“Public sector accounting reforms: assessing Indonesia’s readiness towards implementing accrual accounting”

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SECTION 2. Management in firms and organizations

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Public sector accounting reforms: assessing Indonesia's readiness towards implementing accrual accounting

Abstract

The Indonesian government, following the global trends in adopting new public management practices, has seen the need for reforms in its public accounting practices. One of the reforms adopted by this country is the use of accrual based accounting system to improve the quality of financial reporting information and enhance public sector accountability and transparency. However, the introduction of a new accounting system is not an easy and simple process. There is a wide gap between changes to the concept of formal accounting practices and its ultimate development and implementation. As such, this study analyzes the readiness of the Indonesian public sector towards adoption of accrual accounting as part of the public sector reform efforts by reviewing relevant laws, guidelines and regulations. In this study, the framework adopted by the New Zealand government (Ouda, 2008) is used to analyze Indonesia's readiness towards adopting the new system. The findings reveal that several initiatives were taken to support the adoption of the new system namely (a) enactment of new regulations and laws; (b) usage of varieties of communication channels to explain the system; and (c) obtaining inputs from the professional and academic accounting community. However, it is evident that the adoption of accrual accounting continues to face challenges and major inadequacies including insufficient training, lack of professional public sector accountants especially at the local government level, continued implementation of cash based budgeting together with non-integration of various information technology systems. Hence, these issues need to be addressed to ensure public sector readiness towards implementing accrual accounting in Indonesia.

Keywords: accrual accounting, public sector accounting, accounting reform, Indonesia.
JEL Classification: M41.

Introduction

Indonesia has undergone dramatic reforms in its political, economic and public administration systems since the late 1990s. These reforms have encompassed all aspects of good governance practices with one specified agenda which is to serve the people in a more effective, efficient, responsive, transparent, and accountable manner. The objective was to strengthen public service delivery from the aspect of the demand side. In addition, such reforms were also targeted to foster greater participation and empowerment of the citizenry, promote a more democratic system based on legal supremacy that respects human rights, and reduces corruption at all levels of the Indonesian government.

In 1999, the Indonesian government issued Act No. 28 to regulate anti-corruption, collusion, and nepotism through good governance practices (Harun, Peursem & Eggleton, 2012; Marwata & Alam, 2006; Prasojo, Kurniawan, & Holidin, 2007). The country also issued Act 22/1999 (replaced by Act 32/2004) which is concerned with local government systems or decentralization, and Act 25/1999 (replaced by 33/2004). These Acts regulate the government's financial management systems, that is, the fund balance of the central and local governments. They intend to ensure good governance of the local government in resource management. The decentralization of power and authority from the central to the regional and local government has led to the increase in demands for more specific information on the performance of the public sector. The new management systems have denoted an inevitable shift that represents progress towards a more advanced administration (Osborne & Gaebler, 1993).

Given that the traditional cash accounting system was unable to provide the additional required financial information as a result of the new public management orientation (Oliorilanto, 2008; Ouda, 2006; Steger, 2010; Upping & Oliver, 2011), the public sector reforms in Indonesia had to incorporate changes in its accounting practices. The accrual accounting system is able to better support the NPM (New Public Management principles of efficiency, effectiveness, transparency and accountability). This system is also able to show the organization's performance including financial statements of the public institutions (Mardiasmo, Barnes, & Sakurai, 2008). The application of the accrual-based accounting rule in many developed countries has brought about several benefits, such as better financial management, sound understanding of program costs, improved resource allocation information, comprehensive

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financial reporting, as well as efficient management of assets, including cash (Van Der Hoek, 2005).

However, introduction of a new accounting system is not a simple process (Dambrin, Lambert, & Sponem, 2007). A wide gap exists between the changes to the concept of formal accounting practices and its ultimate development and implementation. Given that formal adoption of the accrual accounting would not automatically bring intended outcomes, it is pertinent to analyze and evaluate the readiness and preparedness of the Indonesian government towards adopting accrual accounting as part of the reform efforts. The framework developed by New Zealand government (Ouda, 2008) was used to assess those variables that must simultaneously be available for implementation of accrual accounting in the public sector in an efficient, effective and economic way and to attain the targeted benefits from the reforms.

