

School of Accounting

**Isomorphic Pressures Influencing the Level of Mandatory Disclosure
within Financial Statements of Indonesian Local Governments**

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**This thesis is presented for the Degree of
Doctor of Philosophy
of
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Declaration

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgement has been made.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

Signature:

Date:2014

Abstract

Using isomorphic institutional theory this study examines the level of mandatory disclosure within financial statements of Indonesian local governments. As an additional contribution to the accounting literature, this thesis employs an outsider-insider research approach that evaluates influence from both outside and inside the organisation. This is important because Indonesia has recently undergone major governmental financial reform and is seeking to greatly enforce its financial accounting transparency. The level of mandatory disclosure is measured using a 57 item index (Government Compliance Index=GCI) derived from the Indonesian Government Accounting Standards (PP No. 24 of 2005) to explore in greater depth the relationship between GCI and key predictor variables both outside and inside the organisation.

The findings reveal there is a moderate level of compliance with key mandatory disclosures (69.6%). The highest level of disclosure is on issues relating to Financial Statement Items (91.7%) whereas the lowest level is for Non-Financial Information Items (44.7%). Regression analysis shows that Java/non-Java jurisdiction, presence of a supportive assistance and training programme, and the proportion of non-supporting parties in local parliament are positively significant predictors of the level of mandatory disclosure. This highlights the influence of mimetic outsider-insider and normative outsider pressures on mandatory disclosure practices within financial statements in Indonesian local governments. Moreover, age of local government, the magnitude of the Human Development Index (*HDI*), and degree of financial independence are also positively significant predictors of the level of mandatory disclosure within financial statements of Indonesian local governments.

Given overall non-compliance rate of over 30% there is a clear need for the Indonesian government and Supreme Audit Board (BPK) to better enforce local government's compliance combined with important financial accounting reforms and rules. Increased enforcement of compliance with increased transparency could improve public governance and better inform the populace of the pressures on and the activities of Indonesian local governments.

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Abbreviations and Translations

AASB	Australian Accounting Standards Board
ADB	Asian Development Bank
AFA	ASEAN Federation of Accountants
ANOVA	Analysis of Variance
APBD	Anggaran Pendapatan dan Belanja Daerah (Budgetary Revenue and Expenditure)
APIP	Aparat Pengawasan Intern Pemerintah (Government Internal Control Apparatus)
ASEAN	Association of Southeast Asian Nations
BAKUN	Badan Akuntansi Negara (State Accounting Agency)
BAPPENAS	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BPK	Badan Pemeriksa Keuangan (Supreme Audit Board)
BPKP	Badan Pengawasan Keuangan dan Pembangunan (Financial and Development Supervisory Agency)
BUMD	Badan Usaha Milik Daerah (Local Owned Enterprises)
BUMN	Badan Usaha Milik Negara (State Owned Enterprises)
CEO	Chief Executive Officer
CIV	Coercive Insider Variable
COV	Coercive Outsider Variable
DAU	Dana Alokasi Umum (General Allocation Fund)
DKS	Dewan Konsultatif Standar (Standards Consultative Board)
DPA	Dewan Pertimbangan Agung (Supreme Advisory Council)
DPD	Dewan Perwakilan Daerah (Regional Representative Council)
DPR	Dewan Perwakilan Rakyat (Indonesian Parliament)
DPRD	Dewan Perwakilan Rakyat Daerah (Indonesian Local Parliament)
DSAK	Dewan Standar Akuntansi Keuangan (Financial Accounting Standards Board)
DSP	Dewan Standar Profesional (Professional Standards Board)
DSPAP	Dewan Standar Profesional Akuntan Publik (Board of Public Accountants Professional Standards)

ECMA	Egyptian Capital Market Authority
FSB	Federal Statutory Bodies
GCI	Government Compliance Index
GDP	Gross Domestic Product
HDI	Human Development Index
IAI	Ikatan Akuntan Indonesia (Indonesian Institute of Accountants)
ICW	Indische Comptabiliteitswet (Indonesian Treasury Act)
IFAC	International Federation of Accountants
IGAS	Indonesian Government Accounting Standards
IPSAS	International Public Sector Accounting Standards
KEMKOMINFO	Kementerian Komunikasi dan Telekomunikasi (Ministry of Communication and Information)
KEPMENDAGRI	Keputusan Menteri Dalam Negeri (Decision of Home Affairs Minister)
KKN	Korupsi, Kolusi dan Nepotisme (Corruption, Collusion and Nepotism)
KMK	Keputusan Menteri Keuangan (Decision of Financial Minister)
KPK	Komisi Pemberantasan Korupsi (Corruption Eradication Commission)
KPU	Komisi Pemilihan Umum (National Election Commission)
KSAP	Komite Standar Akuntansi Pemerintahan (Governmental Accounting Standards Committee)
KSAPD	Komite Standar Akuntansi Pemerintahan Pusat dan Daerah (Accounting Standards Committee Central and Local Government)
KY	Komite Yudisial (Judicial Commission)
MA	Mahkamah Agung (Judicial Supreme Court)
MDI	Mandatory Disclosure Index
MAKUDA	Manual Administrasi Keuangan Daerah (Regional Financial Administration Manual)
MIV	Mimetic Insider Variable
MK	Mahkamah Konstitusi (Constitutional Court)
MOV	Mimetic Outsider Variable
MPR	Majelis Permusyawaratan Rakyat (People's Consultative Assembly)
NIV	Normative Insider Variable

NOV	Normative Outsider Variable
OLS	Ordinary Least Squares
PAD	Pendapatan Asli Daerah (Local Own Source Revenue)
PAN	Perhitungan Anggaran Negara (State Budget Calculation)
PARAN	Panitia Retooling Aparatur Negara (Committee Retooling State Apparatus)
PERDA	Peraturan Daerah (Local Government Regulation)
PKI	Partai Komunis Indonesia (Communist Party of Indonesia)
PMK	Peraturan Menteri Keuangan (Regulation of the Minister of Finance)
PERMENPAN	Peraturan Menteri Pendayagunaan Aparatur Negara (Regulatory of State Empowerment Utilization and Bureaucracy Reform of Indonesia)
PERMENDAGRI	Peraturan Menteri Dalam Negeri (Regulatory of Home Affairs Minister)
PP	Peraturan Pemerintah (Government Regulation)
RUPS	Rapat Umum Pemegang Saham (General Meeting of Share Holders)
SAKD	Sistem Akuntansi Keuangan Daerah (Financial Accounting System of Local Government)
SBY	Susilo Bambang Yudhoyono
SIKD	Sistem Informasi Keuangan Daerah (Financial Information System of Local Government)
SiKPA	Selisih Kurang Perhitungan Anggaran (Government Budget Deficit)
SiLPA	Selisih Lebih Perhitungan Anggaran (Government Budget Surplus)
SKPD	Satuan Kerja Perangkat Daerah (Local Government Task Force)
SOEs	State Owned Enterprises
SUPERSEMAR	Surat Perintah Sebelas Maret (the Letter of Instruction of March Eleventh)
UNDP	United Nations Development Programme
USA	United States of America
UU	Undang-Undang (Government Act)

Related Thesis Publications

Journal article

Arifin, J., G. Tower, and S. Porter. 2013. Fiscal Policy Disclosure in Indonesia Local Governments. *Jurnal Akuntansi dan Auditing Indonesia (JAAI)*, Vol. 17 No.1.

Conference papers

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Arifin, J., G. Tower, and S. Porter. 2012. Mimetic Pressures Influencing Mandatory Disclosure of Local Government Financial Statements in Indonesia. Presented at *The 2012 American Accounting Association Annual Meeting (4th-8th August)*, Washington DC, USA.

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Arifin, J., G. Tower, and S. Porter. 2013. Adherence to the Law: Accounting Compliance of Local Governments in Indonesia. Presented at *Curtin Business School Doctoral Colloquium 2013 (1st-2nd October)*. Perth, Australia.

Chapter 1

Overview of Research Study

1.1 Introduction

This thesis empirically examines the level of mandatory disclosure within financial statements of local governments in Indonesia. The level of regulatory disclosure compliance is measured using a 57 item Government Compliance Index (GCI) derived from the requirements of the Indonesian Government Accounting Standards. Isomorphic institutional theory is adopted as the underlying theoretical framework. Hypotheses are developed based on three variants namely coercive, mimetic, and normative isomorphism. Based on an empirical positivist paradigm, a quantitative methodology is adopted. Statistical tests (T-test and multiple regressions) are conducted to examine the effect of isomorphic determinants proposed in this thesis on the extent of mandatory disclosures in local government financial statements. It is expected that the findings of this thesis will encourage important policy recommendations to the government of Indonesia in improving public governance.

1.2 Background

Indonesia is a developing country in Asia that is currently undergoing comprehensive public sector reform. This new political history has changed the direction of the Indonesian national state system as a whole in almost all aspects of life (Lindsey and Dick 2002). One change is “an effort to create good governance that is free from corruption, collusion, nepotism and the creation of a government system which is relatively more balanced among the executive, judicial, and legislative” (Gie 2003, 12). Bureaucratic reform in Indonesia has increased the participation of the general public from that previously circumscribed by past regimes in power¹ (Rosser 2009). This growing participation is beginning to translate into the people’s demands on the government to enhance accountability and transparency of state

¹ Over 32 years (1966 -1998) Indonesia was led by Suharto’s regime which was known as the ‘orde baru’ (New Era). During this era, free speech and the role of the press were limited (Wibowo 2009).

administration. In order to better achieve transparency and accountability, the government continues to make efforts to revise the areas of legislation, institutions, systems, and improve the quality of human resources (Keban 2000).

The population of Indonesia according to the latest national census in 2010 was 237.6 million, with 58% living on the island of Java, the world's most populous island (Biro Pusat Statistik 2011). Indonesia includes numerous ethnic, cultural and linguistic groups. Since independence in 1945, Indonesian (a form of Malay and the official national language) is the primary language for communication in all areas of education, government, and business.

The country is divided into autonomous and administrative entities in accordance with the provisions of Article 18 of the 1945 Constitution². The autonomous entities are the manifestation of the decentralization principle which according to Tommasi (2007) is known as the transfer of responsibilities from the central or higher level government to the lower level government. Local autonomy is defined as "the right, authority and responsibility of sub-national entities to regulate and manage their own affairs" (Rasyid 2007, 10). Under the decentralization principle, two levels of autonomous entities in Indonesia are created consisting of municipalities/districts, and autonomous provinces.

Municipalities and districts are technically the same level of government with the distinction based on whether the government administration is located in an urban area (municipality) or a rural area (district). A province has a unique duality of authority, on one side as an administrative area which is subordinate to the central government and has authority over a municipality/district in administrative matters only. However, a province also has a position as an autonomous local governing area and this arm of a province in many ways is the same as the position of a municipality/district.

² The Constitution of Indonesia (Indonesian: Undang-Undang Dasar Republik Indonesia 1945, UUD '45) is the basis for the government of Indonesia. The constitution was written in 1945, when Indonesia was emerging from Japanese control at the end of World War II. It was abrogated by the Federal Constitution of 1949 and the Provisional Constitution of 1950, but restored on 5 July 1959.

At the provincial level, the governor is responsible to the people through the local provincial parliament (Indonesia=DPRD provinsi).

Following decentralization in 1999, there has been a surge in the number of municipalities and districts, numbering over 490, while the number of provinces has remained stable at 33 in 2010. An important issue germane to this thesis is that the Indonesian Minister of Finance admits that Indonesian municipalities and districts have low levels of compliance regarding their financial statements (Kompas 2010) and the issue of UU No. 22 of 1999 on local governments requiring better accountability. These themes provide this study with the opportunity to focus on the municipality and district levels that are referred to in this study as 'local government'. A more detailed framework for these levels of government is provided in chapter 2.

Prior to 2003, Indonesia's state finance system was still using the colonial Dutch law provisions (Rudianto 2007)³. Although these laws are no longer used, there are several legacies from the old Dutch laws, including weaknesses in the legislation, in areas of planning and budgeting, in treasury, and in the field of auditing (Tjandra 2006).

During the year 2003-2004, the Indonesian government revamped the nation's financial regulations by replacing all of the old rules. The government issued a package of government acts (UU) that focused on the financial sector. These government acts, referred to as Undang-Undang (UU) in Indonesia comprise: (1) UU No. 17 of 2003 on state finances; (2) UU No. 1 of 2004 on the state treasury; and (3) UU No. 15 of 2004 on the management and financial responsibility of the state. These new regulations play an increasingly prominent role in supporting government policy on decentralization in accordance with the UU No. 22 of 1999 (Suhardjanto, Sulistyorini, and Hartoko 2009).

³ The Dutch law provisions were: (1) Indische Comptabiliteitswet (ICW Stbl No. 1925.448); (2) Indische Bedrijvenwet (IBW Stbl No. 1927. 419); and (3) Regleme Voorhet Administratief Beheer (RAB Stbl No. 1933. 320).

The Law (UU No. 17 of 2003) recommends that every government institution prepares financial statements based on government accounting standards, gradually moving toward a full accrual basis. In that regard, in 2005 the Indonesian government issued Government Regulation (PP) No. 24 of 2005 on the Indonesian Government Accounting Standards. Although this important regulation has been in force for more than five years, the Ministry of Finance has questioned the level of compliance (Mulyani 2010).

In 2010 the government issued new regulation PP No. 71 on the Governmental Accounting Standards and Financial Information System. This regulation replaces PP No. 24 of 2005 which uses a modified accrual basis⁴. The new regulation requires that every government institution, including local government authorities, is required to prepare their financial statements using accrual accounting. The government plans to begin implementing the new regulation (PP No. 71 of 2010) gradually in 2012 to be fully compliant no later than 2015 (Komite Standar Akuntansi Pemerintahan 2011). The gradual roll out recognises that Indonesia still has limited human resources who are experts in government accounting⁵.

As PP No. 24 of 2005 was still in force at the time this research (2010 sample period) was undertaken, modified accrual accounting is used as the basis for analyzing the level of mandatory disclosure in local government financial statements in this thesis.

The Supreme Audit Board (Badan Pemeriksa Keuangan=BPK) in 2009 argues that the financial statements of local governments in Indonesia have not met expectations (Badan Pemeriksa Keuangan 2009). They state many Indonesian local governments have not fully prepared their financial

⁴ Modified accrual basis uses cash basis to recognise revenue, expenditure and financing transactions, but it uses the accrual basis to recognise assets, liabilities, and equity funds (Peraturan Pemerintah No. 24 tahun 2005).

⁵ Fontanella (2010) states that to be able to implement the set of regulations of the local government financial management, there is a need for human resources which at the very least have minimal accounting competence and background. Furthermore, Prodjoharjono (2008) states that any local government task force (Satuan Kerja Perangkat Daerah: SKPD) needs at least 2 accountants, while the number of local governments in Indonesia were 484 in 2008, the average number of SKPD is 40 for each local government, the requirement of accountants throughout the total local governments of Indonesia in 2008 is thus arguably: $2 \times 484 \times 40 = 38.720$ accountants. A very fantastic amount that is difficult to fulfil in the short term (Prodjoharjono 2008).

statements in accordance with standards and regulations. The Supreme Audit Board of the Republic of Indonesia is the highest (supreme) audit institution in the land, it is responsible for the auditing of the state finance, including the budget implementation of the central government and local government, state-owned entities, and those enterprises owned by local governments. In short, they are responsible for the entire wealth of the State (Artjan 2011). The Supreme Audit Board has issued a series of reports highlighting problems with compliance in Indonesian local government⁶ (see Badan Pemeriksa Keuangan 2010) which highlights a clear need to research local government compliance.

Herawati and Susanto (2009) argue that one of the important aspects to obtain an unqualified opinion from BPK is the adherence to accounting standards. Therefore, this thesis examines the level of compliance with government accounting standards, and more specifically examines the level of mandatory disclosure within financial statements of local governments in Indonesia.

1.3 Research Question

The purpose of this thesis is to identify the level of mandatory disclosure within financial statements of local governments in Indonesia and explore factors potentially affecting that level. The primary research questions in this thesis are:

- 1) To what extent do local governments in Indonesia implement the mandatory disclosure requirements in their financial statements?
- 2) What factors help explain the level of mandatory disclosure in local government financial statements?

Using annual reports from the available sample of the population of Indonesian local governments, this thesis investigates the level of mandatory disclosure in local government's financial statements. A Government

⁶ According to BPK's report less than 5% of Indonesian local government financial statements have an "unqualified opinion" during 2007 to 2009 (in 2007: 4 local governments (1%), in 2008: 13 local governments (3%), and in 2009: 15 local governments (4%)) (Badan Pemeriksa Keuangan 2010).

Compliance Index (GCI) is used to measure the level of mandatory disclosure in local government's financial statements.

The 57 item GCI is derived from the crucially important PP No. 24 of 2005. Statistical testing is conducted to explore the associations between the extent to which size of local government, jurisdiction, and political influence affect regulatory government compliance by Indonesian local governments.

This thesis adopts institutional theory (isomorphism dimension) as the underlying theoretical framework explaining mandatory disclosure practices in Indonesia. Institutional theory argues that organisations are faced with institutional pressures and react to these pressures (Perera 2007).

As stated by DiMaggio and Powel (1983), isomorphism consists of three processes: coercive isomorphism, mimetic isomorphism, and normative isomorphism. Coercive isomorphism refers to a situation in which an organisation undertakes institutional practices (e.g. mandatory disclosure practices) because of pressures from stakeholders who are considered important and influential to that organisation (Deegan 2006). This thesis examines two predictor coercive variables: the number of local parliamentarians as an outsider influence, and local government budget expenditure as an insider influence. More detailed explanation about the selection of these two coercive variables is presented in Chapter 3 of this thesis.

Mimetic isomorphism refers to a situation in which an organisation copies institutional practices (e.g. mandatory disclosure practices) of other organisations, often for competitive advantage in terms of legitimacy (Deegan 2006). There are two predictor mimetic variables that are examined in this thesis. Jurisdiction is considered as an outsider variable and is measured by the proxy of Java/non-Java. An existing 'quality improvement programme' of local government financial statements is considered as an insider mimetic influence. Further explanation on the selection of the two mimetic variables is presented in Chapter 3.

Normative isomorphism refers to the pressure arising from group norms which influences managers, for example, to adopt particular institutional practices such as mandatory disclosure practices (Cheng and Yu 2008). The element of pressure is normally developed by professional and occupational groups (Rahaman, Lawrence, and Roper 2004). Within the framework of normative isomorphism, this thesis examines two predictor variables. First, political influence which is measured by the proportion of non-controlling parties in the local parliament is considered as an outsider normative variable. Second, the number of internal auditors in every local government potentially affecting mandatory disclosure practices is considered as an insider influence. More detailed explanation on the selection of these two normative variables is presented in Chapter 3 of this thesis.

Through an examination of these six isomorphic predictor variables, this cross sectional study is expected to provide important insights into the types of, and extent of information that are communicated in local government financial statements.

1.4 Significance and Contribution of the Study

This study is important for several key reasons. First, the research is conducted in Indonesia which has recently undergone major public sector financial reform and has a unique governmental structure as a developing country. Indonesia requires the implementation of good governance in the public sector which is a crucial element in providing effective public services. Although disclosure is mandatory, and has been in place for over five years, there remains a low level of compliance (Badan Pemeriksa Keuangan 2010). This research will shed light on what influences local governments to comply (or not) and the results will assist in improving management performance, government oversight and accountability of the sources of public funding.

Second, this study investigates local governments in Indonesia, where accountability issues are still in an early stage of development given that the democracy system is improving subsequent to the resignation of a powerful

dictatorship in 1998⁷. It is expected that the findings of this study will generate helpful policy recommendations to the government of Indonesia in pursuing better public governance.

Third, since the issuance of UU No. 22 of 1999 on local government, and UU No. 25 of 1999 on financial balance between central government and local governments, Indonesian local governments have been under greater scrutiny from various parties. The UU No. 22 of 1999 emphasises the importance of local government's authority to regulate and manage the interests of the community through their own initiatives. These recent initiatives potentially generate more pressure regarding the increasing need for accountability in Indonesian local governments. The results of this research are expected to provide useful inputs to local governments in improving the quality of their external communication.

Fourth, this study uses institutional theory to examine mandatory disclosure compliance. This theory has been widely used by researchers as a theoretical basis to explore issues on organisational compliance in public sector organisations (see Verbruggen, Christiaens, and Milis 2011; Falkman and Tagesson 2008; and Collin *et al.* 2008). Seijaaka (2004) posits that this theory potentially provides greater insights into mandatory disclosure practices. Of particular importance in this research is that within this framework, key variables have been selected to represent the potential 'outsider' and 'insider' influences on disclosure⁸.

Finally, this thesis is the first known study focussing on mandated compliance with the Indonesian Government Accounting Standards (PP No. 24 of 2005) in a local government context using an institutional theory approach. The findings are expected to generate important implications for standard setters,

⁷ Since the resignation of Suharto as president of Indonesia on 21 May 1998, the move towards these reforms is considered as a positive step that lessens forms of discrimination, injustice, intervention, and suppression of freedom that had occurred during the earlier New Order (Robison and Hadiz 2007). Therefore, the resignation of Suharto as president of Indonesia provides hope for a more democratic life of the nation, with related improvement in public sector transparency.

⁸ The use of an outsider and insider research approach will generate more insights concerning the potential factors from both outside and inside an entity which affects the entity's activities (Homburg and Bucerius 2006).

regulators, the accounting profession, the central government and other stakeholder groups.

1.5 Assumptions and Limitations

There are several assumptions and limitations in this research. First, there is the assumption that the financial statements⁹ are the main source of information including financial and accounting information that is used by the public. Prior studies (Beets and Souther 1999; Healy and Palepu 2001; Banghoj and Plenborg 2006) emphasise that annual reports present reliable and credible information about an organisation. Although there are other alternative sources of information regarding performance of an organisation, for example, interim reports in a firm (see Roosenboom and Goot 2004) and half yearly and quarterly reports (see Gajewsky and Quere 2001), financial statements are the most widely chosen as a source of data because they are easily accessed (McQueen 2001), and are also communicated widely (Beattie, McInnes and Fearnley 2004). This is particularly true in Indonesia where other forms of data are not readily available.

Second, this thesis assumes that local governments have a clear understanding of regulatory and statutory laws in relation to the preparation of financial statements, particularly mandatory disclosure practices within financial statements. This is consistent with the statement by the Indonesian Home Affairs Minister that the government has attempted to disseminate the regulations with regard to financial statements of local government in order to improve the transparency and accountability of local government financial statements (Bandariy and Rohman 2011).

There are potential limitations with the research. First, this thesis uses cross-sectional rather than longitudinal data. As a result, it does not detect any temporal changes of mandatory disclosure practices by local governments. This may impact on the examination of mimetic copying behaviour of for

⁹ PP No. 24 of 2005 states that the concept of 'financial statements' is intended to meet the general purposes of financial reporting. Therefore, the phrase 'financial statements' in an Indonesian context is synonymous with the phrases 'annual report' and 'financial report'.

example Java versus non-Java where variances can be noted but direct measurements cannot be undertaken when analysing only one year.

This study uses 2010 annual reports, which might be considered a limitation as they are not the most currently available. However, the use of 2010 as the period of study is appropriate as new regulation applicable to local government had been recently introduced and importantly because of the political conditions at that time¹⁰.

Finally, this thesis does not analyse any specific cultural elements. Rosenberg (2003, 437) states that “culture is identified as a system that include the evolution of social organisations and social facts, which allow a person to understand social situation and social reality”. The importance of culture is that it frames and illustrates social facts and, in turn, queries how practices and habits are performed, developed and accepted. Indonesia has 17,500 islands with 1,128 tribes and extensive ethnic diversity (Biro Pusat Statistik 2010), therefore there are multiple cultural aspects that are outside the scope of this thesis.

1.6 Thesis Outline

This thesis is organized as follows. Chapter 1 provides an overview of the study, including the introduction, background, research questions, significance and contribution of the study, assumptions and limitations.

The remainder of the thesis is organized as follows.

Chapter 2 reviews the regulatory and compliance environment of government financial reporting in Indonesia. This chapter begins with a discussion of the demographic, economic and social background of Indonesia including an overview of local government and the government authority in Indonesia. This is followed by an overview of Indonesian political and regulatory reform, a discussion on Indonesian accounting development, and an overview of the current Indonesian regulatory system.

¹⁰ The year 2010 is chosen as the period for this study. This year encompasses political events that occurred in Indonesia including the election of members of Parliament and the most recent Indonesian presidential election. Details of these matters are described in Chapter 4 Section 4.3 of this thesis.

Chapter 3 presents the literature review and hypotheses development, including the tenets of institutional theory as well as key concepts of past accounting compliance studies. It then advances the hypotheses to be tested in this thesis.

Chapter 4 explains the research methodology and design adopted for this empirical quantitative thesis. This chapter describes the data sources, variables (dependent, independent, and control) in the research, and then outlines and justifies the specific statistical methods to test the hypotheses.

Chapter 5 advances a comprehensive summary of the descriptive statistics. This chapter calculates the level of mandatory compliance with key accounting standards and the financial characteristics of Indonesian local governments.

Chapter 6 provides statistical analysis to generate key results, utilizing t-test, ANOVA, correlation and multiple regressions analyses for hypotheses testing.

Chapter 7 discusses the results on additional analysis of the predictor variables to be associated with the seven major categories of GCI.

Chapter 8 advances the implications, conclusions, and suggestions for further research. This final chapter reviews the key empirical findings on compliance with mandatory accounting rules by Indonesian local governments in its broader context.

Chapter 2

Indonesian Accounting Environment

2.1 Introduction

This chapter outlines the demographic characteristics of Indonesia and the government authority in Indonesia. This is followed by a detailed outline of Indonesian political and regulatory reform. A review of financial reporting regulation, especially those concerned with mandatory disclosure practices, in an Indonesian context is then provided. Indonesian accounting development and the current regulatory system are then presented. The final section provides a summary of the key points from the chapter.

2.2 Indonesian Overview

Indonesia, officially known as the Republic of Indonesia, is a country situated in Southeast Asia and Oceania. Indonesia is located between two continents (Asia and Australia) and two great oceans (Pacific Ocean and Indian Ocean). Due to its unique location (see Figure 2.1), this country is also called Nusantara which when translated means island between two great oceans and continents (Kroef 1975). Indonesia is a republic, with an elected legislature and president. The nation's capital city is Jakarta.

Figure 2.1: Map of Indonesia



Across its many islands, Indonesia consists of distinct ethnic, linguistic, and religious groups. The Javanese are the largest and politically dominant ethnic group. Indonesia has developed a shared identity defined by a national language, ethnic diversity, religious pluralism with a majority Muslim population, and a history of rebellion against colonialism (Bauman 2002). Indonesia's national motto, '*Bhinneka Tunggal Ika*' ('Unity in Diversity' literally means, many, yet one), articulates the diversity that shapes the country (McVey 2006). Despite its large population and densely populated regions, Indonesia has vast areas of wilderness that support the world's second highest level of biodiversity. The country is richly endowed with natural resources, yet poverty remains widespread (World Factbook 2011).

As shown in Figure 2.1, Indonesia shares land borders with East Timor (228 km), Malaysia (1,782 km) and Papua New Guinea (820 km) and ocean borders with other neighbouring countries including Singapore, the Philippines and Australia. Indonesia, the largest archipelago in the world, has an area of 2 million km² scattered over 17,508 islands. These islands, and the six oceans that separate them, lies in an area that measures more than 5,000 kilometres from east to west and 2,000 kilometres from north to south (World Factbook 2011).

Indonesia has mostly coastal lowlands and some large islands that are characterised by interior mountains (World Factbook 2011) with over 500 volcanoes of which 129 are still active (World Bank 2010). With a tropical climate, this country has the world's third largest area of tropical forest and is globally very significant for its biodiversity (White and Martin 2002).

Table 2.1 shows recent demographic, economic and social indicators for Indonesia.

Table 2.1: Indonesian Statistics

Indicators	
Capital city	Jakarta
Population 2010	237.6 million
Population growth rate (2010)	1.49%
Annual growth rate - GDP % (2010)	6.1%
GDP per capita (2010)	US \$ 4,668
Inflation (2010)	6.22%
Poverty level (2010)*	12.49%
Unemployment (2010)	6.80%
Proportion of religious adherents (2010)	Muslem (87.16%), Protestant (6.96%), Catholic (2.91%), Hindu (1.69%), Other (1.28%)
Source: Biro Pusat Statistik 2011.	
* Poverty level is measured by the number of population below the poverty line divided by total population. Poverty line per capita monthly is 211.726 Rupiah ¹¹	

The fourth most populous country in the world (after China, India and the USA), Indonesia had a population of 237.6 million people in 2010, with 58% living on the island of Java, one of the most densely populated regions in the world (Biro Pusat Statistik 2011). The capital city of Jakarta is the ninth most densely populated city in the world with 78,760 people per square mile (Biro Pusat Statistik 2010). Java is the centre of economic and political power in Indonesia (Chalmers and Hadiz 2005). For example, 82% of total large and medium firms (16,610 entities) are located and operated in Java (Biro Pusat Statistik 2011). Therefore, separate jurisdictional analysis (Java/non-Java) is deemed worthy of study in this thesis.

In 2010, the Gross Domestic Product (GDP) per capita was US \$ 4,668 with the annual growth rate of 6.1% (Biro Pusat Statistik, 2010). Among countries in Southeast Asia, the Indonesian economy grew at a comparative level in 2010. The GDP growth rate of the Philippines, Malaysia, Singapore and Vietnam were 6%, 6.5%, 14% and 6.8% respectively (World Bank 2010). However, Indonesia was less negatively affected during the recent 2007-2009 Global Financial Crisis compared to their ASEAN neighbours (Simorangkir, Iskandar and Adamanti 2010). The percentage of the

¹¹ This amount is equal to US \$ 23.53.

population that are poor and unemployed in 2010 was 12.5% and 6.8% respectively, while inflation is at a relatively high rate at 6.22% (Biro Pusat Statistik 2011). The composition of religious communities in Indonesia are Muslim 87.16%, Protestant 6.96%, Catholic 2.91%, Hindu 1.69%, and other religions 1.28% (Biro Pusat Statistik 2011).

Although the Indonesian economy is growing (growth of GDP 5.7% in 2005 to 6.1% in 2010) (Lembaga Penyelidikan Ekonomi dan Masyarakat 2010), the devastating economic crises of the 1990's (such as the Asian currency crisis) still impact on social conditions and social welfare¹² and has contributed to the over-exploitation of natural resources at the expense of sustainability issues and concentration of growth of the Indonesian industrial sector continues in heavily concentrated urban areas (Ministry of Social Affairs 2010). Industrial pollution combined with pollution from urban sources (vehicle emissions, human waste and solid waste) poses an immediate threat to Indonesians' health and human welfare (World Bank 2010) and growing congestion raises major problems for Indonesian commuters.

The demographic data highlights that Indonesia has abundant natural resources but the population levels are very high and uneven because most Indonesian citizens live in Java. The Indonesian demographic, economic and social conditions are potential factors that can affect the level of mandatory disclosure within financial statements of local governments.

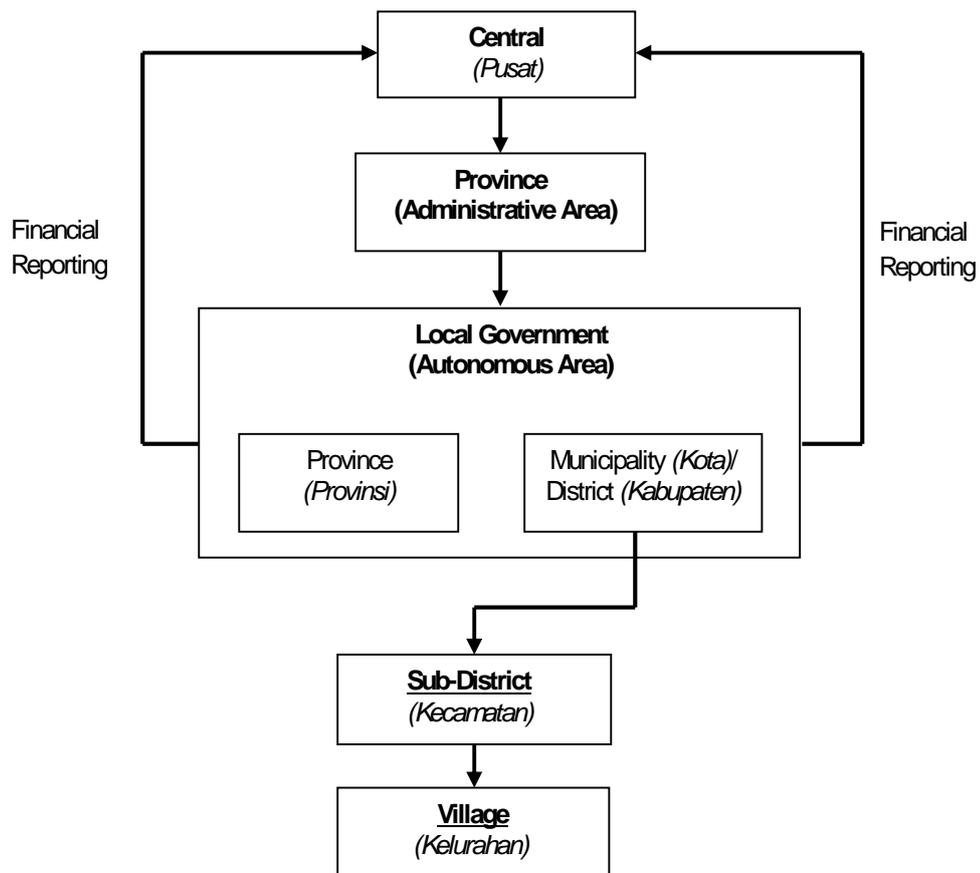
2.3 Governmental Authority in Indonesia

The territory of Indonesia is divided into provinces (*propinsi*), municipalities (*kota*) and districts (*kabupaten*). A province is headed by a governor (*gubernur*) who is directly elected by the people for a term of five years. A municipality is headed by a mayor (*walikota*) and a district is headed by a regent (*bupati*) (Asshiddiqie 2010). The mayor/regent and the member of representatives are elected by popular vote for a term of five years. Within districts and municipalities there are sub-districts (*kecamatan*) which are smaller administrative government units. Each sub-district is further divided

¹² For instance the rupiah currency is still in the very low range of 9000 per 1 US\$.

into villages. Villages in rural areas are called 'desa', while in urban areas these are referred to as 'kelurahan' (Usman, 2001). Indonesia has a unique structure of governmental authority, especially the position of the province that has 'two faces' being the administrative area and the autonomous area. Figure 2.2 illustrates the framework of Indonesian Governments and the relationship between a province and the municipality/district.

Figure 2.2: Indonesian Government Framework



Source: Adapted from UU No. 32 of 2004

As illustrated in Figure 2.2 a province adheres to the principle of 'deconcentration and decentralization' (see UU No. 32 of 2004). According to UU No. 32 of 2004 deconcentration means delegation of authority by the central government to the governor (provincial head) as a government representative. As an administrative area, the province receives administrative authority only from the central government but is not granted political authority. Accordingly, when implementing a central government policy, a governor as the head of an administrative area acts on behalf of the

central government, not as a head of an autonomous area. In addition, UU No. 32 of 2004 also explains that in terms of a province as an administrative area, the municipality/district is subordinate to the province. However, provinces are also delegated autonomy, distinct from the administrative area and the autonomous arm of the province is on the same level as a municipality/district. As autonomous areas, provinces and municipalities/districts have to submit their financial statements to the central government.

Based on UU No. 22 of 1999, the municipality/district has great authority. However, there are no laws and regulations which specifically manage the authorities of the municipality/district. The law only gives the general formula¹³ which basically puts all governmental authority responsibilities on the municipality/district, except those specified by the province and central government. Thus, the municipalities/districts can take the initiative to make their own authority based on their needs.

Following the most recent reforms, there has been a remarkable increased growth of district and municipality governments in Indonesia. This process has become known as 'pemekaran' (proliferation) (Yusoff 2008). Following the surge of support for decentralisation across Indonesia which occurred following the end of the Soeharto era in 1998¹⁴, key new decentralisation laws were passed in 1999 (Hadiz 2004). Subsequently, there was a sizeable jump in the number of districts and municipalities from around 300 at the end of 1998 to over 490 ten years later (Badan Perencanaan Pembangunan

¹³ UU No. 32 of 2004 stipulates that areas of responsibilities of municipality/district include both compulsory and optional functions. The 'compulsory function' includes: planning and controlling of development; planning, controlling and utilization of spaces; organizing public order; provision of public facilities; the handling of health; education; alleviation of social problems; services in the field of labour; facilities for developing cooperatives, small and medium business; environmental control; land services; population services; services of government public administration; services of investment administration; and other basic services. The 'optional function' includes government matters which potentially improve the welfare of the community in accordance with the conditions and the uniqueness of the local government (municipality/district) area.

¹⁴ During the 32 year reign of Soeharto (referred to as the New Era), Indonesia was a country with an authoritarian and centralized system. Authoritarian because almost all policies should always be 'what is said' by the president, even the parliament did not have any true functionality as many of the members were president's cronies. The central government was deemed too powerful and monopolized resources. After Soeharto's resignation from the national helm and was replaced by Habibie, the discourse on decentralization rapidly increased momentum and eventually UU No. 22 of 1999 was enacted for local government.

Nasional 2011). By 2010, Indonesia had 398 districts and 98 municipalities¹⁵ (Biro Pusat Statistik 2011). This proliferation of new districts and municipalities, welcomed at first, has become increasingly controversial within Indonesia because the administrative fragmentation has proved costly and has not brought the hoped-for benefits (Darwis 2012).

Each local government (municipality/district) consists of a local parliament (Dewan Perwakilan Rakyat Daerah=DPRD) which has a regional administration and an executive. The DPRD is the partner of the local government's executive (Santoso 2011). Since the enactment of UU No. 32 of 2004 on local government, the head of a local government is no longer responsible to DPRD, and is now instead elected by citizens through head of local government elections. However, the local parliament has 'interpellation right' (hak interpelasi)¹⁶ to request information of the government executive about government policies that are important, strategic or have a broad impact on social life (see Nahdiati 2007). There are legislative penalties for not complying with DPRD requests¹⁷ (Bratakusumah and Solihin 2001).

The focus of this thesis is at the local governmental level categorised as municipalities or districts. To further recognise political development and government management in Indonesia, the next sections discuss the history of leadership and political reforms in Indonesia.

2.4 Indonesian Political and Regulatory Reform

The Republic of Indonesia was established on August 17, 1945, when its independence was proclaimed just days after the Japanese surrender to the Allies. Pancasila¹⁸ became the ideological and philosophical basis of the

¹⁵ At the lowest tier of the administrative hierarchy is the village (*desa*). Indonesia has 76,613 villages and 6,598 sub-districts (*kecamatan*) (Biro Pusat Statistik 2011).

¹⁶ Interpellation is the formal right of a local parliament to submit formal questions to the local government (see UU No. 27 of 2009).

¹⁷ UU No. 27 of 2009 states that DPRD has the right to ask government officials or the public to provide particular information in regard to government's need. The government officials or public must fulfil the DPRD request. If the request is not complied without a valid reason, there is threat of sanction by a maximum of 15 days imprisonment.

¹⁸ Pancasila is the official philosophical foundation of the Indonesian state. Pancasila consists of two old Javanese words, 'panca' meaning five, and 'sila' meaning principles. It comprises five principles held to be inseparable and interrelated.

Republic, and on August 18, 1945 the Constitution was adopted as the basic law of the country (Latif 2011). Following the provisions of the Constitution, the country is now headed by a President who is also the Chief Executive who is assisted by a Vice-President and a cabinet of ministers.

The sovereignty of the people rests with the People's Consultative Assembly (Majelis Permusyawaratan Rakyat=MPR). Accordingly, the president is (supposedly) accountable to the MPR. The legislative power is vested in the House of Representatives (Dewan Perwakilan Rakyat=DPR). Other key institutions of the state are the Supreme Court (Mahkamah Agung=MA), the Supreme Advisory Council (Dewan Pertimbangan Agung=DPA), and the Supreme Audit Board (Badan Pemeriksaan Keuangan=BPK).

Soekarno became the first President and Chief Executive, and Mohammad Hatta, the first Vice-President of the Republic of Indonesia. On September 5, 1945 the first cabinet was formed. It comprised 20 ministers and four officials (Prihartanti 2010) (refer Appendix A for more detailed information on Soekarno's reign).

In 1949 Soekarno was re-elected president of Indonesia. Under his leadership two separate Anti-Corruption Agencies were established, Paran¹⁹ and Operasi Budhi – but the government ran the two agencies with minimum capacity and little obvious commitment (Meuko and Anggadha 2008). The Paran effort ultimately failed because most of the state officials when questioned for improper practices asked for, and received, the protection of the president.

In 1963, through President Decree No. 275 of 1963, the government stated they wanted to more vigorously pursue their efforts to eradicate corruption in Indonesia (Tahyar 2012) and established an institution called Operasi Budhi (Budhi Operation) that was headed by Nasution and assisted by Wiryono. Their stated goal was to continue taking corruption cases to the court.

¹⁹ Paran, stands for Panitia Retooling Aparatur Negara (Retooling Reform Committee) formed under the laws of State Hazard, led by Abdul Haris Nasution and assisted by two members, Professor Mohammad Yamin and Ruslan Abdulgani.

However, this institution also failed because again almost all state officials avoided review (Meuko and Anggadha 2008). Overall, history records that the pursuit of corruption in that era stagnated.

Despite establishment of the Supreme Audit Board of the Republic Indonesia (BPK), public sector accounting and auditing in Indonesia did not significantly evolve in promoting transparency and accountability of government during the period of 1949-1965, The BPK was not as functional as it should have been and this resulted in an ineffective public sector system, marginal public administration and lack of public accountability (Baswir 2002). Local government reporting was minimal at best. This is largely because of the unstable situation and inadequate number of BPK employees (Badan Pemeriksa Keuangan 2011).

Soeharto was assigned emergency powers on March 11, 1966 through a presidential decree by Soekarno known as the 'Supersemar' (Surat Perintah Sebelas Maret). He would then go on to become president in 1967. Soeharto would proclaim the New Order, a system of authoritarian rule to reconstruct the country. Over the next thirty years, Indonesia's economic condition under Soeharto was riddled with corruption and cronyism and offered little assistance when the 1997-1998 Asian financial crisis hit (Lee and Oh 2007). The economic hardship and mounting discontent that followed saw bloody unrest and anti-Chinese violence, and in 1998 he was finally forced to resign (Davidson and Jamie 2003).

During Soeharto's reign there was no true fiscal transparency (Barr, Dermawan, and Purnomo 2011). The objects of BPK audit were confined to the state budget expenditure only. Key elements such as the state budget revenue, non-budgetary issues, state/local-owned enterprises (BUMN/ BUMD), and foundations that use the facilities of the state were not an object of BPK audits.

By the late 1990's, the political-economic system of the late President Soeharto simply could not be sustained. Despite impressive growth rates, in times of crises a system that combined centralized authority with corruption

and weak governance proved to be very vulnerable. Mashad (1999, 57) states that “it could no longer be argued that corruption can be benign, as ultimately it undermines development”.

2.4.1 Pre-Reform Era (Prior to 1998)

Indonesian government accounting in this older period was a colonial legacy of the Dutch. Indische Comptabiliteitswet (ICW) 1925 (later revised by UU No. 9 of 1968) which embodied a colonial government accounting system that regulated the government budget, accounting system and auditing. It was designed to account for the production of Indonesia’s natural resources to the Dutch government. A cash based accounting method was applied to both budgeting and accounting systems. The Indonesian government’s financial report, called budget calculation notes, was solely a comparison between budget and the realization of the various expenditure and revenue accounts. It did not present a formal and systematic report on the government’s debts and assets. The budget calculation notes were not subject to government oversight.

Political conditions within Indonesia prior to 1998 were not conducive to calls for government accountability and transparency (Bertrand 2004). The imbalance of power between the legislative and executive is evident in any authoritative regime, and Indonesia was no exception. Under the Indonesian constitution, the People’s Consultative Assembly (MPR) and the Indonesian Parliament (DPR) held legislative power and the president was the head of the executive branch. However, effective separation of powers for state governance (*trias politica*) did not exist in Indonesia, as Golkar held the majority (more than 60%) of seats in parliament during the entire regime of Soeharto (Liddle and Mujani 2004). Golkar was the partisan political face of the state bureaucracy and Soeharto was directly involved in Golkar’s organisation and policies from the beginning of the New Order. His powers extended to having ultimate authority to choose the head of Golkar. The former authoritarian regime extended its power to create regulation covering parliament and its assembly, elections, opposition parties, media, interest

groups and other organisations. Official control over the party system was pervasive and intrusive (Bertrand 2004).

As the all-powerful state dictated economic structure, it was argued transparency was not needed. During the New Order era, President Soeharto ruled that the state had a legitimate economic role to determine the operations of the market, which must be tempered by social objectives (Hadiz 2004). Therefore, the state had full control of trade and the exploitation of natural resources. The military was used as an entity by which to dominate and manage revenues from resources exploitation, for example in metals and oil mining (Robison and Rosser 1998). Besides the state and military domination of resources, the state controlled business through patronage. Soeharto family members and their associates dominated business in the flour-milling, cement, airlines, forestry and banking industries (Aditjondro 2006).

In this pre-reform era, several financial regulations were initiated including UU No. 9 of 1968 on the changes of Indische Comptabiliteitswet (ICW) 1925; UU No. 5 of 1974 on the principles of local government; PP No. 5 of 1974 on the principles of regional and local government; PP No. 6 of 1974 on the restriction of activities of civil servants in private business; and Financial and Administration Manual for Local Government (Manual Administrasi Keuangan Daerah=MAKUDA) 1981 on the financial accounting system. The implementation of these regulations was less than optimal because the government bureaucracy before the reform era was built with a strong culture of bureaucratic corruption, collusion and nepotism (Setiyono and McLeod 2010).

2.4.2 The Transition Era (1998-2003)

The Post-Soeharto era began with the fall of Soeharto in 1998. Indonesia was then in a period of transition. This era has been called the period of 'reformasi' (reformation), due to a more open and liberal political and social environment in Indonesia after the revolution of 1998.

In the post-Soeharto era, the fight against corruption became the rallying cry of all the political leaders. KKN – *Korupsi, Kolusi, Nepotisme (corruption, collusion, and nepotism)* – characterised the Soeharto era, and getting rid of KKN symbolised a movement to sever ties with the past and create a new democratic state with a cleaner government. One of the first anti-corruption measures taken after the fall of Soeharto was a decree passed by the People’s Consultative Assembly (MPR) in October 1999 calling for a state apparatus that “functions in providing services to the people that are professional, efficient, productive, transparent and free from corruption, collusion and nepotism” (Azra 2002, 31). This was followed by the Clean Government Law (UU No. 28 of 1999), requiring public officials to declare their wealth and agree to periodic audits. A Commission to audit the wealth of state officials was established in support of this law. The Law on the Eradication of Corrupt Acts (UU No. 31 of 1999) was also passed, to enhance development and efficiency and acknowledging the huge financial losses to the state caused by corruption. Law 31 also defined criminal corruption and established charges and procedures for prosecution. To enhance transparency and accountability in the management of state finance, the government of the reform era conducted a more comprehensive review of the financial system than that used in Soeharto’s reign. One of the first actions was to combine the state budget that had previously been divided into two groups, the routine and the development budget. Under Soeharto, the routine budget was controlled by the Ministry of Finance while the development budget was controlled by BAPPENAS (National Development Planning Agency).

Other initiatives during the reform period included steps to minimize the ‘non-budgetary’ budget, the introduction of three new state finance laws 2003-2004²⁰, and the introduction of the Governmental Accounting Standard package on June 13, 2005²¹. This last initiative is crucially important in this

²⁰ The Laws of state finance are: UU No. 17 of 2003 on the financial state; UU No. 1 of 2004 on the state treasury; UU No. 15 of 2004 on audit of management and state financial responsibility.

²¹ This is the Government Regulation (PP) No. 24 of 2005 on the Government Accounting Standards.

thesis as it serves as the basis to examine the level of mandatory disclosures in Indonesian local government financial statements.

In the transition era, there have been many changes especially in the system and bureaucratic structure of government with a clear movement from centralized to decentralized structures. In this period, some regulations were established and enforced. Several key regulations became a base for financial reform in Indonesia. A good example is UU No. 22 of 1999 on local government in which authorities/responsibilities that were situated in the central government and provinces were given to local government. Another reform initiative is UU No. 17 of 2003 on state finance in which every government institution must now prepare financial statements according to government accounting standards.

In addition to these rules, several financial regulations in the transition era were enacted including: UU No. 25 of 1999 on the financial balance between central and local government; PP No. 105 of 2000 for local government management and financial accountability; PP No. 108 of 2000 on the procedures for accountability of the head of the local governments; and the decision of Home Affairs minister (Keputusan Menteri Dalam Negeri=Kepmendagri) No. 29 of 2002 regarding guidelines for financial accountability and local budget preparation.

During this transition period, Indonesia was led by three presidents with each of their tenures being for less than five years; Habibie (May 1998 - October 1999), Abdurrahman Wahid (October 1999 - July 2001), and Megawati Soekarnoputri (July 2001 - October 2004). In the period of these three presidents, more serious anti-corruption efforts began and the implementation of transparency and accountability were more intensively conducted.

2.4.3 Post Transition Era (2004-Present)

Susilo Bambang Yudhoyono (SBY) won the 2004 presidential election, defeating incumbent President Megawati Soekarnoputri. He was sworn into office on 20 October 2004, together with Jusuf Kalla as Vice President. He

ran for re-election in 2009 with Boediono as his running mate, and won with an outright majority of the votes in the first round of balloting; he was sworn in for a second term on 20 October 2009. His term continues until 2014.

