Research Journal of Finance and Accounting
ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)
Vol.5, No.10, 2014


# The Compliance with Mandatory Disclosure of Financial Statement: A Study from Local Government in Indonesia

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**Abstract**

The purpose of this study is to examine the effects of size of district and city, type of local government, wealth, and level of local dependence on central government on compliance with mandatory disclosure of financial statement 2011 in Indonesia. Population in this study is all countries and cities in Indonesia which includes a number of 497 district and cities. This research uses a purposive sampling design, the exact type of quota sampling. This type of sampling design can ensure that certain groups are fairly represented in the study through a quota. which is set for each sub-group based on the number of each group in the population. The number of samples are 104 local governments. The multiple regression used in this research. The results indicate that size of district and city, type of local government, and wealth influenced on compliance with mandatory disclosure of financial statement, while level of local dependence on central government not influenced on compliance with mandatory disclosure of financial statement. This paper is organized as follows. Session 1 background of research. Session 2 review of literature and hypothesis development. Session 3 outlines the research methodology, session 4 describes the results of the study, and session 5 conclusion and recommendations.

**Keywords :** determinants of disclosure compliance with mandatory disclosure of financial statement, local government

## 1. Introduction

Transparency and accountability in the management of public funds became an important issue after the reform. The financial statements of the local government has a strategic role to show useful information for users to make a decision of economic, social and political (Mardiasmo, 2009). Meanwhile, the IFAC (2000) states that the objective of financial statements is to show the accountability of government and government resources entrusted to the government, and providing useful information for decision making. Disclosure of financial statements in Indonesian local government be regulated in Indonesian government accounting standar (IGAS).
Anumber of studies examine the determinants compliance with mandatory disclosure of financial statement has a lot to do, but generally the studies examines in the private sector, while the research is still limited in government entity (Laswad, *et al*. 2005; Styles and Tennyson, 2007). Study that examined factors that influence compliance with mandatory disclosure of financial statement on local government has been done by a Robbins and Austin (1986). Their findings show that level of local dependence on central government and the type of local govermnet influnced on compliance with mandatory disclosure of financial statement, while the wealth not influenced. Other researchers, Giroux and McLelland (2003) founds that wealth influenced to the disclosure, while size and level of local dependence on central government not influenced. Laswad, *et al*. (2005) showed that the type of local government and wealth influenced on compliance with mandatory disclosure of financial statement, while size not influenced on compliance with mandatory disclosure. Further research, Styles and Tennyson (2007) found that size and wealth influenced on compliance with mandatory disclosure, while the government structure not influenced.

Other studies of government financial statements focused on the impact of financial disclosure in indonesia have been done Martani dan Lestiani (2012). They found that disclosures have a positive relation to complexity of local government, management incentive and audit quality. Based on Indonesian Gavernemnt Accounting Standard (IGAS) as the disclosure measure, there is a positive relationship between government complexity and quality of audit and the level of local government disclosures.

 

This study also tested determinants that are empirically influence compliance with mandatory disclosure, they are size of local government, type of local government, wealth, and level of local dependence on central government.

## 2. Review of Literature and Hypothesis Development

### 2.1. Determinant of compliance of mandatory disclosure.

Government financial statement have been recognized as media to show accountability for use of public resources in goverment entities (Tayib, *et al*., 1999; Coy, *et al*., 2001; Hooks, *et al.,* 2002). In this study, determinants that influence compliance with mandatory disclosure of financial statement on local government are size local government, (Connoly and Hyndman, 2004; Styles and Tennyson, 2007; Laswad, et al.,2005; Falkman and Tageson 2008), type of local government (Robbins dan Austin,1986; Laswad, et al, 2005; Martani dan Lestiani, 2012), wealth (Giroux and McLelland, 2003; Robbins and Austin, 1986; Ingram, 1984; Laswad, et al. 2005), and level of local dependence on central government (Robbins and Austin, 1986; Giroux and McLelland, 2003; and Falkman and Tageson, 2008).