1. Literature review

Empirical evidence shows the difficulties of adopting new public management oriented practices in developing countries. Developing countries confront obstacles such as: (1) overwhelming capacity constraints; (2) other urgent priorities besides improving public accounting practices; (3) corruption and vested interests that could undermine the efforts; (4) donors' activities that could reduce coherence of the reforms; (5) reform fatigue that impede the initiatives; (6) limited technological infrastructure that reduce options and raise costs; and (7) limited capacity of supreme audit institutions (SAIs) (Athukorala & Reid, 2003). Hence, developing countries face a myriad of challenges in implementing accrual accounting for the public sector.

Although it is generally recognized that accrual-based accounting is superior to cash based accounting, opponents tend to raise concerns about adoption costs and difficulties. Recent literature on public sector accounting critically questioned the claimed benefits of the accrual accounting reports (Carlin, 2005; Christensen, 2007; Christensen & Rommel, 2008; Connolly & Hyndman, 2008). Some public administration scholars argued against the full implementation of accrual-based accounting system in the public sector (Ellwood & Newberry, 2007; Wynne, 2007). They questioned the scope and benefits of implementation of the accrual-based accounting system, the purpose of its use in the public sector, its impact on the relevance, reliability and understanding of the resulting financial information for the public sector (Kober, Lee, & Ng, 2010). They also pointed out that only a few countries have implemented it, and the accrual-basis does not remedy the "off-balance sheet" problems. Therefore, it was proposed that the emphasis should first be on getting the basics right (Athukorala & Reid, 2003).

Experience from some developing countries shows that technical and institutional problems potentially hamper the government's efforts in reforming public sector accounting to improve efficiency. Unsuccessful accounting reforms were encountered by Fiji (Sharma & Actrence, 2009) and Nepal (Adhikari & Mellemvik, 2011). Nepal has been acquainted with the notion of accrual accounting since the late 1980s. The interest of international organizations and the involvement of professional accountants (consultants) are the two main factors driving the adoption of accrual accounting. Empirical evidence from two public sector organizations in Fiji which underwent structural reforms, reveal the difficulties of transformation and how the local needs were not met for the purpose for which the organizations were established. Similar findings were drawn from the public reforms in Sri Lanka. These reforms demand new skills and attitudes on the part of both bureaucrats and politicians. There is undoubtedly a need to develop and implement new initiatives to improve transparency in the public sector management. However, it is questionable whether political commitment for such reforms exists (Samaratunge & Bennington, 2002).

A study that compared public sector accounting reform practices in Malaysia and the UK (Saleh & Pendlebury, 2006) found that the principles of accrual accounting were introduced in the UK primarily for managerial accounting and control purposes. Whereas Malaysia focused primarily on management accounting initiatives for the development of governmental accounting. Currently, Malaysia is considering the use of accrual accounting to improve further its financial management procedures. Financial management in the government includes planning processes, implementation and control on the use of assets and public financial resources. To increase efficiency in financial management, Malaysian public services have strengthened the implementation of the micro accounting system, introduced standard computerized accounting and undertaken follow up actions on the Auditor General's Report (Saleh & Pendlebury, 2006).

Evidence indicates that the U.S. government produces audited consolidated financial statements for budget entities, but it excludes several bodies such as the Army and Air Force Exchange Services. The UK government adopted accrual accounting in phases, not through the big-bang approach. Australian government produces audited financial statements for the federal government as a whole, including analysis of the key aggregates related to

general government entities, public nonfinancial corporations, and public financial corporations under the control of the federal government. Similarly, New Zealand government produces audited financial statements for the government as a whole (Athukorala & Reid, 2003; Khan & Mayes, 2005, 2009). A study in New Zealand on the accounting systems and accountability transformation of public service institutions into "successful businesses" showed that the process is still ongoing (Lawrence & Doolin, 1997). Nevertheless, New Zealand successfully undertook the accounting reforms in a big bang approach and applied bold ideas and innovative theories. The reforms commenced in May 1986 with control of its state-owned enterprises. This was followed by management reforms, including financial reform, that involved changing from an input to an output-based budget, and shifting from cash to an accrual accounting system in 1989. Another study that examined the accrual accounting and public sector reforms in the Northern Territory revealed that the reforms did not achieve their intended objective of increasing accountability (Ali, 2008). The small private sector in the Northern Territory was unable to support the creation of a competitive market for most government goods and services. Although accrual accounting provided full cost information, the heterogeneity of some government services resulted in questionable full cost estimates.

