Audit Findings, Local Government Characteristics, and Local Government Financial Statement Disclosure

Review of Integrative Business & Economics Research

Sri Wahyu Agustiningsih
Faculty of Economics, Universitas Veteran Bangun Nusantara, Indonesia

Sri Murni
Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia

Gustita Arnawati Putri*
Faculty of Economics, Universitas Veteran Bangun Nusantara, Indonesia

ABSTRACT

The research aims to analyze the effect of local government characteristics on the disclosure level in local government financial statement with audit findings as a moderating variable. Financial statement as a form of public accountability reflects a comprehensive condition on the operational activities, financial position, cash flow, and disclosure of posts in the financial statement. Company characteristics are predictor of disclosure quality, the statement that can be implemented on the local government. Local government characteristics can explain the obedience in mandatory disclosure in financial statement, thus local government characteristics is a predictor of mandatory disclosure. This research was performed using moderated regression analysis to test the simultaneous effect of several independent variables and one dependent variable. Based on the analysis and discussion result, we can conclude that audit finding moderates the effect of local government characteristics which measured through local government wealth on the level of disclosure in local government financial report. However, audit finding does not moderate the positive effect of local government size on the level of disclosure in local government financial report.

Keywords: local government characteristics, local government wealth, local government size, and level of disclosure in local government

1. INTRODUCTION

Public sector accounting is an implementation of good state governance, both in the central government level and the local government level. Community as a party who grant trust to the government as the manager of public finance has a right to receive the information regarding government finance which in turn will enable them to evaluate the government policies (Mardiasmo, 2002). The general purpose of financial information is providing financial information to assist the decision making for the parties who will use the report. Similarly, government financial report will be used as the consideration in taking economic, social, and political decision.

The main role of public sector accounting is providing financial statement as an implementation of public accountability (Mardiasmo, 2002). The public accountability can be implemented through the formulation of financial statement that consists of

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

periodic repost, interim financial reports, and financial reports (Wilson and Kattelus, 2002). The challenge faced by public sector accounting is providing information that can be used to monitor local government accountability that consists of financial accountability, managerial accountability, legal accountability, political accountability, and policy accountability.

The information provided in the financial statement has to be equipped with proper disclosure so that it is understandable and do not leads to misinterpretation. The disclosure aims to provide the information that are regarded as important in achieving financial reporting purposes and to serve various parties that have different interest (Suwardjono, 2005). Disclosure has two characteristics; mandatory disclosure and voluntary disclosure (Suwardjono, 2005). Voluntary disclosure is a non-mandatory choice for management to provide accounting and another information that are considered relevant and can support the decision making process performed by the user of the financial statement, while the disclosure is mandatory if it is required by a prevailing convention/standard.

The level of accounting quality is related with the level of completeness in financial report disclosure (Imhoff in Hertanti, 2005). The level of mandatory disclosure in the Indonesian government financial report is still low this is reflected in the disclosure level in which there are no local government that perform full disclosure. The average of local government disclosure is diverse, among other 52.57% (Mandasari, 2009), 54.54% (Retnoningsih, 2009), and 22% (Lesmana, 2010). The quality of decision will be higher if financial information is presented transparently and fulfill user's need according to the current economic condition.

The characteristic of an entity will affect the level of financial statement disclosure completeness. In this study the entity is the local governments in Indonesia. Various studies regarding local government characteristics provide diverse results. The qualification of city accounting staff, dependence level, the level of city wealth, and the area coverage of a city have positive effect on the level of disclosure obedience (Christiaens, 1999). Local government assets, dependence level, local government complexity, number of audit findings, and local government type have positive effect on local government disclosure in the financial statement (Martani and Liestiani, 2010). Local government assets, population, and deviation level have positive effect on the level of disclosure in financial statement in the provincial government (Martani and Zulhilmi,2012)

Study on the disclosure in local government financial statement and the factors that affect it is important because it will provide overview on the difference of disclosure level among local governments and the factors that affect it, as well as providing guidance on the government condition in a certain time period. This study is conducted to analyze the effect of local government characteristics on the disclosure level in local government financial statement with audit findings as a moderating variable.

