and location of Indonesian local governments in relation to compliance, and the hypotheses development.

A. Theoretical Background

There are many theories used to discuss the compliance of financial statements of agency with certain standards. A research by Arifin investigates the impact of governance on the informativeness of local government financial reports in Indonesian context. The research framework borrows from agency theory hypothesizing that governance mechanism might mitigate the conflict between the agent and principal resulting in more informative financial reports (2010).

Agency theory itself is focused on the relationship between the principals and agents (for example, the relationship between shareholders and corporate managers), a relationship which, due to various asymmetries, created much uncertainty (Deegan, 2004). Jensen and Meckling defined the agency relationship as:
A contract under which one or more (principles) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent (1976, p.308).

It is assumed within agency theory that principals will assume that the agent (like the principal) will be driven by self-interest which may lead to the asymmetries information between the manager and the owner. Therefore, the principals will anticipate that the manager, unless restricted from doing otherwise, will undertake self-serving activities that could be detrimental to the economic welfare of the principals (Deegan, 2000).

In the domain of public sector, ownership distribution and board of directors might be argued as identical to voter’s distribution and local parliament respectively while the standard provision is similar to local government regulation (Arifin, 2010). The agency problem, then, possibly emerges between the voters as the principal that trust the management decision to executive party as the agent (Arifin, 2010). The logic comes from the fact that the issuance of UU no. 17 year 2003 which obligates the government agencies in Indonesia to make a financial report that comply with the mandatory disclosures set by Governmental Accounting Standard/ SAP.

Another practice of agency theory in the governmental sector is that in the condition of absence of stock exchange market mechanism, legislative body serves as a main instrument in monitoring the behaviour of bureaucrat (Fama, 1980; Miller and Moe, 1983; Weingast, 1984; Spencer, 1982 in Misra, 2010). Legislative body is regarded to be trying to maximize their chances for the upcoming election by
commit to user performing monitoring function towards the behaviour of governmental bureaucracy (Misra, 2010).

In the context of agency theory, Misra support that legislative body represents as principal while the executive plays as the agent. A research by Retnoningsih (2009) broadens this assumption based on the legitimacy theory. She states that as the principal, individuals in the legislative body should acquire knowledge, skills, and competences to be legitimate before the society (Retnoningsih, 2009) as legitimacy indicates that one is qualified for particular professions (Lawrence in Retnoningsih, 2009). This implies educational background and educational level become crucial factors for legislators. The findings suggest that the higher educational level of parliament members is, the higher expectation and awareness to the compliance of mandatory accounting disclosure elements is. This means the financial report produced will highly comply with the standard which give assess to the society to do analysis based on the information provided in the reports.

As stated before, annual financial report is the main medium of accountability (Mack et al. 2010) since it function is to give relevant information for the decision-making (Naim dan Rakhman 2000). Using the stakeholder perspective, Kloot and Martin (2001) argue that managers, in making annual reports, in local government have to contend with multiple accountabilities to multiple stakeholders: ratepayers, the wider community, councillors, and their state governments. They suggest that the more varied the user of information is, the more complex and complete the financial report is. Further, Mack et al propose the users of local governments’ annual financial commit to user
statement as ratepayers & residents, other resources providers, councillors, other recipients of services, oversight bodies, internal users and other councils (2010).

B. Level of Government Agencies and Location of Indonesian Local Governments

As mentioned before, this research investigates the compliance level of local governments’ financial statements with its established official standard, SAP. Particularly the study will compare the level of compliance between different levels of agency and between different location of local governments. The different level of government agency is taken into account as such agency in Indonesia is divided into provinces and municipalities/cities (Indonesian Constitution 1945, second amendment, Chapter VI about Local Government, Article 18, Verse 1). The different location is also taken into account since geographically Indonesia consists of thousand islands (www.wikipedia.com 2010).

This different level of agency in Indonesia affects the fund distribution from the central government, namely the intergovernmental revenue. The receipt of intergovernmental revenue has been positively associated with organizational innovativeness (Ingram and De Jong, 1987). State and federal governments provide intergovernmental revenue to local governments; they also regulate the way in which the funds can be used (Patrick in Mandasari, 2009). To be accountable and governance, recipients of funds must meet the financial statements and auditing standards of grantors (Ingram and De Jong 1987). This means that the local commit to user
governments who receive the intergovernmental revenue will comply more to the established official standard because they have resources to do so (Pugh, Hickson, Hinings, Turner, 1969; Ingram and De Jong, 1987).

Another motivation for Indonesian local government to be accountable and transparent in managing their fund is that the fact that they may receive different amount of intergovernmental revenue in different accounting period for some reasons (Mandasari, 2009). One of them is the local government incapability of managing the fund indicated by the some remaining amount of fund in the end of financial period. This condition is regulated by the Law of Financial Minister no.59/PMK.06/2005. Under this law, if the local government still has some remaining amount of intergovernmental revenue, the state government will assume that the local government is incapable of managing the fund, so in the next financial period, the state government will decrease the fund distribution.

Further, this research also compares the compliance of Java local governments with non Java local governments. Indonesia consists of thousand islands with wide ranging geographical condition (www.wikipedia.org, 2010). The conditions above may affect the presentation of financial statements of local governments. Java and non-Java differs in its human resources and economic condition (Retnoningsih, 2009). Human resource quality growth of Java Island is higher than outside Java Island (Bhinadi, 2003) and education and health facilities in Java are far different from those in Non-Java Island. In Australia case of study, geographic location and isolation were important determinants of variations in operating practices in local
governments including their annual reports (Kloot and Martin, 2001). In Portugal, local authorities and municipalities in particular aim to satisfy the interests of a certain geographic territory through their annual reports (Carvalho et al., 2007). Urban area with extensive legislative changes and easy access to other regions tends to quickly adapt to new rules compared to rural and remote area reports (Kloot and Martin, 2001).

Kloot and Martin also identify that rural and remote community tend to have a strong resource of economy which results in the reluctant to change their annual reports to the new standard. Accountability is continually being socially constructed (Parker and Gould in Kloot and Martin, 2001). This means that the more modern and developed the society in a certain area, the higher level of financial statement compliance they perform (Mandasari, 2009; Retnoningsih, 2009).