#### 2.1.1. Size Of Local Government

The large local government generally has a relatively large number of total aset (Baber, 1983). In this study, influence size of local governmnet on compliance with mandatory disclosure analyzed with legitimacy theory. This theory explained that organization will be continue work to ensure that the organization operates within the frame and norms that exist in community or environment in which the organization was and continues to ensure that activities of the organization accepted by stakeholders as a legitimate.

As long as both the value system aligned, so it is legitimate for the organization (Dowling and Pfeffer. 1975). Adopted from the description, local government which has a hight level monitoring will be more motivated to use strategy disclosure to realize the expectations of the society, that is the demand for transparency and accountability. Disclosure is a mechanism that can be used to communicate about condition of the organization to stakeholders and its means to obtain benefits or repair legitimacy (Campbell, et al. 2003; Lindbolm, 1994). Giroux and McLelland (2003) stated that along with the change of meaning of accountability, local government obtained increasing demand for information and obtained greater level of monitoring performance. Based on the description above, the hypothesis in this study is:

**H1 :** The size of district and city has a positive effect on compliance with mandatory disclosure

#### 2.1.2. Type of Local Government

Type of local government is defined as a form of local government. Indonesia has more than twelve thousand islands and more than two hundred and fifty million people. Indonesians have three levels of governments, which are central, provincial, and municipal (city or district) governments. Each type of local goverment that have different population characeristics.

Ingram (1984) argue that city area is a favorite destination of urbanization which have a large population and have a more heterogeneous population both in terms of education, social, and economic. Cities have characteristics of strong economic factors supported by good infrastructures and many centres of educational activities to make the city more often interact with the community. So city government should be motivated to be more transparent in revealing their financial reports. Cities sometimes hire consultants to improve the quality of financial statements including the disclosure. Therefor, city government encountered more greater agency problem than district governemnt mainly related to the asymmetry information. Several studies that examine the type of local government on compliance mandatory disclosure has been done by Robbins and Austin (1986) and Laswad, et al. (2005). Their findings indicate that the type of local government has a positive realtionship on disclosure of financial statements. Hypothesis based on these predictions and the alternative hypothesis is stated as follows.

**H2 :** The type of local government has a positive effect on compliance with mandatory disclosure

#### 2.1.3. Level of Local Dependent On Central Government

Local governments that have high percentage of intergovernment revenue will be more compliance with mandatory disclosure. Its mean to reduce the problem of asymmetry information between local governemnt and central government. it is an attempt to demonstrate that the local government has been carried out in a transparency and accountability.

The relationship between local government and central goverment can be described as a relationship of agency, central government as principle and local goverment as agent (Banker and Patton, 1987). In this scenario assumed mayor does not always act in accordance with the wishes of the central government and inclined to act for its own interest. Zimmerman (1977) describes the interest of mayor, as an example interest in the election for mayor in the coming period or other interests related to money or not.

Several studies that examine the level of local dependence on central government to compliance mandatory disclosure has been done by Robbins and Austin (1986) and Laswad, *et al.* (2005). Their findings indicate that the level of local dependence on central government has a positive realtionship on compliance with mandatory disclosure of financial statements. Hypothesis based on these predictions and the alternative hypothesis is stated as follows.

**H3 :** The level of local dependence on central government has a positive effect on compliance with mandatory disclosure

### 2.1.4. Wealth

According to Cohen and Kaimenakis (2008), municipalities that do not heavily rely on government subsidies are expected to be keen in showing their good financial health and therefore be more willing to comply with accounting standard. In this way, municipality does not give signal of doubt in relation to their true financial condition to all interested stakeholders. Mayors who wish to politically benefits from their municipality's good financial health also drive this behaviour (Cohen and Kaimenakis 2008).

Empirical evidence suggests that wealth has a positive realtionship on disclosure of financial statements have been found by Giroux dan McLelland (2003), Laswad, et al.(2005) dan Styles dan Tennyson (2007). Hypothesis based on these predictions and the alternative hypothesis is stated as follows.

**H4 :** The wealth has a positive effect on compliance with mandatory disclosure

## 3. Research Methodology

### 3.1. Population and Sample

The population was all district and city of goverment in Indonesia. The sampling design used is non probability, namely judgment sampling with the following criteria. (1) local government financial statements are available (2) district and city of government which have autonomous (3) District and city of governments that own and deliver a complete set of financial statements in 2011.

