

**Graduate School of Business
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**Non-Compliance in Public Financial Management: A Case
Study of a Local Government in Indonesia**

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**This thesis is presented for the Degree of
Doctor of Business Administration
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 acknowledgment has been made.

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

The research presented and reported in this thesis was conducted in accordance with the National Health and Medical Research Council National Statement on Ethical Conduct in Human Research (2007) – updated March 2014. The proposed research study received human research ethics approval from the Curtin University Human Research Ethics Committee (EC00262), Approval Number RDBS-01-15.



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Abstract

A number of studies regarding Public Financial Management (PFM) in Indonesia, especially those conducted after the major PFM reform in 2004, have shown the PFM legal framework to be robust and adequately designed. Nevertheless, a number of problems that hinder the achievement of PFM objectives also have been highlighted in many studies. This creates a concern regarding actual PFM practices in Indonesia and curiosity about how those practices support or retard the effectiveness of PFM.

This study investigates non-compliance within the context of the operational components of PFM in local government. It utilises documentation analysis of the external auditor's reports to understand the context, and to identify the systemic problems arising from, non-compliance across local governments in Indonesia. Specifically, this study aims to examine non-compliance from the perspective of PFM actors, or those who are involved in various stages and components of PFM operations. It examines the extent to which the individual motives of the PFM actors and the bureaucratic traditions within the PFM operations allow the emergence of non-compliance. Further, it elaborates on how those two factors influence the PFM actors to become involved in non-compliant acts and behaviours. This study adopts a qualitative research methodology using a single case study method, along with various data-gathering techniques of documentation, focus group discussion and semi-structure interview.

The examination, within the context of this study, has confirmed the presence of non-compliance in PFM operational practices across local governments in Indonesia. Those non-compliance practices exist within almost all components of PFM operations and have led to systemic problems in the three main elements of local government PFM operations. The first element, the internal control system, has been characterised as exhibiting a lack of more detailed and proper standards, procedures and guidelines for actions in order for PFM actors to carry out their duties in accordance with the stipulated requirements in the PFM rules and regulations. In regard to the second element, budget execution, it is clear that local governments have been struggling to improve their efficiency and effectiveness in revenue collection, disbursement processes, procurement practices, treasury systems and asset management. The third element, financial accounting and reporting, has been impacted by a lack of proper transactional records and inappropriate reporting

processes, which has affected the ability of local governments to prepare fair financial statements in accordance with the applicable accounting standards.

This study has found variations in the PFM actors' motives, within the workplace of a public bureaucracy's organisational setting, that ranges from a simple financially-related, self-interested motive to a more community service-oriented, public-interested motive. Both types of motives have influenced the PFM actors to commit, or become involved in, acts of non-compliance that have resulted in the above-mentioned systemic problems in PFM operations. Along with a lack of consistent and regular direct control over the behaviour of the PFM actors, the lack of a proper system of incentives has also facilitated those PFM actors who are driven by self-interest motives to commit non-compliant acts. PFM actors who possess public-interested motives, on the other hand, break the rules and become involved in non-compliance because they have the perception that rules do not support the provision of more effective, efficient and timely public services.

This study also identified influences of dysfunctional bureaucratic structures upon non-compliance among the PFM actors. Rules that govern PFM operational practices have been identified as being ineffective and are characterised by contradictions, misinterpretations and defectiveness, causing confusion among the PFM actors about how they are to be implemented. The hierarchy tends to shift the PFM actors' loyalties to their superiors, enabling them to neglect their obligations to comply with the rules and regulations in order to attain organisational goals. The division of labour has fragmented the mindset of the PFM actors, causing the problem of a silo mentality that allows the PFM actors to focus only on the responsibilities of their own units, instigating non-compliance problems at the organisational level. An improper arrangement in the division of labour has also resulted in imbalanced workloads among the PFM actors, causing those who have a greater workload to be more prone to making errors. Dysfunctional bureaucratic structures were also displayed by the failure to establish expertise among the PFM actors, due to inappropriate human resources management policies. That failure has prevented the development of skills, capabilities and knowledge among the PFM actors that would have enabled them to comply with the rules and regulations that govern the overall PFM operational processes.

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List of Abbreviations and Terms

ADB	Asian Development Bank
BLU	<i>Badan Layanan Umum</i> / Public Service Agency
BPK	<i>Badan Pemeriksa Keuangan</i> / Audit Board of the Republic of Indonesia
BPKP	<i>Badan Pengawasan Keuangan dan Pembangunan</i> / Development and Financial Supervisory Agency
BPS	<i>Badan Pusat Statistik</i> / Statistics Indonesia
CFO	Chief Financial Officer
CIPFA	The Chartered Institute of Public Finance and Accountancy
CMO	Commitment-Making Official
COO	Chief Operational Officer
DFID	Department for International Development
DPPKD	<i>Dinas Pendapatan dan Pengelolaan Keuangan Daerah</i> / Revenue and Financial Management Service
FGD	Focus Group Discussion
FMIS	Financial Management Information System
FMU	Financial Management Unit
FS	Financial Statement
FY	Financial Year
GAS	Government Accounting Standard
Gol	Government of Indonesia
GR	Government Regulation
IHPS	<i>Ikhtisar Hasil Pemeriksaan Semesteran</i> / Summary of Semesterly BPK's Audit Reports
Kabupaten	District
Kepmendagri	<i>Keputusan Menteri Dalam Negeri</i> / Ministry of Home Affairs Decree

KPPOD	<i>Komite Pemantauan Pelaksanaan Otonomi Daerah / Monitoring Committee for the Implementation of Regional Autonomy</i>
LEG	Local Economic Governance
Lombok Barat	West Lombok
MAKUDA	<i>Manual Administrasi Keuangan Daerah / Local Government Financial Administration Manuals</i>
MoHA	Ministry of Home Affairs
MP3EI	<i>Masterplan Percepatan dan Perluasan Pembangunan Ekonomi Indonesia / Masterplan for Acceleration and Expansion of Indonesia's Economic Development</i>
MTEF	Medium Term Expenditure Framework
NGO	Non-Government Organisation
NPM	New Public Management
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability
Pemkab	<i>Pemerintah Kabupaten / District Government</i>
Permendagri	<i>Peraturan Menteri Dalam Negeri / Minister of Home Affairs Regulation</i>
Perda	<i>Peraturan Daerah / Local Law</i>
PFM	Public Financial Management
PR	Presidential Regulation
SAI	Supreme Audit Institution
SIMDA	<i>Sistem Informasi Manajemen Daerah / Local Government Management Information System</i>
SIPKD	<i>Sistem Informasi Pengelolaan Keuangan Daerah / Local Government Financial Management Information System</i>
SKPD	<i>Satuan Kerja Perangkat Daerah / Local Government Spending Unit</i>
SOP	Standard Operations and Procedures
TSA	Treasury Single Account

Chapter 1

Introduction

Assessment on public financial management (PFM) in Indonesia, especially after the major PFM reform in 2004, have shown the PFM legal framework in Indonesia to be of robust and adequately designed (World Bank 2007; 2012). Nevertheless, a number of problems that hinder the achievement of PFM objectives have also been highlighted in many studies (see for example: Achmad 2012; Kristiansen et al. 2009; Siallagan 2012; Harun et al. 2012; Blondal et al. 2009). This creates a concern regarding the actual PFM practices in Indonesia and curiosity about how those practices support or retard the effectiveness of PFM.

The author for this thesis, who works at BPK¹, is also aware of the increasing number of audit findings reported by BPK in its audit reports. As a result of the PFM reform, BPK has an important role as the independent and external institution that has a mandate to assess and audit the financial management of Indonesia's public institutions. It does the assessment and audit by collecting evidence regarding a set of criteria, usually derived from the requirements stipulated in legal documents, and then reports findings where the criteria have not been met. Usually, such reported findings are material in nature – either quantitatively or qualitatively. The increasing number of BPK's audit findings contribute to more doubt about the effectiveness of the PFM practices after the reform. Without undermining the achievement of the PFM reform so far, a more thorough study of the actual practices of specific aspects of PFM after the reform is now overdue. This thesis focuses on the practices of PFM operations at the local government² level in Indonesia following the PFM reform of 2004.

In this introductory chapter, several aspects of the research which provide direction to the presentation of this thesis are outlined commencing with a section that describes the background, context and scope of the study. It is then followed by the research objectives and questions section before a brief summary of the research methodology and techniques that were developed and implemented in this research.

¹ BPK, or *Badan Pemeriksa Keuangan*, is the Audit Board of the Republic of Indonesia.

² The term 'local government' in this study refers to the subnational level of government, which includes provinces (*provinsi*), cities (*kota*), and districts (*kabupaten*).

The last section of this chapter describes the structure of the thesis to guide its overall presentation.

1.1. Background and Context

Following the fall of the Suharto regime in 1998, Indonesia has been continuing to place considerable effort into the democratisation of its political, legal, social, and economic systems to safeguard the establishment of a welfare state, as mandated by the Constitution. In the democratisation process, the development and implementation of a strong and effective governance framework are critical. McLeod and MacIntyre (2007) suggest that an effective governance framework can sustain the elements necessary to, and favourable for, maintaining strong economic growth. In the long run, it is expected that an effective governance framework will sustain strong economic development in Indonesia and will contribute to Indonesia's model of democracy.

The World Bank (2006) has further explained that the elements of a governance framework include: (1) voice and accountability, (2) political stability and absence of violence, (3) government effectiveness, (4) regulatory quality, (5) rule of law and (6) control of corruption. Without undermining the other elements, government effectiveness which covers the quality, credibility and commitment to public service necessary to run the government's operations effectively, is one of the major elements that shapes the accountability of government to its legislature and citizenry. Thus, efforts to establish a strong governance framework during the democratisation process must also cover the area of public sector management.

Public sector management reform is one of the processes being pursued to strengthen governance frameworks in Indonesia after the resignation of President Suharto. According to Pollitt and Bouckaert (2004), public sector management reform usually comprises of four different components: (1) financial, (2) personnel, (3) organisation, and (4) performance measurement systems. Among those components, efficient financial management is considered to be the essential component that can influence the achievement of the whole set of public management objectives (Lane 2004; Ingraham and Kneedler 2000). Thus, it is important to conduct a study on certain aspects of PFM reform in Indonesia in order to examine the extent to which reform has been able to achieve its intended objectives.

The major PFM reform in Indonesia was started in 2003 through the enactment of Law 17/2003 regarding State Finance. This law was then followed by two further laws enacted in 2004, which were Law No. 1/2004 regarding State Treasury and Law No.

15/2004 regarding State Audit, to complete the trilogy of financial laws. Those laws established a new regulatory framework for PFM practices in Indonesia replacing the system that had remained unchanged since Indonesia became independent in 1945.

The introduction of the new PFM legal framework was a priority selected by the Indonesian government to develop adequate controls, as well as to overcome the operational, structural and systemic problems and weaknesses that were present in the old PFM arrangements and practices in Indonesia (Achmad 2012). It also described the effort to promote good governance by curtailing opportunities and incentives for corruption and other rent-seeking practices (Siallagan 2012). The new PFM regulatory framework, as stipulated in Law No. 17/2003, incorporates the principles of transparency, results-oriented accountability, professionalism and independent external auditing mechanisms to establish good governance in the management of public resources which aligns with the principles of democracy. Further, Siallagan (2012) also notes that the new framework reflects efforts to instil modern practices of financial management and to replace the traditional public financial administration model. Those efforts include, among other things, the integration of a dual-budgeting system (e.g. routine and development budgets) into a single unified budget, the application of a lengthier budgeting perspective through the introduction of a medium-term expenditure framework, the endowment of more flexibility for public managers by shifting from input-oriented budgeting to a more output- and outcomes-focused budgeting system, and the adoption of an accrual accounting system in the preparation of governments' financial reports, with the objectives of enhancing the effectiveness, efficiency, transparency and accountability of the governments' financial management and operations (Gol 2003).

A number of studies have been conducted to evaluate the effectiveness of some aspects of PFM in Indonesia after the reform. The World Bank (2007) concluded that, at a national level, an adequate regulatory PFM framework had been established, even though some challenges affecting the consistency of its implementation were also identified. By 2012, in almost all areas of PFM, including at the local government level, Indonesia had completed the establishment of its legal and regulatory architecture and had shifted its focus toward the effective implementation of its new PFM practices (World Bank 2012).

Despite its sound and robust design, a number of issues with regard to the implementation of the new PFM regulatory framework have also been reported. In terms of the budgeting process, the enduring emphasis on detailed input bases within official budget documentation and the concentration of budget spending, especially

for capital expenditures, within the last months of the fiscal year impede the implementation of a modern legal budgeting framework (Blondal et al. 2009; World Bank 2012). In the public accounting arena, Harun et al. (2012) depict the struggle to institutionalise accrual accounting within public institutions, specifically at the municipality level, due to the intricacies of political and economic forces, the limitations of technical capacity, the reluctance to abandon old practices, and the lack of enthusiasm to utilise accounting financial reports that have been prepared according to accrual accounting principles. Performance measurement systems, which have been designed as one core element of public accountability mechanisms under the new PFM framework, have not been able to improve the effectiveness and efficiency of public institutions because the development of performance indicators is being undertaken solely to meet regulatory requirements (Akbar et al. 2012). Based on fieldwork interviews in 2006 to 2007, Kristiansen et al. (2009) have highlighted the failure to enhance public financial transparency and accountability at district and municipality levels in Indonesia after the implementation of its decentralisation policy.

While the implementation of the new PFM laws in 2003 to 2004 aimed to establish stronger regulations for improving the transparency and accountability of local government, findings from the above-mentioned studies identified the existence of problems that contribute to the lack of transparency and accountability, potentially hampering the achievement of the overall objective of the PFM reform in local government. Further, the studies mentioned above clearly show the difficulties that arise when directing the performance of public institutions to comply adequately with the PFM regulatory framework that has been established. Proposed recommendations from those studies, however, do not focus on minimising these compliance gaps³ in the performance of public institutions. They seem to focus on the technical aspects of the PFM system and fail to recognise the endogenous characteristics of individual public employees and officials as well as the specific bureaucratic tradition in Indonesia's public institutions.

Bresser-Pereira (2004) suggests that the extent to which any public sector reform program is successful relies on the government's ability to direct and control bureaucrats to adapt their behaviours according to the reform objectives. Public employees and officials are the driving force for improving accountability, transparency, efficiency and effectiveness of the new PFM framework in Indonesia. The absence of an examination of the non-compliance of public employees and

³ The term 'compliance gap' is used in this thesis to refer to the deviation of the actual PFM practices from the expected practices stipulated in the relevant PFM rules and regulations.

officials in the previous studies has resulted in partial assessment of the implementation of the new PFM framework in Indonesia. This study aims to fill this gap by examining problems of non-compliance identified in relation to the implementation of the new PFM framework from the perspective of public employees, the main actors who carry out the reform tasks.

1.2. Scope of Study

Apart from the PFM reform, efforts to democratise Indonesia's governmental system also include the devolution of the central government's authorities, including the authorities regarding financial management, to local governments, through the adoption of a regional autonomy policy. The policy was established through the enactment of Law 22/1999 regarding Local Government and Law 25/1999 regarding Fiscal Balance. These regulations were then updated, in 2004, through the enactment of Law 32/2004 and Law 33/2004, respectively⁴. The new PFM regulatory framework, as stipulated in Law 17/2003, explicitly states that it not only provides a reference for the PFM reform but also intends to strengthen the foundation for implementing decentralisation policy in Indonesia. These twofold objectives of the PFM reform at the local government level add to the complexity of its actual practices, which leads to the importance of this current study to focus on the implementation of the new PFM regulatory framework at the level of local government in Indonesia.

Despite the transformation of the definition of PFM and the expansion of its coverage, in this study, PFM is simply defined as the management of the government budget. The design of the new PFM framework covered in the trilogy of financial laws, which is applied to all levels of government within Indonesia, encompasses the overall government budgeting processes that begin with policy design to develop the government's programs and activities and end with external audit and evaluation. Given the broader coverage of the government budgeting processes, the scope of this study only covers the implementation stage of the annual budget, which covers budget execution and accounting and reporting phases, starting from the preparation of a budget execution document and concluding with the preparation and finalisation of the government's financial reports. The term 'PFM operations', as introduced by

⁴ In 2014, a new local government law, Law 23/2014, was enacted to replace Law 32/2004. However, no major changes in the financial management of local governments resulted from the stipulations of the new law. The previously derived PFM regulations for local governments are still being enforced after the enactment of the new law. Most of the sections regarding local government financial management in the new law incorporate the arrangements that were established within the Trilogy of PFM Laws.

CIPFA (2010), is used throughout this thesis to refer to the above-mentioned scope of the study.

1.3. Objectives and Questions

The existence of compliance gaps in the implementation of the new PFM regulations after the reform in 2004 is of a great interest to the researcher. This study further examines those gaps from the perspective of public employees who are involved in the PFM operational processes on a daily basis. The gap refers to the non-compliance of public employees, which potentially leads to a number of systemic problems in PFM operational practices. Such problems may not only impede the efficiency and effectiveness of government operations but may also contribute to a lack of financial transparency and accountability within Indonesian public institutions.

The objective of this study is to examine the non-compliant behaviour of public employees who are involved in PFM operational processes in local governments in Indonesia. It encompasses the extent to which the non-compliance of the PFM actors⁵ has led to a number of systemic problems in PFM operations, the motives of PFM actors to become involved in non-compliant behaviour, and the influence of bureaucratic traditions in PFM operations upon non-compliance. This objective will assist current efforts to gain a more profound understanding of the nature of non-compliant behaviour of public employees involved in PFM operations, within the context of Indonesian local governments. This deeper understanding is essential to gain more insights for formulating better recommendations on how to confidently and steadily move the PFM reform agenda forward and to attain the objectives of the PFM reform.

To accommodate the above-mentioned objective, this study proposes the following research questions:

- 1. What are the systemic problems resulting from non-compliance that hinder the effective implementation of the new PFM operational framework in Indonesia's local government?*
- 2. What are the motives behind the behaviours of the PFM actors and how do those motives influence PFM actors to be involved in non-compliance?*

⁵ The term 'PFM actors' is used throughout this thesis to refer to public employees who are involved in various stages and components of the PFM operations.

3. *How do bureaucratic traditions in PFM operations influence the PFM actors to be involved in non-compliance?*

1.4. Methodology

This study follows interpretive research philosophy because the PFM practices undertaken by public employees display social constructs based on their personal interpretations and understanding of the new PFM regulatory framework. These characteristics lead to the application of a qualitative research methodology. The nature of the research questions in this study requires a two-stage research process through the adoption of content analysis and a case study method that uses a mix of documentation, focus group discussion and semi-structured interviews as the data gathering techniques.

The first stage addresses the first research question to identify the systemic problems in Indonesia's PFM operational practices after the reform as a consequence of non-compliant behaviour of the PFM actors. It adopts the content analysis method and applies it to BPK's Audit Reports Summary that sums up BPK's audit findings disclosed in all audit reports published during a certain semester⁶. The description of the audit findings reported in the audit reports reveals the nature of PFM actors' non-compliance, including the relevant rules and regulations that have been violated and the causes and impacts of those non-compliant behaviours. Comments from the relevant officials on the audit findings and the proposed recommendations from BPK to overcome the problems also are included in the audit reports. Since the coverage of the Audit Reports Summary includes audit findings for all local governments in Indonesia, that is also the scope of the analysis for the first stage of this research.