Susilo Bambang Yudhoyono has made it one of his goals to lift Indonesia's rating in the corruption-perception index issued by the Berlin-based Transparency International and is intent on raising Indonesia's score from three (as it was in 2011) to five by the end of his administration in 2014²² (the higher the rating, the less corrupt the country is perceived to be) (Fitriady and Adi 2012).

In the reign of President Susilo Bambang Yudhoyono, a package of regulations relating to the government financial sector was created and better enforced in the hope of enhancing government accountability. Several rules are considered a milestone of financial reform in Indonesia such as UU No. 32 of 2004 on local government (this law is a revision of UU No. 22 of 1999) and the regulatory of Home Affairs Minister (Permendagri) No. 13 of 2006 on guidelines for government financial management. Another milestone, PP No. 24 of 2005 on government accounting standards, is used in this thesis as the key benchmark to examine the extent of local government financial disclosures. These rules are encouraging the transformation of government accounting in Indonesia (Martani and Lestiani 2012).

In addition to these three recently issued rules, there are other regulations enacted to enhance the accountability and transparency in Susilo Bambang Yudhoyono's era such as UU No. 1 of 2004 on the state treasurer; UU No. 15 of 2004 on the examination of management and financial responsibility of the state; UU No. 33 of 2004 on the financial balance between central and local government (the regulation is a revision of UU No. 25 of 1999); and PP No. 58 of 2005 on the distribution of government affairs.

In Susilo Bambang Yudhoyono's era, the government launched an important new regulation PP No. 71 of 2010. Importantly, this standard requires the use

²² In fact, Susilo Bambang Yudhoyono's performance in raising the Corruption Perception Index score is remarkable. The Corruption Perception Index score in 2011 was three, and it increased dramatically to thirty-two in 2012. However, in 2013 the score of Indonesia's Corruption Perception Index has not changed from the previous year, it is still thirty-two (Biro Pusat Statistik 2013).

of accrual basis accounting in local government financial statements whereas the older PP No. 24 of 2005 focused on the modified accrual basis. This new regulation (PP No. 71 of 2010) is being applied in stages from 2012 until 2015²³ (Komite Standar Akuntansi Pemerintahan 2011). This long transitional time period is allowed by the government because they believe Indonesia has limited expertise on government accounting and therefore the implementation of accrual-based accounting needs a long preparation time.

During the SBY reign, the Corruption Eradication Commission (Komisi Pemberantasan Korupsi=KPK) has shown some success in exposing corruption cases in Indonesia (see Suryanto 2009). The commission has succeeded in sending to jail army and police generals, senior judges and prosecutors, former cabinet ministers, governors and mayors, ambassadors, and senior politicians (Rianto 2009).

From the review of the Indonesian political and regulatory history, it can be concluded that the issues of corruption, transparency, and accountability in Indonesia have only recently begun to be seriously addressed. This thesis examines the implementation of public governance in Indonesia from the aspect of transparency and accountability in which the mandatory disclosures within financial statements are used as a measure of transparency at the Indonesian local government level. The focus of the thesis is on the implementation of the set of mandatory disclosure contained within PP No. 24 of 2005 on Indonesian government accounting standards for every Indonesian local government. It is associated with the existence of UU No. 17 of 2003 that states every government institution in Indonesia must prepare financial statements in accordance with PP No. 24 of 2005. Therefore, preparing financial statements based on this broad set of government accounting standards (PP No. 24 of 2005) is mandatory for all Indonesian local governments. Disclosure of financial statements is clearly important to

²³ This accrual-based standard (PP No. 71 of 2010) is to be implemented no later than five years after fiscal year 2010 (Komite Standar Akuntansi Pemerintahan 2010). This accrual-based standard can be implemented in stages of cash towards accrual-based (PP No. 24 of 2005). Further provisions concerning the gradual application of accrual-based standard at the central government are regulated by the Ministry of Finance, while the local government is regulated by the Ministry of Home Affairs (Article 7 of PP No. 71 of 2010).

achieve transparency which in turn will support public accountability (Kasri and Lukviarman 2009). A comprehensive study will provide a better understanding as to the extent that local governments in Indonesia implement the mandatory disclosure requirements in their financial statements.

2.5 Indonesian Accounting Development

Before the era of government financial management reform, the government administration system was using a single entry²⁴ accounting system and cash basis²⁵ accounting process (Priyono 2012). As a result, the government has no comprehensive records of fixed assets, account receivables, account payable, or equity of an entity. Moreover, the government could not show the balance sheet which illustrates the financial position of the government as discussed above. The Indonesian government is slowly transforming the accounting method from a cash basis toward an accrual²⁶ basis (Kusuma and Fuad 2013).

Table 2.2 illustrates that in 1975, the government of Indonesia did not have any type of comprehensive accounting system, but used a manual administration system. In addition, there was no government accounting standard as a reference for the preparation of financial statements. The only government financial accountability reports to parliament were the state budget calculations (Perhitungan Anggaran Negara=PAN) which were compiled manually using single entry. The change from a cash basis to an accrual basis of accounting is in part motivated by public finance reforms as mandated in PP No. 17 of 2003 which will be implemented in stages. The

²⁴ A single entry system records each accounting transaction with a single entry to the accounting records, rather than the vastly more widespread double entry system. The single entry system is centred on the results of a business that are reported in the income statement. The core information tracked in a single entry system is cash disbursements and cash receipts. Asset and liability records are usually not tracked in a single entry system; these items must be tracked separately.

²⁵ The cash basis of accounting is where income is recorded when cash is received, and expenses are recorded when cash is paid out. This method of accounting does not conform with the provisions of GAAP and is not considered a good management tool because it leaves a time gap between recording the cause of an action (sale or purchase) and its result (payment or receipt of money). However, it is simpler than the accrual basis of accounting and quite suitable for small organisations that transact business mainly in cash.

²⁶ The accrual basis of accounting includes the recognition of assets, liabilities, and equity in the balance sheet (Kusuma and Fuad 2013).

stages include going from the original cash basis, to a modified cash basis, then to a modified accrual basis, and finally to an accrual basis.

Table 2.2: Phases of Indonesian Government Accounting Developments

Year	Description
1975	- There was no comprehensive accounting system, there was only an administrative system.
1979-1980	- Government administration system was still manual. - There were no government accounting standards. - The calculation of state budget (Perhitungan Anggaran Negara=PAN) was prepared in a 'single entry' approach within a government financial accountability report.
1986	- A central accounting system and accounting system agencies were designed. - Formation of a proposal for a chart of standard accounts and Government Accounting Standard.
1987-1988	- Simulation of manual system in several government departments. - The idea of using computer-based accounting system advanced by the Finance Department.
1992	- A State Accounting Agency (Badan Akuntansi Negara=BAKUN) is formed which has the function as the Central Accounting Office.
2001-2002	- January 1, 2001, regional autonomy and fiscal decentralization in Indonesia are simultaneously implemented. - There are changes in the budget and reporting format. - The regulation of Home Affairs minister (Kepmendagri) No. 29 of 2002 began to introduce the use of cash basis of accounting and 'double-entry' bookkeeping.
2003-2004	- Accounting reform of the public sector (issued three of the Laws on State Finance: UU No. 17 of 2003; UU No. 1 of 2004; and UU No. 15 of 2004).
2005	- Governmental Accounting Standards Committee (KSAP) was formed. - The issuance of PP No. 24 of 2005 on Government Accounting Standards.
2010	- The issuance of PP No. 71 of 2010 on Government Accounting Standards (amendment of 'cash towards modified accrual basis' to 'full accrual basis' that should be gradually implemented at the latest in 2015).

Source: Adapted from Priyono 2012; Simanjuntak (2005); Ministry of Home Affairs 2002.

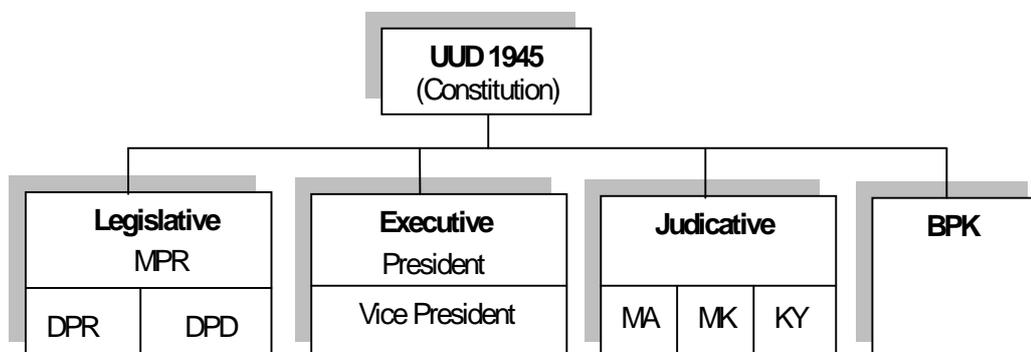
This thesis uses PP No. 24 of 2005 which is still based on a cash basis system moving towards an accrual base as as the key point of reference.

2.6 Indonesian Current Regulatory System

As in other democratic countries, the Republic of Indonesia applies the 'Trias Politica' principle that recognises the separation of the legislative, executive and judicial bodies (Budiardjo 2003). The legislative authority is under the MPR that consists of two bodies, the Parliament composed of members of political parties (DPR), and the Regional Representative Council (Dewan Perwakilan Daerah=DPD) composed of representatives from each province in Indonesia. Each province is represented by four delegates of DPD

members that are elected by the people in their respective region (Muis 2010). The structure of the Indonesian regulatory system is established by the constitution under basic Law²⁷ as illustrated in Figure 2.3.

Figure 2.3: The Structure of the Indonesian Government System



Legend: MPR (Majelis Permusyawaratan Rakyat (People’s Consultative Assembly); DPR=Dewan Perwakilan Rakyat (House of Representative); DPD=Dewan Perwakilan Daerah (Regional Representative Council); MA=Mahkamah Agung (Judicial Supreme Court); MK=Mahkamah Konstitusi (Constitutional Court); KY=Komite Yudisial (Judicial Commission); BPK=Badan Pemeriksa Keuangan (Supreme Audit Board).

Source: Adapted from Pigome (2011); Dwiputrianti (2011); and BPK (2011).

The MPR was originally the highest state institution. However, since the amendment of the 1945 Constitution, the position of MPR aligns with other state institutions. Upon the Amendment of the 1945 Constitution, the membership of the MPR starting for the period of 1999-2004, was amended to include not only the members of the DPR (House of Representative) but also the members of the DPD (Regional Representatives Council). For the period of 2009-2014, the number of members of MPR is 692 people consisting of 560 people of the DPR and 132 people of the DPD (Komandoko 2010). The members of DPR and DPD are elected every five years (Muis 2010). Since 2004, the MPR has become a bi-chamber parliament with the DPD as the second senate-style chamber.

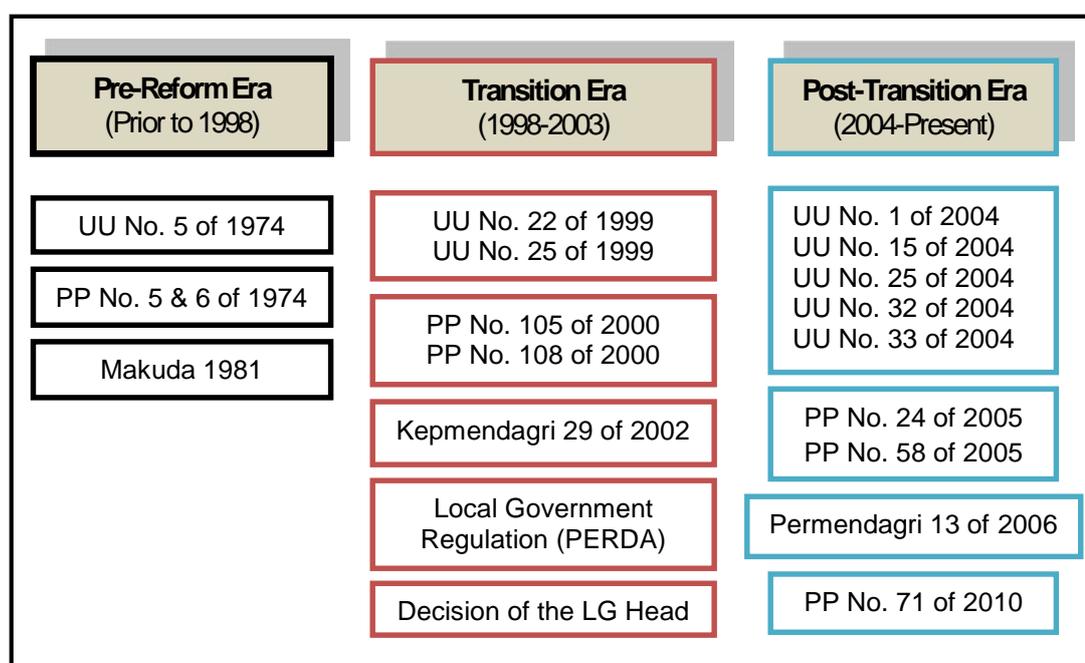
The executive institution is centralized under the president, vice president, and the cabinet of ministers. The cabinet is a presidential cabinet in which the ministers report to the president and do not represent their political parties. A presidential election is held every five years. Since 2004, the

²⁷ The Constitution of the Republic of Indonesia 1945 (UUD45) is the basic Law of Indonesia. In the period of 1999-2002, the UUD 45 was amended four times changing the composition of institutions in the constitutional system of the Republic of Indonesia.

President of the Republic of Indonesia is elected through direct election by the people (UU No. 22 of 2007). The judicial institution, since the reform era and upon the amendment of the 1945 Constitution, is administered by the Mahkamah Agung (Supreme Court), Mahkamah Konstitusi (Constitutional Court), and Komite Yudisial (Judicial Commission).

In summary, based on the description of the Indonesian political and regulatory reform above, it can be highlighted that the history of Indonesian financial regulatory reform is divided into three phases as illustrated in Figure 2.4. Over time there has been a slow and uneven move towards greater accountability and transparency.

Figure 2.4: History of the Indonesian Financial Regulatory Reform



Source: Adapted from Ministry of Finance (2010); BPK (2011).

2.6.1 The Role of Supreme Audit Board (BPK)

Since 1946 (from the establishment of the Audit Board of the Republic of Indonesia, or BPK), public sector auditing in Indonesia has not traditionally involved a great deal in promoting transparency and accountability of government. This is as a result of an ineffective public sector system, public administration, and lack of public accountability (Rai 2008). Although the BPK had the legal authority to audit public finance, its *de facto* remit was limited.

Nasution (2009), a former leader of the BPK, recalls that the BPK had limited audit scope and organisation, budget and staff control and the audit report was also not publicly available.

Since 1998, Indonesia has achieved a critical transition from a centralised authoritarian government in the New Order Era to a more decentralised democratic government during the Reformation Era. These changes have consequences that budgetary authority at the provincial and local government level are increasing annually but also leads to a variety of new problems. Santoso (2011) reveals that decentralisation has made worse the practice of corruption, collusion and nepotism at the regional level, both for the Executive and Legislative branches. This is because the local official has more authority and no parties actively control the local official's authority. The institution in charge of controlling the performance of regional executive does not run properly (Pradita and Adi 2010). As a result, corruption has changed its original point in certain areas as it spreads to the regional governments (provinces and local governments) and legislative bodies. This condition requires the BPK to work even harder to perform its roles and functions to examine public sector accountability in managing and spending public resources, and to prevent misuse or abuse of public funds and resources.

From 2001, as mandated by the third amendment of the 1945 Constitution, the BPK is confirmed as the only external audit institution in Indonesia. BPK has worked hard to provide better performance in the auditing sector and to gain trust from the public (Dwiputrianti 2011). However, some analysts have still identified poor implementation of the Indonesian public sector auditing in performing its role. As stated by Gronlund, Svardsten and Ohman (2011), the poor performance of public sector auditing was an indication of ongoing bad governance in Indonesia. Moreover, studies from the Asian Development Bank (Asian Development Bank 2003; 2006) about Indonesian public sector auditing, note ongoing problems of legal obstacles, absence of public accountability, unsettled audit institutional arrangements, insufficient numbers of qualified auditors and low public awareness of audit functions. Combined these factors generate a long term story of regulatory

ineffectiveness of public sector auditing in Indonesia. Therefore, in 2007, BPK was prioritised as a public sector institution that had to be reformed. This was due to the deemed importance of the audit functions of the BPK to improve the accountability and performance for the public sector. To improve its performance, BPK has now developed three types of audit; financial audit, performance audit, and special audit (Nasution 2009).

2.6.2 BPK Reforms Initiatives

The Supreme Audit Board of Indonesia (Badan Pemeriksa Keuangan=BPK) started its reform initiatives in 2005 to better achieve the goals of the fiscal system reforms. Four important roles have been included in BPK's Strategic Plan and Implementation 2005-2010 document (BPK 2011):

- To actively participate in efforts to eradicate corruption, collusion and nepotism;
- To improve transparency and accountability of state finance;
- To assist the Government in implementing the package of three new laws on State Finance; and
- To assist the Government in conducting institutional reform including restructuring State Owned Enterprises (SOEs) and public service entities such as public schools/universities and hospitals.

This thesis examines the level of mandatory disclosure within financial statements of local governments in Indonesia. Information relating to the role of BPK is very important because it provides a better understanding of their efforts in improving transparency and accountability through audits of government institutions. In conducting their audit of the government institutions, BPK uses the 'government accounting standard' package as a basis for audit. Therefore, local governments in Indonesia are required to use these government accounting standards in preparing their financial statements. UU No. 17 of 2003 clearly states that all Indonesian government institutions must prepare financial statements based on the Indonesian government accounting standards.

2.6.3 Indonesian Institute of Accountants (IAI)

Another key institution that impacts on the Indonesian government accounting standards is the national Indonesian Institute of Accountants or Ikatan Akuntan Indonesia (IAI) (Christiawan 2002). It was established on December 1957 and is a founding member of the International Federation of Accountants (IFAC) and the ASEAN Federation of Accountants (AFA) (IAI 2005).

IAI has a complete organisational structure designed to support its mission. Professional Standards Board (Dewan Standar Profesional=DSP) and Standards Consultative Board (Dewan Konsultatif Standar=DKS) are the two bodies in IAI associated with the preparation of financial accounting standards. These bodies have an important role in drafting and ratifying the accounting standards and their interpretation. The Professional Standards Board consists of the Financial Accounting Standards Board (Dewan Standar Akuntansi Keuangan=DSAK), Standards Board of Public Accountant Profession (Dewan Standar Profesional Akuntan Publik=DSPAP), and Professional Standards Board (Dewan Standar Profesional=DSP). DSAK is formed with the aim to create and develop accounting standards in Indonesia. Currently, DSAK consists of 17 people representing several parties including public accountants, academics, and government representatives.

In connexion with the preparation of government accounting standards, the Minister of Finance issued Decree No. 308/KMK.012/2002 regarding the determination of the Accounting Standards Committee Central and Local Government (Komite Standar Akuntansi Pemerintah Pusat dan Daerah=KSAPD). The membership of this committee consists of representatives from the Ministry of Finance, Ministry of Home Affairs, Finance and Development Supervisory Agency (BPKP), IAI, and Universities (IAI 2005). Therefore, the IAI helps shape public sector accounting.

2.6.4 Indonesian Government Accounting Standards (IGAS)

The enactment of government regulation (PP No. 24 of 2005) on government accounting standards provides hope that the Indonesian government will provide better quality financial statements at the central and local government levels (understandable, relevant, reliable and comparable). The audited reports should enhance the credibility of the report before being delivered to the stakeholders such as; executives, parliament, investors, creditors and the public as an important medium of accountability.

PP No. 24 of 2005 on Government Accounting Standards consists of eleven Statements of Financial Accounting Standards (Pernyataan Standar Akuntansi Pemerintahan=PSAP) which in aggregate are the reference points for Indonesian governmental institutions in preparing their financial statements include balance sheet, budget realization report, statement of cash flow, and notes to the financial statements. These eleven standards are shown in Table 2.3.

Table 2.3: 11 PSAP Standards (as of 31 December 2010)

PSAP	Regulated Issues
PSAP.1	Presentation of Financial Statements
PSAP.2	Budget Realization Report
PSAP.3	Cash Flow Statement
PSAP.4	Notes to the Financial Statements
PSAP.5	Inventory Accounting
PSAP.6	Investment Accounting
PSAP.7	Fixed Asset Accounting
PSAP.8	Construction in Progress Accounting
PSAP.9	Accounting Obligations
PSAP.10	Error Correction
PSAP.11	Consolidated Financial Statements

Source: Adapted from Indonesian Institute of Accountants (IAI) (2007).

The existence of these government accounting standards is expected to encourage the achievement of transparency, participation and accountability of financial management to achieve good governance. Accordingly, it requires strategic steps that need to be realised with the implementation of the government accounting standards.

One of the steps taken by the government is developing an accounting system which specifically refers to these government accounting standards

(Puspita and Martani 2012). The accounting system at government level is set by the Regulation of the Minister of Finance (Peraturan Menteri Keuangan=PMK). Currently, it has issued the PMK No.59/PMK.06/2005 on Accounting and Financial Reporting System at the Central Government level. While, the Government Regulation (PP No. 105 of 2001) states that every local government has an authority to set systems and procedures of local financial management in the form of local regulation (PERDA=Peraturan Daerah).

In this thesis the level of mandatory disclosure within financial statements of local governments is measured using a Government Compliance Index (GCI) which has been adapted and developed from the 11 statements of PSAP. Coy, Tower, and Dixon (1994); Pina and Torres (2003); and Coy and Dixon (2004) have developed an index in a similar fashion to proxy measure public accountability.

2.7 Summary

This chapter overviews the Indonesian government accounting background including demographic, economic and social statistics for the country. Furthermore, the evolving regulatory structure is highlighted including Indonesian local government (district and municipality) structure, changing expectation for local government financial statements, the roles of the Supreme Audit Board (Badan Pemeriksa Keuangan=BPK), Indonesian Institute of Accountants (IAI), and Indonesian Government Accounting Standards (PP No. 24 of 2005). The important aspect that this thesis will analyse is to what extent local government entities are reporting mandated accounting disclosure items.

During the process of financial reform, there are several rules that are now the key aspects of financial reform in Indonesia including UU No. 22 of 1999 on local government; UU No. 17 of 2003 on the financial expectations in which all governments agencies are required to prepare financial statements according to government accounting standards, and PP No. 24 of 2005 introducing Indonesia government accounting standards. With these three broad set of rules, Indonesian local governments now have the authority to

better manage their resources itself but it is concurrently required to generate higher quality financial statements in accordance with the new Indonesian government accounting standards package.

The political reform movement in Indonesia encourages financial reforms through regulatory and institutional elements. The long journey of regulatory reform focuses on the improvement of accountability of governmental activities. Local government transparency in Indonesia is part of this reform package.

BPK is the government institution that now has a stronger strategic role in achieving good public governance in Indonesia. BPK is the only government agency that has the right to audit all government agencies including local governments. The degree to which local governments are transparent about their mandated disclosures is the key theme of this thesis.

The next chapter outlines the paradigm and the theoretical framework of this thesis. The literature review examines theories that have been used in mandatory accounting research. This is followed by a detailed discussion on institutional theory, the approach chosen as the underlying theoretical framework in this thesis.

Chapter 3

Literature Review and Hypotheses Development

3.1 Introduction

Chapter 2 provided an overview of the Indonesian government accounting background including demographic, economic and social statistics for the country. Chapter 3 presents the literature review of the thesis. It begins with the discussion of the research paradigm adopted for this thesis. This is followed by the discussion of the different characteristics between business and public sector organisations. After presenting the key aspects of past mandatory disclosure studies, this chapter then examines institutional theory, which is adopted as the underlying theoretical framework in this thesis, leading into the hypotheses development.

3.2 Research Paradigms

The concept of a paradigm is the researcher's overall conceptual framework (Sarantakos 2005). Guba and Lincoln (1994, 105) define it as "the basic belief system or worldwide view that guides the investigations".

Peile (1994, 20) argues that:

paradigms are not hard and fast sets of rules, they are more correctly, loose and evolving frameworks for the ongoing production and resolution of problems. As such, their historical context is very important.

Each research paradigm is usually framed by three questions. Ontology concentrates on the concept of reality, epistemology is concerned with the relationship between reality and the researcher, and methodology focuses on the technique used to discover reality (Guba and Lincoln 1994).

Table 3.1 summarizes the four predominant research paradigms. Each paradigm provides a different basis for establishing theoretical frameworks which assist in explaining or generating insights into the phenomenon under study.

Table 3.1: Research Paradigms and Their Characteristics

Paradigm Features	Positivism	Critical Theory	Constructivism	Participatory
Ontology (How the world is viewed)	Naïve realism - 'real' reality but apprehensible	Historical realism – virtual reality shaped by social, political, cultural, economic, ethnic, and gender values; crystallized over time	Relativism – local and specific co-constructed realities	Participative reality – subjective-objective reality, co-created by mind and given cosmos
Epistemology (How knowledge is gained)	Dualist/objectivist; findings true	Transactional/subjectivist; value mediated findings	Transactional/subjectivist; co-created findings	Critical subjectivity in participatory transaction with cosmos; extended epistemology of experiential, propositional, and practical knowing; co-created findings
Methodology (Procedures for gaining knowledge)	Experimental/manipulative; verification of hypotheses; chiefly quantitative methods	Dialogic/dialectical	Hermeneutical/dialectical	Political participation in collaborative action inquiry, primacy of the practical; use of language grounded in shared experiential context
Methods (How data is gathered and analysed)	Statistical analysis; sampling; measurement and scaling; data reduction	Life history; oral history	Participant observation; Non-participant observation, visual ethnographic methods, and interpretative methods.	Observation through an involvement or an engagement within a researched process

Sources: Adapted from Janesick (1994); Heron and Reason (1997); Crotty (1998); Coughlan and Coughlan (2002); and Guba and Lincoln (2005); Cahaya (2011). The shaded column represents the position taken in this thesis.

Positivism views a phenomenon as a 'real thing'. According to Peile (1994, 21) the phenomenon is assumed as “predictable, knowable, and measurable”. Moreover, positivism also sees that behaviours within a phenomenon can be predicted and explained based on a “certainty of sense experience” (Peile 1994, 21). In addition, Guba and Lincoln (1994) argue that

under positivism, a researcher is independent from the research object, therefore there are no researcher's influences on the result of the studies.

Hovenkamp (1990, 817) states that a positivist methodology in the area of economics is:

a procedure by which one formulates a hypothesis and then tests its reliability by attempting to falsify it through empirical observation. To the extent that a hypothesis cannot be falsified, it is said to be robust or predictive.

Meanwhile, Bryman (2012, 35) defines quantitative research as:

a research strategy that emphasises quantification in the collection and analysis of data and that entails a deductive approach to the relationship between theory and research, in which the accent is placed on testing of theories; has incorporated the practices and norms of the natural scientific model and positivism in particular; and embodies a view of social reality as an external, objective reality.

Unlike positivism, the other three paradigms, namely critical theory, constructivism, and participatory research, do not see any 'real' realities within a phenomenon. The reality of a phenomenon is considered "totally developed by economic, social, cultural, political, ethnic, and gender factors that are crystallized overtime or constructed by the phenomenon's local and specific nature" (Reason 1998, 43). To better understand a phenomenon, researchers believing any of these other three paradigms are interactively linked and interact with a process or an action within that phenomenon (Guba and Lincoln 2005). The results of the research conducted under any of these three paradigms are therefore literally created as the investigation proceeds (Guba and Lincoln 1994; Heron and Reason 1997). This discussion leads to the often debated conclusion that, within critical theory, constructivism, and participatory research, knowledge gained is less objective than a positivist approach.

This thesis is conducted under the positivist research paradigm outlined in Table 3.1. This choice is based on the best fit of distinguishing features such as the explanatory-style research objective stated in Chapter 1, the cycle of

enquiry chosen using inferential statistical tests, the methodology employed including type of data used, the empirical large scale data collection techniques and the researcher's approach to bias reduction.

Having discussed the major paradigms within the area of social science and outlined the choice of the paradigm of this thesis, the following section presents the literature review of relevant past studies. The examination focuses on the disclosure practices in public sector organisations, then on past mandatory disclosure studies. An explanation of the theory adopted in this thesis is then used as the basis for developing the hypotheses.

3.3 Literature Review

Financial reporting is “the information that links communication of an entity with investors, creditors and other interested parties to such information” (Alexander, Britton and Jorissen 2007, 3). Information in financial statements must be presented adequately to allow for a prediction of the financial condition, cash flow and profitability of an entity in the future (Bushman and Smith 2003). Furthermore, Ronen (2003) argues that information disclosed in financial statements must be tailored to the interests of users. Valetta (2005) also states that more transparent information will enhance the success of management in managing the organisation on an ongoing basis.

Healy and Palepu (2001, 406) defines disclosure “as the communication of economic information, whether financial or non-financial, quantitative or otherwise, concerning a company's financial position and performance”. While Sloan (2001) limits disclosure only to the understanding of matters relating to financial reporting.

Information disclosed in an entity's annual report is grouped into two types: mandatory and voluntary disclosure (see Polinsky and Shavell 2006). To gain a clearer understanding of both types of disclosures, Tian and Chen (2009) compare and contrast mandatory and voluntary disclosures as shown in Table 3.2.

Wallace and Naser (1995) provide a definition for voluntary disclosure as any intentional release of financial and non-financial information to various stakeholders by the management. Whilst, Akra, Eddie and Ali (2010, 172) defines mandatory disclosure as “the provision of information that must be disclosed to comply with the regulations”. The definition of both types of disclosure based on Tian and Chen (2009) is described in Table 3.2. This thesis focuses solely on mandatory disclosure in the financial statements of local governments in Indonesia.

Table 3.2: A Comparison of Voluntary and Mandatory Disclosure

Items	Mandatory Disclosure	Voluntary Disclosure
Definition	Information that is required to be disclosed according to the securities law, accounting principles, and regulatory agencies' regulations.	Except compulsory disclosures, the information disclosed by organisations for the sake of corporate image, relationship with the investors and avoidance of accusation risks.
Motive	Using laws and regulations to adjust the communication of information between organisations and other interest-related parties.	Self-interested communication of information between organisations and other interest-related parties.
Content	Consists of introduction, basic financial information, information of board and top managers, significant transactions, and explained for important items.	Consist of organisations strategies, research and development plans, prediction of information, investment project analysis, financial information analysis, purchased and merger information.
Carrier	Annual report and certain interim report.	Annual report, booklets, websites, road shows, and other public announcements.
Time	Fixed time in year and season	Potentially throughout the fiscal period.
Balance mechanism	Laws' regulations and execution	Corporate governance mechanism's design and effectiveness.
Root of disclosures	Monopoly of organisations on self-information.	Economic globalization and globalization of capital market.

Source: Adapted from Tian and Chen (2009, 59).

In relation to the comparison between mandatory and voluntary disclosure, it is important to know the type of entity that is making financial statement disclosures. Boyne (2002) argues that local government, as part of the public sector organisation, has different characteristics from a business

organisation, and this causes a difference in orientation and the purpose of the organisation. This can lead to a different pattern of external communication. Accordingly, the next section discusses the differences between business organisation and public sector organisations.

3.3.1 Business Organisations versus Public Sector Organisations

A public sector organisation is defined as “an organisation oriented toward the public interest” (Helden 2005, 430). Therefore, profit is not the final destination (see Bommert 2010). However, as an organisation, the management process still includes planning, controlling, staffing, evaluating and reporting. The different orientation and goals require more variation of planning and controlling because public sector organisations use more parameter measures of success than business organisations (Sihombing and Puvanasvaran 2010).

Some basic differences in accounting for government and private organisations exist, particularly in relation to aspects of ownership, accountability mechanisms, accounting standards, recording approach, and regulation (Barton 1999). Local government entities are public sector organisations. Accordingly, a study of financial statement disclosures in local government needs to be aware of the different properties and characteristics of the public sector organisation accounting practices (see Pangesti 2012).

In business organisations, corporate ownership can be clearly identified (Rufin and Santos 2012). The accounting assumption is that of an ‘economic entity’, meaning that investor ownership is limited to the number of shares which are invested. In a government organisation, the ‘owner’ is the community (Gedeona 2007).

Because of the different ownership structure, the mechanism of operational and financial accountability between a business organisation and a government organisation are also different. In a business organisation, the mechanism of operational and financial accountability are implemented by a Board of Directors through the general meeting of shareholders (Rapat Umum Pemegang Saham=RUPS), while in a government organisation it is

through the representative bodies that are called the House of Representatives or local parliament (the Indonesian phrase is Dewan Perwakilan Rakyat Daerah= DPRD).

Accounting standards in business organisations are also different from government accounting standards. In Indonesia, accounting standards for business organisations are promulgated by the Indonesian Institute of Accountants (Ikatan Akuntan Indonesia =IAI), while the accounting standards for government organisations are compiled by the Government Accounting Standards Committee (Komite Standar Akuntansi Pemerintahan=KSAP)²⁸. In addition, government organisations are strongly influenced by government policies, such as economic, political, and monetary policies (Brown and Knudsen 2012). Budgeting and accounting in government organisations do not depend on market mechanisms nearly as much as do business organisations.

This thesis focuses on mandatory disclosure within local government financial statements. The preparation of financial statements and the practice of mandatory disclosure of local governments have to follow the principles of accounting practices in public sector organisations. The following section examines studies on mandatory disclosure in both business organisations and local government.

3.3.2 Studies on Mandatory Disclosure

Studies on mandatory disclosure have adopted a variety of theories. These include agency theory (Mahoney 1995; Arrunda 2000; Palmer 2008; Doshi, Dowell and Toffel 2013), legitimacy theory (Gray, Kouhy and Lavers 1995; Cowan and Gadenne 2005; Mobus 2005), capital market theory (Cunningham 1994; Easterbrook 1997; Rock 2001; Schon 2006), institutional theory (Yoshikawa, Tsui and McGuire 2007; Costova, Roth and Dacin 2008, Doshi, Dowell and Toffel 2013), and political economy theory (Gray, Kouhy

²⁸ KSAP prepares the draft Indonesian Government Accounting Standards as the accounting principles that must be applied in preparing and presenting the financial statements of central government or local government entities. In its daily tasks, KSAP regularly report their activities to the Minister of Finance. KSAP is responsible to the President through the Minister of Finance.

and Lavers 1995; Campbell and Pedersen 2007). Recently, some researchers have employed institutional theory in the public sector area specifically on financial accounting disclosure such as Flack and Ryan 2003; Tagesson, Klugman, and Ekstrom 2011; and Stamatiadis and Eriotis 2011. Sejjaka (2004) argues that this theory potentially provides greater insights regarding mandatory accounting disclosure practices. This study uses institutional theory to examine the level of mandatory disclosure within financial statements of local governments.

Consistent with Owusu-Ansah (1998), this study defines mandatory disclosure compliance as the minimum amount of accounting information that is required to be disclosed, insofar as applicable to organisations under a disclosure regulatory framework. Therefore there is an implication that statutory requirements become the minimum standard of disclosure.

The study of mandatory disclosure on government institutions is important, particularly in determining whether the public sector organisation has implemented good governance practices especially from a transparency aspect (Nurunnabi, Karim and Norton 2011). A review of past literature indicates that mandatory disclosure studies of government institutions are very limited. Therefore, to better understand organisational compliance level, several past studies on mandatory disclosure in the business sector (companies) are also presented in the following section.

3.3.2.1 Mandatory Disclosure Studies: Public Sector Focus

Several prior studies of mandatory disclosure practices have been conducted in the public sector including local government entities, although they are not as prolific as the research on listed companies. While Table 3.3 summarizes past studies on mandatory disclosure studies in public sector entities, the following section examines in detail the literature on compliance with mandatory disclosures in both the public and business sectors.

Table 3.3: Summary of Studies on Mandatory Disclosures in Public Sector Entities

Study	Scope	Level of Compliance	Reporting Year	Disclosure Items	Findings
Robins and Austin (1986)	200 largest USA Municipalities	57.31%	1981	27	Administrative powers, management incentives, and types of local government are positively associated with the level of mandatory disclosures.
Ingram and DeJong (1987)	USA 544 Cities	58.2	1981	10	Economic incentives and structural setting of accounting standards are positively associated with the level of mandatory disclosures.
Copley (1991)	USA 262 Municipalities	Ns	1984	Ns	Reputation of auditor is positively associated with the level of mandatory disclosures.
Cheng (1992)	Federal Governments in USA	Ns	1986	Ns	Political environment and the power of government institutions are positively associated with the level of mandatory disclosures.
Ryan, Stanley and Nelson 2002	Australia 36 LG Councils	58.43%, 59.37%, and 60.80%	1997, 1998, 1999	22	Size of local councils is positively associated with mandatory disclosures.
Tagesson, Klugman, and Ekstrom (2011)	290 Swedish Municipalities	43.57%	2006	22	Size of municipality, tax base, tax rate, financial performance, and political majority are positively associated with the level of mandatory disclosure.
Martani and Lestiani (2012)	Indonesia 92 LG	35.45%	2006	Ns	Wealthy and complexity of local government, and audit findings are positively associated with the level of mandatory disclosures.
Suhardjanto and Yulianingtyas (2011)	Indonesia 51 LG	30.85%	2007	51	Number of local parliamentarians is positively associated with the level of mandatory disclosures.
Retnoningsih <i>et al.</i> (2011)	Indonesia 118 LG	60.64%	2007	43	Educational level of accounting department personnel and the location of local government are positively associated with the level of mandatory disclosures.
Bakar and Saleh (2011)	Malaysia 111 FSB	45.9%	2008	55	Size of entities and accessibility of entity annual report are positively associated with the level of mandatory disclosures.

Legend: Ns=Not specified; LG=Local Government; FSB=Federal Statutory Bodies.

Robbins and Austin (1986) examined the sensitivity of factors that affect the quality of mandatory disclosure in the financial statements of the municipalities in Chicago, New York, Boston, and Atlanta. The result of their study reveals that administrative powers, management incentives, and local government type relate to disclosure quality.

Cheng (1992) in his research found that the practice of mandatory disclosure by government agencies is affected by the political environment and the power of government institutions. In an earlier study, Ingram and DeJong (1987) explain that the mandatory disclosure practices are influenced by economic incentives and the structural setting of accounting standards by the state government. While Copley (1991) found that the reputation of the auditor who audits a government institution affects the level of mandatory disclosure.

Ryan, Stanley and Nelson (2002) in their research note that there is an association between the size of local government and the quality of reporting but the quality of disclosure is not associated with the timeliness of reports. The result of the study also indicates that although the quality of reporting by local governments has improved over time, councils generally do not report information on aspects of remuneration of executive staff, personnel, occupational health and safety, equal opportunity policies, and performance information.

In addition Bakar and Saleh (2011) conducted a study on the factors influencing the level of mandatory disclosure in the annual report of Federal Statutory Bodies (FSB) in Malaysia. Using 2008 annual reports of 93 FSB, their results show that there is a negative relationship between FSB reliance on federal government and disclosure level. Size of FSB and accessibility of FSB annual report has positive and significant influence on the level of mandatory disclosure.

Although there are three known Indonesian studies, they use agency theory as opposed to institutional theory which is used in this thesis. Suhardjanto

and Yulianingtyas (2011) used the number of local government's work unit²⁹, size, type of local governments, number of local parliamentarians, and jurisdiction as predictor variables to examine the level of mandatory disclosure of local governments by using agency theory. Their sample of 51 local government financial statements for the period of 2008 reveals that only the number of local parliamentarians has a positive and significant relationship to the level of mandatory disclosure. This study contrasts with research conducted by Retnoningsih *et al.* (2011) which reveals the number of local parliamentarian does not influence the level of mandatory disclosure in Indonesian local governments. The authors use agency theory as a theoretical framework in their study.

Tagesson, Klugman, and Ekstrom (2011) explained the extent and variation of content in mandatory disclosure among Swedish municipalities. They found that the extent of disclosure is associated with size of municipality, tax base, tax rate, financial performance, and political majority.

Martani and Lestiani (2012) examined the level of mandatory disclosure of 92 local governments in Indonesia for the period of 2006. Using agency theory, six predictor variables were explored including wealth of local government, dependency of local government, complexity of government, number of audit findings, value of audit finding, and type of local government. Their result noted that wealth of local government, complexity of government, and number of audit findings has a positive and significant relationship to the level of mandatory disclosure.

In summary, the mandatory disclosure studies that examine public sector entity compliance find varying degrees of mandatory disclosure across countries and time frames. The sub-section below explores business sector organisational compliance.

²⁹ A work unit of local government is referred to as SKPD (Satuan Kerja Perangkat Daerah) in Indonesia. SKPD is the local government agency that is answerable to the head of local government for all governmental tasks related to public service agencies, local government technical institutes, and the police force.

3.3.2.2 Mandatory Disclosure Studies: Business Sector (Companies)

Focus

Based on Table 3.4, none of the studies on mandatory disclosure are industry specific. The number of firms varied from 49 firms in Zimbabwe (Owusu-Ansah 1998) to 566 firms in three Asian countries namely Bangladesh, India and Pakistan (Ali, Ahmed and Henry 2004). Almost all of the studies adopt some kind of disclosure index as the dependent variable. The level of compliance varied widely from between 36% to 85%. The amount of disclosure items that comprise the disclosure indices varied from a minimum of 10 (Clarkson, Bueren and Walker 2006) to a maximum of 214 items (Owusu-Ansah 1998). According to the literature reviewed, past accounting compliance studies predominantly examine the level of compliance with accounting standards in two major streams: (1) level of compliance of measurement, presentation and disclosure; and (2) determinants of level of compliance.

In addition, Table 3.4 shows that the number of disclosure items is not always aligned with the level of compliance. A study with a lower number of disclosure items does not necessarily have a higher level of compliance. For example, Clarkson, Bueren and Walker (2006) used only 10 disclosure items and found a 36% level of compliance, while research conducted by Owusu-Ansah (1998) by using 214 disclosure items has 75% level of compliance.

Moreover, it can be seen from Table 3.4 that the type of country (developed or developing) does not necessarily affect the level of compliance. Companies which operate in a developed country do not necessarily have a higher level of compliance compared to companies operating in developing countries. Clarkson, Bueren and Walker (2006) and Palmer (2008) both conducted their research in a developed country (Australia) finding a compliance level of 36%, while research conducted by Ali, Ahmad and Henry (2004) in several developing countries (India, Pakistan and Bangladesh) were all found to have a higher level of compliance at 80% (whole sample), 79% (India), 81% (Pakistan), and 78% (Bangladesh).

Table 3.4: Summary of Studies on Mandatory Disclosures in Business Sector Entities (Companies)

Study	Country	Level of Compliance	Reporting Year	Disclosure Items	Findings
Wallace and Naser (1995)	Hong Kong	73%	1991	142	Significant positive association between firm size and the extent of mandatory disclosure. Whereas, significant negative association between profitability and the extent of mandatory disclosures.
Hasan, Karim and Quayes (2008)	Bangladesh	85%	1991 and 1998	57	Multinationality, firm size, profitability, and age are significant positive association with the extent of mandatory disclosures.
Owusu-Ansah (1998)	Zimbabwe	75%	1994	214	Multinationality, firm size, profitability, and age of company are significant positive association with the extent of mandatory disclosures.
Ali, Ahmed & Henry (2004)	India, Pakistan, Bangladesh	80% (whole sample), 79% (India), 81% (Pakistan), 78% (Bangladesh)	1998	131	Multinationality, firm size, and profitability are significant positive association with the mandatory disclosures
Clarkson, Bueren & Walker (2006)	Australia	36%	1998-2004	10	Firm size and profitability are significant positive association with the extent of mandatory disclosures.
Taplin, Tower, Hancock (2002)	Multiple Countries	23% - 64%	1999	26	Multinationality and industry are positively significant predictor of the extent of mandatory disclosures.
Glaum and Street (2003)	Germany	84%	2000	153	Size of audit firm is significant positive association with the extent of mandatory disclosures.
Nelson, Gallery and Percy (2010)	Australia	Ns	2001-2004	35	Firm size, industry, and size of audit firm are significant positive association with the extent of mandatory disclosures.
Kent & Stewart (2008)	Australia	Ns	2004	51	Firm size is significant positive association with the extent of mandatory disclosures.
Palmer (2008)	Australia	36%	2005	53	Leverage, firm size, size of audit firm, and audit findings are significant positive association with the extent of mandatory disclosures.

Legend: Ns=Not specified.

Using agency theory, Wallace and Naser (1995) examine the level of accounting compliance of 80 annual reports of companies listed on the Stock Exchange of Hongkong. Their accounting compliance index derives from Hong Kong Statements of Standard Accounting Practice issued by Hong Kong Society of Accountant. They calculate a slightly lower compliance level of 73%. The regression results note both firm size and profitability are important predictor of compliance.

In contrast, Taplin, Tower and Hancock (2002) focus on the level of disclosure compliance and measurement compliance with 26 International Accounting Standards in six Asia-Pacific countries. The researchers computed the level of accounting compliance for Australia as 54%, Hong Kong 53%, Malaysia 41%, Thailand 39%, Singapore 38%, and Philippines 28%. The result of their study shows that country of origin is highly significant for accounting compliance, and that number of days since the issue of a company's annual report is negatively related to the level of accounting compliance.

Meanwhile Ali, Ahmad and Henry (2004) examine the magnitude of compliance with mandatory disclosure in the East Asia countries of Pakistan, India and Bangladesh. The sample consists of 229 (Pakistan), 219 (India), and 118 (Bangladesh) companies. The results show that on average, the compliance level is 80% for the whole sample, with 81% for Pakistan, 79% for India, and 78% for Bangladesh firms. The researchers state that the different levels of compliance might be due to institutional or regulatory differences.

Similar research was conducted in Australia by Clarkson, Bueren and Walker (2006) who examine mandatory disclosures of Chief Executive Officer (CEO) remuneration in Australia in the period 1998 to 2004. Disclosures on remuneration paid to company directors and executives have been compulsory since the introduction of the Company Law Review Act 1998. The result shows that firms generally did not comply until the formalization of

the accounting standard 'Director and Executive Disclosures by Disclosing Entities' became operative in 2004. Based on their sample of 124 Australian firms during 1998 to 2004, Clarkson, Bueren and Walker (2006) found a systematic increase in the level of disclosure in each successive year from 1999 to 2003 and that this was largely due to the extent of public scrutiny. The researchers emphasised that:

allowing discretion in disclosure choices leads to poor quality disclosure, and this is so despite ongoing media and regulatory interest in the disclosure. A far more effective regulatory strategy is to clearly stipulate what is considered minimal disclosure at the outset, leaving as few issues as possible open to interpretation (Clarkson, Bueren and Walker 2006, 772).

In the same region, Hasan, Karim and Quayes (2008) investigate the degree of accounting compliance of 86 listed companies in Bangladesh. The researchers analysed two time periods 1991 (less regulated) and 1998 (more regulated). The creation of the Mandatory Disclosure Index (MDI) was based on 22 mandatory items (1991) derived from the Companies Act 1913 and the Securities and Exchange Rules 1987, and 57 mandatory items (1998) derived from the Bangladesh Companies Act 1994 and 1997 amendment of the 1987 Securities and Exchange Rules. The result of this research showed that the levels of adherence to accounting rules were 75% in 1991 and 85% in 1998. They also found that qualification of accounting staff, size of firm, and reputation of auditing firm are significant predictors, with other predictors such as multinational affiliation, profitability, and leverage not significant.

Kent and Stewart (2008) examine the relationship between the level of mandatory disclosure of Australian Accounting Standards Board (AASB) 1047 and corporate governance quality by Australian listed companies. The proxy measures for corporate governance quality included composite of board independence, CEO-duality, board size, board diligence, existence of audit committee, audit committee independence, audit committee expertise, audit committee diligence, and audit committee size. The results from their sample of 965 companies show evidence of an association between corporate governance quality and a greater level of disclosures, in particular, with regards to board and audit committee diligence.

Palmer (2008) looks at the level and quality of Australian listed firm's compliance with the mandated disclosures of AASB 1047. In this research, Palmer finds that firm size, leverage and auditor firm size affect the extent and quality of compliance with AASB 1047. It is also shown that auditor firm's size makes the strongest contribution to both the extent and quality of the mandatory disclosures. The researcher suggests that "many companies might have relied extensively, if not solely, on the example disclosures provided by their auditors as a means of meeting the requirements of AASB 1047" (Palmer 2008, 867).

In summary, the mandatory disclosure studies that examine company compliance find varying degrees of mandatory disclosure across countries and time frames, and that certain variables consistently affect the level of disclosure.

3.3.3.3 Reviews on Variables of Previous Mandatory Disclosure Studies

Based on the preceding literature review on mandatory disclosure, a number of studies have highlighted that certain variables positively affect the level of mandatory disclosure both in public and business sector organisations. In business organisations, there are several variables that are often found to positively affect the level of mandatory disclosure such as multinationality, leverage, firm size, profitability, industry, size of audit firm, audit findings, and age. Firm size, particularly, has been found to be a very powerful variable affecting the level of mandatory disclosure (see Wallace and Naser 1995; Owusu-Ansah 1998; Taplin, Tower, and Hancock 2002; Glaum and Street 2003; Ali, Ahmed and Henri 2004; Owusu-Ansah and Yeoh 2005; Clarkson, Bueren and Walker 2006; Hasan, Karim and Quayes 2008; Kent and Stewart 2008; Palmer 2008; and Nelson, Gallery and Percy 2010).

