



ORGANIZATIONAL CHARACTERISTIC AND DISCLOSURE PRACTICE OF GRAND EXPENDITURE ON INDONESIAN LOCAL GOVERNMENT ANNUAL REPORT

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Abstract

Financial reports disclosure is a mechanism to increase the financial transparency and accountability of government. This research aims to identify the factors that affect the extent of local government grant expenditure disclosure on financial statement notes. The samples were financial reports of 86 local governments in Java region that had been audited and were published on BPK and KPU website. The data were analyzed by multiple linear regression technique. The results showed that intergovernmental revenue and political competition had positive impact on the extent of local government grant expenditure disclosure. It was not affected by debt financing because of the very small amount of debt. The average level of disclosure was low so it needs to be regulated in order to improve the transparency of financial management in local government.

Keywords: *Disclosure, Financial Reports, Local Government, Grant expenditure*

INTRODUCTION

There is a growing concern about transparency issue in Indonesia. One of the indicators is the establishment of Law Number 14 of 2008 on Public Disclosure Law, which states that the whole range of public officials must be transparent, accountable, and have orientation on people service as well as possible (Sinaga, 2011). According to Mulyana (2006) one of the factors that influence the increase in demand for local financial transparency was public trust crisis in financial management of the Government. One effort to achieve the transparency of financial management is to improve the financial reports disclosure. The conceptual framework of the Government Accounting Standards state that the full disclosure, i.e. the thoroughly disclosure of information both on financial statement and the Notes to the Financial Statements, is one of the principles in government financial reporting.

According to Government Regulation Number 58 of 2005, Grant budget is government expenditure which its allotment has been specifically designated for Government or other local governments, regional companies, communities and civil society organizations, in form of money/goods or services, is neither mandatory nor binding, and not continuously. The Corruption Erradication Commission review on local government policy in the period of January until March 2011 found a number of cases related to misallocation of grants expenditure. The presentations of grant expenditure on local government financial reports are so diverse that its use cannot be controlled properly. It is concerned with the absence of regulation on detail disclosure at national level so that the level of reporting is very dependent on the policies of each local government. Even still, many local governments have not revealed the grant expenditure details in Notes to Financial Statements (CaLK)



although the Technical Bulletin 04 had arranged additional information on expenditure items to be disclosed in CaLK which at least include expenditure details by the organization, expenditure details by function, expenditure details by program and activities, as well as expenditure details by governmental affairs.

Ingram (1984) studied show the correlation between economic factors and their variations in accounting practice of local governments in the United States. Four economic and political factors include coalition of voters, administrative selection process, alternative information source, and management incentive. Similarly, Darmastuti's study (2012) showed that the characteristics of local governments affected the disclosure of social assistance budget of Indonesian local government. The most influential factor according to Darmastuti was supervision from external environment.

This study aims to test whether the characteristics of local government has an impact on the extent of local government grant expenditure disclosure in the period before act on grant expenditure disclosure by Minister of Internal Affairs Regulation. Therefore, the research problem is whether political competition, intergovernmental revenue and debt financing have significant impact on the extent of grant expenditure disclosure? The study may provide an information for the authorities on grant expenditure in Indonesia and an empirical evidence of public sector accounting practice in Indonesia.

LITERATURE REVIEW

Local Government Financial Reports Disclosure

General purpose of financial reports is to present information regarding the financial position, the realization of the budget, cash flow, and financial performance of a reporting entity which are useful for users in making and evaluating decisions about the resources allocation. Specifically, the purpose of government financial reporting is to provide government with useful information for decision-making and to demonstrate accountability of the reporting entity for the resources entrusted to the government.

Jensen and Meckling (1976) explained that there were differences of interest between the principal and agent, so the agent does not always follow the wishes of the principal. The same relation also occurs in Government, in which the local government as a principal and community as an agent. Government can make policies that favor the officials' interests with the exclusion of welfare of the served community. To reduce the conflict, supervision by the principal of what is being done by the agent is required.

The transparency in financial reports and disclosures to the public is one way to reduce the agency cost. Darrough (1993) suggested two types of disclosure. The first was mandated disclosure, as the minimum disclosure required by the applicable accounting standards, and the second was Voluntary Disclosure that was issued by the government without any requirements from the applicable regulations.