Local governments in Java Island can be assumed as the urban area since they locate next to Jakarta, Indonesia’s capital city (www.wikipedia.com, 2010). This results in the higher human resource quality compared to those from Non-Java Island (Bhinadi 2003). Urban groups are likely to be more educated and mobile group who will use information to change their consumption or living preferences (Zimmerman 1997). This implies that the urban local government will disclose more information for their users.
C. Hypothesis Development

This research investigates the compliance of local governments’ financial statements with its established official standard, SAP. Particularly the study will compare the level of compliance between different levels of agency and between different levels of location of local governments. The different level of government agency is taken into account as such agency in Indonesia is divided into provinces and municipalities/cities (Indonesian Constitution 1945, second amendment, Chapter VI about Local Government, Article 18, Verse 1). In term of location, Indonesia geographically consists of thousand islands with wide ranging geographical condition (www.wikipedia.com, 2010). Its five biggest islands are Jawa, Sumatera, Kalimantan, Sulawesi and Papua. Java and non-Java differs in its human resources and economic condition (Retnoningsih, 2009). Human resource quality growth of Java Island is higher than outside Java Island (Bhinadi, 2003) and education and health facilities in Java are far different from those in Non-Java Island.

1. **Provinces’ financial report disclosure is different from cities’/ municipalities’ financial reports**

According to Indonesia Constitution 1945 (Undang - Undang Dasar 1945), local governments of Indonesia are regulated in Chapter VI, article 18, verse 1. This rule mentions that Indonesia consists of provinces and every province consists of municipalities and cities in which the provinces, municipalities, and cities are having local governments which are regulated by the law (UUD 1945). Another fact is that
Indonesia administratively consists of provinces, municipalities/cities, district, residence (kemukiman), village (kelurahan/desa), and other lower level of place (tingkat yang lebih rendah) (www.wikipedia.com, 2010).

As mentioned before, Indonesia consists of provinces that are headed by governor. Each province consists of municipalities and cities. Municipality and city are administrative regions after province in Indonesia (www.wikipedia.com 2010). Those autonomous regions have authority to manage their own government. According to UU Number 34/2004 about local government, there are structural differences between city and municipality. The municipality is headed by regent, while the city is headed by mayor (walikota). Both regent and mayor are not responsible to governor. Moreover, the main source of city’s PAD is derived from industry and tourism. Meanwhile, the main source of municipality’s PAD is derived from agriculture.

Another thing differs province, municipality, and city is that they have a different size (wide of region). Province is the largest area since it includes several municipalities, while city is the smallest area. As an example, the area of municipality contributes around 4% - 24% of the total area in West Sumatra, while the area of city only contributes around 0.3% (www.wikipedia.com 2010).

Region with wider area (province) is assumed to have more functional differentiation (Satuan Kerja Pemerintah Daerah/ SKPD) compared to the smaller one (municipality/city). It means that province shall comply more on SAP compared to the municipalities/cities (Mandasari, 2009). Lawrence and Lorsch (1967);
Damanpour (1987) argue that functional differentiation facilitates the sharing of ideas and information because varies organizational members bring different ideas to the organization for consideration. Therefore, the more different departments exist in a local government, the more ideas, information, and innovations are available. With more ideas, information and innovations, certain local government will comply more on the mandatory accounting disclosure set by the government.

Different level of governmental agencies also impact on different level of intergovernmental revenue. The amount of the fund distributed to province is for sure different from the fund distributed for city/ municipal. As reflected in the budget realization report, the fund distributed to province is bigger than the one distributed to city/ municipal. Intergovernmental revenue is positively associated with the innovativeness (Pugh, Hickson, Hinings, Turner, 1969; Ingram and De Jong, 1987); this implies the more the fund is, the more innovative the local governments is. As mentioned before that local government with higher level of innovativeness will comply more on the mandatory accounting disclosure of SAP. Therefore, the second hypothesis is:

H₁: The compliance level of provinces’ financial report disclosure is different from those of cities’/ municipalities’.

2. **Java’s local governments compliance is different from Non-Java’s local governments**

*commit to user*
Previous research done by Kloot & Martin (2001) suggests that perceptions of local government managers regarding accountabilities varied depending on their geographic location and isolation. In term of geographic location, managers of urban area will have different level of accountability compared to managers from non-urban area. Further, in terms of the isolation, the accountability level of large cities will be different from small or remote areas.

This condition can also be found in Indonesia. Geographically, Indonesia consists of 17,508 islands with its 5 biggest islands: Sumatera (473,606 km$^2$), Java (132,107 km$^2$), Kalimantan (539,460 km$^2$), Sulawesi (189,216 km$^2$) and Papua (421,981 km$^2$) (www.wikipedia.com, 2010). Indonesia’s capital city is Jakarta which is located in Java Island. This condition causes other island outside Java may have different level of human resources as well as economic condition.

Bhinadi (2003) investigated economic growth between Java and non-Java Island. His finding suggests that human resource quality growth of Java Island is higher than outside Java Island one. Suryadarma in Retnoningsih 2009) finds that education and health facilities in Java are far different from outside Java. These crucial infrastructures contribute to the different human quality growth between Java and outside Java. These differences are assumed influencing the compliance level of mandatory accounting disclosure elements between Java area and non-Java area (Suryadarma in Retnoningsih, 2009). Then, the first hypotheses of this research is $H_2$: The compliance level of local government financial report disclosure in Java is different from those of non-java.
CHAPTER III
RESEARCH METHODOLOGY

This chapter mainly discusses the method used in the research as well as the hypotheses testing employed. It then consists of type of research, population and sample, data source and data collection, and the techniques of analysis.

A. Type of Research

This research is quantitative research. Different from the qualitative research, in this research a deductive form of logic is used wherein theories and hypotheses are tested in a cause-and-effect order (Creswell, 1994; Sekaran, 2003; Sutopo, 2006). Furthermore, concepts, variables, and hypotheses are chosen before the study begins and remain fixed throughout the study. Creswell (1994) also argue that the intent of this study is to develop generalizations that contribute to the theory and that enable one to be better predict, explain and understand some phenomena. This means that there is a hypothesis built and tested in this research.