Whereas in public sector organisations, the variables that positively affect the level of mandatory disclosure include size of entity (Ryan, Stanley and Nelson (2002); Tagesson, Klugman and Ekstrom (2011); Bakar and Shaleh (2011)), management incentives (Robins and Austin (1986)), administrative

powers (Robins and Austin (1986)), type of local government (Robins and Austin (1986)), political environment (Cheng (1992); Tagesson, Klugman and Ekstrom (2011)), government institution's power (Cheng (1992)), economic incentives (Ingram and DeJong (1987)), structural setting of accounting standards (Ingram and DeJong (1987)), reputation of auditor (Copley (1991)), educational level of accounting department personnel and location of local government (Retnoningsih *et.al* (2011)), accessibility of entities annual report (Bakar and Saleh (2011)), tax base, tax rate and financial performance (Tagesson, Klugman and Ekstrom (2011)), political majority (Cheng (1992); Tagesson, Klugman and Ekstrom (2011)), wealth of local government, complexity of government and number of adverse audit findings (Martani and Lestiani (2012)), and number of local parliamentarians, number of citizens (Suhardjanto and Yulianingtyas (2011)).

This study adopts variables that have influenced the level of mandatory disclosure in public and business organisations as predictor variables such as age of entity, type of local government, financial independence, and audit findings. These are chosen due to their relevance to the research question and availability of data within an Indonesian context. Three independent variables have been adopted that have been commonly used as possible determinants of mandatory disclosure practice (number of local parliamentarians, local government budget, and political influence). This thesis also uses three other factors that are specific to this study (Java/non-Java jurisdiction, presence of an assistance and training programme, and number of internal auditors) and potentially influences mandatory disclosure practices.

This thesis posits that all six independent variables namely local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of an assistance and training programme, proportion of non-supporting parties, and number of internal auditors are potential determinants of mandatory disclosure practices in Indonesian local government within the framework of isomorphic institutional theory. These six independent variables and their proposed impact on local government

disclosure are examined further in the hypothesis development in Section 3.5. The following sections explain and justify the adoption of this theory which is then used as the basis for developing the hypotheses.

3.3.3 Adoption of Isomorphic Institutional Theory

Institutional theory has been employed to understand various organisational and individual practices and activities (see for example: Scott 1987; Carpenter and Feroz 2001; Dacin, Goodstein and Scott 2002; Kostova, Roth and Dacin 2008; Mucciarone 2008; Cahaya 2011; Choi 2011). The theory has been applied in a diversity of settings, for example, local authorities, universities, health care, and government institutions, to better understand accounting practices, including budgeting, the adoption of generally accepted accounting principles (GAAP), accounting systems, and financial reporting (Covaleski and Dirsmith 1988; Dacin, Goodstein and Scott 2002; Flack and Ryan 2003; Mucciarone 2008; Choi 2011; Usman and Rosidi 2012). In addition, a number of studies have used institutional theory as the framework for better understanding mandatory disclosures in a public sector setting (see Flack and Ryan 2003; Collin *et al.* 2008; Falkman and Tagesson 2008; Stamatiadis and Eriotis 2011).

Institutional theory is concerned with how organisations structure themselves and gain acceptance and legitimacy which may be at the expense of efficiency. Legitimacy is the acceptance of an organisation by certain social actors in society as not all parties have the standing to confer legitimacy. Kostova and Zaheer (1999) note that institutional theory supporters such as DiMaggio and Powell (1983) and Meyer and Rowan (1977) have identified certain determinants of organisational legitimacy and the characteristics of the legitimating process. They cite three sets of factors that shape organisational legitimacy: (1) the environment's institutional characteristics, (2) the organisation's characteristics, and (3) the legitimating process by which the environment builds its perception of organisations.

Pressures to conform arise from a variety of factors including uncertainty and task requirements, professional norms and standards, and a broader

normative environment (Dacin 1977). Delmas, Magali and Toffel (2004, 210) argue that:

the institutional sociology framework emphasised the importance of regulatory, normative, and cognitive factors that affected organisation' decisions to adopt a specific organisation practice, beyond and further than the technical efficiency of the practice.

Carpenter and Feroz (2001) and Ashworth, Boyne and Delbridge (2007) suggest that isomorphic pressures differ based on organisational characteristics. Using this strand of thought, this study examines isomorphic variables such as local government parliamentarians, local government budget, Java/non-Java (jurisdiction), presence of assistance and training programme, non-supporting parties, internal auditors and their potential relationship with the level of mandatory disclosure.

In line with the pressure for legitimacy, the institutional perspectives highlight the importance of an organisation's 'social contract' (Deegan 2006; 2009). This is supported by Meyer and Rowan (1977, 343) who state that "companies operate within a social framework of norms, values and assumptions that are concerned about what constitutes fit or acceptable economic behaviour". The common idea is that the survival of an organisation depends on meeting the expectations of social norms. In achieving continued support from society and legitimating an organisation's formal structures, procedures and policies are essential to make sure there is compliance with institutionalized rules (Meyer and Rowan 1977; Scott 1987). Institutional theory has two main dimensions, decoupling and isomorphism (Deegan 2006; Costova, Road and Dacin 2008). Decoupling refers to a situation in which the apparent practice of an organisation is different from the actual practice (Meyer and Rowan 1977, Carruthers 1995; Cahaya 2011). Isomorphism refers to particular practices by an organisation because of institutional pressures and is a process that forces a unit to conform to other units in the population that deal with similar situations (DiMaggio and Powell, 1983). Accordingly, an organisation will become progressively more alike within a certain area and conform to the expectations of the wider institutional environment as a result of isomorphic pressures (Perera 2007; Deegan

2009). Through becoming 'isomorphic', organisations may achieve legitimacy (DiMaggio and Powell, 1983). However, Kostova and Zaheer (1999, 77) in their study on multinational enterprises, claim "given the multiplicity and variety of institutional environments and the cross country differences between these environments, achieving isomorphism becomes difficult".

There are two main types of isomorphism: competitive and institutional. Competitive isomorphism is associated with a free and open competitive market; while institutional isomorphism is concerned with the organisational fight for political power, social fitness and legitimacy (DiMaggio and Powell 1983). Institutional isomorphism is adopted in this thesis as it is more appropriate to the study of Indonesian local governments. As argued by Frumkin and Galaskiewicz (2004) the public sector is susceptible to institutional pressures because of the lack of accountability links towards financial indicators, for example, profit and sales, and the public sector is more inclined towards a bureaucratic structure. This argument is closely related to the role of the government as a funding provider and regulator of business activities. The multiple roles of government entail the implementation of certain rules and procedures which, in turn, require compliance by organisations such as local authorities.

From 2005 to 2010, the Supreme Audit Board of Indonesia (Badan Pemeriksa Keuangan=BPK) reported that the quality of local government financial statements including mandatory disclosure practices have not shown satisfactory results (Badan Pemeriksa Keuangan 2011). In 2010, only 9% of local government financial statements which were audited by BPK obtained an unqualified opinion.³⁰ Accordingly, the government increased their efforts to improve the quality of local government financial reports by introducing, mentoring and training accounting staff, promoting assistance in financial statement preparation, and providing scholarships to accounting staff to conduct further studies (Akbar 2011). These renewed efforts by the government have been driven by a demand for better accountability and

³⁰ In 2010, BPK audited 358 local government financial statements, and made the following audit opinion determinations: 9% (32 local governments) unqualified opinion, 76% (271 local governments) qualified opinion, 3% (12 local governments) disclaimer opinion, and 12% (43 local governments) adverse opinion (Badan Pemeriksa Keuangan 2010).

transparency from various stakeholders such as communities, investors, local parliament and central government (Renyowijoyo 2009). The commitment of the Indonesian local governments to improve mandatory disclosure practices highlights that they are not simply creating an image that is different from reality (as in decoupling). These perceptions support the adoption of the isomorphic influence of institutional theory in this study.

As one important form of government in the public sector, local authorities are subject to various types of pressure with Zucker (1987) stating that both outsider and insider factors influence organisations.

3.3.4 An Additional Outsider-Insider Approach

Adding an additional outsider and insider research lens to the analysis will provide management with better knowledge and understanding of the communication influences upon an organisation, allowing them to adopt policies to achieve better results (Homburg and Bucerius 2006). According to Xu *et al.* (2003, 15) the word 'outsider' means "the environmental conditions that are beyond the control of the organisation who have a significant effect on an organisation's operational and strategic plans". Dwyer and Buckle (2009, 55) define 'insider' as "various things or parties directly related to an organisation's routine activities that effect each organisation's programmes and policies".

Fang (2006) states that companies with stronger inside governance (such as higher ownership concentration and smaller boards) tend to manage earnings more than companies with stronger outside governance (such as higher institutional holdings and higher takeover pressures). The outsider and insider research approach has been used to examine the interaction between variables in the field of corporate governance systems (see Tan and Wang 2002 and Barker 2006). Lindblom, Sandahl and Sjogren (2010) argue that both outsider and insider dominated financial and corporate governance systems (FCGS) can induce short-term pressures on management which inhibit spending on innovation. The outsider-insider approach has also been adopted in the field of organisational studies, (see Gioia *et al.* 2010; Hunker and Probst 2008; Lievens, Hoye and Anseel 2007; Louis and Bartunek,

1992) and in Corporate Social Responsibility practices (Cui, Jo and Na (2012); Post, Rahman, and Rubow (2011); and Mattila (2009)). In the Indonesian local authority environment, sources of pressure come from citizens, service users, taxpayers and the ministry, highlighting both internal and external pressures. Therefore, this study adopts an additional perspective using an insider/outsider approach to determine factors that potentially affect the level of mandatory disclosure of financial statements of Indonesian local governments.

3.3.5 Explanation of Predictor Variables

Within institutional isomorphism there are three tenets that have potential explanatory powers: coercive, mimetic and normative isomorphism. In selecting the predictor variables for this study, all three variants are employed, whilst co-adopting an additional insider/outsider perspective.

According to DiMaggio and Powell (1983, 149), coercive isomorphism results from “both formal and informal pressures exerted by other organisations on which an organisation may be dependent, as well as cultural expectation in which the organisations operate”. The formal pressure they refer to is a regulative process where regulators have the capacity to set up rules and procedures, monitor compliance and, when necessary, apply sanctions. In relation to this study, coercive pressures includes the power of local parliament to control and supervise the performance of the executives of local governments in regards to the quality of disclosures in the financial statements as a medium of accountability to the public. This factor is considered as an outsider coercive influence. In addition, the role of the local budget to trigger executive activities to perform government activities including the preparation of financial statements and mandatory disclosure as a medium of accountability to the public is considered as an insider coercive pressure.

DiMaggio and Powell (1983, 150) then further explain that “mimetic isomorphism is where organisations tend to model themselves and imitate the practices and policies of those organisations perceived to be legitimate

and successful". Mimetic isomorphism is often referred to as a response to uncertainty. Furthermore, Baker and Rennie (2006, 88) state that:

while these organisations may not be certain about what they should do when facing challenges by adopting structures and processes used by similar organisations, they are, at the very least being seen to be doing something.

In this study, the behaviour to mimic (copy) the communication of mandatory disclosures by local governments with less facilities (non-Java) to local governments with more complete facilities (Java) is considered as an outsider mimetic influence. Whereas, the behaviour of local government in mimicking the materials obtained from a training programme to enhance the quality of financial statements and mandatory disclosure practices is considered an insider mimetic influence. Mimetic behaviour studies are commonly conducted via a longitudinal research approach. A longitudinal study could capture the changes of local government's economic performance in different economic conditions over time and the impact these changes have on mandatory disclosure practices. This thesis solely focuses on the 2010 fiscal year, because of the limitation associated with the political condition of Indonesia which is discussed in Chapter one. A limitation of using a cross sectional study, is that the mimetic proxy variable more indicates the possibility of mimicking behaviour rather than actual behaviour (see Section 1.5).

The third isomorphic tenet is normative. Ryan and Purcell (2004, 10) explain that "normative influences refer to shared norms of organisational members, that is, those values that may be unspoken or expectations that have gained acceptance within organisations". The element of pressure is normally developed by professional and occupational groups (Rahaman, Lawrence and Roper 2004). DiMaggio and Powell (1983, 152) argue that:

the more highly professionalized a workforce becomes in terms of academic qualifications and participation in professional and trade associations, the greater the extent to which the organisation becomes similar to other organisations in the fields.

Hidayat and Raharjo (2011, 14) define the term professional as “a job or position requiring expertise, reliability, independency, and giving priority to the public interest”.

From a normative isomorphic viewpoint, this study examines whether the leaders of local government who focus on public interests rather than the interests of their own party will achieve a higher level of mandatory disclosure in the financial statements. This supports a statement that professional behaviour should be independent of any parties in the organisation that could potentially lead to collusion and nepotism (Hidayat and Raharjo 2011). This professional behaviour is measured by the proportion of local parliament members who are independent of the executive of local government and behaviour is considered as an outsider normative influence. The behaviour of the second influencing group is also measured by the total number of internal auditors in every local government. This is consistent with a statement by Hidayat and Raharjo (2011, 14) that “professional behaviour is reflected by the level of expertise in a specific area”. Internal audit is a profession which requires a special expertise with a specific educational qualification. The number of internal auditors in local governments potentially affects the extent of mandatory disclosure practices within local government financial statements and this study uses the number of internal auditors as an insider normative isomorphism variable.

While institutional theory could be applied to a longitudinal study to explain the process of adaptation or changes by Indonesian local governments in mandatory disclosure practices over time (see Cormier, Magnan, and Velthoven 2005), the theory is employed in this thesis as an explanatory tenet of a cross-sectional mandatory disclosure phenomenon in Indonesian local governments. Such an analysis is considered appropriate and important to solely focus the examination on the financial year of the application of legislated mandatory disclosure practices in Indonesia. DiMaggio and Powell (1983, 148) state that “managers action in responding to institutional pressures are not necessarily strategic in a long-run sense”. The design of the predictor variables is presented in Table 3.5.

Table 3.5: Design of Predictor Variables with Outsider-Insider Approach

	Coercive	Mimetic	Normative
Outsider influences	COV	MOV	NOV
Insider influences	CIV	MIV	NIV

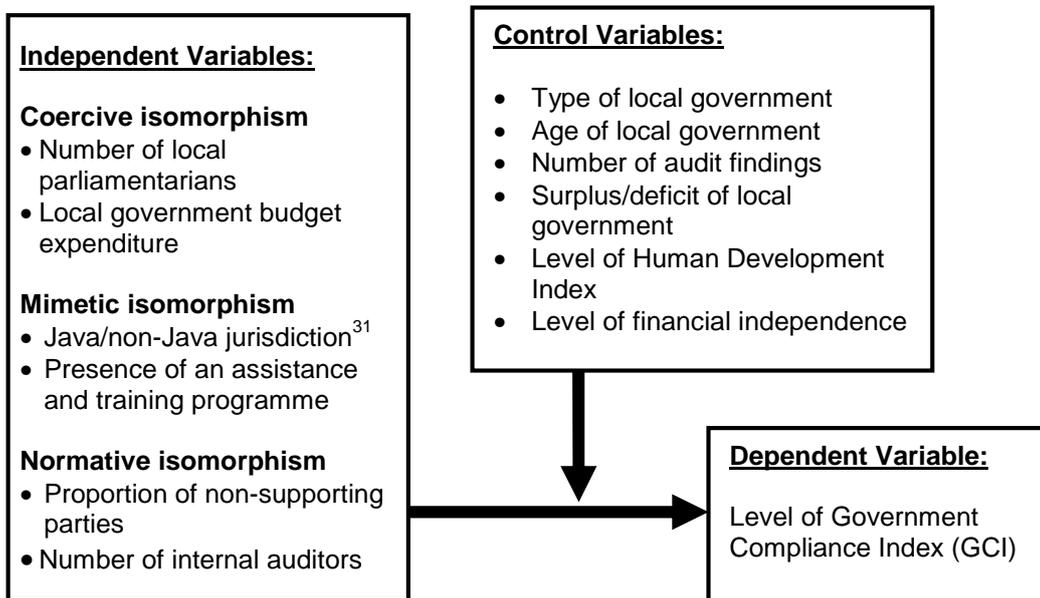
Legend: COV=Coercive outsider variable, MOV=Mimetic outsider variable, NOV=Normative outsider variable, CIV=Coercive insider variable, MIV=Mimetic insider variable, NIV=Normative insider variable.

The following section discusses the possible determinants which will be used to develop hypotheses based on isomorphic institutional theory.

3.4 Conceptual Schema

Heckman and Vytlačil (2005, 671) state that “a variable is the central idea of research”. A basic causal relationship needs dependent, independent, and control variables (Neuman 2000). This thesis tests empirically the relationship among those three types of variables in the research model through a measurement process. This study tests six independent variables: number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of assistance and training programme, proportion of non-supporting parties, and number of internal auditors. The conceptual schema for illustrating the whole set of the independent, control, and dependent variables in this thesis is presented in Figure 3.1.

**Figure 3.1: Conceptual Schema: Key Variables within Isomorphism
Institutional Theory**



In addition to the examined predictor variables and consistent with prior research (Lev and Schwartz 1971; Ingram 1984; Robbins and Austin 1986; Cheng 1992; Huther and Shah 1998; Keating and Frumkin 2003; Giroux and McLelland 2003; Falkman and Tagesson 2008; Suhardjanto and Yulianingtyas 2011; Tagesson, Klugman, and Ekstrom 2011; Martani and Lestiani 2012; Hilmi and Martani 2012) this thesis employs types of local government, age of entity, audit finding, surplus/deficit local government, level of Human Development Index, and financial independence as control variables.

The following sections discuss the possible determinants described in Figure 3.1, develop the hypotheses that will be tested for the independent variables, and explains the inclusion of the control variables in this thesis.

³¹ As stated earlier a jurisdictional proxy cannot measure copying behaviour of non-Java as compared to Java local government entities. Instead it can measure the potential for such mimicking behaviour.

3.5 Hypotheses Development

3.5.1 Coercive Isomorphism Related Hypotheses

Within the framework of coercive isomorphism, two hypotheses are developed in this study. Number of local parliamentarians is used as the coercive isomorphism outsider hypothesis, and the local government budget expenditure amount is used as the coercive isomorphism insider hypothesis. Both hypotheses are used to examine the level of mandatory disclosure within financial statements of Indonesian local governments.

3.5.1.1 Number of Local Parliamentarians (H1)

In Indonesia, local parliament is an institution that has a strategic position associated with the area of financial control (Suhardjanto and Yulianingtyas 2011). As a representative institution, local parliament is a balancing force to control the performance of the local government executive (see UU No. 27 of 2009). As elected citizen representatives in a local government, their role in the local parliament has three main functions, namely: legislative function, budgeting function, and oversight function (see Santoso 2011).

Several studies use size of local parliament as a measurement of local government size (Gilligan *et al.* 2001; Laswad, Fisher and Oyelere 2005; Hix, Noury and Roland 2005; Suhardjanto and Yulianingtyas 2011). In line with coercive isomorphism of institutional theory, the local parliamentarians are thought to have the power to pressure local government executive to align with society's aspirations. Accordingly, this study uses the number of local representatives in Indonesian local parliament as a proxy to measure size as a predictor of the level of mandatory disclosure in financial statements.

Indonesian local parliaments have a varying number of members, depending on the size and influence of the local government. As stated in Indonesian Law (UU No. 10 of 2008) on the election of Indonesian parliamentarians (DPR and DPRD) and regional representatives (DPD), a member of local parliament is considered a political mediator of the people within a local government. The greater number of local parliament members means the greater the number of local community representatives who will hold a

legislative function to influence local government executives in performing their duties (Bendor, Taylor and Van Gaalen 1987; Sotiropoulos 2008; Retnoningsih *et al.* 2011). Therefore, there is potentially greater pressure from those local members representing local community as a coercive isomorphic influence of local government executives to make disclosures on their operational activities.

To capture this potential coercive isomorphic pressure the following hypothesis is proposed:

H1: There is a positive association between number of local parliamentarians and the extent of mandatory disclosure in local government financial statements.

3.5.1.2 Local Government Budget Expenditure (H2)

In the management of local government, the budget is a guideline to assess whether the activities of the local government are appropriate with local government regulation of the local budget (Perda APBD)³² which contains all programmes and activities implemented by the local government in a fiscal year.

In a broader context, the local budget has several diverse functions such as serving as a political instrument, fiscal policy decisions, planning tool, and controlling mechanism (see Mardiasmo 2002 and Warimon 2005). While in a narrower context, the local budget is a source of funding of all activities organized by a local government for the benefit of society and the development of government (Kelly and Rivenbark 2010).

The bigger the expenditure budget, the more likely the complexity of local government activities to fulfil public needs. Thus, Ismoyo (2011) argues that the greater the expenditure made by an entity, the more accounting information will increasingly affect the completeness of the disclosure of financial statements.

³² Perda APBD (Peraturan Daerah APBD) is enacted legislation containing the revenue and expenditure budget made by local government by mutual approval with local parliament.

Hilmi and Martani (2012) reveal that the greater the activity level of a local government, then the greater is the requirement of financial disclosure to help users in understanding the financial statements. Meanwhile, Cordella and Ariccia (2003) argue that a more adequate budget will support local governments to carry out all activities because they have the ability to finance their programmes.

Several studies (Patrick 2007; Friedman 2013) argue that a higher expenditure budget of local government supports citizens to get better information on local government activities. This can then cause an increase in citizens' demand for full disclosure within financial statements. Furthermore, Marston and Shrives (1991) explain that full disclosure is clearly important to avoid misconceptions in understanding the financial statements.

Accordingly, it can be concluded that local government expenditures have potentially coercive pressure on the practice of mandatory disclosure in the financial statements of the local government. Therefore, this thesis adopts local government expenditure as a potential factor in explaining the variability of mandatory disclosure by proposing a directional hypothesis:

H2: There is a positive association between the local government budget expenditure and the extent of mandatory disclosure in local government financial statements.

3.5.2 Mimetic Isomorphism Related Hypotheses

Within the framework of mimetic isomorphism, two hypotheses are developed to test the impact of jurisdiction (Java/non-Java) as the outsider hypothesis, and an assistance and training programme, developed by BPKP but used by some local governments, as the insider hypothesis.

3.5.2.1 Java/Non-Java Jurisdiction (H3)

Indonesia has a population of 237.6 million people in 2010, with 58% living on the island of Java, one of the most densely populated regions in the world (Biro Pusat Statistik 2011a). Java is the centre of economic and political

power in Indonesia (Biro Pusat Statistik 2011b). For example, 82% of total large and medium firms (16,610 entities) are located and operated in Java (Biro Pusat Statistik 2011c). These conditions provide Java with a competitive advantage compared to other Indonesian islands.

Jakarta is the capital of Indonesia. The capital's location influences the surrounding area to strive for better facilities. The amenities in every local government located in Java are generally better than in non-Java with the government of Indonesia, through the Ministry of Communication and Information (Kemkominfo), admitting to a gap in terms of construction and development of telecommunications and other facilities on the islands between Java and non-Java (Tadda 2010). For instance, Ball (2001); Olajumuke (2010); and Salehi and Torabi (2012) feel that the quality of telecommunication infrastructure will affect the quality of an entity's financial reporting. With a better communication system, an organisation can more easily monitor its development, and matters relating to the operations can be shared with all stakeholders more quickly to support the advancement of the organisation. In addition, Java has better educational facilities than non-Java with most of the leading universities being located in Java (Tadda 2010). On a very wide rank of economic, social and cultural fronts the Javanese population has more advanced infrastructure than the non-Javanese population.

Institutional theorists argue that "within a similar industry, companies tend to model themselves especially after they see that similar companies gain more successful results in their business or in securing legitimacy due to the adoption of a particular practice" (DiMaggio and Powell 1983, 151). Based on this argument, several activities are being pursued by non-Java local governments which represent areas with inadequate facilities, to improve their financial statements such as comparative studies with their Java local government counterparts, working visits, and employee training by Java local governments. Jaya (2010), a local parliament member of Lubuk Linggau (non-Java municipality) states that there are three criteria for Java local governments intended for the purposes of comparative studies: the awarding

of an unqualified opinion from BPK, advanced information technology facilities, and a good administrative system. Appendix B shows the impact on non-Java local governments which undertake comparative studies with Java local governments relating to financial statement improvement during 2008 to 2010. Local governments that undertake comparative studies have achieved a higher score of Government Compliance Index (GCI) in 2010 (above 69.6%, the score of total GCI). It is therefore suggested that non-Java local governments will potentially mimic administrative practices of Java local governments, including the practice of mandatory disclosure in the financial statements. Accordingly, the following mimetic outsider hypothesis is proposed:

H3: There is a positive association between local governments that are located on the island of Java and the extent of mandatory disclosure in the local government financial statements compared to non-Java entities.

Section 1.5 highlights a limitation to the jurisdictional proxy measure. The measure cannot detect mimic behaviour in one year, rather it can note the 'possibility' of mimic behaviour measured by differences in GCI scores between Java and non-Java local government entities.

3.5.2.2 Presence of an Assistance and Training Programme (H4)

Currently, the Indonesian government continues to improve accountability of public financial management in accordance with principles of good governance. In the government regulation (PP) No. 56 of 2005 which was further amended by PP No. 65 of 2010 on Regional Financial Information System (Sistem Informasi Keuangan Daerah=SIKD), the government expects each local government to implement a computer based programme (SIKD) for reporting financial information. This computer based programme (SIKD) is able to handle the process of financial management, from budgeting to financial reporting area (Tuasikal 2007).

Government regulation (PP) No. 105 of 2000 and No. 108 of 2000 also requires local governments to account for their financial management in the form of accountability reports based on the financial accounting principles. To

support this programme, the Financial and Development Supervisory Agency (Badan Pengawasan Keuangan dan Pembangunan=BPKP)³³ provides an assistance and training programme relating to the implementation of the financial accounting system of local government (Sistem Akuntansi Keuangan Daerah=SAKD). These activities include the preparation of accounting policies, the preparation of accounting systems and procedures, and the preparation of financial statements in accordance with accounting standards (Badan Pemeriksa Keuangan 2011). However, Chapter 5 identifies that almost half the local government entities did not implement this assistance and training programme.

Several prior studies have revealed that a financial accounting system encourages financial transparency of the organisation including mandatory disclosure as required by the regulator (see Bushman and Smith 2003; Rohman 2009; Arfianti and Kawedar 2011). In addition, Ball 2001; Lambert, Leuz, and Verrecchia 2007; and Ratifah and Ridwan 2011 conclude that the quality of financial accounting systems positively affects the quality of financial reporting and the level of mandatory disclosure.

It is suggested that local governments that have sought and received an assistance and training programme have better mandatory disclosure practices because they imitate (mimic) the materials which have been obtained from the programme. Accordingly, the following insider mimetic hypothesis is proposed:

H4: There is a positive association between the presence of an assistance and training programme conducted by BPKP and the extent of mandatory disclosure in the local government financial statements.

³³ BPKP is an important non-ministerial Indonesian government institution which is responsible for the implementation of financial supervision and development in the form of audit, consulting, assistance, evaluation, corruption eradication, education and training of financial control in accordance with applicable regulations. The result of financial supervision is reported to the President as the head of government as consideration for setting the policies of governance and accountability. The result is also required by other government institutions, including the provincial and districts/municipalities in the achievement of an agency's performance.

3.5.3 Normative Isomorphism Related Hypotheses

Under normative isomorphism tenets, two additional independent variables: proportion of non-supporting parties (normative isomorphism outsider pressure) and number of internal auditors (normative isomorphism insider pressure) are examined as hypothesized in the following sub-sections.

3.5.3.1 Proportion of Non-Supporting Parties (H5)

In the public sector governance structures, local parliament is an institution that has an important check and balance function to better ensure that the local government executives execute their job well in the interests of all stakeholders (Lyngstad 2010). The composition between supporter parties and non-supporter parties of the head of local government in local parliament will help determine the quality of professionalism for both the local parliament and head of local government in conducting their duties. Riege and Lindsay (2006, 26) defines professional as “activities that have strong motivation, sufficient knowledge, service-oriented, and priority to public interest”. A leader of local government should be professional in carrying out their tasks and must be independent of the political parties which have supported him/her in the election.

In Indonesia, a leader of local government is promoted by a political party or a coalition of several political parties (Asshiddiqie 2006). If the composition of members of local parliament is dominated by the majority party³⁴, the quality of supervision of the executive will potentially decrease because they have the same interests as the leader. This condition potentially reduces the professionalism of local government leaders.

In regards to local parliament’s supervision, several prior studies document that a decline in the quality of supervision of the executive would result in decreased quality of mandatory disclosure on the executive accountability report, including disclosures in its financial statements (Werimon 2005; Ying and Zheingfei 2006, and Darmastuti and Setyaningrum 2012). Moreover, Silva (2009) argues that the composition of members of local parliament

³⁴ A majority party is a political party or a coalition of several political parties which supports the leader of local government.

could be used as benchmarks to see the power of pressure exerted by the local parliament over the executive government. If the proportion of local parliament members is dominated by the majority party, and the chairman of local government is from the same party or a coalition, then the quality of supervision conducted on the performance of the executive may decline. Consistent with normative isomorphism of institutional theory, it can therefore be argued that a local parliament of a local government with a greater composition of non-supporting parties (minority parties) will have a higher level of mandatory disclosure for that local government entity. Based on these ideas, the following outsider normative hypothesis is proposed:

H5: There is a positive association between the proportion of local parliament members who are independent of the executive and the extent of mandatory disclosure in the local government financial statements.

3.5.3.2 Number of Internal Auditors (H6)

In achieving good governance, an entity needs the role of an internal auditor to examine the accounting system and evaluate all management's policies that have been implemented by an entity. Sari and Raharjo (2012, 23) state that an "internal auditor is a profession which supports the realization of good governance that has evolved into a key component in improving government organisation". An internal auditor is expected to add value to an organisation as an independent party which creates a professional attitude in all activities (Johnsen *et al.* 2001). The improvement of internal control within an organisation requires the availability of internal audit in terms of both quality and quantity, in order to create better internal control processes (Dittenhofer 2001).

Wardoyo and Lena (2010) argue that internal auditors are required to provide information on the adequacy and effectiveness of internal control systems that exist within the organisation, because a good internal control system will support the quality of the organisation's financial statements. Furthermore, Tria and Valotti (2012) state that one of the important tasks of an internal

auditor is to ensure that the organisation has carried out the main principles of good governance including transparency and accountability.

In an Indonesian context, every local government has internal auditors, referred to as APIP (Aparat Pengawasan Intern Pemerintah)³⁵. The number of APIP on each local government is not related to the size of the local government, but tends to be more related to the availability of human resources in accordance with the minimum requirements set by the government (see PERMENPAN No. 36 of 2012)³⁶. Therefore, the number of internal auditors in Indonesian local government is not equal.

Mercer (2004) states that the credibility of mandatory disclosure within financial statements is influenced by the number of the internal auditors in an organisation. With sufficient personnel, the process of internal control within an organisation is more optimal, therefore the accountability and transparency of financial statements will be better. Mandatory disclosure within financial statements is one of the aspects of transparency (Bushman and Smith 2003; Marshall and Weetman 2007). In line with normative isomorphism of institutional theory, it can therefore be argued that local governments with a greater number of internal auditors will have a higher level of mandatory disclosure. Based on these explanations, the following insider hypothesis is formulated as follows:

H6: There is a positive association between the number of internal auditors and the extent of mandatory disclosure in the local government financial statements.

3.5.4 Control Variables

This study also examines six control variables: type of local government, age of entity, number of audit findings, surplus/deficit local government, level of

³⁵ There is an argument that the Internal Control Apparatus (APIP) should no longer simply act as a watchdog, but must be able to act as a consultant to management. With the new role as a consultant, the focus is more on prevention. As an example, if there are any problems then the internal auditors should provide recommendations for improvement.

³⁶ The regulation of the Minister of State Empowerment Utilization and Bureaucracy Reform of Indonesia (PERMENPAN) No. 36 of 2012 is on the technical compilation and application of the standard service. This regulation sets the minimum number of employees which should be met in a public service entity.

Human Development Index, and level of financial independence. Justification for using these variables in this study is provided below.

As stated by Martani and Lestiani (2012), the level of mandatory disclosure may be related to the types of local government as a district or a municipality. Municipalities have characteristics of stronger economic factors supported by better infrastructure and more centres of educational activities to make it more likely the municipalities interact more often with the community. Therefore, the municipalities may have greater motivation to be more transparent in revealing their financial reports. In addition, the municipalities sometimes hire consultants to improve the quality of financial statements including disclosure practices. These characteristics are often missing from districts which are local governments in more rural areas.

Age of an entity may affect the quality of its financial statements. The older local governments tend to provide better financial reporting quality because there has been a longer learning process (Lev and Schwartz 1971). Older local governments also have more experience being audited by the Supreme Audit Board (BPK), therefore the quality of the financial statements should be better. New local governments generally do not have experienced human resources. Suseno (2010) states that new government entities lack experts in accounting. This could potentially affect the quality of its financial statements.

Audit finding is a determinant that is widely used by researchers to measure the level of accounting compliance for both profit and non-profit entities. Keating *et al.* (2003) uses audit findings to examine whether resources are spent by non-profit organisations in accordance with the resource provider's intentions, while Street, Gray, and Bryant (1999) conducted a study using the variable of audit findings to gauge the level of compliance with international accounting standards.

Local governments may have a surplus or a deficit budget. Darmastuti and Setyaningrum (2012) state that local governments with greater revenues than

expenses (surplus) tend to get budget leaking³⁷, while local government with greater expenditure (deficit) tend to be more wasteful. Jorge *et al.* (2011) find that an entity with greater revenues (surplus) tends to have higher levels of disclosure of its financial statements. This may be caused by public pressures towards local executive to make more complete disclosure in the financial statements.

Ravallion (2011, 475) defines the Human Development Index (HDI) as “a comparative measure of life expectancy, average educational level and standards of living for country worldwide”. Huther and Shah (1998) state that the level of Human Development Index (HDI) influences government accountability. Local governments that have a high HDI are expected to have better mandatory disclosures because they receive greater pressure from the public (Nurhayati, Brown, and Tower 2006). Finally, as stated by Robbins and Austin (1986), local governments with high financial dependence tend to have a high level of disclosure in their financial statements.

Financial independence reflects the ability of local governments to finance their activities and service to the public who have paid taxes as a source of revenue for local government (Mahmudi 2007). Suhardjanto and Lesmana (2010) find that there is a positive association between financial independence and the extent of disclosure in local government financial statements.

3.6 Summary

This chapter outlines the relevant literature of accounting compliance for mandatory disclosure studies. Using isomorphic institutional theory as the major theoretical framework and employing an additional outsider-insider approach, this study examines the level of mandatory disclosure within financial statements of local government in Indonesia. Six hypotheses based on the literature are presented in this chapter and these are summarised in Table 3.6.

³⁷ Budget leakage occurs when the realization of budget revenue is less than it should be, this is often due to state revenue misappropriation by unscrupulous government officials (Atmasasmita 2002).

Table 3.6: Summary of Hypotheses

	Coercive isomorphism	Mimetic isomorphism	Normative isomorphism
Outsider influences	Number of local parliamentarians (H1)	Java/non-Java jurisdiction (H3)	Proportion of non-supporting parties (H5)
Insider influences	Local government budget expenditure (H2)	Presence of an assistance and training programme (H4)	The number of internal auditors (H6)

This chapter also provides explanations for the inclusion of type of local government, age of entity, number of audit findings, surplus/deficit local government, level of HDI, and financial independence as control variables of this thesis.

The next chapter outlines the research methodology by discussing the research process, data sources, sample selection, and measurement of variables (dependent, independent, and control) to be examined in this research.

Chapter 4

Research Approach

4.1 Introduction

Chapter 3 reviewed prior studies in relation to mandatory disclosure practices, presented the conceptual schema, and developed the hypotheses. This chapter explains the research process in more detail, focusing on the methodology, explaining the measurement techniques for the dependent, independent, and control variables, and the adaption of the Government Compliance Index (GCI) which is used to measure the level of mandatory disclosure in Indonesian local government financial statements.

4.2 The Research Process

As discussed in Chapter 3, a positivist-empirical quantitative research approach is used in this thesis to describe and explain the compliance of mandatory disclosure in financial statements of Indonesian local governments. Belkaoui (2001) views accounting as a social science, and notes that different research practices in accounting have been based on different perspectives. This thesis adopts the positivist paradigm, therefore, an objective positivist research process is adopted in this thesis.

The positivist paradigm has a naïve realist approach, in which relationships are determined, predictable and reductionist (Guba and Lincoln 1994). This thesis investigates the level of mandatory disclosure among Indonesian local governments and identifies possible key determinants to predict the level of mandatory disclosure.

Based on Dawson (2002), epistemology is the study of knowledge and the origin of that knowledge. This thesis adopts an objectivist epistemology that suggests that reality exists independent of human perception. Meanwhile, Tan (2005) states that a distinguishing feature of objectivism is that the main focus of the research is on the facts, and then the researcher looks for causality, formulates hypothesis, and finally tests them to discover

knowledge. Since the level of mandatory disclosure among Indonesian local governments is studied through the information disclosed in financial statements, the researcher is considered independent of the research object. In this thesis, the researcher first develops the hypotheses based on isomorphism institutional theory and evidence reported from prior studies. The researcher incorporates them in the unique environment of Indonesian local government, and then integrates the data found in financial statements and tests them using inferential statistical tools.

Bryman (2004) states that the choice of a specific methodology in research depends on the research question and what the researcher intends to achieve. The research methodology involves particular research methods employed to achieve the required knowledge. In order to answer the two research questions of this thesis, the use of secondary data which is an analysis of financial statements of Indonesian local governments, is utilized in a positivist empirical quantitative fashion to explain the phenomena.

The research method explains the specific set of techniques employed to obtain the final results. Positivist research often relies on the use of quantitative, systematic and precise data such as: the use of secondary data, statistics and objective measures for testing hypotheses (Neuman 2000). This thesis analyses the possible determinant of Indonesian local governments' mandatory disclosure via inferential statistical tests using the descriptive statistics, t-tests, ANOVA (Chapter 5) and multiple regression (Ordinary Least Square) and backward regression techniques (Chapter 6).

4.3 Data Sources

The main data sources for measuring the level of mandatory compliance with the Government Accounting Standards (PP No. 24 of 2005) are the financial statements of Indonesian local governments (districts and municipalities). In this thesis, Indonesian local governments' financial statements for the year 2010³⁸ are the data set used to derive the sample. All these entities have 31 December fiscal year ends. These reports are obtained from Indonesian

³⁸ The reason why this thesis uses the year 2010 is discussed in Section 4.3.2 of this chapter.

Supreme Audit Board (BPK) because every local government in Indonesia has an obligation to submit their financial statement to the BPK every year. However, many local governments do not submit their financial statements to the BPK.

As shown in Table 4.1, the total population of local governments in Indonesia as of 31 December 2010 is 496, consisting of 398 districts and 98 municipalities. This total number can also be broken down by geography: there are 118 local government entities in Java (84 Java districts; 34 Java municipalities) and 378 in non-Java areas of Indonesia (314 non-Java districts; 64 non-Java municipalities). However, 143 local governments did not submit their 2010 financial statements to BPK and are not publically available. Therefore, there are 353 (71% of the total population) publically available financial statements (Badan Pemeriksa Keuangan 2011). Most of these non-reporting local governments are located in remote areas and far from their provincial capitals and some of them are newly established local governments. This creates issues of potential 'non-response bias' of the data set. This is discussed in more depth in Appendix C.

Six local governments, five Java municipalities and one Java district, are further excluded from the list, because they are part and parcel of the administrative area of Jakarta (the capital of Indonesia), which do not meet the stand-alone criteria as the sample frame of this thesis. A further 29 local government financial statements are also excluded from the list because they are incomplete or illegible³⁹ and do not qualify as research samples. Accordingly, there are 318 complete and available financial statements comprising 71 Java districts; 29 Java municipalities; 168 non-Java districts; and 50 non-Java municipalities.

³⁹ Obtaining past Indonesian local government financial statements is difficult. The only source available is a series of scanned files. 29 of these financial statements cannot be used in the research sample due to incomplete pages or pages that are not legible.

Table 4.1: Stratified Sample Selection Criteria

	JAVA		NON-JAVA		TOTAL
	District	Municipality	District	Municipality	
Population	84	34	314	64	496
Financial statements not available*	<1>	<0>	<133>	<9>	<143>
Financial statements available	83	34	181	55	353
Jakarta administrative regions (non-autonomous)	<1>	<5>	0	0	<6>
Incomplete financial statements	<11>	0	<13>	<5>	<29>
Total financial statements	71	29	168	50	318
Final sample size	71	29	50	50	200

Legend: *The possible consequences and implications of these missing data points are discussed later in Appendix C.

From these 318 available financial statements, a final sample of 200 financial statements is used for this study⁴⁰, 100 from Java and 100 from non-Java. As there are more than 100 non-Java districts available, a stratified random sample selection of 50 non-Java districts from a total of 168 financial statements is conducted.

This study is cross-sectional rather than longitudinal due to data availability issues. Cross-sectional data refers to data collected by observing many things (such as individuals, firms or countries/regions) at the same point of time, without regard to differences in time (Lang and Lundholm 1993).

4.3.1 Selection of Municipalities/Districts

Municipality/district is selected as the Indonesian local governments subject focus for this doctorate study for two primary reasons. First, since the issuance of UU No. 22 of 1999 on local government, all Indonesian local governments (municipalities/districts) are given the freedom to manage their respective regions. Therefore, every municipality/district needs strong financial accountability. In addition, another effect of the law is a high recent increase in the number of municipalities/districts. This is because some local governments that traditionally had a large area to govern (particularly non-

⁴⁰ The proportion of financial statements number of non-Java districts is quite high from three other jurisdictions (see Table 4.1). That results inequality between Java and non-Java in term of the number of financial statements. To ensure equal representation in between the number of Java and non-Java financial statements, 50 samples were taken from non-Java districts. A stratified random sample is conducted because it allows all the districts in the area of non-Java to be considered as a research sample.

Java local governments) were becoming burdened in conducting government activities, and were subsequently divided into new districts and municipalities (Indonesia=pemekaran wilayah)⁴¹. This sudden increasing number of local governments due to the regional proliferation has caused the financial accountability at the municipality/district level to become a very important issue. In regard to financial accountability, Chavent *et al.* (2006, 184) states that “full disclosure in financial statements are very important to help misconceptions in understanding financial statements”.

Second, the BPK audit results during 2007 to 2009 showed that the financial statements of Indonesian municipalities and districts are alarmingly inconsistent (Badan Pemeriksa Keuangan 2010). During those three years, the number of ‘unqualified opinion’ for Indonesian local governments (municipalities/ districts) was no more than 5% (2007=1%; 2008=3%; 2009=4%) (Badan Pemeriksa Keuangan 2011). Martani and Lestiani (2012, 17) argue that:

“to obtain an ‘unqualified opinion’, there are four criteria which need to be considered including: compliance with accounting standards, the effectiveness of internal control, compliance with laws and regulations, and the adequacy of disclosure (full disclosure)”.

These alarming results and the recent proliferation of municipalities/districts since the introduction of UU No. 22 of 1999 highlight the need to study municipalities and districts financial disclosures and adherence to the law.

4.3.2 Selection of 2010 Sample Period

This thesis uses 2010 as the base year of this study. There are three clear reasons for using this period. First, the election of the head of a municipality/district and the local parliamentarians occurs every 5 years. The last election for parliamentarians was held in 2009. The elections for head of municipalities/districts do not occur simultaneously and parliamentarians are elected prior to the head of municipalities/districts election. Second, the latest

⁴¹ Regional proliferation (pemekaran wilayah) is the development of an autonomous area into two or more autonomous areas. The latest legal basis for regional expansion in Indonesia is UU No. 32 of 2004 on local government.

direct election of the president of Indonesia was undertaken in 2009. Thus 2009 to 2010 are the early round for President Susilo Bambang Yudhoyono and his new cabinet during his second period. This is the period where several new important presidential rules were implemented which could potentially affect the economic and political situation at the municipality/district level (such as the Presidential Decree No. 15 of 2010 on acceleration response of poverty; the Presidential Decree No. 36 of 2010 on the requirements in the field of investment; and the Presidential Decree No. 54 of 2010 on the procurement of goods and services of government agencies). Third, the latest law regarding the Indonesian Government Accounting Standards (PP No. 71 of 2010) requires the use of accrual accounting basis for all government agencies including local governments. This new standard is planned to be implemented gradually from 2012-2015 (Komite Standar Akuntansi Pemerintahan 2011). Therefore, the use of 2010 as the base period of study is appropriate as new regulation applicable to local government had been recently introduced and because of the changing political landscape.

4.4 Dependent Variable: Government Compliance Index (GCI)

The dependent variable, Government Compliance Index (GCI), is the level of compliance with the key Indonesian Government Accounting Standards by Indonesian local governments (IGAS). In accordance with IGAS, disclosure is (supposedly) mandatory (Suhardjanto and Lesmana 2010; Hilmi and Martani 2012). The level of compliance with IGAS in the financial statements is measured by an index which has been adapted based on PP No. 24 of 2005. Marston and Shrivess (1991) note that a properly constructed compliance index is seen as a reliable measurement device. The use of the GCI to measure the level of mandatory disclosure in this study is similar to that used by Hasan, Karim, and Quayes (2008) in which they construct a disclosure index to measure the level of mandatory disclosure on the companies listed on the Dhaka Stock Exchange in 1991 and is also consistent with a series of other prior studies (Owusu-Ansah 1998; Tower, Hancock, and Taplin 1999; Street, Gray and Bryant 1999; Taplin, Tower, and Hancock 2002; Atmadja and Tarca 2004; and Akhtaruddin 2005).

4.4.1 Disclosure Index

Whether based on mandatory or voluntary elements, a disclosure index can be classified as a weighted or unweighted index (see Cooke 1991). In a weighted disclosure index, particular disclosure items are given a higher (or lower) score (when those items are disclosed) than the other disclosure items based on the perceived importance of those particular items (Cooke 1991). Whereas, in an unweighted index, each disclosure item is deemed equally important and therefore each item is awarded the same score when it is disclosed (Cooke 1991; Meek, Roberts and Gray 1995). Most prior studies use an unweighted disclosure index to measure the level of disclosure as this technique is considered far less subjective than a weighted index and is more relevant to all entities (Cooke 1991; Coy, Tower and Dixon 1993; Craig and Diga 1998; and Watson, Shrives and Marston 2002). Accordingly, this thesis adopts an unweighted technique for scoring each disclosure item.

In a disclosure index, the contents of each financial statement are compared to the items listed on a checklist and coded as 1 or 0, depending upon whether or not the content conforms to the items listed on the checklist (Meek, Roberts, and Gray 1995). A disclosure index score for every Indonesian local government in the final sample is then calculated as the ratio of the total score awarded to the local government divided by the maximum number of items that are applicable for the entity (Meek, Roberts, and Gray 1995).

GCI is calculated as the total number of required items provided by the Indonesian local governments on their financial statements divided by the maximum applicable number of items. Each required item on the checklist is coded "1" if it is disclosed and "0" if the item is not disclosed. The index is expressed as a percentage ratio ranging from 0% to 100%, and it is the dependent variable in this thesis.

Government Compliance Index (GCI):

$$\frac{\text{Actual number of items in financial statements}}{\text{Total applicable items (maximum 57 items)}}$$

Such a measurement approach is suitable for measuring the level of disclosure in developing nations whose set of economic, political and social conditions often differs from those of developed nations (see Nurhayati, Brown, and Tower 2006).

4.4.2 Development of Disclosures Indices

The aim of this study is to identify the level of mandatory accounting disclosure in Indonesian local government financial statements and the factors affecting that level. To achieve the research objective, this study generates an index measuring the extent of mandatory disclosure by Indonesian local governments. The adaptation of the GCI consisted of three stages as detailed below (see Table 4.2).

Table 4.2: Creation of the Final Government Compliance Index (GCI)

Stage	Explanation	Change in number of items
Stage-1	An extensive review of previous research on mandatory disclosure items within financial reports of local governments is conducted. A list of disclosure items based on PP No. 24 of 2005 (Indonesian Government Accounting Standards) is examined. A preliminary list of items is created.	75
Stage-2	The preliminary list is filtered to eliminate non-applicable items including all non-mandatory items, and those items listed in PP No. 24 of 2005 which applied to other government entities but not local governments.	(15)
Stage-3	A pilot study is conducted to test the developed list of mandatory disclosure items. Based on the pilot study, several items are not deemed applicable to all Indonesian local governments and are excluded from the list. The final mandatory disclosure items are established and are referred to as Government Compliance Index (GCI) consisting of 57 items. See Appendix D for more detail concerning the 18 excluded items.	(3) <hr/> 57

Stage-1: Benchmarking

As Table 4.2 highlights, Stage 1 commenced with an extensive review of previous research on mandatory disclosure items within financial statements of local governments (refer Marston and Shrivess 1991; Akhtaruddin 2005; Suhardjanto and Yulianingtyas 2011). A list of disclosure items based on the IGAS PP No. 24 of 2005 was also examined which consists of eleven

standards, which in aggregate, are the reference point for every government institution of Indonesia when preparing their financial statements. From prior research and PP No. 24, a preliminary list of items was created (75 items).

Stage-2: Selection of Mandatory Items

The preliminary list was filtered to eliminate non-applicable items including all non-mandatory items, and those items listed in PP.No. 24 of 2005 which applied to other government entities but not local governments (15 items are excluded from the list).

Stage-3: The Final GCI List

The final step in developing the GCI was to undertake a pilot study on 80 local governments, divided into 40 Java local governments (20 districts+20 municipalities), and 40 non-Java local governments (20 districts+20 municipalities). Based on the pilot study, 3 items were excluded as they could not be applied to every local government in Indonesia. The final list consisted of 57 items (see Table 4.2) and is referred to in this thesis as the Government Compliance Index (GCI). Appendix D provides a more detailed breakdown explaining the development of the original PP No. 24 of 2005 items to create the final GCI.

The Indonesian Government Accounting Standards (PP No. 24 of 2005) categorizes disclosure items in order to achieve adequate disclosure. The item categories include information on fiscal policy, macroeconomic, local budget targets, financial performance, accounting policy, financial statement items, and non-financial information. Such a categorization provides a deeper analysis of the mandatory disclosures in the financial statements of local governments as detailed in Chapter 7 of this thesis. Table 4.3 presents the full and final list of the total of 57 items within the GCI index.