The second and third research questions are addressed in the second stage of the research design. Given some resource constraints, the second stage adopts a single case study method. West Lombok District has been selected as the subject of the study. Content analysis of the audit reports was repeated in the second stage but was limited to the audit reports of West Lombok District. This reiteration was important to provide the context for this particular case because not all systemic problems identified in the first stage occurred in West Lombok District. Similarly, not all problems found in West Lombok District were identified, or significant, at all local government level. A focus group discussion (FGD) with BPK's auditors who audited West Lombok

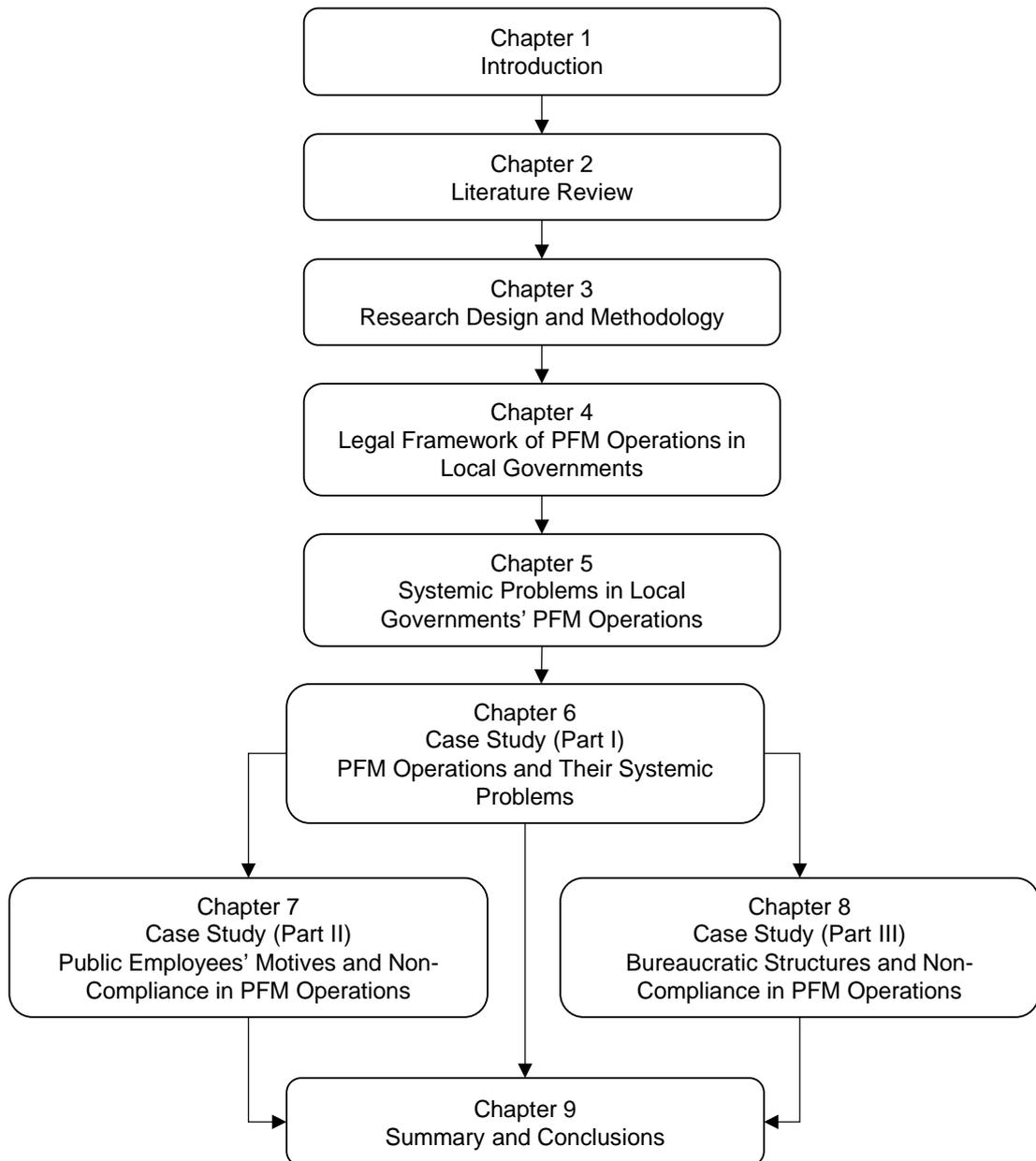
⁶ Financial year in Indonesia starts from 1 January to 31 December. A Summary of Semesterly Audit Reports for the first semester sums up all BPK's audit reports published between 1 January and 30 June, while the summary for the second semester encapsulates the audit reports published between 1 July and 31 December.

District was also conducted to supplement and expand upon the results of the content analysis. The understanding of the context of the case that was gained from content analysis of audit reports and the FGD with the auditors was then utilised to develop in-depth semi-structured interview questions. The respondents of the interviews were public service employees who worked in various positions within agencies and offices in West Lombok District. Thematic analysis of the interview transcripts, using the template analysis method, was conducted to identify and examine the motives of the PFM actors and the influence of bureaucratic traditions upon the occurrence of non-compliance in PFM operations.

1.5. Thesis Structure

To provide guidance on the overall presentation of this thesis, Figure 1-1 depicts its general structure. Following this introductory chapter, Chapter 2 reviews the literature relevant to this present study, focusing on the two main aspects: (1) PFM and its operational components, and (2) bureaucracy, the dominant organisational model in public sector institutions. Chapter 2 provides a point of reference for the researcher to examine the perspectives of public employees to problems of non-compliance in PFM operations, through the lens of public bureaucracy theory.

**Figure 1-1
Structure of the Thesis**



Chapter 3 deals with the research methodology. It extends the discussion of research methodology in this introductory chapter by providing further details on the research approach and methods, as well as data gathering techniques and analysis, including other essential elements such as research ethics and confidentiality of research data.

Chapter 4 describes the legal framework that is applied to PFM operations within all local governments throughout Indonesia. It provides a reference for the expected practices and behaviours of local government employees undertaking all processes involved in PFM's operational stages.

Chapter 5 discusses the content analysis results of BPK's audit reports. It specifically addresses the first research question and examines non-compliant behaviour, exemplified by the actual local governments' PFM operational practices. It also elaborates upon the impacts of those non-compliant behaviours to the emergence of systemic problems in the PFM operations of local governments in Indonesia.

Chapter 6 commences the case study report. It aims to provide contextual information regarding PFM operational practices in West Lombok District. It describes the profile of West Lombok District, the single local government case selected for this study, which is then followed by discussion regarding its specific PFM operational arrangements and the identified systemic problems, as disclosed in BPK's audit reports. The discussion in Chapter 6 provides contextual information and a reference for the actual PFM operational practices and non-compliance of PFM actors in West Lombok District, which is essential for comprehending subsequent chapters that discuss the influences of PFM actors' motives (Chapter 7) and the bureaucratic traditions in local government PFM operations (Chapter 8) upon non-compliant behaviour.

The overall conclusion of the research and the implications of the study are presented in Chapter 9, which also provides suggestions for the future direction of research into PFM in the Indonesian context, in particular, and in the context of developing countries in general.

Chapter 2

Literature Review

This chapter considers the literature pertinent to the topic and scope of this study. It is separated into two major sections. The first section reviews the literature regarding public financial management (PFM). General aspects, such as its definition, coverage, key objectives and the PFM reform processes, are described, followed by a discussion of its cycle within the phases of overall government budgeting. A more detailed review relevant to the operational aspects of PFM, including its components, practices, key actors and common problems of non-compliance, is then extensively discussed. The first section provides a reference for addressing the first research question of this present study. The second section focuses on public bureaucracy, which is the broader organisational context within which PFM operates. It discusses two typical characteristics of public bureaucracy and the impacts of both characteristics in allowing the manifestation of non-compliance among public employees and officials. The first characteristic is the public employees' motives in carrying out their roles and the second is the bureaucratic traditions in public institutions, which refer to the structural features of public bureaucracy. The second section aims to provide relevant references for addressing the second and third research questions of this study.

2.1. Public Financial Management (PFM)

The literature that discusses PFM is substantial, ranging from theoretical academic textbooks and articles by scholars in political science and public administration to weighty handbooks on PFM reform prepared by a number of international organisations. A large number of evaluation reports and case studies at a country-specific level further expand the world of PFM literature. Fedelino and Smoke (2013) argue that the key elements of PFM and the budgeting process are similar for all levels of government; thus, while the discussion of PFM literature in this section mostly refers to the central government level, it is also applicable to local governments. Additional explanation is provided, as required, where there are differences between the central and local government levels. It is also important to note that different legal and institutional contexts among countries have often caused PFM to be seen as a domestic issue, with only a rare general international view of PFM being found in the literature (Steccolini 2010). A more thorough and contextual

review of PFM in Indonesia's local governments, specifically in relation to its operational components, is presented and discussed in Chapter 4.

2.1.1. Definition and Coverage

Initially, PFM belongs within the domain of public finance, which is basically about the taxing and spending activities of a government (Rosen 1999). According to Miller (1994), PFM can be viewed using three different frameworks: economics, accounting and budget execution. All of those frameworks define PFM in relation to the management of government budgets, as it is also defined by Hughes (2003).

Recent developments in the field of PFM have demonstrated a broader and more complex PFM structure (Pretorius and Pretorius 2009; Cangiano et al. 2013). It is not merely related to technical issues, such as the accounting and reporting mechanisms of government budgets (Lawson 2015), but covers the holistic revenue and expenditure management of government and how that impacts the overall allocation of public resources. The broader coverage of PFM has led to the development of a holistic and more objective-focused definition of PFM. The Chartered Institute of Public Finance and Accountancy (CIPFA) has initiated the development of a universal definition of PFM by identifying the effectiveness of PFM in achieving its goals and delivering the best goods and services to the citizens as the core of PFM (CIPFA 2010). CIPFA (2010, 5) further defines PFM as *“the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective delivery of public service goals”*.

This recent development shows that PFM goes beyond the narrow government budget definition. Cangiano et al. (2013, 2) posit PFM *“as an umbrella definition, covering a set of systems aimed at producing information, processes, and rules that can help support fiscal policymaking as well as provide instruments for its implementation”*. It covers all aspects of managing public resources including progressive expansion into fiscal policymaking. It supports the development of sustainable fiscal policies from the perspectives of both the medium- and long-term. It forecasts the potential impacts and risks of today's policy decisions in regard to public resources. Those characteristics of PFM provide support to the formulation of a sustainable fiscal policy for any country.

Such expansion displays a broader public sector context in which PFM operates, beyond the central government level. For example, most local governments still rely on grants from their central government to finance their activities because they may have limited authority to collect taxes on the economic activities taking place or from

the institutions residing within their borders. In addition, public corporations may engage in specific transactions to carry out government functions or operations. Thus, their activities may have impacts upon a country's fiscal sustainability. To accommodate this, Cangiano et al. (2013) have included broader public sector institutions in the scope of PFM, which involves all levels of government that includes central, state/provincial, and local governments, as well as public corporations, such as state-owned enterprises, public-private partnerships, and the central bank.

The term 'PFM' is occasionally used interchangeably with the term 'public expenditure management', which is defined by Allen et al. (2004, 2) as:

“... all of the components of a country's budget process – both upstream (preparation and programming) and downstream (execution, accounting, control, reporting, monitoring, and evaluation) – including legal and organisational framework arrangements”.

It includes the formulation of potential revenues and expenditures, the development of medium-term expenditure frameworks, the efforts to link budget with policymaking, the preparation of budget, the management of cash and expenditure, the procurement of public goods and services, the management of assets, the implementation of an internal control and monitoring system, the implementation of a financial accounting and reporting system, the establishment of government performance management frameworks, and the establishment of an effective external audit function including the proper oversight roles of the legislature and other bodies (Allen et al. 2004). While the term 'public expenditure management' seems to focus on the expenditure side of the budget (Potter and Diamond 1999), it does include the formulation process of potential revenues, such as from taxation and revenue-sharing in the case of local government, to assist the formulation of expenditures budgets, especially in terms of prioritisation of the proposed activity to be included in the budget and identification of other revenue sources. In terms of PFM's definition, despite the debate about the inclusion of revenue mobilisation in the definition of PFM (Simson et al. 2011), most scholars agree that PFM encompasses the mobilisation of public revenue, allocation of public funds, undertaking of public spending, procurement of public goods and services, management of public assets, treasury management, and government accounting and auditing (Premchand 1999; Kioko et al. 2011; Lawson 2015; Simson et al. 2011).

2.1.2. Key Objectives and the PFM Reform

The transformation of the definition of PFM and its coverage has made it possible for PFM to actively contribute to the achievement of its widely accepted key objectives

of: (1) maintaining a sustainable fiscal position, (2) effective allocation of resources, and (3) efficient delivery of public goods and services (Schick 1999; Allen and Tommasi 2001; PEFA 2011). The first objective of maintaining aggregate fiscal discipline has a nation-wide perspective in providing the overall expenditure control of government spending, coordinated by the Ministry of Finance (Allen and Tommasi 2001). At this level, budgeting is used to ensure the achievement of sustainable macroeconomic indicators, such as the level of fiscal deficit and public debt ratio in the long run. Those indicators are included in a medium-term macroeconomic framework, which is commonly prepared in many developed countries to guide the development of their annual budgets.

The second objective of allocative efficiency focuses on the establishment of priorities within the budget to strategically allocate the scarce public resources to chosen development sectors, on the basis of both the government's priorities and the demand of the public in general. It refers to resources allocation decisions and is mainly under the responsibility of line ministries, spending agencies and the inter-ministerial coordination mechanisms (Allen and Tommasi 2001).

The third objective of operational efficiency deals with maximising value for money. It ensures the optimum combination of economy, efficiency and effectiveness in the provision of public goods and services by the government (Lawson 2015). This objective focuses on the lower-level government functions such as directorates, programs, or projects (Allen and Tommasi 2001).

Lawson (2015) argues that the success of a PFM system depends on how its implementation can simultaneously achieve those objectives. However, the interdependence among those objectives creates a major issue for any government to concurrently achieve all of the objectives within an optimum balance (World Bank 1998; Allen and Tommasi 2001). Efforts to focus on the achievement of a certain PFM objective may undermine the achievement of the other objectives. For example, lack of discipline in prioritising resources allocation among strategic programs, as required to achieve allocative efficiency, may cause a mismatch between policy objectives and resource allocation at the aggregate fiscal discipline level, hence resulting in inadequate funding of resources to achieve operational efficiency.

In addition to those three key objectives, Parry (2010) and Lawson (2015) have highlighted the importance of enhancing transparency and ensuring accountability as another dimension of a sound PFM system. Transparency and accountability encompass a wider public sector domain and are important elements of a democratic

society. They should exist in all government activities, including efforts to achieve the key objectives of a PFM system. In relation to PFM, transparency is achieved through open processes and freely available public financial information and reports; while accountability is achieved through adherence to legislation, regulations, rules and procedures, including an ethical code of conduct and the avoidance of corrupt practices. Information regarding the level of conformity of the PFM processes to the regulations should be made public to ensure accountability through the application of democratic checks and balances mechanism (Lawson 2015).

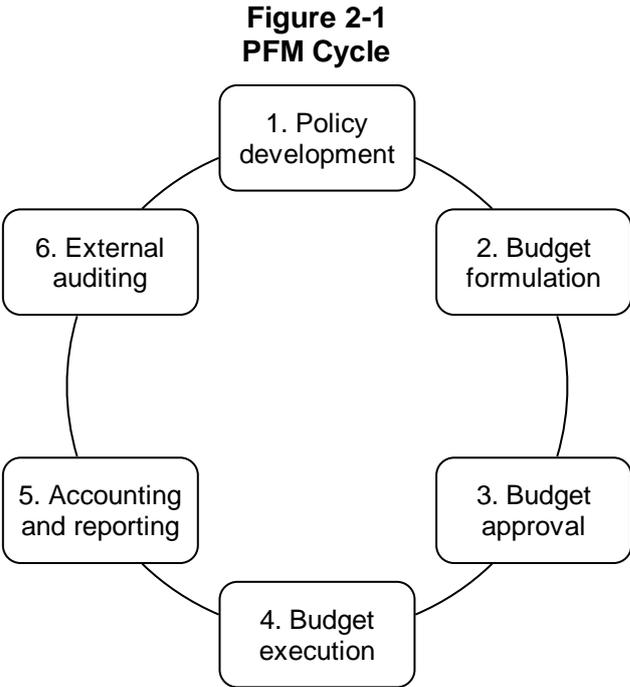
PFM reform aims to ensure the establishment of those PFM key objectives. It involves adjustments in the financial management and administration processes through the identification and utilisation of new information and the establishment of constraints under which the individuals act and behave (Schick 2013). By the same token, Allen (2013) indicates that PFM reform refers to the effort to strengthen the enforcement of laws, procedures, and rules to effectively align the behaviour of public officials and organizations towards the attainment of the PFM key objectives. Numerical fiscal rules, for example, have been used in many countries as an instrument to shape and direct the behaviour of the PFM actors towards the establishment of medium and long term fiscal sustainability (Budina et al. 2013). Nevertheless, the reform process in developing countries, as suggested by Allen (2013), is *'difficult and slow'*. The typical approach of the PFM reform that predominantly focuses on the formal and technical characteristics of the PFM system has contributed to the slow progress of the reform. The approach has ignored the presence of informal rules and the lack of incentive structures in the organization that do not induce individuals to act and behave in accordance to the intended objectives of the reform. Further, Allen (2013) mentions that factors other than the technical ones have increased the complexity of the PFM reform.

2.1.3. PFM Cycle and Budgeting Phases

Despite the expansion of PFM's definition and coverage, a government's budget remains the vital instrument in a PFM system (CIPFA 2010) and it is used to ensure the achievement of the key PFM objectives (World Bank 1998; Allen and Tommasi 2001; Lawson 2015). PFM encompasses a broader function than being merely a technical financial management process and it is generally considered to be a comprehensive budgeting cycle that has six phases (Lawson 2015) as depicted in Figure 2-1. The budgeting cycle commences with policy development where a number of stakeholders including the public, research bodies, political parties and the

government's executive are involved in providing advice, input and suggestion on what programs and activities should be prioritised to be carried out. In a decentralised government, local communities are also encouraged to participate in the policy development process to ensure the inclusion of local needs in the local government budget and to close the gap in the policy development.

The second phase is budget formulation, where the policy priorities are linked to the next year's available public financial resources (Simson et al. 2011), and it is presented in monetary terms. The Ministry of Finance usually prepares a Medium Term Expenditure Framework (MTEF) where macroeconomic targets are set to guide the budget formulation process that is technically prepared by the spending agencies under the coordination of the Ministry of Finance. The MTEF generates a link to allow expenditures in the annual budget to be driven by policy priorities while still being able to accommodate the realities of limited resources (World Bank 1998). The application of an MTEF is widely accepted and serves as a central element of sound PFM in developing countries where, as Houerou and Taliercio (2002) argue, the disconnections among policy-making, planning and budgeting are still common. However, the impact of the MTEF on local government budgeting processes is rather problematic. An MTEF can be seen as a pressure from central government that potentially diminishes the role of local government in policy development (Holmes and Evans 2003). During the budget formulation process, oversight in the form of ongoing consultation with the legislative bodies also usually occurs.



Source: Lawson (2015)

The third phase, budget approval, marks the end of the budget formulation phase. The budget is approved by the legislative body and is enacted in the form of budget law. Budget approval by a legislative body, which in a democratic country is a representative organ of its citizens, is a fundamental principle whereby the executive is given the authority to collect money from the public and to spend those monies in accordance with a set of appropriations that are stated within the budget (Schiavo-Campo 2007a).

These first three phases of the PFM cycle are considered to be the budget preparation stage and mainly address the PFM's key objectives of maintaining a sustainable fiscal position and effective allocation of resources (Schiavo-Campo 2007b). A sound budgeting system must set clear sequences and timetables of budget preparation activities, in advance, to ensure that the budget is approved before the beginning of the new financial year (DFID 2001). The differences among systems of government and the roles of key actors in the budget preparation stage may alter the detailed practices and activities of the phase of policy development, budget formulation and budget approval within each country (Potter and Diamond 1999).

Once the budget law has been enacted and the new fiscal year starts, spending agencies and the Ministry of Finance begin the fourth phase of the PFM cycle: the budget execution. Spending agencies have the authority to spend the money according to the appropriation stipulated in the budget. However, in some countries, the appropriated budget amounts still need to be converted into a more detailed budget document in the form of government decrees or regulations (Lienert and Jong 2004). Budget execution involves not only the disbursement processes of the budget in the form of, for example, payment of salaries and wages, payment of operational costs of government offices and payment of procurement of goods and services to run the public service delivery functions of the government, but also the revenue collection processes and treasury management (i.e. cash, debt and investment). They are also essential factors in the budget execution phase because they may affect the availability of funding to make timely payments for running government programs.

The fifth phase, accounting and reporting, occurs in parallel throughout the budget execution phase. Each spending agency is required to record its financial transactions according to certain accounting standards set by the government, with a consistent and comprehensive classification of accounts to facilitate the preparation of a financial statement that can be analysed and compared over a period of time (World Bank 1998). Lienert and Jong (2004) consider the accounting and reporting phase to be

part of the budget's execution. A well-defined accounting system must exist to assist the preparation of periodic budget execution reports. These reports are not only essential for the government to internally monitor its budget execution but also for the legislative body to perform its function of controlling the implementation of the government's budget. The content of the report may contain financial data, such as budget realisation figures for all accounts, as well as non-financial data, such as information in regards to the attainment of the performance targets. At the end of the fiscal year, the Ministry of Finance prepares a consolidated financial statement that demonstrates how the budget has been implemented.

The last phase of external auditing involves external scrutiny by a Supreme Audit Institution (SAI)⁷, which is an independent government body, to ascertain the fairness of the government's financial statement and to ensure that agencies have acted in accordance with laws and regulations. Recent developments in the field of external auditing have displayed a common trend among SAIs to also undertake a value-for-money audit that assesses the economy, efficiency and effectiveness of government agencies in achieving the stated goals and objectives. External auditing by an SAI is the main accountability mechanism for financial management in public institutions. The publication of its audit reports also heightens the transparency of the overall PFM system.