Disclosure of Grant Expenditure



By 2011, grant expenditure disclosure in CaLK also covered voluntary disclosure because there was no detailed mandatory settings on matters that should be disclosed in financial reports by the reporter's entity. Consequently, each local government made its own policies which produces various extent of disclosure among the reporter's entities. In addition to the absence of mandatory rules on the way of disclosure, terms of budgeting and implementation of grant expenditure had not been clearly regulated. There was even a political budget trend around the election of regional head of government. On the other hand the Regional Representatives Council had difficulties to carry out the budgeting functions and supervision functions associated with the grant. The problems associated with grant budgeting and implementation created a potential abuse of the budget for inappropriate reason. Because of this, the Representatives Council also asked the Government to develop guidelines that provide definitions and clear accounting usage associated with grant expenditure.

Local governments make their own policies on grant expenditure based on some regulations. The regulations include the Government Regulation Number 58 of 2005, the Regulation of Internal Affairs Minister Number 59 of 2007, and the Regulation of Internal Affairs Minister Number 32 of 2008.

Article 26, paragraph 7 letter F from Government Regulation Number 58 of 2005 states that the grant is used for budgeting administration of money / goods or services to the government or other local government, local companies, communities and civil society organizations, which its allotment has been specifically designated, is neither mandatory nor binding, and not continuously. Furthermore, Regulation of Internal Affairs Minister Number 13 of 2006 article 44 mentions that grant expenditure to the government is managed in accordance to the State Budget mechanism, whereas grants to other local governments and to the regional companies, private agencies/institutions/organizations and/or community groups/individual that are managed by the Regional Budget mechanism in accordance with the laws. Furthermore, Article 133 states that the recipients of subsidies, grants, social assistance, and financial assistance are responsible for the usage of money/goods and/or services usage they receives and shall submit a report to the regional head of government. Those regulations provide general guidelines about grant expenditure but have not clearly regulated the procedures for budgeting, implementation, accountability, record keeping, and disclosure of grant expenditure.

HYPOTHESES

Local government who had high political competition had a tendency to provide information (Baber, 1983 in Laswad, et al 2005). The same result was also indicated in the study conducted by Ingram (1984), Evans and Patton (1987), Giroux (1989). Baber (1983) in Laswad (2005) stated that the elected regional heads of a local government with high political competition bore the high long-term costs in terms of the fulfillment of the promises before the election. Elected regional heads also bore the greater monitoring costs because there were more parties watching. Furthermore, Baber and Sen (1984) in Laswad, et al (2005) stated that elected regional head of a



local government area with high political competition were more susceptible to political rival claims or criticism.

Regional heads who are born from high political competition want to show the realization of their promises to the people and political opponents before the election through good performance reporting. One form of performance reporting is to increase the transparency of grant expenditure reporting since the item is the center of attention of the wider community as a result of the Corruption Eradication Commission findings in 2011 associated with grant expenditure corruption. Thus, it is suspected that the higher political competition, the more extensive grant expenditure disclosures on local government's CaLK.

H₁.

Political competition level has a positive impact on the extent of grant expenditure disclosure

Patrick (2007) defined intergovernmental revenue as budget transfers from central government and federal government to local governments. In Indonesia Balancing Fund is in the form of intergovernmental revenue, which is a transfer from central government to local government in the framework of financial balance in increasingly widespread era of regional autonomy. Sumarjo (2010) projected intergovernmental revenue with the ratio of balancing funds. Darmastuti (2012) found a positive impact of intergovernmental revenue on the disclosure of social assistance expenditure details. In relation with the mandatory disclosure by the Government, Suhardjano (2010) found a positive effect of intergovernmental revenue on the level of mandatory disclosure of the Local Government. This means that the greater the dependency level on central government, the more extensive the disclosures made by the relevant Local Government.

Local government with high intergovernmental revenue indicates that the local government has a level of financial dependence to central government for financing the programs implemented by local government. So that local government will be encouraged to increase the transparency of the funds it received in order to increase central government trust and to demonstrate compliance with relevant regulations. Disclosure of grant expenditure details is one way to boost trust, especially in 2011 when the grant expenditure created many polemics. Therefore, the research hypothesis is formulated as follows:

H₂.

Intergovernmental revenue has positive impact on the extent of grant expenditure disclosure

Obligation or debt is transactions that arise from past events the settlement of which resulted in outflow of government's economic resources (SAP Number 09). Darmastuti (2012) examined the impact of debt financing on the level of social assistance expenditure disclosure. The study found no effect of debt financing on the level of disclosure of social assistance expenditure details in CaLK.