Table 4.3: Government Compliance Index (GCI)

Government Compliance Index (GCI) 57 Items
<p>FISCAL POLICY (5 items)</p> <ol style="list-style-type: none"> 1. Provides important difference of position and financial condition of the current period of fiscal compared to the previous one. 2. Provides important difference of position and financial condition of the current period of fiscal compared to a budget. 3. Provides the government policy regarding the increase of revenue. 4. Provides the government policy regarding the efficiency on expense. 5. Provides the government policy regarding the determination of the sources and uses of financing.
<p>MACROECONOMICS (5 items)</p> <ol style="list-style-type: none"> 1. Information of Gross Regional Domestic Product. 2. Information of economic growth. 3. Information of the level of inflation. 4. Information of the rupiah exchange rate. 5. Information of the level of interest.
<p>LOCAL BUDGET TARGETS (4 items)</p> <ol style="list-style-type: none"> 1. The explanation of the obstacles in achieving the budget targets. 2. The explanation on the budget changes during the current period compared with the first budget approved by local parliament. 3. The explanation of other problems that are considered important for the report reader regarding the local budget. 4. The explanation of financial information that affects the implementation of the budget.
<p>FINANCIAL PERFORMANCE (8 items)</p> <ol style="list-style-type: none"> 1. The explanation of the realization and financial performance plan. 2. The presentation of the information needed to understand the indicators, outcomes, and differences that exist with the plan. 3. Comparing the achieved result with the stated purpose and initial plan. 4. The explanation to confirm that the financial performance information is relevant and reliable 5. The presentation of strategies and resources used to achieve goals. 6. The explanation of difficulties related with measurement and reporting of financial performance. 7. The presentation of historical data relevant to the discussion on financial performance. 8. The presentation of activities and plans to improve programme performance.
<p>ACCOUNTING POLICY (13 items)</p> <ol style="list-style-type: none"> 1. The presentation of accounting policy on fixed assets. 2. The explanation of the accounting basis underlying the preparation of financial statements. 3. The presentation of the accounting policy on inventories. 4. The presentation of accounting policy on liabilities. 5. The presentation of accounting policies on investments. 6. The explanation of reporting entity. 7. The presentation of accounting policy on receivables. 8. The presentation of the accounting policy on cash. 9. The presentation of the accounting policy on revenues. 10. The presentation of the accounting policy on expenditures. 11. The explanation of the measurement basis used for financial statement formulation. 12. The presentation of accounting policy on equities. 13. The presentation of the accounting policy on financing activities.
<p>FINANCIAL STATEMENT ITEMS (14 items)</p> <ol style="list-style-type: none"> 1. The disclosure of information on revenues <i>(Including further details of the type of revenues).</i> 2. The disclosure of information on expenditures <i>(Including presentation of expenditure classification by organisation and function).</i>

<ol style="list-style-type: none"> 3. The disclosure of information on fixed assets <i>(Including disclosures concerning construction in progress).</i> 4. The disclosure of information on investments. <i>(The amount of investment, the level of control, methods of assessment).</i> 5. The disclosure of information on cash flow <i>(Classification of cash flows based on the operating activities, investing activities of non-financial assets, financing activities, and non-budgetary activities).</i> 6. The disclosure of information on cash and cash equivalents. 7. The disclosure of information on receivables <i>(Explanation of tax and non-tax receivables).</i> 8. The disclosure of information on financing activities. 9. The disclosure of information on liabilities <i>(Short-term liabilities and long term liabilities).</i> 10. The disclosure of information on equities <i>(Including the description of equity of current fund, equity of investment fund, equity of reserved fund).</i> 11. The disclosure of information on transfers. 12. The disclosure of information on inventories <i>(Explanation of condition and the use of inventories).</i> 13. A description of the remaining budget financing (SILPA/SIKPA). 14. An explanation of the surplus/deficit.
<p>NON FINANCIAL INFORMATION (8 items)</p> <ol style="list-style-type: none"> 1. The disclosure of the information on the domicile and entity form of law together with the jurisdiction of the existed entity. 2. The disclosure of any matters which have social impacts. 3. The explanation on the nature of entity operation and its primary activity. 4. The explanation on the mistakes of the previous management which has been corrected by the new management. 5. The explanation on the acts which become the basis of its operational activities. 6. The explanation on the commitment or contingency which is not presented on balance sheet. 7. The explanation on the merger or the development of the ongoing year of the entity. 8. The explanation on the replacement of governmental management during the current year.

Of the final 57 items, five relate to the category of fiscal policy; five to macroeconomics; four to local budget targets; eight to financial performance; thirteen to accounting policies; fourteen to financial statement items; and eight to non-financial information. These items are used as the basis to analyse in detail the Indonesian local governments' financial statements as at the 31 December 2010 year end.

The following validation methods are undertaken to test the GCI score for each Indonesian local government entity. Detailed compliance checklists for each standard are double-checked. In terms of minimizing uncertainty in coding, the entire annual report of each local government is read thoroughly. The purpose of reading the annual report before scoring is to understand the nature and complexity of each local government operations. This procedure is consistent with prior compliance studies (e.g. Street and Bryant 2000). The third step is to complete a compliance scoring work-sheet for each annual

report to determine the extent of compliance with the IGAS (PP No. 24 of 2005). The final proxy compliance measure used is the Government Compliance Index (GCI) checklist illustrated in Table 4.3.

4.5 Measurement of Independent and Control Variables

Data for the independent variables (number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of assistance and training programme, proportion of non-supporting parties, and number of internal auditors), and control variables (type of local government, age of entity, number of audit findings, surplus/deficit of local government, level of Human Development Index, and level of financial independence) are then derived (see Chapter 3 for an in-depth coverage of all these predictor variables). A summary of the measurement technique for each of these variables and definitions used in this thesis is presented in Table 4.4.

As explained in Chapter 3, this thesis uses an additional outsider-insider research approach in the selection of the independent variables. Accordingly, each isomorphism component (coercive, mimetic, and normative) has two predictor variables incorporating both an outside and inside aspect of the entity.

This thesis uses the number of local parliamentarians as the outsider coercive isomorphism variable to predict the level of mandatory disclosure in the financial statements of local governments. Prior researchers have used the number of local parliamentarians to examine the level of mandatory disclosure in financial statement (see Hix 2004 and Retnoningsih *et al.* 2011). This measurement technique is supported by the statement "the greater number of the local parliament members reflects the greater pressure on the local government executive" (Sotiropoulos 2008, 29). Data on local parliamentarians is obtained from the National Election Commission (Komisi Pemilihan Umum=KPU) for 2010.

Table 4.4: Measurement Techniques of the Independent and Control Variables

	Independent Variables	Control Variables	Measurement	Type of Data
Coercive isomorphism	<ul style="list-style-type: none"> • Number of local parliamentarians • Local government budget expenditure 		<ul style="list-style-type: none"> • Total number of local government parliamentarians • Local government budget expenditure 	Continuous (metric) Continuous (metric)
Mimetic isomorphism	<ul style="list-style-type: none"> • Java /non –Java jurisdiction • Presence of an assistance and training programme 		It is measured by dichotomous categorical coding: 1 = if it is located in Java 0 = if it is not located in Java It is measured by dichotomous coding: 1 = If local government had an assistance and training programme 0 = If local government did not have an assistance and training programme	Categorical (non-metric) Categorical (non-metric)
Normative isomorphism	<ul style="list-style-type: none"> • Proportion of non-supporting parties • Number of internal auditors 		<ul style="list-style-type: none"> • Proportion of non-controlling parties in the local parliament • The number of internal auditors in local government 	Continuous (metric) Continuous (metric)
		Type of local government	1 = Municipality 0 = District	Categorical (non-metric)
		Age of entity	Number of years from inception	Continuous (metric)
		Audit findings	Number of audit findings recommendations	Continuous (metric)
		Surplus/deficit of local government	1 = if surplus (revenue > expenditure) 0 = if deficit (revenue < expenditure)	Categorical (non-metric)
		Financial independence	Ratio of Local Government Financial Independence (RLGFI). $\frac{\text{Local government own source revenue}}{\text{Local government own source revenue} + \text{revenue from state/province}} \times 100\%$	Continuous (metric)
		Quality of citizenship	Level of Human Development Index (HDI)	Continuous (metric)

*Unit of measure is presented in brackets.

Local government budget expenditure is used as the coercive isomorphism insider variable to test the level of mandatory disclosure in the financial statements of the local governments. This variable has been used to test the compliance with accounting standards by previous researchers (see Patrick 2007; Cohen and Kaimenakis 2008; Suhardjanto and Lesmana 2010). Local government budget expenditure data is obtained from the final sample of 200 local government financial statements for the fiscal year 2010.

The location of entities, Java/non-Java, is used as the outsider mimetic independent variable to measure the potential for copying behaviour. It is

measured by a dichotomous coding of Java (coded as 1) and non-Java (coded as 0) jurisdiction location. Java is the most advanced region in Indonesia, more densely populated, and has superior facilities and infrastructure (Hadi 2013). Hasibuan (2007) states that areas with good infrastructure and facilities will have better management of their fiscal information. This could include local government revenue resources and allocation of local government budget expenditures.

In this thesis, the adoption of a voluntarily assistance and training programme to improve financial accounting systems for local government (Sistem Akuntansi Keuangan Daerah=SAKD) is used as the mimetic insider isomorphic proxy variable. This variable is used to predict the level of mandatory disclosure practices in financial statements of local governments. Local governments which adopt such a programme are given a score of 1, while local governments that do not follow the programme are given a score of 0. Such a coding is based on the premise that local government choosing to utilize such assistance and training programme of SAKD have better knowledge in their preparation of their financial statements and mandatory disclosure practices than local governments that do not follow this programme.

This thesis employs non-supporting parties in Indonesian local parliament as the normative outsider isomorphism proxy variable. Non-supporting parties are measured by the proportion of local parliament members who are members of a different political party than the chairman of local government, and are therefore considered independent of the executive (chairman of local government). Data of the proportion of non-supporting parties are obtained from National Commission Election (Komisi Pemilihan Umum=KPU).

As can be seen in Table 4.4, the number of internal auditors is used as the normative insider isomorphism variable. Data on the number of internal auditors in every Indonesian local government in 2010 is obtained from the Financial and Development Supervisory Agency (Badan Pengawasan Keuangan dan Pembangunan=BPKP).

This thesis also uses six control variables: type of local government; age of local government; number of audit findings; surplus/deficit of local government; level of financial independence; and level of Human Development Index (HDI).

The type of local government is measured by a dichotomous coding of municipality (coded as 1) and district (coded as 0). According to PP No. 22 of 1999, the Indonesian local government structure is divided into municipality (urban area) and district (rural area) jurisdictions. Type of local government usually reflects the economic development level and infrastructure of an area (Usman 2001). This variable focuses on how the jurisdiction (municipality or district) interacts with the community. Arguably, a municipality may be motivated to be more transparent in preparing their financial statements than their rural counterparts due to potentially greater institutional pressures (Suhardjanto and Yulianingtyas 2011).

The age of an entity may affect the quality of financial statements. The older the local government entity, the more the likelihood of better quality because there has been a longer learning process (Lev and Schwartz 1971). Many new local governments have been formed since the issuance of UU No. 22 of 1999 on local government. The new local governments are the result of older local government's proliferation (see Table 5.7). Age of entity is measured by the number of years from inception of the local government.

The number of BPK audit finding concerns is derived from the governmental auditor findings based on several classifications. The total number of documented concerns is used to measure the audit findings variable. This measurement proxy is previously used in Martani and Lestiani (2012) study. The number of audit findings of each Indonesian local government is derived from audit report of BPK in the fiscal year of 2010.

The budget surplus or deficit of a local government is measured using a dichotomous scale. If government revenue is greater than its expenditure (surplus) then a score of 1 (one) is given, whereas a score of 0 (zero) is given if government revenue is less than expenditure (deficit). This coding is

consistent with Stalebrink (2007) when examining the extent of disclosures in the financial statements of cities in Sweden.

Financial independence is measured by the ratio of Local Government Financial Independence (RLGFI). According to Alicias *et al.* (2007) the local financial formula is calculated as the local government own source revenue divided by local government own source revenue plus revenue from state or province sources.

Klugman, Rodriguez and Choi (2011) argue that a good measure of the quality of a population is the Human Development Index (HDI). This final control variable, HDI is “a comparative measure of life expectancy, average education level and standards of living for countries worldwide” (Ravallion 2011, 475). A score is separately obtained for each jurisdiction in Indonesia. Areas with high HDI tend to have a population with higher levels of education and quality of life. The higher level of education encourages people to develop personally and to process more complex information (Finkelstein and Hambrick 1990). Furthermore, Schofer and Meyer (2005) state that the pressure for practicing good governance is greater in areas with a higher education level. Local governments with a lower overall quality environment tend to have a low HDI, they potentially have lower good governance practices and therefore they may choose to mimic the practices of financial accountability by other local governments which have a better environment and may have better financial statement practices.

Additional testing of the dependent variable via key categories of the Government Compliance Index (GCI) is also conducted. The main index is broken down into seven key sub-sets. This extra analysis is pursued to explore in greater depth the relationship between GCI with the independent and control variables (see Table 4.5).

Table 4.5: Categories of the Government Compliance Index (GCI)

Dependent Variable	Categories of GCI	Number of items
Government Compliance Index (GCI)	1) fiscal policy	5 items
	2) macroeconomics	5 items
	3) local budget targets	4 items
	4) financial performance	8 items
	5) accounting policy	13 items
	6) financial statement items	14 items
	7) non-financial information	8 items
	Total GCI	57 items

Chapter 7 provides more detailed analysis of each of these seven categories of GCI.

4.6 Statistical Analysis

In this quantitative empirical thesis, descriptive and inferential statistics, t-test, ANOVA, Tukey HSD (Honestly Significant Difference) post hoc tests, correlations, and multiple regressions are used to present the characteristics of the data and empirically test the hypotheses. The next sub-sections give an overview of these statistical techniques.

4.6.1 Descriptive Statistics

Descriptive statistics explain the centre, spread, and shape of the data distributions (Cooper and Schindler 2006). Such analysis is helpful as a preliminary tool for data description. Ott and Longnecker (2001 67) affirm that “good descriptive statistics enable researchers to obtain a better sense of the data by reducing a large set of measurement to a few important summary measures”. This provides a good, rough picture of the original measurement. By using descriptive statistics, the attributes of independent variables (number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of an assistance and training programme, proportion of non-supporting parties, and the number of internal auditors) and control variables (type of local government, age of entity, number of audit findings, surplus/deficit of local government, level of Human Development Index, and level of financial independence) can be identified.

The continuous variables (number of local parliamentarians, local government budget expenditure, proportion of non-supporting parties,

number of internal auditors, level of Human Development Index, age of local government, number of audit findings, and level of financial independence) are presented using several different statistical structures including the mean, median, standard deviation, minimum, and maximum. The categorical variables (Java/non-Java jurisdiction, presence of an assistance and training programme, type of local government, and surplus/deficit of local government) are presented in frequencies and percentages. The variables are then further examined using correlation and multiple regression techniques.

4.6.2 T-Tests

T-test is a statistical technique which is used for testing the differences between the means of two independent groups (Ho 2006). In this thesis t-tests are used to examine potential statistical differences between the categorical independent variables of Java/non-Java jurisdiction, presence of an assistance and training programme, type of local government, and surplus/deficit of local government, in relationship to the GCI dependent variable.

4.6.3 ANOVA

ANOVA (Analysis of Variance) is a statistical method that tests whether differences exist between two or more population means (Hair *et al.* 2006). Specifically, the technique analyses the variance of the data to evaluate whether or not the population average differs. ANOVA, in this thesis are used to analyse the GCI score with the type of local government category as a control variable consisting of four categories: Java district, non-Java district, Java municipality, and non-Java municipality.

4.6.4 Tukey HSD (Honestly Significant Difference) Post Hoc Test

To better understand the ANOVA results, Tukey post hoc tests are employed. The Tukey (Honestly Significant Different) tests all pair-wise comparisons among means. This statistical technique determines a critical number such that, if any pair of sample means has a difference greater than this critical number, it can be concluded that the pair's two corresponding

population means are different (Keller and Warrack 2003). It is argued that the HSD test is a more powerful test than other similar statistical tests, for example Dunns test and Scheffe test (Pallant 2007). Accordingly, Tukey's HSD post hoc test multiple comparison method is deemed the most useful for testing this particular data sample set (Rafter, Abell and Braselton 2002). Further, in this thesis, the ANOVA analysis looks at Java/non-Java variable divided into four categories: Java district, non-Java district, Java municipality, and non-Java municipality) as an independent variable. The ANOVA can tell us if each of the four categories statistically differs, then as an extension the post hoc Tukey provides one to one comparative testing.

4.6.5 Correlations

As the main approach for analyzing data in social sciences, correlations are utilized to measure relationships between two observed variables. The relationship does not explain cause and effect; rather it describes the relationship between variables of interest. This is referred to as a correlation coefficient. The value of the correlation coefficient ranges between minus 1 and plus 1. It measures the level of association between two variables.

There are many statistical instruments for correlations, for example Kendall's, Pearson correlation, Spearman rank, Chi-square, and Point biserial correlation. In this study, the variables are examined by using Pearson correlation. These correlations are the most popular type and focus on social sciences type themes (Field 2005). Related Spearman correlation analysis is provided in Appendix E for comparative purposes.

In this thesis, all variables observed are examined in the regression analysis and with regard to testing multicollinearity problems using both Pearson and Spearman tests, the correlation coefficients should be less than 0.80 as a critical limit (Hair *et al.* 1998; Cooper and Schindler 2006; and Ghozali 2005).

4.6.6 Multiple Regressions

Multiple regression analysis is a statistical technique utilized to analyse the relationship between a single metric dependent variable and several metric or non-metric independent variables and control variables (Street and Bryant

2000). Multiple regressions are used in this thesis to model how possible explanatory variables forecast the level of compliance practices of Indonesian local government. Hypotheses testing and conclusions are based on the multiple regression results. There is one metric dependent variable Government Compliance Index (GCI) and six independent variables (number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of an assistance and training programme, proportion of non-supporting parties, and the number of internal auditors), with six control variables (age of entity, level of Human Development Index, surplus/deficit of local government, level of financial independence, number of audit findings, and type of local government). In this study, the main statistical method utilized to test the hypotheses is the Ordinary Least Square (OLS) regression. The full equation is as follows:

$$GCI = \beta_0 + \beta_1 \text{Numpar} + \beta_2 \text{LogBudex} + \beta_3 \text{Javanon} + \beta_4 \text{Assprog} + \beta_5 \text{Nonsup} + \beta_6 \text{NumIA} + \beta_7 \text{Age} + \beta_8 \text{HDI} + \beta_9 \text{Surdef} + \beta_{10} \text{Findep} + \beta_{11} \text{Audfind} + \beta_{12} \text{Mundis} + \epsilon$$

Where:

<i>GCI</i>	= Government Compliance Index
<i>Numpar</i>	= number of local parliamentarians
<i>LogBudex</i>	= local government budget expenditure as reported in 2010, in Rupiah, and logged to reduce skewness
<i>Javanon</i>	= Java/non-Java jurisdiction as measured by dichotomous coding “1” if Java, and “0” if non-Java
<i>Assprog</i>	= presence of an assistance and training programme as measured by dichotomous coding “1” if local government with an assistance and training programme, and “0” if local government without an assistance and training programme
<i>Nonsup</i>	= political influence as measured by proportion of non-controlling parties in local parliament
<i>NumIA</i>	= number of internal auditors in every local government
<i>Age</i>	= age of local government as measured by the number of years from inception
<i>HDI</i>	= level of Human Development Index score of local government
<i>Surdef</i>	= surplus/deficit of local government as measured by dichotomous coding “1” if surplus and “0” if deficit
<i>Findep</i>	= level of financial independence as measured by ratio of local government financial independence
<i>Audfind</i>	= number of audit findings as measured by the number of audit findings recommendation
<i>Mundis</i>	= type of local government as measured by dichotomous coding “1” if municipality and “0” if district
β_0	= intercept
ϵ	= error term

This study also presents a series of backward regressions as further analysis for the purpose of identifying the dominant predictors and particular models about the variables' effect.

4.7 Summary

This chapter outlines the positivist research approach for this study on mandatory disclosures, and then explains and expands on the research process employed in this thesis. This positivist paradigm informs the research methodology leading to specific research methods utilized with the detailed examination of local government's financial statements. The quantitative method of descriptive and statistical analysis is used to examine the level of mandatory disclosure with possible key predictors within financial statements of local governments in Indonesia. A total of 200 Indonesian local governments' annual reports for the period of 1 January 2010 to 31 December 2010 are analysed. Descriptive statistics, univariate tests, correlation matrices, and regression techniques are employed to generate empirical insights.

The results of the statistical analysis are presented in Chapters 5, 6, and 7 consisting of descriptive statistics and inferential statistics respectively.

Chapter 5

Descriptive Statistics and Univariate Analysis

5.1 Introduction

Chapter 4 discussed the research approach to this study including the research process, the measurement techniques for all variables, and the adaption of a Government Compliance Index (GCI) which is used to proxy the level of mandatory disclosure in Indonesian local government financial statements. Chapter 5 presents the descriptive statistical analysis of a representative sample of 200 Indonesian local government's financial statements. This chapter focuses on the coverage of the descriptive statistics of the predictor variables for both the independent variables (number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of an assistance and training programme, number of internal auditors, and proportion of non-supporting parties), and control variables (age of local government, level of Human Development Index, number of audit findings, type of local government, surplus/deficit of local government, and level of financial independence).

This chapter answers the first research question of this thesis: to what extent do local governments in Indonesia implement the mandatory disclosure requirements in their financial statements? To enrich the analysis univariate statistics is performed to examine the statistical differences on the means of the level of mandatory disclosure across the categorical explanatory variables.

5.2 Descriptive Statistics (Government Compliance Index=GCI)

In Indonesia, disclosure of local government financial statements is mandatory in accordance with government regulation (PP) No. 24 of 2005 regarding Indonesian Government Accounting Standards. However, a major theme of this thesis is that many of these rules are not followed by Indonesian local governments. To examine the extent of mandatory compliance with the key Indonesian Government Accounting Standards, this

thesis employs a Government Compliance Index (GCI) adapted from PP No. 24 of 2005.

GCI consists of items that must be disclosed by Indonesian local governments. The 57 items are divided into seven categories (see Appendix D). These categories include information on financial statement items, accounting policy, fiscal policy, financial performance, macroeconomics, local budget target, and non-financial information. As a form of further analysis this study uses the seven categories of GCI to better assess the extent to which local governments provide mandatory disclosure in their financial statements (see Chapter 7).

Table 5.1 illustrates the descriptive statistics of the dependent variable (GCI). The mean GCI level for the 200 strong samples of Indonesian local government is 69.60% with a standard deviation of 11.02%, the scores range from a minimum of 36.80% (Padang Panjang, non-Java municipality), and a maximum of 93.00% (Kebumen, Java district). No Indonesian local government entity demonstrated 100% mandatory disclosure communication.

Table 5.1: Descriptive statistics (GCI)

Variable	Type of Variable	N	Mean	Median	Std. Dev	Min	Max
Government Compliance Index (GCI) (%)	DV	200	69.60	72.00	11.02	36.80	93.00

The level of mandatory disclosure in previous studies has varied from 36% (Clarkson, VanBueren and Walker, 2006; Palmer 2008) to 93% (Owusu-Ansah and Yeoh 2005). Most relevant to this thesis is the Martani and Lestiani (2006) findings of a disclosure level of 35% on 60 Indonesian government agencies. The significantly higher disclosure level of nearly 70% in the current study appears to be influenced by the implementation of PP No. 24 of 2005. The implication of this will be addressed in Chapter 8.

Table 5.2 highlights the specific item detail of the GCI score during 2010. Of the seven categories of GCI, Information on Financial Statement Items (FSi) has the highest level of disclosure (91.70%). Of the 14 items in this category, disclosure of revenues and expenditures are the highest (99% for both),

while only one item below 50% (information on an explanation for a surplus or deficit is the lowest at 49.50%). There are several possible reasons for this very high level of disclosure for the FSi category. First, financial statement items are the basic concept that must be mastered in the preparation of financial statements and local governments may strive to provide complete information of these items. Second, another possible reason is the motivation of every Indonesian local government to obtain the best possible audit opinion (Unqualified Opinion) from the Indonesian Supreme Audit Board (Badan Pemeriksa Keuangan=BPK). This may also be influenced by the fact that the Indonesian central government now gives a reward (35 billion rupiahs) to those local governments which obtain an unqualified opinion from the BPK (Sindo 2013). Accordingly, many local governments may well compete to raise the quality of their financial statements by communicating a fuller set of financial statement items based on Indonesian Government Accounting Standards.

Table 5.2: Government Compliance Index (GCI) 2010: Detailed Items

Cat	Variable items	Items	%	Average of Cat (%)
<i>FSi</i>	<i>FSi1</i>	• information on revenues	99.00%	91.70
	<i>FSi2</i>	• information on expenditures	99.00%	
	<i>FSi3</i>	• information on fixed assets	98.00%	
	<i>FSi4</i>	• information on investments	97.00%	
	<i>FSi5</i>	• information on cash flow	96.50%	
	<i>FSi6</i>	• information on cash and cash equivalent	95.50%	
	<i>FSi7</i>	• information on receivables	95.50%	
	<i>FSi8</i>	• information on financing activities	95.50%	
	<i>FSi9</i>	• information on liabilities	94.50%	
	<i>FSi10</i>	• information on equities	94.50%	
	<i>FSi11</i>	• information on transfers	92.00%	
	<i>FSi12</i>	• information on inventories	89.50%	
	<i>FSi13</i>	• description of the remaining more/less budget financing (SILPA/SIKPA)	83.50%	
	<i>FSi14</i>	• explanation of the surplus/deficit	49.50%	
	<i>Ap1</i>	• fixed assets	93.00%	
	<i>Ap2</i>	• accounting basis underlying the preparation of financial statements	92.00%	
	<i>Ap3</i>	• inventories	90.00%	
	<i>Ap4</i>	• liabilities	89.50%	
	<i>Ap5</i>	• investments	88.00%	
	<i>Ap6</i>	• reporting entity	84.50%	
	<i>Ap7</i>	• receivables	84.00%	

Ap	<i>Ap8</i>	• cash	81.00%	83.20
	<i>Ap9</i>	• revenues	79.00%	
	<i>Ap10</i>	• expenditures	78.50%	
	<i>Ap11</i>	• the measurement basis used for financial statement formulation	78.50%	
	<i>Ap12</i>	• equities	78.00%	
	<i>Ap13</i>	• financing activities	67.00%	
Fp	<i>Fp1</i>	• the financial position and condition of the current period of fiscal compared to the previous one	99.50%	80.20
	<i>Fp2</i>	• the financial position and condition of the current period of fiscal compared to a budget	99.50%	
	<i>Fp3</i>	• the policy regarding the increase of revenue	73.50%	
	<i>Fp4</i>	• the policy regarding the efficiency on expense	72.50%	
	<i>Fp5</i>	• the policy regarding the determination of the sources and uses of financing	55.00%	
FCp	<i>FCp1</i>	• the realization and financial performance plan	81.50%	51.40
	<i>FCp2</i>	• information needed to understand the indicators, outcomes, and differences that exist with the plan	74.50%	
	<i>FCp3</i>	• comparing the achieved result with the stated purpose and initial plan	73.50%	
	<i>FCp4</i>	• confirmation that the financial performance information is relevant and reliable	51.00%	
	<i>FCp5</i>	• strategies and resources used to achieve goals	44.00%	
	<i>FCp6</i>	• information of difficulties related with measurement and reporting of financial performance	32.00%	
	<i>FCp7</i>	• historical data relevant to the discussion on financial performance	26.00%	
	<i>FCp8</i>	• activities and plans to improve programme performance	24.00%	
Me	<i>Me1</i>	• Gross Regional Domestic Product	77.50%	49.10
	<i>Me2</i>	• economic growth	77.00%	
	<i>Me3</i>	• inflation	61.00%	
	<i>Me4</i>	• the rupiah exchange rate	16.50%	
	<i>Me5</i>	• the level of interest	13.50%	
LBt	<i>LBt1</i>	• obstacles in achieving the budget targets	60.50%	48.20
	<i>LBt2</i>	• budget changes during the current period compared with the first budget approved by local parliament	58.00%	
	<i>LBt3</i>	• other problems that considered important for the reader regarding the local budget	39.00%	
	<i>LBt4</i>	• financial information that affects the implementation of the budget	36.50%	
NFi	<i>NFi1</i>	• the domicile and entity form	63.50%	
	<i>NFi2</i>	• information of any matters which have social impacts	63.50%	
	<i>NFi3</i>	• the nature of the entity's operation and its primary activity	59.00%	
	<i>NFi4</i>	• the mistakes of the previous management which has been corrected by the new management	54.00%	
	<i>NFi5</i>	• the acts which become the basis of its operational activities	47.00%	

	<i>NFi6</i>	• the commitment or contingency	31.00%	
	<i>NFi7</i>	• the merger or the development of the ongoing year of the entity	19.00%	
	<i>NFi8</i>	• the replacement of governmental management during the current year	17.50%	44.70
		Average disclosure		69.60

Legend: Cat=Category, *FSi*=Financial Statement Items, *Ap*=Accounting Policy, *Fp*=Fiscal Policy, *FCp*=Financial Performance, *Me*=Macroeconomics, *Lbt*=Local Budget Target, *NFi*=Non-Financial Information.

As shown in Table 5.2, the second category *Accounting Policy*⁴² (GCI*Ap*) is also highly disclosed (83.2%) by Indonesian local governments. Within this category the presentation of accounting policy on fixed assets has the highest disclosure (93%), while the presentation of the accounting policy on financing activities is the lowest (67%). One explanation for this high level of disclosure is that local governments may assume that any required information on accounting policies is needed by users in understanding the financial statements of local governments, especially with regard to specifying principles that may differ among other local governments, such as the recognition of receivables and inventory determination. Therefore, information regarding accounting policies may be considered as important strategic information that should be disclosed by local governments.

The information on Fiscal Policy (GCI*Fp*) category is disclosed by 80.20% of Indonesian local government entities. Of the five items within this category, information on the position and financial condition is disclosed the most (99.50%) and information on government policy regarding the determination of the sources and uses of financing are disclosed the least (55%). Information on fiscal policy is highly disclosed because it reflects the ability of local governments in managing their local finances. Therefore, if the information of fiscal policy is well communicated, it may greatly affect the government, peers and user's perception on the performance of the local governments' executive, particularly in conducting financial management of local government.

⁴² According to Krishnan and Visvanathan (2008, 10), accounting policies are "the specific accounting principles and the methods of applying these principles that are assessed by the management as the most appropriate to the existing conditions to present the financial position fairly, changes in the financial position, and the results of operations in accordance with Generally Accepted Accounting Principles".

The final four categories have much lower levels of disclosure. The category Information on Financial Performance (GCIFCp) is only disclosed moderately (51.40%). Within this category, the realization and financial performance plan has the highest disclosure (81.50%) while the presentation of activities and plans to improve programme performance has the lowest disclosure (24%). Four of the eight items have less than 50% disclosure. This indicates that there is a problem with local governments in Indonesia disclosing their financial performance in their financial statements. There are possible reasons for this moderate level of disclosure. The concept of financial performance measurement in local government may be less easily understood. This is because the performance measurement is conducted for a non-profit organisation (public sector), but there is a view that the key success factors are not as simple as for a for profit organisation (Tilbury 2006). Accordingly, the local governments may have more difficulty in communicating the performance measurement activities such as the determination of performance indicators especially in the fields of financial performance and strategy of financial performance improvement (Azhar 2010).

As depicted in Table 5.2, the category Information on Macroeconomics (GCIMe) is communicated by 49.10% of Indonesian local governments. Information of Gross Regional Domestic Product has the highest disclosure (77.50%), while information of the level of interest has the lowest disclosure (13.50%). There are at least two possible reasons for this moderately low level of communication. First, the data of macroeconomics in Indonesia tends to be inconsistent and incomplete. In addition, some cases reveal that different data sources state different numbers (Kuncoro 2013). If the macroeconomics data differs from one source to another, then uncertainty arises which will decrease the motivation to communicate the data within financial statements. Second, there seems to be a gap between 'official' economic indicators with the every day reality experienced by Indonesian society. As a result, the government is often accused of 'lying' in presenting the economic indicators (such as level of poverty, income per capita, level of inflation, and level of unemployment) (Stiglitz 2011). This decreases

motivation to communicate information on local government macroeconomics data within financial statements.

The category Information on Local Budget Target (LBt) is also below 50% at 48.20% with obstacles in achieving budget targets being the most disclosed item (60.50%) and an explanation of financial information that affects the implementation of the budget having the lowest disclosure (36.50%). This finding is in line with the result of a survey conducted by Hoesada (2010) that most Indonesian local governments tend to use traditional budgetary systems in the preparation of their budget. Local governments often simply increase or decrease the amount of rupiah (Indonesian currency) in budget items that already exist using the previous year's data as a basis to adjust the amount of the addition or reduction without conducting an in-depth review. This has implications for the allocation of funds that are not efficient and effective because they are not based on the actual achievement of the performance of programmes and activities. This may negatively affect the motivation to disclose the information on local budget target.

As shown in Table 5.2, the final sub-category of Non-Financial Information (NFi) has the least disclosure at 44.70%. Of the eight items, information on the domicile and entity form of law has the highest disclosure (63.50%), while information on the replacement of governmental management in the current year has the lowest (17.50%). Four of the eight items have disclosures of less than 50.00%. This finding implies that Indonesian local governments tend to focus on financial rather than non-financial aspects. This is probably due to concerns that non-financial information is very descriptive and highly subjective. Subjective norms often have a negative effect on the motivation to act (Mustikasari 2007). Therefore, the high subjectivity could lessen the motivation to disclose non-financial information in the financial statements.

5.3 Descriptive Statistics of Predictor Variables

The predictor variables, consisting of six independent variables and six control variables can be classified as either continuous or categorical variables. The descriptive statistics of all predictor variables are presented in the following sub-sections.

5.3.1 Descriptive Statistics of Continuous Predictor Variables

The descriptive statistics of the eight continuous predictor variables include number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), proportion of non-supporting parties (*Nonsup*), number of internal auditors (*NumIA*), age of local government (*Age*), level of Human Development Index (*HDI*), level of financial independence (*Findep*), and number of audit findings (*Audfind*) are displayed in Table 5.3. For the continuous variables, histograms are also plotted (see Appendix F).

Table 5.3: Descriptive statistics of Continuous Predictor Variables

Variables	Types of Variables	Mean	Median	Std. Dev	Min	Max
<i>Numpar</i> (number of people)	IV	38.35	40.00	10.42	20.00	50.00
<i>Budex</i> (in million Rupiah)	IV	902.9	777.0	574.1	233.4	4.986.0
<i>LogBudex</i> (log Rupiah)	IV	11.88	11.85	0.23	11.37	12.90
<i>Nonsup</i> (in %)	IV	67.01	72.50	19.52	10.00	100.00
<i>NumIA</i> (number of people)	IV	8.00	3.00	9.19	0.00	55.00
<i>Age</i> (years)	CV	254	155	292	1.00	1328
<i>HDI</i> (in %)	CV	72.18	72.59	4.79	47.37	79.52
<i>Findep</i> (in %)	CV	8.24	7.15	5.17	0.60	29.80
<i>Audfind</i> (number of findings)	CV	19.27	18.00	6.81	6.00	47.00

Legend: for parametric analysis purposes, the data regarding budget expenditure is transformed into logarithm. IV=Independent Variable, CV=Control Variable.

Table 5.3 shows that on average, the number of local parliamentarians is 38.35⁴³, ranging from 20 to 50. This is in accordance with the regulation of Indonesian electoral commission No.17 of 2008⁴⁴ that the number of local

⁴³ This average of 38.35 people elected as local parliament official is very high compared to Australian local governments that consisted in average of 5 to 15 people (Australian Government 2013).

⁴⁴ The number of seats allowed for local government is based on the local resident population as follows:

- Population up to 100,000 allocated 20 seats
- Population 100,000 – 200,000 allocated 25 seats
- Population 200,000 – 300,000 allocated 30 seats
- Population 300,000 – 400,000 allocated 35 seats
- Population 400,000 – 500,000 allocated 40 seats
- Population 500,000 – 1000,000 allocated 45 seats
- Population >1000,000 allocated 50 seats

parliamentarians shall be at least 20 seats and at most 50 seats. The number of local parliament members is influenced by the number of residents in each local government. The higher the population the greater the number of local parliament members as representatives of their constituents who are responsible for communicating the aspirations of the people to the government (Suwardi, Sendjaya and Budi 2002).

In 2010, Kutai Kartanegara (non-Java district) had the highest local government expenditure compared to other local governments with an expenditure of 4,986,000 million rupiah⁴⁵. Whereas Mesuji (non-Java district) had the lowest local budget (233.4 million Rupiah). The mean value suggests that, on average, all 200 local governments have total expenditure amounting to approximately 902.9 million Rupiah. The median is approximately 776.9 million Rupiah, highlighting that there is a difference between the mean and median of local expenditure, further indicating that the data of local expenditure is considerably skewed. Accordingly, this thesis transforms the data of local expenditure into the value of logarithm to reduce such skewness⁴⁶. According to Permendagri No.13 of 2006, the structure of local government budget consists of operating expenditures, capital expenditures, unexpected expenditures, and transfer expenditures. The expenditures in every local government are strongly influenced by the condition and the capacity of local government finance in creating their own financial resources and transfer from the central government. Fathony (2011) reveals that local government expenditure is influenced by two factors namely local source revenue and fund balance. Meanwhile Argi and Sasana (2011) also explain that local tax and Domestic Gross Regional Product affects the local government expenditures.

⁴⁵ Rupiah is the local Indonesian currency. As shown in Table 5.3 the amount of local government expenditure is calculated in millions of rupiah (Indonesian currency). Therefore, the actual number for the average expenditure of 902,879,273,766 is stated as 902,879. This also applies to the maximum and minimum value of local government expenditure. In December 2010, one Australian dollar was worth approximately 8,300 rupiah (<http://aud.fx-exchange.com/idr/exchange-rates-history.html>, retrieved 17 September 2013).

⁴⁶ One of the requirements for regression testing is the data should be normally distributed (Tabachnic and Fidell, 2007). One method to overcome the normality of the data is to perform data transformation. As stated by Ott and Longnecker (2001), the standard method for doing the transformation is a logarithm. Thus, this thesis employs the logarithm of local government budget expenditure as the proxy measure for the insider coercive variable.

The proportion of non-supporting parties in each local parliament is also quite varied with an average of 67% of minority parties. This relatively high number may bode well for transparency initiatives. The lowest at 10% are a series of non-Java districts and municipalities: the districts of Tulang Bawang, Sumba Tengah, Seram Bagian Barat, and the municipalities of Kupang, Sorong, Prabu Mulih. Several local governments from both Java and non-Java have the highest score (100%) such as Garut (Java district), Bengkulu Selatan (non-Java district), Kutai Kartanegara (non-Java district), Aceh Selatan (non-Java district), Medan (non-Java municipality), and Sabang (non-Java municipality). A score of 100% is possible due to the regulation of local government leader election. Since the Constitutional Court (Mahkamah Konstitusi) annulled the judicial review of Article 59 of UU No. 32 of 2004 on local government, the mechanism of the local elections allows the nomination of a local government leader individually (instead of political parties). This has led to several local governments electing someone who comes from the civil servants (government officials) who are not supported by any political party or a coalition of several political parties. Therefore, the proportion of non-supporting party members can be 100%.

In regard to internal auditors, Table 5.3 shows that the mean number of internal auditors in 200 Indonesian local governments is 8, ranging from 0 to 55, with a median score of 3. The local government with the highest number of internal auditors is Yogyakarta (Java municipality) with 55 internal auditors. However, there are many local governments that do not have any internal auditors. Of the 100 Java local governments, there are 15 local governments (15%) with no internal auditors, while of the 100 non-Java local governments, there are 33 local governments (33%) that have no internal auditor (see Appendix G). This indicates that the number of internal auditors in Indonesian local governments has not been evenly distributed. In addition, Prasojo (2012) reveals that Indonesia is desperately short of government auditors. This result suggests that the Indonesian government must immediately meet the shortage of government auditors, particularly for non-Java local governments (Triyuswanto 2012).

Indonesia began a new form of governance that gives a greater role to local governments through the implementation of UU No. 22 of 1999 on local government. Between 1999 and 2012, the number of districts increased by 41%, and the number of municipalities increased by 37% (Prayitno 2012). Local governments in Indonesia have a wide range of ages. The average age is 254 years, with the newest local government Tulang Bawang (a non Java district) existing for only 1 year as of 2010, while Palembang (non-Java municipality) is the oldest and has existed for 1328 years.

The Human Development Index (HDI) scores for Indonesian local governments vary widely. Of the 200 sample local governments, the minimum score is 47.37% (Sumbawa Barat, non-Java district) and the maximum score is 79.52% (Yogyakarta, Java municipality) with the mean value of all local governments being 72.18%. These results show that the Indonesian local governments have a moderate⁴⁷ level of Human Development Index (HDI).

Financial independence, as measured by the ratio of local government financial independence, ranges from 0.60% to 29.80%. The small value of 0.6% (Mesuji, non-Java district) and 0.8% (Puncak Jaya, non-Java district), suggests that some local governments in Indonesia have a high level of financial dependence on the central government. In regards to financial independence, the Indonesian government through UU No. 32 of 2004 on local government and UU No. 33 of 2004 on fiscal balance between the central and local government is supposedly conducting a policy of fiscal decentralization⁴⁸ in the hope of reducing the problem of local government financial dependence on the central government. According to Adi (2012), the reliance on central government grants should be as minimal as possible,

⁴⁷ Todaro and Smith (2006) note three levels of HDI overall quality: high (above 80%), moderate (50%-80%), and low (less than 50%).

⁴⁸ The principle of fiscal decentralization is 'money follows functions', where the local governments have the authority to conduct the functions of development and public services in their own region. The central government handed over certain sources of revenue to local governments to be managed optimally in order to finance their own region. In addition, the central government provides funds transfers that can be managed by local government to carry out the government's activities. The goal is to address the fiscal imbalance between central government and other local governments. However the 8.24% average financial independent score reveals the local governments remain dependent.

therefore the local own source revenue (Pendapatan Asli Daerah=PAD) should be the greatest financial source that are supported by the financial balance policies between local and central governments. Moreover, Ferdian (2013) states that ideally local government expenditures should be fulfilled by using local own source revenue (PAD) so that the area can be completely autonomous, no longer dependent on the central government. This goal is yet to be achieved. The current level of financial independence (8.24%, Table 5.3) is very low.

The descriptive statistics further shows that the mean number of audit findings in Indonesian local governments is 19. Trenggalek (Java district) and Jepara (Java district) are local governments with the least audit findings (with 6 adverse findings), whereas the largest number of adverse audit findings is Maros (non-Java district) with 47 adverse audit findings. Audit findings derive from a variety of cases found by BPK on local government financial statements related to offences conducted by local government toward the internal control provisions or legislation. The number of audit findings shown in Table 5.3 is the total of all three types of audit findings including financial statements, management control systems, and legal compliance.

5.3.2 Descriptive Statistics of Categorical Predictor Variables

Figure 5.1 shows the descriptive statistics of the categorical variables of Java/non-Java jurisdiction, presence of an assistance and training programme, type of local government, and surplus/deficit of local government.

The descriptive statistics presented in Figure 5.1 show that the data sample used in this study consists of 100 Java local governments (50%), and 100 non-Java local governments (50%). The sample selection criteria are described in more detail in Chapter 4 Section 4.3 of this thesis.

In regards to local government type, Figure 5.1 shows that 79 (40%) of sample local governments are classified as municipalities, while 121 (60%) of the sample local governments are classified as districts.

Figure 5.1: Descriptive Statistics of Categorical Variables

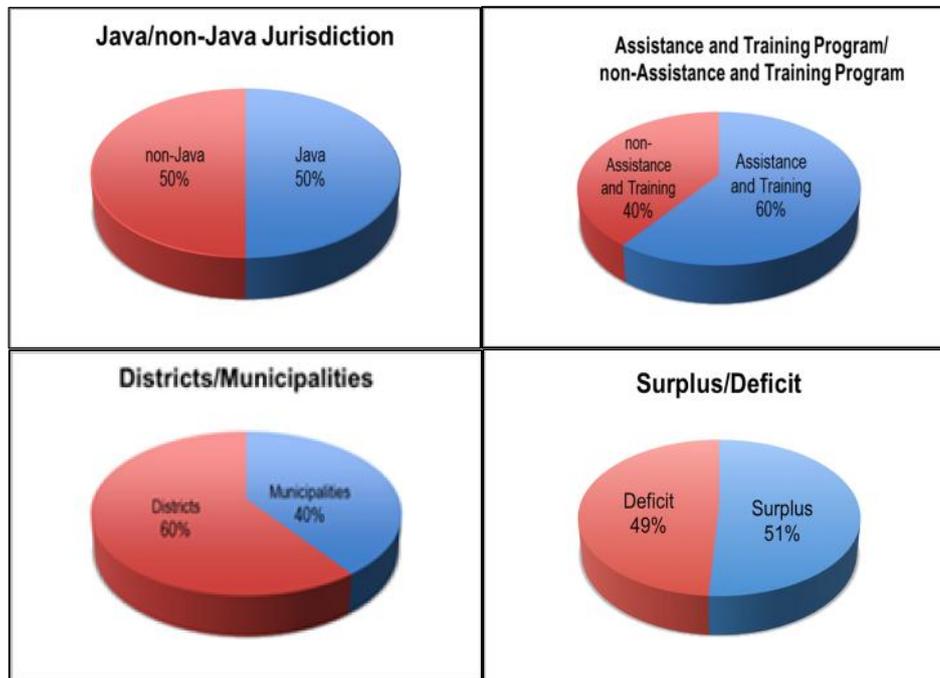


Figure 5.1 highlight that 121 (60%) of the sample local governments use the assistance and training programme developed by BPKP relating to the implementation of the local financial administration system (Sistem Administrasi Keuangan Daerah=SAKD) whereas 79 local governments (40%) do not use the programme. This indicates that the implementation of a specific programme expected to improve the quality of local government financial statements have not been utilized by all local governments in Indonesia. According to Suseno (2010) this is due to factors including inadequate budgets and lack of competent human resources in the implementation of the programme.

The descriptive statistics presented in Figure 5.1 also show that 103 (51%) of sample local governments have a surplus budget whereas 97 (49%) have a deficit budget.

5.3.3 Univariate Analysis of GCI Practices across the Categorical Variables

Table 5.4 highlights several important findings from a series of t-tests. The mean of GCI between Java and non-Java is statistically highly significantly different (p -value=0.000). The highest GCI score in Java is 93.00% (Surabaya, Java municipality; and Kebumen, Java district), while the lowest score is 49.10% (Cimahi, Java municipality). Meanwhile, the highest score of GCI for non-Java local governments is 86.00% (Bau-Bau, non-Java municipality; and Ambon, non-Java municipality), and the lowest score is 36.80% (Padang Panjang, non-Java municipality). Overall Java local government entities have an overall higher average of GCI score than non-Java (Java=73.48% and non-Java=65.78%). This is statistically different (t-test; p -value=0.000). These initial results provide support for H3 that local governments which are located in Java have better mandatory disclosure in their financial statements compared to non-Java local governments.

The mean of GCI between local governments using the assistance and training programme (71.98%) versus those that are not (66.01%) has a statistically highly significant difference (t-test; p -value=0.000). This is consistent with the expectation that the assistance and training programme for improving the local financial administration system conducted by the Financial and Development Supervisory Agency (BPKP) appears influential in improving the practice of mandatory disclosure in the financial statements of local governments in Indonesia. The BPKP training materials⁴⁹ supports local governments in conducting financial management, and preparing financial statements as a means of accountability to public. In addition, this is in line with the statement of Presidential Instruction No. 4 of 2001 that the assistance programme for local government aims to increase the understanding for government officials in conducting financial management, increasing compliance with laws, and improving the quality of financial reporting.

⁴⁹ BPKP training materials for local governments include: development of SAKD, governmental accounting standards, asset management in local government, local government accounting policy, public financial management, technical ability of local financial management, internal control system of local government, local government agency performance reports, and performance-based budgeting (BPKP 2012).

Table 5.4: GCI Practices across the Categorical Variables

Variables	GCI Mean	N	Standard Deviation	Minimum	Maximum
Java	73.48	100	9.23	49.10	93.00
Non-Java	65.78	100	11.37	36.80	86.00
T-test p.value	0.000***				

Variables	GCI Mean	N	Standard Deviation	Minimum	Maximum
Assistance	71.98	121	10.67	40.40	93.00
Non-Assistance	66.01	79	10.63	36.80	86.00
T-test p.value	0.000***				

Variables	GCI Mean	N	Standard Deviation	Minimum	Maximum
Municipality	69.39	79	11.91	36.80	93.00
District	69.78	121	10.46	42.10	93.00
T-test p.value	0.811				

Variables	GCI Mean	N	Standard Deviation	Minimum	Maximum
Surplus	69.21	103	10.25	40.40	87.70
Deficit	70.08	97	11.83	36.80	93.00
T-test p.value	0.579				

***significant at 1% level; **significant at 5% level; *significant at 10% level.

Although the GCI score of district (69.80%) is slightly higher than municipality (69.40%), there is no statistically significant difference (p-value=0.811). The minimum score of GCI in municipalities is 36.80% (Padang Panjang, non-Java municipality) and the maximum score is 93% (Surabaya, Java municipality) while the minimum score of GCI in districts is 42.10% (Mamasa, non-Java district) and the maximum score is 93% (Kebumen, Java district).