2.1.4. PFM Operations

The previous sections have discussed PFM from a holistic point of view. In this section, a further review relevant to the scope and focus of the study is presented. As mentioned in Chapter 1, the scope of this research is the budget implementation stage, which covers both the budget execution and the accounting and reporting phases of the budgeting cycle. Some literature considers the accounting and reporting phase as part of the budget execution phase (see for example: Allen and Tommasi 2001; Lienert and Jong 2004) and the terms 'budget implementation' and 'budget execution' are used interchangeably. This thesis uses the term 'PFM operations', as introduced by CIPFA (2010), to refer the above-mentioned scope of the study, starting from the preparation of the budget execution document until the preparation and finalisation of financial statements. The first part of this section discusses the main components of PFM operations, while the second part discusses problems of non-compliance problems in PFM operations.

⁷ BPK has a role as the SAI of the Republic of Indonesia.

2.1.4.1. Components of PFM Operations

According to CIPFA (2010), PFM operations are the principal financial management activities that are embodied in the overall PFM system to assist in the achievement of the PFM key objectives and they comprise eight main components, as follow: (1) budget execution, (2) procurement, (3) revenue collection, (4) treasury management, (5) financial transactions, (6) accounting, (7) financial management information systems, and (8) reporting. The following section discusses each component in more detail.

2.1.4.1.1. Budget Execution / Disbursement

CIPFA (2010) uses the term 'budget execution' to refer to the process of spending the financial resources already allocated in the budget to deliver the government's programs and policies. Simson et al. (2011) simplify the process of budget spending into the four main steps of: (1) authorisation and allocation, (2) commitment to pay, (3) verification of deliveries, and (4) payment. The annual budget law gives formal authority for spending units to spend the allocated funds according to the program's appropriation and budget classification. Nevertheless, in many countries, this still needs to be converted into a more detailed budget execution document. A budget execution document is prepared to give de facto authority to spending units to utilise resource allocation in the budget for the provision of goods and services in the current year (Allen and Tommasi 2001). A timely completion of the budget execution document (i.e. before the start of the fiscal year) is important to ensure the smoothness of a government's operations at the beginning of the fiscal year.

A spending unit, based on the budget execution document, can carry out contracts for the provision of goods and services that eventually generate commitments to pay for the government. A successful disbursement process relies on the ability of the agencies to record and monitor commitments that have been made (Allen and Tommasi 2001). This ability is important to enable the government to make accurate and timely payments, which ultimately builds trust in the government and provides appropriate assurances for other parties that provide goods and services to the government.

A verification process is established before the payment to each outstanding commitment can be processed and executed. The spending unit carries out the verification process to check whether or not goods and services have been delivered and whether they conform to the provision specified in the agreements of the contract. For very technical items, such as road or building construction work, a specialised

handover committee may be established to conduct the verification process. The general principle of segregation of duties separates the unit that receives and verifies the goods and services from the entity or officials that authorise the payment, even though they may be in the same agency (Allen and Tommasi 2001).

After goods and services have been received and verified, payment orders are prepared by the spending units. The Ministry of Finance verifies the payment orders to ensure that the payment does not exceed the budget ceiling, that the classification of accounts is correct, that the authorised officials have signed the payment order properly, and that the supporting documents are attached (Hashim and Allan 2001; in Achmad 2012). Once the payment orders have been verified, payments can be processed by transferring money from the government's bank accounts to the appropriate beneficiaries. Similar disbursement procedures of commitment, verification, issuance of payment orders and actual disbursement of fund are also applied when handling routine payments, such as for personnel expenses (i.e. salaries, pensions, entitlements, etc.).

The interplay with other components of PFM operations, such as treasury management, is evident in the disbursement process. The verification process for payment orders is an attempt to match payment orders with the availability of funds before the payment is made, hence avoiding the risk of accumulation of payment arrears (Potter and Diamond 1999). As it also checks the conformity of the payment orders with the classification of accounts and budget items, the verification process can prevent the problems of potential overspending and misallocation of funds that can disrupt the activities of other agencies and the overall government's programs (CIPFA 2010). It can also prohibit any payments to unauthorised recipients (Allen and Tommasi 2001).

In addition, unexpected changes in the macroeconomic environment may occur at any time and should be accommodated properly to avoid any disruptions to the activities of the agencies (Simson et al. 2011). This leads to an important role of the Ministry of Finance in monitoring and managing those changes and proposing any necessary budget alterations. The complexity of the budget execution also increases because agencies must transmit the message incorporated in the budget into the actual delivery of government programs and activities while, at the same time, responding to the feedback received from the actual implementation of the budget in a timely manner and appropriate fashion. Any budget alterations require amendment of the annual budget and cannot be executed without approval from the legislative body. Supplemental budget requests can be considered to accommodate any

substantial changes that need to be implemented immediately while the budget amendment is being prepared and submitted to the parliament for its approval (Simson et al. 2011). The capacity of agencies to manage that complexity in an effective way is essential to ensure budget execution can actively support the achievement of the three key objectives of PFM: fiscal stability, effective utilization of resources, and value for money in the delivery of public services.

2.1.4.1.2. Procurement

Procurement is the process of acquiring goods and services, including construction works, which are then utilised to deliver the governments' programs as stipulated in the budget. Obviously, it comes before the disbursement process, however, agencies cannot initiate procurement without the initial inclusion within the budget document of the programs that are going to utilise the procured goods and services. The procurement of low-cost goods can be conducted according to a simple procedure; however, the procurement of more expensive goods and services requires a complex competitive bidding process (Simson et al. 2011). Procurement involves the process of identification of needs, determination of procurement procedure and a tendering process (Allen and Tommasi 2001). CIPFA (2010) also considers the procurement cycle to include the process of managing and monitoring the progress and delivery of the contract, the management of the procured assets throughout their useful lifetimes and the eventual disposal of the assets.

Allen and Tommasi (2001) argue that procurement is one common source of corruption. They contend that sound procurement policies and practices that adopt open competition, transparent procedures and principles of fairness are required to minimise the risk of corruption, while also providing equal opportunity to all bidders and ensuring the acquisition of goods and services at a competitive price without undermining the quality of the procured items. The PFM legal framework of a country should include a procurement standard that can minimise any conflicts of interest of the public officials who are involved in the procurement process by having adequate segregation of duties, proper delegation of financial authority and clear assignment of responsibilities. In addition, a periodic rotation of officials is also essential to mitigate the risk of corruption as a result of potential collusion practices between the buyer (i.e. the government's officials) and the supplier. Hence, while procurement can be viewed as an independent topic on its own, it is also an integral and essential part of PFM operations (CIPFA 2010) and has a significant impact on the operational efficiency of the whole PFM system.

Simson et al. (2011) highlight the trend toward the adoption of a more decentralised procurement system by most countries, whereby each spending agency maintains its own procurement process. In such a system, however, a central public procurement board exists to supervise and oversee the overall procurement system. The board establishes procurement policies, coordinates strategic purchasing decisions across the spending units and both informs and publishes procurement guidelines to all stakeholders (i.e. potential bidders, suppliers, and internal government units as buyers). The board can also promote competencies, introduce good practices and initiate improvement plans that are required to empower spending units in a decentralised procurement process. CIPFA (2010) views a central procurement board as a good governance arrangement within a public procurement system.

2.1.4.1.3. Revenue Collection

This component refers to a government's activity in collecting revenues from taxes and other non-tax sources. In general, the provisions regarding taxation and other types of revenue should be based on a clear and legitimate regulatory framework (CIPFA 2010). The framework should lay out clear rules and regulations regarding the assessment basis for calculating the amount of tax payable, the due date of payments and the procedure for making payments. Strict application of the rules should be enforced to ensure certainty in the amounts of revenues to be collected and the times they are going to be received.

The entire revenue collection process, from registration and assessment to payment, should be efficient so that high collection rates can be attained and the cost of collection is minimised. In addition, prompt and timely collection of valid revenues is important to ensure the availability of cash for paying off any commitments that emerge from carrying out government programs (Tommasi 2007). Advancement in the banking sector's network and infrastructure has enabled commercial banks to provide a more efficient revenue collection process than the conventional way of collecting revenue through the government's tax office. On the one hand, payment through banks provides convenience to taxpayers to fulfil their taxation liabilities; while, on the other hand, it allows the government to focus its efforts on ensuring the compliance aspects of the revenue collection process. Those compliance activities may include identifying and tracking taxpayers, issuing accurate and timely tax assessments, and monitoring timely payments (Tommasi 2007). To effectively improve the level of tax compliance, governments should also consider instigating tax education and public awareness programs, extensive efforts to collect tax arrears,

examination of tax payment obligations, and the imposition of sanctions and penalties for any violations of tax obligations (CIPFA 2010).

2.1.4.1.4. Treasury Management

Treasury management plays a central role in ensuring timely availability of funds to meet payment commitments and to prevent accumulation of arrears, while also minimising the necessity for borrowing and optimising the returns on idle cash (Simson et al. 2011). Tommasi (2007) highlights the coverage of treasury management to include cash management, management of government's bank accounts, accounting and reporting, cash flow forecasting, management of government debt and management of financial assets. In developing countries, it should also include the administration of foreign grants and other international aid.

Sound cash management requires good periodic cash planning and adequate control over cash transactions. Based on its annual budget appropriation for each activity, a spending agency prepares a cash plan by forecasting its monthly revenue and expenditure flows, and reporting the forecast to the treasury office. Some developed countries can prepare a more detailed daily or weekly cash plan. Even so, constant revision of the forecast is required to ensure up-to-date cash planning (Hashim and Allan 2001). Cash management is the heart of a public treasury system. It makes significant contributions to the support of fiscal discipline and the maintenance of adequate cash balances while also providing expeditious support for spending units in the disbursement process. Unfortunately, many developing countries still struggle to maintain a sound cash management system and often confuse the term 'cash management' with 'cash rationing', which usually leads to undesired budget cuts (Lienert 2009).

Central control over cash can be achieved through the adoption of the Treasury Single Account (TSA) method. TSA is defined as "*a unified structure of government bank account enabling consolidation and optimum utilization of government cash resources*" (Pattanayak and Fainboim 2011, 2). The application of TSA requires the provisions of all government receipts and payments to be transacted through a single bank account or a set of linked bank accounts so that a consolidated view of the cash position can be recognised at the end of each day. In the TSA model, even though cash balances must be centralised, all payment funds can be allocated to the spending agencies' bank accounts for payment processes adopting the imprest system, by which spending agencies are given the funds, in advance, to be cleared on a periodical basis (Simson et al. 2011). In countries that have a well-developed

commercial banking system, spending agencies can maintain bank accounts for their receipts and payments at commercial banks (Pattanayak and Fainboim 2011). However, the main TSA account should be held at the central bank because it is the fiscal agent of the government.

The adoption of TSA can assist government in making a strategic decision in regards to not only its cash management but also its debt and investment management (Lienert 2009). TSA enhances the ability of government to comprehensively monitor the consolidated cash resources, preventing them from borrowing money and paying costly interest charges to fund the expenditures of some agencies while other agencies have idle cash in their bank accounts. On the other hand, when a cash surplus is identified, the excess can be invested into profitable financial instruments.

2.1.4.1.5. Financial Transactions

Financial transactions are embedded in all activities of governments. CIPFA (2010) highlights that typical financial transactions of government, such as revenue, payments, payroll and pension administration, require adequate performance indicators to measure unit costs, trends, accuracy and timeliness. In addition, strict internal control procedures should be applied due to the complexity and the immense volume of the government's financial transactions (CIPFA 2010).

Financial transactions do not stand in isolation. They require proper recording procedures to be implanted within the accounting system and the inclusion of the financial transactions data in the government's financial management information system (FMIS) database. The interconnection of financial transactions with an accounting system and FMIS is essential to ensure a reliable financial reporting process for the government.

2.1.4.1.6. Accounting

Accounting is a central element of PFM for ensuring the accountability of the government in the management of public finances. An accounting system enables government to record, classify and summarise its financial transactions as well as report on financial outcomes. An appropriate accounting system assists government to ensure that its financial activities comply with financial management rules and that public funds are being used in accordance with the intended purposes stipulated in the budget (Simson et al. 2011). Allen and Tommasi (2001) consider the core components in a government's accounting system to be the maintenance of spending authorisation records on budget execution, the recording of all financial transactions,

the maintenance of general ledger accounts and the presentation of the financial reports.

Most developing countries are still using a cash-based accounting system (Simson et al. 2011; USAID 2008), which recognises financial transactions based on the timing as to when cash is received or disbursed. However, recent global trends have shown a preference toward an accrual-based accounting system, which records the transactions when an obligation or a right is established. Accrual accounting enables government to record its payables, receivables, assets and liabilities. It provides more accurate information regarding the government's financial position and performance, allowing a better assessment of its financial outcomes against the budget. Despite its advantages, the adoption of accrual accounting by developing countries that do not have adequate financial management infrastructure and capacity has to be considered carefully (Simson et al. 2011). In practice, a variety of modifications from cash-based to accrual-based accounting have been developed to provide options for the gradual adoption of accrual-based accounting by developing countries.

2.1.4.1.7. Financial Management Information System (FMIS)

The availability of reliable and timely government financial data and information is one critical factor that can impact the effectiveness of budget management of a country. In some developing countries, budget execution and accounting processes are still characterised by manual processing and inadequate computerised infrastructure, causing a lack of reliable and timely government financial data and information (Diamond and Khemani 2005). This situation restricts the ability of the government to properly plan, implement, monitor and report its budget. It also hampers the transparency and accountability of the government, and undermines the governance arrangements of most developing countries.

An FMIS is considered as a set of tools that link and integrate planning, budget preparation, budget implementation and the accounting and reporting phase of budgeting cycle (DFID 2001). It enables the integration of financial information into all PFM operational components via the utilisation of IT resources throughout the government's line ministries and spending agencies (Diamond and Khemani 2005). The implementation of an FMIS requires at least a well-established accounting system, as it is the core element that can generate accurate and complete general ledger where all inflows and outflows of government funds are recorded (Allen and Tommasi 2001). Other information systems, such as payroll, budget development, procurement, assets and individual project ledger, do not necessarily have to be

included in the FMIS (Diamond and Khemani 2005; Allen and Tommasi 2001). Interfaces can be developed and established to link the core accounting and reporting systems to other information systems in order to create a fully integrated FMIS.

Despite the significant advantages of implementing an FMIS, Diamond and Khemani (2005) found that the development and adoption of an FMIS in developing countries is very expensive and vulnerable to failure. Most developing countries do not have strong political commitment, sufficient human and financial resources, widespread internal governmental support or an effective change management agenda to support the adoption of an integrated FMIS (Diamond and Khemani 2005). A gradual and phased approach to the implementation of an FMIS in developing countries has been suggested by some PFM scholars (Simson et al. 2011).

2.1.4.1.8. Reporting

The publication of a government's budget and accounts is the primary instrument for public accountability. The PFM framework of a country should be able to provide clear and objective information regarding its government's budget and accounts. In regards to financial reporting, this involves the extraction of data from the government's accounting system and the presentation of the data in a way that can facilitate both internal analysis and external public scrutiny (Simson et al. 2011). The government's reports should include not only financial information regarding the budget and its execution but also information beyond the government's financial accounts: for example, assessment reports on the outcomes of budgetary policies. In most developing countries, the adoption of performance-based budgeting creates difficulties because it asks for the presentation of non-financial information that can link financial information to progress in the achievement of outputs and outcomes stipulated in the budget.

In general, the following reports are typically required as part of sound PFM operational practices: daily cash flows monitoring report, monthly budget execution and management reports, mid-year financial and performance reports, annual financial reports for external audit, and accountability reports to the parliament (Simson et al. 2011; Allen and Tommasi 2001). In developing countries where international financial aid is provided, the government may be required to prepare separate reports to fulfil lenders' needs. Overall, the reporting component of PFM operations should be designed to enable the government to present its budget and financial reports in a number of various formats to accommodate the different needs of its audiences (CIPFA 2010).

Apart from the eight components of PFM operations mentioned above, CIPFA (2010) also includes internal control within the PFM operational design. It is a complementary component of PFM operations that aims to measure the progress and achievement of budget milestones and to keep the government on track in actualising the ultimate outcomes of their budget (CIPFA 2010). It refers to policies and procedures that are put in place by the government to ensure: the achievement of its agencies' objectives and missions; the adherence to laws, regulations and other internal directives such as standard operating procedures (SOP); the safeguarding of public resources, including assets, against waste, abuse and mismanagement; the stimulation of effective and efficient government operations; and the presentation of reliable, fair and timely financial information (INTOSAI 2001). Internal control encompasses a number of components that include: performance management; budget monitoring; risk management; internal financial controls; fraud prevention, detection, and investigation; internal regulations, written standards and manuals of operation; and partnership frameworks (CIPFA 2010). New developments in the field of PFM encourage the establishment of an internal audit function (Simson et al. 2011), which is distinct to an internal control (CIPFA 2010). It independently reviews, examines and reports upon the implementation of programs and policies to the heads of government agencies. In summary, the World Bank (1998) states that a professional internal audit function is an important element of modern internal control in the public arena.

2.1.4.2. Problems of Non-compliance in PFM Operations

The major challenge that PFM systems face is the necessity to simultaneously meet the three key objectives of maintaining a sustainable fiscal position, allocating public funds effectively and promoting efficiency in the delivery of goods and services (ADB 1999). The PFM operational processes mostly deal with the third objective of maximising the value for money, which ensures the optimum combination of economy, efficiency and effectiveness in the provision of public goods and services by the government (Lawson 2015). At this level, it is critical to maintain compliance with the budget allocations stipulated within the budget law and with other relevant laws or regulations that provide detailed procedures for arranging the actual spending and disbursement of funds (Lienert and Jong 2004). Simson et al. (2011) further express the view that emphasis on compliance with the appropriation limits and other rules is required in the execution of a budget to prevent corruption and overspending, while ADB (1999) mentions that focus on compliance would ensure the disbursement of funds under the budget's ceiling and according to its intended purposes. Conformity with budgetary authorisation also ensures proper control over the overall budget

execution processes and can ultimately enforce the achievement of the fiscal target (ADB 1999). Conformity with budget law and relevant PFM rules and regulations is also essential for ensuring the accountability of public institutions.

The day-to-day PFM operational processes are mainly carried out by lower-level government functions, such as directorates, programs or projects, within the line ministries or local government units (Allen and Tommasi 2001; CIPFA 2010). In contrast, the legal PFM operational framework is commonly stipulated in the PFM organic laws and it is set by the central government (Schiavo-Campo 2007a) through approval from the Parliament. The same process also applies to the preparation of the annual budget. While lower-level government functions are involved in the budgeting process through a technocratic process of preparing their budget proposals, finalisation of the government's budget is made through political process involving the central government bodies and the Parliament. Other derivatives regulations are also set centrally by the Ministry of Finance and they are applied to all public institutions. This situation creates potential conflict during budget implementation because policies and programs stipulated in budget document and PFM rules and regulations may not be properly interpreted by the lower-level operational units (Hackbart and Ramsey 1999). As a result, the actual behaviour of the PFM actors often deviates from the intended behaviour as specified in the budget documents and regulations. The potential for conflict is enormous because PFM operational processes involve a large number of players who have to coordinate their roles and responsibilities effectively. Such a complex environment may limit the ability of internal controls and other enforcement measures to effectively monitor the behaviour of the PFM actors and to ensure their adherence to the stipulated rules and regulations. In addition, the risk of individual characteristics of public employees to pursue their own personal interests (Downs 1967; Niskanen 1971; McLean 1987) may lead to further deviation from the desired practices of PFM operations.

The following section reviews some empirical evidence from several developing countries regarding common problems that originated from non-compliance practices in their actual PFM operations and the impact of those problems of non-compliance on accountability, transparency, efficiency and effectiveness of the overall PFM system.

In his analysis of the Auditor General of Lesotho's Reports, Wallis (1989) found that the long delay before the publication of the audit reports was mainly due to the failure of the Treasury to prepare the government's financial statements in a timely manner. Delay in the finalisation of unaudited financial statements left the Auditor General with

nothing to enable adequate assessment of the quality of financial management of the government. The audit reports further elaborated upon the causes of the long delay in the presentation of financial statements, which included the absence of accounting records, the absence of several crucial documents and the time-consuming exercise of the compilation of financial statements. Wallis (1989) further highlighted the laxity in the management of financial affairs in Lesotho's government by referring to lack of discipline in financial management practices that led to non-compliance with financial regulations, rules and instructions and catastrophically impacted the effectiveness of the financial controls in Lesotho. He observed the interrelated and systemic impacts of laxity problems within public employment upon all elements of PFM operations. The negligence of tendering procedures in the provision of goods and services, for example, caused inflated prices for the awarded contracts. The failure to promptly update and keep adequate records of employees' rotation resulted in double payments being made to some employees. Payments could also be made for inaccurate claims for some expenses, such as car mileage, which could have granted some officers with extra income at the expense of the public funds. Lesotho's case illustrates that delay in the finalisation of financial statements indicates a symptom of loose, or even almost non-existent, financial controls that provide opportunities for fraud and criminal actions (Wallis 1989), resulting in waste and inefficiency in the financial management of a public sector institution.