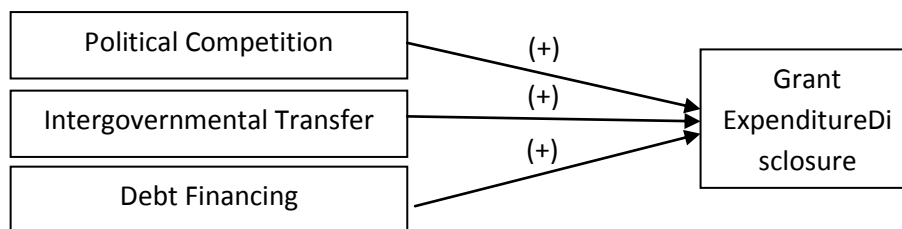
Local government with high debt financing indicates dependence upon external funding. Dependence on external sources of funding will encourage organizations to

better inform the organization's management ability to guarantee the organization's ability to restore maturing obligations. One indicator of good management is the government's adherence to the grant funds usage in accordance with terms in the existing regulations. Therefore, the research hypothesis is formulated as follows:

H₃

Debt financing has positive impact on the extent of grant expenditure disclosure.

The correlation between the various variables to be tested in this study can be described in the following models:



RESEARCH METHOD

This study analysed secondary data from financial reports of local governments in 2011 obtained from Financial Audit Agency (BPK) and the data of political competition from Election Commission's website www.jariungu.com. The study populations were Districts / Local Governments in Java in 2011 as the province with the largest allocated grant expenditure in the year. Samples were selected by purposive sampling method with the criteria in Table 1.

Table 1
Selection of Study Samples

NOTES	AMOUNT
Local government in the Provinces of Java in 2011	111
Local government where the information of supporting party for the elected regional heads and the number of seats for local parliament in 2011 cannot be obtained	(25)
Selected samples	86



The operational definition and measurement of the variables are represented in Table 2.

Table 2
Operational Definition and Measurement of the Variables

Nu	Variable	Operational Definition	Empirical Indicator
1	Grant Expenditure Disclosure (Y)	The amount of grant expenditure disclosure details, i.e. money/goods or services given to the government or other local government, local companies, communities and civil society organizations, which allotment has been specifically designated, is neither mandatory nor binding, and not continuously.	1. Expenditure details disclosure by organization
			2. Expenditure details disclosure by function and classification of expenditure
			3. Expenditure details disclosure by programs and activities
			4. Expenditure details disclosure by governmental affairs
			5. Expenditure details disclosure by direct expenditure and indirect expenditure
			6. Other explanation of the disclosure for full disclosure
2	Political Competition (X1)	The number of supporting party seats in parliament of (incumbent) which support the regional head than the total seats in parliament	$\frac{\text{Number of Seats of the Elected regional head's supporters}}{\text{Number of Parliamentary Seats}}$
3	<i>Intergovernmental Revenue</i> (X2)	The number of funds transfers comparison from central government to local governments with total local government revenue	$\frac{\text{Balance Fund from central}}{\text{Total Revenue}}$
4	Debt Financing (X3)	The debt repayment ability of local government	Total Obligation
			$\frac{\text{Total Obligation}}{\text{Total Equity}}$

HYPOTHESIS TESTING

Before performing hypothesis test, Classical Assumptions Test was performed to look at the feasibility of the data that would be analyzed using multiple regression techniques. The test includes data normality test (Kolmogorov-Smirnov method), Multicollinearity Test (VIF Value and tolerance value), Autocorrelation Test (Durbin



Watson method), and Heteroscasticity Test (Park Test). The result of analysis showed that all the classical assumptions had been fulfilled to test the hypothesis.

Hypothesis test was firstly performed with **t test** to find out if there was significant partial effect of independent variables (political competition, intergovernmental revenue and debt financing) on the dependent variable (the extent of disclosure grant expenditure). F test was then performed to determine whether all the independent variables in the model were jointly had impact on the dependent variable. T test and F test were determined at 95% confidence level and 5% significance level.

RESULTAND DISCUSSION

The Description of Research Object

In Table 3 we may observe that there was local government who didn't perform grant expenditure disclosure in CaLK while others have revealed a maximum value of 6 items, include expenditure details by organization, expenditure details by function, expenditure details by programs and activities, as well as expenditure details by governmental affair. The deviation standard percentage from the mean was 38.63 percent on the political competition data, and 11.25 percent on the intergovernmental revenue data. The percentage was less than 50 percent which means there was no significant variation in the data. However, for the extent of disclosure data the ratio was 50.57 per cent and for the debts data was 143 percent, which shows wide various extent of disclosure and local government debt.

Table 3.