There is no significant difference between GCI of a surplus or deficit budget of local governments (p-value=0.579). It can be seen from Table 5.4 that the GCI of local governments with a deficit budget is slightly higher than those with a budget surplus. The minimum score of GCI on local governments with a surplus is 40.40% (Sorong, non-Java municipality), and the maximum score is 87.70% (Madiun, Java district). While the minimum score on local governments with a deficit budget is 36.80% (Padang Panjang, non-Java municipality), and the maximum score is 93% (Surabaya, Java municipality, and Kebumen, Java district).

Table 5.5 describes the ANOVA of GCI results based on jurisdictions. Java-municipalities have the highest score (74.71%) with a sample of 29 local governments and non-Java municipalities are 66.31% with a sample of 50 local governments. For districts, Java scores 72.97% with a sample of 71 local governments, with non-Java at 65.25% with a sample of 50 local governments.

Table 5.5: GCI by Jurisdictions (ANOVA)

Variable	Java Municipalities (mean) N=29	Java Districts (mean) N=71	Non-Java Municipalities (mean) N=50	Non-Java Districts (mean) N=50	P-Value
Government Compliance Index (GCI) (%)	74.71	72.97	66.31	65.25	0.000***

***significant at 1% level; **significant at 5% level; *significant at 10% level.

From the ANOVA results in Table 5.5, it can be concluded that the GCI scores statistically differ across the four jurisdictional groupings. Java municipality (74.71%) and Java district (72.97%) are higher than the total mean of GCI (69.60%) (refer Table 5.1), while the score of GCI for non-Java municipality (66.31%) and non-Java district (65.25%) is much lower than the total GCI mean (69.60%). These results highlight that Java local governments (both municipalities and districts) are more dominant in the practice of mandatory disclosure within financial statements as compared with non-Java local governments.

5.4 Univariate Analysis: T-Test and ANOVA with the Government Compliance Index (GCI)

Tables 5.6, 5.8, 5.9 and 5.10 show statistically significant differences for several predictors including number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), proportion of non-supporting parties (*Nonsup*), number of internal auditors (*NumIA*), age of local government (*Age*), level of Human Development Index (*HDI*), level of financial independence (*Findep*), and number of audit findings (*Audfind*) between Java/non-Java local governments, assistance and training programme/non-assistance and training programme, district/municipality, and surplus/deficit of local governments.

Table 5.6 highlights that six predictor variables include number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), number of internal auditors (*NumIA*), age of local government (*Age*), level of financial independence (*Findep*), and number of audit findings (*Audfind*) are statistically significantly different between Java and non-Java local government entities. The average number of local parliamentarians of Java local governments is statistically greater than non-Java local governments (Java= 44.76, non-Java=31.94). This is perhaps not surprising given that Java is more densely populated than non-Java and therefore has higher numbers of local parliamentarians (Kartasasmita 2009). This is consistent with the discussion in the earlier sections that the number of local parliamentarians is strongly influenced by the number of people that qualify to participate in the legislative election⁵⁰.

Table 5.6: T-Test Analysis of Independent Variables by Java/non-Java Jurisdiction

Variables	Java (mean)	Non-Java (mean)	P-Value
<i>Numpar</i> (number of people)	44.76	31.94	0.000***
<i>Budex</i> (in million Rupiah)	1.076.055	729.702	0.000***
<i>LogBudex</i> (log Rupiah)	11.99	11.80	0.000***
<i>Nonsup</i> (in %)	68.75	65.26	0.207
<i>NumIA</i> (number of people)	9.03	6.34	0.038**
<i>Age</i> (years)	358.57	150.73	0.000***
<i>HDI</i> (in %)	72.16	72.20	0.946
<i>Findep</i> (in %)	10.03	6.47	0.000***
<i>Audfind</i> (number of findings)	16.98	21.56	0.000***

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level.

As shown in Table 5.6, the budget expenditure of Java local governments is greater than non-Java local governments (Java=Rp.1,076,055,713,581, non-Java=Rp.729,702,833,951). The result of the t-test of *LogBudex* (local government budget expenditure (log)) shows a highly significant difference (p-value=0.000). This indicates that the expenditure activities of Java local governments are greater than non-Java local governments.

⁵⁰ The provisions concerning the right to vote in the election (UU No. 10 of 2008) is as follows: a minimum of 17 years old and/or has been married, registered as a voter, healthy soul and mind, voting rights are not revoked by a judgement which has the force of law and a voter can only be registered once.

The average number of internal auditors (*NumIA*) in Java local government is greater than non-Java local governments (Java=9.03; non-Java=6.34) and is statistically significant (p-value= 0.038). This suggests that the greater distribution of internal auditors tends to be concentrated in Java. The number of internal auditors in every local government is not necessarily related to the size of local government, but more related to the availability of human resources with the minimum requirements stipulated in the regulation of Minister of State Apparatus Reform No. 36 of 2012. Accordingly, the Indonesian government needs to pursue the addition of new internal auditors to meet existing deficiencies, especially for non-Java local governments.

Furthermore, the value of financial independence (*Findep*) in Java is higher than non-Java (Java=10.03%; non-Java=6.47%) and statistically significantly different (p-value=0.000). This indicates that the local source revenue of Java local governments are higher than non-Java local governments providing Java local governments with more independence than non-Java local governments.

Overall, the average age of Java local governments is far older than non-Java (Java=358.57, non-Java=150.73) and statistically significantly different (p-value=0.000). Many local governments already existed in Java before Indonesia's independence (1945). In addition, since the issuance of regional autonomy law (UU No. 22 of 1999), many new local governments have been formed, predominantly in non-Java jurisdictions (95%), while only 5% of the new entities are located in Java. Table 5.7 provides further detail of this phenomenon of the notable increase in the number of local governments since the publication of UU No. 22 of 1999 until 2010 highlighting that by 2010 there were 490 local governments consisting of 397 districts and 93 municipalities.

Table 5.7: Growth of Local Governments in Indonesia 1999-2010

	1999	number of changes			2010
		Java	non-Java	Total	
Number of districts	234	1	162	163	397
Number of municipalities	59	8	26	34	93
Total number	293	9	188	197	490*

Legend: *the number does not include six non-autonomous administrative areas in Jakarta province
Source: Kepmendagri (2010).

As depicted in Table 5.8, there are three variables statistically significantly different between local governments with the presence of an assistance and training programme and those without an assistance and training programme. These three variables are local budget expenditure (p-value=0.006), proportion of non-supporting parties (p-value=0.098), and level of financial independence (p-value=0.014). The five other variables are not significantly different between local governments that have an assistance and training programme and those that do not (number of local parliamentarians, number of internal auditors, age of local government, level of Human Development Index, and number of audit findings).

Table 5.8: T-Test Analysis of Independent Variables by Assistance and Training Programme/Non-Assistance and Training Programme

Variables	Assistance and Training (mean)	Non-Assistance and Training (mean)	P-Value
<i>Numpar</i> (number of people)	38.96	37.42	0.308
<i>Budex</i> (in million Rupiah)	992.078	766.258	0.006***
<i>LogBudex</i> (log Rupiah)	11.93	11.84	0.004***
<i>Nonsup</i> (in %)	68.85	64.18	0.098*
<i>NumlA</i> (number of people)	7.87	7.39	0.717
<i>Age</i> (years)	247.93	264.95	0.688
<i>HDI</i> (in %)	72.47	71.75	0.301
<i>Findep</i> (in %)	8.97	7.13	0.014**
<i>Audfind</i> (number of findings)	19.42	19.04	0.698

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level.

Table 5.9 highlights that in relationship to the municipality/district categorization, four variables are highly statistically significantly different including *number of local parliamentarians (Numpar)* (p-value=0.000), *local government budget expenditure (log) (LogBudex)* (p-value=0.004), *level of Human Development Index (HDI)* (p-value=0.000), and *level of financial independence (Findep)* (p-value=0.000). In addition, *number of audit findings (Audfind)* is statistically significantly different (p-value=0.026). The remaining variables are not statistically significant. The average *number of local parliamentarians (Numpar)* in districts is greater than in municipalities (districts=41.54; municipalities=33.47), reinforcing that the average number of residents in districts is higher than in municipalities. On average, districts have higher budget expenditure (*LogBudex*) than municipalities

(districts=11.93; municipalities=11.84). The Indonesian government is currently encouraging Indonesian districts to build public facilities relating to transportation and telecommunication at a rapid rate in order to improve public services (see Badan Perencanaan Pembangunan Nasional 2012). This causes an increase in district budget expenditure. In contrast, municipalities have a higher Human Development Index (*HDI*) than districts (municipalities=75.55; districts=69.97). This is largely due to municipalities having more complete facilities relating to health and education (Sudarti, Malik and Sutikno 2012).

Table 5.9: T-Test Analysis of Independent Variables by Municipalities and Districts

Variables	Municipalities (mean)	Districts (mean)	P-Value
<i>Numpar</i> (number of people)	33.47	41.54	0.000***
<i>Budex</i> (in million Rupiah)	836.664	946.110	0.188
<i>LogBudex</i> (log Rupiah)	11.84	11.93	0.004***
<i>Nonsup</i> (in %)	65.90	67.73	0.519
<i>NumIA</i> (number of people)	7.05	8.09	0.432
<i>Age</i> (years)	226.32	273.15	0.269
<i>HDI</i> (in %)	75.55	69.97	0.000***
<i>Findep</i> (in %)	10.57	6.74	0.000***
<i>Audfind</i> (number of findings)	20.59	18.40	0.026**

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level.

Table 5.9 also reveals that municipalities have a higher financial independency score than districts (municipalities=10.57; districts=6.74). This result indicates that municipalities which normally represent an area with more complete facilities and a better infrastructure of telecommunication are financially more independent than districts. Almost all Indonesian municipalities have greater income from local taxes and levies compared to districts (Bagijo 2011). Greater tax intakes support the local revenue base of municipalities therefore the dependency towards central government is reduced. Interestingly, municipalities have a higher number of adverse audit findings than districts (municipalities=20.59; districts=18.40), which is statistically significantly different (p-value=0.026). This indicates that municipalities have lower levels of adherence to the rule than districts. In connexion with this result, Prasetyo (2010, 73) states that “urban lifestyle

drives the behaviour of non-adherence to the rules, indiscipline, and shortcuts to reach goals”.

Table 5.10 reports the results of univariate tests associated with all predictor variables on local government with a surplus versus a deficit budget. The statistical analysis shows that two predictor variables are statistically significantly different, *number of internal auditors (NumIA)* (p-value=0.000); and *level of financial independence (Findep)* (p-value=0.013).

Table 5.10: T-Test Analysis of Independent Variables by Budget Surplus and Deficit

Variables	Surplus (mean)	Deficit (mean)	P-Value
<i>Numpar</i> (number of people)	38.36	38.34	0.990
<i>Budex</i> (in million Rupiah)	853.949	954.835	0.215
<i>LogBudex</i> (log Rupiah)	11.87	11.91	0.163
<i>Nonsup</i> (in %)	68.05	65.90	0.437
<i>NumIA</i> (number of people)	5.04	10.49	0.000***
<i>Age</i> (years)	238.86	271.41	0.433
<i>HDI</i> (in %)	71.79	72.58	0.246
<i>Findep</i> (in %)	7.37	9.19	0.013**
<i>Audfind</i> (number of findings)	19.16	19.39	0.807

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level.

As shown in Table 5.10 the number of internal auditors for deficit local government is greater than surplus local government (deficit=10; surplus= 5). As stated earlier the number of internal auditors in every local government is likely linked to the availability of the human resources who are experts in the field of internal auditing. Table 5.10 notes that the deficit local governments have more internal auditors than the surplus local governments. This may be due to the thought that deficit local governments need more attention relating to their financial accountability. This relates to the statement of Sesotyaningtyas (2012) that deficit local governments tend to get greater pressure from the public relating to the demands of financial transparency.

In addition, Table 5.10 reveals that the financial independence between local governments with surplus versus deficit budgets are significantly different (p-value=0.013). Local governments with a deficit budget have a higher score of financial independence than local governments with a surplus budget

(deficit=9.19%; surplus=7.37%). Financial independence is associated with local government own source revenue (PAD) and transfers from the central or provincial government (see the formula of RLGFI in Chapter 4 Section 4.5). The greater the PAD and the smaller the transfer from central or provincial government, indicates a more financially independent local government with lower dependence on the central government. Local governments with higher PAD tend to spend more funds in order to meet their public needs. This may lead to the condition of excessive budget spending which eventually causes deficit budgets.

Table 5.11 highlights interesting results regarding the predictor variables associated with the condition of local government jurisdiction in Indonesia. There are six predictor variables that have a highly significant difference (p-value=0.000) among the four areas of jurisdiction in Indonesia. These six variables include number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), age of local government (*Age*), level of Human Development Index (*HDI*), level of financial independence (*Findep*), and number of audit findings (*Audfind*).

From Table 5.11 it can be seen that the Java district category has the highest average number of local parliament members (47.55), followed by Java municipalities (37.93), non-Java districts (33.00), and non-Java municipalities (30.88). The number of local parliament members in each local government depends on the population of the area (Asshiddiqie 2006) and the results reflect that the Java-district category has the greater population who are eligible (see UU No. 10 of 2008) to elect local parliament members, this is followed in descending order by Java municipality, non-Java district, and non-Java municipality categories.

Table 5.11: ANOVA Analysis: By Category Jurisdictions in Indonesia

Variables	Java Municipalities (mean) N=29	Java Districts (mean) N=71	Non-Java Municipalities (mean) N=50	Non-Java Districts (mean) N=50	P-Value
Numpar (number of people)	37.93	47.55	30.88	33.00	0.000***
Budex (in million Rupiah)	991.156	1.110.732	747.059	712.346	0.000***
LogBudex (log Rupiah)	11.90	12.02	11.81	11.79	0.000***
Nonsup (in %)	69.17	68.58	64.00	66.52	0.569
NumIA (number of people)	9.00	9.04	5.92	6.76	0.214
Age (years)	294.72	384.65	186.64	114.82	0.000***
HDI (in %)	75.57	70.77	75.55	68.86	0.000***
Findep (in %)	14.07	8.37	8.53	4.41	0.000***
Audfind (number of findings)	18.69	16.28	21.70	21.42	0.000***

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level.

As depicted in Table 5.11, Java local governments have higher budgets than non-Java local governments, with Java districts having the highest budget overall. Consistent with these results, Lowndes and Pratchett (2011, 28) state that “the bigger the local government, then the local government will face more complex and difficult problems”. To accommodate the needs of the public, the local government must increase their budget.

The average age of the local governments in Indonesia among Java municipalities, Java districts, non-Java municipalities, and non-Java districts are statistically significantly different (p-value=0.000). It can be seen that Java local governments (municipalities/districts) are considerably older than non-Java local governments. Local governments of Java districts have the oldest average age (384.65 years) while local governments in the non-Java districts have the youngest average age (114.82 years).

The average value of *HDI* among Java municipalities, Java districts, non-Java municipalities, and non-Java districts are statistically significantly different (p-value=0.000). Table 5.11 reveals that Java municipality category has the highest *HDI* (75.57%), followed by non-Java municipalities (75.55%); then Java districts (70.77%); and the lowest is non-Java districts (68.86%).

These results support that in Indonesia, the *HDI* score of municipalities is higher than districts (see again Table 5.9).

The financial independence level among the four jurisdictions are highly significant ($p\text{-value}=0.000$). Java municipality category has the highest average value (14.07), followed by non-Java municipalities (8.53), Java districts (8.37), and non-Java districts (4.41). This indicates that municipalities have higher financial independency than districts. Municipalities have a higher local own source revenue (PAD) which potentially comes from taxes and levies. With high local own source revenue (PAD), the financial dependence on the central government is reduced (Setiawan and Wahyudi 2011).

The average number of audit findings among Java municipalities, Java districts, non-Java municipalities, and non-Java districts are highly significantly different ($p\text{-value}= 0.000$). Non-Java municipalities have the highest number of adverse audit finding (21.70), followed by non-Java districts (21.42), Java municipalities (18.69) and the lowest is Java districts (16.28). Java locales reflect an area with more complete and advanced public facilities than non-Java. In this sense Java local governments have better financial reporting than non-Java local governments because the number of adverse audit findings of Java local governments is less than non-Java local governments.

5.5 Summary

This chapter presents descriptive statistical results as well as independent t-test and ANOVA analysis relating to the GCI dependent variable and possible predictor variables. The findings address research question one in this thesis by examining the extent of mandatory disclosure within financial statements of local governments in Indonesia. The evidence from the descriptive statistics highlights some interesting aspects of the mandatory disclosure practices of Indonesian local government's financial statements. After five years of implementing PP.No.24 of 2005 (Government Accounting Standards), the level of mandatory disclosures within financial statements of Indonesian local governments in 2010 is a moderate figure of 69.60%.

Statistical analysis shows that Java local governments have a fundamentally higher GCI score than non-Java local governments (Java=73.5%; non-Java=65.8%). The statistical results also reveal that local governments which implement an assistance and training programme have a higher GCI score than local governments without an assistance and training programme (local governments with assistance and training programme=71.98%; local governments without assistance and training programme=66.01%). Additional analysis highlights that Java districts have the highest average score in practicing mandatory disclosure within financial statements (47.55%), followed by Java municipalities (37.93%), non-Java districts (33.00%), and the lowest is non-Java municipalities (30.88%).

The following chapter provides the main statistical analysis and testing of the independent variables hypothesized to be associated with GCI.

Chapter 6

Multivariate Statistics

6.1. Introduction

Chapter 5 presented the descriptive statistical analysis for all variables examined in this thesis. Chapter 6 reports the multivariate testing of the six hypotheses. The statistical analysis focuses on the independent and control predictor variables to be associated with the Government Compliance Index (GCI). The statistical tests involve use of Ordinary Least Square (OLS) multiple regression techniques with GCI as the dependent variable in relation to the possible predictor variables.

This thesis examines the relationship between six independent variables (number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of an assistance and training programme, proportion of non-supporting parties, and number of internal auditors), six control variables (type of local government, age of local government, number of audit findings, surplus/deficit of local government, level of financial independence, and level of the Human Development Index), and the dependent variable (Government Compliance Index).

Furthermore, for a deeper analysis of mandatory disclosure practices within financial statements of Indonesian local governments, regression tests are conducted in Chapter 7 with the seven categories of GCI (financial statement items, accounting policy, fiscal policy, financial performance, macroeconomics, local budget targets, and non-financial information). Analyses of these categories of GCI add insights concerning influencing factors.

6.2. Multivariate Regression Model

For the purposes of this thesis, a multiple regression model is developed in order to test the association between the dependent variable (Government Compliance Index) and the set of predictor variables.

$$GCI = \beta_0 + \beta_1 Numpar + \beta_2 LogBudex + \beta_3 Javanon + \beta_4 Assprog + \beta_5 Nonsup + \beta_6 NumIA + \beta_7 Age + \beta_8 HDI + \beta_9 Surdef + \beta_{10} Findep + \beta_{11} Audfind + \beta_{12} Mundis + \epsilon$$

Where:

Dependent variable:

GCI = Government Compliance Index

Independent variables:

Numpar = number of local parliamentarians
LogBudex = local government budget expenditure (logged to reduce skewness)
Javanon = Java/non-Java jurisdiction
Assprog = presence of assistance and training programme
Nonsup = proportion of non-supporting parties
NumIA = number of internal auditors

Control variables:

Age = age of local government
HDI = level of Human Development Index
Surdef = surplus/deficit of local government
Findep = level of financial independence
Audfind = number of audit findings
Mundis = municipality/district (type of local government)
 β_0 = intercept
 ϵ = Error term

6.3. Statistical Testing Assumptions

To better ensure that the results of the Government Compliance Index (GCI) regression model are reliable, several important assumptions of the Ordinary Least Square (OLS) regression model are tested. These assumptions include normality, linearity, multicollinearity, homoscedasticity, outlier issues, and reliability. These tests are outlined below.

6.3.1 Normality

Martin and Bridgmon (2012) state that when the skewness and kurtosis z-score values are less than ± 3.29 , it can be concluded that the distributions are not significantly skewed.

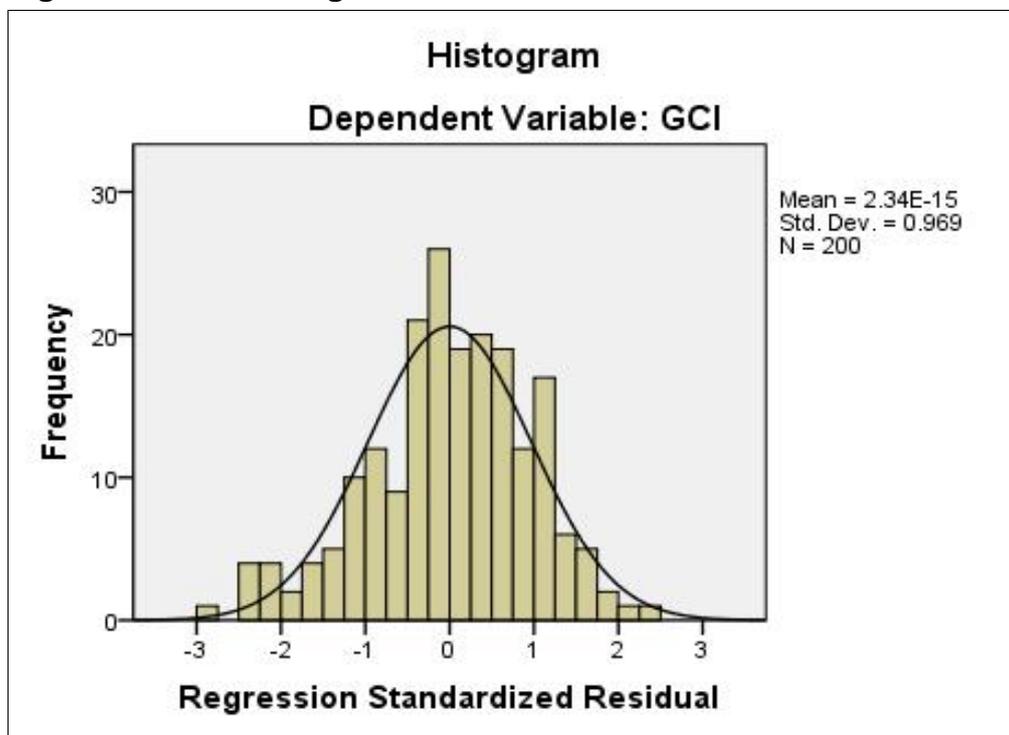
Table 6.1: Normality Test Regression

	Skewness		Kurtosis	
	Statistic	Std. Error	Statistic	Std. Error
Unstandardised Residual (n=200)	-0.432	0.172	0.175	0.342

It can be seen from Table 6.1 that skewness ratio and kurtosis ratio is between -3.29 and +3.29, the distribution of data in this thesis is thus within the normal range ($-0.432/0.172 = -2.510$ (for skewness ratio)), and ($0.175/0.342 = 0.511$ (for kurtosis ratio)). Overall, the tests exploring this statistical assumption as illustrated above provide evidence that the model is valid. In addition, the Figure 6.1 histogram of GCI (dependent variable) is in the shape of a bell shaped curve that seems to be a normal distribution.

Taken together, the normality assumption of the regression analysis of this study is deemed to have been met.

Figure 6.1: GCI Histogram



6.3.2 Linearity

Another assumption underlying regression analysis is that the residuals have a reasonably linear relationship with the predicted dependent variable, and that the residuals for the predicted dependent variable scores are the same for all predicted scores (Hair *et al.* 2006). Tabachnick and Fidell (2007) states that linearity is very important due to the limitation that Pearson's r only capturing the linear relationships among variables.

Figure 6.2: P-P Plot Regression of GCI

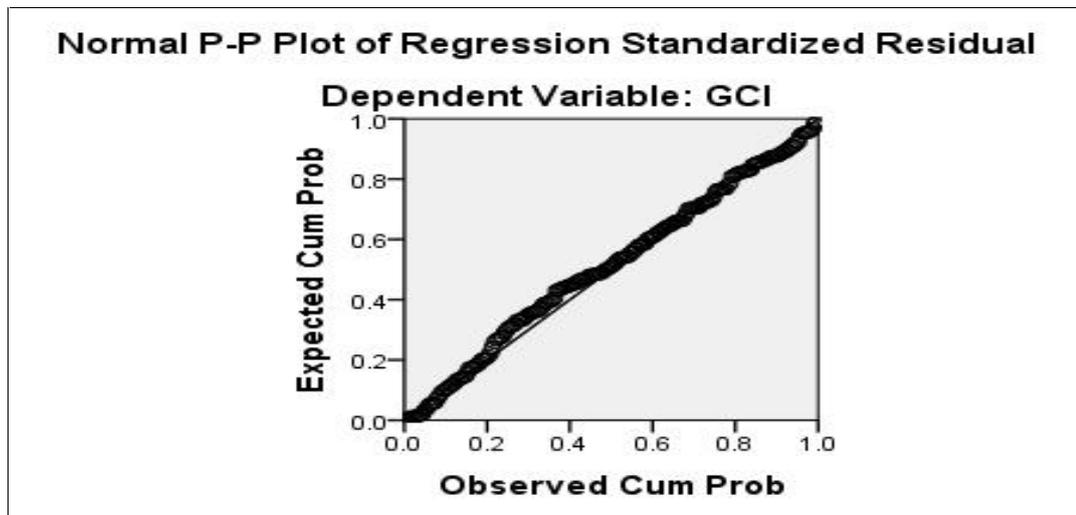


Figure 6.2 shows that there is a clear relationship between the residual and the predicted value; this is consistent with the assumption of linearity. Accordingly, the model is deemed to meet the assumption of linearity.

6.3.3 Multicollinearity

Section 6.3 of the main text concludes that there were no multicollinearity problems encountered in this study as the correlation coefficient between predictor variables is below the critical limits of 0.80. Although correlation matrices are the common procedures used in empirical studies, they are not completely capable of detecting linear relationships among more than two variables. Therefore, due to this concern, Variance Inflation Factor (VIF) and Tolerance scores are also computed for every predictor variable. The VIF provides information relating to the strength of the linear relationship between one predictor to other predictors in a regression model (Field 2005).

Variance Inflation Factor (VIF) and Tolerance of GCI

In terms of possible problems with multicollinearity of variables observed, as extra analysis this study tests VIF (Variation Inflation Factor) and Tolerance measures. This is a prerequisite in statistical analysis before the variables in the data sample set should be run by using multiple regressions analysis. If there is no multicollinearity problem observed with the variables, then the next procedure is to run multiple regressions. Pallant (2007) describes tolerance as an indicator of how much of the variability of the specified independent is not explained by other independent variables in the model, this is calculated by the formula $1-R^2$ for each variable. Moreover, Pallant (2007) also states that if the value is very small or less than 0.10, this is an indication that multiple correlations with other variables is high, suggesting the possibility of multicollinearity. In addition, Pallant (2007) points out that VIF scores above 10 indicate multicollinearity in the model data sample set.

Table 6.2 below presents the values of the VIF and the tolerance of predictor variables.

Table 6.2: VIF and Tolerance Values

Variables	Variable Types	Collinearity Statistics	
		Tolerance	VIF
<i>Numpar</i> (H1)	COV	.292	3.425
<i>LogBudex</i> (H2)	CIV	.373	2.679
<i>Javanon</i> (H3)	MOV	.519	1.927
<i>Assprog</i> (H4)	MIV	.903	1.108
<i>Nonsup</i> (H5)	NOV	.905	1.105
<i>NumIA</i> (H6)	NIV	.761	1.315
<i>Age</i>	CV	.634	1.576
<i>HDI</i>	CV	.593	1.688
<i>Surdef</i>	CV	.864	1.157
<i>Findep</i>	CV	.501	1.996
<i>Audfind</i>	CV	.838	1.193
<i>Mundis</i>	CV	.429	2.329

Legend: n=200, COV=Coercive Outsider Variable, CIV=Coercive Insider Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, NIV=Normative Insider Variable, CV=Control variable, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (*log*), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=Municipality/district (type of local government).

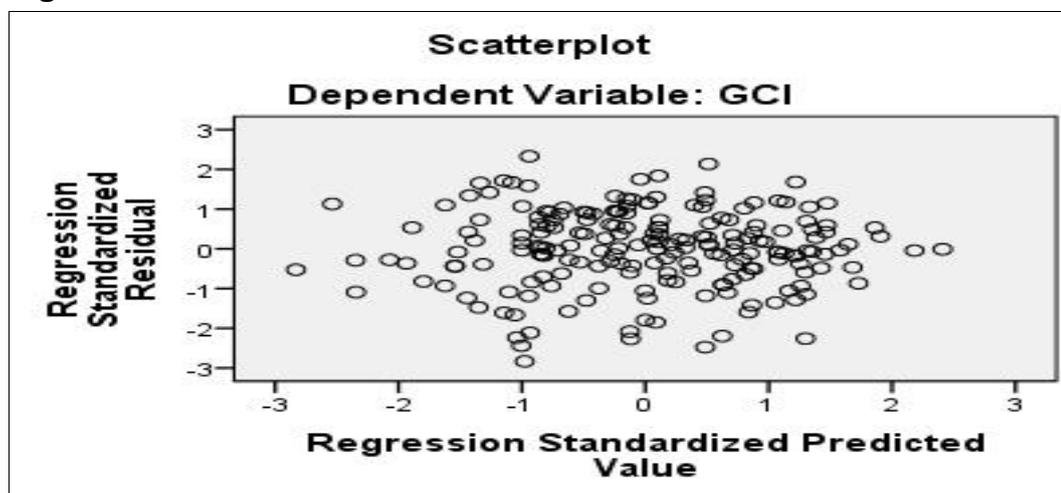
This study uses SPSS programme version 20.00 to analyse whether or not the variables have such multicollinearity problems. Given that the data sample set should test problems with multicollinearity, this suggests that the process of identifying a multicollinearity problem will identify components that may not be found in the correlation matrix (the correlation matrix can be used to examine whether or not there is a possible multicollinearity problem in the variables analysed, see Table 6.7).

In summary, as shown in Table 6.2, tolerance scores are all greater than 0.10 benchmark, meanwhile the values of VIF for each predictor variables are well below the 10 benchmark. Table 6.7 (described later) also reveals no problems. Accordingly, it can be concluded that multicollinearity does not seem to be a concern in explaining the regression results model.

6.3.4 Homoscedasticity

Homoscedasticity is an assumption related to dependency relationships between variables (Hair *et al.* 2006). Tabachnick and Fidell (2007, 85) states “homoscedasticity means that the variability of one continuous variable is roughly the same as the values of other continuous variables”. There are many ways to test homoscedasticity, two of them are Glejser Tests and scatter plots (Coakes 2009). It can be seen from Figure 6.3 that there is no specific pattern in the scatter plots. Therefore, the regression model is felt to meet the assumption of homoscedasticity.

Figure 6.3: Scatter Plot of GCI



6.3.5 Outlier Issues

By observing Mahalanobis and Cook's distance scores, this thesis checks for the possible existence of outliers. Cook's distance is defined as a "summary measure of the influence of a single case based on the total changes in all other residuals when the case is deleted from the estimation process" (Hair *et al.* 1998, 218). The second measure, Mahalanobis distance, is defined as the "measure of uniqueness of a single observation based on differences between the observation's values and the mean values for all other cases across all independent variables" (Hair *et al.* 1998, 219).

Cook's Distance

Field (2005), Maindonald and Braun (2010) note that any case which has a value of Cook's distance of more than 1.0 is considered as a possible outlier. Table 6.3 presents the summary results of Cook's distance calculation.

Table 6.3: The Results of Cook's Distance

	Mean	Minimum	Maximum	Standard Deviation
Cook's Distance	.005	.000	.043	.008

As shown in Table 6.3, the maximum score of Cook's distance for 200 Indonesian local governments is 0.043, that is well below the benchmark of 1.0 (one). Therefore, according to the Cook's distance benchmark criterion, there is no multivariate outlier in the data set of 200 Indonesian local governments.

Mahalanobis Distance

Table 6.4 illustrates the results of Mahalanobis distance calculation. This study uses 12 predictor variables (12 degree of freedom), therefore a multivariate outlier exists where its Mahalanobis score exceeds the value of 32.91 at an alpha level of 0.001 (see Coakes and Steed 2007 for a detailed explanation on the criteria for determining outliers).

Table 6.4: The Results of Mahalanobis Distance

	Mean	Minimum	Maximum	Standard Deviation
Mahalanobis Distance	11.940	4.105	42.168	6.785

As depicted in Table 6.4, Mahalanobis scores range from a minimum of 4.105 and a maximum of 42.168. After conducting the Mahalanobis tests, the detailed results reveal that there are four potential multivariate outliers in the data set (with Mahalanobis scores of 35.1, 40.2, 42.2, and 39.5 respectively). However, as highlighted below, the extra analysis conducted shows that there are no major statistical differences when comparing the results of the two datasets, with or without the removal of the four outliers (see Table 6.5). Accordingly, Section 6.5 presents the main thesis results of multiple regressions by using the full dataset and without removing the outliers (n=200).

Table 6.5 compares the results of multiple regression analysis, with (n=200) and without (n=196) removing the four possible outliers. As depicted in both tables, the same three independent variables are significant predictors of the extent of mandatory disclosure in Indonesian local governments. In particular, both results provide evidence which supports H3, H4, and H5. Table G.4 also reveals that H1 and H6 are not supported by the results of both regressions. In addition, H2 is also not supported by the results of both regressions due to the unexpected directionality (it reveals a negative directionality instead of the hypothesised positive directionality).

In regard to the control variables, after removing the four outliers, Table 6.5 shows that surplus/deficit local government is no longer a significant predictor for GCI. Moreover, other control variables such as age of local government, level of Human Development Index, and level of financial independence are still significant predictors of GCI in a positive direction. Meanwhile, number of audit findings (*Audfind*) and municipality/district (*Mundis*) have unexpected directionalities (the prediction sign of *Audfind* is negative, but the statistical analysis result reveals a positive directionality). Meanwhile, *Mundis* has a positive prediction sign, but the statistical analysis result shows negative

directionality. Accordingly, *Audfind* and *Mundis* are not included as predictor variables of the extent of GCI.

Theoretically, the four outliers violating the benchmark of Mahalanobis scores should be eliminated from the data set. However, the values of Cook's distance indicate that all local governments are within the benchmark and only four data points are raised as possible outliers using Mahalanobis scores. Since the results of with/without multiple regressions analysis show no major difference regarding the testing of the six hypotheses (number of local parliamentarians, local government budget expenditure, Java/non-Java jurisdiction, presence of an assistance and training programme, proportion of non-supporting parties, and number of internal auditors), this thesis presents the multiple regression with a full $n=200$ dataset as the main statistical analysis (see Section 6.5).

Table 6.5: Multiple Regression Results with and without Removal of the Outliers

Variables	Variable Types	Prediction	Full data set (n=200)			Removing outliers (n=196)		
			T-Stat	Coeff	P-Value	T-Stat	Coeff	P-Value
(Constant)			3.639	213.007	.000	2.961	195.152	.003
<i>Numpar</i>	COV	+	1.215	.144	.226	.868	.109	.387
<i>LogBudex</i>	CIV	+	-3.258	-16.791	.001*** ^Δ	-2.532	-14.664	.012*** ^Δ
<i>Javanon</i>	MOV	+/-	3.238	6.056	.001***	3.161	5.979	.002***
<i>Assprog</i>	MIV	+/-	4.282	6.148	.000***	4.260	6.197	.000***
<i>Nonsup</i>	NOV	+	1.997	.072	.047**	1.965	.072	.051*
<i>NumIA</i>	NIV	+	-.037	-.003	.970	-.212	-.019	.833
<i>Age</i>	CV	+	1.917	.005	.057*	1.925	.005	.056*
<i>HDI</i>	CV	+	2.504	.453	.013**	1.678	.370	.095*
<i>Surdef</i>	CV	+/-	-.359	-.519	.720	-.413	-.607	.780
<i>Findep</i>	CV	+	2.501	.458	.013**	2.366	.447	.019**
<i>Audfind</i>	CV	-	1.781	.192	.077* ^Δ	1.805	.197	.073* ^Δ
<i>Mundis</i>	CV	+/-	-2.122	-4.449	.035*** ^Δ	-2.006	-4.301	.046***
			Adj R ² : .260			Adj R ² : .227		
			F : 6.830			F : 5.774		
			Sig. : .000			Sig. : .000		

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level, ^Δ Unexpected directionality.

Legend: Shaded areas denote statistically significant findings. *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (*log*), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

6.3.6 GCI Reliability Check

To check the reliability of GCI, two independent evaluators well established in accounting academia were requested to double check the data set to better ensure reliability. Such additional testing helps control for subjectivity in the interpretation of the 57 item content of the Government Compliance Index (GCI). The two independent assessors are both knowledgeable accounting academics with corporate reporting expertise.

The independent assessors reviewed a sample of 20 local government financial statements (representing 10% of the total sample) and completed the scoring sheet of the GCI as a reliability check. This method is based on Krippendorff's (1980) approach which recommends that at least two researchers do the analysis independently and compare the results as a reliability check. The unweighted GCI scores of the independent assessors are then compared with the researchers' scores to ascertain if there are any statistically significant differences. In this regard, a t-test for difference means from GCI scores is conducted. The results of the t-test are shown in Table 6.6.

Table 6.6: Reliability Test for GCI

	Mean	t-test	p-value (2-tailed)
2010 reports	0.6921		
Researcher Evaluators	0.6964	-0.818	0.424

Legend: n=20

As shown in Table 6.6, the result of t-test indicates that the mean GCI score between the researcher and the independent evaluators does not differ significant ($p > 0.05$). Accordingly, the subjectivity problem arising from scoring procedure against the GCI instrument is deemed inconsequential. The scores for the GCI are considered reliable.

In summary, the results of several important assumptions tests of the linear Ordinary Least Square (OLS) regression model including normality, linearity, multicollinearity, homoscedasticity, outlier issues, and reliability reveal that the overall regression model in this thesis is deemed reliable meeting

statistical assumptions. Therefore, it can be concluded that the results of the regression analyses are free from statistical bias.

6.4 Correlation Matrices of the Dependent, Independent and Control Variables

The validity of the models is assessed prior to the regression analysis. One of the potential issues in multivariate analysis is the multicollinearity statistical problem. Multicollinearity happens when there are high multiple correlations between the predictor variables. A correlation coefficient between independent variables of 0.80 or higher is often the benchmark score for multicollinearity concerns⁵¹ (Cook and Hawkins 1989; Gujarati 1995; Bryman and Cramer 1997; Hair *et al.* 1998; Ghozali 2005; and Cooper and Schindler 2006).

Table 6.7 reveals that the highest correlation among the predictor variables is 0.741. This correlation value is below the critical limit of 0.80, it is thus suggested that the multicollinearity problem between independent variables is not a serious concern.

Table 6.7 also shows the correlation matrix between the dependent variable (Government Compliance Index=GCI) with independent variables (number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), Java/non-Java jurisdiction (*Javanon*), presence of an assistance and training programme (*Assprog*), proportion of non-supporting parties (*Nonsup*), and number of internal auditors (*NumIA*)), and control variables (age of local government (*Age*), level of Human Development Index (*HDI*), surplus/deficit of local government (*Surdef*), level of financial independence (*Findep*), number of audit findings (*Audfind*), and type of local government

⁵¹ To better test the multicollinearity issue, this thesis also calculates the Variance Inflation Factors (VIF) and Tolerance of GCI scores. VIF and Tolerance are widely used methods to detect and measure the multicollinearity problem for variables (Field 2009). The results of the VIF and Tolerance calculation reveal that the values of VIF are under the key cut off point (10) (Field 2005), and the tolerance value of all variables are all more than 0.10 (see Table 6.2 and Section 6.3.3 discussion). Therefore, it can be concluded that there is no multicollinearity problem observed within the variables.

(municipality/district) (*Mundis*) for Pearson correlations⁵². The results indicate the following:

- Coefficient correlations provide initial support for Hypothesis 1 (H_1 : number of local parliamentarians (*Numpar*), positive, $p < 0.01$), Hypothesis 2 (H_2 : local government budget expenditure (*LogBudex*), positive, $p < 0.05$), Hypothesis 3 (H_3 : Java/non-Java jurisdiction (*Javanon*), positive, $p < 0.01$), Hypothesis 4 (H_4 : presence of an assistance and training programme (*Assprog*), positive, $p < 0.01$), Hypothesis 5 (H_5 : proportion of non-supporting parties (*Nonsup*), positive, $p < 0.05$), and Hypothesis 6 (H_6 : number of internal auditors (*NumIA*), positive, $p < 0.05$).
- The highest correlation between GCI and its independent variables is between GCI and Java/non-Java jurisdiction (*Javanon*) (Pearson: 0.350, $p < 0.01$). The lowest correlation is between GCI and number of internal auditors (*NumIA*) (Pearson: 0.149, $p < 0.05$).
- Table 6.7 then reports the coefficient correlations for the control variables. There are three control variables that have highly significant positive association with GCI, these are (age of local government (*Age*) ($p < 0.01$), level of Human Development Index (*HDI*) ($p < 0.01$), and level of financial independence (*Findep*) ($p < 0.01$)).
- The highest correlation between GCI and its control variables is between GCI and level of financial independence (*Findep*) (Pearson: 0.293, $p < 0.01$). The lowest correlation is between GCI and type of local government (municipality/district) (*Mundis*) (Pearson: -0.017).
- The highest correlation among independent variables is between Java/non-Java jurisdiction (*Javanon*) and number of local parliamentarians) (*Numpar*) (Pearson: 0.617, $p < 0.01$). The lowest

⁵² This thesis also performs Spearman correlation test. The results of the Spearman correlation test are presented in Appendix G. The results are very similar. For the Spearman Correlations, three hypotheses are initially supported: Hypothesis 1 (H_1 : number of local parliamentarians), Hypothesis 3 (H_3 : Java/non-Java jurisdiction), and Hypothesis 4 (H_4 : presence of an assistance and training programme). In addition, there are two control variables initially supported (*Age* and *Findep*). The highest correlations among the predictor variables is between *LogBudex* and *Numpar* (Spearman: 0.749, $p < 0.01$), again lessening concerns about multicollinearity.

correlation is between the presence of an assistance and training programme (*Assprog*) and Java/non-Java jurisdiction (*Javanon*) (Pearson: 0.010).

- The highest correlation among control variables is between level of financial independence (*Findep*) and level of Human Development Index (*HDI*) (Pearson: 0.401, $p < 0.01$). The lowest correlation is between number of audit findings (*Audfind*) and surplus/deficit of local government (*Surdef*) (Pearson: -0.017).

In summary, even though there are slight differences, the overall results of the Pearson correlation test are very similar to the Spearman correlation test (refer Appendix H).

Table 6.7: Pearson Correlation Matrix

		DV			IV				CV					
	Variables	<i>GCI</i>	<i>Numpar</i>	<i>LogBudex</i>	<i>Javanon</i>	<i>Assprog</i>	<i>Nonsup</i>	<i>NumIA</i>	<i>Age</i>	<i>HDI</i>	<i>Surdef</i>	<i>Findep</i>	<i>Audfind</i>	<i>Mundis</i>
DV	<i>GCI</i>	1.000												
	<i>Numpar</i>	.268**	1.000											
	<i>LogBudex</i>	.153*	.741**	1.000										
IV	<i>Javanon</i>	.350**	.617**	.443**	1.000									
	<i>Assprog</i>	.265**	.072	.205**	.010	1.000								
	<i>Nonsup</i>	.176*	.205**	.194**	.090	.117	1.000							
	<i>NumIA</i>	.149*	.213**	.209**	.147*	.026	.116	1.000						
	<i>Age</i>	.223**	.329**	.272**	.356**	-.029	.071	.215**	1.000					
	<i>HDI</i>	.182**	-.037	.057	-.005	.073	.003	.148*	.058	1.000				
	<i>Surdef</i>	-.039	.001	-.099	.010	-.068	.055	-.297**	-.056	-.082	1.000			
CV	<i>Findep</i>	.293**	.319**	.439**	.344**	.174*	.085	.244**	.157*	.401**	-.176*	1.000		
	<i>Audfind</i>	-.038	-.166*	-.047	-.337**	.028	-.062	.009	-.202**	.062	-.017	-.053	1.000	
	<i>Mundis</i>	-.017	-.380**	-.201**	-.215**	.109	-.046	-.056	-.078	.571**	-.116	.363**	.158*	1.000

Legend: *Correlation is significant at the 0.05 level (2-tailed). **Correlation is significant at the 0.01 level (2-tailed). DV=Dependent Variable, IV=Independent Variables, CV=Control variables. *GCI*=Government Compliance Index, *Numpar*= number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

6.5. Multiple Regression Results: Hypothesis Testing

In this study, multiple regressions are used as the main form of statistical analysis. The p-value derived from regression analysis are primarily interpreted at the 5% significance level ($p < 0.05$). This is consistent with previous social science and business studies (Pallant 2007; Garson 2008). When appropriate $p < 0.01$ or $p < 0.10$ findings are also noted.

Table 6.8 reveals the results of the multiple regression of the main dependent variable (GCI). The predictor variables analysed are: six independent variables, number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), Java-non-Java jurisdiction (*Javanon*), presence of an assistance and training programme (*Assprog*), proportion of non-supporting parties (*Nonsup*), and number of internal auditors (*NumIA*); and six control variables, age of local government (*Age*), level of Human Development Index (*HDI*), surplus/deficit of local government (*Surdef*), level of financial independence (*Findep*), number of audit findings (*Audfind*), and type of local government (municipality/district) (*Mundis*).

As presented, Table 6.8 shows that the adjusted coefficient of determination (adjusted R-Squared) of the model is 0.260 (26.0%), indicating that the predictor variables of the model explain 26% of the variation in the Government Compliance Index (GCI). In addition, the overall model is highly significant ($p\text{-value} = 0.000$ and $F\text{ statistics} = 6.830$).

Table 6.8 highlights that Java/non-Java jurisdiction (*Javanon*) and presence of an assistance and training programme (*Assprog*) are positively and highly significant with p-value of 0.001 and 0.000 respectively. In addition, proportion of non-supporting parties (*Nonsup*) is also positively and statistically significant with p-value of 0.047. These findings support Hypothesis 3 (H_3 : Java/non-Java jurisdiction), Hypothesis 4 (H_4 : presence of an assistance and training programme), and Hypothesis 5 (H_5 : proportion of non-supporting parties). Two other independent variables namely number of local parliamentarians (*Numpar*) and number of internal auditors (*NumIA*) are not significant predictors of the level of mandatory disclosure (GCI) since their p-values 0.226 (*Numpar*) and 0.970 (*NumIA*) are greater than the

benchmark 0.05 ($p > 0.05$) significant level. Thus Hypothesis H_1 and H_6 are rejected. Moreover, local government budget expenditure (log) (*LogBudex*) (H_2) is also rejected due to the unexpected directionality (it reveals a negative directionality instead of the hypothesised positive directionality). This indicates that the larger the local government budget the lower the mandatory disclosure on local government financial statements or vice versa.

Table 6.8: Multiple Regression Analysis: GCI (n=200)

Variables	Variable Types	Predicted Sign	T-Stat	Coefficient	P-Value
(Constant)			3.639	213.007	.000
<i>Numpar</i> (H_1)	COV	+	1.215	.144	.226
<i>LogBudex</i> (H_2)	CIV	+	-3.258	-16.791	.001*** Δ
<i>Javanon</i> (H_3)	MOV	+/-	3.238	6.056	.001***
<i>Assprog</i> (H_4)	MIV	+/-	4.282	6.148	.000***
<i>Nonsup</i> (H_5)	NOV	+	1.997	.072	.047**
<i>NumIA</i> (H_6)	NIV	+	-.037	-.003	.970
<i>Age</i>	CV	+	1.917	.005	.057*
<i>HDI</i>	CV	+	2.504	.453	.013**
<i>Surdef</i>	CV	+/-	-.359	-.519	.720
<i>Findep</i>	CV	+	2.501	.458	.013**
<i>Audfind</i>	CV	-	1.781	.192	.077** Δ
<i>Mundis</i>	CV	+/-	-2.122	-4.449	.035**
Adj R ² : .260					
F : 6.830					
Sig. : .000					

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level, Unexpected directionality.

Legend: COV=Coercive Outsider Variable, CIV=Coercive Inside Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, NIV=Normative Insider Variable, CV=Control Variable, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Table 6.8 also shows that four control variables are statistically significant predictors of the extent of mandatory disclosure (GCI). *Age of local government* (*Age*) is moderately significant ($p < 0.10$). While, level of Human Development Index (*HDI*), level of financial independence (*Findep*), and type of local government (*Mundis*) are significant ($p < 0.05$). One control variable namely surplus/deficit of local government (*Surdef*) is not a significant predictor of the extent of mandatory disclosure (GCI) ($p > 0.10$), and number

of audit findings (*Audfind*) is also not a predictor of the extent of mandatory disclosure (GCI) due to the unexpected directionality (the prediction sign of number of audit findings (*Audfind*) is negative, but the statistical analysis result reveals a positive directionality). This indicates that the greater the number of audit findings, the higher the level of mandatory disclosure practices. Accordingly, this result is contrary to the ideas developed in this thesis (see Section 3.5.4).

This study also conducts a series of backward regressions as further analysis for the purpose of identifying the dominant predictors and particular models about the variables effect on the level of mandatory disclosure practices. The sequence of this process starts with a model which contains all predictor variables and then eliminates those predictor variables that are not significant (Field 2005; Pallant 2007). The dominant predictors appear in the final model.

The backward regression analysis of GCI includes the model summary, ANOVA, and the coefficients as the basis of the conclusions (see Table 6.9).