In another developing country in Africa, Ghana, problems of non-compliance in PFM operations were also visible. Certan et al. (2013) mentioned that Ghana faced challenges in assuring the compliance of its budget execution practices with formal procedures of budget execution. Informal practices that deviated from the formal procedures were commonly carried out in many areas of budget execution. The implementation of a clear and comprehensive legal framework for its tax and revenue system, for example, failed to minimise tax arrears. Accurate and timely information on tax arrears was also lacking because the actual practices of tax revenue administration could not be used to aggregate and monitor tax arrears collection activities at the district level. Expenditures in Ghana also experienced a high volume of arrears. The expenditure arrears figures were derived not only from the provision of goods and services activities but also from personnel expenses, such as salaries and wages. Payroll management suffered from a lack of accurate personnel data due to cumbersome personnel administration practices. Hence, despite there being a direct link between its payroll system and personnel database, long delays in entering information about new recruits, promotions, transfers and retirements into the

personnel database caused the accumulation of personnel expenditure arrears. Lack of liquidity due to bad cash management practices, such as reluctance to update cash flow plans and to monitor up-to-date information on cash balances in all government bank accounts, was another cause for arrears. In the procurement of goods and services, lack of liquidity was followed by the adoption of practical solutions to bypass the release of funds procedures, thereby undermining the effectiveness of the procurement system for ensuring value for money. In its accounting system, the introduction of a standardised chart of account was not followed by its consistent application across the core areas of PFM: budgeting, execution and reporting. To further complicate the problems, bank accounts were not adequately reconciled. Reconciliation for some accounts was performed annually, while for other accounts it was done quarterly. The reconciliation of the treasury main accounts, even though it was done on a monthly basis, still suffered from a significant delay of up to three months, heightening the problems in both treasury management and accounting components of Ghana's PFM operations.

In regard to the Southeast Asian region, Myanmar experienced a number of problems and weaknesses in its PFM operational practices (Taliencio et al. 2012). Its accounting and reporting system was incapable of performing timely monthly reconciliation and compilation of its accounts reports. In general, up to three months was needed to complete the reconciliation and compilation of accounts, delaying the finalisation of the monthly financial report which, in the end, jeopardised the preparation of the annual financial report. Combined with the limited degree of analysis included in the monthly reports, this condition weakened the capacity of government to receive any proper feedback during its in-year budget monitoring process. At the time, Myanmar also still relied heavily on manual aggregation processes in its reporting system, causing difficulties for preparation of the reports in different formats that could accommodate different readers and purposes. The disbursement process in Myanmar was also characterised by the lack of an accurate database on commitment records, which systematically weakened the control over the flow of payments. In some cases, payments were carried to the following fiscal year, contributing to another problem in budget management. Delay of the detailed budget approval had also forced the execution of some initiatives and programs into the final few months of the year. Problems in the disbursement process were also compounded by a weak revenue collection system that caused a high amount of on-going arrears. Improvement in the legal basis of taxation was not followed by better taxpayer registration and tax assessment, especially at local government level. The

procurement area in Myanmar also displayed some shortcomings due to the absence of detailed procedures and systems for ensuring more open competitive tendering, causing variations in procurement practices from one agency to another.

Another Southeast Asian country, the Philippines, also suffered from an inability to prepare and publish timely financial reports (World Bank 2015a). Some local government units were not able to finalise their financial reports within nine months after the end of the fiscal year. Some basic control procedures, including periodic reconciliation of bank accounts were absent and cash advances were not managed well. Lack of adequate financial and non-financial information records in asset and inventory management, due to its manual record-keeping systems, further deteriorated the quality of its financial statements. The majority of financial statements of the government agencies continued to receive 'qualified audit opinions' from the Commission of Audit, contributing to a lack of integrity and completeness for the overall financial data of the whole government. Further, World Bank (2015a) also highlighted some deficiencies in the Philippines' internal control and reporting system. Those shortcomings weakened the overall quality of public service delivery due to the inability of government programs to achieve the expected outcomes as outlined in the budget.

In Vietnam, there were weaknesses in actual revenue collection, procurement, cash management, and accounting and reporting activities (World Bank 2013). Tax administration required more effort to improve tax collection performance. Although there had been some improvement, the amount of outstanding tax arrears in Vietnam was still substantial. The application of competitive bidding procedures in Vietnam was also limited, due to their preference to direct the contracting method to a single supplier. In cash management, until 2010, Vietnam had not adopted the TSA approach and it had to maintain substantial cash reserves in all agencies, including local governments. This implies inefficiency in cash management practices because the government was not able to utilise idle cash for investment purposes or for reducing debt. Some components of government revenues and expenditures in Vietnam were managed outside the budget. The preparation of the final budget execution statement in Vietnam could take up to 14 months due to some complexities in consolidating financial information from all lower-level government units. Therefore, Vietnam could not publish any consolidated financial statements for the whole government, weakening its accountability and the transparency of the government's financial management.

The discussion in previous paragraphs has displayed the greater span of PFM operational problems in developing countries, which encompasses almost all components of PFM operations. In more advanced developing countries, such as Thailand, Serbia and Brazil, PFM operational problems do exist, but they are commonly limited to only a specific area and are not necessarily triggered by practices of non-compliance. In Thailand, the absence of a unified chart of accounts has created difficulty in linking the accrual-based financial statement with the cash-based budgeting (World Bank 2009b). Tax revenue collection in Serbia has been managed adequately with a sufficient daily monitoring tool; however, emphasis on improving voluntary compliance of taxpayers was still required (World Bank 2015b). In Brazil, fiscal controls have been strictly implemented at the expense of budget flexibility and improvement in the performance of public service delivery (World Bank 2009a). In contrast, many developed countries have been executing their PFM operations according to the best international practices. Norway, for example, has not shown any significant problems in its actual PFM operational practices (Mundal 2008).

To assist developing countries in tackling their PFM problems, international bodies such as the Asian Development Bank (ADB) have published a handbook that can be used as a guideline for establishing a sound PFM framework and practice. The handbook also underlines common problems that have been identified from the practices in its member countries. In the disbursement process, ADB (1999) identifies the problem of overspending in public fund disbursement when officials of a spending unit breach the spending limits defined in the budget. In a well-designed PFM operation, cash is generally controlled and each spending unit will be allocated only the amount of cash in accordance with their appropriated expenditures. In most cases, the schedule of payment is also set and money will not be available outside the payment schedule. Nonetheless, such control can be so complicated that it causes officials to bypass the procedures, for example, through off-budget spending mechanisms. This non-compliant action, if not properly addressed, would generate uncontrollable arrears that could further damage management of public finances. In another case, overruns could also be caused by inadequate budgeting where the inflation rate, multi-year investment commitments and continuing expenditures (i.e. salary, wages, retirement benefits, etc.) are not adequately addressed during the budgeting process.

ADB (1999) also considers that impediments in the budget spending process can cause poor program implementation, which eventually contributes to ineffective strategic allocation priorities and inefficient use of resources. The Ministry of Finance

could, at any time, initiate budget cuts by authorising expenditures lower than the amount already provided in the budget. Such cuts are rarely applied to outlays on salaries and other personnel-related expenses but tend to fall heavily on operational costs and capital expenditures. Cuts to operational costs may immediately impact the delivery of government services and operation, while the impact of cuts on capital spending may occur in the long run. Insufficiency of funds in government's bank accounts and non-compliance with requirements of government tendering processes may also delay the authorisation of expenditures, compounding the effect upon overall government operations. Another common issue of non-compliance in budget execution relates to the actual utilisation of funds where expenditures may be applied to purposes different from those originally intended, even though they may reflect the correct budget items or categories. Improper practices in budget execution may also include *inter alia*: delay in the distribution of the detailed budget to spending units, inadequate forecasting of cash requirements, and inadequate on-time information on actual expenditure.

2.2. The Organisational Context of PFM Operations

The discussion in this chapter so far has been focused on PFM in general and the technical details of PFM operations. It has been recognised in the literature that financial resources are the essence of public sector organisations (Kioko et al. 2011; Lane 2004; Ingraham and Kneedler 2000; CIPFA 2017). Hughes (2012) also argues that PFM is the most important part of the internal management of government. Since the early 20th century, the operations of the government sector have been dominated by the traditional bureaucratic model of public administration. Nevertheless, the current trend in governmental sector reforms suggests a preference toward the New Public Management (NPM) approach (Hood 1991; Larbi 1999; Polidano and Hulme 1999). Increasingly popular since its inception in the 1980s, NPM assumes that the traditional long-standing bureaucratic model of public administration is malfunctioning and inefficient (Osborne and Gaebler 1992). It needs to be fixed by reinventing government operations through the adoption of efficient private sector solutions such as market-like competition and the fulfilment of public needs through a customer-driven policy development model being integrated into public sector operations (Osborne and Gaebler 1992; Savoie 1995).

It is contended that the global and widespread PFM reform also displays a preference for the NPM principles of adopting private sector practices (Ferlie and Steane 2002). The PFM reform has reconstructed the overall PFM framework and processes of

government budget management, from its formulation stage to its ultimate stage of public service delivery (Rubin and Kelly 2007; Humprey et al. 2005). Generally, the NPM-based PFM reform shifts the line-item input-based budgeting towards a more output- and outcome-focused budgeting, and allows the implementation of a results-based performance measurement system. It discontinues the application of a cash basis accounting method and progresses to an accrual basis accounting system that can provide more accurate financial information essential for improving the transparency, accountability and efficiency of public resource allocation. NPM-based PFM reform also introduces a market-oriented approach in the provision of public services to promote efficiency in government operations. The reform also heightens the monitoring process by establishing an internal control system and an external audit mechanism. Nevertheless, Rubin and Kelly (2007) suggest that other factors, such as local politics, history, culture, previous reforms and advice from international organisations, may be accommodated within this reform, resulting in diversities in the application of NPM principles in different countries.

While the NPM model is conceptually promising, the implementation of NPM principles into government operations has not necessarily resulted in the expected outcomes. Empirical studies on the implementation of NPM have exhibited, to some extent, the failure of NPM-based public sector management to implant its characteristics into the traditional bureaucratic model of public administration (see, for example, Kim and Han 2015; Schofield 2001; Manning 2001; and Dunn and Miller 2007). Such failure is also evident in some OECD countries which are regarded as the native habitat of NPM practices (Manning 2001). Specifically, in the PFM area, the NPM-based PFM reforms also have not significantly changed the PFM practices that have been established under the traditional bureaucratic public administration model of government. In Australia, for example, the reform to move towards outcomes-based budgeting and an accrual-based accounting system have not changed the underlying orientation of the actual budgeting and accounting practices, which remain focused on traditional cash-based inputs (Carlin and Guthrie 2003). Further, Carlin and Guthrie (2003) also mentioned that the reform was largely superficial and failed to provide a better quality of performance information required to improve management and control of budgeting processes.

In developing countries, the experiment-based (Polidano and Hulme 1999), gradual (Manning 2001), and incomprehensive (Turner 2002) adoption of NPM principles, along with the existence of other models of public sector management reform that have focused on improving the capabilities of governments (Polidano and Hulme

1999), have allowed the bureaucratic model of public sector administration to remain relevant despite the influence of the NPM model to reduce the government's role in public management. Cheung (2005) further argues that in most Asian countries, including Indonesia, the NPM approaches and techniques actually coexist with the 'old' public administration system.

2.2.1. Structural Features of Bureaucracy

The endurance of bureaucracy as a model for government operations (Aucoin 1997; Zafirovski 2001; Drechsler 2005; Meier and Hill 2007; Dunn and Miller 2007; Kettl 2008) has made it a relevant theoretical perspective for the examination of the second and third research questions of this study. The term 'bureaucracy' comes from a French word, *bureau*, which can be traced back to the 13th century to refer to an exclusive room where the King's administrators usually stored their financial records (Kettl 2008). In the 19th century, the term was generally used to define a political system in a hereditary monarchy where the King appointed career officials to occupy ministerial positions and run the day-to-day administration of the monarchy (Beetham 1996).

In the early 20th century, Max Weber, a German sociologist, introduced the use of bureaucracy as a term outside the traditional monarchical system of government. He viewed bureaucracy from a sociological perspective and explained its general characteristics and structural features where the application of a bureaucratic model was conceivable (Heady 1959; Beetham 1996; Anderson 2004). To Weber, bureaucracy meant a system of organisations within a large organisation that was characterised by complex administrative problems requiring a systematic process and structure to coordinate the work of many individuals within that organisation (Blau and Meyer 1987). In other words, bureaucracy refers to a structured division of labour to assist a large organisation to achieve its purposes.

Weber's model of bureaucracy was derived from the rise of the rational legal authority model (Rainey 1991; Wallis 1989), as opposed to the traditional and charismatic leadership models which were no longer compatible with modern society (Kettl 2008). The model has established legal instruments (i.e. laws and their derivatives, including rules, regulations, instructions, procedures, standards, etc.) as the main sources of authority (Wallis 1989; Hughes 2012), and which govern the whole operation of a bureaucratic organisation (Blau and Meyer 1987; Gawthrop 1969). Bureaucracy extensively uses legal rules to distribute the operational activities through the divisions of labour that are required to realise its purposes, in a fixed way, and to establish the

official duties of its members (Weber et al. 2009). People who decide to become the members or employees of a bureaucratic organisation, whether they like it or not, have to accept their official duties as specified in the regulations (Wallis 1989). The rational legal authority model further characterises the structure of bureaucracy which, according to Beetham (1996), can be summarised into the four basic attributes of: (1) hierarchical structure, (2) expertise, (3) impersonality and (4) continuity. The rest of this section further explains each of those attributes in more detail.

Firstly, bureaucracy accommodates the delegation of legal authority within the hierarchical structure of an organisation (Hughes 2012). It refers to various layers of official formal positions (Wallis 1989) that are characterised by the separation of superiors from subordinates to form clear accountability relationships (Gawthrop 1969). The layers of hierarchy can be many, depending on the size of the organisation. Every official in the hierarchy is accountable to his or her superiors; in turn, superiors have the authority to control and monitor the performance of their subordinates (Beetham 1996). Superiors have the authority to give orders to their subordinates; while subordinates have the responsibility to obey their superior's commands (Blau and Meyer 1987). The authority, however, is not inherent to any individual but to the position that he or she holds within the hierarchy (Hughes 2012). Superiors can only give commands that are relevant to their official functions (Blau and Meyer 1987) and that are aligned with the objectives of the organisation as specified in the rules. Downs (1967) adds that hierarchical structure in a bureaucratic organisation exists in terms of not only formal authority but also a formal communication network.

The second basic feature, that of expertise, derives from the division of labour attributes of the bureaucratic organisation (Beetham 1996). The division of labour involves horizontal distribution of tasks among the officials in a manner that allows the development of their expertise through specialisation of their functions (Blau and Meyer 1987). The application of merit-based assessment in the employment selection processes, both in the initial hiring stage and the promotional system within the organisation (Downs 1967), along with the provision of continual training (Beetham 1996; Wallis 1989), further ensures a high degree of expertise and competency of the officials. Gawthrop (1969) adds another aspect that may reflect the expertise of bureaucratic officials, namely, their access to information and knowledge concerning the operational rules, regulations and procedures that are stored in the organisation. The expertise of the officials, both in terms of their functional responsibilities and their knowledge about rules that govern their bureaucratic organisation, contributes to the

effective performance of their duties (Blau and Meyer 1987) and assists in the achievement of the organisation's goals or purposes.

The third basic feature of bureaucracy, impersonality, deals with the characteristics of a bureaucratic organisation where there is a separation between working life and private life. Wallis (1989, 3) contends that: "*Officials do not own their jobs, that is, the job itself belongs to the organisation, not the individual who happens to be occupying a particular position in the hierarchy at any point of time*". Weber et al. (2009, 197) specifically assert that: "*public monies and equipment are divorced from the private property of the official*". Impersonality requires officials to prevent the involvement of their personal feelings, emotions, and values when discharging their official roles within the organisation and making official decisions (Blau and Meyer 1987). Such a requirement ensures equity and justice through the provision of equal treatments of all individuals (e.g. as clients, superiors, subordinates or fellow members) who are interacting within the bureaucracy (Blau and Meyer 1987). The impersonal character of a bureaucratic organisation is linked to its legal formalistic attributes, where written documentation of rules and procedures are preserved (Blau and Meyer 1987). Written documents, such as laws and rules, normally set out and specify the authority of the bureaucracy and the obligations that have to be fulfilled (Wallis 1989). They are used to control the actions of its members and set the structure of the administration (Wallis 1989). Gawthrop (1969) enlarges upon the importance of written documentation in the internal operation and management of a bureaucratic organisation because documents are used as a formal communication channel enabling the transmission of information, decisions and directives within the organisation. Dependence on written documentation cannot be avoided in a bureaucratic organisation because it tends to keep records of every transaction emanating from its daily operations (Beetham 1996). Nowadays, the advancements in science and technology sector have increased the reliance on a computerised system to manage the written documentation of an organisation in the form of electronic records, files and databases (Wallis 1989).

The fourth basic feature of bureaucracy is continuity. This feature assumes the long-term establishment of bureaucracy as a result of the permanent employment status of its members and the opportunity for regular career advancement across hierarchical structures (Beetham 1996). Downs (1967) argues that members of a bureaucratic organisation are also financially and economically dependent on the existence of the organisation to support the continuity of the bureaucracy in the long run. The protection of employment status from arbitrary dismissal (Weber et al. 2009;

Blau and Meyer 1987) further supports the continuity feature of bureaucratic organisations. Written documents in which actions, decisions and processes have been recorded, together with the impersonal characteristic of a bureaucracy, to a large extent have supported the continuity of the operations of a bureaucratic organisation (Wallis 1989). Those records gradually construct the image of the organisation, assist the development of effective operating procedures and engender organisational loyalty, which then generates personal commitments among its members to go hand-in-hand towards achieving the purposes of organisation (Gawthrop 1969). Specifically within the public sector, continuity is linked to the long-run perspective of the public bureaucracies because they are not created on an ad-hoc basis to achieve short-term objectives (Wallis 1989). Wallis (1989) further contends that changes in government will not necessarily cause the operation of any public sector bureaucracies to cease. Another characteristic of a public bureaucracy that supports its continuity is the principle of *'tenure for life'* that applies to the possession of an official position within the institution (Weber et al. 2009, 202).

2.2.2. Bureaucracy in the Public Sector

In a democratic system, the term 'bureaucracy' is used to refer to public sector institutions of central and local government, including public corporations (Gormley and Balla 2008), while the term 'bureaucrat' technically refers to a public sector employee who exercises the executive decision (Jackson 1982) or, in other words, an appointed official of a government institution. Nevertheless, as the distinction between public employees who do and do not exercise executive decisions is unclear, the term 'bureaucrat' generally refers to all public sector employees (Jackson 1982; Beetham 1996). Weber's description regarding bureaucracy in terms of its essential structural characteristics being a prerequisite to accomplishing large-scale administrative tasks in a modern organisation has been widely accepted due to its clarity, precision and generalisability (Beetham 1996). This definition can be applied to all political systems and to all complex and large-scale organisations (Beetham 1996; Blau and Meyer 1987) where those features are met, including the government sector.

The territory of a bureaucracy within the public sector is also explored by political economy and public administration scholars (Beetham 1996). Both perspectives augment Weber's structural characteristics definition of a bureaucracy by emphasising certain important assumptions in their analyses of public bureaucracies. According to the perspective of a political economist, public bureaucracy is characterised by a non-market method of financing where its operations are not

financed by selling products or services in the market but, instead, by general endowment from its parent organisation in the form of a government budget (Downs 1967; Niskanen 1971). The individual members of a bureaucratic organisation, like the economic actors in the market, are assumed to pursue their rational self-interested motives (Downs 1967) while exercising their roles within the hierarchy. They have motives that are linked to maximising their position or status in the bureaucracy or accumulating personal gain through money, income, power and prestige (Wise 2004). In the market setting, the impact of self-interested motives upon the operational inefficiency of the organisation is minimised by the existence of a profit and price mechanism to create an effective performance system that provides incentives for the economic actors to behave efficiently in the marketplace (Peters 1981).

Public bureaucracy, on the other hand, relies heavily on the bureaucracy's structural characteristics to direct the behaviour of its members. A hierarchical structure and division of labour, for example, can serve as a substitute for the profit mechanism to allow cooperation among the members of the bureaucracy and the creation of a supervision system to monitor and control their work and behaviour (Beetham 1996). A legal instrument that establishes a reward and punishment framework is also used in a bureaucratic organisation to ensure the alignment of individual members' behaviours with the organisation's goals and objectives. The political economy tenet, however, upholds the superiority of a market-based incentives system and argues that the absence of such incentives within a bureaucracy has provided an opportunity for the individual members to shirk and prioritise their own personal goals (Beetham 1996) at the expense of the organisational goals.

Different from the perspective of political economy, which brings the economic point of view into the discussion about public bureaucracy, public administration scholars underline the distinct features of public accountability in a public bureaucracy as a result of its public nature (Peters 1981). In a democratic system, the government, which is the politicians elected via a democratic general election process, must be held accountable to the people through a representative assembly of parliament. However, instead of carrying out the mandate of the voters directly themselves, the government appoints bureaucratic officials to deliver the government policies and to manage the operations of the government units in the provision of public goods and services. The appointed officials are given the mandate to exercise the executive decisions and policies of the government that have been assigned to their units. They are supported by a hierarchical civil service system to run the day-to-day operations and decision-making of the government. Such a chain of accountability forces a public

bureaucracy to be accountable to the public. The discipline of public administration views public accountability as the major distinctive element of a public bureaucracy (Beetham 1996).