B. Population and Sample
Population can be explained as collection or numbers of people or events that are interesting to be analyzed (Sekaran, 2003). Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate (Sekaran, 2003). The population in this research is the 33 provinces’ audited financial statements.

Sample is part of population, which is consisted of elements having similar characteristics with population (Sekaran, 2003). Furthermore, Sekaran explains that sampling is the process of selecting a sufficient number of elements from population, so that a study of the sample and an understanding of its properties or characteristics would make it possible for us to generalize such properties or characteristics to the population elements. The sampling method used is purposive-judgment-sampling. (Sekaran, 2003). This means that the researcher gains information only from certain data which meet these criteria:

1. the Indonesian provinces which issued financial statement in 2008 and published the financial statement in BPK RI website (www.bpk.go.id)

2. The financial statement chosen will be those with qualified opinion and unqualified opinion. Financial statements having adverse and disclaimer opinion are not chosen since the information within that financial statement may not be relevant. Further, this kind of information can not be used in decision making of financial statement users.

Recall the criteria above and that this research talks about provinces and municipalities/ cities in Java and Non-Java; it takes 22 out of 33 provinces of
Indonesia, 80 municipalities/cities are taken also (40 are from Java Island and 40 others are from Non-Java Island).

C. Data Source and Data Collection

Data used in this study is secondary data which is taken from internet. Sekaran (2003) explains that secondary data refer to information gathered from sources already existing. The data source of this research is the financial statement of Indonesian provinces published in www.bpk.go.id in 2008. The data are gathered by the researcher through softcopy data basis from the internet and the document.

D. The Measurement Issue of Compliance

As stated in the SAP, local governments’ financial statement consists of four items namely, Balance Sheet, Budget Realization Reports, Cash Flow Statements and Notes on Financial Statement (SAP 2005). Among those elements, this research focuses on the balance sheet items. The items of balance sheet cover inventory accounting (PSAP 5), investment accounting (PSAP 6), fixed-asset accounting (PSAP 7), assets under reconstruction (PSAP 8), and lastly liability accounting (PSAP 9) with total is 34 items. This means that every local government which complies with all the balance sheet mandatory accounting disclosure will have total score of 34.

In measuring the compliance, this research uses PC unweighted method instead of unweighted method. Most of the time, research about measuring
compliance level uses dichotomous or unweighted method (Cooke, 1996). As the alternative is the partial compliance (PC) unweighted method (Al-Shiab, 2008). These two methods differ for unweighted gives equal weight to the individual items required to be disclosed by all standards, meanwhile, the PC unweighted assumes that each standard is of equal importance and consequently gives equal weight to each standard (Tsalavoutas, Evans, and Smith 2008). The common approach for determining compliance on SAP done by private companies or public sector entities is that of unweighted disclosure index (Yeoh, 2005; Ah et al., 1994; Craig & Diga, 1998; Patton & Zelenka, 1997; Cooke, 1996; Ahmed & Nicholls, 1994; Wallace et al., 1994; Spero, 1979 in Tsalavoutas, Evans, and Smith 2008). Under this method, if a required item is disclosed, it is scored as 1 and if it is not, it is scored as 0. For example, in PSAP 5 about inventory, the first items mentions about disclosing accounting policy for inventory measurement. If certain local government clearly mentions it uses certain method of measurement, it is scored ‘1’ otherwise is ‘0’. This then is called as ‘dichotomous’ method. However, it is not strictly ‘dichotomous’ because some items may not be applicable to every company, and therefore scored as ‘not applicable’ (NA) (Tsalavoutas et al., 2008). The detail illustration is as follows:

Table 1

<table>
<thead>
<tr>
<th>The Scoring System</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Items of PSAP 05 (Inventory)</td>
<td></td>
</tr>
<tr>
<td>Disclosing accounting policy for inventory measurement</td>
<td></td>
</tr>
<tr>
<td>Mentioning it uses certain method of measurement (Biaya perolehan apabila diperoleh dengan pembelian, etc.)</td>
<td>1</td>
</tr>
<tr>
<td>Not Mentioning it uses certain method of measurement</td>
<td>0</td>
</tr>
</tbody>
</table>
If the local government does not have any inventory - (Not Applicable/ A)

The exact example below is taken from the Gorontalo’s financial statements.

**Table 2**

**The scoring system in Nangroe Aceh Darussalam’s’s financial statement**

<table>
<thead>
<tr>
<th>Score</th>
<th>Nangroe Aceh Darussalam’s FS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(1) Accounting policy for inventory measurement (PSAP 5: Inventory) NAD is scored 1 for this rule since it mentions the accounting policy for inventory measurement. The statement is as follow: “Persediaan dicatat pada akhir periode akuntansi berdasarkan hasil inventarisasi fisik dan dinilai berdasarkan harga perolehan”.</td>
</tr>
<tr>
<td>0</td>
<td>(03) Inventory condition (ex: the detail amounts of each inventory, the price (value) of each inventory, and explanation of good/ broken condition) (PSAP 5: Inventory) NAD gets 0 because it does not mention the detail amounts of each inventory and does not explain the condition of the inventory whether it is in a good/ broken condition. However, NAD mentions the price of the inventory. The statement is: “Persediaan, merupakan persediaan barang pakai habis dalam TA 2007 yang tersisa masing-masing untuk alat tulis kantor dan barang pakai habis lainnya sebesar Rp1.564.065.030,00 dan obat-obatan sebesar Rp7.068.762.059,00.”</td>
</tr>
<tr>
<td>-</td>
<td>(NA) If the fixed asset recorded as revaluation amount, these things need to be disclosed: The name of independent appraiser. (PSAP 7: Fixed Asset) This rule is not applicable (NA) for NAD because NAD does not revaluate its fixed asset. So, NAD is scored by “-“:</td>
</tr>
</tbody>
</table>

In fact, some standards require a large number of items to be disclosed while some others require only a view. As a result,

‘standards which require more items to be disclosed or, in other words, standards with more items included in the index are unintentionally and indirectly not treated equally with those that require fewer items to disclosed’ (Al-Shiab, 2008: 222).
An alternative method, avoiding the problem, is the ‘Partial Compliance (PC) unweighted approach’ employed by Street & Gray (2001) and Al-Shiab (2008). It explains that

‘the degree of compliance for each company is measured by adding the degree of compliance for each standard and then dividing this sum by the number of standards applicable to each company. This implicitly gives equal weighting to each applicable standard and avoids the problem of unintentionally giving more weight to a standard with a larger number of items in the index’ (Al-Shiab, 2008: 223).

