

# “Factors influencing financial statement disclosure: Empirical evidence from Indonesia”

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# FACTORS INFLUENCING FINANCIAL STATEMENT DISCLOSURE: EMPIRICAL EVIDENCE FROM INDONESIA

## Abstract

Identifying the characteristics of Indonesian local governments that disclose financial statements looks relevant in order to find out the reasons for local governments in making policies to disclose financial statements. This study aims to examine whether financial condition, financial independence and political competition have an effect on the disclosure of financial statements in local governments, particularly districts/cities in Sumatra, Indonesia. A sample of 151 districts and cities on the Indonesian island of Sumatra were used in this quantitative analysis. The use of cluster sampling due to the implementation of accrual accounting based on the government regulation No. 71 of 2010 is applied in all districts/cities in Sumatra and has the same characteristics. The data analysis technique used in this study is a multiple linear regression with the SPSS test tool. The results reveal that factors influencing the financial statements disclosure is influenced by financial conditions ( $\beta = 0.095$ ;  $p < 0.05$ ), financial independence ( $\beta = 0.069$ ;  $p < 0.05$ ), and political competition ( $\beta = 0.038$ ;  $p < 0.05$ ). Overall, the results show a strong conclusion regarding the factors that affect the financial statements of the Indonesian government. The findings of this investigation can be a useful consideration for local governments in improving the quality of their external communications and improving public governance.

## Keywords

disclosure, financial condition, financial independence,  
Indonesia, political competition, regulation

## JEL Classification

G18, H83, M41, M48

## INTRODUCTION

The government in Indonesia, through democracy, must establish what is called good governance to control social problems. The regional government is expected to be able to implement regional autonomy, which is closely related to government management as a form of good governance. Marked by the existence of good governance, it can encourage the government to assess the government governance index as seen from monitoring, providing criticism, evaluation, and suggestions in response to information. The government continues to make efforts that include Regional Government Financial Statements (LKPD), which must be presented and prepared in accordance with the provisions of Government Accounting Standards (SAP) in order to make decisions.

In 2018, the Supreme Audit Board (BPK) stated that the financial statements (FS) of Indonesian local governments did not meet government requirements (BPK, 2018). BPK RI examination results on 542 LKPD indicated that the WTP opinion given during the last 5 years has increased. In 2018, it was revealed that out of the 443 LKPD who were given a qualified opinion, 82%, out of the 86 LKPD who were given an unqualified opinion, 16%, and out of the 13 LKPD who were

given an adverse opinion, much as 2%. When compared with the achievements in 2017, the quality of financial reports in 2018 has increased by showing an increase in qualified opinion of 6%, namely from 76% LKPD in 2017 to 82% LKPD in 2018. According to the above summary of the BPK audit results, Indonesia local government has a problem with FS disclosure.

Several international studies have met disclosure issues back this up. According to Owusu-Ansah and Yeoh (2005), 93 percent of FS of companies listed in New Zealand are disclosed. In Kazakhstan, corporate disclosures of 37 companies are liquid as much as 33 percent. Meanwhile, other studies show an average disclosure of 58.2% (Ingram & DeJong, 1987), and in local governments such as Swedish municipalities the level of disclosure is 43.57% (Tagesson et al., 2013). The quality of the accounting information, disclosure of the Lithuanian municipality was 37.87% in 2013, and in 2016 the mandatory disclosure of information increased to 45.50%. In Indonesia, Marsella and Aswar found as many as 82 local governments that disclosed FS.

In the Governmental Accounting Conceptual Framework, Paragraph 24 (PP No. 71 of 2010) states that financial statements are prepared to provide relevant information about the financial position and all transactions by a reporting entity in one reporting period. One of the principles of accounting and financial reporting is full disclosure. This principle expects that financial statements provide complete information needed by users. However, in reality there are still some local governments that do not disclose full information on their financial statements. As a result, there may be more information asymmetry, making decision-making more challenging for stakeholders. In the context of Indonesia, this study provides a unique study of FS disclosure in developing counties. The practice of disclosing FS in local governments is claimed to be influenced by financial condition, financial independence and political competition.

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## 1. LITERATURE REVIEW

Disclosure can be interpreted as a financial report that provides complete information that users need. According to Ghozali and Chariri (2014), disclosure is not covered or not hiding, if it is related to FS that disclosure is a financial report that is required to provide complete, clear and uncovered information. Disclosures convey accurate and timely information related to material company information, including financial situation, performance, ownership and organizational governance (Sumatriani et al., 2021). A study by Patrick (2007) is related to the dependent variable, namely the application of the Intergovernmental Accounting Standard Board (GASB) 34 with a measurement based on whether the local government has adopted GASB 34 or not. Previous research related to the level of disclosure of local government FS using a scoring system, which is the same in Marsella and Aswar (2019) and Aswar et al. (2021). The scoring system is used to prove whether the local government financial reports have disclosed the items that are required in the government's accounting standards accordingly or not. When

measuring the disclosure of financial statements, up to 50 items are used, namely mandatory disclosure items based on Government Accounting Standards.