2. THEORY AND HYPOTHESES DEVELOPMENT

2.1. Agency Theory

Agency theory is the basic theory that becomes the foundation of business practice. The theory is the result of synergy among economic theory, decision theory, sociology, and organizational theory. The main principle of this theory states that there

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

is partnership between the parties who grant authority (principal) in this case the investors, with the party who receive the authority (agency), in this case the managers, in the form of partnership contract namely the nexus of contract (Subaweh, 2008). The agency theory is implemented in local government from 1999 when regional autonomy is implemented in Indonesia. The selection of agency theory based on the analysis on two perspectives, relationship between executive and legislative and legislative and the people, in which the implication may come in positive way in the form of efficiency, but often time come in negative way in the form of opportunistic behavior (Subaweh, 2008). This consequence takes place because the agent understands financial information better than the principal, while the principal tends to force their private interest (self-interest) because they have the authority. Agency problem arises when executive tends to maximize their self-interest started from budgeting process, decision making, until the preparation of fair financial statement to show that they have a good performance, besides to secure their position in the legislative and people eyes.

Agency theory also states that general agent tends to behave in an opportunistic way and they tend to avoid risk (risk averse) (Herawati and Baridwan, 2007). The responsibility performed by local government as the executive is not stopped in the preparation of complete and fair financial statement, but also on how they can open the access for financial statement users (stakeholders). Local government as agent will avoid the risk in the form of stakeholder distrust toward their performance. Thus, local government will try to show that they have well and accountable performance in managing local government finance.

The relationship between agency theory and this study is government acts as a gents (government managers) have to decide a certain strategy to provide their best service for the people who acts as principal. The principal will expect for the best performance from the agent and one of the performances is reflected in the financial report and good service, while the assessment on a good reporting and service depends on the strategy implemented by the government. If government has good performance, people will trust the government. Thus, the selection of strategy will affect people trust as principal toward their government as their agent.

2.2. Mandatory Disclosure in Local Government Financial Statement

Governmental Accounting Standard is accounting principle implemented in preparing and presenting government financial report. Indonesian Governmental Accounting Standard is a procedure for manual or computerized system starting from data collection, recording, classification, and reporting of government financial position and financial operation. Government prepares a government accounting system that refers to Governmental Accounting Standard. Regulation Number 32 of 2004 regarding Local Government states that local government financial statement is prepared and presented according to Governmental Accounting Standard determined by the government through government regulation.

Governmental Accounting Standard is needed in preparing the report on Local Government or Central Government Budget implementation in the form of financial report which at least covers budget realization, balance sheet, cash flow, and notes to financial statement. Notes to financial statement includes the explanation or complete list or analysis on a value of a post presented in budget realization report, balance sheet, and cash flow, including the presentation of information mandated and suggested by Governmental Accounting Standard as well as another disclosure needed in fair

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

presentation of financial statement. The minimum disclosure required in notes to financial statement with the purpose to make the report usable for the users in understanding and comparing the report with the report from another entity is regulated in Governmental Accounting Standard. The research on the implementation of mandatory disclosure in public sector in Indonesia has been conducted by Mandasari (2009), Lesmana (2010), and Retnoningsih (2009). Mandasari (2009) and Lesmana (2010) explain that local government characteristics affect the obedience in mandatory disclosure in the financial statement.

2.3. Local Government Characteristics, Audit Findings, and Level of Mandatory Disclosure in Local Government Financial Statement

Financial statement as a form of public accountability reflects a comprehensive condition on the operational activities, financial position, cash flow, and disclosure of posts in the financial statement. Previous studies show that the level of obedience on mandatory disclosure can be affected by several factors. These factors may come from the characteristics of local government parliament, local government characteristics, or organizational component (organizational structure, organizational culture, and organization external environment) (Suhardjanto *et al.*, 2010). Choiriyah (2010) states that company characteristics can explain he variation of voluntary disclosure in financial statement.

Company characteristics are a predictor of disclosure quality. The statement can be implemented on the local government. Local government characteristics can explain the obedience in mandatory disclosure in financial statement, thus local government characteristics is a predictor of mandatory disclosure. Further, local government characteristics are special traits that adhere to a local government, mark a local government, and distinguish a local government from another local government (Poerwadarminta, 2006). Thus, the difference in characteristics among local government is assumed to affect the obedience in accounting mandatory disclosure. This study will only determine local government characteristics into items or comparison of items (ratio) included in local government financial statement, among others are area coverage and wealth of a local government.