In other words, it is giving unequal weighting to the disclosure items in different standards.

This research uses PC unweighted method instead of the unweighted since it considers some standards that might be inapplicable for certain local government. PC unweighted method formula is:

\[ PC_j = \frac{\sum_{i \in k} X_i}{R_j} \]

where \( PC_j \) is the total compliance score for each company and \( 0 \leq PC_j \leq 1 \). \( X_i \) is the level of compliance with each standard’s mandatory disclosure requirements. This means that, initially, using the ‘dichotomous’ approach, the researcher calculates the compliance with each standard separately. Subsequently, the sum of these compliance scores (X) is divided by the total number of relevant/applicable standards for each company j i.e. \( R_j \).
For example, the SAP requires local government to disclose amount of short
term and long term liability that are classified based on the creditor (PSAP 9:
Liability). If certain local government has liability both short term and long term then
it states the amount of the debts based on the creditor, the researcher scores it ‘1’. If
the local government has short term and long term liability but does not mention the
amount and/or the creditor, that local government is scored with ‘0’. Lastly, if the
local government does not have any liability whether it is short term or long term, it
is given (-) since such mandatory disclosure is not applicable to the local government.

E. Technique of Analysis

1. Descriptive statistic

The purpose of descriptive statistics is to provide description of distribution
and behavior of the samples (Iriawan and Astuti 2006). Jogiyanto (2005) states that
descriptive statistic provides frequency value, measures of central tendency (mean,
median, mode), measures of spread (range, standard deviation, variances, and
interquartile range), and measures of shapes (skewness and kurtosis). The
computation of analysis technique is done with SPSS.

2. Hypotheses testing

a. Normality Test

Before having an advanced analysis on the data, the classical assumption
test is done. Actually, classical assumption tests are needed as a precondition fro
multiple regression test (Gujarati, 2003). Even this research is only a comparative one, one of classical assumption—normality test—is still employed in the purpose of knowing whether or not the data is normally distributed. This test is usually done to test data in a ordinal scale, interval or even ratio. The normality of the data can be tested by Histogram Graph and One Sample Kolmogorov-Smirnov. This research employs One Sample Kolmogorov-Smirnov as the tools with the p-value 5% Significant level which means that the data is normally distributed if the significance is $> 5\%$ or 0.05 (Piyatno, 2008).

b. Independent-Sample t-test

The dependent variable of this research is the compliance level while the independent variables are local governments’ structure (province and city/municipality) and local governments’ geographical locations (located in Java Island and in Non-Java Island).

Independent-Sample t-test is used to identify the significance of mean’s difference between two groups (Supranto, 1996). This test is employed to compare the compliance level of Indonesian local governments based on the local governments’ structure (province and city/municipality) and local governments’ geographical locations (located in Java Island and in Non-Java Island). If the significance value is lower that the significance level (5%), the alternative hypothesis is accepted.
CHAPTER IV
DATA ANALYSIS AND DISCUSSION

This research examines the differences in compliance of financial reports to SAP between Java’s local governments and Non-Java’s local governments. It also analyzes the difference level of compliance between provinces and cities/municipalities. As samples, this research employs 22 provinces of Indonesia and 80 municipalities/cities (30 are from Java Island and 40 others are from Non-Java Island). The financial reports are produced in 2007 and published through BPK site in 2008.

This chapter provides details about data description, hypotheses testing, analysis and discussion.

A. Data Description

1. Sample selection

This study uses secondary data from local governments’ audited financial reports issued by BPK in its official website (www.bpk.go.id 2008). This research is cross sectional according to the time dimension (Sekaran, 2003), so the reports are from the year 2007 which were published by BPK in 2008 both in the first and second semester of reporting. Table 3 below describes the population and sample in detail:

commit to user
Table 3
Local Governments’ Financial Statements 2007
(Reported in 1st and 2nd Semester of 2008)

<table>
<thead>
<tr>
<th>Region</th>
<th>Type</th>
<th>Loc. Gov’s FS Published</th>
<th>Sample</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Province</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Java Island</td>
<td>6</td>
<td></td>
<td>4</td>
<td>22</td>
</tr>
<tr>
<td>Non-Java Island</td>
<td>27</td>
<td></td>
<td>18</td>
<td>33</td>
</tr>
<tr>
<td>Cities/Municipalities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Java Island</td>
<td>118</td>
<td></td>
<td>40</td>
<td>80</td>
</tr>
<tr>
<td>Non-Java Island</td>
<td>317</td>
<td></td>
<td>40</td>
<td>435</td>
</tr>
</tbody>
</table>

Source: www.bpk.go.id (2008)

There are 33 provinces and 435 cities/municipalities reporting their financial statements in BPK site. This research uses purposive sampling technique where the samples are selected based on some criteria set before (Sekaran, 2003; Sutopo, 2006). As mentioned earlier, the samples taken are financial statements of Indonesia’s local governments with unqualified or qualified opinion. Among 33 provinces, there are 22 provinces which are granted unqualified or qualified opinion from BPK for their annual reports. This research employs the 22 provinces as the samples. Of 435 cities/municipalities across Indonesia, researcher only takes 80 cities/municipalities as samples. This is based on the analogy that “the minimal sample size in multiple regression analysis should be at least 10 times of independent variables used in the research” (Rosche 1975 in Sekaran 2003). The independent variable in this research is only 1; compliance. The big sample size will increase degree of freedom from the
statistical measurements (Jogiyanto 2005), so 80 cities/ municipalities taken as sample are enough.