Financial condition describes a health condition in the organization. After the financial statements are prepared based on relevant data, the financial condition will be shown. The financial condition in question is knowing how much assets (wealth), liabilities (debt), and capital (equity) are in the financial statements. These financial conditions are used to evaluate company performance (Kasmir, 2009). It can be concluded that the financial condition is a condition that as a whole describes the performance of the local government in which the financial condition can be useful for various parties who need it. Tabash (2019) states that high disclosure will have higher operating performance. A study related to financial conditions, namely Giroux and McLelland (2003), shows that financial conditions have a positive effect on the disclosure of FS with total debt as an indicator. In addition, Nor et al. (2019) measured online disclosure using a binary variable or dichotomy, namely 0 for

not reporting and 1 for reporting. Furthermore, Cinca et al. (2009) used the following indicators in their study: investment per inhabitant, tax burden per inhabitant, tax revenue to operating revenue, financial expenses to total expenses and operating expenses to total expenses.

Kasmir (2009) defines a financial condition that describes an organization's health condition after the FS are prepared based on relevant data, it will show the financial condition. According to Muoz and Bolvar (2015), while discussing organizational or institutional challenges, a statement concerning financial constraints is frequently discussed. The government's financial situation is an important factor in its ability to meet its payment obligations (Giroux & Deis, 1993). This means that, in order to send good signals about their performance, local governments must make their financial reports, public as a monitoring mechanism (Garcia & Garcia, 2008). Furthermore, users of financial reports also want to know how government funds are used, particularly when it comes to funding service providers and public programs (Styles & Tennyson, 2007). In line with Marsella and Aswar (2019), local governments with good financial conditions will increase the disclosure of financial statements. Giroux and McLelland (2003) found that the role of governance as measured by financial conditions can increase the value of information presented by existing regulations. Financial conditions can have an impact on FS disclosure, since financial statements are an important part of the government's financial credibility (Ingram & DeJong, 1987).

Suparno and Nanda (2016) state that financial independence means a regional government capability when self-funding government activities, as well as services to the public for their compliance with paying fees and taxes, which is one of the sources of regional income, thus causing a large public demand for the level of disclosure the greater one. Law No. 32 of 2004 explains that decentralization can give authority and power to local governments in managing and utilizing existing resources in their own regions and in terms of managing their finances. The goal of regional independence is to determine the extent to which local governments' ability to support operational activities is not reliant on balancing funding from the federal government.

Regional financial independence shows a region's ability to finance its government activities independently (Suparno & Nanda, 2016). This means that local governments can carry out their own activities independently without dependence on balancing funds sourced from the center. The larger the public's contribution to compliance with levies and tax payments, the higher the ratio of regional independence to PAD, which is followed by substantial demands for openness and accountability in the presentation of local government financial reports (Fuadi & Asmara, 2020). Local governments with high financial independence will affect the disclosure of LKPD, where, when the financial independence of a region is high, the regional government is obliged to fully disclose the sources of funds received and also how much balance funds are received, because in the end this information is useful central in making economic decisions.

Political competition is a competition to gain power to control the government and allocate available resources for the benefit of politics and society (Bardhan & Yang, 2004). Political competition is a competition to get the most votes from voters to run a policy stage that is feasible to run. Meanwhile, political competition, according to Persson and Tabellini (2000), can be interpreted as the decentralization of political authority. There is strong competition when political authority resides in various regions. This type of political competition is related to the distribution of political power between the executive and legislative governments.

Bardhan and Yang (2004) state political competition is competition for the power to control the government and allocate available resources for political and community interests. Several studies have discovered a positive and statistically significant association between political rivalry and financial transparency, as politicians seeking votes strive to accommodate the requirements of as many people as possible. Therefore, the higher the motivation to share information, the greater the level of competition (Pérez et al., 2008). According to Rahim and Martani (2010), examples of good political competitiveness are local governments. It is due to the supervision of political parties, high political competition will be the type of supervision of the elected government, and local governments with

high political competition will have intense financial data disclosure. Pérez et al. (2008) discovered a positive and statistically significant link between political rivalry and public financial transparency, proposing that politicians seeking more votes aim to accommodate the requirements of as many voters as feasible. Therefore, the more competition, the more incentives one receives to disclose. In addition, Laswad et al. (2005) state that high political competition will result in more supervision by political competitors and society. Political competitors will monitor the performance of local governments and find weaknesses. Local governments with high political competition will disclose their financial reports to demonstrate fulfillment of promises during the campaign.