The following section expands the discussion regarding problems of non-compliance in public bureaucratic setting. While most of the literature which is reviewed in the following section is in the context of public bureaucracy in general, it can also be used to provide a reference for the examination of non-compliant behaviour in the PFM operational context.

2.2.3. Non-compliant Behaviour in Bureaucratic Organisations

Since Merton's study, in 1940, that attempted to link the structural characteristics of bureaucracy and the behaviour of bureaucracy's members, most studies on bureaucratic behaviour have been focused on the rule-bound bureaucratic personality image where every member of bureaucracy is viewed as a normative individual characterised by their refusal to deviate from any organisational rules (DeHart-Davis 2007). This trend is not surprising due to the very strong impersonal principle attached to a bureaucratic organisation. In his study, Merton (1940) argues that bureaucracy has a tendency towards strict adherence to every single prescribed rule in whatever situation, despite the fact that such a tendency may lead to goal displacement. Crozier (1971) believes that rigidity in following rules has been so attached to bureaucracy that it has made bureaucracy inflexible and incapable of creating innovations or taking appropriate actions to maintain its efficiency, especially in a changing environment. Thompson (1961) also elaborates upon the existence of feelings of personal insecurity within a bureaucratic organisation, especially at the higher hierarchical positions, which has led to the application of a strict control mechanism to ensure that subordinates perform their roles and behave in accordance with the predetermined standards for actions. From subordinates' perspectives, strict adherence to rules and public sector values, norms and ethos is a typical response to protect themselves against any potential complaints from their superiors when they are exercising their roles and functions within the public sector (Crozier 1971).

The reliance of public bureaucracy on conformity to rules and regulations has also been reinforced by its basic characteristic of using a non-market method of financing, which then leads to the application of the concept of public accountability in the field of public bureaucracy (Peters 1981). Public bureaucracies rely on public money, as stipulated by the government's budget, to finance their operations. Therefore, they are responsible for the management of the budget and must be held accountable to

the public. This concept of public accountability requires public bureaucracies to be able to protect their actions and decisions against any potential complaints from the public, which can only be provided through their strong adherence to rules and procedures. Process-based accountability, which is commonly practiced in public bureaucracy administration, invites scrutiny from external/public monitoring bodies such as the auditor general, legislative committees and even the media and press, should there be a small pattern of errors emerging from their operations (Behn 1998). Savoie (1995) also adds that the political environment of a public bureaucracy, which always looks for errors and has a very low tolerance for any mistakes, has further driven the necessity for public employees to always adhere to the prescribed rules.

The absence of a market mechanism has also constrained public bureaucracies to have a strong performance measurement system based on the output price and financial profit (Barton 1979), which further impose the adoption of a compliance-based performance system to manage the organisation (Rainey 1991). In US counties, for example, many measures that are used to appraise employees' performance are concerned with the issue of compliance (Berman et al. 1999). Such bureaucratic environments tend to reward their members for compliance with rules, regulations and procedures, which inhibits them from doing a better job by creatively inventing a more efficient way of conducting their roles (Peters 1981). Peters (1981) argues that the requirement to fulfil accountability to the public and the lack of a performance measurement system due to the absence of a market mechanism have forced public bureaucracies to be more concerned with maintaining their conformity to rules and norms. As a result, public officials and employees are inclined to strictly follow the rules.

However, the strong association of bureaucratic behaviour with rule adherence does not eliminate conflict because each individual within a bureaucratic organisation could have his or her own interpretation of the same rules (March and Olsen 1989). In addition, empirical evidence also displays an insignificant occurrence of strict rule-bound behaviour, both in public and private bureaucracies (Foster 1990; in DeHart-Davis 2007). DeHart-Davis (2007, 893) argues that it is reasonable to turn the attention of the study of bureaucracy to its "*unbureaucratic personality*" characterised by rule-bending behaviour, which is defined as "*a willingness to depart from rules and procedure*". In the context of the workplace, employees' rule-breaking behaviour is commonly defined as deviant behaviour and can be differentiated as productive deviance and property deviance (Hollinger 1986). The former denotes any action to modify the application of workplace rules that causes deviation in the actual

production from its expected level as a result of unfair working conditions perceived by the workers, while the latter refers to rule-breaking actions that lead to inappropriate and unauthorised utilisation of the organisation's assets. Puffer (1987) uses the term 'non-compliant behaviour' for any dysfunction in the conduct of non-task behaviour⁸ and places emphasis on the negative impact of such behaviour upon the organisation. Vardi and Wiener (1996, 151) categorise non-compliance as part of organisational misbehaviour, which is defined as *"any intentional action by members of (an) organisation that violates core organisational and/or societal norms"*, including formal laws, rules, regulations, standard operational procedures, etc., that are applicable to the organisation.

Non-compliant behaviour can be viewed as organisational deviance, which according to Vaughan (1999, 273) is defined as:

"an event, activity, or circumstance, occurring in and/or produced by a formal organisation, that deviates from both formal design goals and normative standards or expectations, either in the fact of its occurrence or in its consequences, and produces a suboptimal outcome"

This definition extends non-compliance to not only cover the actions of breaking the rules and regulations but also to include any actions that negatively impact the performance and hinder the attainment of, or cause deviation from, the organisational goals (Camilleri and Heijden 2017). It can refer to routine non-conformities and explains how things can be so erroneous within a socially organised setting (Vaughan 1999), including in the context of public bureaucracies.

According to a number of sociological theories and concepts, Vaughan (1999) asserts that the cognitive practices of individuals within an organisation is one of the factors contributing to the emergence of routine non-conformity. Similar to Vaughan (1999), DeHart-Davis (2007) also argues that rule-bending intentions and attitudes are influenced by the individual characters of public employees and officials. In proposing the solution for public bureaucracy's problems, Barton (1979) highlights the necessity to carefully analyse the personal traits of the bureaucrats. The following section reviews the literature on public employees' motives, which is one of the personal dispositions of individual members of a public bureaucracy that has the potential to influence non-compliant behaviour.

⁸ Non-task behaviour refers to behaviour that is relevant to the work context but not directly related to focal tasks (Puffer 1987, 615).

2.2.3.1. Public Employees' Motives at Work

It is argued that, in general, bureaucrats own “a complex set of goals” comprising the elements of income, power, prestige, security, convenience, personal loyalty, pride in excellent work and a desire to serve the public interest (Downs 1965, 441). The list of possible goals of individuals within an organisation ranges from a rational motive of pursuing a purely self-interested goal of financial income to the most normative altruistic motive of fulfilling public interest (Downs 1965).

The rational motives of public employees are derived from self-interest assumption of individuals within a public bureaucracy (Downs 1965; 1967; Niskanen 1971). Under this assumption, the behaviour of government employees can be explained through the lens of logic of consequentiality where their behaviour is not influenced by their identity and expected roles in the society but, instead, by their values and the consequences of alternative behaviour that match to those values (March and Olsen 1989). In this case, public employees tend to pursue their personal gains by attempting to “*maximize the payoff that they receive from public actions. This payoff may be in the form of benefits or less difficult work*” (Wise 2004, 674).

Normative motives of public employees, on the other hand, are generated from the establishment of the norms, rules and procedures that are applied in public institutions, which also align with their expected roles in society to fulfil the public's best interest. The impersonal characteristics of public bureaucracy nourish the tendency of public employees to possess normative motives and conduct their actions and behaviours according to their expected roles in the organisation. The concept of norm-based motives is widely used in the study of bureaucracy from a public administration perspective, where the behaviour of individuals within a public bureaucracy follows the logic of appropriateness (Wise 2004) to satisfy public interest. In other words, the behaviour of public bureaucrats is determined by the appropriate roles and functions that they hold within the hierarchy, as stipulated in the rules and procedures (March and Olsen 1989).

Downs (1967), however, argues that such normative objectives do not practically exist because it is impossible for the public employees to fully abandon their self-interest motives. Only a fraction of their time would be allocated to the division of labour mechanism of public bureaucracies that requires them to put public interest above their self-interested motives, while most of their time and commitment would actually be devoted to their own personal purposes. Based on this argument, Downs classifies bureaucrats into two major types: (1) purely self-interested officials and (2) mixed-

motives officials. The former refers to bureaucrats who possess, and are entirely inspired by, personal goals that promote their own profit and welfare (i.e. income, power, prestige, security and convenience) instead of goals that benefit their organisation and the public at large. The other goals (i.e. loyalty, pride in excellent work and desire to serve public interest) are considered as a combination of self-interested and altruistic motives and are assigned to the latter. They seek power that will enable them to effectively exercise government policies that have been established to manifest the government's purposes of accommodating the public needs. They enjoy their involvement in the government's programs because it can also provide them with prestige in their society. Working in the public sector allows individuals to satisfy their personal needs while also serving the public's needs (Perry and Wise 1990). Despite the emphasis on the self-interested motives of individual members of a public bureaucracy, Downs (1967) does not nullify the notion of normative bureaucrats that are discussed in the public administration literature. He defines them as 'statesmen' who possess a significant degree of altruism motives and loyalty to serve the society as a whole.

Therefore, it is reasonable to conclude that the work motivational factors of an individual employee in the public sector range between the two extremes of self-interested and public-interested motives (Hirschman 1982; in Perry and Wise 1990). This reflects the complexity of human behaviour that should not be avoided when examining the motivation of individuals working in public bureaucracies (Olsen 2004; in Wise 2004). In the context of this study, both self-interested and public-interested motives of public bureaucrats could potentially influence public employees to involve in non-compliant behaviour while undertaking their official duties and roles within public organisations.

2.2.3.1.1. Self-interested Motive and Non-compliance

Morrison (2006), for example, argues that the motive of self-interest is one of the sources of employees' deviant behaviours. The self-interested motive, along with the opportunity to shirk and the lack of effective controls to ensure rule compliance, encourages employees to break organisational rules and take advantage of their organisation (Eisenhardt 1989a; in Morrison 2006). The assumption of an individual's self-interested motives in the discussion of public bureaucracies has provided superior explanations of some of the negative consequences of non-compliant behaviour, including: shirking, when bureaucrats 'goof off' on the job; subverting, when bureaucrats commit acts of administrative malfeasance; and stealing, when

bureaucrats use their public office for private gain (Dilulio and Dilulio 1994). From the perspective of political economy, the failure to establish an effective system of incentives and punishments within the public bureaucratic system provides an opportunity for individuals to shirk and pursue their motive of self-interest in maximising their personal gains by committing non-compliant behaviour, thereby hindering the achievement of the organisational goals (Beetham 1996). In other words, the establishment of adequate institutional arrangements is required in a public bureaucracy to ensure that the deeply-rooted private motives of public bureaucrats will lead them to act and behave according to the expectations of the society that they serve and fulfil public interest (Downs 1967).

Another explanation of how self-interested motives could lead to non-compliance comes from the tendency for the creation of informal structures within the bureaucracy that serve the self-interests of its members (Downs 1967). According to Downs (1967), a bureaucratic organisation can be characterised as a coalition in which the members have some, but not all, goals in common, leading to the divergence of the goals of individual members from the overall objectives of the organisation. Divergence of goals may lead to biased behaviour patterns when there are differences between the way an individual actually performs his role within the organisation and the way he would perform it if he had identical goals as those of the organisation. In such a situation, therefore, it is possible for individuals to pursue their own personal preferences while also carrying out their expected roles within the hierarchical structure of the bureaucracy. To assist them in attaining their personal objectives, they establish an informal structure within the organisation that augments the formal structure that has been established by rules and hierarchy.

Informal structures depreciate the degree of impersonality in public bureaucracies through the involvement of members' personal dispositions in conducting their roles within the organisations. Carlisle (1971) contends that reliance on impersonal structure contributes to the appearance of conflict between an individual's goals and the organisation's goals; a common problem in bureaucracy when the opportunity for a member's self-actualisation is limited due to the application of a compliance-based reward system.

Informal structure could also be established in the manner of an informal network, which may distort the decision-making process within the organisation (Vaughan 1999). Knowledge claims, where the relevance of information is determined by its social appropriateness and technical correctness, may not be properly attained because an informal network could lead to the omission of certain relevant

information, causing partial understanding and thereby contributing to non-conformity and unexpected negative outcomes.

In another occasion, motive for self-interest influences individual members of a bureaucracy to escape from a complex and difficult work situation by remaining ignorant of their official duties and roles as public employees. They do not care and do not want to understand the goal of the organisation; hence, they are prone to deviant behaviour and are likely to breach formal organisational rules (Morrison 2006). Further, Morrison (2006) contends that non-compliance may also refer to unintentional violations when individuals in the organisation are ignorant and unaware of the rules.

2.2.3.1.2. Public-interested Motive and Non-compliance

In regard to the public-interested motives of public bureaucracy, Wise (2004) argues that the failure of an impersonal structure of rules to accommodate public needs may potentially trigger a high degree of non-compliant behaviour. Such failure represents the absence of a valid means-ends relationship among the rules of a public bureaucracy. The lack of a valid means-ends relationship can be caused by changes in the environment in which public bureaucracy operates (Desai 2010). Current rules may fail to accommodate new public needs as a result of the changes in the environment. Public employees who are driven by public-interested motives, hence, are prone to break the rules to enable them to better serve the public and accommodate the public's needs. While this argument displays the limitation of rules to appropriately capture and accommodate the dynamics of the environment, it also sheds a positive light on the non-compliant behaviour that searches for new and better ways of organising the operations of a public bureaucracy (Desai 2010). DeHart-Davis (2008) further argues that non-compliance does not always lead to negative consequences of inefficiency and deviation from the organisation's goals; in the situation when there is a gap in the formal rules, non-compliance can be beneficial and positive for the organisation.

More recent studies in sociology have also discussed non-compliant behaviour within public bureaucracies from a more positive point of view, that is, in providing benefits for the organisation (Larsson and Ramstedt 2013; Borry 2013). Morrison (2006), for example, introduces the term 'pro-social rule breaking' to refer to non-compliant behaviour that is intentionally committed by public employees to more efficiently exercise their roles, assist their subordinates or colleagues and improve public service deliveries. Pro-social rule breaking behaviour displays the non-selfish nature of non-

compliant behaviour in public institutions when the violation of rules and regulations may reflect public employees' desires to better exercise their organisational roles and to contribute a good thing to the organisation and the larger community. Brockmann (2015) uses the term 'unbureaucratic behaviour' to refer to the non-compliance of individuals for the purpose of procedural improvements in public bureaucracies. Such behaviour is driven by pressures from the public to provide better and more efficient public service deliveries, requiring the public bureaucracy to work innovatively and go beyond its traditional belief to always comply with the rules. This positive perspective of non-compliance confirms the existence of public-interested motives that are able to drive public employees to conduct their roles in accordance with the public's needs despite the fact that they do not comply with the organisational rules and regulations.

2.2.3.2. Structural Factors of Bureaucracy

Other than the individual dispositions of public employees, Vaughan (1999), DeHart-Davis (2007), and Barton (1979) also mention the structural characteristics of public bureaucracy as another factor that may contribute to the existence of non-compliant behaviour among public employees who carry out public duties and roles as civil servants. Weber's description of bureaucracy, in terms of its essential structural characteristics that are prerequisite to the accomplishment of large-scale administrative tasks in a modern organisation, has generally been accepted due to its clarity, precision and generalisability (Beetham 1996). However, it has also been criticised for its inherent flaws when those structures become dysfunctional and impede its superiority in attaining the highest degree of efficiency, thereby impacting the attainment of the organisational objectives (Hughes 2003). Bureaucracy establishes formal structures and coordination whereby complex tasks are distributed into a series of manageable jobs through the establishment of organisational rules that promote precision, speed, clarity, expertise, consistency, quality, uniformity and reduction of friction throughout the administrative processes (Mongkol 2007). However, those bureaucratic structures can also produce negative consequences diverting the actual final outcomes from the expected ones (Vaughan 1999).

Acar and Aupperle (1984) argue that, in a bureaucratic organisation, the functions to attain organisational goals are manifested and embodied into the major structures of impersonality, division of labour and hierarchy. Certain assumptions regarding conditions and environment are carefully examined and defined to ensure that the established structures can effectively support the functions of the organisation in the attainment of its objectives and purposes. In a small organisation, those assumptions

can be easily communicated to all members, enhancing their understanding of the policies, strategies and procedures of the organisation. However, in a large bureaucratic organisation, it is unlikely that subordinates will have adequate comprehension of the rationale behind the establishment of these structures. Peters (1981, 77) argues that the structure of a bureaucracy can “*block the smooth flow of [legal] authority downward*” within the hierarchy resulting in a failure to comprehend the ‘meaning’ of the rules. As a result, those who are performing the tasks remain unconnected to the functions and the ultimate goals of the organisation (Acar and Aupperle 1984), leading to the failure of members of the bureaucracy to fully comprehend their roles or to conduct their functions as designed by the formal structures.

2.2.3.2.1. Ineffectiveness of Rules

One of the major characteristics of bureaucracy is its impersonality, which is directly derived from the rational-legal authority assumption. Structures in the form of vertical and horizontal divisions of labour, along with their expected roles, functions, and responsibilities, are formalised through rules, regulations, procedures, etc. (Borry 2013). Rules separate the involvement of personal attributes of the individuals holding the positions within the structure from the execution of their roles and duties within those organisations (Scott 1987; in Borry 2013). From a sociological perspective, prescribed rules are assumed to be functional and effective when the pattern of behaviour of the bureaucracy’s members is in accordance with the rules’ descriptions (McLean 1987).

However, rules may have their own drawbacks that can trigger non-compliant behaviour. DeHart-Davis (2008) differentiates ineffective rules from the effective ones. Ineffective rules refer to ‘red tape’ (DeHart-Davis 2008) and may include circumstances when there are too many rules (Borry 2013). In the case of red tape, conformity to rules generates unanticipated negative consequences that threaten the overall efficiency of the organisation (Merton 1940). Ineffective rules engender a compliance burden. Thereby inhibiting those rules as a rational-legal instrument for attaining their intended purposes of establishing the organisation’s goals (Bozeman 2000; in Borry 2013).

DeHart-Davis (2008) further elaborates upon the characteristics of effective rules by proposing Green Tape Theory. The theory stipulates a number of characteristics that can impact upon the effectiveness of rules, which include:

- (1) Rules are written

The extent to which rules are written enables them to be functional and effectively implemented. Written rules nullify the personal attributes of the officials who hold positions, allowing them to optimally impose the rules to the regulated, while unwritten rules are viewed as unacceptable and subjective.

(2) Rules have valid means-ends relationship

Means and ends link organisational rules to their expected goals and purposes. A valid means-ends relationship displays the rationality of rules, thereby allowing them to gain cooperation from the stakeholders, a condition that is vital for ensuring that rules are applied and supported in the realisation of their objectives.

(3) Rules have optimal control

Optimal control of rules refers to the level of control that rules impose. Rule over-control may result in the feeling of distrust among the regulated, thus reducing their desire to follow the rules, while rule under-control may appear artificial to stakeholders, thus weakening the rule's ability to achieve its intended objectives. Optimal control ensures the effectiveness of a rule to achieve its objectives by communicating its genuine objectives and establishing trust among stakeholders, thereby enhancing stakeholders' cooperation in rule implementation.

(4) Rules are consistently applied

Consistent application of rules deals with the establishment of fairness and justice. It eliminates favouritism and any feeling of inequality in the organisation, encouraging the stakeholders to accept the rules and voluntarily comply with them.

(5) The purposes of rules are understood by stakeholders

Understanding rules' purposes improves the compliance level of the employees. Employees who have little understanding of the rules' purposes may fail to comprehend their contribution to the organisation and feel alienated in the workplace. Efforts to ensure employees' understanding of rules' purposes, such as through training and supervision activities (Oberfield 2010), enable them to see the importance of their presence in the bureaucratic system, thereby increasing their cooperation and level of compliance in rule implementation.

2.2.3.2.2. Dysfunctional Hierarchical Authority

The complexity of tasks that are dispersed along the vertical division of labour in a large organisation can also be so intricate that it limits the ability of higher hierarchical officials to adequately control the actual behaviour of their subunits (Vaughan 1999).

From a rational choice perspective, lack of controls from the organisation provides opportunities for employees to shirk and violate the rules in an attempt to pursue their own self-interests at the expense of the organisation (Morrison 2006). Granovetter (1985) further observes the potential failure of the established bureaucratic structures to maintain appropriate intra-organisational relational ties, which may result in the diminishment of trust and control, thereby providing individual members with the opportunity to cheat and commit wrongdoings.