Among the 22 provinces, 4 are from Java Island, namely West Java, Central Java, Yogyakarta, and Banten; 18 others are from Non-Java Island, namely NAD, West Sumatra, Riau, Jambi, South Sumatra, Bengkulu, Lampung, Bangka Belitung, Riau Island, Bali, NTT, South Kalimantan, North Sulawesi, Central Sulawesi, South-East Sulawesi, Gorontalo, West Sulawesi and Papua. The 80 cities/ municipalities taken as sample consist of 40 from Java Island and another 40 from Non-Java Island. Appendix I is the name of provinces and cities/ municipalities used as samples.

2. **Classical assumption**

Gujarati (2003) states that classical assumption is needed as a precondition for multiple regression tests to make sure that the research is valid, not bias, and consistent. The classical assumption used in this research is normality test. This research employs *One Sample Kolmogorov-Smirnov* as the tools with the p-value 5% significant level which means that the data is normally distributed if the significance is > 5% or 0.05 (Trihendradi, 2007).

The result shows that all of the data are normally distributed. The detail of the classical assumption test can be seen in the Appendices II.

3. **Items of mandatory accounting disclosure**

*commit to user*
This research again deals with the compliance practices of local government financial statement toward SAP set by the government. SAP consists of 11 statements, one conceptual framework and some attachments. Among the 11 statements, there are four (4) main elements of local governments’ report, namely budget realization report (PSAP 2), Cash Flow Statement (PSAP 3), Notes on Financial Statement (PSAP 4), and balance sheet which consists of inventory accounting (PSAP 5), investment accounting (PSAP 6), fixed-asset accounting (PSAP 7), assets under reconstruction (PSAP 8), and lastly liability accounting (PSAP 9). This research, then, pays attention on the item of balance sheet only since it reflects the condition of an entity financially; how much its resources and how much its debt. The items of balance sheet cover inventory accounting (PSAP 5), investment accounting (PSAP 6), fixed-asset accounting (PSAP 7), assets under reconstruction (PSAP 8), and lastly liability accounting (PSAP 9). The detail of every item in every PSAP is summarized in the Table 4 where there are 3 items under inventory, 6 items under investment, 12 items under fixed asset, and 8 items under liability.

<table>
<thead>
<tr>
<th>Mandatory Accounting Disclosure Elements</th>
<th>Total</th>
<th>Mean (%)</th>
</tr>
</thead>
</table>

Table 4
Mandatory Accounting Disclosure Items in Balance Sheet

commit to user
PSAP 5: Inventory

01 Accounting policy for inventory measurement
02 Further explanation of inventory (ex: the total amount of each inventory)
03 Inventory condition (ex: the detail amounts of each inventory, the price (value) of each inventory, and explanation of good/broken condition)

PSAP 6: Investment

04 Accounting policy for the decision of investment’s value
05 Type of investment (permanent and non-permanent)
06 Market price changing in short term and long term investment
07 Significant value decreasing of investment and the cause of decreasing

Table 4 (Continued)

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Mean (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>08 Fair value investment</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>09 The changing of investment post</td>
<td>97</td>
<td>95</td>
</tr>
</tbody>
</table>

PSAP 7: Fixed Asset

01 Valuation bases to decide carrying amount
02 Reconciliation of recorded amount in the beginning and end the of period that shows: additional, lessening, depreciation accumulation and value change, and other fixed asset mutation
03 Depreciation information: depreciation value; depreciation method; time benefit and depreciation tariff; and brutto carrying amount and depreciation accumulation in beginning and the end of period
04 Existence and limits of fixed asset property right
05 Accounting policy for capitalization related to fixed asset
06 Expenditure amount of fixed assets under construction
07 Commitment amount for fixed asset acquisition
If the fixed asset recorded as revaluation amount, these things need to be disclosed:
08 Rule bases to revaluate the fixed asset
09 Effective date of revaluation
10 The name of independent appraiser
11 Every clue used to decide the change cost
12 Carrying amount of every fixed asset

PSAP 8: Assets Under Construction

80 79 98 96 65 64

commit to user
(22) Contract details of assets under construction including finishing level and duration
(23) Amount of construction’s value and funding resource
(24) Amount of expenditure
(25) Down payment
(26) Retention

**PSAP 9: Liability**

(27) Details list of liability to give a better information to the users
(28) Amount of short term and long term liability that are classified based on the creditor
(29) Amount of liability that are classified by the type of security’s liability and due date
(30) Interest in the current period and the level of interest
(31) Consequences of completing the liability before the due date
(32) Agreement of liability’s restructuring: decreasing of liability; modification of liability’ conditions; decreasing of liability’s interest level; delay of liability’s due date; decreasing of liability’s due date value; and decreasing of interest amount until the reporting period
(33) Amount of liability’s arrears that are presented in the list based on creditor
(34) Liability’s cost: treatment of liability’s cost; amount of liability’s cost that are capitalized in the current period; and capitalization level

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Mean (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSAP 9: Liability</td>
<td>27</td>
<td></td>
</tr>
<tr>
<td>(27) Details list of</td>
<td>100</td>
<td>98</td>
</tr>
<tr>
<td>liability to give a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>better information to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>the users</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(28) Amount of short</td>
<td>91</td>
<td>89</td>
</tr>
<tr>
<td>term and long term</td>
<td></td>
<td></td>
</tr>
<tr>
<td>liability that are</td>
<td></td>
<td></td>
</tr>
<tr>
<td>classified based on</td>
<td></td>
<td></td>
</tr>
<tr>
<td>the creditor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(29) Amount of</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>liability that are</td>
<td></td>
<td></td>
</tr>
<tr>
<td>classified by the type</td>
<td></td>
<td></td>
</tr>
<tr>
<td>of security’s liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and due date</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(30) Interest in the</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>current period and the</td>
<td></td>
<td></td>
</tr>
<tr>
<td>level of interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(31) Consequences of</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>completing the liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>before the due date</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(32) Agreement of</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>liability’s restructuring:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>decreasing of liability;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>modification of liability’ conditions;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>decreasing of liability’s interest level;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>delay of liability’s due date;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>decreasing of liability’s due date value; and decreasing of interest amount until the reporting period</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(33) Amount of liability’s arrears that are presented in the list based on creditor</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>(34) Liability’s cost:</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>treatment of liability’s</td>
<td></td>
<td></td>
</tr>
<tr>
<td>cost; amount of liability’s</td>
<td></td>
<td></td>
</tr>
<tr>
<td>cost that are capitalized in the current period; and capitalization level</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: SAP (2005)

Among 5 items in balance sheet, there are 80% of local governments comply on inventory, 45% comply on investment, 45% comply on fixed assets, 27% comply on liability and only 18% comply on the asset under reconstruction respectively.