Descriptive Statistic of dependent variable

	N	Minimum	Maximum	Mean	Std. Deviation
DISCLOSURE	86	0	6	3.14	1.588
POLCOM	86	.10	.89	.3639	.14058
IR	86	.27	.78	.6467	.07274
DEBT	86	.0000	.0431	.004416	.0063543

Table3alsoshowsthatthe averagepercentage of regional head's supporting partyseats to thetotalnumber of seatsinparliament(political competition) in the District/Cityis36percent. This means thatthe supportingpartyof the regional headdid not dominate the legislativeseatsso thatsurveillanceofpoliticalopponentswould be high. Local governmentsin Javais stilldependent onthe transferfrom the central government. Itcan be seenfromthe averageintergovernmental revenue of64percent whichmeansthat most Budget and Expenditure aresupportedby the central government'sbudget. Theaverage percentage oflocal governmentdebtfinancing was0.04 percentwitha maximumrateof 0.44percent which means a smallvalue of financing source from debt.

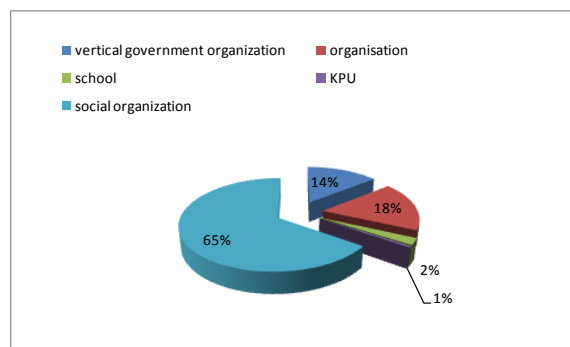
The most frequently disclosed of grant expenditure disclosure items was expenditure details item by organization and it was very rarely that Local Government perform the other explanation of disclosure for full disclosure (Table 4).

TABLE 4
Number of Local Government that perform grant expenditure disclosure

Disclosure Items	Percentage
Expenditure details disclosure by organization	86%
Expenditure details disclosure by program and activity	67,44%
Expenditure details disclosure by governmental affair	61,62%
Expenditure details disclosure by function and classification expenditure	51,16%
Expenditure details disclosure by direct and indirect expenditure	26,74%
Other explanation disclosure for <i>full disclosure</i>	20,93%

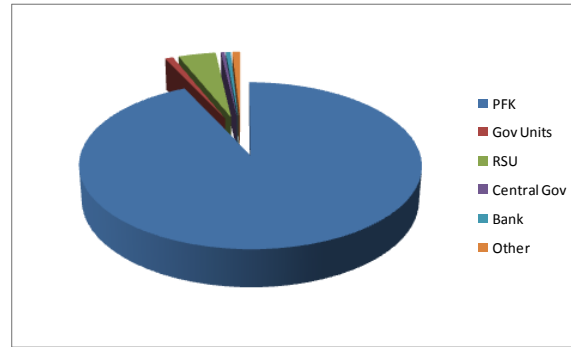
Graph 1 shows that the largest recipient of grant expenditure in Java in 2011 was a group of people (65.31%) but there were no further details of the intended community groups. Furthermore respectively are foundations/institutions/ organizations (17.62%), vertical institutions (14.20%), schools (2.3%), the Election Commission and the Election Supervisory Committee (48%).

GRAPH 1
GROUP OF GRANT EXPENDITURE RECIPIENTS



The Greatest obligation of local governments in Java in 2011 was Third Party Calculation (PFK) which was equal to 93 percent (Figure 2). PFK is government's debt to another parties due to the government position which collects tax or other levies, such as Income Tax, Value Added Tax, Askes, TASPEN, and Taperum (PSAP Number 09). Thus PFK is basically a fund deposit liabilities, which its amount does not take into account the ability of local government to pay back the obligations.

GRAPH 2
LOCAL GOVERNMENT DEBT



Statistical Test

The test with SPSS 16.0 gives the results as Table 5 shows

TABLE 5
Coefficients^a

Model	Unstandardized Coefficients		Standardize Coefficients	T
	B	Std. Error	Beta	
1 (Constant)	-1.299	1.633		-.795
POLCOM	2.144	1.199	.190	1.788
IR	5.506	2.319	.252	2.375
DEBT	21.972	26.300	.088	.835

a. Dependent Variable: DISCLOSURE
 Sources: processed secondary data, 2013

From table 5 it can be obtained a multiple linear regression equation as follows:

$$Y = -1,299 + 2,144 X_1 + 5,506 X_2 + 21,972 X_3$$

It means that if there is no political competition, intergovernmental revenue and debt financing, the extent of grant expenditure disclosure will decrease. Whereas if the ratio of political competition increases, the the extent of grant expenditure disclosure will increase as well. Similarly, the increase of intergovernmental revenue ratio and debt financing ratio will increase the extent of grant expenditure disclosure.