Acar and Aupperle (1984) also observe that the discretion and authority in a bureaucratic organisation tend to be centralised in the higher levels of office due to the higher level of task uncertainty in such elevated hierarchical positions. Centralisation of authority, according to Vaughan (1999), may be beneficial because it can improve coordination; however, on the negative side, it can also reduce flexibility, thereby increasing the potential for rule violation at lower hierarchical levels. In such situations, individual responsibility and initiative are discouraged (Beetham 1996), causing individuals in the lower hierarchy to make some poor judgments, for example, during the information screening process (Gawthrop 1969). Peters (1981, 77) contends that a hierarchical structure can create communication problems that “*block the smooth flow of information upward*”. Ultimately, the top hierarchy may experience a lack of relevant information required for effective decision-making and control (Gawthrop 1969).

2.2.3.2.3. Ineffective Division of Labour

Another bureaucratic structure, the horizontal division of labour, aims to develop expertise through rational specialisation of tasks. Specialised experts are engaged in each particular position and they are responsible for exercising their skills to support the effective performance of their duties (Blau and Meyer 1987). However, it may also result in boring and routine activities that lead to careless performance, non-conformity and low productivity. Specialisation, while it can improve efficiency through expertise, also tends to create tunnel vision where the specialised experts have a narrow outlook of their own department and fail to view their functions within the big picture of the whole organisation (Martin 2015). Specialisation helps to clarify the responsibilities of each individual member of the organisation, but it can also induce a rivalry among departments and ignorance of what other departments have done. Loyalty of the individual members to the overall bureaucratic structure has been interpreted and practised in terms of unit loyalty (Gawthrop 1969), which further complicates the tunnel vision problem within the bureaucracy. The strengths and

advantages of the horizontal division of labour are then easily transformed, at the same time, into the damaging problem of the silo effect (Tett 2015).

A number of tasks within the organisation also require not only specific expertise but also explicit tacit knowledge, which is the core set of knowledge related to the task that cannot be articulated by others (Collins 1981; in Vaughan 1999). The absence of this core set of knowledge represents imperfect knowledge of the individual and could endanger his expertise. This, in turn, can lead to unanticipated suboptimal outcomes, including non-conformity behaviour. Vaughan (1999) also points out the structural secrecy phenomenon whereby segregation of knowledge about tasks and goals presents in the bureaucratic organisation as another source of non-conformity. It involves the deletion and distortion of information as it passes through the system of the organisation. Similar to the absence of tacit knowledge, structural secrecy can also lead to partial and incomplete information and knowledge, which increases the possibility of non-conformity, especially in relation to cross-boundary tasks. Unfortunately, non-conformity can emerge not only when the information shrinks but also when there is abundant information (Feldman 1989; in Vaughan 1999). To make things worse, structural secrecy negatively impacts upon the effectiveness of the organisation's monitoring and control system to identify, and take actions to control, any activities that deviate from the normative standards of expectations.

2.2.3.3. Environmental Factors

In addition to the individual dispositions of public employees and the dysfunctional bureaucratic structures, Vaughan (1999) notes the environment of the organisation as the third factor that can contribute to the emergence of routine non-conformity. Environmental factors, according to organisation theory, include both the internal organisational setting, such as networks and inter-organisational relations, and the social contexts of politics, technology, economy, law, demography, ecology and culture (Vaughan 1999). One central feature of the environment that could lead to non-conformity and deviation from the expected outcomes is its uncertainty. Barton (1979) specifically points out uncertainty in terms of political pressure whereby politicians may request, at any time, to implement certain policies or programs that do not represent the desires of the public in general. Given that public bureaucracy is not in the proper position to reject or avoid the directives from its political master, non-conformity in the execution of the programs can be expected and may eventually derail the actual outcomes of the programs. Advancements in technology, to give another example of uncertainty within the environment, may also create unclear

conditions because appropriate rules cannot be established before the adoption of new technology; instead, rules emerge from the practice and experience in implementing the new technology (Wynne 1988; in Vaughan 1999). Changes in the environment often cannot be accommodated within the regulations in a timely manner. Hence, efforts from the organisation to respond to the threats of uncertainty, as a result of changes in the environment of the bureaucracy, may lead to non-conformity to the current rules (Vaughan 1999).

Other than uncertainty, social agreement, especially in regard to cultural aspects, could also produce organisational deviance. Individuals may apply their cultural values that are embedded in their traditions (Giddens 1991) while exercising their roles and functions within the organisation. The bindingness of particular traditions, stemming from norms and values that exist in the society, may result in resistance to applying new practises introduced through formal rules (Giddens 1991). Norms and values as a result could modify the original understanding of what was expected by the organisation (Sackmann 1991). Such actions are prone to any organisational deviance. In a patrimonial culture, for example, bureaucracy may not be able to fully apply its meritocracy principle. Individual members may alter the application of certain procedures to accommodate the social expectations in that culture. Further, the external environment of a bureaucratic organisation may define members' interpretations of the rules and impact the way they implement and execute the rules (Albrow 1970).

2.3. Chapter Summary

This chapter have reviewed the literature in the field of PFM and the theory of public bureaucracy. In general, PFM operations, as the context of this study, have been referred to the implementation stage of the government's budget, starting from the preparation of the budget execution document until the preparation and finalisation of financial statements. At this operational level, compliance with budget allocations, which have been stipulated in the budget law, and adherence to other relevant laws or regulations that govern the detailed arrangements for managing PFM operations are critical to assist the attainment of one of the PFM key objectives to maximise the optimum combination of economy, efficiency and effectiveness in the provision of public goods and services.

Despite efforts to ensure compliance, the risk of non-compliance in PFM operations, especially in developing countries, cannot be fully negated. This chapter has shown that developing countries, such as Lesotho, Ghana, Myanmar, the Philippines and

Vietnam, have experienced a significant level of non-compliance in their PFM operational practices. In those countries, non-compliant behaviour has caused a number of problems in all components of PFM operations, including delays in the details of budget approval, the existence of informal practices in budget execution processes, failure to effectively collect tax arrears, a higher volume of expenditure arrears, lack of liquidity due to bad cash and treasury management, the absence of valid and complete accounting and transaction records, inability to prepare a consolidated financial statement, and delays in the preparation of financial statements.

This chapter has also exposed that the recent PFM reform trend toward an NPM-based PFM model, especially in developing countries, does not eliminate the existence of recognisable structural features of bureaucracy in PFM operations. This evidence allows the examination of non-compliance problems in PFM operations in Indonesia through the lens of public bureaucracy theory. The theory indicates the influences and the roles of three major factors to non-compliant behaviour among public employees: the individual dispositions of public employees, the structural characteristics of public bureaucracies and the environmental factor.

In summary, this chapter has provided adequate references from the literature to address the three research objectives of this study. Empirical evidence on the pattern of non-compliance problems in the PFM operations, especially among developing countries, assists the discussion regarding the first objective to identify the systemic problems in Indonesia's local government PFM operations as a result of non-compliant behaviour of the PFM actors. Further, reviews of the literature on non-compliant behaviour from the perspective of public bureaucracy theory support the discussion to address the second and third research objectives. They provide explanation on how the PFM actors' motives at work and the bureaucratic traditions in PFM operations have instigated the emergence of non-compliance problems in the Indonesia's local government PFM operations.

Following this literature review, Chapter 3 elaborates upon the development of the research design and methodology that is appropriate to address the research objectives of this study.

Chapter 3

Research Design and Methodology

This chapter describes the design and methodology applied to conduct this present study. It aims to provide an explanation and justification of how the research methods used in this study have appropriately addressed the research objectives and questions. This research adopts a qualitative research methodology using a combination of several research techniques including content analysis, a case study, and thematic and template analyses. Data were mainly collected from documents, an FGD and semi-structured in-depth interviews. The chapter begins with a discussion about the nature of the research, the appropriateness of the application of a qualitative research methodology and how the research process can fulfil the assumptions required for the qualitative research. The development and the application of a two-stage research design and how it can address the proposed research questions are then explained. Further, this chapter describes the actual data collection processes, including the method of selecting the timeframe of the study, the case to be studied, the participants for the FGD, the respondents for the interviews and other relevant aspects of the data gathering fieldwork. Later in this chapter, details of how the data were analysed and how the ethical issues were handled are also presented.

3.1. Development of the Research Design

Social research is driven by a number of motivational factors in order to gain knowledge and understanding about social phenomena. Those factors include the intention to search for a solution to overcome a social problem, the necessity to evaluate potential consequences of alternative actions or decisions, and the simple passion for gaining knowledge about ourselves, our society and the world we live in (Chadwick et al. 1984). Regardless of what factor motivates the research, Chadwick et al. (1984) note that proper development of the research design is important to ensure that the research makes a valuable contribution to the body of knowledge (i.e. science) or finds a practical solution for the social problem in question.

3.1.1. Qualitative Nature of the Study

The nature of this study focuses on the actual PFM operational practices following up the implementation of the new PFM rules and regulations. The actual PFM operational practices encompass personal interpretation of those who are working in the public sector, especially the PFM actors who are involved in various stages of the PFM

operational processes. Their experiences and interactions with others, along with the historical, cultural and personal characteristics of the PFM actors, may result in different views and understandings among them about how they have to behave in accordance with the new PFM rules and regulations.

In such a situation, the researcher seeks to evaluate all of the meanings, and the research relies on the participants' understanding of the situation (Creswell 2007). As a result, an interpretive research philosophy is assumed, leading to the application of a qualitative research methodology in this study. The research questions that focus on the new PFM operational practices and the understanding of people who are involved in those practices (Rosaline 2008) also support the selection of a qualitative research methodology for this study. In addition, as Creswell (1998) mentioned, qualitative research does not need to be contrasted with quantitative research. It can stand on its own right without losing its reliability and credibility.

3.1.2. Basic Philosophical Assumptions of the Study

The qualitative research methodology adopted in this study has guided the development of the research design to fulfil a set of basic philosophical assumptions that, according to Creswell (2007), consists of ontological, epistemological, axiological, rhetorical and methodological. An ontological assumption refers to the nature of the reality being studied. In this study, the implementation process of the new PFM framework involves subjective and differing interpretations, as seen by the PFM actors (i.e. the respondents of this research) regarding the new PFM laws and their derivative rules and regulations. This assumption requires the disclosure of different perspectives through the use of quotes and themes in words provided by the respondents themselves regarding all aspects of their actions and behaviour under the expected PFM practices stipulated in the PFM rules and regulations.

Epistemological assumption deals with the question about the appropriate way to know the reality being studied. In a qualitative research, the interpretive nature of the reality being studied requires the researcher to lessen the 'distance' between he/she and those who are being studied. The application of FGD and the semi-structured interviews for data gathering in this study expose the attempt to narrow the distance between the researcher and the respondents, which assisted the researcher to gain insider views via the responses provided by the respondents.

Axiological assumptions refer to the roles of values in the research. This study recognises that the values of the respondents are inherent in their responses. They are not omitted but, in fact, are acknowledged and discussed openly in this study. In

conjunction with the interpretations of the researcher, the values of the respondents are analysed and, ultimately, form the basis for the formulation of the research findings.

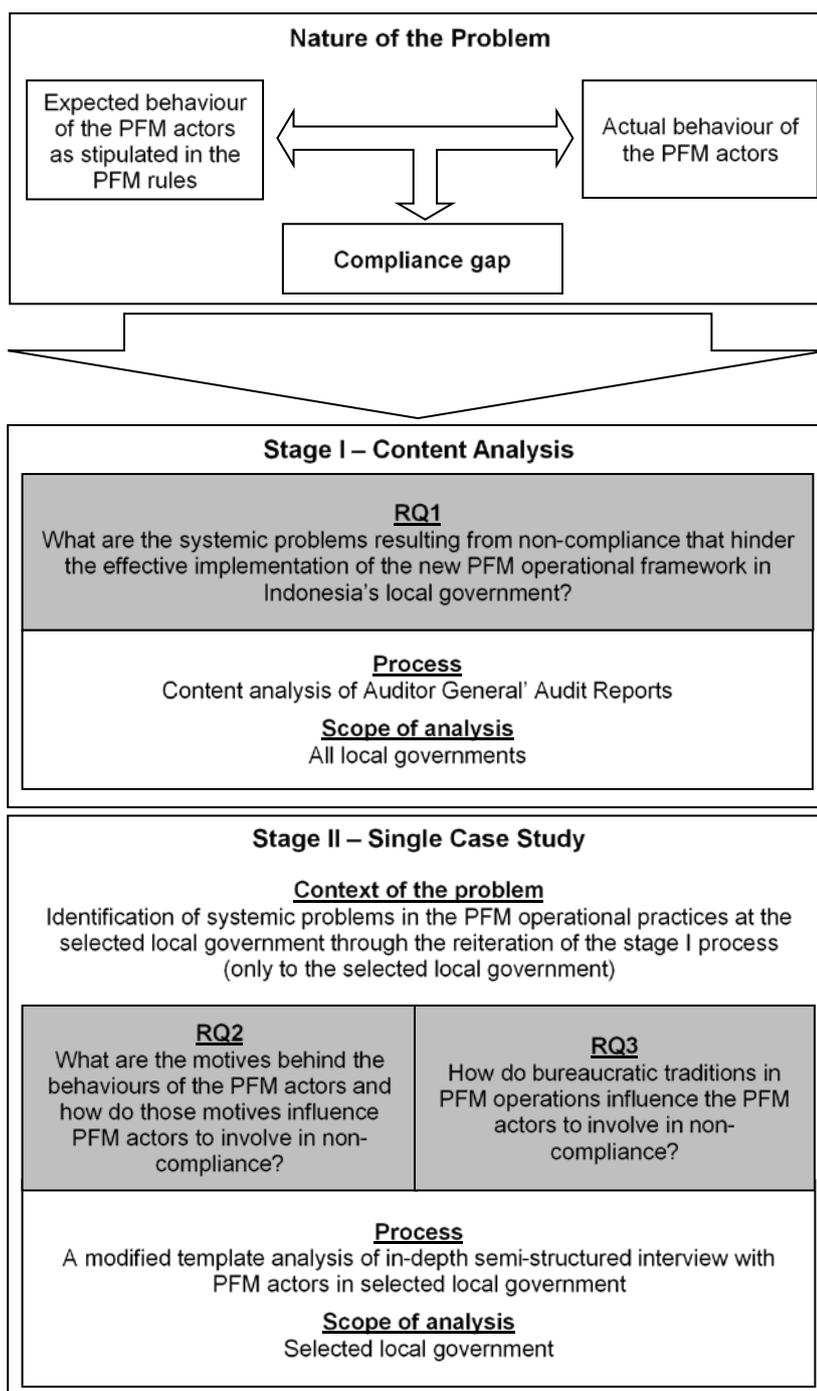
The term 'rhetorical assumption' denotes the language of the research. More specifically, in this study, the literal and personal narrative responses from the respondents were used extensively. Direct quotes from the respondents' are used in this research thesis to identify and clarify any patterns, categories or themes that emerged from interactions with the respondents during the study.

The last philosophical assumption, i.e. methodological, is derived from the previous four assumptions (Creswell 1998). It is concerned with the research processes that, in a qualitative study, are characterised by an inductive logic, are contextually-bound and use emergent design. This study applies both content and thematic analyses of the data by which patterns, categories and themes are developed, both deductively and inductively, into more abstract units of information. Details about the context of the study are presented as part of the case study method being applied in this study. Thus, sections that describe the context of PFM in Indonesia's local government, including the history of the PFM in Indonesia, the PFM regulatory framework, the profiles of the local government selected for the study and other relevant matters, will be presented in this thesis prior to discussion of the research findings.

3.1.3. Two-stage Research Design

A research design is developed in order to answer the research questions and achieve the research objectives. The nature of the research questions in this study has led to the development of a two-stage research design, as displayed in Figure 3.1. The first stage addresses the first research question. At this stage, a content analysis technique is employed by analysing the contents of the audit findings, as expounded in the external audit reports of local governments. The Indonesian public sector external audit institution, BPK, generally applies the requirements stipulated in the law as its audit criteria. Therefore, any negative findings in the audit reports indicate compliance gaps between the actual behaviour and practices of the PFM actors and the expected behaviours as stated in the law. This study considers any compliance gap as a non-compliance problem. The disclosure of those non-compliance problems in BPK's audit reports potentially signifies the existence of systemic problems in the implementation of the new PFM framework.

**Figure 3-1
Two-Stage Research Design**



Considering the resource constraints and the high number of local governments in Indonesia⁹, the second stage adopted a single case study method in one local government. It addressed the second and third research questions relying on the results from interviews with a number of a local government officials and employees

⁹ As of 2014, the total number of local governments in Indonesia was 542, which consisted of 34 provinces, 415 districts and 93 cities (Direktorat Jenderal Otonomi Daerah 2014)

who were involved in the PFM operational processes. A case study requires an understanding of the case being studied (Stake 1994; Creswell 2007). For that purpose, a documentation review regarding the local government selected for the study was also conducted to gain knowledge about the profile and other contextual information of the case in the study. It also included the reiteration of content analysis of audit reports that had been conducted in the first stage, but was limited to the audit reports of the local government being studied, in order to gain information about relevant non-compliant behaviour prevailing in that specific local government.

3.2. First Stage – Content Analysis of Audit Report

Content analysis is a method which has a long history in the qualitative research realm. According to Dovring (1954), the history of content analysis dates back to 1743, when a collection of religious Christian hymns entitled “Songs of Zion” was published in Sweden. Later, in the 1940s, content analysis became very popular as a research technique to examine the content of mass communication, mostly in its quantitative nature that focused on the calculation of frequencies of the contents (Berelson 1971). Further, criticisms of the quantitative characteristics of content analysis were raised, resulting in the development of qualitative approaches to content analysis (Mayring 2000).

Content analysis is a data reduction process (Weber 1990; Patton 2014) by which qualitative data is systematically identified, categorised and described (Hsieh and Shannon 2005; Patton 2014; Mayring 2000) to obtain something meaningful in regard to its content. The quantitative and qualitative traditions embedded in content analysis alternate the application of content analysis in the research. The quantitative tradition of content analysis evaluates the text material deductively and quantifies elements of meaning, whereas the qualitative tradition works inductively to summarise and classify the elements of meaning in the text material (Donsbach 2008) relevant to the study. Despite those differences, in conclusion, content analysis allows a qualitative analysis of the text material while, at the same time, calculating the frequency of certain concepts that emerge from the analysis (Berg and Lune 2014; Vaismoradi et al. 2013). Quantification of concepts allows content analysis to identify the magnitude of each concept appearing in the study and helps the researcher in looking for patterns that support the research findings (Berg and Lune 2014).

The first stage of this study deals with the identification of systemic problems in the implementation of the new PFM operational legal framework in Indonesia’s local governments. It provides the context of the study where gaps exist between the

expected practices, as stipulated in the new PFM operations rules and regulations, and the actual practices performed by the PFM actors. Under the new PFM framework, these gaps are documented in the audit reports, a legitimate form of documentation regarding the quality of PFM in Indonesia that is published by BPK. While a number of studies have utilised the general information of BPK's audit reports, such as its financial audit opinion on government institutions' financial statements, there are still very limited number of studies that have examined the more detailed audit information of BPK, such as its audit finding database and the qualitative data of the audit findings disclosed in the audit reports. The availability, format, structure, and arrangement of BPK's audit findings database management, especially its audit findings statistics, have supported the application of the content analysis technique used in the first stage of this study. Further, the qualitative data and information available in the audit reports have enabled deeper understanding regarding the nature of non-compliant behaviour of the PFM actors.

3.2.1. *BPK's Audit Reports at a Glance*

BPK has a mandate to audit the management and accountability of the state's finance. The new PFM laws strengthen the role and function of BPK as the only external auditor of public financial management and accountability for both central government institutions and local government jurisdictions. In carrying out its mandate, BPK conducts three types audit: financial audit, performance audit and special purpose audit. For each of those assignments, BPK publishes an audit report that generally consists of five components: 1) audit finding, 2) audit criteria, 3) cause, 4) impact and 5) recommendation (BPK 2014c). In addition to those components, for financial audits, BPK also presents its audit opinion regarding the fairness of the government's financial statements; and for performance and special purposes audits, BPK presents its audit conclusions (GoI 2004b).

According to the state audit law, the auditees have the opportunity to provide their comments on the reported findings, conclusions, and recommendations. BPK is required to incorporate the comments into the audit reports. In the case of local governments, at the end of the audit reporting process, BPK submits the audit reports to the local governments official (governors, mayors, and/or regents) and the local parliaments (GoI 2004b). As part of its transparency, audit reports that have been submitted to the government and local parliaments are publicly available¹⁰.

¹⁰ Though the law explicitly states that BPK's audit reports are public documents, BPK decides not to upload the finalised individual audit reports on its website, except for the IHPS and Financial Audit

Article 18 of Law No. 15/2004 regarding State Audit specifically mentions the requirements for BPK to submit an *Ikhtisar Hasil Pemeriksaan Semesteran* (IHPS) or a Summary of Semesterly Audit Reports to the parliament (i.e. the House of Representatives and the House of Regional Representatives) within three months after the end of each semester. BPK is also required to hand in the IHPS to the President, all governors, all mayors, and all regents to ensure that all levels of government have nation-wide information about the audit findings of the audit reports. It took two years before BPK was finally able to submit its first IHPS to the Parliament in September 2007, which covered BPK's audit reports published in the first semester of 2007.