Table 6.9: Model Summary and ANOVA of GCI (Backward Regression)

Model	R	R Square	Adjusted R Square	Std. Error of The Estimate	F	Sig.
1	.552 (a)	.305	.260	9.48396	6.830	.000
2	.552 (b)	.305	.264	9.45874	7.491	.000
3	.552 (c)	.304	.267	9.43703	8.265	.000
4	.547 (d)	.299	.266	9.44803	9.001	.000

a. Predictors: (Constant), *Mundis*, *Nonsup*, *Age*, *Surdef*, *Assprog*, *Audfind*, *NumIA*, *LogBudex*, *Javanon*, *HDI*, *Findep*, *Numpar*

b. Predictors: (Constant), *Mundis*, *Nonsup*, *Age*, *Surdef*, *Assprog*, *Audfind*, *LogBudex*, *Javanon*, *HDI*, *Findep*, *Numpar*

c. Predictors: (Constant), *Mundis*, *Nonsup*, *Age*, *Assprog*, *Audfind*, *LogBudex*, *Javanon*, *HDI*, *Findep*, *Numpar*

d. Predictors: (Constant), *Mundis*, *Nonsup*, *Age*, *Assprog*, *Audfind*, *LogBudex*, *Javanon*, *HDI*, *Findep*

g. Dependent Variable: *GCI*

As illustrated in Table 6.9, Model 3 possesses the highest adjusted R^2 score (0.267). The coefficients of backward regression of GCI indicate four models of the process of elimination of each of the least dominant predictor variables observed (described in more detail in Appendix I).

Table 6.10 Backward Regression Analysis: GCI (n=200)

Variables	Variable Types	Prediction Sign	Coefficient	T-Stat	P-Value
(Constant)			210.954	3.638	.000
<i>Numpar</i> (H1)	COV	+	.141	1.210	.231
<i>LogBudex</i> (H2)	CIV	+	-16.619	-3.283	.001*** ^Δ
<i>Javanon</i> (H3)	MOV	+/-	6.022	3.240	.001***
<i>Assprog</i> (H4)	MIV	+/-	6.163	4.316	.000***
<i>Nonsup</i> (H5)	NOV	+	.070	1.993	.048**
<i>Age</i>	CV	+	.005	1.968	.051*
<i>HDI</i>	CV	+	.450	2.536	.012**
<i>Findep</i>	CV	+	.465	2.599	.010**
<i>Audfind</i>	CV	-	.191	1.790	.075** ^Δ
<i>Mundis</i>	CV	+/-	-4.410	-2.152	.033**
Adjusted R ² :	.267				
F :	8.265				
Sig :	.000				

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. Unexpected directionality.

Legend: CIV=Coercive Inside Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, CV=Control Variable. *Numpar*=Number of local parliamentarians, *LogBudex*=Local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *Age*=age of local government, *HDI*=level of Human Development Index, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

The results of these backward regression models are depicted in Table 6.10. The table confirms that Java/non-Java jurisdiction (*Javanon*) and presence of an assistance and training programme (*Assprog*) are positively and highly significant ($p < 0.01$), while proportion of non-supporting parties (*Nonsup*) is positively significant ($p < 0.05$). Local government budget expenditure (log) (*LogBudex*) again has unexpected directionality. Two control variables namely level of Human Development Index (*HDI*) and level of financial independence (*Findep*) are positive and highly significant ($p < 0.01$), while type of local government (*Mundis*) is negative and significant ($p < 0.05$), age of local government (*Age*) is positive and moderately significant ($p < 0.10$). In addition, it is also revealed that number of audit findings (*Audfind*) has unexpected directionality. Table 6.9 also reveals a slightly higher adjusted R² predictive power (0.267) than the original Table 6.8 full regression model (0.260). The Tables 6.9 and 6.10 backward regression analyses support the Table 6.8 multiple regression findings.

The key point is that both the multiple regression and backward regression show that Java/non-Java jurisdiction (*Javanon*) (mimetic-outsider), presence of an assistance and training programme (*Assprog*) (mimetic-insider), proportion of non-supporting parties (*Nonsup*) (normative-outsider), age of local government (*Age*) (control variable), level of Human Development Index (*HDI*) (control variable), and level of financial independence (*Findep*) (control variable), are the dominant predictors for the level of mandatory disclosure (GCI).

Overall, this section gives important insights concerning the influencing factors on the practice of mandatory disclosure within financial statements of local governments in Indonesia.

Number of local parliamentarians (*Numpar*) (coercive outsider) is not a significant predictor of the extent of GCI. This indicates that the number of local parliamentarians does not appear to affect the practice of mandatory disclosure within financial statements of Indonesian local governments. The results of both multiple regression and backward regression show that local government budget expenditure (*LogBudex*) (coercive insider) has an unexpected directionality of the prediction sign, therefore hypothesis 1 is rejected. Similarly, number of internal auditors (*NumIA*) (normative insider) has no significant effect of the level of GCI, therefore hypothesis 6 is rejected.

Both mimetic variables namely Java/non-Java jurisdiction (*Javanon*) (mimetic outsider) and presence of an assistance and training programme (*Assprog*) (mimetic insider) have positive effects on the level of mandatory disclosure within local government financial statements. Local governments that are located in Java have a higher level of GCI than non-Java. Whilst this does not directly prove that non-Java local governments mimic their Java equivalents, it does highlight the potential to copy the higher GCI-style reporting. As shown in Appendix B, 35 non-Java local governments were involved in comparative studies with Java local governments. The results from the analysis highlight those non-Java local governments involved in the studies provides better quality financial statements than those local

governments not participating in comparative studies. Although there are some limitations with the Appendix B analysis, it does provide further evidence that non-Java local governments do in fact mimic Java local governments. In addition, local governments that have an assistance and training programme facilitated by the Financial and Development Supervisory Agency (BPKP) have higher levels of GCI than those not adopting the assistance and training programme. Such programmes seem to make a positive difference. The findings support the acceptance of hypothesis 3 (Java/non-Java jurisdiction) and hypothesis 4 (presence of an assistance and training programme).

The regression analysis also reveals that the proportion of non-supporting parties (*Nonsup*) (normative outsider) has a positive effect on the extent of GCI. This means that the greater the number of local parliamentarians who are independent of the local governments executive the higher the level of GCI.

Findings for the control variables indicate that age of local government is an important factor associated with mandatory disclosure in Indonesian local government financial statements (Table 6.8). This result supports the findings of some prior studies such as Owusu-Ansah and Yeoh (2005); Akhtaruddin (2005); Suhardjanto and Lesmana (2010). In particular, it is found in this thesis that older local governments tend to engage in higher levels of mandatory disclosure within financial statements. Furthermore, the level of the Human Development Index (*HDI*) is significant and positive in its association with mandatory disclosure practices (Table 6.8). This finding supports the result of Salter (1998). The finding in this thesis also indicates that the level of financial independence (*Findep*) is another predictor of the level of mandatory disclosure practices in Indonesian local governments (Table 6.8). This finding is consistent with some prior studies such as Ingram (1984); Falkman and Tagesson (2008); Suhardjanto and Lesmana (2010). In particular, Indonesian local governments which have a higher financial independence score tend to engage in more mandatory disclosure practices than those less financial independent. Whereas, the variable that measures

surplus/deficit of local government (*Surdef*) lacks statistical significance within Indonesian mandatory disclosure practices (Table 6.8). The number of audit findings (*Audfind*) does not directly explain the mandatory disclosure practices in light of institutional theory due to unexpected directionality (Table 6.8). The finding does not support Martani and Lestiani (2012) study that there is a negative influence between the level of audit findings (*Audfind*) and the level of mandatory disclosure. Finally, the type of local government (*Mundis*) also influences the mandatory disclosure practices (Table 6.8). This result is consistent with a prior study that was conducted in an Indonesian local government context by Martani and Lestiani (2012).

6.6 Summary

This study examines the effect of institutional factors focusing on coercive, mimetic, and normative pressures on mandatory disclosure within financial statements of local governments in Indonesia. These institutional factors have been widely used to examine compliance practices in organisations (see Carpenter and Feroz 2001; Delmas and Toffel 2004; and Verbruggen, Christiaens and Milis 2011). Accordingly, this study uses these as a basis to test factors impacting on compliance levels of mandatory disclosure in Indonesian local government's financial statements. In addition, this thesis uses an outsider-insider research lens to note any aspects from outside and inside an organisation that potentially affect the level of mandatory disclosure within financial statements of Indonesian local governments. As the key focus, six hypotheses were proposed to identify the potential institutional factors which affect the level of mandatory disclosure within financial statements of local governments in Indonesia. These six hypotheses include: H1: Number of local parliamentarians (*Numpar*) (coercive outsider), H2: Local government budget expenditure (log) (*LogBudex*) (coercive insider), H3: Java/non-Java jurisdiction (*Javanon*) (mimetic outsider), H4: Presence of an assistance and training programme (*Assprog*) (mimetic insider), H5: Proportion of non-supporting parties (*Nonsup*) (normative outsider), and H6: Number of internal auditors (*NumIA*) (normative insider). The multivariate statistical analysis reveal that the overall model is highly significant (p-value=0.000 and F statistics=6.830).

The results of this study reveal that mimetic pressure is the most dominant institutional factor affecting the level of mandatory disclosure in Indonesia since both hypotheses H3: Java/non-Java jurisdiction (*Javanon*) (mimetic outsider) and H4: Presence of an assistance and training programme (*Assprog*) (mimetic insider) are accepted. Both mimetic variables have a very strong influence on the level of mandatory disclosure (p-value=0.001 for Java/non-Java jurisdiction (*Javanon*), and p-value=0.000 for the presence of an assistance and training programme (*Assprog*)). This seems to indicate the potential for and actual impact of mimicking copying behaviour. Local governments which are located in areas with likely better facilities, and those governments who have utilised the assistance and training programme provide more mandatory disclosure.

This highlights that H5: Proportion of non-supporting parties (*Nonsup*) (normative outsider) is also accepted (p-value=0.047). Indicating that higher proportion of political parties in local parliament that are independent of the chief of local government selected are associated with a higher level of mandatory disclosure.

However, the results of the statistical tests cannot show the effect of coercive pressures (outsider-insider) on the level of mandatory disclosure within financial statements of Indonesian local governments. The statistical analysis reveals that the pressure from local parliamentarians (H1) (coercive outsider) does not appear to affect the level of mandatory disclosure in Indonesian local governments. The pressure from local government budget expenditure (log) (H2) (coercive insider) does not seem to affect the level of mandatory disclosure in Indonesian local governments due to unexpected directionality (analysis reveals a negative directionality instead of the hypothesised positive directionality).

The pressure from the number of internal auditors (H6) (normative insider) also does not affect the level of mandatory disclosure in Indonesian local governments.

For the control variables, four out of the six variables may be additional drivers influencing the extent of mandatory disclosure. Specifically, age of local government (*Age*), level of Human Development Index (*HDI*), and level of financial independence (*Findep*) have positive and statistically significant impacts on the level of mandatory disclosure. Older local governments are found to be associated with a higher level of mandatory disclosure. A higher score of Human Development Index (*HDI*) results in increased mandatory disclosure. A higher score of local government financial independence is also associated with a higher level of mandatory disclosure. In addition, type of local government (*Mundis*) has a negative and statistically significant impact on the extent of mandatory disclosure. Meanwhile, number of audit findings (*Audfind*) is found to have unexpected directionality, therefore is not included as a directionally-linked predictor variable for the extent of mandatory disclosure within financial statements of Indonesian local governments.

The next chapter reports further analysis of the predictor variables to be associated with the seven major categories of GCI.

Key conclusions, implications of these results, reviews of these findings in relation to past studies, and the ability of institutional theory to help explain mandatory disclosures by Indonesian local government authorities are then detailed in Chapter 8.

Chapter 7

Additional Analysis

7.1 Introduction

Chapter 6 details the statistical findings of the association between the main dependent variable, the extent of Government Compliance Index (GCI), and the independent and control predictor variables. This chapter reports the results on additional analysis of the predictor variables associated with the seven major categories of GCI (fiscal policy, macroeconomics, local budget target, financial performance, accounting policy, financial statement items, and non-financial information). The purpose of this chapter is to explore in greater depth the relationship between various components of the GCI Index with the independent and control predictor variables.

7.2 Additional Analysis of Seven Major Categories of GCI

A series of Ordinary Least Square (OLS) regressions are conducted to examine the potential factors that influence local government disclosures within the seven major categories that make up the overall GCI. The seven component categories of GCI are separately regressed against the predictor variables, which include number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), Java/non-Java jurisdiction (*Javanon*), presence of an assistance and training programme (*Assprog*), proportion of non-supporting parties (*Nonsup*), number of internal auditors (*NumIA*), age of local government (*Age*), level of Human Development Index (*HDI*), surplus/deficit of local government (*Surdef*), level of financial independence (*Findep*), number of audit findings (*Audfind*), and type of local government (*Mundis*). The new dependent variables in these additional tests are the disclosure score of each of the seven categories of GCI including: *Fiscal Policy* (GCIFp) which comprises five items, *Macroeconomics* (GCIME) which has five items, *Local Budget Target* (GCILBt) with four items, *Financial Performance* (GCIFCp) has eight items, *Accounting Policy* (GCIAp) with its thirteen items, *Financial Statement Items* (GCIFSi) which is composed of the highest number being fourteen items, and lastly *Non-Financial Information*

(GCINFi) with its eight items (see the complete list of these items in Table 5.2).

The purpose of this additional analysis is, first, to examine whether the results are consistent with the main regression result in Section 6.5, and second, to glean a greater understanding of the extent to which local governments comply with various key aspects of the GCI-measured rules and what factors influence the communication of these GCI categories. Further sub-sections individually discuss the result of multiple regression and backward regression analyses for each of the GCI categories. The related backward regression analyses can be found in Appendix J.

An estimate of the new regression equation model regarding these additional elements is as follows:

$$\begin{aligned} \text{Categories of GCI} = & \beta_0 + \beta_1 \text{Numpar} + \beta_2 \text{LogBudex} + \beta_3 \text{Javanon} + \beta_4 \text{Assprog} + \beta_5 \text{Nonsup} + \\ & \beta_6 \text{NumIA} + \beta_7 \text{Age} + \beta_8 \text{HDI} + \beta_9 \text{Surdef} + \beta_{10} \text{Findep} + \beta_{11} \text{Audfind} \\ & + \beta_{12} \text{Mundis} + \end{aligned}$$

Where:

Dependent variables:

Categories of *GCI* = information on fiscal policy, or information on macroeconomics, or information on local budget target, or information on financial performance or information on accounting policy, or information on financial statement items, or information on non-financial information.

Independent variables:

Numpar = number of local parliamentarians
LogBudex = local government budget expenditure (logged to reduce skewness)
Javanon = Java/non-Java jurisdiction
Assprog = presence of an assistance and training programme
Nonsup = proportion of non-supporting parties
NumIA = number of internal auditors

Control variables:

Age = age of local government
HDI = level of Human Development Index
Surdef = surplus/deficit of local government
Findep = level of financial independence
Audfind = number of audit findings
Mundis = municipality/district (type of local government)
 β_0 = intercept
 ϵ = error term

Seven new regressions are thus presented in this chapter to better explain communication influences upon the seven categories of GCI (see Table 7.1).

The highest correlations for GCIFp, GCIMe, GCILBt, GCIFCp, GCIAp, GCIFSi, and GCINFi remains less than 0.8 (see Appendix H, Tables H.1 and H.2). Accordingly, there is no perceived problem of multicollinearity between the independent and control variables in these additional regression models. Similarly the various statistical assumptions (as discussed for the main regression model in Section 6.3) for all seven of the additional regressions are analysed with the conclusion that they all meet these assumptions.

7.3 Multiple Regression Results: Seven Categories of GCI

This section presents the results of multiple regression analyses for the seven categories of the Government Compliance Index (GCI). Table 7.1 summarises the results of the multiple regression analyses for the dependent variables of *Fiscal Policy* (GCIFp), *Macroeconomics* (GCIMe), *Local Budget Target* (GCILBt), *Financial Performance* (GCIFCp), *Accounting Policy* (GCIAp), *Financial Statement Items* (GCIFSi), and *Non-Financial Information* (GCINFi) (the full regression results can be found in Appendix K).

7.3.1 Number of Local Parliamentarians (*Numpar*)

Table 7.1 shows that the coercive outsider variable, number of local parliamentarians (*Numpar*) is not a statistically significant predictor for any of the seven GCI categories. This result is consistent with the statistical result of the main regression analysis as reported in the preceding chapter in particular regarding to the coercive outsider variable (*Numpar*). This result appears to be impacted by the enactment of UU No. 27 of 2009 (see Appendix L) which effectively reduced the authority of the supervisory function performed by local parliament. Therefore even though there has been an increase in the legislator numbers this has not influenced the level of disclosure for any of the GCI categories. Further discussion about the decreasing role of the Indonesian parliament is conducted in Section 8.3.2.1.

Table 7.1: Multiple Regressions Analyses of Seven GCI Categories

Variables	Variable Types	Prediction	P - Value						
			<i>GCIFp</i>	<i>GCIMe</i>	<i>GCILBt</i>	<i>GCIFCp</i>	<i>GCIAp</i>	<i>GCIFSi</i>	<i>GCINFi</i>
(Constant)			.181	.083	.001	.037	.122	.227	.158
<i>Numpar</i> (H1)	COV	+	.176	.413	.448	.586	.503	.619	.308
<i>LogBudex</i> (H2)	CIV	+	.181	.032** ^Δ	.001*** ^Δ	.025** ^Δ	.368	.731	.079* ^Δ
<i>Javanon</i> (H3)	MOV	+/-	.019**	.000***	.141	.079*	.650	.306	.220
<i>Assprog</i> (H4)	MIV	+/-	.037**	.045**	.043**	.056*	.014**	.344	.008***
<i>Nonsup</i> (H5)	NOV	+	.437	.407	.589	.047**	.199	.620	.227
<i>NumIA</i> (H6)	NIV	+	.348	.784	.727	.666	.753	.430	.695
Control Variables									
<i>Age</i>	CV	+	.316	.501	.498	.084*	.314	.371	.218
<i>HDI</i>	CV	+	.053*	.013**	.055*	.052*	.564	.833	.054*
<i>Surdef</i>	CV	+/-	.669	.121	.070*	.665	.791	.185	.412
<i>Findep</i>	CV	+	.479	.725	.161	.002***	.594	.416	.076*
<i>Audfind</i>	CV	-	.575	.072* ^Δ	.841	.878	.087* ^Δ	.430	.026** ^Δ
<i>Mundis</i>	CV	+/-	.308	.420	.082*	.053*	.597	.521	.536

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. (n=200). ^Δ Unexpected directionality.

Legend: *GCIFp*=Government Compliance Index Fiscal Policy, *GCIMe*=Government Compliance Index Macroeconomics, *GCILBt*=Government Compliance Index Local Budget Target, *GCIFCp*=Government Compliance Index Financial Performance, *GCIAp*=Government Compliance Index Accounting Policy, *GCIFSi*=Government Compliance Index Financial Statement Items, *GCINFi*=Government Compliance Index Non-Financial Information, COV=Coercive Outsider Variable, CIV=Coercive Insider Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, NIV=Normative Insider Variable, CV=Control Variable, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

7.3.2 Local Government Budget Expenditure (log) (*LogBudex*)

As depicted in Table 7.1, the coercive insider variable, local government budget expenditure (log) (*LogBudex*) is not statistically significant for three GCI categories including Government Compliance Index – Fiscal Policy (GCIFp) (p-value=0.181); Government Compliance Index – Accounting Policy (GCIAp) (p-value=0.368); and Government Compliance Index – Financial Statement Items (GCIFSi) (p-value=0.731). Conversely there is a statistically significant but unexpected negative directionality for four GCI categories including Macroeconomics (GCIMe) (p-value=0.032); Local Budget Target (GCILBt) (p-value=0.001); Financial Performance (GCIFCp) (p-value=0.025); and Non-Financial Information (GCINFi) (p-value=0.079) (see Appendix K for more detailed regression results).

Chapter 6 highlighted that H2 was rejected due to the unexpected directionality, with this additional analysis highlighting that this is due to four of the seven GCI categories. The negative directionality of GCI Macroeconomics means that the greater the local government budget expenditure the lower the communication on macroeconomic information in local government financial statements or vice versa. Where the estimation of budget revenue does not meet the budget expenditure, the motivation to disclose information of macroeconomics within local governments' financial statements is low. The most likely cause for the unexpected directionality of GCI Local Budget Target is that few local governments fully implement the principles of budgetary discipline. The unexpected directionality of Local government budget expenditure (log) (*LogBudex*) is also rejected as a predictor variable for GCIFCp because the financial performance measurement programme which has been planned for in local governments' budget is not implemented optimally. Local government budget expenditure (log) (*LogBudex*) is also rejected as a predictor for GCINFi due to the unexpected directionality and is most likely because the accounting improvement programme in particular of non-financial statements disclosure based on accounting standards, that has been proposed in local governments' budget is not optimally implemented. Several local

governments did not seem to implement the program although it has been proposed in their local budgets.

The rejection of Local government budget expenditure (log) (*LogBudex*) as a predictor of the GCI categories of Fiscal Policy (GCIFp) and Financial Statement Items (GCIFSi) appear to be due to the fact that many local governments do not exercise consideration of their budget expenditure. The local government budget expenditure (log) (*LogBudex*) is also not a statistically significant predictor for the GCI category of Accounting Policy (GCIAp), possibly due to the fact that many local governments assume that accounting policies are very important for an organisation and therefore communications are carefully considered so as not to affect the public perception.

Overall, these regression results are consistent with the main regression analysis which rejects the coercive insider variable (local government budget expenditure (log) (*LogBudex*) as a predictor for the extent of GCI. However, the additional analysis does highlight that the statistically significant but unexpected directionality of the three GCI categories of Fiscal Policy (GCIFp), Financial Statement Items (GCIFSi), and Accounting Policy (GCIAp), are the cause for rejecting H2 (see Table 7.1).

7.3.3 Java/Non-Java Jurisdiction (*Javanon*)

The mimetic outsider variable (Java/non-Java jurisdiction (*Javanon*)) is statistically significant for the three GCI categories of Fiscal Policy (GCIFp) (p-value=0.019); Macroeconomics (GCIMe) (p-value=0.000); and Financial Performance (GCIFCp) (p-value=0.079). It is not statistically significant for the four GCI categories of Local Budget Target (GCILBt), Accounting Policy (GCIAp), Financial Statement Items (GCIFSi), and Non-Financial Information (GCINFi). The finding that only three of the seven categories are statistically significant is important given that Chapter 6 found that Java/non-Java jurisdiction was statistically significant and supported the acceptance of H3.

As discussed in Chapter 6, the statistical significance of Fiscal Policy (GCIFp), Java/non-Java jurisdiction (*Javanon*) does not prove that non-Java

governments mimic their Java counterparts but it does reflect that Java local governments work more effectively than non-Java, which in turn encourages non-Java local governments to mimic these practices.

Java/non-Java jurisdiction (*Javanon*) is a statistically highly significant predictor (positive, p -value=0.000) for the GCI category of Macroeconomics (GCIMe). This is perhaps not surprising as Java local governments are supported by more complete facilities and technology infrastructure.

Java/non-Java jurisdiction (*Javanon*) is not accepted as a predictor of the GCI category of Local Budget Target (GCILBt) (p -value=0.141). This is likely due to the fact that several Java and non-Java local governments still implement the traditional budgetary systems in their budgeting process. This causes a less than optimal budget target than that proposed in the budget, so that the information of local budget target is less communicated by local governments within financial statements.

For GCI Financial Performance (GCIFCp), Java/non-Java jurisdiction (*Javanon*) pressures may work well (positive, p -value=0.079) because local governments which are located in the jurisdiction with better facilities tend to have better financial performance, so that the information on financial performance within financial statements tend to be better than those with inadequate facilities.

The GCI Accounting Policy (GCIAp), Java/non-Java jurisdiction (*Javanon*) is rejected as a predictor (p -value=0.650) as the accounting policy applied to each local government differs from one another, preventing any mimicking behaviour.

Java/non-Java jurisdiction (*Javanon*) is rejected as a predictor of the GCI category of Financial Statement Items (GCIFSi). This result reflects the fact that the two areas of jurisdiction (Java/non-Java local governments) properly communicate financial statement items and negates the need for mimicking behaviour. This is supported by the results of Table 5.2 which shows that GCIFSi score is 91.70% (the highest score from the seven GCI categories).

Table 7.1 also reveals that Java/non-Java jurisdiction (*Javanon*) is not accepted as a predictor of Non-Financial Information (GCINFi). This is most likely caused by the fact that the communication of non-financial information within financial statements in both Java and non-Java local governments is low. It can be seen from Table 5.2 that the score of Non-Financial Information (GCINFi) is only 44.70% (the lowest score from the seven GCI categories).

7.3.4 Presence of an Assistance and Training Programme (*Assprog*)

As can be seen in Table 7.1 the mimetic insider variable namely presence of an assistance and training programme (*Assprog*) is the most dominant predictor of the extent of GCI categories. This variable is statistically significant for all GCI categories except the GCI category of Financial Statement Items (GCIFSi).

The underlying reason for the significance of the six GCI categories of Fiscal Policy (positive, p-value=0.037), Macroeconomics (positive, p-value=0.045), Local Budget Targets (positive, p-value=0.043), Financial Performance (positive, p-value=0.056), Accounting Policy (positive, p-value=0.014), and Non-Financial Information (positive, p-value=0.008) is that there are clear assistance and training programs to support these functions and it is clear that the majority of local governments mimic the materials provided.

Conversely, for Government Compliance Index - Financial Statement Items (GCIFSi), the mimetic insider variable (presence of an assistance and training programme (*Assprog*)) is rejected due to the fact that the information of financial statement items has been highly communicated (91.70%) in Java/non-Java local governments (see Table 5.2), thus they obviate the need for mimicking behaviour.

7.3.5 Proportion of Non-Supporting Parties (*Nonsup*)

Table 7.1 shows that the normative outsider variable (proportion of non-supporting parties (*Nonsup*)) is accepted as a predictor for only one GCI category namely Financial Performance (GCIFCp) but is rejected as a predictor for six other GCI categories including Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Local Budget Target (GCILBt), Accounting Policy

(GCIAp), Financial Statement Items (GCIFSi), and Non-Financial Information (GCINFi).

This result is perhaps a little surprising given that the results in Chapter 6 found the normative outsider variable (proportion of non-supporting parties (*Nonsup*)) to be a significant predictor. However, it can be argued that the proportion of non-supporting parties (*Nonsup*) is a significant predictor (p-value=0.047) because the proportion of non-supporting parties as a measure of opposition parties is very concerned about local government performance measurement as a means of control and accountability and provides sufficient pressure on local governments to enhance the disclosure of financial performance information (GCIFCp).

7.3.6 Number of Internal Auditors (*NumIA*)

As depicted in Table 7.1, the normative insider variable (number of internal auditors (*NumIA*)) is not statistically significant for all seven GCI categories which is consistent with the results from Chapter 6. Insufficient numbers and the low level of expertise and professionalism of internal auditors are possible reasons for the lack of influence on any of the GCI categories.

7.3.7 Control Variables

For Government Compliance Index – Financial Performance (GCIFCp), age of local government (*Age*) is statistically moderately significant (positive, p-value=0.084), a result consistent with Chapter 6. This indicates that older local governments tend to have better disclosure of financial performance information in their financial statements than new local governments. This may be because older local governments more quickly adapt to changes and have a better ability to be innovative to achieve an optimal government financial performance. However, age of local government (*Age*) is not accepted as a predictor of the extent of six other GCI categories including Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Local Budget Target (GCILBt), Accounting Policy (GCIAp), Financial Statement Items (GCIFSi) and Non-Financial Information (GCINFi).

Human Development Index (*HDI*) is accepted as a predictor for five GCI categories including Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Local Budget Target (GCILBt), Financial Performance (GCIFCp), and Non-Financial Information (GCINFi) (p-value= 0.053; 0.013; 0.055; 0.052 and 0.054 respectively). These results support the main analysis in Chapter 6 that *HDI* is a predictor of the GCI. Local governments with better life expectancy, level of education, and standards of living tend to have citizens who are critical of the local government executive performance. This encourages the demand for mandatory disclosure practices within local government financial statements. However, *HDI* is not statistically significant for two GCI categories namely Accounting Policy (GCIAp) and Financial Statement Items (GCIFSi).

Table 7.1 reveals that surplus/deficit of local government (*Surdef*) is accepted as a predictor for Local Budget Target (GCILBt) (p-value=0.070), a result which is consistent with the main analysis in Chapter 6. This may be due to information that the local budget target is closely related to factors which cause surplus/deficit of local government budget. However, surplus/deficit of local government is not accepted as a predictor for the six other GCI categories including Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Financial Performance (GCIFCp), Accounting Policy (GCIAp), Financial Statement Items (GCIFSi), and Non-Financial Information (GCINFi). Furthermore, this finding also shows that financial independence (*Findep*) is statistically significant for Financial Performance (GCIFCp) and Non-Financial Performance (GCINFi) (p-value=0.002 and 0.076 respectively), which is consistent with the results of Chapter 6. Local government with high financial independence tends to communicate information better on financial performance and non financial information. Meanwhile, financial independence (*Findep*) lacks statistical significance within Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Local Budget Target (GCILBt), Accounting Policy (GCIAp) and Financial Statement Items (GCIFSi).

As can be seen in Table 7.1, number of audit findings (*Audfind*) has an unexpected directionality, which is also consistent with Chapter 6 results, for

the GCI categories of Macroeconomics (GCIMe) (p-value=0.072), Accounting Policy (GCIAp) (p-value=0.087) and Non-Financial Information (GCINFi) (p-value=0.026) (Appendix K shows the regression results in more detail). Accordingly, number of audit findings (*Audfind*) is rejected for these three GCI categories. In addition, number of audit findings (*Audfind*) is not statistically significant for four other GCI categories namely Fiscal Policy (GCIFp), Local Budget Target (GCILBt), Financial Performance (GCIFCp) and Financial Statement Items (GCIFSi). Therefore, it can be concluded that number of audit findings does not influence any of the seven GCI categories.

As presented, Table 7.1 shows that municipality/district (*Mundis*) is accepted as a predictor of two GCI categories, Local Budget Target (GCILBt) (p-value=0.082) and Financial Performance (GCIFCp) (p-value=0.053). This result is consistent with the main regression in Chapter 6 and is a reflection of municipalities having stronger economic factors which are supported by better infrastructure and facilities. These support the achievement of local budget targets and improvements in financial performance providing municipalities with more motivation to be transparent in disclosing their local budget target and financial performance. However, the results reveal that municipality/district (*Mundis*) is rejected for five other categories of GCI including Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Accounting Policy (GCIAp), Financial Statement Items (GSIFSi), and Non-Financial Information (GCINFi).

7.4 Summary

Overall, Chapter 7 adds depth to our understanding of mandatory disclosure practices of Indonesian local governments by examining the potential determinants of the seven categories of information within the GCI. The results shown in Table 7.1 indicate that the mimetic outsider variable (Java/non-Java jurisdiction (*Javanon*)) positively and significantly influences mandatory disclosure of Fiscal Policy (GCIFp), Macroeconomics (GCIMe), and Financial Performance (GCIFCp). This is consistent with the results of the main regression presented in Chapter 6 which finds that local governments that are located in Java potentially have higher mandatory

disclosures than non-Java local governments. Local governments which have less facilities thus have the potential to imitate the better disclosure practices of local governments with more complete facilities and if local governments were to mimic such behaviour there would be an improvement in the quality of mandatory disclosure practices within their financial statements. This supports the view of mimetic isomorphism that an organisation is influenced (or can be influenced) by a broad scope of organisations, where organisations affect each other through the process of adoption or institutionalisation. DiMaggio and Powell (1983) refer to this as a process of imitation or mimetic adoption of an organisation amongst other organisations.

The results also reveal that the presence of an assistance and training programme (*Assprog*) (mimetic insider variable) positively and significantly affects almost all GCI categories except Financial Statement Items (GCIFSi). This is consistent with the main regression results, which report that local governments that follow a special assistance and training programme that is facilitated by the Financial and Development Supervisory Agency (BPKP) tend to have higher mandatory disclosure practices. The copying process of the assistance and training programme material facilitated by BPKP is also a type of local government institutionalisation process through mimetic adoption affecting the level of mandatory disclosure in local governments.

The results further reveal that the proportion of non-supporting parties (*Nonsup*) (normative outsider variable) positively and significantly influences mandatory disclosure of Financial Performance (GCIFCp). Again, this result is consistent with the main regression, which reports that a higher proportion of non-supporting parties in local parliament increases the extent of mandatory disclosure practices within financial statements of Indonesian local governments. Non-supporting parties may better reflect the groups who will criticize local government policies that have no benefit to society. Therefore, executive of local government is required to be professional in conducting public service and developing local government. This is consistent with the concept of normative isomorphism where an organisation

adopts other organisations' practices due to the demands of professionalism (Donaldson 1995). Yet, the influence of non-supporting parties only seems related to the financial performance category (GCIFCp). Perhaps, these non-supporting parties need to broaden the scope of their critical analysis.

For control variables, it can be seen in Table 7.1 that the Human Development Index (*HDI*) is the most dominant factor that may be chosen as an additional driver in determining the extent of mandatory disclosure. In addition, Financial Independence (*Findep*) and type of local government (Municipality/District) (*Mundis*) can also be considered as additional drivers for determining the predictor of GCI.

In summary, the analysis of key categories of GCI reveals that the mimetic pressure works effectively in providing a platform for influencing most categories of GCI in Indonesian local governments. The mimetic insider variable (Presence of an Assistance and Training Programme (*Assprog*)) is the strongest predictor of six GCI categories (Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Local Budget Target (GCILBt), Financial Performance (GCIFCp), Accounting Policy (GCIAp), and Non-Financial Information (GCINFi)). In addition, the mimetic outsider variable (Java/non-Java jurisdiction (*Javanon*)) is the second strongest predictor of three GCI categories (Fiscal Policy (GCIFp), Macroeconomics (GCIMe), and Financial Performance (GCIFCp)). Furthermore, the regression results also reveal that the normative outsider variable (Non-Supporting Parties (*Nonsup*)) is a predictor variable with only one category namely Financial Performance (GCIFCp).

The next chapter offers a summary of the entire thesis. It provides the main conclusions, key contributions and implications of the thesis findings and advances future research suggestions.

Chapter 8

Implications and Conclusions

8.1 Introduction

This thesis investigates the practice of mandatory disclosure within financial statements of Indonesian local governments in their 2010 annual reports. Using an institutional theory framework, a conceptual model is developed and tested empirically against key predictor variables based on three key components of institutional theory: coercive, mimetic and normative including an additional outsider-insider perspective. This final chapter offers the concluding remarks of this thesis, highlights the key findings, puts forward theoretical and practical implications, and offers future research suggestions.

This chapter is organized as follows. The research objectives and research questions are restated in Section 8.2. Significant findings and implications are presented in Section 8.3. Section 8.4 highlights the thesis contribution, followed by future research directions proposed in Section 8.5. Finally, Section 8.6 summarises the key contributions of this thesis.

8.2 Overview of Thesis

This thesis investigates Indonesian local government financial statements, especially in relation to its mandatory disclosure practices. This is important because Indonesia has recently undergone major government financial reform and is seeking to greatly enforce its financial accounting transparency (Rosser 2009). The level of mandatory disclosure in this thesis is measured using a 57 item index (Government Compliance Index=GCI) derived from the key Indonesian Government Accounting Standards (PP No. 24 of 2005) to explore in greater depth the relationship between mandatory disclosures (as measured by GCI) and key predictor variables both outside and inside these institutions.

As detailed in Chapter 1, the specific research questions addressed in this thesis are as follows:

- 1) To what extent do local governments in Indonesia implement the mandatory disclosure requirements in their financial statements?
- 2) What factors help explain the level of mandatory disclosure in Indonesian local government financial statements?

Financial data utilized in this thesis is obtained from the annual reports of a large sample of 200 Indonesian local governments for the year ending 31st December 2010. Other needed data such as the number of local parliamentarians, age of local government, and Human Development Index (*HDI*) are obtained from the website of each Indonesian local government, data regarding local budget expenditures are obtained from the Supreme Audit Board (Badan Pemeriksa Keuangan=BPK) database, the number and proportion of minority parties are obtained from the Indonesian General Election Commission (Komisi Pemilihan Umum=KPU), and the number of internal auditors are obtained from the database of Financial and Development Supervisory Agency (Badan Pengawasan Keuangan dan Pembangunan=BPKP).

The growing importance of studies on mandatory disclosure in government entities arises as a result of public sector reform. In regard to government reforms, Tolbert and Zucker (1983, 25) state that “the rapid institutionalism of the reform rested on the assumed isomorphism between it and the ideal rational bureaucratic form”. Institutional theory considers roles in society and the way they act to comply with societal norms. Institutional theory suggests that “organisations pursue legitimacy by conforming to isomorphic pressures in their environment” (Ashworth, Boyne and Delbridge 2007, 1).

Isomorphism describes the process of the homogenization of an organisation within a given environment (DiMaggio and Powell 1983). Therefore, isomorphism “is a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions” (DiMaggio and Powell 1983, 149).

There are three main mechanisms of isomorphism underlying the tendency for an organisation to become isomorphic in its use of practices such as

mandatory disclosure practices. These can exist even in spite of a number of differences in technologies between organisations (DiMaggio and Powell 1983). The mechanisms are: (1) coercive: which stem from political influence and legitimacy, (2) mimetic: which is an entity's copying response to uncertainty, and (3) normative: which is associated with professionalism.

The theory has been used in numerous studies (see Flack and Ryan 2003; Falkman and Tagesson 2008; Collin *et al.* 2008; Appari, Johnson and Antony 2009; Stamatiadis and Eriotis 2011; Doshi, Dowell and Toffel 2013).

This thesis investigates the practices of mandatory disclosure in Indonesian local governments within an institutional theory framework. Based on the explanation of the three types of institutional factors, this thesis develops a model that is expected to help explain the factors affecting the level of mandatory disclosure within financial statements of Indonesian local governments. As an additional contribution to the accounting literature the model adds an outsider-insider research perspective, which considers the aspects and pressures from both outside and inside local government. The outsider-insider research approach has been widely used in previous organisational research (see Lievens, Hoye and Anseel 2007; Hunker and Probst 2008; Mattila 2009; Gioia *et al.* 2010; Cui, Jo and Na 2012) but rarely in the accounting institutional theory literature. This multi-focused approach will hopefully provide management with better knowledge in understanding the strengths of an organisation and allow them to adapt policies to achieve a more optimal result (Homburg and Bucerius 2006).

This thesis proposes six main hypotheses to test whether these independent variables influence the level of mandatory disclosure within financial statements of Indonesian local governments; H1: Number of local parliamentarians (*Numpar*) (coercive outsider), H2: Local government budget expenditure (log) (*LogBudex*) (coercive insider), H3: Java/non-Java jurisdiction (*Javanon*) (mimetic outsider), H4: Presence of an assistance and training programme (*Assprog*) (mimetic insider), H5: Proportion of non-supporting parties (*Nonsup*) (normative outsider), and H6: Number of internal auditors (*NumIA*) (normative insider) (see Table 3.6). This thesis also tests

six control variables that may help further explain the extent of mandatory disclosure in the Indonesian context. These six control variables include age of local government (*Age*), level of Human Development Index (*HDI*), surplus/deficit of local government (*Surdef*), level of financial independence (*Findep*), number of audit findings (*Audfind*), and type of local government (municipality/district) (*Mundis*).

With a focus on the Indonesian local government's context, the next section summarizes the key findings of this thesis and highlights implications in both the theoretical and practical realms.

8.3 Summary of Key Findings

This thesis advances valuable findings relating to the practice of mandatory disclosure within financial statements of Indonesian local governments. Table 8.1 provides a summarized list of the major findings for the two Research Questions, followed by a more in-depth discussion of the explanatory factors of mandatory disclosure.

Table 8.1: Summary of Research Findings

Research Questions	Findings
To what extent do local governments in Indonesia implement the mandatory disclosure requirements in their financial statements?	<p>Thesis findings indicate that the overall mandatory disclosure (as measured by the Government Compliance Index (GCI)) is 69.60% (see Table 5.1). On average nearly seven of every ten mandated disclosures are provided by Indonesian local governments.</p> <p>Within the GCI themes, the disclosure results for the seven key categories of mandatory disclosures are as follows:</p> <ul style="list-style-type: none"> • Three categories demonstrate high levels of compliance: <ul style="list-style-type: none"> ○ Government Compliance Index - Financial Statement Items (GCIFSi): 91.70%, ○ Government Compliance Index - Accounting Policy (GCIAp): 83.20%, and

	<ul style="list-style-type: none"> ○ Government Compliance Index - Fiscal Policy (GCIFp): 80.20% (see Table 5.2). ● Whereas the other four categories of GCI all have below 60% compliance levels: <ul style="list-style-type: none"> ○ Government Compliance Index - Financial Performance (GCIFCp): 51.40%, ○ Government Compliance Index - Macroeconomics (GCIMe): 49.10%, ○ Government Compliance Index - Local Budget Target (GCILBt): 48.20%, and ○ Government Compliance Index - Non-Financial Information (GCINFi): 44.70% (see Table 5.2).
<p>What factors help explain the level of mandatory disclosure in local government financial statements?</p>	<p>For the overall Government Compliance Index (GCI), the main predictors are:</p> <ul style="list-style-type: none"> ● Statistically significant with positive associations: <ul style="list-style-type: none"> ○ Java/non-Java jurisdiction (mimetic outsider), ○ Presence of an assistance and training programme (mimetic insider), ○ Proportion of non-supporting parties (normative outsider) (see Table 6.8). Specifically, the statistical testing of the six hypotheses reveals: <p>H1 (Number of Local Parliamentarians) is rejected.</p> <p>H2 (Local Government Budget Expenditure) is rejected due to unexpected negative directionality.</p> <p>H3 (Java/Non-Java Jurisdiction) is supported.</p> <p>H4 (Presence of an Assistance and Training Programme) is supported.</p> <p>H5 (Proportion of Non-Supporting Parties) is supported.</p> <p>H6 (Number of Internal Auditors) is rejected.</p>

	<ul style="list-style-type: none"> • For the control variables: <ul style="list-style-type: none"> ○ Age of local government (<i>Age</i>), level of Human Development Index (<i>HDI</i>), and level of financial independence (<i>Findep</i>) have a positive association with the extent of GCI. ○ The number of audit findings (<i>Audfind</i>) and municipality/district (<i>Mundis</i>) are rejected due to unexpected directionality. The predicted sign of <i>Audfind</i> is negative, but the statistical analysis result reveals a positive directionality. Whereas, <i>Mundis</i> (municipality/district classification has a positive prediction sign, but the statistical analysis result shows negative directionality) (see Table 6.8).
<p>Statistically significant predictors for seven categories of GCI.</p>	<p>Additional multiple regression analysis is provided for the seven categories of the Government Compliance Index (GCI).</p> <p>For the Government Compliance Index - Fiscal Policy (GCIFp), the statistical predictors are:</p> <ul style="list-style-type: none"> • Significant positive associations: Java/non-Java jurisdiction (<i>Javanon</i>), presence of an assistance and training programme (<i>Assprog</i>), and level of Human Development Index (<i>HDI</i>) (Tables 7.1 and K.1). <p>For the Government Compliance Index Macro-economics (GCIMe), the statistical predictors are:</p> <ul style="list-style-type: none"> • Significant positive associations: Java/non-Java jurisdiction (<i>Javanon</i>), presence of an assistance and training programme (<i>Assprog</i>), and level of Human Development Index (<i>HDI</i>) (Tables 7.1 and K.1). <p>For the Government Compliance Index - Local Budget Target (GCILBt), the statistical predictors are:</p> <ul style="list-style-type: none"> • Significant positive associations: Presence of an assistance and training programme (<i>Assprog</i>), and level of Human Development Index (<i>HDI</i>),

	<ul style="list-style-type: none"> • Significant negative associations: Surplus/deficit of local government (<i>Surdef</i>), and Municipality/district (<i>Mundis</i>) (Tables 7.1 and K.1). <p>For the Government Compliance Index - Financial Performance (GCIFCp), the statistical predictors are:</p> <ul style="list-style-type: none"> • Significant positive associations: Java/non-Java jurisdiction (<i>Javanon</i>), presence of an assistance and training programme (<i>Assprog</i>), proportion of non-supporting parties (<i>Nonsup</i>), age of local government (<i>Age</i>), level of Human Development Index (<i>HDI</i>), and level of financial independence (<i>Findep</i>), • Significant negative association: Municipality /district (<i>Mundis</i>) (Tables 7.1 and K.2). <p>For the Government Compliance Index – Accounting Policy (GCIAp), the main predictors are:</p> <ul style="list-style-type: none"> • Significant positive association: Presence of an assistance and training programme (<i>Assprog</i>) (Tables 7.1 and K.2). <p>For the Government Compliance Index – Financial Statement Items (GCIFSi), the main predictors are:</p> <ul style="list-style-type: none"> • None of the predictor variables affect the level of GCIFSi (Tables 7.1 and K.3). <p>For the Government Compliance Index – Non-Financial Information (GCINFi), the main predictors are:</p> <ul style="list-style-type: none"> • Significant positive associations: Presence of an assistance and training programme (<i>Assprog</i>), level of Human Development Index (<i>HDI</i>), and level of financial independence (<i>Findep</i>) (Tables 7.1 and K.3).
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The following sub-sections provide a more detailed discussion of the findings for the two research questions.

8.3.1 The Extent of Mandatory Disclosure

Using an unweighted disclosure scoring method for mandatory disclosure items, the answer for Research Question 1 *'To what extent do local governments in Indonesia implement the mandatory disclosure requirements in their financial statements?'* is discussed below in more detail. The evidence reported in Table 5.1 and Table 5.2 reveal that in aggregate, the level of mandatory disclosure by Indonesian local governments (n=200) is arguably moderate (with a mean of 69.60% with a large variation of disclosure of each item ranging from 13.50% to 99.50%).

As a point of reference, this 69.60% average mandatory disclosure score is higher than most prior studies on government entity settings such as Robbins and Austin (1986) in the USA (57.31%, 27 items); Herawaty and Hoque (2007) in Australia (58.0%, with 47 items); Palmer (2008) in Australia (36.0%, with 53 items); Bakar and Saleh (2011) in Malaysia (45.90%, with 155 items); Stamatiadis and Eriotis (2011) in Greece (50.53%, with 16 items); Tagesson, Klugman, Ekstrom (2011) in Sweden (43.60%, with 22 items). This indicates that Indonesian local governments have higher mandatory disclosure practices than certain government institutions in other countries.

However, the average score of the practice of mandatory disclosure of this study is lower than some other previous studies on various business organisations such as Wallace and Naser (1995) in Hong Kong (73%, with 142 items); Owusu-Ansah (1998) in Zimbabwe (75.0%, with 214 items); Glaum and Street (2003) in Germany (84.0%, with 153 items); Ali, Ahmed and Henry (2004) in India, Pakistan and Bangladesh (80%, with 131 items); Hasan, Karim and Quayes (2008) in Bangladesh (85%, with 57 items). Overall, it is impossible to make a completely direct comparison, given that every study whether government or business organisation focused, measures the extent of mandatory disclosure differently.

Nevertheless, it can be seen from these previous studies that typically government entities have relatively lower levels of mandatory disclosure practices. This is probably due to the absence of shareholder pressure groups as in business entities. In a business organisation, shareholder

groups exert strong market-based pressure to influence management decisions (Karpoff 1998). In the context of institutional theory, shareholder pressure can be considered as a coercive outsider pressure which potentially affects the level of mandatory disclosure. Such a pressure point is absent in a local government public sector context.

In connection with these research results, there are several possible reasons to explain why the extent of mandatory disclosure (GCI) in Indonesian local governments is only at a moderate level (69.60%). Given the mandatory nature of these disclosures, why is there not 100% compliance?. First, the lack of effective regulation and law enforcement by the Indonesian central government may contribute to lower levels of information transparency, especially mandatory disclosure practices. For example, when an Indonesian local government fails to provide financial statements or is late in providing such information, then the Indonesian Ministry of Finance in theory imposes sanctions by withholding 25% of the monthly general allocation fund (Dana Alokasi Umum=DAU)⁵³ (as per PP No. 65 of 2010 on Local Financial Information System). However, in reality, common practice is that the DAU will be given immediately back to the local government after submitting the report no matter how late. Therefore, there is no real enforced deadline. This sanction does not provide strong pressure on local governments for better practices. From the perspective of institutional theory, sanctions from a higher government institution are considered as a coercive outsider pressure. In this case, the coercive outsider pressure does not seem to be working properly, therefore the motivation of local governments to undertake mandatory disclosure practice decreases.

Second, as of 2010, Indonesia has had 188 new local governments since the issuance of UU No. 22 of 1999 (see again Table 5.7). These local governments are inexperienced and new to the process of preparing annual reports for a wide range of stakeholders and thus, they may have a tendency

⁵³ General Allocation Fund (Dana Alokasi Umum=DAU) is a fund that is allocated to local governments in each year as a form of development funds. DAU is a component of state expenditure, and becomes one of the components of revenue in the local government budget. The purpose of the DAU is the equalization of financial capacity to support the needs of local governments in the implementation of decentralization.

to more narrowly report as mandated and on a more limited basis. The result can be lower mandatory disclosure practices. In this case, the institutional counter pressure within local government in the form of copying practices of other organisations that have been more successful in preparing their financial reports (mimetic insider pressure) as a reaction to the face of uncertainty may enhance communication.

Third, the issue of low professionalism of local government leaders (normative pressure) is also a possible reason for the moderate level of GCI reporting. Local governments which have a lower proportion of non-supporting parties in local parliament tend to have low financial supervision from the local parliament. This potentially decreases the mandatory disclosure practices in local government.