The use of full cost pricing did not achieve its intended benefits because of the absence of competitive market pressures. Further, the use of cost information in benchmarking was lessened mainly due to higher costs of services arising from 'capital cost disabilities' prevalent in the Northern Territory which is not associated with performance efficiency. Furthermore, accrual budgeting was not utilized properly and therefore, it was failed to achieve its objectives. However, it cannot be denied that accrual reporting has improved the completeness of the availability of accounting information at all government levels. Despite this, things have not changed much from cash reporting in discharging good governance practices at the organizational and governmental levels.

2. Methods

This paper adopted a combination of descriptive and analytical methods. It was conducted by examining secondary data and information as well as reviewing the strategy of accrual accounting adopted in Indonesia. Secondary data in the form of regulations or documents, issued from 1975 to 2013 as listed in Table 1, were examined in this study.

Table 1. Regulations examined

Year	Type	No	Content
1975	Act	5	Management, accountability and audit on local government finance
1999	Act	22	Local government system (decentralization)
1999	Act	25	Financial arrangements between the central and local governments
1999	Act	28	Clean and free from corruption, collusion and nepotism in state governance
2003	Act	17	State finances
2004	Act	1	State treasury
2004	Act	5	Audit and financial accountability
2004	Act	15	Audit management and accountability of state financial management
2004	Act	25	System of national development planning
2004	Act	32	Local government (revision of Act 22/1999)
2004	Act	33	Financial arrangements between the central and local governments (revision of Act 25/1999)
2005	Act	8	Local government
2006	Act	15	The state audit board
1975	GR	6	Budgeting, execution and responsibility of budget usage
2000	GR	25	Central government authority and the authority of provincial government as an autonomous local government
2000	GR	104	The equilibrium (transfer) fund
2000	GR	105	Local government financial management and responsibility
2000	GR	107	The debt of local government
2000	GR	108	The accountability procedures for head of local authority
2001	GR	20	Development and control over the functioning of local government
2003	GR	8	The guideline for local government organizational unit
2004	GR	3	Provincial, regency and city general allocation fund for budget year 2005
2004	GR	24	Protocol and financial position of the head and members of the local parliament
2005	GR	15	Financial management of public agencies
2005	GR	23	Financial management of public service agencies
2005	GR	24	Government Accounting Standards (GAS)-Standar Akuntansi Pemerintahan, SAP
2005	GR	79	The guideline for nurturing and controlling local government management
2006	GR	6	Management of state/local government assets
2006	GR	8	Financial and performance reporting of government agencies
2007	GR	38	Authority delegation between central, provincial, and district governments
2007	GR	39	State and local government financial management
2007	GR	41	Organizational units within local government
2007	GR	59	Revision of financial management for local governments issued in 2006
2008	GR	60	Government intern control system
2008	GR	61	Internal control system of government agencies
2010	GR	71	Amendment of GR. 24/2004 concerning government accounting standards-Standar Akuntansi Pemerintahan, SAP
1999	MoHA	13	Format and structure of budget report/accountability in local government

Table 1 (cont.). Regulations examined

Year	Type	No	Content
2000	MoHA	903 /27 35/ SJ	Guideline for local government budgeting and responsibility of budget 2001
2002	MoHA	29	Administrative guideline, regional financial responsibility and control, procedures for preparing local government budget, execution and accountability
2002	MoHA	29	Guideline for financial management in local government
2006	MoHA	13	Guideline for financial management in local government (the amendment of the MoHA Statement No.29/2002)
2007	MoHA	59	Guideline for financial management in local government (the amendment of MoHA Statement No.13/2006)
2013	MoHA	3	Government accounting system
2012	Per-55/ 2012	Per-55	Government accounting system
2005	PD	2	Committee of government accounting standards