Audit findings are everything related to the statement of fact (Tuanakota, 2008). Various findings needed to support or avoid misunderstanding on the conclusion and recommendation made by internal control that has to be written in the final audit report. Various information or findings that are not as important can be informed verbally or through correspondence of information. Audit findings are generated from the comparison of "what should be there" and "what are found there". From the comparison result, internal auditor has a basis for formulating a report. If the reported condition is in line with the criteria, a statement of satisfactory performance can be generated. The findings should be based on the following consideration (Tuanakota, 2008): criteria, condition, causes, and results. In the report of findings, auditor may include several recommendation, result achieved by the company, and other information that are not written in other parts.

De Angelo (1981a) states that the value of audit findings shows the ability of Indonesian Supreme Auditing Board auditors in detecting errors in local government financial statement, the total number of findings found by Indonesian Supreme Auditing Board consists of: (1) local government loss; (2) the potency of local government loss; (3) decrease in income; (4) administration; (5) extravagance; (6) inefficiency; and (7)

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

ineffectiveness. These findings are reported toward financial statement users, in this term the parliament who represents people as financial statement users, and return it to the local government with an expectation that local government will provide response, or to provide feedback for future development.

2.4. Hypothesis Development

In the agency view, the level of disclosure reflects a good will from the agent to provide information that is beneficial for their principals. The higher the level of disclosure performed by agent in the financial statement, the bigger the agent's will to provide information for their principals. In the government accounting context, local government head as the agent who receive authority to manage people wealth as a principal has higher preference. The high amount of wealth indicates that local government has sufficient resource to disclose information in their financial report. With the availability of resources, it enables and requires local government to perform higher disclosure of information in their financial report.

The level of local government wealth is measured using total assets. The higher the local government wealth, the larger the resources that can be used to perform disclosure, thus the increase in local government resource will leads to the increase in the disclosure level in financial report. The result of study conducted by Ingram (1984) shows that there is a positive and significant relationship between disclosure of local and state government wealth report. Besides that, Robbins and Austin (1986) find similar result with the neighboring city. While Christiaens (1999) also find significant result on the relationship between local government wealth and disclosure level in Flemish city. In this study we expect that the larger the resources owned by local government will improve audit quality, so that it will be able to reduce audit findings and can strengthen positive effect of local government wealth on the level of local government disclosure in the financial report. Based on the description above, we can propose the following hypothesis.

H_1= *Audit findings moderates the effect of local government wealth on the level of disclosure in local government financial report.*

Disclosure in financial report will provide information on funds management by agent for the principals, as stated in agency theory. In governmental organization context, the people are the principals who will use the information. The large number of population shows higher need of information on fund management. Thus, the larger the number of population then the higher the complexity of the government in performing its role as people servant. This study propose that the increase in the number of financial report users will increase audit quality and reduce audit findings as well as strengthening the positive effect of local government size on the level of disclosure in local government financial report. Based on the description above, we propose the following hypothesis.

H_2= *Audit findings moderates the effect of local government size on the level of disclosure in local government financial report.*

3. RESEARCH METHOD

The object in this study is city and district governments in one of Indonesia's provinces during 2010-2011 periods. The samples are selected through purposive sampling technique to get the representative samples according to the predetermined

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

criteria. Based on the data collected from Statistic Bureau, we find that there are 70 samples there the selection of the samples is described in Table 1.

Table 1
Research Samples

Samples Criteria	Number of samples
City and Local Governments in Central Java Province	70
City and Local Government with adverse opinion	1
City and Local Government with incomplete data	1
Variables loss due to Log Value	12
Total companies sampled	56

Source: processed secondary data

Moderated regression analysis is aimed to test the simultaneous effect of several independent variables and one dependent variable. We employ regression analysis to make an estimation of condition (the increase and decrease) of dependent variable, and if two or more independent variables are manipulated or its value is added or reduced (Sugiyono, 2007). Regression analysis will provide answer on the level of influence from each independent variable on the dependent variable. The multiple regressions developed in this study is as follows:

$$DISC = \quad \alpha + \beta 1 WEALTH + \beta 2 SIZE + \beta_3 (WEALTH * FIND) + \beta_8 (SIZE * FIND) + \varepsilon$$

notes:

DISC	= Mandatory Disclosure Index,
α	= Constant
$\beta_1, \beta_2, \beta_3, \ldots, \beta_9$	= Regression coefficient
EXC	= Accounting staff qualification
WEALTH	= Local government wealth
DEPEND	= Dependency on debts
SIZE	= Local government size
FIND	= Total audit findings
ε_1	= Standard error

4. RESULT

Descriptive statistic provides an overview or description of data from its mean, standard deviation, variant, maximum, minimum, sum, range, kurtosis, and skewness (skewed distribution). Descriptive Statistic analysis is used to see the overview of local government characteristics, level of disclosure in local government financial report, and audit findings in the sampled local government financial report.

Table 2
Descriptive Statistic

Variable	N	Mean	Std. Dev	Min.	Max.
DISC	56	0,65	0,053	0,54	0,69
WEALTH	56	3.465.588,08	3.334.568,35	993.368,62	15.936.290,22
SIZE	56	969.106,96	429.890,74	118.606,00	1.744.119,00
FIND	56	6,29	3,17	2,00	20,00

Source: SPSS output, processed secondary data

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

Hypothesis testing is performed to find the effect of local government characteristics on the level of mandatory disclosure. The result shows the significant level that can be tolerated, 0.10 (α = 10%). In hypothesis testing showed that the local government wealth and the local government size has a negative effect on the level of disclosure in the financial report of local government. This show that the higher local government wealth and the local government size declining level of disclosure in local government financial report. While variable of total audit findings does not have a direct effect on the level of disclosure.

Table 3 shows the result of interaction between local government characteristics and total audit findings. The result show t-count value of 1,836 which means audit findings moderates the positive effect of local government wealth on the level of disclosure in local government financial report with significance level of 0.072. The significant level is not higher than 0.10. Thus, the number of audit findings moderates the positive effect of local government wealth on the level of disclosure in local government financial report. This result is in line with the study conducted by Ingram (1984) who found that there is a relationship between local government wealth with the level of disclosure in local government financial report. Similarly, with the study conducted by Robbins and Austin (1986) and Christiaens (1999) which find that local government wealth affects the disclosure in local government financial report.

Table 3
t-test Results

Variables	B	t	Sig.
(Constant)	0,721	26,004	0,000
WEALTH	-4.789E-009	-1,799	0,078
SIZE	-5.475E-008	-2,651	0,011
(Constant)	0,729	25,306	0,000
WEALTH	-4.507E-009	-1,685	0,098
SIZE	-4.925E-008	-2,310	0,025
FIND	-0,002	-1,035	0,305
(Constant)	0,756	10,732	0,000
WEALTH	-2.690E-008	-2,162	0,035
SIZE	-2.751E-008	-0,640	0,525
FIND	-0,006	-0,557	0,580
WEALTH_FIND	3.649E-009	1,836	0,072
SIZE_FIND	-3.639E-009	-0,601	0,550

Source: SPSS output, processed secondary data

While for interaction between audit finding and local government size shows audit findings do not moderates the effect of local government size on disclosure level in local government financial report with t-count of -0, 601 and significance level of 0.55. The significance level is higher than 0.10. This means that the number of audit findings have not the effect of local government size on the level of disclosure in local government financial report. Table 3 shows that audit findings do not moderate the effect of local government size on the level of disclosure in local government financial report. This result is not in line with this study proposition, the increase in the number of users who need information will increase audit quality, so that it will reduce the number

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

of audit findings and strengthen the positive effect of local government size on the level of disclosure in local government financial report. This is not in line with the study conducted by Martani and Liestiani (2010), Hilmi and Martani (2012) who in their study find evidence that the number of population has significant effect on the level of disclosure in local government financial report.

5. CONCLUSION, IMPLICATION, LIMITATION AND SUGGESTION

5.1. Conclusion and Implication

Based on the analysis and discussion result, we can conclude that audit findings moderates the effect of local government characteristics measured through local government wealth on the level of disclosure in local government financial report. However, audit findings do not moderate the positive effect of local government size on the level of disclosure in local government financial report.