The disclosure compliance on the inventory accounting is relatively high or the highest among all disclosure compliance. Among 102 samples, there are 98 (96%) local governments which comply with the item number 2 (Further explanation of inventory (ex: the total amount of each inventory)) then followed by the item number...
1 (Accounting policy for inventory measurement) complied by 81 local governments (79%). Meanwhile, item number 3 Inventory condition (ex: the detail amounts of each inventory, the price (value) of each inventory, and explanation of good/ broken condition). This finding is the same with the previous research by Mandasari (2009). Local governments must disclose the condition of inventory in more detail, such as the number of each item and the price (value). The detail amount of inventory’s item is easy to be recorded and disclosed; however, the price (value) of inventory’s item is not always disclosed. This requirement is not always fulfilled by the municipality due to the complex condition. Some of the inventory can be in the form of drug and livestock. Therefore, there will be difficulties due to the valuation of each item, also deciding whether the drug and livestock are in a good condition or is broken.

In PSAP 6 about investment, the Indonesian local governments comply in more-varied amount, ranging from 0%-95%. The highest compliance is on the changing on the investment post (95%) then followed by the type of investment whether it is permanent or non-permanent (94%). In other hand, there is no local government disclosing the market price changing in short term and long term investment. This is probably due to the complex process needed to calculate the value of the investment with the new market price.

The compliance level for PSAP 7 (fixed assets) is also varied, ranging from 0 to 94%. The lowest level of compliance in this SAP is for the commitment amount for fixed asset acquisition. In the reporting year of 2007, none of the local governments listed in the BPK disclose any information on commitment amount for
fixed assets acquisition. The highest compliance is for the changing of investment post (94%).

For PSAP 8 (assets under construction), the highest level of compliance is for item number 3 (amount of expenditure) which reaches 69%. In contrary, retention is only in level 1%. Ideally, a construction contact has rules on retention, for example maintenance term which is hold by the employer. The amount is disclosed in the Notes on Financial Statement. Yet, none of Indonesian local government disclosed retention amount in their financial reports in 2007.

In PSAP 09 or liability accounting, 100 local governments out of 102 samples or 98% disclose the detail list of liability to give better information to the users. This term is usually in term of dividing the liability into short term and long term, showing the source of debt and giving the amount. Meanwhile, item number 5, 6 and 8 are complied in the level of 0% by 102 local governments. No one of the sample disclose any information about consequences of completing the liability before the due date. Some of the local government mentions about the due date of their long term liability but they do not mention anything about the consequences of completing the liability before the due date. Agreement of liability’s restructuring: decreasing of liability; modification of liability’ conditions; decreasing of liability’s interest level; delay of liability’s due date; decreasing of liability’s due date value; and decreasing of interest amount until the reporting period (item 6) and liability’s cost: treatment of liability’s cost; amount of liability’s cost that are capitalized in the current period; and capitalization level (item 8) also earn 0% in average of compliance. The reason is
probably the complexity faced by the local government in disclosing the items or the idea of the useless of disclosing those items in the financial reports. They probably think that the most important information for their users of financial reports regarding the liability is the type and the amount of the liability.

As mentioned in the Chapter III, this research employs PC unweighted method in measuring the compliance level of local governments’ financial statement. Refer to the Appendix III, the average level of compliance level under unweighted method is 37.94%. Meanwhile the average level under PC unweighted is slightly higher; that is 41.71%.

The idea of Governmental Accounting Standard is issued is to give guidelines for the creation of financial statement of local government across Indonesia. Ideally, every local government in Indonesia (whether it is municipal/ city or province; whether it is located in Java Island or in Non Java Island) must fully comply with the SAP (Sinaga, 2011). Yet, the result above says differently where the average level of mandatory disclosure compliance level is 41.71%. It means that the Governmental Accounting Standard is partially complied by local government in Indonesia. This result is supported by Mandasari (2009), Misra (2009) and Retnoningsih (2009).

The poor performance of Indonesian local governments’ compliance is critical phenomenon to be considered. This is due to the needs of information required by the users of FS in making the decision (Supriyanto, 2011). It has been argued throughout the study that the accounting reforms can be considered successful in delivering high
quality information to decision makers only when the issuing organizations comply with accounting standards and when their respective external auditors provide ample information concerning the extent of their clients’ compliance (Cohen and Kaimenakis 2008). Applying total accrual accounting in Indonesian context seems quite hard; that is why the government decides to have transition time in applying accrual accounting (Robinson and Harun, 2004). SAP regulates the accounting bases for revenue, expenditure, transfer and funding is cash bases, while accrual is for assets, liability and equity. The transition is considered far from successful since the quality of information provided by the new accounting systems is rather low. Therefore its use for decision making purposes should be made with caution (Mandasari, 2009).

As mentioned before, the results of PC unweighted is higher than the unweighted method, the next computation uses PC unweighted as the base of computation.

3. Descriptive statistic

This research aims at figuring out the local governments’ financial report compliance level towards SAP with two comparisons: (1) between provinces and cities/ municipalities, and (2) between local governments located in Java Island and local governments located in non-Java Island.