As mentioned earlier, the framework adopted by New Zealand government (Ouda, 2008) was used to analyze Indonesia's readiness towards adopting the new system. Based on the framework, the following factors must simultaneously be in place to facilitate implementation of accrual accounting in the public sector in an efficient, effective and economic way in order to attain the targeted benefits from the reforms. The assumptions that underlie the development of the framework are the stimuli (driving force) and the reform decisions which must be strong, i.e. more than one or two-stimuli are required to adopt the change (Ouda, 2005, 2006, 2007, 2008). The elements of the framework are as follows:

a) *Management culture change*: internal management changes – focus on output, efficiency and effectiveness.
b) *Political and bureaucratic support from the legislative and executive*.
c) *Professional and academic (advisory) support in the fields of accounting and auditing*.
d) *Communication strategy*: extensive communication strategy is a key factor in shaping the understanding of the essential principles of accounting change for politicians and parties involved in the implementation process.
e) *Willingness to change*: willingness and qualifications of staff are needed to develop and implement accounting changes to achieve successful implementation.
f) *Consultation and coordination with relevant government entities that adopt accrual accounting*.
g) *Budgeting adoption cost*: estimation of cost is very important in determining the necessary funds for the implementation process.
h) *Tackling specific accounting issues*: identification and valuation of assets, assets registration, the reporting entity, etc.
i) *Information technology capability*: the reform process should involve increase of computerized information system as the key for accounting, budgeting, and financial management.
j) *Accounting and budgeting consistency (integration) help in dealing with the obstacles in the process of implementation.*
k) *International financial support*: adequate financial and technical support are required especially for developing countries.

3. Findings

The analysis and evaluation on the readiness of the public sector in Indonesia towards the adoption of accrual accounting are presented as follows.

3.1. Management change. This accounting reform took place following the public sector reforms in Indonesia in 1998. The timing was right for the change. The time frame given for full adoption was five years from the establishment of the GR (government regulation), i.e., in year 2015. As agreed by the government, the parliament and the Government Accounting Standards Committee (KSAP – Komite Standar Akuntansi Pemerintahan), the adoption of the accrual-based accounting in the public sector should be implemented in phases, as shown in Table 2.

Table 2. Phases of implementation of accrual-based accounting

Year	Phases of implementation of accrual-based accounting
2010	Issuance of Accrual-based Government Accounting Standards; developing the framework of accrual-based accounting; socialization of the GAS and the framework.
2011	Preparing the technical policies and guidance; developing accounting system and IT – stage I (the business process and system requirements); human resources development.
2012	Developing the accounting system and IT – next stage; preparing the technical policies and guidance; developing the accounting system and IT – stage I (the business process and system requirements); development of human resource capacity (next stage).
2013	Undertaking pilot projects in some ministries and SOE; review, evaluate and improve the system; development of human resource capacity (further stage).
2014	Undertaking parallel run of the system for all government agencies; review, evaluate and improve the system; continue the development of human resource capacity.
2015	Full implementation, and continuing development of human resource capacity.

3.2. Political and bureaucratic support from the legislative and executive powers. To support the reforms, new regulations were issued by the government, for instance, the statement of the Ministry of State Apparatus KEP/26/ M.PAN/2/2004 on improving public services and statement no

10/2010 on roadmap for bureaucracy reform 2010-2014, Act 25/2009 on the public services, and Act 14/2008 on public information. These regulations are among the government's efforts to manage the changes (reform). These are used as references for all public agencies to provide better service quality, and to improve transparency and accountability.

To promote good governance, especially accountability and transparency in the public sector, the Indonesian government issued various regulations and technical guidelines as presented in Table 1. In 2000, the government issued GR 105/2000 (amendment by GR 58/2005) related to local government financial management and responsibility and GR 108/2000 on the accountability procedures for head of local authorities. In addition, the Government Accounting Standards Committee was established by the President Decree 84/2004 (amended by Decree 2/2005). These regulations strengthened the Committee's position.