5.2. Limitations

This study has several limitations that can be considered by future study. The limitations are: (1) adjusted R square value is 15.3%, which means the ability of independent variable to explain dependent variable is low, and (2) the method used to determine the level of disclosure in financial report tends to be subjective in nature. This happened due to the difference in point of view from each reader.

5.3. Suggestions

Based on the description of limitations, we offer the following suggestions what future study is expected to include other variables that are suspected to influence disclosure in local government financial report, such as the lifespan of local government, total number of work unit in the local government, etc. Thus the ability of independent variables to explain dependent variable will increase. And to achieve better study result it is suggested to include other parties in determining the level of disclosure as a source of re-examination.

REFERENCES

[1] Christiaens, Johan. 1999. *Financial Accounting Reform in Flemish Municipalities: An Empirical Investigation*

[2] Choiriyah, Umi. 2010. *Information Gap Pengungkapan Lingkungan Hidup di Indonesia*. Skripsi S1 Fakultas Ekonomi Universitas Sebelas Maret Surakarta.

[3] DeAngelo, L. E. December 1981. Auditor size and audit quality. Journal ofAccounting and Economics 3(4): 183- 199.

[4] Hartati, Y. 2010. Analisa Pengungkapan Laporan Keuangan Opini Wajar Tanpa Pengecualian Study Kabupaten Padang Pariaman & Kota Pariaman.

[5] Herawati, Nurul dan Zaki Baridwan. 2007. “Manajemen Laba pada Perusahaan yang Melanggar Laibilitas”. Simposium Nasional Akuntansi 10. Makassar.

[6] Ingram, Robert W. 1984. “Economic Incentives and the Choice of State Government Accounting Practices”. Journal of Accounting Research. Vol. 22. No. 1. pp.126-144.

[7] Lesmana, S.I. 2010. Pengaruh Karakteristik Pemerintah Daerah terhadap Tingkat Pengungkapan Wajib di Indonesia. Tesis Master. Universitas Sebelas Maret.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

[8] Martani, D., dan A. Liestiani. 2010. *Disclosure in Local Government Financial Statements: the Case of Indonesia*. 2010. Annual Meeting and Conference Asian Academic Accounting Association (AAAA).
[9] Mardiasmo. 2002. *Akuntansi Sektor Publik*. Yogyakarta: Andi.
[10] Mandasari, P. 2009. *Practices of Mandatory Disclosure Compliance in Indonesian Local Government*. Tesis Master. Universitas Sebelas Maret.
[11] Martani, D., dan A. Zulhilmi. 2012. Analisis Faktor-faktor yang Mempengaruhi Tingkat Pengungkapan Laporan Keuangan Pemerintah Provinsi. *Simposium Nasional Akuntansi.*
[12] Retnoningsih, H. 2009. *Mandatory Accounting Disclosure and Parliament Characteristics: An Empirical Study on Public Sector*. Tesis Master. Universitas Sebelas Maret.
[13] Robbins, W. A. and Austin, K. R. Autumn 1986. Disclosure quality in governmental financial reports: an assessment of the appropriateness of a compound measure. Journal of Accounting Research 24(2):412-426.
[14] Suwardjono. 2005. *Teori Akuntansi: Perekayasaan Akuntansi Keuangan*. Edisi Kedua BPFE: Yogyakarta.
[15] Subaweh. 2008. Analisis Perbandingan Kinerja Keuangan Bank Syariah dan Bank Konvensional Periode 2003-2007. *Jurnal Ekonomi Bisnis No. 2 Vol. 12*.
[16] Suhardjanto, D., Rusmin, Mandasari, P., dan Brown, A. 2010. *Mandatory Disclosure Compliance and Local Government Characteristics: Evidence from Indonesian Municipalities.* Working Paper Series.
[17] Tuanakota. M. T. 2008. *Menghitung Kerugian Keuangan Negara dalam Tindak Pidana Korupsi*. Jakarta : Penerbit Salemba Empat.
[18] Wilson and Kattelus, 2002. Accounting For Govermental and Non Profit Entities. 13th Edition, Irwin,North America.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)