Table 5
Descriptive Statistics

commit to user
<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>City/ Municipal</td>
<td>80</td>
<td>13.33</td>
<td>58.17</td>
<td>41.68</td>
<td>9.52</td>
</tr>
<tr>
<td>Province</td>
<td>22</td>
<td>27.38</td>
<td>61.60</td>
<td>41.79</td>
<td>8.13</td>
</tr>
<tr>
<td>Municipal/ City, Prov. (Java Island)</td>
<td>44</td>
<td>13.33</td>
<td>58.17</td>
<td>43.58</td>
<td>8.91</td>
</tr>
<tr>
<td>Municipal/ City, Prov. (Non-Java Island)</td>
<td>58</td>
<td>14.52</td>
<td>61.60</td>
<td>40.31</td>
<td>9.48</td>
</tr>
</tbody>
</table>

Table 5 displays the descriptive statistics of the compliance level of Indonesian financial report. There are 80 cities/ municipalities being studied in this research. The minimum value of the compliance in the level of cities/ municipalities is 13.33. This is for Kabupaten Majalengka. The highest compliance value is 58.17 that is for Kabupaten Pekalongan. The average level of compliance of financial statements is 41.68%. It means that in average, Indonesian local governments’ financial report comply with SAP in 41.68%.

Among 22 provinces studied in this research, the minimum value of compliance is 27.38, Sulawesi Barat; meanwhile, Riau has the highest level of compliance that is 61.60. The average level of compliance in province is 41.79% with 8.13 deviations.

The total number of local governments’ financial reports studied in Java Island is 44 local governments consisting of 40 municipalities/ cities and 4 provinces. The lowest level of the compliance is 13.33, Kabupaten Majalengka. Meanwhile, the highest level for compliance is 58.17, Kabupaten Pekalongan. The average level of compliance in Java Island is 43.58.
The total number of local governments’ financial reports studied in Java Island is 58 local governments consisting of 40 municipalities/cities and 18 provinces.

C. Hypothesis Testing

The dependent variable of this research is the compliance level while the independent variables are local governments’ structure (province and city/municipality) and local governments’ geographical locations (located in Java Island and in Non-Java Island).

Independent-Sample t-test is used to identify the significance of mean’s difference between two groups (Thihendradi, 2007). This research investigates the difference level of financial statements compliance with SAP between the province and municipal/city and between local government located in Java and local government located in Non-Java.

This research has two hypotheses. Hypothesis 1 mentions ‘Provinces’ financial report disclosure is different from cities’/municipalities’ financial report.’ Below is the group statistics of the hypotheses 1.

Recall table 5, the mean/average level of compliance in province is 41.7905 while compliance for municipal/city is 41.6828. In order to identify the significance of mean’s difference between two groups (Thihendradi, 2007), the independent sample t-test is conducted.
Table 6
The t-test Analysis (Independent Sample t-Test)

<table>
<thead>
<tr>
<th>Levene’s Test for Equality of Variances</th>
<th>T-test for Equality of Means</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equal variances assumed</td>
<td>Equal variances not assumed</td>
</tr>
<tr>
<td>F</td>
<td>Sig.</td>
</tr>
<tr>
<td>0.831</td>
<td>0.364</td>
</tr>
<tr>
<td>0.053</td>
<td>0.958</td>
</tr>
</tbody>
</table>

*Significance level: 0.05

F value is used to identify the variance assumed in the research. F value is 0.831 with the significant value is 0.364. This significant value is higher than the significant level (5%), it means the test is not significant or the variance is equally assumed. This research compares the compliance level of province and municipal/city. That is why the t-test is conducted. The result show that the t value is 0.048 with the significant value is 0.961. Since the significant value is higher than 0.05, the result is not significant. It means that there is no significant difference between compliance level of provinces’ financial statement and municipals’/ cities’ financial statement. In other word, the H<sub>1</sub> is rejected.

The main issue of different agency level in Indonesia is the fund distribution from the central government. This fund is called intergovernmental revenue. The amount of intergovernmental revenue distributed to province is for sure different from the amount given to the city/municipal. Since province is larger than municipal/city; it is assumed that the province will get higher intergovernmental revenue than municipal/city.
Suppose, every agency received fund from the central government will follow any regulation set by the central government, including the SAP. If certain local government received intergovernmental revenue, it will be more innovative in making its financial report since recipients must meet the financial reporting and auditing standards of grantors (Ingram and De Jong 1987).

However, the result of the t-test above indicates that having different amount of intergovernmental revenue does not impact of different level of compliance. This result is supported by the research by Mandasari (2009) where intergovernmental fund distributed to the municipalities does not influence the financial compliance level of the municipalities. Patrick (in Mandasari 2009) also finds the negative association between adoptions of new accounting standard with intergovernmental revenue.

This might be caused by the absence of penalty given to the governmental agencies which do not comply with the standard. The absence of penalty will raise the ignorance to the compliance since it is less likely to affect the next year budget. This condition does not only happen in local governments, the Indonesian central government also suffers from this condition. Central governments’ financial report of the budget year 2008 gets disclaimer opinion from BPK and it was the fifth time BPK issued disclaimer opinion for Indonesian central government (www.hukumonline.com, 2010). This means that since the first issuance of SAP in 2004, the central government always gets disclaimer opinion. According to BPK, the central government institution contribute to this opinion are mainly from Law commit to user
Institutions, such as Mahkamah Agung, Kejaksaan Agung, Departemen Hukum dan Hak Asasi Manusia, Badan Pertahanan Nasional and Kepolisian Republik Indonesia (www.hukumonline.com, 2010). If there is sanction imposed, the central government will not continually suffer from the disclaimer opinion for five years because it will try to meet the standard it violates for the next year budget. This means that the financial report will be better through years. Government should start to make rules and to regulate any violation to SAP even it is done by law institutions.

Recall the case above, the central government seems to forget its role as a model or example for the agencies under it. It is very common in Indonesian culture to have model as a motivation to do something. If the central government follow the standard it made, SAP; the local governments will be motivated to do the same.

Another reason supporting the research finding is the UU number 32 year 2004 about local government autonomy. This law suggests that every local government in Indonesia is an autonomous entity which is not dependent to the upper level of agency. In term of financial report, local government chief responsibility is only in the informing the report, without any consequences (Article 27 verse 2, UU No 32 year 2004). So, even the central government has distributed some fund and regulated the way the fund is used, the local government will less likely to follow the rule since both are independent entity, meaning do not responsible one another.