As part of its mandate, BPK viewed the necessity to establish an audit findings database (BPK 2010c). Such a database would allow BPK to develop and present some statistics about its audit findings. For that purpose, in 2010, BPK issued BPK Decree No. 5/K/I-XIII.2/8/2010 regarding its Technical Guideline for Audit Finding Classification. The guidelines are used to categorise audit findings based on the problems found and described in the audit reports. As part of their audit assignment, auditors would analyse the audit findings. Each audit finding can be categorised into one or more audit cases. Auditors would further evaluate each audit case and categorise it as one appropriate audit case item, according to the guideline. The audit case item is the third or the lowest level of the audit finding classification hierarchy. It consists of 80 items which can be further classified into audit finding sub-groups (the second hierarchy) and groups (the first hierarchy). The result of the audit findings evaluation, categorisation and classification processes is then input into BPK's integrated audit management information system¹¹. The availability of an audit findings database enables BPK to conduct further analyses that are beneficial in assisting the stakeholders with their decision-making (BPK 2010c).

The audit finding classification guideline categorises the audit findings items into three broader groups, which consist of 1) non-compliance with legal rules, 2) internal control weaknesses, and 3) 3Es findings¹². The first group, non-compliance findings, is then

Report on Consolidated Central Government Financial Statement. BPK had published BPK Regulation No. 3/2011 regarding Public Information Management in BPK which sets the protocols and procedures that need to be followed for gaining access to individual audit reports and other information regarding BPK.

¹¹ Integrated Audit Management Information System refers to *Sistem Manajemen Pemeriksaan*. It is a web-based application that is used by BPK to manage audit data and information throughout all audit stages, consisting of an audit planning module, an audit fieldwork module, an audit follow-up module and an audit evaluation and monitoring module (BPK 2011f).

¹² 3Es stands for economy, efficiency, and effectiveness. "3Es findings" refers to audit findings that have caused waste, inefficiency and ineffectiveness in government operations.

categorised into 5 sub-groups based upon the impacts, which are: a) causing the occurrence of state losses, b) potentially causing the occurrence of state losses, c) causing a shortage in government revenue collection, d) causing administration deficiencies, and e) indicating criminal and/or corruption offences. The last item of the non-compliance group of audit findings, an indication of criminal and/or corruption offences, is considered to be confidential information. Hence, the statistics of this audit findings group are not disclosed in the IHPS¹³. The second group, internal control weaknesses, is divided into three sub-groups, namely: a) accounting and reporting control weaknesses, b) budget execution control weaknesses, and c) internal control structure weaknesses. The last group of 3Es findings are simply divided into three sub-groups, as follow: a) waste, b) inefficiency, and c) ineffectiveness. Appendix 2 displays the 80 audit finding items and their classification into audit findings sub-groups and groups, as specified in the guidelines.

To provide more holistic information about the accountability and management of public finance throughout Indonesia, both at central and local government levels, BPK includes the statistics from the audit finding classifications in its IHPS. In Semester I/2008, BPK piloted the inclusion of audit findings statistics in the IHPS, even though it was only limited to financial audit reports. In 2009, BPK was finally able to present audit findings statistics that covered all types of audit reports for all government institutions, including local governments, in its IHPS. Since then, the frequencies of the audit findings classification items have been included in the IHPS.

3.2.2. Selection of the Audit Reports

As mentioned earlier, a complete and reliable audit findings database was not made available by BPK until 2009. As a result, the analysis presented in this study covers the audit findings reported in the local governments' audit reports that were published from 2009 until 2014. Every year, BPK conducts financial audits on local governments' financial statements. Financial audit on local governments is conducted and published by BPK's Regional Offices, located in all provinces throughout Indonesia. All local governments' financial audit reports are included in the analysis, except the audit reports on local governments for which their finalisation and publication had been delayed for more than one year. Under the current PFM framework, local governments are required to submit their unaudited financial statements to BPK three

¹³ BPK is required to report any criminal and/or corruption offences found during its audits to law enforcement agencies (i.e. National Police Agency, Attorney General and Corruption Eradication Commission).

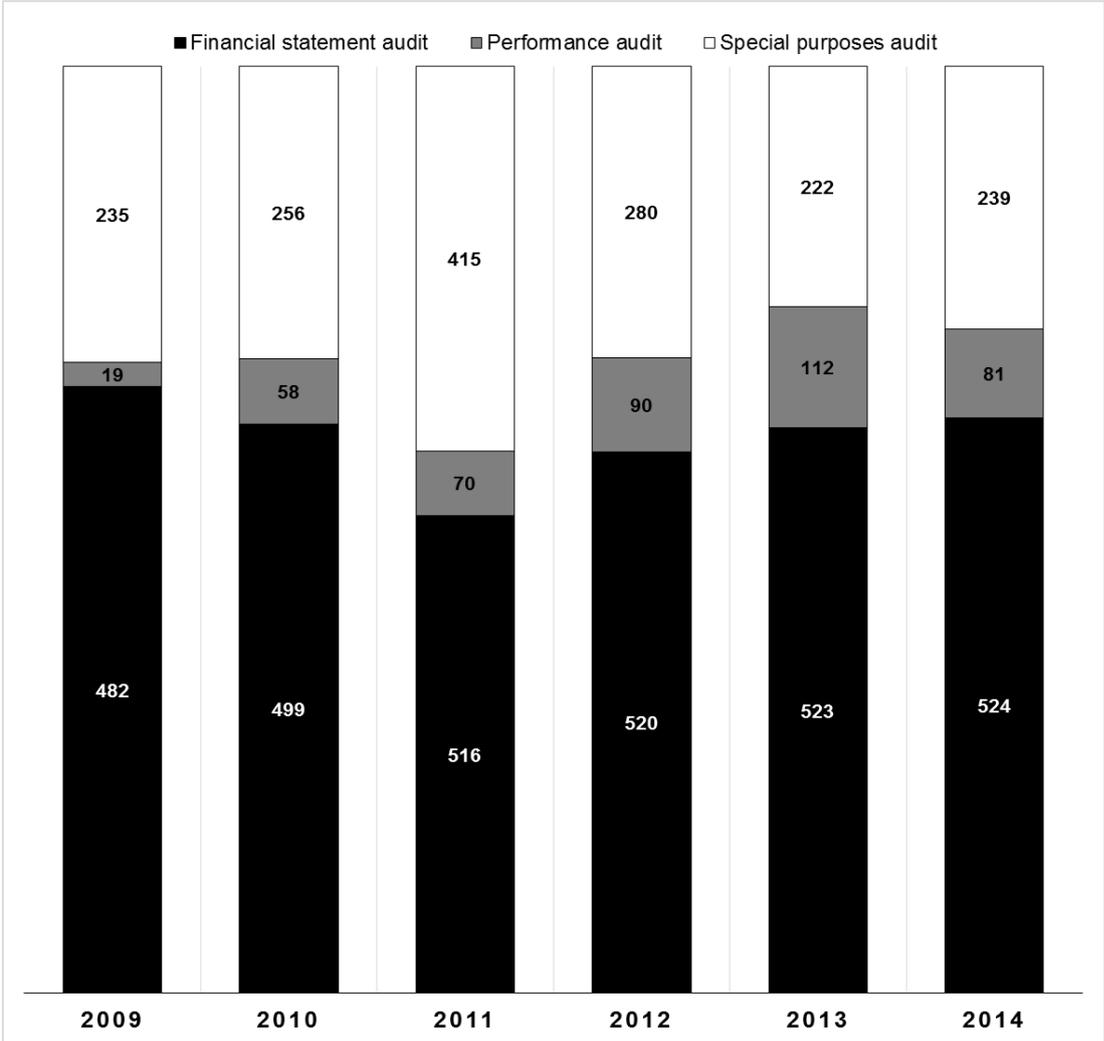
months after the end of the financial year at the latest or, in other words, by 31 March in the following year. BPK then has to publish its financial audit report by the end of the first semester of the subsequent year, or by 30 June. In the early implementation of this requirement, most local governments were not able to submit their financial statements within this timeline, causing BPK to also delay its financial audit assignment. For local governments that submitted their financial statement within the timeline, BPK did complete its financial audit in the first semester of the subsequent year. The statistics on the audit findings of that financial audit are then reported in the IHPS Semester I. Financial audit assignments on those local governments that were not able to submit their financial statements on time were conducted in the second semester, causing the statistics of those audit findings to be reported in IHPS Semester II. Nevertheless, there have been occasions when the delay of unaudited financial statement submissions to BPK has been more than one year. In such cases, BPK did not publish the audit finding statistics of those audit reports in its IHPS. As a result, 19 financial audit reports on various local governments for financial year 2009 until 2014 could not be included in the analysis due to the extensive delays of the respective local governments in submitting their unaudited financial statements to BPK.

The audit processes for performance audit and special purposes audit on local governments are not similar to that of financial audit. These audits are not necessarily conducted by BPK's Regional Offices. Some of these audits, commonly known as thematic audit, are planned and conducted by BPK's Headquarters in Jakarta, especially for strategic, complex and nation-wide audit themes (BPK 2008). In a number of instances, BPK has published one performance or special purposes audit report as part of its thematic audits on several local governments. On other occasions, BPK has supplemented the audit report with an individual audit report on each local government included in the audit. The main consideration on whether BPK publishes one audit report or more is based on the resources being used for the audit. When the audit is funded fully from the budget of BPK's headquarters, the audit is conducted by auditors from the headquarters and the audit report is also published by the headquarters. However, when the audits involve resources (e.g. budget and auditors) from BPK's Regional Offices, individual audit reports are also published by the regional offices. In addition to that, BPK's Regional Offices publish a number of performance audits and special purposes audits on their local government portfolio. In this study, only performance and special purposes audit reports on local

governments published by BPK’s Regional Offices during the period of study are included in the analysis.

Using a selection method described in the previous paragraph, this study has examined 5,141 audit reports on local government published between 2009 and 2014. It represents about 94.11% of the total 5,463 audit reports published within the same period. Figure 3.2 below breaks down the number of audit reports included in this study based on the audit types.

**Figure 3-2
Number of Audit Reports Included in the Content Analysis**



3.2.3. Criteria for Systemic Problem Identification

From section 3.2.1, we can conclude that the preparation of the IHPS is one type of quantitative content analysis because it analyses the text material (e.g. the audit reports) deductively, using audit finding classification as the criteria for categorising the qualitative data of the audit findings disclosed in the audit reports. It enables BPK

to present the aggregate information about the frequencies of each audit finding classification item in the IHPS based on the type of audit and the type of government institution (i.e. ministries, local governments, and government-owned enterprises). A complete set of data regarding the audit findings classification of each individual audit report is available in BPK's audit findings database.

Based on the selected audit reports, as discussed in Section 3.2.2, the researcher developed a separate audit findings database for local governments' audit reports that was used to identify any systemic problems resulting from PFM operational practices at local governments. Three criteria were then used to analyse the local governments' audit findings database and to identify the systemic problems. Those criteria are the frequency of the audit finding, the locus of the audit finding, and the impact of the audit finding to the overall PFM objectives.

3.2.3.1. The Frequency of the Audit Finding Items

The frequency of each audit finding item can be easily calculated and summarised based on the audit finding database used in this study. Krippendorff (1980) suggests that the summarising function of a content analysis can be made in terms of absolute frequencies or relative frequencies. Absolute frequencies recapitulate the number of each incident, in this case each audit findings item that was found in the audit finding database, while relative frequencies present the percentage of each incident compared to the total incidents reported in the database. The calculation of frequencies is the most basic and common form of data analysis (Krippendorff 1980), and it often provides significant findings regarding the data. The higher the frequency of certain audit findings, potentially, the more likely it is that they could contribute to the existence of systemic problems in the PFM operational practices. The greater number of certain audit findings reported during the period of the study reveals the inability of the current PFM practices in local government to prevent the problems from occurring. In addition, higher frequencies of certain audit findings increase the probability that the findings do commonly occur in most local governments showing the inherent flaws of the PFM operational framework and design.

In implementing this first criterion, the aggregate audit findings database used in this study was sorted based on the absolute frequency of each type of audit finding item. Then, a careful examination of the items was undertaken to identify any similar items that could be combined into a single item. This examination was conducted because the nature of the audit findings classification guideline allows problems that have similar characteristics to be categorised under a different item. For example,

overpayment of business travel expenses and overpayment of emolument are classified separately in the guideline, although they have the same characteristics of problems (i.e. non-compliance findings which cause expenses payments that exceed the applicable standard). To further simplify the analysis, 1% relative frequency was used as a cut-off point to eliminate any insignificant audit finding items in the subsequent examination. In other words, any audit finding items that were less than 1% of the total audit finding items reported during the period of the study were considered not to be significant or to have any potential to cause PFM systemic problems.

3.2.3.2. Locus of the Audit Findings Within the PFM System

PFM is considered as a system that consists of a number of sub-systems. The PFM model developed by CIPFA (2010, pg. 16), for example, consists of eight process elements whereby each element represents a PFM sub-system that can be broken down into several PFM components. In the Indonesian context, the PFM model refers to the framework stipulated in the trilogy of financial laws that govern the whole PFM system, both at central as well as local government levels. As the focus of this study is the operational element of the PFM (i.e. budget execution and accounting and reporting), the identification of PFM systemic problems includes the identification of the PFM operational components in which the problems occur. Those seven sub-systems are: 1) revenue collection, 2) disbursement process (including procurement), 3) financing activity, 4) cash and treasury management, 5) asset management, 6) accounting and reporting, and 7) internal control¹⁴.

The nature of the external audit function performed by BPK ensures that the occurrences of its audit findings are within the operational elements of the PFM framework. As a result, it can be assumed that audit findings reported in BPK's audit reports would fall under the seven PFM operational sub-systems, as mentioned in the previous paragraph. While a detailed examination of each audit finding case was not possible, due to the high frequency of the incidents¹⁵, an examination of the definition and scope of each audit finding item described in the guideline was conducted to ensure that the occurrences of audit findings were within the PFM operational sub-systems.

¹⁴ The seven components of PFM operations are based on the PFM legal framework after the reform. A more detailed discussion of PFM operational components in Indonesia's local governments is presented in Chapter 4 (Section 4.3.3).

¹⁵ The total audit findings reported during the period of study (i.e. 2009 to 2014) are 104,903 cases.

3.2.3.3. Impact Upon the Overall PFM Objectives

A system model focuses on the mechanisms to optimise the overall results of the system, not the performance of each individual component (CIPFA 2010). To be categorised as a systemic problem, audit findings items that met the first two criteria above were analysed further to identify their links to the overall PFM objectives. Such analysis involved an examination to identify and determine the negative consequences of the audit finding items in regard to the achievement of the PFM objectives, which are, according to the trilogy of the financial laws, to ensure that public money and resources are managed in an orderly manner, are compliant with the regulations and are economical, efficient, effective, transparent and accountable (GoI 2003; 2004a; b). The presentation of audit findings in BPK's audit report follows a certain format and includes a description of the audit findings, the criteria of the audit, the causes of the findings, the impacts of the findings, comments from auditees and the auditors' recommendations. The analysis to evaluate the impacts of the audit finding items that have met the first two criteria of systemic problems was conducted purposely by selecting the appropriate sections of BPK's IHPS and audit reports that explained the auditors' evaluations of the impacts of the audit findings.

3.2.4. Limitations

The design of the content analysis specifically accommodated the internal BPK's audit processes and practices. That may have limited the comparability of this study to other countries. In addition, this study does not differentiate the audit findings statistics based on the type of audit despite the fact that one type of audit may significantly contribute to a certain classification of audit findings. For example, performance audit findings were mostly categorised as 3E audit findings, while financial audit findings contribute more to internal control weaknesses.

3.3. Second Stage – Single Case Study

Yin (2014, 16) defines a case study as *“an empirical enquiry that investigates a contemporary phenomenon in depth and within its real-world context when the boundaries between phenomenon and context may not be clearly evident”*. PFM reform in Indonesia is a contemporary phenomenon that has been studied from a number of different perspectives (for example in: Achmad 2012; Siallagan 2012; Mir and Sutiyono 2013; Prabowo et al. 2013). Findings from those studies are mixed and it is still difficult to draw a general conclusion on whether the new practices introduced through the reform have already been embraced, adopted and implemented. The context of Indonesia as a developing and newly democratic country could be one

factor that contributes to the complexity of the phenomenon and causes such difficulty. Nevertheless, from the scientific point of view, this situation makes it attractive for more research to be undertaken to examine the phenomenon in more detail. The new PFM practices, as the phenomenon under study, are bound within Indonesia's public sector system that functions as the context of the phenomenon. They are also integral to Indonesia's political and governmental system, which can be seen as the macro context of the phenomenon. While the dynamics in the political and public sector arenas would have an impact upon the operation of the PFM framework on the one hand, the actual performance and operation of the PFM could possibly impact the accountability of the governments and trigger the deterioration of the public's trust in the public sector on the other hand. In some cases, a lack of accountability in PFM could generate an unstable political situation. Thus, it is apparent that the boundaries between PFM practices and both the public sector and the government's political system are vague. This discussion about the characteristics of PFM in the broader public service and governmental political system suggests the applicability of a case study method for this study because it fits into the scope of a case study as defined by Yin (2014). Therefore, given the qualitative nature of this study, a qualitative case study was employed in this research.

The selection of a research method should be guided by the research questions and objectives (Yin 2014; Flyvberg 2011). The selected qualitative case study method conforms to the objective of this study to present an in-depth and extensive description of the topic of the study from the perspective of the public sector employees. The conformity of this study with the case study research method is also supported by the ability of a case study to answer the what, why and how questions (Saunders et al. 2012), which are the types of research question to be answered by this research.

The second stage of this study attempted to examine the link between the non-compliance of public employees and the PFM operational practices in Indonesia's local government. It is expected that further similar studies in a number of local governments in Indonesia can be conducted in the same way. The diversity of cultural, demographic, social and economic characteristics among local governments in Indonesia offers a potential for deviation in the linkages between the public employees' behaviour and the PFM practices across local governments in Indonesia. This study can serve as a model, considering that the most appropriate case has been selected, which can be replicated in future research covering other local governments in Indonesia, in particular, and in other developing countries, in general. The future

potential for further research, along with the limited resources available to conduct the study, provides a rationale for selecting a single case study method for this study.

3.3.1. Selection of the Case

Stake (1995) suggests that, when selecting the case for a case study, the main factor that needs to be taken into account is to maximise what we can learn. However, context differences among case studies limit the generalisability of case study findings to the population (Creswell 2007). Seawright and Gerring (2008) further suggest that a case study would only be useful if the case selected could represent the population. Representativeness is essential to ensure that the case study can provide insight into a broader phenomenon within the population (Gerring 2007). Creswell (2007) further argues that the selection of representative cases could best generalise the case study findings. Failure to select a representative case could jeopardise the contribution of the study to the body of knowledge or limit its application to the real world.

There is advice from the perspective of quantitative research to randomly select such cases to avoid any selection bias. In other instances, practical considerations such as resources, access to the institutions, knowledge of the researchers and prominent methods within the field of study may also influence the case selection process. Nevertheless, those options cannot ensure the representativeness of the selected cases. Therefore, the adoption of a purposive case selection technique is often unavoidable. A purposive case selection technique was used in selecting the case for this study because it allowed the researcher to select the most appropriate case while also maintaining the representativeness of the case and meeting other important theoretical considerations (Seawright and Gerring 2008). Further, Patton (1990) also argues that a purposeful sampling method is commonly used in qualitative inquiry because it focuses on in-depth analysis of the selected cases.

A critical step toward selection of the most appropriate case is to gather as much information as possible about the population, which then can be used as a reference for selecting the most representative case to be studied (Flyvberg 2011). Even though it is difficult to achieve representativeness, Seawright and Gerring (2008) further argue that typicality addresses the main objective of case selection when choosing a case that could represent the population. Typicality could be judged according to the mean, median or mode on a number of variables that are relevant to the population of the cases. When potential cases are large and the selection criteria variables are multidimensional, some prominent factors could be used for the identification of the most typical cases. The typical case selection technique may also involve a

theoretically based argument of some phenomenon in the population. In this second stage of the study, a typical case selection technique proposed by Gerring (2007) has been adopted to choose one local government to be studied. Through this typical case, the study has the potential to draw a general conclusion about the mechanism of the linkage between the behaviour of the public employees and the PFM operational practices, which then can be used to explain this issue in relation to other local government jurisdictions.