To support all the needs and the regulations mentioned, Indonesian government issued Act 17/2003, and Act 1/2004 concerning recognition and measurement of government revenue and expenditure, using the accrual basis. Act No. 17, Article 36 paragraph (1) required revenue and expenditure to be recognized and measured on an accrual basis and the accrual-based system to be implemented no later than five years (by year 2008). Further, Act 1/2004 on state treasury, Act 32/2004 on regional government and Act 15/2004 on audit of state financial management and accountability also enforced similar requirements.

Act 17/2003 and Act 32/2004 required central/local government to prepare an accountability report for budget implementation in line with the government accounting standards (GAS). In consideration of the readiness of the resources and existing capabilities, the government, through the Government Accounting Standards Committee (KSAP) did not directly adopt the accrual-based accounting system, but rather used the cash-based system, which was modified, towards accrual-based accounting system. After a review by the Supreme Audit Body (an independent body that has the authority to audit and investigate financial reports and accounts of the Indonesian authorities at the national and local level), KSAP issued the first government accounting standard (GAS) that used cash towards the accrual-based system (GR No. 24/2005). Indonesian GAS was developed with reference to the International Public Sector Accounting Standards. The GAS regulates the basic framework in preparing government accountability report on budget implementation. The reports are in the form of financial statements that consist of budget realization (balance sheet, statement of cash flows, and notes to financial statements).

In addition, Indonesian government also issued Act 15/2004 concerning audit and accountability on financial performance of the government. These regulations strengthen the control of the central government over local officials and budgets. To improve the quality of accountability reporting or information from financial reporting, it is imperative to implement the accrual accounting system because it renders financial and asset management to be more transparent and accountable.

In 2010, GR 24/2005 was superseded by GR 71/2010. It required financial reports of the government agencies to include budget realization, statement of cash flows, balance sheet, statement of financial performance, statement of changes in equity, and notes to financial statements. The main objective of accrual-based accounting is to improve transparency and accountability, and also determine the cost of services. The new GAS requires total adoption of accrual-based accounting by both central and local governments. However, cash towards the accrual system is still allowed to be continually used if the respective governments are not ready for full adoption of the accrual-based accounting system. The issuance of regulations shows the support of the state legislature, and its applications which is the evidence of the support and commitment of the government executives.

3.3. Professional and academic support. Academic and professional support were solicited in the standard setting process conducted by KSAP and in the process of setting the budget of local governments. This is based on the Discussion Memorandum of Implementation of Accrual Basis in Government Accounting in Indonesia in 2006, conducted by accommodating the opinions of professionals and academics related to the government accounting and financial reporting. Similarly, the statement of MoHa No 13/2006 requires stakeholders' involvement, including the professional bodies and members of academia in the yearly budget formulation of both local and central governments.

3.4. Communication strategy. As mentioned in GR 71/2010, the Ministry of Finance (MoF) is responsible for the implementation of the accrual-based accounting at the central government level, while MoHA is responsible for the local governments. Various communication channels, such as the internet, monthly magazine/bulletin, workshop, seminar were used to communicate information about the reforms, the system, and details of implementation. These channels were used to discuss any arising issues in the implementation of accrual accounting.

3.5. Willingness to change. It has been argued that public sector reforms in Indonesia and the accounting reforms were initially imposed by the international donor agencies. The desire for change towards accrual accounting is clearly written in Act 17/2003 and Act 1/2004. Subsequently, MoF and MoHA conducted several trainings and workshops to support the adoption of the new system. However, these trainings were not sufficient to cater for all the staffs in the government agencies. Another issue that impacted the implementation of accrual accouting is the problem of getting enough professional accountants to work in local governments, which was compounded by the problematic recruitment system and unclear job analysis.

3.6. Consultation and coordination. In the GAS, statements or regulations from MoF (Per-55/2012) and MoHA (13/2006) are regarded as the general guidelines of the government accounting system. There is coordination between various agencies and bodies, i.e, MoF, KSAP and MoHA in setting the government accounting standards and guidelines. Technical consultancy related to the implementation of accrual accounting is facilitated by the Directorate General of Finance of Local Government of MoHA (for local government), and the Directorate General of Treasury of MoF (for central government). KSAP plays a key role as the facilitator in socialization of the standards and its implementation.