### 3.2. Data Sources and Data Analysis Techniques

This study uses secondary data, in the form of local goverment financial statement is audited by supreme audit instutution.

### 3.3. Variable and Measurement.

1. Local government size in this study is proxied by the end of the years the total of aset owned by the local government. This study uses the total assets to conduct the analysis. as is done by Laswad, et al. (2005), Suhardjanto and Yulianingtyas (2011).
2. Type of local government in this study is a dummy variable, which gives value (1) for city and value (0) for district. Several studies using this proxy are Laswad, et al. (2005) and Robins dan Austin (1986). This study uses the district and the city because both types of local governments are equally as two levels of local government.
3. The local government wealth is measured by the own revenue for each person in the local goverment. Ingram (1984) also used own revenue per capita as local wealth. Own revenue is revenue collected by local government. By Indonesian law, local governments can collect local taxes, i.e., restaurant tax, movies tax, billboard promotion tax and water tax. Local governments can generate income from local state-owned companies, tourism and parking fees. According to Ingram (1984) ratio of inter-governmental revenue to total revenue is a proxy of the level of dependency local government to the central government.
4. Level of local dependent on central government in this study is measured for ratio of inter-governmental revenue to total revenue. According to Ingram (1984) ratio of inter-governmental revenue to total revenue is a proxy of the level of dependency local government to the local government.
5. The level of disclosure in this study is mandatory disclosure level of local government. This study uses the framework disclosure compliance measured by partial compliance unweighted diclosure. Framework refers to the disclosure items contained accounts of the balance sheet, budget realization reports, cash flows and notes to financial statements based on Indonesia Government Accounting Standard (IGAS) contained in the Statement of Governmental Accounting Standards No. 2 to 9. The compliance with mandatory disclosure of financial statement based on Indonesia government accounting standard (IGAS) showed table 1.

### 3.4. Empirical Models

This study uses analysis Ordinanary Least Square (OLS) for cross-sectional data

$$Disc = \beta0 + \beta1Size + \beta2Type + \beta3\ Depend + \beta4Wealth + e \qquad (1)$$

Where:

| | | |
|---|---|---|
| β0 | = | Intercept of regression |
| β1, β2 … | = | Slope |
| Disc | = | disclosure, measured by index numbers |
| Size | = | Company size as measured by log total year-end assets. |
| Type | = | Industry type is measured using a dummy variable, 1 = for city, 0 = for district |
| Depend | = | Number of general allocation fund that transfer from central government to local government devide by total actual budget |
| Wealth | = | Wealth is measured by total local revenue devided to the total population. |
| e | = | Error Term |

## 4. Result and Discussion

### 4.1. Sample Description

This research uses a purposive sampling design, the axact type of quota sampling. This type of sampmg design can ensure that ceratin groups are fairly represented in the study though a quota, which is set for each sub-group based on the number of each group in the population.

**4.2 Data Description**Description of the data shown in table 2 shows the variation of the dependent and independent variable data.

### 4.3 Regression Analysis Result

The results of the multiple regression analysis between compliance with mandatory disclosure and independent variables are size of district and city, type of local goverment, level of local dependence on central government and wealth are presented in the following tables 4. Clasical assumption test (Table 3) were undertaken before the regression analysis.

#### 4.3.1 The Effect of Company Size

The test results showed a positive and size district and city is statistically significant on the level of compliance with mandatory disclosure The significant variable is size of district and city (p-value 0,000) that significant at 0,05. Therefore, it can be concluded that size of district and city influence compliance with mandatory disclosure. Theory that support and provide positive direction to build a hyphothesis in this study is leqitimacy theory. Some studies obtain the same result (Connoly and Hyndman, 2004: Styles dan Tennyson, 2007)

#### 4.3.2 The Effect of Type of local government

The results showed a positive effect of type of local government and statistically significant on the level of compliance with mandatory disclosure The significant variable is size of district and city (p-value 0,043) that significant at 0,05. Therefore, it can be concluded that type of local government influence compliance with mandatory disclosure. Theory that support and provide positive direction to build a hyphothesis in this study is agency theory. Some studies obtain the same result (Robbins and Austin,1986; Laswad, et al. 2005).