The purpose of this paper is to examine the relationship between FS disclosure factors so that appropriate policies can be developed for local governments in Indonesia to improve the quality of information released and serve as a model for developing countries such as Indonesia

## 2. HYPOTHESES DEVELOPMENT

A combination of disclosure theory and experimental evidence was used to generate the research hypotheses. The agency theory's theoretical structure illustrates how determining elements influence the disclosure of financial statements. When considered together, the following hypotheses are presented:

- H1: Financial condition has a positive effect on financial statement disclosure.*
- H2: Financial independence has a positive effect on financial statement disclosure.*
- H3: Political competition has a positive effect on the disclosure of financial statements.*

## 3. METHODOLOGY

This study uses quantitative research with a secondary data approach. The secondary data is in the form of regional government financial reports

obtained from the BPK that are used to obtain information on financial condition, financial independence and political competition for FS disclosure, as well as other supporting sites such as [www.bpk.go.id](http://www.bpk.go.id) and [kpu.go.id](http://kpu.go.id). The population used in this study is the local government of Sumatra and the data used is from 2019. Based on Table 1, the sample criteria are in accordance with those previously determined using cluster sampling, it has been determined that of the existing 154 populations, there are 151 are districts/cities in Sumatra in 2017 that were selected as research samples. Districts/cities in Sumatra were selected as samples because districts/cities in Sumatra were the ones with the lowest disclosures in their FS and there were still many districts/cities that received the predicate of unqualified opinion and adverse opinion.

**Table 1.** Summary of the final sample

Source: Authors' elaboration.

No.	Criteria	Total
1.	Population	154
2.	Financial reports are not available	(0)
3.	Financial reports are available	154
4.	Incomplete financial report	(3)
	Number of financial reports	151

Government Regulation No.71 of 2010 requires the disclosure of local government FS based on government financial accounting standards. Disclosure of FS is used to provide complete information required by users and the information has been presented fairly (PP No. 71 2010) adopted from Aswar et al. (2021) and Aswar et al. (2022) by using a disclosure item with a total of 50 items. The total number of items that must be available at the LKPD is divided by the highest number of items that are applicable. The percentage ratio for the indicator is in the range of 0% to 100%, and each item in the financial statements is examined and coded "1" if revealed and "0" if not disclosed.

There are three independent variables, namely financial condition, financial independence and political completion (Table 2). According to Giroux and McLelland (2003), the overall debt ratio in local government FS is used to measure financial condition. The ratio of regional financial independence is measured by dividing the total revenue received from the region by the number of

**Table 2.** Measurement of variables

Variable	Acronym	Measurement	Source
Financial Condition	FC	Total debt ratio	Giroux and McLelland (2003)
Financial Independence	FI	Total regional own-source revenue divided by loans and grants from the federal and provincial governments	Ermawati and Aswar (2020)
Political Competition	PC	Number of candidates/ positions available	Laswad et al. (2005)

central transfer receipts plus provincial transfer income and regional loans (Ermawati & Aswar, 2020). According to research undertaken by the American Political Science Association, political competition is assessed by comparing the number of candidates to the number of open posts (Laswad et al., 2005). In addition, the data analysis method employed in this study is divided into two parts: descriptive statistical tests and hypothesis testing. Multiple linear regression with the SPSS was employed in this study for data analysis.

## 4. EMPIRICAL RESULTS AND DISCUSSION

The research object used in this study is the district/city government of Sumatra in 2019. The data used as the research object was obtained from the Republic of Indonesia BPK. The SPSS algorithm was then used to evaluate the data. The descriptive statistics for the data are presented in Table 3.

Descriptive statistics in Table 3 illustrate that the average level of FS disclosure for the district/city on Sumatra is 0.842 or 84.2%, and no local government of Sumatra shows 100% mandatory disclosure. The descriptive statistics for FC, FI and FS show that the mean value is greater than the standard deviation value, so it can be said that the data is homogeneous. Multiple regression is done to determine the effect of the independent variable on the dependent variable. The coefficients are generated from the regression analysis for each of the independent variables. This coefficient is obtained by predicting the value of the dependent variable with an equation. The results of data

processing performed with the help of Statistical Product and Service Solution for Windows version 23 are shown in Table 4.

**Table 4.** Multiple regression test

Variable	B	t	Sig
(Constant)	0.925	26.731	0.000
Financial Condition (FC)	0.095	2.164	0.037
Financial Independence (FI)	0.069	2.072	0.004
Political Competition (PC)	0.038	1.939	0.042

Based on the findings above, the first hypothesis test illustrates the impact of financial condition on FS disclosure. Thus, H1 is accepted, governments with high debt ratios will have a harder time disclosing their FS. The findings of this study are consistent with agency theory, in which the local government debt ratio becomes a financial performance factor and poses a significant danger of abuse. As a result, local governments find it difficult to reveal their FC because they do not want to appear to be violating principles, which will erode public trust in the government. Creditors who provide loans to debtors need complete information in order to predict that the debtor can fulfill its obligations to pay debts at a predetermined time, therefore the Sumatran regional government must prepare transparent and accountable financial reports.