3.7. Adoption of cost budgeting. Indonesia continues to use cash-based budgeting despite the fact that accrual basis of accounting is the underlying financial reporting basis required by the government agencies.

3.8. Specific accounting issues. Specific accounting issues were described in details under Regulation number 71, 2010. One is the identification and evaluation of assets, contained in the Supplement Sheet PP 71/2010, i.e. Statement of Standard No. of Fixed Assets and No. 8 of Construction in Progress. Classification of Construction in Progress are in Kepmendagri 29/2002 where assets are grouped, and costs and depreciation are calculated. Basically, recording and recognizing Construction in Progress as in PP 71/2010 is the same, but if depreciation cannot be determined, it must be disclosed in the Notes to the Financial Statements.

3.9. Information technology capacity or financial management information system. Indonesian government developed some systems to implement accrual accounting, but they were not integrated. These include free and open source SIM by MoHA, SIMDA by the Supreme Audit Body and SPAN by MoF.

3.10. International financial support. Indonesia received support from various international organizations for its accounting reform initiatives to provide better governance. This includes funding from the World Bank as well as assistance from IMF and the Asian Development Bank to train local government staff at related accounting departments.

Discussion and conclusion

Participation, transparency, and accountability are the three main principles underlying good governance. Participation requires citizen involvement in decision-making and delivery of government services. Transparency refers to information disclosure, and accountability means preparation of information or accurate and timely reports. Accountability and transparency will be improved if it is supported by an accounting system that produces timely and reliable information. As such, accrual accounting assists in improving quality of decision making. This system could also show the organization's performance, including financial statements of public institutions (Mardiasmo, Barnes & Sakurai, 2008).

Since the 1980s, accounting reforms have been a central aspect of NPM philosophies (Allen, 2009; Arnaboldi & Lapsley, 2009; Broadbent & Guthrie, 2008; Upping & Oliver, 2011a). Therefore, Indonesian government also endeavored to reform its public accounting practices. As noted earlier, to ensure that the change to accrual accounting is successfully implemented, various elements have to be in place. Those elements as suggested by Ouda (2010) include the culture of change management that focuses on output, efficiency and effectiveness as well as political and bureaucratic support from the leaders and the professional bodies and the members of academia. In addition, communication strategy to shape understanding on the change principles, the willingness to change, the availability of consultation and coordination, adequate budgeting adoption cost, and addressing specific accounting issues, IT capability, international financial support together with the integration of implementation of accounting and budgeting are required for successful implementation of the accrual accouting system.

In Indonesia, the adoption of an accrual accounting system by government agencies is supported through the issuance of various laws and government regulations to improve the quality of financial reporting information and enhance accountability and transparency. Various communication channels were used to explain the system and details of the implementation. Inputs from the professional and academic accounting community were solicited, especially in setting the government accounting standards (GAS).

However, several factors impeded the readiness of the public sector in Indonesia towards adoption of accrual accounting system. Provision of training to support the implementation of the new system was insufficient since it failed to cater for all the staff in governmental agencies. This would affect the technical ability of the public officers to understand and to implement the reforms. As Hepworth (2003) argues, there is a risk in moving from cash to accrual if the changes are not well understood. Moreover, the technical skills and capability of public sector officials are lacking, especially at the local government level due to the lack of professional accountants in the organizations. These were compounded with the problematic recruitment system and job analysis of professional public sector accountants.

Emprical evidence indicates that the most significant obstacle to the accrual-based system is resistance from those who are unwilling to change their old habits and practices. Therefore, change requires strong political support and leadership resolve. Hence, unless the issue of staff training, professional accounting, human resources and good change management system are addressed, the adoption of the new accounting system would encounter problems. There is a dire need to improve the communication strategy with respect to the adoption of accrual-based system and more trainings and workshops must be conducted. The incentive system has to be improved given that the issue of incentive system has not been given due consideration in the amendment process. Undoubtedly, the public sector would be able to attract professional accountants and improve staff's motivation with better incentives. Other factors that have to be addressed are ensuring integrated IT system capacity and capability, improving internal control procedures and integrating budgeting and financial accounting systems.

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