8.3.2 Reflexion on Hypotheses Testing

By using the framework of institutional isomorphism theory and an outsider-insider research approach, this thesis hypothesizes that the extent of mandatory disclosure within financial statements of Indonesian local governments is influenced by certain factors including the number of local parliamentarians (coercive outsider), local government budget expenditure (log) (coercive insider), Java/non-Java jurisdiction (mimetic outsider), presence of an assistance and training programme (mimetic insider), proportion of non-supporting parties (normative outsider), and number of internal auditors (normative insider). The following section discusses and analyses the results advancing both theoretical and practical implications.

8.3.2.1. Number of Local Parliamentarians (H1)

This thesis finds no statistically significant association between the number of local parliamentarians and the extent of mandatory disclosure within financial statements of Indonesian local governments (Table 6.8). The finding in this thesis is similar to a study by Marfiana and Kurniasih (2013) who failed to find a significant relationship between the number of local parliamentarians and the extent of disclosure in Indonesian local governments. However, there are a number of studies that report a significant association between these two

variables such as Suhardjanto and Yulianingtyas (2011) in Indonesian local governments, and Tagesson, Klugman and Ekstrom (2011) in Swedish municipalities. These studies suggest that size of organisation including the local parliament is a strong proxy to explain the level of mandatory disclosure. This is consistent with the mindset that the number of local parliamentarians affects the quality of financial statements including mandatory disclosure practices (see Schick 2002).

Local parliament as the representative body of the people in local government arguably has an important role in achieving good governance (Werimon 2005). The role is embodied in three functions, namely legislation, budgeting, and control (Santoso 2011). The rejection of H1 may be related to the implementation of these three functions. Authors have stated that the Indonesian local parliament has many problems in implementing these three functions, thus the role of local parliament needs to be better optimized (Santoso 2011). Barriers to successful legislative functions of parliament are possibly caused by lack of; human capacity, technical mastery in legal drafting, willpower, and coordination, and inadequate infrastructure and facilities (Pradiningrum, Larasati, and Santosa 2013; Puspitorini 2012; Robinson 2006). Meanwhile, barriers in the budgeting function may be caused by the lack of budget experts (Arifin 2012). In addition, problems with the control function may be a result of inadequate human resources, a lack of commitment and motivation of local parliament members, and lack of response from local government executives. The weaknesses of these three legislative functions may result in the local parliament (coercive outsider) not having sufficient power or expertise to push local government executives to improve mandatory disclosure practices.

Another possibility that may cause the decline of coercive outsider pressure is the reduction of local parliament's authority. Since the enactment of UU No. 32 of 2004 which has been updated with UU No. 27 of 2009 (see Appendix L) the power of local parliament is diminished. Currently, the local parliament cannot dismiss the head of local government directly, although it has a right to propose to the Minister of Home Affairs through the governor to

dismiss the head of local government. This more convoluted condition potentially reduces the power of coercive outsider pressure causing the quality of supervision conducted by local parliament to decrease. This condition may reduce the coercive pressure upon the quality of local government financial statements including mandatory disclosure practices.

8.3.2.2. Local Government Budget Expenditure (H2)

The statistical findings of this study does not support the H2 hypothesis that local government budget expenditure is a predictor for the extent of mandatory disclosure practices due to unexpected directionality (the results reveals a negative directionality instead of the hypothesized positive directionality), therefore H2 is rejected. Contrary to expectations, if the budget expenditure is high, then the mandatory disclosure practices are low for Indonesian local governments. The finding of this thesis is similar to Martani and Lestiani (2012) who fails to find a significant relationship between the budget expenditure and the extent of mandatory disclosure. However, there are several studies that report a significant association between these two variables such as Ingram (1984); Gore (2004); and Puspita and Martani (2012). These studies suggest that higher costs are required to produce complete information in the financial statements.

There are some possible reasons for this unexpected result. First, it may be that the level of local budget expenditure is not optimal, especially in relation to programmes for financial statements quality improvement. Budget allocation for any financial statement improvement programme in the fiscal year of 2010 may be disproportionate to the benefits obtained, and this can lead to wasteful spending. In this situation, the coercive pressure which could arise by the power of the size of the local government budget expenditure (pressure from inside the organisation) does not necessarily affect local government's communication practices of mandatory disclosure in the financial statements. Second, it may be because the budgetary discipline principles have not been fully implemented by local governments. Lubis (2011) divides the budgetary discipline into three types including budget planning, budget execution and budget accountability disciplines. If

budgetary discipline is not adhered to, this may lead to a decrease in the budget function as a tool of control (Dafflon 2010; Jones 2010). Both of these reasons may result in the coercive insider pressure not working efficiently. While the two predictor coercive variables examined in this study appear to have no influence on mandatory disclosures, this may be because there is insufficient scrutiny or incentives for local governments to report. Alternatively, there may be other coercive predictors of local government disclosure that have not been examined in this thesis.

8.3.2.3. Java/Non-Java Jurisdiction (H3)

This thesis generates evidence that local governments which are located in Java-based jurisdictions have higher mandatory disclosure practices than non-Java (see Tables 5.4 and 6.8), therefore, H3 is supported. This hypothesis deals with the potential of future copying behaviour by identifying clear and significant differences in GCI by jurisdiction. This implies that the more complete facilities and infrastructure of telecommunications, education and other facilities located on the large and more prosperous island of Java can positively influence the level of mandatory disclosure practices in some future period. This finding therefore supports the statement of Hoecht (2006) that disclosure of financial statements will be better in jurisdictions with such positive characteristics, therefore local governments with less facilities can mimic the communication of mandatory disclosure of local governments with more complete facilities.

Meanwhile, local governments with fewer facilities could mimic local governments with more complete facilities which seem to have better accounting practices in preparing financial statements and communicating mandatory disclosure. The data in the main chapters lend support for H3 in that differences in GCI clearly exist between Java and non-Java local governments. Thus, future mimicking behaviour is clearly possible. Whereas the Appendix B evidence provides more direct support for H3 in that it shows successful copying patterns for GCI items in a government supported comparative programme between Java and non-Java local governments. From an institutional theory perspective, there is an institutional ability (main

chapters evidence) and institutional examples for copying better mandatory disclosures (see Appendix B). In this case, the mimetic outsider pressure seems to work effectively, supporting the practice of mandatory disclosure.

8.3.2.4. Presence of an Assistance and Training Programme (H4)

The empirical evidence in this thesis provides statistical support for the H4 proposition that there is a positive association between the presence of an assistance and training programme⁵⁴ that is offered by the Financial and Development Supervisory Agency (Badan Pengawasan Keuangan dan Pembangunan=BPKP) and the extent of mandatory disclosure within financial statements in Indonesian local governments.

This finding is consistent with the mimetic isomorphism tenet that an organisation will imitate practices of other more successful organisations (see Frumkin and Galaskiewics 2004 and Choi 2011). The results could lead to better conditions and gain a higher level of legitimacy from society (Baker and Rennie 2006).

It can be argued that under the mimetic strand of institutional theory, local governments which follow an assistance and training programme of Financial Accounting System of Local Government (Sistem Akuntansi Keuangan Daerah=SAKD) facilitated by the BPKP will attempt to imitate materials provided in the programme. The goal of such mimetic behaviour is to enhance their quality of financial statements as well as mandatory disclosure practices.

Overall, the data clearly shows that in the context of Indonesian local governments, the presence of such an assistance and training programme relating to the implementation of SAKD helps assist local governments in improving their level of mandatory disclosure. Accordingly, the mimetic pressure in the form of copying/mimicking the materials of assistance and training programme as well as the SAKD training programme arising from

⁵⁴ As discussed in Section 3.5.2.2, the BPKP conducts an assistance and training programme relating to the implementation of Financial Accounting System of Local Government (SAKD). These programmes include the preparation of accounting policies, the preparation of accounting systems and procedures, and the preparation of financial statements based on government accounting standards.

inside local government (mimetic insider) has a very strong influence on the level of mandatory disclosure practices within financial statements of Indonesian local governments.

8.3.2.5. Proportion of Non-Supporting Parties (H5)

The fifth hypothesis in this thesis, H5 proposes a positive association between the proportion of non-supporting parties in local parliament and the extent of mandatory disclosure within financial statement of Indonesian local governments. The results reported in Table 6.8 reveal that there is a significant and positive association between the proportion of non-supporting parties and the extent of mandatory disclosure. Thus, H5 is supported. This result lends support to the findings of several studies, which have found a positive association between the proportion of non-supporting parties (minority parties) in local parliaments and the extent of mandatory disclosure such as Suhardjanto and Yulianingtyas (2011), Darmastuti and Setyaningrum (2012) in Indonesian local governments and Jacobs and Jones (2009) study in Australia. These prior studies reveal that the higher proportion of non-supporting parties increases the quality of supervision of the local government's executive that can result in increased quality of disclosure within financial statements.

The role of political parties in the election mechanism of Indonesian local government's leader is very strong (Banuaji, Widayati and Astuti 2013). If the composition of members of the local parliament is dominated by the majority parties, then the quality of supervision on local government executive may decrease due to problems of self-interest (Santoso 2011; Arifin 2012). This condition potentially negatively impacts the professional aspect of local government leaders. This is in line with the normative isomorphism tenet of institutional theory that professionalism can exert pressure on a local government to undertake mandatory disclosure practices. Accordingly, non-supporting parties is an institutional factor from outside local government (normative outsider) that exerts pressure upon local government entities regarding mandatory disclosure within financial statements of Indonesian local governments.

8.3.2.6. Number of Internal Auditors (H6)

Finally, this thesis finds no statistically significant association between the number of internal auditors in each local government and the extent of mandatory disclosure within financial statements of Indonesian local governments. This result is surprising because the role of internal auditors in Indonesian government agencies, including local governments, is expected to be influential in relation to the improvement of organisational performance, especially in terms of financial reporting (Badan Pengawasan Keuangan dan Pembangunan 2012).

There are three possible reasons for this surprising result, all reflecting that the quality of human resources is varied. Although there are many excellent internal auditor personnel, there are also many inexperienced auditors (Suseno 2010; Boediono 2012). Second, the distribution of internal auditors in Indonesian local governments is uneven. From the descriptive statistical analysis (see Chapter 5), it can be seen that there is a clear difference between the number of internal auditors in Java and non-Java local governments (see Table 5.6). Third, there is a lack of internal auditors in Indonesian government agencies including local governments (Suseno 2010). In a local government context, the lack of internal auditors is clear from the absence of internal auditors in several local governments in Indonesia. Appendix G reveals that in 2010, of the 200 local governments, 48 local governments (Java, 15 and non-Java, 33) have no internal auditors. The normative influence potentially caused by the internal auditors is considered a potential pressure from inside local government (normative insider). In this study, the pressure arising from the presence of internal auditors (normative insider) does not apparently have sufficient power, skills or motivation to push Indonesian local government to enhance their mandatory disclosure practices.

8.4 Key Contributions of this Thesis

The results of this thesis contribute to the accounting and public sector literature in a number of important ways. First, in light of limited research on mandatory local government disclosure practices in Indonesia or other countries, this thesis is one of the first known studies examining the mandatory disclosure practices in local government context using institutional theory tenets. Within the Indonesian setting, it is often posited that Indonesian local governments exhibit a lack of information transparency and accounting compliance (Setyadi *et al.* 2009). Nevertheless, there have been very few empirical studies providing evidence supporting or refuting this view. Therefore, the findings of this thesis are expected to be the basis for subsequent studies that examine key institutional factors. Such new insights can enhance our understanding concerning the quality of financial statements in the public sector including local government entities.

Second, the results of this study reveal that the coercive pressures, both from outside and inside local government, do not seem to affect the level of mandatory disclosure within financial statements of local governments in Indonesia. This finding can serve as input for the Indonesian government in formulating public policies by considering potential factors that are expected to increase the power of coercive pressure. An example could be creating more effective regulation that encourages such practices or implementing law enforcement more consistently. The lack of effective regulation and law enforcement likely contributes to the indifferent impact of coercive determinant variables used in this study regarding the level of mandatory disclosure in Indonesian local governments.

Third, the findings show that the mimetic pressures, both from outside and inside the local government could have very strong influence on the practice of mandatory disclosure in Indonesian local governments. This indicates that the culture to imitate other successful organisational practices and implement what is taught by professional agencies can be strong. This is particularly relevant in relation to the insider coercive variable of assistance and training programme where there is clear evidence that those local governments who

do use the programmes clearly mimic the materials and provide better disclosures. In addition, this provides evidence that the culture to mimic something better in order to increase legitimacy is embedded in Indonesian local governments. Such a finding highlights the need that giving an example of good practice or good performance is potentially a very effective way to get better results in implementing public policy in the Indonesian local government context.

Last, the findings indicate that normative pressures emanating from outside local governments (normative outsider) exhibit mixed success in positively influencing communication. The proportion of non-supporting parties as an outside normative pressure affects the level of mandatory disclosure within financial statements of Indonesian local governments. This finding should be considered by the Indonesian government in creating new regulations or revising old regulations on the mechanism of local elections, particularly with respect to the level of influence of various political parties in local parliament. Yet, the results of this study reveal that the normative insider pressure (*number of internal auditors*) does not seem to affect the level of mandatory disclosure. This final finding may provide input to the Indonesian government in setting up public policy relating to the provision of internal auditors for Indonesian local governments. Internal auditor quality improvement should be implemented to enhance the power of such a professionally-based normative insider pressure. One way forward would be to have a more equitable distribution of internal auditors across Indonesian local governments. Better training programmes to improve quality and implementing better performance measurements of internal auditors periodically are also needed.

8.5 Future Research Suggestions

The findings of this thesis and its inherent limitations point to some further research opportunities. First, this study limits its scope to a cross-sectional study for the year 2010. Future studies could extend this approach to a longitudinal analysis to better detect disclosure patterns of mandatory disclosure practices in Indonesian local governments over time.

Second, this thesis suggests that future studies could adopt alternative quantitative or qualitative methods such as interviews of senior local government officials or surveys to further explore the various influences and pressures relating to local government entities. A variety of such methods can explore in more depth the main motivations that drive the practice of mandatory disclosure.

Third, as noted in Section 1.5, this thesis focuses solely on financial statements to investigate the issue of mandatory disclosure practices within financial statements, yet, there are other communication mediums by which local governments can communicate information. Therefore, it is suggested that in the future, additional research could explore other disclosure channels such as website data or press releases, although the latter is not a common form of communication in Indonesia.

Fourth, to complement the findings of this thesis, further research needs to be pursued in other jurisdictions. For example other countries (both within Asia or more globally) could be scrutinised by adjusting the GCI measurement items to provide insightful comparative country analysis.

Fifth, future research could pursue other alternative institutional factors which potentially affect mandatory disclosure practices within government institutions or public sector entities. New and expanded measures of institutional factors (coercive, mimetic, and normative) could be created and the outsider-insider perspective could be expanded.

Finally, testing the potential link between the number or type of audit findings and mandatory disclosure communication could be further examined and might generate new insights.

8.6 Concluding Remarks

This study provides important insights regarding the issues of accounting compliance to government regulations in Indonesian local governments. This thesis is the first known that addresses the issues of mandatory disclosure practices by Indonesian local governments using institutional theory as a

theoretical framework. Another important strength of this thesis is the inclusion of an outsider-insider perspective in the determination of institutional factors that potentially affect the level of mandatory disclosure in the Indonesian local governments. This multi-focused approach should provide management with better knowledge in understanding positive influencing factors upon an organisation (local government) and allowing them to adapt disclosure policies to achieve a more optimal communication result.

The empirical findings of this thesis are potentially important for regulatory bodies, professional accounting bodies, local governments, central governments, and the users of local government financial statements. The findings can be applied to develop and improve public sector governance applications. In particular, these findings can serve as an input for public policy-making in better calibrating the implementation of PP No. 71 of 2010, to best obtain full implementation in all Indonesian government institutions by 2015.

These thesis findings can specifically be used as the basis for making law reform policy decisions, since Indonesia faces major problems in the field of law application including accounting rules enforcement. The approximately 30% level of non-compliance clearly indicates that regulatory bodies in Indonesia must apply more stringent law enforcement in order for local governments to better adhere to accounting rules and other mandatory communication items.

From a theoretical perspective, there is evidence to support the use of isomorphic institutional theory as a useful framework for explaining mandatory disclosures practices in government institutions or other public sector entities especially in regards to mimetic influences. In addition, the use of an additional outsider-insider research approach sharpens the analysis and our understanding to predict the level of mandatory disclosure.

Overall, the results of this thesis generate important insights about Indonesian local governments and support a call for continued research in this fascinating, yet under researched area.

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Appendix A

Soekarno's Reign

Soekarno became the first president of Indonesia in 1945. He was a leader of Indonesia's nationalist movement during the Dutch colonial era. Throughout his reign, Soekarno did not overly concern himself with economic or social problems. Instead he devoted his time to political posturing, playing games in international politics flirting in turn with the Soviets, the Chinese and the West (Wilson 2001). He verbally abused the West because he found this brought responses, not only from the West but also from the Soviets and Chinese. This balancing of opposition forces extended to internal politics. His avowed movement was called Nasakom, which stood for nationalism, religion and communism (Sutley 1988). He maintained close relations with the Communist Party of Indonesia (Partai Komunis Indonesia=PKI).

It is a cliché that Indonesian leaders are like a puppet master of the Indonesian shadow puppets⁵⁵, but in fact Indonesian culture strongly encourages this power role for leaders (Mujadi and Liddle 2010). For instance, Marshall Green, the U.S. ambassador to Indonesia from 1965 to 1968 states that Soekarno sought out U.S. Information Service libraries in Indonesia as targets for mobs that would burn their books. The pictures of these burnings would gain worldwide attention, particularly for Western and Socialist bloc leaders. Soekarno seemingly wanted Indonesia to appear to be at the centre of world events. But these games of manipulation ultimately would bring his downfall. Soekarno remained President of Indonesia until 1967 but his power was progressively diminished after disruptive events of 1965⁵⁶. From this review it can be concluded that the internal management of Soekarno's reign resulted in the role of many government agencies being less than optimal.

⁵⁵ Nurgiyantoro (2011) suggest that the 'dalang' (a puppet master) controls the story of the shadow puppet show as a whole. Indonesia leaders at Soekarno's era are likened as the 'dalang' that greatly influenced the course of the government.

⁵⁶ There was a rebellion of the Communist Party of Indonesia in 1965 (known as G30S PKI) and after this period, Soekarno's power as a president declined.

Appendix B

Comparative Study of Financial Statements Non-Java to Java Local Governments

In 2008-2010 there was an initiative by Indonesian government where non-Java local government were encouraged to mimic Java local government financial statements quality. This initiative provides support for mimetic isomorphism tenets. Table B.1 shows a number of non-Java local governments (n=35) which engaged in comparative links of financial statements to Java local governments. This initiative seems to arise from the management of certain non-Java local governments wanting to enhance their quality of financial statements. Section 3.5.2.1 in the main text has explained the criteria for Java local governments as the target of comparatives studies conducted by non-Java local governments such as the awarding of an unqualified opinion from BPK, having advanced information technology facilities, or having good administrative systems (see Jaya 2010).

Table B.1 shows the non-Java local governments (n=35) which conducted comparative study of financial administration to some Java local governments. The comparative activities were implemented during 2008-2010.

Table B.1: Non-Java Local Governments (n=35) Which Do Financial Comparative Study to Java Local Governments

No	Non-Java LG	GCI 2010	Comparative Partner (Java LG)	No	Non-Java LG	GCI 2010	Comparative Partner (Java LG)
1	Mandailing Natal**	80.7	Sragen	19	Jambi*	70.2	Tangerang
2	Mesuji**	78.9	Yogyakarta	20	Palembang*	64.9	Tangerang
3	Sarolangun**	78.9	Batu	21	Denpasar***	80.7	Pekalongan
4	Padang Pariaman**	77.2	Depok	22	Ambon***	86.0	Depok
5	Muara Enim*	59.6	Yogyakarta	23	Banjarmasin*	71.9	Tangerang
6	Mamuju*	68.4	Sragen	24	Samarinda**	75.4	Surabaya
7	Pinrang*	73.7	Purworejo	25	Makasar**	70.2	Sragen
8	Klungkung**	82.5	Sleman	26	Sabang**	73.7	Sumedang
9	Kolaka***	80.7	Situbondo	27	Dumai*	63.2	Bandung
10	Asahan*	73.7	Indramayu	28	Bukit Tinggi**	73.7	Yogyakarta
11	Musi Rawas*	63.2	Yogyakarta	29	Lubuk Linggau*	68.4	Yogyakarta
12	Tulang Bawang*	70.2	Bantul	30	Kupang*	54.4	Surabaya
13	Dompur*	75.4	Surakarta	31	Singkawang*	63.2	Surabaya
14	Kotawaringin Barat**	78.9	Tangerang	32	Palu*	57.9	Tangerang
15	Buton***	80.7	Garut	33	Prabumulih*	52.6	Surabaya
16	Poso*	73.7	Yogyakarta	34	Pare-Pare*	73.7	Surabaya
17	Maluku Tenggara*	75.4	Semarang	35	Bengkulu*	73.7	Ciamis
18	Banda Aceh*	78.9	Pasuruan				
					Non-Java (Involved) Average GCI score	72.13	

Legend: *one visit, **two visits, *** three visits.
LG: Local Government

Table B.2: Non-Java Local Governments Which Did Not Do Financial Comparative Study to Java Local Governments (n=65)

No	Local Government's Name	GCI 2010	No	Local Government's Name	GCI 2010
1	Aceh Tengah	63.2	34	Medan	71.9
2	Bengkulu Selatan	56.1	35	Temate	71.9
3	Pesisir Selatan	43.9	36	Pekanbaru	47.4
4	Lampung Selatan	77.2	37	Padang	80.7
5	Bangka Selatan	49.1	38	Bandar Lampung	70.2
6	Lombok Barat	54.4	39	Pangkal Pinang	77.2
7	Sumbawa Barat	54.4	40	Batam	78.9
8	Kepulauan Selayar	66.7	41	Mataram	52.6
9	Kapuas	63.2	42	Pontianak	63.2
10	Kutai Kartanegara	56.1	43	Palangkaraya	52.6
11	Ende	75.4	44	Gorontalo	63.2
12	Aceh Besar	52.6	45	Kendari	77.2
13	Aceh Selatan	56.1	46	Binjai	57.9
14	Aceh Singkil	47.4	47	Tebing Tinggi	49.1
15	Langkat	66.7	48	Sawah Lunto	66.7
16	Solok	47.4	49	Pagar Alam	64.9
17	Bintan	73.7	50	Metro	77.2
18	Gianyar	82.5	51	Tanjung Pinang	71.9
19	Sumba Tengah	45	52	Sungai Penuh	63.2
20	Pontianak	64.9	53	Bima	47.4
21	Nunukan	64.9	54	Sibolga	68.4
22	Bulukumba	56.1	55	Balikpapan	64.9
23	Tana Toraja	73.7	56	Tarakan	64.9
24	Bone	64.9	57	Palopo	59.6
25	Maros	73.7	58	Bau Bau	86
26	Maluku Tengah	73.7	59	Jaya Pura	70.2
27	Donggala	59.6	60	Sorong	40.4
28	Buol	71.9	61	Padang Sidempuan	70.2
29	Bima	50.9	62	Tanjung Balai	64.9
30	Mamasa	42.1	63	Padang Panjang	36.8
31	Seram Bagian Barat	50.9	64	Pariaman	63
32	Puncak Jaya	64.9	65	Payakumbuh	68.4
33	Pegunungan Bintang	47.4		Non-Java (Non-involved) Average GCI score	62.37

A t-test is used for the two groups between non-Java local governments who were involved in the comparative study and the non-Java local governments that were not involved in the comparative study. The question is whether the non-Java local governments have higher quality financial statements (measured by the GCI proxy) than those not involved. Did mimic behaviour have positive results? Table B.3 shows the results of the t-test.

Table B.3: The T-Test Results between Local Governments Which Do Comparative Study and Non-Comparative Study

	Mean	n	Std Dev	Min	Max
LG involved	72.13	35	8.13	52.6	86.0
LG non-involved	62.37	65	11.45	36.8	86.0
T-test p.value: 0.013**					

***significant at 1% level; **significant at 5% level; *significant at 10% level.

Legend: LG involved=non-Java local governments involved in the comparative programme; LG non-involved=non-Java local governments not involved in the comparative programme.

As can be seen in Table B.3⁵⁷, the results of t-test show that the probability value (p-value) is 0.013. This means that there is a statistically significant difference between the non-Java local governments which were involved in comparatives of financial statements to Java local government with other non-Java local governments that were not involved in the comparative study. Based on the Table B.3 statistical analysis, it is therefore suggested that non-Java local governments potentially mimic administrative practices of Java local governments, including the practice of mandatory disclosure within financial statements. This provides some evidence that mimetic outsider pressure seem to encourage non-Java local governments to enhance their quality of financial statements as measured by mandatory disclosure practices.

⁵⁷ There are some limitations to the Table B.3 analysis. It is not known whether the non-Java local governments that chose to become involved were fundamentally different from those that did not (earlier data not readily available). Therefore, true improvement cannot be clearly measured. The Appendix B data does provide an implication that mimics behaviour may (or potentially could) improve the quality of financial statements. Chapters 5 and 6 explore this issue in far greater depth.

Appendix C

Non-Response Bias

Non-response bias occurs when data is unable to be obtained for the research study (Lineback and Thompson 2010). The key issue of non-response bias is whether the non-respondent group fundamentally differs from the respondent group (Little and Vartivarian 2005). If the non-respondent group is fundamentally different from the respondent group, the interpretation of the results and the strength of the confidence in the interpretation can vary considerably. Although the non-response issue can greatly impact the results, such an issue does not always lead to bias or measurement errors (David, Stirling and Weldon 1998). Prior studies indicate that the extent of non-response problem can vary according to different types of research. For instance, Smith (2003) observes and concludes that a response rate of less than 25% is common among accounting research. Babbie (2010) argues that a response rate of at least 50% in analysis and reporting research is considered adequate while Singleton and Bruce (2005) quite pessimistically state that an acceptable rate of 85% for interview surveys is required.

As discussed in Section 4.3, of all 496 local governments in Indonesia, only 358 local governments submit the complete financial statements to BPK for the 2010 fiscal year. This thesis uses 200 financial statements of local governments that are collected for the period ending 31st December 2010.

From the total of 496 local governments, there are 358 local governments (72%) that are audited by BPK. It means that there is 28% non-response rate (local government with no availability of financial statements). This Appendix thus investigates whether there is a fundamental difference between the respondent group and non-respondent group in terms of known characteristics. A total of 200 local governments (40.3% of the population) are used as the sample frame of this research is labelled as the respondent group. Meanwhile, 100 local governments that are not audited by BPK (without financial statements) are used to be the non-respondent group. Given the considerable amount of local governments without financial

statements, an assessment of this issue - the non-response data is critical for interpreting the results of this thesis.

This thesis considers using three predictor variables namely local government budget expenditure (log) (*LogBudex*), number of local parliamentarians (*Numpar*), and level of Human Development Index (*HDI*) for conducting non-response bias test because these three types of data are continuous (enabling t-tests) and the availability level is higher than the other predictor variables.

Table C.1: T-Test of Respondent Group and Non-Respondent Group

Statistics	<i>LogBudex</i>	<i>Numpar</i>	<i>HDI</i>
Panel A: Local Governments in respondent group (n=200)			
Mean	11.96	38.35	72.18
Median	11.89	40.00	72.59
Standard Deviation	0.21	10.42	4.79
Minimum	11.37	20.00	47.37
Maximum	12.70	50.00	79.52
Panel B: Local Governments in non-respondent group (n=100)			
Mean	11.86	37.45	71.37
Median	11.81	40.00	71.33
Standard Deviation	0.25	8.83	2.35
Minimum	11.40	20.00	63.21
Maximum	12.90	50.00	76.46
T-tests (p-value)	0.309	0.459	0.115

Legend: Logbud is converted into logarithm to eliminate the skewness in the data.

***highly significant at 1% level, **signiicant at 5% level, *moderately significant at 10% level.

The t-test is used in providing preliminary evidence regarding non-response bias (see Table C.1). The results of the t-test show that the probability value (p-value) for each construct is > 0.05 (local government budget expenditure (*LogBudex*) 0.309; number of local parliamentarians (*Numpar*) 0.459; and level of Human Development Index (*HDI*) 0.115). This means that there is no significant difference between the respondent group and non-respondent group at least in relationship to the three independent characteristics examined. Accordingly, there is some evidence that the respondent and non-respondent group appear similar based on certain independent and external criteria.

Appendix D

Government Compliance Index (GCI)

The purpose of this thesis is to identify the level of mandatory accounting disclosures in Indonesian local government financial statements and the factors affecting that level. The Government Compliance Index (GCI) is created with an aim to measure the level of mandatory disclosure in local government financial statements. GCI consists of items that must be disclosed by Indonesian local governments. Therefore, the GCI is composed as a list of items based on key accounting rules that are deemed by the Indonesian government as appropriate, necessary and consistent with the transparency intentions placed upon the Indonesian local governments. In this thesis, the level of GCI is the key dependent variable; there are six independent variables analysed including the number of local parliamentarians (proxy for coercive outsider isomorphism); the local government budget expenditure (proxy for coercive insider isomorphism); Java/non-Java jurisdiction (proxy for mimetic outsider isomorphism); the presence of an assistance and training programme (proxy for mimetic insider isomorphism); the proportion of non-supporting parties (proxy for normative outsider isomorphism); and the number of internal auditors (proxy for normative insider isomorphism).

Indonesian Law (PP No. 24 of 2005) is the key accounting statute in Indonesia. This includes the Indonesian Government Accounting Standards (IGAS) consisting of eleven statements which in aggregate are the reference point for Indonesian governmental institutions in preparing their financial statements. These statements are called the Statements of Governmental Accounting Standards (Pernyataan Standar Akuntansi Pemerintahan: PSAP). These eleven PSAP are shown in Table D.1 as follows:

Table D.1 Statements of Governmental Accounting Standards (PSAP) Based on PP No. 24 of 2005

Standard's number	Statement
PSAP No.1	Presentation of Financial Statements
PSAP No.2	Budget Realization Report
PSAP No.3	Cash Flow Statement
PSAP No.4	Notes to the Financial Statements
PSAP No.5	Inventory Accounting
PSAP No.6	Investment Accounting
PSAP No.7	Fixed Asset Accounting
PSAP No.8	Construction in Progress Accounting
PSAP No.9	Accounting Obligations
PSAP No.10	Error Correction
PSAP No.11	Consolidated Financial Statements

The disclosure index used in this thesis, the GCI, is a derivative of these Indonesian Government Accounting Standards (PP No. 24 of 2005). The objectives of these standards are to organize the presentation and disclosures required in financial statements. The GCI is evolved from the relevant and appropriate elements of PP No. 24 of 2005.

There are several items contained within PP No. 24 of 2005 that are not included in the final GCI. These are eliminated for several reasons such as: some items are rarely applicable, other items are not appropriate at the local governments' level, and yet others are only voluntary (non-mandatory) disclosures. Table D.2 describes how the GCI is derived from the PP No. 24 of 2005 document.

Table D.2 Evolution of the Government Compliance Index (GCI)

All disclosure items in PP No. 24 of 2005	Items included in the final Government Compliance Index (GCI)	Explanation of inclusions and exclusions
<p>FISCAL POLICY (5 items)</p> <ol style="list-style-type: none"> 1. Important differences of position and financial condition of the current period of fiscal compared to the previous one. 2. Important differences of position and financial condition of the current period of fiscal compared to a budget. 3. The government policy regarding the increase of income. 4. The government policy regarding the efficiency on expense. 5. The government policy regarding the determination of the sources and uses of financing. 	<p>FISCAL POLICY (5 items)</p> <ol style="list-style-type: none"> 1. Important differences of position and financial condition of the current period of fiscal compared to the previous one. 2. Important differences of position and financial condition of the current period of fiscal compared to a budget. 3. The government policy regarding the increase of revenue. 4. The government policy regarding the efficiency on expense. 5. The government policy regarding the determination of the sources and uses of financing. 	<p>There are five items in IGAS in the 'Fiscal Policy' category. These five items are mandatory and are included in the GCI.</p>
<p>MACROECONOMICS (7 items)</p> <ol style="list-style-type: none"> 1. Information of economic growth. 2. Information of Gross Regional Domestic Product. 3. Information of the level of inflation. 4. Information of the rupiah exchange. 5. Information of the level of interest. 6. <i>Information of the price of oil.</i> 7. <i>Gross Domestic Product.</i> 	<p>MACROECONOMICS (5 items)</p> <ol style="list-style-type: none"> 1. Information of Gross Regional Domestic Product. 2. Information of economic growth. 3. Information of the level of inflation. 4. Information of the rupiah exchange rate. 5. Information of the level of interest. 	<p>There are seven items in IGAS in the Macroeconomics category. However, only five items are applicable to the local government level and these items only are included in the GCI.</p> <ul style="list-style-type: none"> • Item number 6 is excluded from the GCI because most Indonesian local

		<p>governments have only minimal issues with oil and gas.</p> <ul style="list-style-type: none"> Item number 7 is excluded from the GCI because Gross Domestic Product is a national scale measurement whereas the scope of this study is on Indonesian local governments.
<p>LOCAL BUDGET TARGET (4 items)</p> <ol style="list-style-type: none"> The explanation of the obstacles in achieving the budget targets. The explanation on the budget changes during the current period compared with the first budget approved by local parliament. The explanation of other problems that are considered important for the report reader regarding the local budget. The explanation of financial information that affects the implementation of the budget. 	<p>LOCAL BUDGET TARGET (4 items)</p> <ol style="list-style-type: none"> The explanation of the obstacles in achieving the budget targets. The explanation on the budget changes during the current period compared with the first budget approved by local parliament. The explanation of other problems that are considered important for the report reader regarding the local budget. The explanation of financial information that affects the implementation of the budget. 	<p>All four items in the 'Local Budget Target' category in IGAS are included into the GCI.</p>
<p>FINANCIAL PERFORMANCE (8 items)</p> <ol style="list-style-type: none"> The explanation of the realization and financial performance plan. The presentation of the information needed to understand the indicators, outcomes, and differences that exist with the plan. Comparing the achieved result with the stated purpose and initial plan. The explanation to confirm that the financial performance information is relevant and reliable. The presentation of strategies and resources used to achieve goals. 	<p>FINANCIAL PERFORMANCE (8 items)</p> <ol style="list-style-type: none"> The explanation of the realization and financial performance plan. The presentation of the information needed to understand the indicators, outcomes, and differences that exist with the plan. Comparing the achieved result with the stated purpose and initial plan. The explanation to confirm that the financial performance information is relevant and reliable. The presentation of strategies and resources used to achieve goals. 	<p>All eight items in the 'Financial Performance' category are included into the GCI.</p>

<p>6. The explanation of difficulties related with measurement and reporting of financial performance.</p> <p>7. The presentation of historical data relevant to the discussion on financial performance.</p> <p>8. The presentation of activities and plans to improve programme performance.</p>	<p>6. The explanation of difficulties related with measurement and reporting of financial performance.</p> <p>7. The presentation of historical data relevant to the discussion on financial performance.</p> <p>8. The presentation of activities and plans to improve programme performance.</p>	
<p>ACCOUNTING POLICY (27 items)</p> <ol style="list-style-type: none"> 1. The explanation of reporting entity. 2. The explanation of accounting basis underlying the preparation of financial statements. 3. The explanation of measurement basis used for financial statement formulation. 4. The presentation of the accounting policy on revenues. 5. The presentation of the accounting policy on expenditures. 6. The presentation of the accounting policy on financing activities. 7. The presentation of the accounting policy on cash. 8. The presentation of accounting policy on receivables. 9. The presentation of the accounting policy on inventories. 10. The presentation of accounting policies on investments. 11. The presentation of accounting policy on fixed assets. 12. The presentation of accounting policy on liabilities. 13. The presentation of accounting policy on equities. 14. <i>Changes in accounting policy that does not materially affect the current period but it will affect materially in the further years.</i> 15. <i>Disclosure of implemented accounting policies that is unregulated in the PP No. 24 of 2005.</i> 16. <i>Accounting policy on revenue recognition.</i> 17. <i>Accounting policy on expense recognition.</i> 18. <i>Accounting policy on the principals of consolidation report compilation.</i> 19. <i>Accounting policy on investment.</i> 20. <i>Recognition and amortization of tangible and intangible assets.</i> 	<p>ACCOUNTING POLICY (13 items)</p> <ol style="list-style-type: none"> 1. The explanation of reporting entity. 2. The explanation of the accounting basis underlying the preparation of financial statements. 3. The explanation of the measurement basis used for financial statement formulation. 4. The presentation of the accounting policy on revenues. 5. The presentation of the accounting policy on expenditures. 6. The presentation of the accounting policy on financing activities. 7. The presentation of the accounting policy on cash. 8. The presentation of accounting policy on receivables. 9. The presentation of the accounting policy on inventories. 10. The presentation of accounting policies on investments. 11. The presentation of accounting policy on fixed assets. 12. The presentation of accounting policy on liabilities. 13. The presentation of accounting policy on equities. 	<p>There are 27 items in IGAS in the 'Accounting Policy' category. However, only 13 items are mandatory and these items only are included in the GCI.</p> <ul style="list-style-type: none"> • Item number 14 is rarely applicable. Therefore it is considered less effective as a basic reference for disclosure of financial statements. Therefore they are excluded from the GCI. • Item numbers 15 to 27 are excluded from the GCI because they are non-mandatory (see PSAP No.4 paragraph 50).

<p>21. <i>Accounting policy on constructive contracts.</i></p> <p>22. <i>Accounting policy on the policy of expense capitalization.</i></p> <p>23. <i>Accounting policy on partnerships with third parties.</i></p> <p>24. <i>Accounting policy on the cost of research and development.</i></p> <p>25. <i>Accounting policy on the formulation of reserve fund.</i></p> <p>26. <i>Accounting policy on employment welfare fund.</i></p> <p>27. <i>Accounting policy on the explanation of foreign currency.</i></p>		
<p>FINANCIAL STATEMENT ITEMS (14 items)</p> <ol style="list-style-type: none"> 1. The disclosure of information on revenues. <i>(Including further details of the type of revenues).</i> 2. The disclosure of information on expenditures. <i>(Including presentation of expenditure classification by organisation and function).</i> 3. The disclosure of information on fixed assets. <i>(Including disclosures concerning construction in progress).</i> 4. The disclosure of information on investments. <i>(The amount of investment, the level of control, methods of assessment).</i> 5. The disclosure of information on cash flow. <i>(Classification of cash flows based on the operating activities, investing activities of non-financial assets, financing activities, and non-budgetary activities).</i> 6. The disclosure of information on cash and cash equivalents. 7. The disclosure of information on receivables. <i>(Explanation of tax and non-tax receivables).</i> 8. The disclosure of information on financing activities. 9. The disclosure of information on liabilities. <i>(Short-term liabilities and long term liabilities).</i> 10. The disclosure of information on equities. <i>(Including the description of equity of current fund, equity of investment fund, equity of reserved fund).</i> 11. The disclosure of information on transfers. 12. The disclosure of information on inventories. <i>(Explanation of condition and the use of inventories).</i> 	<p>FINANCIAL STATEMENT ITEMS (14 items)</p> <ol style="list-style-type: none"> 1. The disclosure of information on revenues. <i>(Including further details of the type of revenues).</i> 2. The disclosure of information on expenditures. <i>(Including presentation of expenditure classification by organisation and function).</i> 3. The disclosure of information on fixed assets. <i>(Including disclosures concerning construction in progress).</i> 4. The disclosure of information on investments. <i>(The amount of investment, the level of control, methods of assessment).</i> 5. The disclosure of information on cash flow. <i>(Classification of cash flows based on the operating activities, investing activities of non-financial assets, financing activities, and non-budgetary activities).</i> 6. The disclosure of information on cash and cash equivalents. 7. The disclosure of information on receivables. <i>(Explanation of tax and non-tax receivables).</i> 8. The disclosure of information on financing activities. 9. The disclosure of information on liabilities. <i>(Short-term liabilities and long term liabilities).</i> 10. The disclosure of information on equities. <i>(Including the description of equity of current fund, equity of investment fund, equity of reserved fund).</i> 11. The disclosure of information on transfers. 12. The disclosure of information on inventories. <i>(Explanation of condition and the use of inventories).</i> 	<p>All 14 items in the 'Financial Statement Items' category are included into GCI.</p>

<p>13. A description of the remaining budget financing (SILPA/SIKPA). 14. An explanation of the surplus/deficit.</p>	<p>13.A description of the remaining budget financing (SILPA/SIKPA). 14.An explanation of the surplus/deficit.</p>	
<p>NON FINANCIAL INFORMATION (10 items)</p> <ol style="list-style-type: none"> 1. The disclosure of the information on the domicile and entity form of law together with the jurisdiction of the existed entity. 2. The explanation on the nature of entity operation and its primary activity. 3. The explanation on the acts which become the basis of its operational activities. 4. The explanation on the replacement of governmental management during the current year. 5. The explanation on the mistakes of the previous management which has been corrected by the new management. 6. The explanation on the commitment or contingency which is not presented on balance sheet. 7. The explanation on the merger or the development of the ongoing year of the entity. 8. The disclosure of any matters which have social impacts. 9. <i>The disclosure of changes in accounting policies.</i> 10. <i>The disclosure of the information on consolidated financial statements.</i> 	<p>NON FINANCIAL INFORMATION (8 items)</p> <ol style="list-style-type: none"> 1. The disclosure of the information on the domicile and entity form of law together with the jurisdiction of the existed entity. 2. The explanation on the nature of entity operation and its primary activity. 3. The explanation on the acts which become the basis of its operational activities. 4. The explanation on the replacement of governmental management during the current year. 5. The explanation on the mistakes of the previous management which has been corrected by the new management. 6. The explanation on the commitment or contingency which is not presented on balance sheet. 7. The explanation on the merger or the development of the ongoing year of the entity. 8. The disclosure of any matters which have social impacts. 	<ul style="list-style-type: none"> • Again, eight items are included. This time in reference to the final 'Non-Financial Information' category. • Item No.9 is excluded from GCI because change of accounting policy at local government level is rare, therefore it is less effective as a basic reference for disclosure of financial statements. • Item No.10 is excluded as GCI because this item is not appropriate for local governments.
<p>SUMMARY OF CHANGES: There are 75 total items in PP No. 24 of 2005. However 18 items (discussed above) are excluded from the final GCI.</p>	<p>The Government Compliance Index (GCI) contains 57 relevant and mandatory items based on the mandatory PP No. 24 of 2005.</p>	<p>In the creation of the GCI 18 items are removed from the PP No. 24 of 2005 because they are not relevant and/or non-mandatory for Indonesian local government entities.</p>

Legend: shaded and italics items are excluded from the final Government Compliance Index (GCI).

The purpose of Appendix D is to explain how the GCI is formed. GCI is created from the items contained in PP.No. 24 of 2005 (Indonesian Government Accounting Standards). The final GCI is derived by analyzing each item to best determine inclusion/exclusion of the items of PP No. 24 of 2005 that best fits with the accounting compliance transparency conditions with the local governments of Indonesia. Only items that are suitable and applicable to the accounting expectations for the local government level are included in the GCI. GCI thus reflect key accounting rules of government accounting in particular relating to disclosure within the Indonesian local government financial statements. In summary, it is argued that the GCI is a relevant and valid proxy measure for Indonesian local government accounting compliance in this thesis.

Appendix E

Spearman Correlation between GCI and Predictor Variables

Pallant (2007) states that the Pearson correlation test is primarily designed for continuous data, whereas the Spearman correlation test is for ordinal data. This thesis has both continuous and ordinal data. Therefore, to enrich the main chapter results of the Pearson Correlation test which is conducted in Section 6.3, this thesis also performs tests of correlation using Spearman Correlation.

Table E.1 reveals the correlation matrix between the dependent variable (GCI) with independent variables (Number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), Java/non-Java jurisdiction (*Javanon*), presence of an assistance and training programme (*Assprog*), proportion of non-supporting parties (*Nonsup*), and number of internal auditors (*NumIA*), control variables (age of local government (*Age*), level of Human Development Index (*HDI*), surplus/deficit of local government (*Surdef*), level of financial independence (*Findep*), number of audit finding (*Audfind*), and type of local government (municipality/district) (*Mundis*) for Pearson correlations. The results indicate the following:

- Coefficient correlations provide initial support for Hypothesis 1 (H_1 : the number of local parliamentarians, $p < 0.01$), Hypothesis 3 (H_3 : Java/non-Java jurisdiction, $p < 0.01$), Hypothesis 4 (H_4 : presence of an assistance and training programme, $p < 0.01$).
- There are two control variables that have high association with GCI: age of local government (*Age*) (positive, Spearman: 0.206, $p < 0.01$) and level of financial independence (*Findep*) (Spearman: 0.270, $p < 0.01$).
- The highest correlation among the independent variables is between Local government budget expenditure (log) (*LogBudex*) and number of local parliamentarians (*Numpar*) (Spearman: 0.749, $p < 0.01$).

- The highest correlation among the control variables is between level of financial independence (*Findep*) and level of Human Development Index (*HDI*) (Spearman: 0.480, $p < 0.01$).

In summary, although there are slight differences, the overall results of this Spearman correlation test is very similar to the Pearson correlation test used in the main thesis.

Table E.1. Spearman Correlation Matrix: GCI

		DV	IV						CV					
	Variables	GCI	<i>Numpar</i>	<i>LogBudex</i>	<i>Javanon</i>	<i>Assprog</i>	<i>Nonsup</i>	<i>NumIA</i>	<i>Age</i>	<i>HDI</i>	<i>Surdef</i>	<i>Findep</i>	<i>Audfind</i>	<i>Mundis</i>
DV	<i>GCI</i>	1.000												
IV	<i>Numpar</i>	.228**	1.000											
	<i>LogBudex</i>	.109	.749**	1.000										
	<i>Javanon</i>	.328**	.638**	.489**	1.000									
	<i>Assprog</i>	.267**	.070	.174*	.010	1.000								
	<i>Nonsup</i>	.103	.217**	.149*	.107	.081	1.000							
	<i>NumIA</i>	.086	.283**	.260**	.170*	.009	.124	1.000						
CV	<i>Age</i>	.206**	.498**	.423**	.431**	-.053	.182*	.392**	1.000					
	<i>HDI</i>	.017	-.175*	-.022	-.102	.125	-.056	.040	.016	1.000				
	<i>Surdef</i>	-.059	-.008	-.089	.010	-.068	.065	-.255**	-.073	-.144*	1.000			
	<i>Findep</i>	.270**	.376**	.395**	.455**	.136	.031	.207**	.270**	.480**	-.158*	1.000		
	<i>Audfind</i>	-.038	-.173*	-.074	-.355	.066	-.111	-.073	-.229**	.036	.017	-.141*	1.000	
	<i>Mundis</i>	-.020	-.368**	-.260**	-.215**	.109	-.062	-.174*	-.164*	.714**	-.116	.376**	.141*	1.000

Legend: *Correlation is significant at the 0.05 level (2-tailed). **Correlation is significant at the 0.01 level (2-tailed). DV=Dependent Variable, IV=Independent Variables, CV=Control variables, *GCI*=Government Compliance Index, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=Surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Appendix F

Histograms of Variables Observed

Chapter 5 of the main text considers the descriptive analysis of the Government Compliance Index (GCI) and its predictor variables. Appendix F contains the histograms of the continuous independent variables (number of local parliamentarians, local government budget expenditure, proportion of non-supporting parties, and number of internal auditors) and continuous control variables (age of local government (*Age*), level of Human Development Index (*HDI*), level of financial independence (*Findep*), and number of audit findings (*Audfind*)). Figures F.1 to F.8 reveal the histograms of continuous variables utilized in this study.

Histograms can be defined as visual graphs indicating frequency of a range of data observed (Toolingu 2008). Histograms consist of a vertical axis and horizontal axis. The vertical axis presents the frequency of cases, while the horizontal axis indicates the midpoint of the value ranges in the data sample. Histogram is important graphical device for assessing normality of a variable. A normal distribution of data is generally a prerequisite for multiple regression analysis (Hair *et al.* 2006). The score of data should be reasonably normally distributed for the population especially the predictor variables.

Section 5.3 of the main text presents the descriptive statistics results of the four independent variables (number of local parliamentarians (*Numpar*), local government budget expenditure (log) (*LogBudex*), proportion of non-supporting parties (*Nonsup*), and number of internal auditors (*NumIA*)) and four control variables (age of local government (*Age*), level of Human Development Index (*HDI*), level of financial independence (*Findep*), and number of audit findings (*Audfind*)). Figures F.1 to F.8 below reveal the histograms of these continuous independent and control variables.