Large debt financing means that local government activities are financed through debt and not all local governments finance their activities through debt. Thus, the existence of debt financing puts pressure on the Sumatran regional government to increase the disclosure of its financial statements due to the large average debt financing. This study

**Table 3.** Summary of descriptive statistics

Variables	N	Minimum	Maximum	Mean	Std. Dev
Financial statements disclosure (FSD)	151	0.750	0.970	0.842	0.055
Financial Condition (FC)	151	0.000	0.945	0.324	0.161
Financial Independence (FI)	151	0.046	5.982	1.397	0.993
Political Competition (PC)	151	2.000	6.000	3.388	1.420

consistent with Muñoz and Bolívar (2015) conducted a meta-analytic study of 36 articles and the local government as the focus of the study found that financial conditions have a relationship with FS disclosure. Local governments' maturity is shown in the relationship between financial situations and FS disclosure.

The results of financial independence have an effect on the disclosure of FS. This means that local governments can carry out their own activities independently without depending on balance funds sourced from the center. The more the public's contribution to compliance with levies and tax payments, the higher the ratio of regional independence to local revenue, which indicates the greater the public's contribution to compliance with levies and tax payments, the larger the demands for openness and accountability in the presentation of regional government financial reports.

A government that has high local own-source revenue automatically makes disclosures with high information content. This means that the level of FS disclosure depends on the level of a region's independence. This significant relationship is also due to the higher ratio of financial independence of the Regional Government; this demonstrates that the regional government is more self-sufficient in funding its own government activities, development, and community services, indicating a high level of reliance on third parties. This is what motivates local governments to disclose their FS because of the high demands for transparency and accountability of LKPD from external parties.

Furthermore, the third hypothesis testing shows that there is an effect of political competition on FS disclosure. An average political competition of 3,388, it shows that political competition in Indonesia is quite competitive. The H3 is accepted, which suggests that political competitiveness on Sumatra increases pressure on financial transparency. If elected officials keep their political prom-

ises, their power will be weakened. The findings of this study support agency theory, indicating that political rivals on Sumatra are fiercely competitive and exert pressure on local governments to reveal their financial figures.

High political competition has forced local governments to better meet the interests of all parties. An increasing number of political parties that support regional heads, the community and other parties, especially competitors for regional heads in the post-conflict local election, are increasingly demanding local governments to be more transparent regarding regional financial management. Regional financial accountability can be realized by making it easy to access regional financial information on the local government's official website. This is done so that local governments are not only oriented to their personal interests. The more political parties that support it, the more diverse the demands of each political party. The high level of political competition is expected to increase the disclosure of regional financial statements. Ease of access to regional financial information is carried out by local governments as a fulfillment of demands from the community and other parties.

According to institutional theory, the Sumatra regional government is under pressure from political rivals to make disclosures, implying that the regional government will engage in disclosure activities to demonstrate the quality of its regional government. This result is in line with the previous study by Garcia (2010) that states that political competition has a significant positive effect on the level of voluntary disclosure of accounting information on the internet by local governments. This is consistent with some previous studies in local governments which found that political competition had an impact on FS disclosure (Zimmerman, 1977; Cinca et al., 2009). Muñoz and Bolívar (2015) used a meta-analytic methodology to examine 36 publications and found that political competition has a significant impact on FS disclosure.

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## CONCLUSIONS AND RECOMMENDATIONS

This study aims to examine the factors that influence the level of FS disclosure of local government in Indonesia, namely financial condition, financial independence and political competition. Based on the results of the analysis, it was found that the overall level of LKPD disclosure on the island of Sumatra

in 2019 was evidenced by an average of 84.20%. The findings of this study show that financial condition affects FS disclosure. The debt ratio is used to assess financial status, and it indicates that when the debt ratio is high, it is difficult to publish financial statements. Second, financial independence has an effect on FS disclosure. This indicates that dependence on the central government requires local governments to increase FS disclosure. Lastly, political competition has an influence on the disclosure of FS. This indicates that political competition on Sumatra puts pressure on FS disclosure.

The limitations of this study are that it uses only research objects on the island of Sumatera, financial reports are the main source of information. This study is expected to provide an overview to local governments about the accountability and openness of local government financial management, so that people can assess local government policies and performance as well as efforts to create good governance for the community and become input in increasing local government FS disclosure. Further research should be undertaken in other jurisdictions, such as other countries, to extend the longitudinal analysis (other countries). The disclosure index measurement items could also be changed.

## AUTHOR CONTRIBUTIONS

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