The second hypothesis is ‘Local governments’ financial report disclosures compliance in Java Island differs from than compliance of local governments in Non-Java Island’.

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Recall the table 5, among 44 local governments located in Java Island, the average level of compliance is 43.5486. This result is slightly higher than 58 local governments in Non Java Island which has 40.3081 as the average level of their financial statements. Again, in order to identify the significance of mean’s difference between two groups (Thihendradi 2007), the independent sample t-test is conducted.

### Table 7
The t-test Analysis (Independent Sample t-Test)

<table>
<thead>
<tr>
<th></th>
<th>Levene’s Test for Equality of Variances</th>
<th>T-test for Equality of Means</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F</td>
<td>Sig.</td>
</tr>
<tr>
<td>Java vs Non Java</td>
<td>Equal variances assumed</td>
<td>1.502</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>1.806</td>
</tr>
</tbody>
</table>

*Significance level: 0.05

The test for equality variance results in the F value of 1.502 with the significant value is 0.223. Since the significant value is higher than the significant level (0.05), the variance is equally assumed. The significant value of the test is 0.078. This number is also higher than the significant level that is 0.05. This means that the result is not significant. In other words, there is no significant difference between the financial statements compliance level of local governments located in Java Island and in Non-Java Island or H₂ is rejected.

Different geographical location of local governments (in Java Island vs Non Java Island) does not impact on the different level of their compliance. This result align with the Robinson & Harun (2004) and Carvalho et al (2007) who argue that...
governmental accounting standard aimed at ensuring standardization and uniformity across the nation.

Further, there is a pilot project of new accounting standard held throughout the Indonesia, represented by 11 city governments namely Semarang, Sleman, Sawahlunto, Sukabumi, Metro Lampung, Solo, Probolinggo, Sumbawa, Kendari, Gorontalo, and Mataram (Robinson & Harun, 2004). Those city governments have represented the whole Indonesia geographically. 5 local governments from Java Island and 6 others are from Non Java Island. This implies that the governmental accounting standard has been introduced starting in 2001. The success of those 11 local governments in implementing the new regulation is regarded as signal that local governments located in Non Java have the same ability to adapt to new regulation as those located in Java Island. This is then supported by this research finding where there is no different in compliance level of local governments located in Java Island and local governments of Non Java Island.

However, this result does not align with Retnoningsih (2009) which mentions that local government located in Java Island present higher level of compliance in the financial reports compared to the local government located in Non-Java Island. Her argument for this is that Java and non-Java differs in its human resources and economic condition (Retnoningsih, 2009). In general, Java Island is identical with urban area since it is where the Indonesian capital city located. Meanwhile, the Non-Java Island is assumed to have criteria as rural since they are located far from the
capital city of Indonesia. This implies that education facilities in Java Island are far developed from the facilities in Non Java Island.

People live in Java Island are assumed to have higher level of education compared to those in Non Java Island (Bhinadi, 2003). The more varied educational institutions (start from elementary school until universities) and large number of the institution will lead the society to pay attention more on the education. Innovators and early adopters tend to come from higher socioeconomic backgrounds or higher educational level, have better access to information, are more intelligent and rational, have better attitudes towards science and change in general, and are able to cope with uncertainty (Mandasari 2009). Following this logic, local governments employee whose educational background is economics/accounting and who assumed to have better knowledge in economic/accounting tends to encourage the disclosure compliance align with SAP.

This result also contradicts Zimmerman (1997), Kloot and Martin (2001), Bhinadi (2003) and Carvalho et al (2007) who argue that urban area will comply more for the standard set by the government because of the more educated community and more varied users of financial statements.
CHAPTER V

CONCLUSION AND RECOMMENDATION

Chapter V reveals the conclusion, suggestions, limitations, and recommendations. The details of this chapter are explained in the following section:

A. Conclusion

This research aims at figuring out the difference level compliance of local government financial reports with SAP, particularly comparing between province and municipals/ cities and between local governments located in Java and local government located in Non Java Island.

Using the PC unweighted method; the average level of local governments’ financial statements (the items of Balance Sheet) with SAP is 41.71%. This means the Indonesian local governments partially comply with SAP.

The test shows that a hypothesis 1 is rejected. It means that there is no difference on compliance level of financial reports between the province and municipal/ city. This is due to the absence of penalty imposed on the failure to comply with SAP, the lack of positive example and the feeling of independency resulted from UU 32 2004.

Hypothesis 2 is also rejected or there is no difference on disclosure compliance level between local government located in Java and local government located in Non Kava Island. Previous researches may identify if Java is higher
compared Non Java Island in terms of the education and health facilities. Yet, this research finds that the ability in adapting to the new regulation which can be associated with the higher level of education is the same between local governments located in Java and those located in Non Java Island. The possible explanation for this is before the legal issuance of SAP in 2004, there was pilot project aiming at knowing whether or not the local governments able to adapt to the new regulation. This pilot project was done by 11 city governments from throughout Indonesia and the result showed that they could adapt to the new regulation well (Robinson & Harun, 2004).

Finally this research proves that local governments in Indonesia have the same level of compliance for their financial reports, neglecting their different level of agency and different geographical location. This is due to the fact that governmental accounting standard (SAP) made by the government is aimed at standardizing and uniforming the governmental agencies’ financial reports throughout Indonesia (Robinson & Harun, 2004 and SAP 2005).

B. Suggestions

Here are suggestions for the next research on the compliance issue of local governments’ financial statement. Since this research focuses on the items of balance sheet, the next research is encouraged to analyze all elements of local governments’
financial statement; budget realization report, cash flow statement, and note on financial statement.

Further, this kind of research should use panel expert method in assessing the compliance of certain items so that the judgment will be objective. Expert panels can be particularly helpful in arriving a judgments relating to the quality and relevance of programs (http://ec.europa.eu/regional, 2011).

C. Research Limitations

This study identifies the comparison of local governments’ financial reports with SAP in regards to the different level of local governments (province and municipal/ city) and different geographical location (Java and Non Java). However, this research has drawbacks that this study only uses balance sheets as the item of analysis. This means that the result of this research cannot be used to generalize any item of financial statement, but balance sheet.