Figure F.1: Histogram of Number of Local Parliamentarians
(*Numpar*)

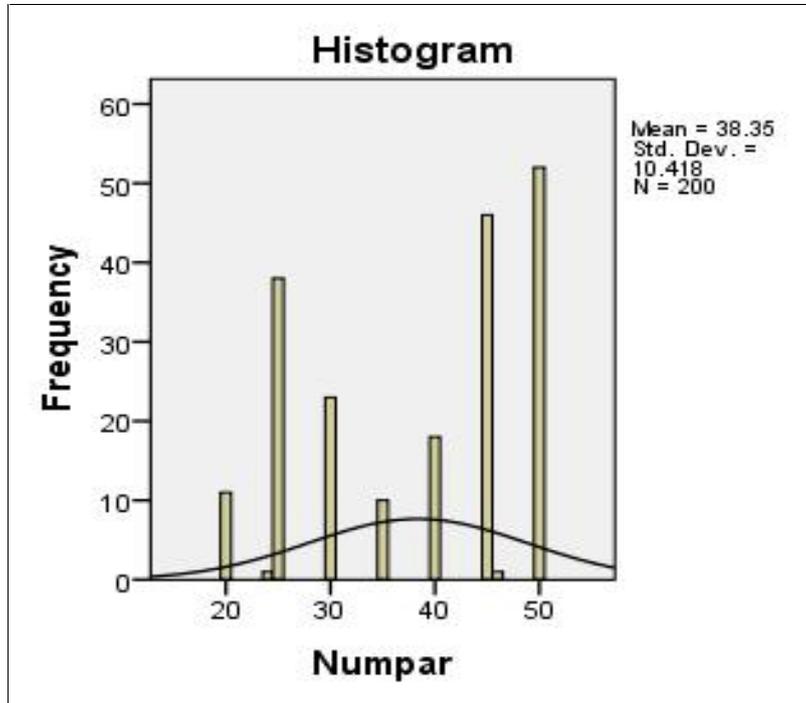


Figure F.2.a: Histogram of Local Government Budget Expenditure
(before transformed into logarithm)
(*Budex*)

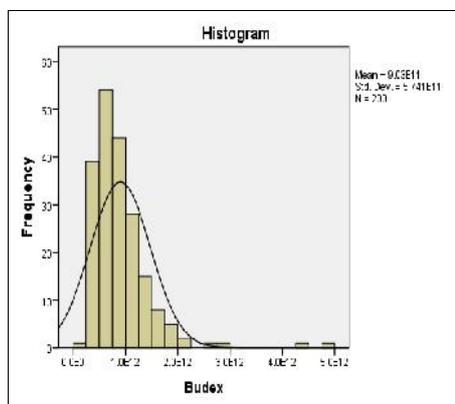


Figure F.2.b: Histogram of Local Government Budget Expenditure
(after transformed into logarithm)
(*LogBudex*)

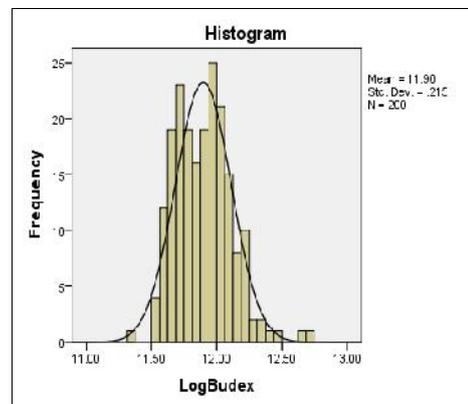


Figure F.3: Histogram of Proportion of Non-Supporting Parties (*Nonsup*)

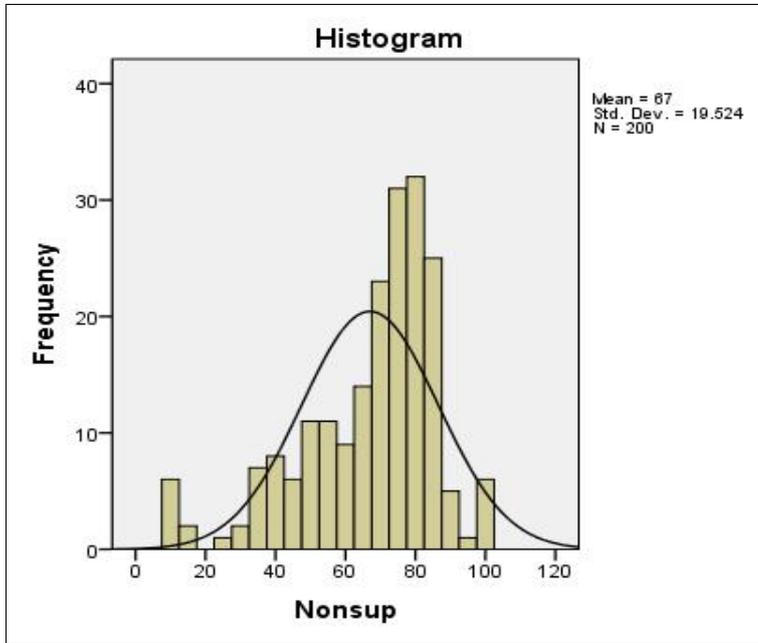


Figure F.4: Histogram of Number of Internal Auditors (*NumIA*)

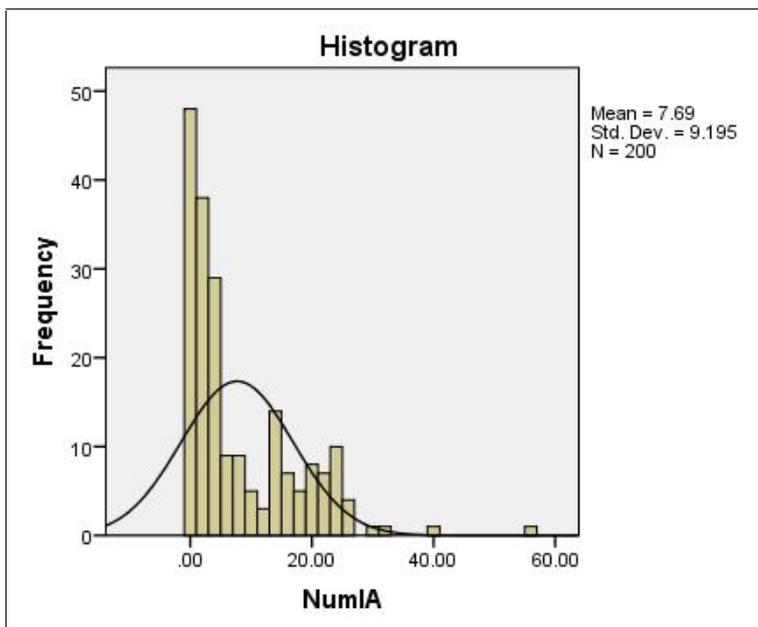


Figure F.5: Histogram of Age of Local Government (*Age*)

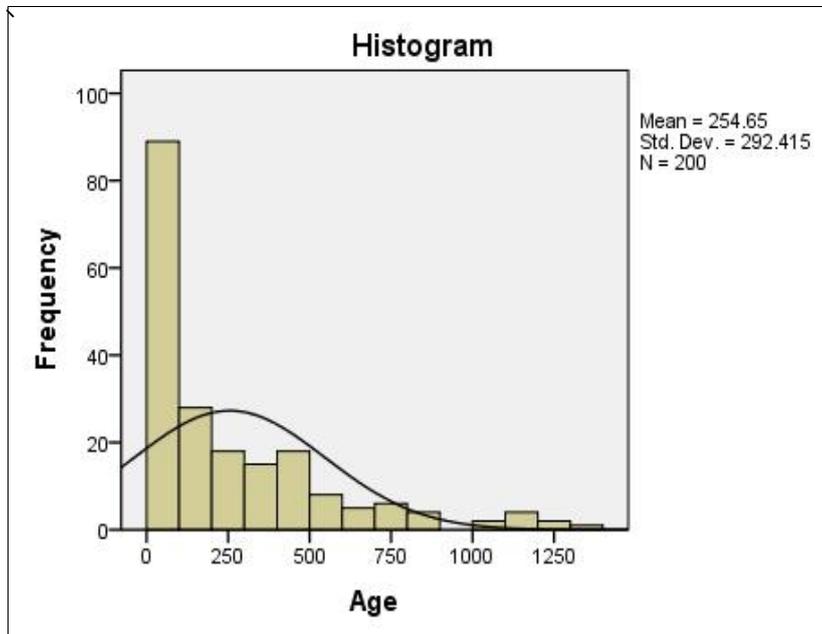


Figure F.6: Histogram of Level of Human Development Index (*HDI*)

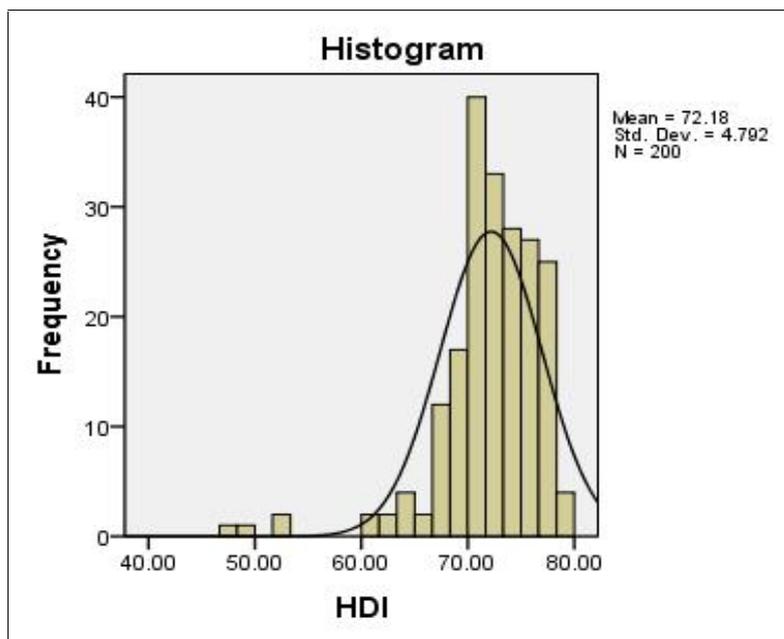


Figure F.7: Histogram of Level of Financial Independence (*Findep*)

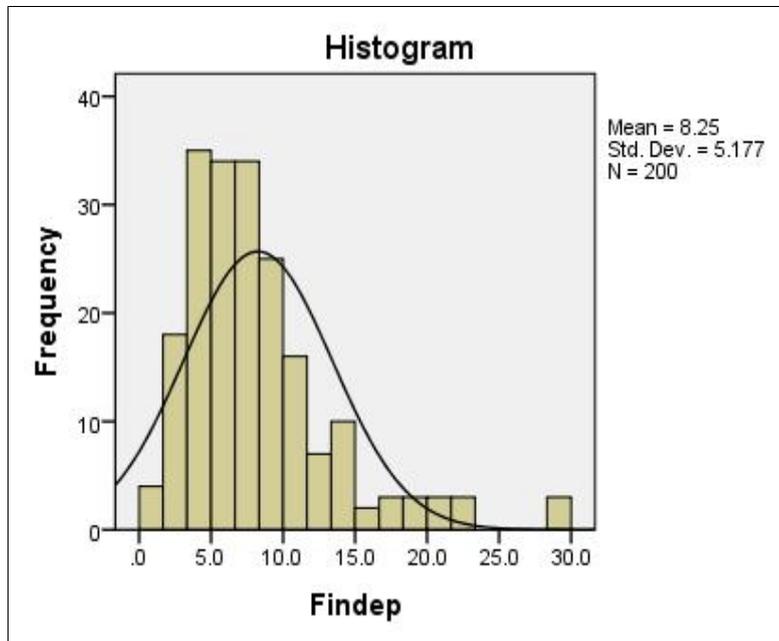
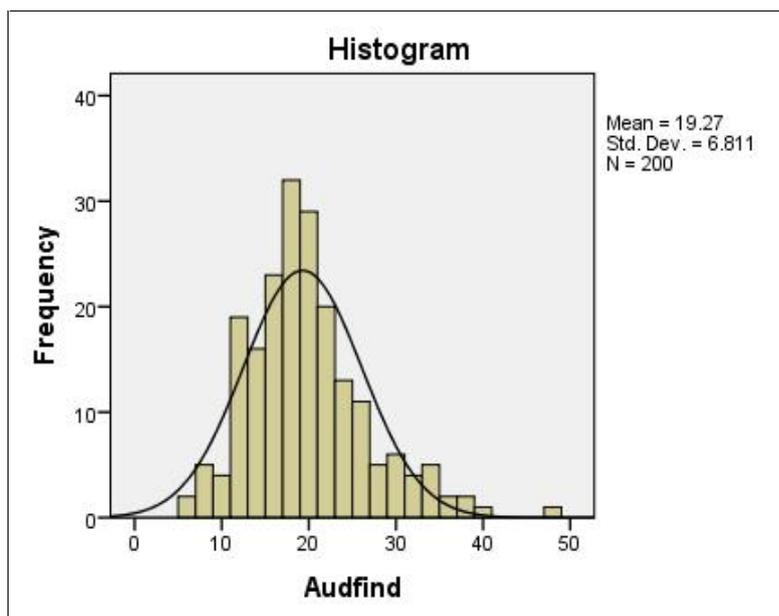


Figure F.8: Histogram of Number of Audit Findings (*Audfind*)



To conclude, as shown in Figures F.1 to F.8, except for Figures 2.a and F.5, it appears that the pattern in the relationship between those independent variables and the dependent variable is reasonably normally distributed. One method of correction is to use a logarithm in order to solve the skewed data. This method is consistent with several prior studies such as Setyadi (2009), and Astami and Tower (2006). Given that local budget expenditure is a key predictor variable, the log of budget (Figure 2.b) is used in the regression analysis. Several confirmations are provided with the median scores listed in Table 5.3 of the main text are also very similar to the mean (except *Age*). The histogram in Figure F.5 (*Age*) reveals skewed data, or more specially, that the age of local government is not normally distributed. Therefore, to solve the skewed data, transformation into logarithm is conducted. However, the results of the regression analysis for this control variable show no significant difference between the use of *Age* and *log Age*. Therefore, the actual age of local government is used in this study. Overall, the assumption of normality in analysing for t-tests, ANOVA, and multiple regression analyses is deemed to be met in this current study.

Appendix G

Number of Internal Auditors in Indonesian Local Governments

Appendix G provides specific details concerning the number of internal auditors for the sample 200 local governments in Indonesia in 2010. Of the 200 local governments, 48 local governments (Java: 15; non-Java: 33) have no internal auditors. However, there is a local government with 55 internal auditors namely Yogyakarta (Java municipality). According to the Regulation of Minister of State Apparatus Reform No. 36 of 2012, the number of internal auditors at every local government is not related to the size of local government, but tends to be more related to the availability of human resources in accordance with the minimum requirements set by the government. Nevertheless, there is clear disparity across jurisdictions.

Table G.1: The Number of Internal Auditors in Indonesian Local Governments

No	Local Government	Number of Int Auditors	No	Local Government	Number of Int Auditors	No	Local Government	Number of Int Auditors
1	Lebak	0	19	Gunung Kidul	13	37	Lamongan	2
2	Tangerang	3	20	Sleman	6	38	Madiun	3
3	Kuningan	22	21	Bekasi	19	39	Pamekasan	0
4	Tasikmalaya	16	22	Cirebon	30	40	Pasuruan	3
5	Sukabumi	5	23	Garut	2	41	Ponorogo	1
6	Cianjur	14	24	Purwakarta	19	42	Sidoarjo	3
7	Banjarnegara	19	25	Boyolali	1	43	Sumenep	3
8	Cilacap	17	26	Jepara	3	44	Ciamis	23
9	Kebumen	8	27	Kudus	18	45	Indramayu	3
10	Purworejo	21	28	Pekalongan	17	46	Majalengka	8
11	Magelang	24	29	Purbalingga	13	47	Kerawang	4
12	Klaten	15	30	Temanggung	1	48	Subang	4
13	Sragen	10	31	Bantul	23	49	Sumedang	3
14	Tulungagung	1	32	Kulonprogo	26	50	Banyumas	6
15	Jombang	16	33	Blitar	6	51	Batang	2
16	Tuban	4	34	Bojonegoro	3	52	Blora	2
17	Mojokerto	0	35	Gresik	3	53	Pati	23
18	Trenggalek	4	36	Kediri	3	54	Brebes	3

No	Local Government	Number of Int Auditors	No	Local Government	Number of Int Auditors	No	Local Government	Number of Int Auditors
55	Demak	23	80	Semarang	39	105	Sarolangun	0
56	Grobogan	5	81	Surakarta	1	106	Pesisir Selatan	1
57	Kendal	23	82	Tegal	23	107	Padang Pariaman	3
58	Rembang	10	83	Salatiga	19	108	Muara Enim	14
59	Tegal	1	84	Pekalongan	8	109	Lampung Selatan	3
60	Wonogiri	25	85	Magelang	14	110	Bangka Selatan	0
61	Wonosobo	6	86	Kediri	2	111	Mamuju	15
62	Banyuwangi	11	87	Blitar	0	112	Pinrang	12
63	Jember	3	88	Malang	2	113	Klungkung	0
64	Nganjuk	1	89	Mojokerto	1	114	Lombok Barat	3
65	Ngawi	1	90	Surabaya	22	115	Sumbawa Barat	0
66	Pacitan	0	91	Yogyakarta	55	116	Kolaka	6
67	Probolinggo	2	92	Bandung	14	117	Kepulauan Selayar	6
68	Bondowoso	2	93	Tasikmalaya	0	118	Kapuas	3
69	Lumajang	8	94	Batu	0	119	Kutai Kartanegara	0
70	Situbondo	19	95	Madiun	0	120	Ende	10
71	Magetan	1	96	Pasuruan	0	121	Aceh Besar	2
72	Cilegon	0	97	Probolinggo	0	122	Aceh Selatan	13
73	Bogor	16	98	Serang	0	123	Aceh Singkil	2
74	Bekasi	22	99	Tangerang	0	124	Asahan	14
75	Cimahi	0	100	Tangerang Selatan	0	125	Langkat	13
76	Sukabumi	1	101	Aceh Tengah	9	126	Solok	16
77	Cirebon	20	102	Mandailing Natal	1	127	Musi Rawas	8
78	Depok	1	103	Mesuji	0	128	Tulang Bawang	1
79	Banjar	1	104	Bengkulu Selatan	24	129	Bintan	0

No	Local Government	Number of Int Auditors	No	Local Government	Number of Int Auditors	No	Local Government	Number of Int Auditors
130	Gianyar	0	155	Pekanbaru	0	180	Tanjung Pinang	0
131	Dompu	18	156	Padang	32	181	Sungai Penuh	0
132	Sumba Tengah	0	157	Palembang	3	182	Bima	0
133	Pontianak	8	158	Bandar Lampung	2	183	Sibolga	1
134	Nunukan	2	159	Pangkal Pinang	2	184	Kupang	2
135	Kotawaringin Barat	14	160	Batam	0	185	Singkawang	4
136	Bulukumba	14	161	Denpasar	17	186	Balikpapan	16
137	Tana Toraja	26	162	Mataram	2	187	Tarakan	0
138	Buton	0	163	Ambon	0	188	Palu	3
139	Poso	0	164	Pontianak	2	189	Palopo	1
140	Bone	21	165	Banjarmasin	0	190	Bau Bau	1
141	Maros	23	166	Palangkaraya	3	191	Jaya Pura	2
142	Maluku Tengah	21	167	Samarinda	23	192	Sorong	0
143	Donggala	3	168	Gorontalo	4	193	Padang Sidempuan	0
144	Buol	2	169	Makasar	21	194	Prabu Mulih	0
145	Bima	7	170	Kendari	0	195	Pare-Pare	13
146	Mamasa	0	171	Sabang	13	196	Tanjung Balai	11
147	Maluku Tenggara	0	172	Binjai	0	197	Padang Panjang	13
148	Seram Bagian Barat	0	173	Dumai	4	198	Pariaman	0
149	Puncak Jaya	0	174	Tebing Tinggi	2	199	Payakumbuh	20
150	Pegunungan Bintang	0	175	Bukit Tinggi	20	200	Bengkulu	0
151	Banda Aceh	7	176	Sawah Lunto	5			
152	Medan	3	177	Pagar Alam	0			
153	Ternate	8	178	Lubuk Linggau	0			
154	Jambi	26	179	Metro	10			

Appendix H

Correlation Matrices of GCI Categories

Tables H.1 and H.2 provide comparative⁵⁸ evidence on the Pearson and Spearman Correlations for the additional Chapter 7 analysis (seven categories of GCI) regression model.

For both Pearson and Spearman Correlation tests, the highest correlation for GCIFp, GCIME, GCILBt, GCIFCp, GCIAp, GCIFSi, and GCIFNi remains less than 0.8. Accordingly, there is no perceived problem of multicollinearity between independent and control variables in these additional regression models.

Table H.1 (Pearson Correlation Matrix) further illustrates that number of local parliamentarians (*Numpar*) is correlated with GCIFp, GCIME, GCIFSi, and GCINFi: positively ($p < 0.01$, $p < 0.05$, $p < 0.01$ and $p < 0.05$). Local government budget expenditure (log) (*LogBudex*) is correlated with GCIFP and GCIFSi: positive direction ($p < 0.05$ and $p < 0.01$). Java/non-Java jurisdiction (*Javanon*) is correlated with GCIFp, GCIME, GCIFCp, GCIFSi, and GCIFNi: positive ($p < 0.01$, $p < 0.05$, $p < 0.01$, $p < 0.01$ and $p < 0.05$). While presence of an assistance and training programme (*Assprog*) is correlated with GCIAp and GCINFi: positive ($p < 0.05$ and $p < 0.01$). Whereas, proportion of non-supporting parties (*Nonsup*) is only correlated with one GCI category namely GCIFCp: positive ($p < 0.05$). There are no significant correlations between number of internal auditors (*NumIA*) and GCI categories.

Table H.2 (Spearman Correlation matrix) has very similar results. It shows that number of local parliamentarians (*Numpar*) is correlated with GCIFp, GCIME, GCIFSi and GCINFi: positive ($p < 0.01$, $p < 0.05$, $p < 0.01$ and $p < 0.05$). While, local government budget expenditure (log) (*LogBudex*) is correlated with GCIFp, GCIFSi: positive ($p < 0.05$ and $p < 0.01$). Java/non-Java jurisdiction

⁵⁸ Pallant (2007) states that the Pearson correlation test is primarily designed for continuous data, whereas the Spearman correlation test is for ordinal data. This thesis has both continuous and ordinal data. Therefore, this thesis runs both Pearson and Spearman correlation tests as a comparative exercise.

(Javanon) is correlated with GCIFp, GCIMe, GCIFCp, GCIFSi, and GCINFi: positive ($p < 0.01$, $p < 0.01$, $p < 0.01$, $p < 0.01$, $p < 0.05$). Presence of an assistance and training programme (*Assprog*) is correlated with GCIFp, GCIFCp, GCIAp, and GCINFi: positive ($p < 0.05$, $p < 0.05$, $p < 0.05$, and $p < 0.01$). In contrast, there are no significant correlations between proportion of non-supporting parties (*Nonsup*) and the seven GCI categories. In addition, number of internal auditors (*NumIA*) is only correlated with two GCI categories namely GCIFSi and GCINFi.

In summary, although there are slight differences, the overall results of the Pearson correlation test are very similar to the Spearman correlation test for the seven additional GCI category regression models.

Table H.1: Pearson Correlation Matrices of Seven GCI Categories

	Variables	DV							IV						CV					
		<i>GCIFp</i>	<i>GCIMe</i>	<i>GCILBt</i>	<i>GCIFCp</i>	<i>GCIAp</i>	<i>GCIFSi</i>	<i>GCINFI</i>	<i>Numpar</i>	<i>LogBudex</i>	<i>Javanon</i>	<i>Assprog</i>	<i>Nonsup</i>	<i>NumIA</i>	<i>Age</i>	<i>HDI</i>	<i>Surdef</i>	<i>Findep</i>	<i>Audfind</i>	<i>Mundis</i>
DV	<i>GCIFp</i>	1.000																		
	<i>GCIMe</i>	.297**	1.000																	
	<i>GCILBt</i>	.208**	.259**	1.000																
	<i>GCIFCp</i>	.380**	.386**	.363**	1.000															
	<i>GCIAp</i>	.054	.166*	.060	.151*	1.000														
	<i>GCIFSi</i>	.038	.124	.010	.075	.136	1.000													
	<i>GCINFI</i>	.170*	.137	.218**	.260**	.006	.055	1.000												
IV	<i>Numpar</i>	.253**	.167*	.013	.091	.109	.262**	.164*	1.000											
	<i>LogBudex</i>	.162*	.065	-.103	.043	.076	.222**	.119	.741**	1.000										
	<i>Javanon</i>	.304**	.281*	.109	.216**	.073	.255**	.169*	.617**	.443**	1.000									
	<i>Assprog</i>	.137	.121	.107	.136	.178*	.082	.202**	.072	.205**	.010	1.000								
	<i>Nonsup</i>	-.008	.073	.027	.146*	.120	.104	.126	.205**	.194**	.090	.117	1.000							
	<i>NumIA</i>	.037	.126	.093	.090	.015	.109	.120	.213**	.209**	.147*	.026	.116	1.000						
CV	<i>Age</i>	.168*	.137	-.014	.172*	.073	.172*	.133	.329**	.272**	.356**	-.029	.071	.215**	1.000					
	<i>HDI</i>	.130	.171*	.116	.176*	-.052	-.020	.211**	-.037	.057	-.005	.073	.003	.148*	.058	1.000				
	<i>Surdef</i>	-.024	-.105	-.124	-.047	.026	.067	.019	.001	-.099	.010	-.068	.055	-.297**	-.056	-.082	1.000			
	<i>Findep</i>	.181*	.123	.100	.273**	.044	.145*	.249**	.319**	.439**	.344**	.174*	.085	.244**	.157*	.401**	-.176*	1.000		
	<i>Audfind</i>	-.072	.007	-.071	-.111	.075	-.136	.085	-.166*	-.047	-.337**	.028	-.062	.009	-.202**	.062	-.017	-.053	1.000	
	<i>Mundis</i>	-.039	.007	.005	.047	-.060	-.126	.086	-.380**	-.201**	-.215**	.109	-.046	-.056	-.078	.571**	-.116	.363**	.158*	1.000

Legend: *Correlation is significant at the 0.05 level (2-tailed). **Correlation is significant at the 0.01 level (2-tailed). DV=Dependent Variable, IV=Independent Variables, CV=Control variables. *GCIFp*=Government Compliance Index Fiscal Policy, *GCIMe*=Government Compliance Index Macroeconomics, *GCILBt*=Government Compliance Index Local Budget Target, *GCIFCp*=Government Compliance Index Financial Performance, *GCIAp*=Government Compliance Index Accounting Policy, *GCIFSi*=Government Compliance Index Financial Statement Items, *GCINFI*=Government Compliance Index Non-Financial Information, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Table H.2. Spearman Correlation Matrices of Seven GCI Categories

	Variables	DV							IV						CV					
		<i>GCIFp</i>	<i>GCIMe</i>	<i>GCILBt</i>	<i>GCIFCp</i>	<i>GCIAp</i>	<i>GCIFSi</i>	<i>GCINFI</i>	<i>Numpar</i>	<i>LogBudex</i>	<i>Javanon</i>	<i>Assprog</i>	<i>Nonsup</i>	<i>NumIA</i>	<i>Age</i>	<i>HDI</i>	<i>Surdef</i>	<i>Findep</i>	<i>Audfind</i>	<i>Mundis</i>
DV	<i>GCIFp</i>	1.000																		
	<i>GCIMe</i>	.290**	1.000																	
	<i>GCILBt</i>	.232**	.255**	1.000																
	<i>GCIFCp</i>	.343**	.371**	.328**	1.000															
	<i>GCIAp</i>	.002	.164*	.116	.144*	1.000														
	<i>GCIFSi</i>	.065	.036	.024	.078	.078	1.000													
	<i>GCINFI</i>	.166*	.148*	.233**	.233**	.001	.128	1.000												
IV	<i>Numpar</i>	.260**	.175*	-.001	.109	.058	.278**	.167*	1.000											
	<i>LogBudex</i>	.161*	.086	-.108	.042	.020	.224**	.120	.749**	1.000										
	<i>Javanon</i>	.328**	.284**	.102	.197**	.039	.232**	.162*	.638**	.489**	1.000									
	<i>Assprog</i>	.148*	.118	.108	.151*	.163*	.086	.211**	.070	.174*	.010	1.000								
	<i>Nonsup</i>	-.054	.024	.006	.080	.066	.084	.123	.217**	.149*	.107	.081	1.000							
	<i>NumIA</i>	.041	.109	.079	.054	.020	.149*	.146*	.283**	.260**	.170*	.009	.124	1.000						
CV	<i>Age</i>	.174*	.182**	.002	.180*	.054	.172*	.106	.498**	.423**	.431**	-.053	.182*	.392**	1.000					
	<i>HDI</i>	.025	.083	.048	.076	-.022	.006	.155*	-.175*	-.022	-.102	.125	-.056	.040	.016	1.000				
	<i>Surdef</i>	-.025	-.095	-.116	-.060	-.006	.072	.018	-.008	-.089	.010	-.068	.065	-.255**	-.073	-.144*	1.000			
	<i>Findep</i>	.198*	.136	.067	.246**	.033	.195**	.208**	.376**	.395**	.455**	.136	.031	.207**	.270**	.480**	-.158*	1.000		
	<i>Audfind</i>	-.070	-.012	-.077	-.112	.045	-.157*	.007	-.173*	-.074	-.355	.066	-.111	-.073	-.229**	.036	.017	-.141*	1.000	
	<i>Mundis</i>	-.025	-.005	.008	.063	-.054	-.113	.093	-.368**	-.260**	-.215**	.109	-.062	-.174*	-.164*	.714**	-.116	.376**	.141*	1.000

Legend: *Correlation is significant at the 0.05 level (2-tailed). **Correlation is significant at the 0.01 level (2-tailed). DV=Dependent Variable, IV=Independent Variables, CV=Control variables. *GCIFp*=Government Compliance Index Fiscal Policy, *GCIMe*=Government Compliance Index Macroeconomics, *GCILBt*=Government Compliance Index Local Budget Target, *GCIFCp*=Government Compliance Index Financial Performance, *GCIAp*=Government Compliance Index Accounting Policy, *GCIFSi*=Government Compliance Index Financial Statement Item, *GCINFI*=Government Compliance Index Non-Financial Information, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Appendix I

GCI Backward Regression: Detailed Analysis

The GCI backward regression detailed analysis (Table I.1) presents four models using the process of elimination of each of the worst predictor variables observed.

Table I.1: GCI Backward Regression: Detailed Analysis

Model	Variables	Unstandardised Coefficients		Standardised Coefficient	t	Sig.	Collinearity Statistics		
		B	Std. Error	Beta			Tolerance	VIF	
1	<i>(Constant)</i>	213.007	58.541		3.639	.000			
	<i>Numpar</i>	.144	.118	.136	1.215	.226	.298	3.357	
	<i>LogBudex</i>	-16.791	5.111	-.327	-3.285	.001	.375	2.665	
	<i>Javanon</i>	6.056	1.870	.275	3.238	.001	.514	1.945	
	<i>Assprog</i>	6.148	1.436	.273	4.282	.000	.913	1.095	
	<i>Nonsup</i>	.072	.036	.127	1.997	.047	.924	1.082	
	<i>NumIA</i>	-.003	.082	-.003	-.037	.970	.785	1.273	
	<i>Age</i>	.005	.003	.130	1.917	.057	.810	1.234	
	<i>HDI</i>	.453	.181	.197	2.504	.013	.602	1.660	
	<i>Surdef</i>	-.519	1.443	-.024	-.359	.720	.865	1.157	
	<i>Findep</i>	.458	.183	.215	2.501	.013	.502	1.991	
	<i>Audfind</i>	.192	.108	.118	1.781	.077	.842	1.188	
	<i>Mundis</i>	-4.449	2.097	-.198	-2.122	.035	.428	2.336	
	2	<i>Constant</i>	212.994	58.384		3.648	.000		
<i>Numpar</i>		.143	.118	.136	1.217	.225	.298	3.353	
<i>LogBudex</i>		-16.784	5.094	-.327	-3.295	.001	.376	2.662	
<i>Javanon</i>		6.057	1.865	.275	3.247	.001	.514	1.944	
<i>Assprog</i>		6.149	1.432	.273	4.294	.000	.913	1.095	
<i>Nonsup</i>		.071	.036	.126	2.010	.046	.935	1.069	
<i>Age</i>		.005	.003	.129	1.939	.054	.829	1.206	
<i>HDI</i>		.452	.178	.196	2.537	.012	.618	1.618	
<i>Surdef</i>		-.503	1.376	-.023	-.365	.715	.945	1.058	
<i>Findep</i>		.457	.180	.215	2.535	.012	.516	1.940	
<i>Audfind</i>		.191	.107	.118	1.789	.075	.848	1.180	
<i>Mundis</i>		-4.434	2.054	-.197	-2.158	.032	.443	2.255	
3		<i>Constant</i>	210.954	57.983		3.638	.000		
		<i>Numpar</i>	.141	.117	.133	1.201	.231	.299	3.342
	<i>LogBudex</i>	-16.619	5.063	-.324	-3.283	.001	.379	2.641	
	<i>Javanon</i>	6.022	1.858	.274	3.240	.001	.516	1.939	
	<i>Assprog</i>	6.163	1.428	.274	4.316	.000	.914	1.094	
	<i>Nonsup</i>	.070	.035	.125	1.993	.048	.940	1.063	
	<i>Age</i>	.005	.003	.131	1.968	.051	.832	1.202	
	<i>HDI</i>	.450	.178	.196	2.536	.012	.618	1.618	
	<i>Findep</i>	.465	.179	.218	2.599	.010	.522	1.914	
	<i>Audfind</i>	.191	.107	.118	1.790	.075	.848	1.180	
	<i>Mundis</i>	-4.410	2.049	-.196	-2.152	.033	.444	2.252	
	4	<i>Constant</i>	172.899	48.622		3.556	.000		
		<i>LogBudex</i>	-13.132	4.152	-.256	-3.163	.002	.564	1.772
		<i>Javanon</i>	6.897	1.712	.314	4.029	.000	.609	1.641
<i>Assprog</i>		6.081	1.428	.270	4.259	.000	.916	1.092	
<i>Nonsup</i>		.075	.035	.133	2.140	.034	.953	1.050	
<i>Age</i>		.005	.003	.137	2.070	.040	.838	1.194	
<i>HDI</i>		.469	.177	.204	2.646	.009	.623	1.606	
<i>Findep</i>		.480	.179	.226	2.691	.008	.525	1.904	
<i>Audfind</i>		.194	.107	.120	1.816	.071	.848	1.179	
<i>Mundis</i>		-5.188	1.946	-.231	-2.666	.008	.493	2.027	

Legend: Shaded areas denote the model that is used for the discussion on the main analysis.

Of the four alternative models, this thesis uses Model 3 for the discussion of the main analysis (see Table I.1). This is because the third model of the backward regression has the highest adjusted R square among three other models (see Table 6.9). Therefore, the third model is used for the comparative discussion of the main full regression model analysis of this thesis.

As seen in Table I.1, it can be concluded that the results of the backward regression analysis are consistent with the full multiple regression analysis in Chapter 6. In both sets of regressions Java/non-Java jurisdiction (*Javanon*) (mimetic-outsider), presence of an assistance and training programme (*Assprog*) (mimetic-insider), proportion of non-supporting parties (*Nonsup*) (normative-outsider), age of local government (*Age*) (control variable), level of Human Development Index (*HDI*) (control variable), level of financial independence (*Findep*) (control variable), and number of audit findings (*Audfind*), are the dominant predictors for the level of mandatory disclosure within financial statements of Indonesian local governments (GCI).

This backward regression analysis supports the multiple regression results from the main text.

Appendix J

Backward Regression: Seven GCI Categories

For the purpose of identifying the dominant predictors, this study performs backward regressions as further analysis concerning the backward regression analyses for the seven major GCI categories. Tables J.1 and J.2 report the statistically significant results.

Table J.1: Backward Regression Analysis: GCIFp, GCIMe, GCILBt, and GCIFCp

		<i>GCIFp</i>		<i>GCIMe</i>		<i>GCILBt</i>		<i>GCIFCp</i>	
		Adj R ² : .112		Adj R ² : .130		Adj R ² : .085		Adj R ² : .142	
		F : 9.378		F : 5.241		F : 3.317		F : 5.131	
		Sig : .000		Sig : .000		Sig : .001		Sig : .000	
Variables	Prediction	Coeff	P-Value	Coeff	P-Value	Coeff	P-Value	Coeff	P-Value
<i>Constant</i>		22.586	0.373	212.313	0.104	597.574	0.001	358.385	0.004
<i>LogBudex (H2)</i>	+			-24.121	0.032*** ^Δ	-54.204	0.000*** ^Δ	-33.491	0.001*** ^Δ
<i>Javanon (H3)</i>	+/-	15.166	0.000***	22.554	0.000***			7.533	0.072*
<i>Assprog (H4)</i>	+/-	6.408	0.063*	8.568	0.045**	9.269	0.033**	7.191	0.048**
<i>Nonsup (H5)</i>	+							0.170	0.056*
<i>Age (CV)</i>	+							0.011	0.087*
<i>HDI (CV)</i>	+	0.639	0.069*	1.428	0.007***	1.069	0.048**	0.842	0.062*
<i>Surdef (CV)</i>	+/-					-8.139	0.051*		
<i>Findep (CV)</i>	+							1.450	0.002***
<i>Audfind (CV)</i>	-			0.554	0.082* ^Δ				
<i>Mundis (CV)</i>	+/-					-11.650	0.061*	-9.043	0.066*

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. ^ΔUnexpected directionality.

Legend: n=200. *GCIFp*=Government Compliance Index Fiscal Policy, *GCIMe*=Government Compliance Index Macroeconomics, *GCILBt*=Government Compliance Index Local Budget Target, *GCIFCp*=Government Compliance Index Financial Performance, *LogBudex*=Local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Table J.2: Backward Regression Analysis: GCIAp, GCIFSi, and GCINFi

		<i>GCIAp</i>		<i>GCIFSi</i>		<i>GCINFi</i>	
		Adj R ² : .031		Adj R ² : .073		Adj R ² : .122	
		F : 1.805		F : 3.228		F : 4.084	
		Sig : .078		Sig : .003		Sig : .000	
Variables	Prediction	Coeff	P-Value	Coeff	P-Value	Coeff	P-Value
<i>Constant</i>		172.740	0.110	84.328	0.000	192.090	0.137
<i>LogBudex (H2)</i>	+					-20.204	0.073* ^Δ
<i>Assprog (H4)</i>	+/-	7.013	0.013**			8.289	0.009***
<i>HDI (CV)</i>	+					0.670	0.055*
<i>Audfind (CV)</i>	-	0.353	0.095* ^Δ			0.527	0.026** ^Δ

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. ^ΔUnexpected directionality.

Legend: n=200. *GCIAp*=Government Compliance Index Accounting Policy, *GCIFSi*=Government Compliance Index Financial Statement Item, *GCINFi*=Government Compliance Index Non-Financial Information, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

In summary, as shown in Tables J.1 and J.2, the results of backward regressions for GCIFp, GCIMe, GCILBt, GCIFCp, GCIAp, GCIFSi, and GCINFi have consistent results with the core Chapter 6 multiple regressions. Overall, the results provide even more evidence supporting Hypotheses H3 and H4 (mimetic outsider-insider isomorphism hypotheses), and H5 partial support for normative outsider isomorphism hypothesis.

Appendix K

Multiple Regression Analyses of Seven GCI Categories

Appendix K explains the results of regressions analyses of the seven GCI categories. As stated in Chapter 7 the purpose of this additional analysis is to explore in more depth the association between various components of the GCI with the predictor variables. The results of regression analyses of the seven GCI categories are presented in more detail in three tables namely K.1, K.2 and K.3. Table K.1 reveals the results of multiple regression analysis for the dependent variables of Fiscal Policy (GCIFp), Macroeconomics (GCIMe), and Local Budget Target (GCILBt). Table K.2 shows the results of multiple regression analysis for the dependent variables of Financial Performance (GCIFCp) and Accounting Policy (GCIAp). While Table K.3 reveals the results of multiple regression analysis for the dependent variables of Financial Statement Items (GCIFSi) and Non-Financial Information (GCINFi).

As can be seen in Table K.1, K.2, and K.3 that local government budget expenditure (log) (*LogBudex*) is rejected as a predictor of Macroeconomics (GCIMe), Local Budget Target (GCILBt), Financial Performance (GCIFCp), and Non-Financial Information (GCINFi) due to the unexpected directionality (it reveals a negative directionality instead of the hypothesised positive directionality). In addition, Table K.1, K.2 and K.3 also reveal that number of audit findings (*Audfind*) is also not accepted as a predictor of the three GCI categories namely Macroeconomics (GCIMe), Accounting Policy (GCIAp), and Non-Financial Information (GCINFi) due to the unexpected directionality (the prediction sign of number of audit findings (*Audfind*) is negative, but the statistical analysis result reveals a positive directionality). Therefore, the result is contradictory to the ideas developed in this thesis.

Table K.1: Multiple Regressions Analyses of GCIFp, GCIMe, and GCILBt

Variables	Variable Types	Prediction	GCIFp			GCIMe			GCILBt		
			T-Stat	Coeff	P-Value	T-Stat	Coeff	P-Value	T-Stat	Coeff	P-Value
<i>(Constant)</i>			1.344	197.217	.181	1.740	305.973	.083	3.307	589.001	.001
<i>Numpar (H1)</i>	COV	+	1.359	.403	.176	.821	.291	.413	.761	.274	.448
<i>LogBudex (H2)</i>	CIV	+	-1.342	-17.191	.181	-2.158	-33.119	.032** ^Δ	-3.445	-53.574	.001*** ^Δ
<i>Javanon (H3)</i>	MOV	+/-	2.371	11.117	.019**	3.617	20.316	.000***	1.478	8.412	.141
<i>Assprog (H4)</i>	MIV	+/-	2.096	7.545	.037**	2.016	8.692	.045**	2.033	8.882	.043**
<i>Nonsup (H5)</i>	NOV	+	-.779	-.070	.437	.832	.089	.407	.541	.059	.589
<i>NumIA (H6)</i>	NIV	+	-.941	-.195	.348	.275	.068	.784	.350	.088	.727
Control Variables											
<i>Age</i>	CV	+	1.004	.006	.316	.674	.005	.501	-.678	-.005	.498
<i>HDI</i>	CV	+	1.951	.884	.053*	2.515	1.365	.013**	1.930	1.061	.055*
<i>Surdef</i>	CV	+/-	-.428	-1.550	.669	-1.559	-6.758	.121	-1.825	-8.013	.070*
<i>Findep</i>	CV	+	.709	.325	.479	-.353	-.194	.725	1.408	.785	.161
<i>Audfind</i>	CV	-	.562	.152	.575	1.809	.584	.072* ^Δ	-.201	-.066	.841
<i>Mundis</i>	CV	+/-	-1.023	-5.375	.308	-.809	-5.091	.420	-1.747	-11.141	.082*
			Adj R ² : .099			Adj R ² : .118			Adj R ² : .070		
			F : 2.816			F : 3.219			F : 2.248		
			Sig. : .001			Sig. : .000			Sig. : .011		

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. (n=200). ^ΔUnexpected directionality.

Legend: GCIFp=Government Compliance Index Fiscal Policy, GCIMe=Government Compliance Index Macroeconomics, GCILBt=Government Compliance Index Local Budget Target, COV=Coercive Outsider Variable, CIV=Coercive Insider Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, NIV=Normative Insider Variable, CV=Control Variable, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Table K.2: Multiple Regressions Analyses of GCIFCp and GCIAp

Variables	Variable Types	Prediction	GCIFCp			GCIAp		
			T-Stat	Coeff	P-Value	T-Stat	Coeff	P-Value
(Constant)			2.106	313.580	.037	1.553	180.861	.122
<i>Numpar</i> (H1)	COV	+	-.546	-.164	.586	.671	.158	.503
<i>LogBudex</i> (H2)	CIV	+	-2.264	-29.424	.025*** ^Δ	-.902	-9.171	.368
<i>Javanon</i> (H3)	MOV	+/-	1.768	8.409	.079*	.455	1.692	.650
<i>Assprog</i> (H4)	MIV	+/-	1.923	7.022	.056*	2.477	7.074	.014**
<i>Nonsup</i> (H5)	NOV	+	1.996	.182	.047**	1.290	.092	.199
<i>NumIA</i> (H6)	NIV	+	-.433	-.091	.666	-.315	-.052	.753
Control Variables								
<i>Age</i>	CV	+	1.736	.011	.084*	1.010	.005	.314
<i>HDI</i>	CV	+	1.956	.899	.052*	-.577	-.208	.564
<i>Surdef</i>	CV	+/-	-.434	-1.591	.665	.265	.761	.791
<i>Findep</i>	CV	+	3.179	1.481	.002***	.534	.195	.594
<i>Audfind</i>	CV	-	-.154	-.042	.878	1.722	.368	.087* ^Δ
<i>Mundis</i>	CV	+/-	-1.948	-10.388	.053*	-.530	-2.210	.597
			Adj R ² : .127			Adj R ² : .014		
			F : 3.417			F : 1.228		
			Sig. : .000			Sig. : .266		

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. (n=200). ^ΔUnexpected directionality.

Legend: GCIFCp=Government Compliance Index Financial Performance, GCIAp=Government Compliance Index Accounting Policy, COV=Coercive Outsider Variable, CIV=Coercive Insider Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, NIV=Normative Insider Variable, CV=Control Variable, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

Table K.3: Multiple Regressions Analyses of GCIFSi and GCINFi

Variables	Variable Types	Prediction	GCIFSi			GCINFi		
			T-Stat	Coeff	P-Value	T-Stat	Coeff	P-Value
(Constant)			1.211	68.068	.227	1.416	184.007	.158
<i>Numpar</i> (H1)	COV	+	.498	.056	.619	1.022	.268	.308
<i>LogBudex</i> (H2)	CIV	+	.344	1.690	.731	-1.769	-20.065	.079* ^Δ
<i>Javanon</i> (H3)	MOV	+/-	1.025	1.841	.306	1.230	5.108	.220
<i>Assprog</i> (H4)	MIV	+/-	.949	1.308	.344	2.691	8.575	.008***
<i>Nonsup</i> (H5)	NOV	+	.497	.017	.620	1.212	.096	.227
<i>NumIA</i> (H6)	NIV	+	.792	.063	.430	.393	.072	.695
Control Variables								
<i>Age</i>	CV	+	.897	.002	.371	1.235	.007	.218
<i>HDI</i>	CV	+	-.211	-.037	.833	1.937	.777	.054*
<i>Surdef</i>	CV	+/-	1.330	1.843	.185	.821	2.631	.412
<i>Findep</i>	CV	+	.815	.143	.416	1.782	.725	.076*
<i>Audfind</i>	CV	-	-.791	-.082	.430	2.244	.536	.026** ^Δ
<i>Mundis</i>	CV	+/-	-.643	-1.294	.521	-.619	-2.882	.536
			Adj R ² : .056			Adj R ² : .114		
			F : 1.985			F : 3.137		
			Sig. : .028			Sig. : .000		

***highly significant at 1% level, **significant at 5% level, *moderately significant at 10% level. (n=200). ^ΔUnexpected directionality.

Legend: *GCIFSi*=Government Compliance Index Financial Statement Item, *GCINFi*=Government Compliance Index Non-Financial Information, COV=Coercive Outsider Variable), CIV=Coercive Insider Variable, MOV=Mimetic Outsider Variable, MIV=Mimetic Insider Variable, NOV=Normative Outsider Variable, NIV=Normative Insider Variable, CV=Control Variable, *Numpar*=number of local parliamentarians, *LogBudex*=local government budget expenditure (log), *Javanon*=Java/non-Java jurisdiction, *Assprog*=presence of an assistance and training programme, *Nonsup*=proportion of non-supporting parties, *NumIA*=number of internal auditors, *Age*=age of local government, *HDI*=level of Human Development Index, *Surdef*=surplus/deficit of local government, *Findep*=level of financial independence, *Audfind*=number of audit findings, *Mundis*=municipality/district (type of local government).

In summary, the results of regression analyses of the seven GCI categories are very similar with the results of the main regression analysis which was reported in Chapter 6. The pressure of the mimetic outsider variable (Java/non-Java (*Javanon*)) and the mimetic insider variable (presence of assistance and training programme (*Assprog*)) work properly in affecting most GCI categories in Indonesian local governments. Java/non-Java (*Javanon*) is accepted as predictor for Fiscal Policy (GCIFp), Macroeconomics (GCIMe), and Financial Performance (GCIFCp). Meanwhile, the presence of assistance and training programme (*Assprog*) is also accepted as predictor for Fiscal Policy (GCIFp), Macroeconomics (GCIMe), Local Budget Target (GCILBt), Financial Performance (GCIFCp), Accounting Policy (GCIAp), and Non- Financial Information (GCINFi). Furthermore, it is also revealed that the normative outsider variable (proportion of non-supporting parties (*Nonsup*)) is also effective in enhancing the level of mandatory disclosure within financial statements regarding information on financial performance (GCIFCp).

Appendix L

The Tasks and Authorities of Indonesian Local Parliament According to the Latest Regulation (UU No. 27 of 2009).

There are numerous tasks and authorities of local parliament (Dewan Perwakilan Rakyat Daerah=DPRD) according to UU No. 27 of 2009. The stated purpose for the enactment of UU No. 27 of 2009 is to enhance the role and responsibilities of local parliament.

The tasks and authorities of local parliament include:

- 1) Forming local regulations together with the head of local government
- 2) Discuss and give approval to the draft of local regulations regarding the local revenue and expenditure budget (Anggaran Pendapatan dan Belanja Daerah=APBD) that proposed by the head of local government.
- 3) Supervise the implementation of local regulations and local budget (APBD).
- 4) Propose the appointment or dismissal of the local government head to the Minister of Internal Affairs through governor.
- 5) Selecting the deputy of local government head (deputy regent / deputy mayor) in the event of vacancy of deputy of local government head.
- 6) Giving opinion and consideration to the head of local government regarding to the plan of international agreements in the local government.
- 7) Giving approval to the plan of international cooperation undertaken by the local government.
- 8) Asking for accountability report information to the head of local government relating to the implementation of local government administration.
- 9) Giving approval to the plan of cooperation with other local governments or with third parties.

- 10) Striving for good implementation of local government obligations in accordance with the provisions of the legislation.
- 11) Conducting other tasks and authorities set out in the provisions of the legislation.

In regard to institutional factors, the number of Indonesian local parliament members is considered a possible coercive outsider pressure that is expected to support local government to improve their practice of mandatory disclosure within financial statements.