T test

In Table 6 it can be seen that intergovernmental revenue has significant effect on the extent of grant expenditure disclosure (t count of 2.375 > t table of 1.989). Political competition has marginal impact (at the 10% significance level) against the

extent of grant expenditure disclosure (t count of 1.759 > t table of 1.66). These results are consistent with the study conducted by Darmastuti (2012) which found that there was an impact of intergovernmental revenue on the social assistance expenditure disclosure. Debt financing did not have impact on the extent of grant expenditure disclosure (t count of 0.835 < t table of 1.989). Minus constant value means, if there is no political competition and intergovernmental revenue, the extent of grant expenditure disclosure will decrease.

TABLE 6

Coefficients ^a				
Model	Unstandardized Coefficients		Standardized Coefficients	T
	B	Std. Error	Beta	
1 (Constant)	-1.299	1.633		-.795
POLCOM	2.144	1.199	.190	**1.788
IR	5.506	2.319	.252	*2.375
UTANG	21.972	26.300	.088	.835

a. Dependent Variable: DISCLOSURE

Significant :*) for the level of 0.05, **) for the level of 0.10

Source: processed secondary data, 2013

F Test

From Table 7 it can be concluded that F count (2.813) > significance (0.05) which means that political competition, intergovernmental revenue and debt financing jointly affect the extent of grant expenditure disclosure. However Adjusted R Square value was only 6% which means a small impacts of the three variables.

Table 7

ANOVA^b

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	20.000	3	6.667	2.813	.044a
Residual	194.326	82	2.37		
Total	214.326	85			

a. Predictors: (Constant), DEBT, POLCOM, IR

b. Dependent Variable: DISCLOSURE

Source: Processed secondary data, 2013

DISCUSSION

Political competition had marginal effect on the extent of grant expenditure disclosure. This result was consistent with the study conducted by Laswad (2005) that the elected regional head of local government with high political competition bore the long-term high costs in terms of the fulfillment of the promises before the election. Hence the regional head with high political competition would be forced to perform transparent grant expenditure because of the great demands of his political opponents. An example was Cilacap regency government with political competitive ratio of 0.26 which disclosure the maximum grant expenditure of 6 items. Meanwhile,



the Government of Mojokerto Regency had political competition ratio of 0.431 (not competitive) that performed only 1 out of 6 items of disclosure.

Intergovernmental revenue had significant impact on the extent grant expenditure disclosure. This result supported the study conducted by Darmastuti (2012). This means that the higher the local governments dependence on the transfer from central government, the more likely the local governments would perform extent grant expenditure transparency in order to demonstrate accountability for the funds usage. As an example is Sumenep's government that has the highest intergovernmental revenue ratio of 0.781, performed 5 items of disclosure. Meanwhile, Bandung's Government with intergovernmental revenue ratio of 0.49, performed only 1 item of disclosure.

On the other hand, the debt financing was not proven to have impact on grant expenditure disclosure. This result was consistent with the study conducted by Darmastuti (2012). This conclusion might be related to the very low financing in local government. It could be seen in Table 4 of Descriptive Statistics that the average value of local government's debt financing in Java in 2011 was only 0.4%, the lowest value of debt financing is 0%. It means that the local government activities that was financed through debts were small and not all local governments financed their activities through debt. Thus the debt financing did not put pressure on local governments to improve the disclosure of grant expenditure.

CONCLUSIONS AND IMPLICATIONS

The conclusions and implications as the result of this study are as follows:

1. Grant expenditure disclosure (reporting transparency) by local governments in Central Java in 2011 was low (52.33% of the 6 items were recommended to be disclosed) and the extent of disclosures had positive correlation with the amount of Intergovernmental revenue and political competition level in local government. The conclusion was in accordance with the studies conducted by Darmastuti (2012) and Laswad (2005)
2. Local government financing from debt source ranged was approximately 0.44% and did not significantly affect the extent of grants expenditure disclosure by local government. This conclusion did not support the study conducted by Darmastuti (2012). Therefore, the voluntary disclosure level by the government was low and varied based on the amount of intergovernmental revenue and political competition level. Thus a policy should be considered to improve the financial reports disclosure by the government accounting standard setter agencies or legislators. Supervision by central government as well as society, especially political parties need to be improved in order to improve the financial accountability performance of local governments.

LIMITATIONS

Local Election in Indonesia was not conducted simultaneously in the same year as well as a very fluid political situation on the parties coalition in Indonesia. It might cause the data distortion in the study of political competition. Most of the data for this study on the parliamentary seats of regional head's supporting party were not taken from the



official website of local Government of the area (East Java and West Java) so that the validity of the data was likely low.

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