#### 4.3.2 The Effect of local dependence on central government

The results showed a positive effect of local dependence on central government and statistically not significant on the level of compliance with mandatory disclosure The significant variable is dependence on central government (p-value 0,245) that not significant at 0,05. Therefore, it can be concluded that local dependence on central government not influence compliance with mandatory disclosure. The test result showed the local dependence on central government is not consistency proven effect on the level of compliance with mandatory disclosure. Agency theory underlying determinants is not always consistent provable. Several studies have also shown inconsistent result. Research conducted Laswad, et al. (2005) and Falkman and Tageson (2008) proved not effect the probability of level of compliance with mandatory disclosure

#### 4.3.4 The Effect of Wealth

The results showed a positive effect of wealth and statistically significant on the level of compliance with mandatory disclosure The significant variable is wealth (p-value 0,009) that significant at 0,05. Therefore, it can be concluded that wealth of local government influence compliance with mandatory disclosure. Theory that support and provide positive direction to build a hyphothesis in this study is signaling theory. Some studies obtain the same result Giroux dan McLelland (2003), Laswad, et al.(2005) and Styles and Tennyson (2007).

## 5. Conclusion and Recommendation

This research can provide theoretical implications, providing empirical evidence applying agency theory, legitimacy theory, and theory of signal in local goverment of Indonesia. The results showed variable size of district and city, type of local government, and wealth consistently affect on the level of compliance with mandatory disclosure. Other variable, namely the level of local dependence on central government may prove inconsistent effect though. Future research is expected make disclosure checklist that give weight to the importance of an item of disclosure. Weighting is expected to obtain weighting is expected to give a weighted value for each non-compliance with an item by considering the importance of an item of disclosure

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**Table 1. The Compliance With Mandatory Disclosure Of Financial Statement Based On Indonesia Government Accounting Standard (IGAS)**

| **Indonesia Government Accounting Standard** | |
|---|---|
| Statement Of IGAS No. 2 | Budget Realization Report |
| Statement Of IGAS No. 3 | Statement of Cash Flows |
| Statement Of IGAS No. 4 | Notes to the Financial Statements |
| Statement Of IGAS No. 5 | Accounting of Inventory |
| Statement Of IGAS No. 6 | Accounting of Investmen |
| Statement Of IGAS No. 7 | Accounting of Fix Asset |
| Statement Of IGAS No. 8 | Accounting of Construction in Progress |
| Statement Of IGAS No. 9 | Accounting of Liabilitiy |

Sumber: PP No. 24/2005 Indonesia Government Accounting Standard

**Tabel 2. Statistic Descriptive Test Results**

| **Variable** | **Minimum** | **Maximum** | **Mean** | **Std. Deviation** |
|---|---|---|---|---|
| Size* | 91.118,8 | 20.298.237,7 | 2.031.276,9 | 2.277.928,6 |
| Depend | 0,7380 | 0,9860 | 0,8905 | 0,06088 |
| Wealth* | 15.900 | 468.343 | 127.910 | 92.251 |
| Disc | 0,3900 | 0,6900 | 0,5566 | 0,07880 |

Source: Data Processed. 2014

**Table 3. Classic Assumptions Test Results**

| Variable | Multicollinearity Test | Linearity | Heteroskedasticity Test | Normality Test |
|---|---|---|---|---|
| | VIF | | | |
| Size | 1,193 | 0,000 | 0,360 | 0.111 |
| Type | 1,280 | 0,002 | 0,051 | - |
| Depend | 1,477 | 0,040 | 0,698 | 0.175 |
| Wealth | 1,220 | 0,000 | 0,504 | 0.793 |

Source: Data processed, 2014

**Tabel 4. Regression Analysis Result**

| Model | Standardized Coefficients Beta | t-statistic | Sig. |
|---|---|---|---|
| (Constant) | | -2.864 | .005 |
| Size | 0.380 | 4.165 | .000 |
| Type | 0.194 | 2.048 | .043 |
| Depend | 0.119 | 1.169 | .245 |
| Wealth | 0.247 | 2.677 | .009 |

Source: Data processed, 2014