The case selection technique mentioned above was applied to 33 provinces, 93 cities, and 398 districts¹⁶. Finding a typical case among those potential local governments was quite a demanding task given the diversity of cultures, customs, demography, economic development, geographical layout and other characteristics that feature within Indonesian local governments. Nevertheless, a selection process using several local governments' financial and non-financial measures that were available as of 2012 was finally arranged. The first selection factor was the level of local government¹⁷. As the design of regional autonomy in Indonesia devolves more authorities to cities/districts than to provincial government (Suryadarma 2012; Djohan 2014), the omission of provincial government as potential cases for this study was justifiable, leaving the selection process to include only 93 cities and 398 districts. For the purpose of the selection process, many variables were considered, including year of establishment, location, BPK's audit opinion of financial statements, number of audit cases reported in audit reports, the performance accountability index published by the Ministry of Administrative and Bureaucratic Reform, and budget figures of the local governments that included actual total revenues, percentage of local revenues compared to total revenues, total budget and percentage of budget realisation. In addition, the Local Economic Governance (LEG) index¹⁸ developed by *Komite Pemantauan Pelaksanaan Otonomi Daerah* (KPPOD) or the Regional Autonomy Watch Committee was considered in the selection process. The 'average' value of each selection variable was calculated to be used as a benchmark for selecting the case. However, the first two variables were independently evaluated because only local governments established before 1999 and not located in Western Indonesia

¹⁶ These figures represent the number of financial statement audit reports on local governments for the financial year of 2012 published by BPK (BPK 2015d).

¹⁷ Local government in Indonesia is divided into two levels or *tingkat*. Level 1 or *Daerah Tingkat I* refers to provincial government, while Level II or *Daerah Tingkat II* refers to cities and districts.

¹⁸ The LEG index is a composite index that measures nine components of local governance that are believed to be under the direct control of the city/district governments and have significant impact upon the business climate in their regions (KPPOD 2011).

were included in the selection process. The omission of local governments established after 1999 was an effort to capture the respondents' experiences and acquaintance with the previous PFM practices before the reform. Meanwhile, the focus on cities and districts located in Central and Eastern Indonesia was due to their geographical distance being farther from the capital city of Indonesia, Jakarta.

The application of these selection criteria resulted in three typical local governments being selected as appropriate for the study: West Kotawaringin District, Kendari City and West Lombok District. As methodological justification was no longer relevant in the last stage of this case selection technique, practical reasons in relation to their proximity and the resources available for this study were considered as the main factor in selecting West Lombok District as the single local government case to be studied. The characteristics of West Lombok District compared to the 'average' characteristics of local governments in Indonesia are depicted in Table 3.1 below, while Appendix 3 shows the geographical location of West Lombok District.

Table 3-1
Characteristics of Selected Local Government for the Study

No	Variable	Average Characteristics	West Lombok	Remark
1	Level of government	Districts (76.44%)	District	Purposely selected
2	Establishment	Before 1999 (60.78%)	1958	Purposely selected
3	Proximity	Western (58.07%)	Central	Purposely selected
4	Audit opinion	Qualified (60.99%)	Qualified	Financial audit report for FY 2012
5	Number of audit finding cases	16-30 cases (56.41%)	20 cases	Financial audit report for FY 2012
6	Performance index	C (55.41%)	C	Performance accountability report assessment for 2012
7	Total revenues (Rp. million)	Rp912,325.17	Rp852,081.77	Average for cities and districts
8	Local revenues (%)	7.37%	11.08%	Average for cities and districts
9	Total budget (Rp. million)	Rp1,003,223.79	Rp892,179.86	Average for cities and districts
10	Budget realisation (%)	90.08%	97.07%	Average for cities and districts
11	LEG index	59.2-64.1	62.1	Mean values for cities and districts

3.3.2. Data Gathering Techniques

One of the key characteristics of case study methodology is the use of multiple data gathering techniques and sources (Saunders et al. 2012; Eisenhardt 1989b). The need for multiple data is consistent with the requirement of a case study to also gain an adequate and relevant understanding of the context of the study (Stake 1995). In the second stage, a number of data gathering techniques and sources were used, which include public documents, internal reports, BPK's audit reports, FGD and semi-structured interviews. While documents and the FGD were used to gain understanding about the context of the study (i.e. the profile and the nature of systemic problems in West Lombok District), semi-structured interviews were used to gain the data necessary for addressing the second and third research questions of this study.

3.3.2.1. Documentation Analysis

This study mostly used documentation to gather information about West Lombok District. General information, such as its history and the characteristics of the district, were acquired from publicly available sources such as the public library, the official website of West Lombok District and reports from the Indonesian Bureau of Statistics. More particular information about the district's financial management procedures and practices was requested and collected during the fieldwork. This documentation was analysed and synthesised to compose a relevant description of West Lombok District's profile, in general, and more specifically of its financial management within the context that is relevant to the topic of this study.

3.3.2.2. Content Analysis

The steps and processes of content analysis were similar to those of the first stage, except that only West Lombok District's audit reports published between 2009 and 2014 were covered. In addition, since content analysis in the second stage aimed to gain understanding of the nature of the audit findings and PFM problems in West Lombok District, it did not apply the three selection criteria for the identification of systemic problems that were used in the first stage (i.e. frequency, locus, and impact). Instead, all audit finding cases reported in the audit reports were included in the analysis and were considered to be relevant for gaining an adequate understanding of the actual PFM problems in West Lombok District. The inclusion of all audit finding items was necessary because the nature of PFM problems in West Lombok District may expose different characteristics than the overall systemic problems of local governments identified and examined in the first stage of this study. In addition, an understanding of the actual PFM problems in West Lombok District was also important to guide the development of the semi-structured interview questions and the selection of interview respondents that could adequately address the second research question of this study.

3.3.2.3. Focus Group Discussion

To gather more insight into the PFM systemic problems in West Lombok District, especially in relation to the audit processes and the nature of the audit findings, an FGD with BPK auditors who conducted the audit on West Lombok District also was arranged. The selection of FGD participants was based on their involvement in the audit assignments on West Lombok District. All types of audit were considered equally relevant, which resulted in a mixed group of participants that included auditors who had conducted financial audits, performance audits and special purpose audits.

According to Berg and Lune (2014), information gathered from an FGD can be used for triangulation. In this case, analysis of the FGD results was used to confirm the findings from the content analysis of audit reports that had been conducted earlier.

3.3.2.4. Semi-structured Interviews

Marshall and Rossman (2006) assert that most qualitative researchers depend quite extensively on in-depth interviews as a data-gathering technique for their studies. This assertion is also supported by Yin (2014) who claims that interviews are commonly used in qualitative case study research. Further, in relation to encapsulating aspects that are difficult to be directly observed, such as the psychological aspects of human behaviour, it is well acknowledged that, in qualitative research, interviews are quite notable and superior to other data collection techniques (Patton 1990; King 1994). It is also summarised in the literature that most case studies deal with human affairs and actions; hence, interviews have become essential sources of evidence for any case studies (Yin 2014). As this case study has the specific aim of examining the behaviour of public employees involved in the PFM processes, the selection of interviews as the main data-gathering technique used in this study is justifiable both from the methodological perspective as well as for practical reasons.

Chadwick et al. (1984) state that interview styles occur along a continuum. The continuum spreads from a highly structured to a highly unstructured interview. While a highly structured interview does not allow any deviation from the initial design of the interview, a highly unstructured interview consists of undirected exploratory questions. The research objectives are the main consideration used by researchers to design their relevant types of interview, which can range between these two extremes. Saunders et al. (2012) further mention that the degree of formality and the structure of interviews are commonly used to categorise them as either structured interviews, semi-structured interviews or unstructured interviews.

A highly structured interview typically consists of a list of very specific questions with exact wording that are asked to all of the interviewees uniformly, according to the sequence and order that have been predetermined (Chadwick et al. 1984). It aims to collect particular data in order to explain the behaviour of respondents within certain settings or situations (Fontana and Frey 2005). These particular data can be collected by asking the participants to choose one of the already pre-defined answers (Saunders et al. 2012). A highly structured interview generally uses closed-ended questions and accommodates a more specific hypothesis that is being tested in the study (Maccoby and Maccoby 1954). Saunders et al. (2012) further posit that the

structured interview is commonly used to collect quantifiable data and generally refers to quantitative research interviews.

According to King (2004), cited in Saunders et al. (2012), the other two types of interview, semi-structured and unstructured, are often defined as qualitative research interviews. Semi-structured interviews involve outlining a set of themes and some key questions to be covered during the interviews. However, themes and questions may not be listed in their actual wording and exact sequence. The list is used as a checklist to ensure that all relevant topics have been included and covered during the interview. The application of this checklist may vary, meaning that the researcher may omit some questions if the specific context of the interviewees is not relevant to the research topic (Saunders et al. 2012). In regard to an unstructured interview, it can be classified as an informal conversational interview relying entirely on the spontaneous generation of questions by the interviewer (Patton 1987). Similarly, Fontana and Frey (2005) underlines the importance for gaining extensive information from unstructured interview by not enforcing any a priori answers, allowing the collection of any relevant data to appropriately understand the intricacy of human behaviour. Saunders et al. (2012) refer unstructured interview to in-depth interview where the interviewer does not prepare any pre-determined list of questions and themes to be asked during the interview. In most cases, the interviewer does not know what is going to happen and what further questions will be asked. Further, Saunders et al. (2012) assert that this type of interview is non-directive. It is the interviewees' perceptions that guide and direct the conduct of the interviews. They are free to talk about any events, behaviour, actions and/or beliefs that are related to the research topic. Nevertheless, the researcher needs to have a clear idea about the pieces of information that are to be explored, as guided by the research objectives. In both qualitative types of research interview, open-ended questions are common, allowing the researcher to exercise his/her active listening skills to further probe the interviewees' responses and obtain a complete and detailed picture of his or her experiences, opinions and perceptions that are essential to the research topic.

The nature of this particular study allows the application of a semi-structured interview style. A highly structured interview does not fit the needs of this study because of its quantitative nature. Unstructured interviews also are not suitable for practical purposes and reasons related to assumptions. From a practical perspective, unstructured interviews require more time because they normally occur as part of ongoing participant observational fieldwork (Berg and Lune 2014). From the assumptions perspective, unstructured interviews assume that the interviewees do not

know in advance what questions will be necessary to ask and that the heterogeneity of the interviewees will potentially cause them to misinterpret some of the meanings of words or terms used in the questions (Berg and Lune 2014).

The early works completed in the first stage of this study to identify the existence of PFM systemic problems, both at the national level and in West Lombok District, provided some context that was necessary for the development of potential questions to be asked during the interview. In addition, an examination of the literature, in terms of the theories and their empirical evidence pertaining to the topic of the study, also provided some insight into the potential responses from the interviews that was important to assist in the development of interview questions. In regard to the interviewees' profiles, the nature of this study required respondents to be involved in, and have adequate experience with, the financial management processes of their local government. Hence, the potential misunderstanding of the themes or questions being asked in the interview would be minimal. Consequently, the assumptions for unstructured interview were not met.

The inappropriateness of both the structured and unstructured interview models for this study led to the development and application of a semi-structured interview model. Semi-structured interviews provide flexibility to ask questions spontaneously as required and to establish a relaxed conversational style of interview while maintaining the focus to gain adequate responses from interviewees on a pre-determined set of questions, themes and topics. The conversational style of a semi-structured interview allows the emergence of unbiased responses as the interviewees answer the questions. In addition, the responses generated from the conversational style of a semi-structured interview are generally more systematic, comprehensive and focused, resulting in an undemanding data analysis process compared to that for an informal conversational interview.

One critical stage for conducting research interviews is the selection of respondents in a way that is relevant to the study and, at the same time, is justified by the theory. This study followed a purposive sampling technique, which Saunders et al. (2012) refer to as "judgmental sampling" because the researcher uses personal judgement to select the respondents, primarily based on their knowledge, information, opinions and experience being relevant to the research questions in order to fulfil the research objectives. This technique was selected due to the nature of the research questions that were specifically focused on the motivation and behaviour of public employees who are involved in various stages of financial management processes. The knowledge of the respondents about BPK's audit reports in regard to the fulfilment of

their roles in the financial management process was also necessary to gain critical and important responses relevant to the research objectives. A variation on the purposive sampling technique that allows for the diversity or heterogeneity of the respondents was also applied to provide comparability of the data collected (Saunders et al. 2012; Maxwell 2005), for example, between the hierarchy levels within the organisational positions of the respondents.

The researcher's understanding gained from the context of the case study guided the application of the purposive sampling technique used in this study. Results of content analysis on BPK's audit reports on West Lombok District and the FGD with BPK's auditors, undertaken previously, provided information about the departments or units within West Lombok District that were experiencing PFM problems. Further, a brief study of the overall organisational structure of West Lombok District was also conducted to provide initial insight into the roles and functions of all local government departments and units and how they intersected with the PFM processes. It was then followed by a careful analysis of the job descriptions of all local government positions in West Lombok District to identify potential respondents who had major involvement in the issues related to financial management.

3.3.3. Data Collection

The data collection process for the case study was divided into two phases. The first phase was conducted from February 2015 to March 2015 and focused on collecting the data from BPK's regional office of West Nusa Tenggara Province, in Mataram. The data gathered in the first phase were mainly relevant for understanding the nature of the PFM problems in West Lombok District. It consisted of BPK's audit reports on West Lombok District and the FGD with BPK's auditors who had audited West Lombok District. The second phase was conducted from May 2015 until mid-July 2015 and mainly focused on conducting interviews with West Lombok District employees in Gerung, West Lombok. Additional documentation about the PFM system, procedures, design and framework was also gathered during the second phase of the data collection process.

3.3.3.1. Content Analysis

A total of 18 West Lombok District audit reports were analysed, which consisted of 6 financial audit reports, 3 performance audit reports and 9 special purposes audit reports. Appendix 6 lists the West Lombok District audit reports that were included in the content analysis.

3.3.3.2. Focus Group Discussion

The FGD took place in the BPK Regional Office of Nusa Tenggara Barat Province, in Mataram, on 23 February 2015. At the time of data collection, there were 55 auditors who had conducted various audit engagements in West Lombok District. However, most of them had already been rotated to other BPK offices, leaving only 16 potential auditors who were available to participate in the FGD. An FGD participant information statement and consent letter (Appendix 8) was sent to those 16 potential auditors, yet only 9 auditors agreed to participate in the FGD. The FGD was conducted in Indonesian language and was documented using a digital voice recorder. An FGD transcript was prepared shortly after the discussion. The profiles of the FGD participants are presented in Appendix 7.

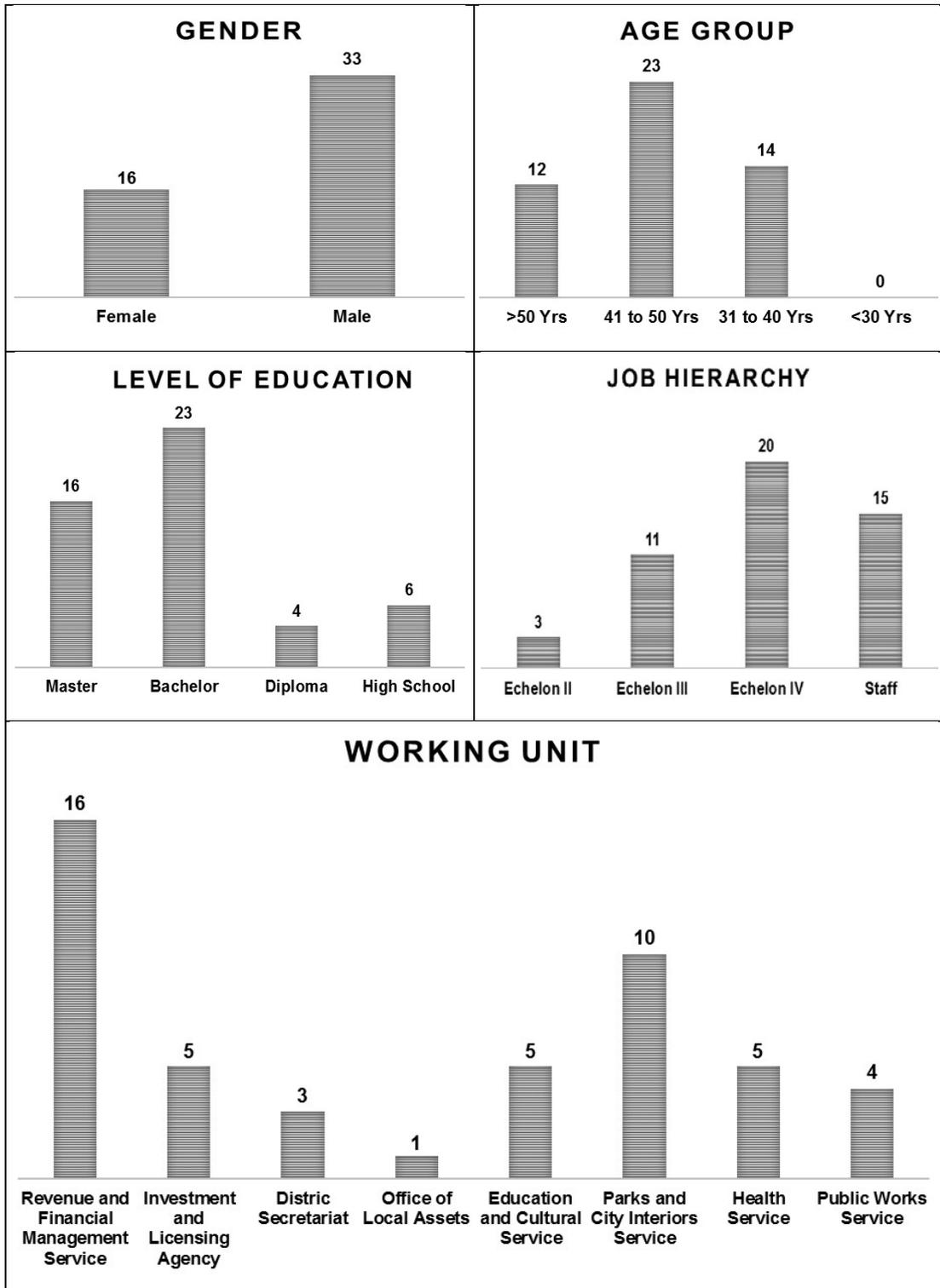
3.3.3.3. Semi-structured Interviews

Yin (2014) emphasises that, in conducting the interview, a researcher has two jobs to be accomplished concurrently. Firstly, he has to follow his own line of inquiry that is aligned with the research objectives. Secondly, he needs to ask the actual questions in an unbiased manner. To ensure the accomplishment of these tasks, interview protocols that provide a general guideline on how to conduct the interview were developed along with the list of interview questions (see Appendix 10). The sequence, wording and selection of the questions in the actual interviews might be different for each interview, depending on the dynamic of the interview processes. Probing was also exercised with due care to gain more detailed and unbiased responses from the respondents.

The results of content analysis of BPK's audit reports on West Lombok District guided the application of the purposive sampling technique that was applied in this case study. Based on the content analysis, there were at least 22 units within West Lombok District that were identified to have problems in various aspects of their financial management during the period of study between 2009 and 2014. Due to resources constraints, only eight major units (i.e. in terms of their functions, the sizes of the the units and the occurrences of the PFM problems) were selected for the interviews. They were the: 1) Revenue and Financial Management Service or DPPKD, 2) District Secretariat, 3) Office of Local Assets, 4) Investment and Licensing Agency, 5) Education and Cultural Service, 6) Parks and City Interiors Service, 7) Health Services, and 8) Public Works Service. A total of 65 potential respondents were approached and invited to join the interviews for this study. An interview information statement and interviewee's consent letter (see Appendix 9) were sent to all of them,

but only 49 respondents positively responded and were actually interviewed. The variation in respondents' profiles based on gender, age, job hierarchy, working units and education background is presented in Figure 3-3 below.

**Figure 3-3
Profiles of Interview Respondents**



3.3.4. Data Analysis

The analysis of BPK's audit reports using the content analysis technique to address the first research question of this study has been discussed in Section 3.2.3. Section 3.3.3.1 further discussed the variations in the content analysis of BPK's audit reports on West Lombok District as part of understanding the nature of the PFM problems in West Lombok District that were relevant to the context of the case study. In addition, as Berg and Lune (2014) suggest, the information gathered from the FGD could be used for triangulation. In this case study, the FGD transcript was used to confirm the existence of PFM problems in West Lombok District, as identified from the content analysis of BPK's audit reports. This section specifically discusses the analysis of the interviews data of the case study to address the second research question.

The semi-structured interviews were conducted in Indonesian language and took place in the respondents' offices. While the interviews with higher echelon respondents went quite well because they had separate offices, the interviews with staff level respondents were quite distracted because their work stations were located in a room with around 10-15 employees. Given the tight schedule of the interviews, the interview transcripts were prepared after the completion of all interviews.

A general thematic analysis technique for qualitative data (Braun and Clarke 2006; Aronson 1994; Saunders et al. 2012; Dey 1993) in combination with the template analysis model developed by King (2012) was used to analyse the interview transcripts. The application of this combined technique was suitable for this study because both techniques can provide flexibility in terms of their methodological and theoretical positions (King 2012). Generic thematic analysis is very useful to attain a rich and detailed analysis of complex and enormous qualitative data (Braun and Clarke 2006). Template analysis can further expand this usefulness by allowing both inductive and deductive approaches during a more structured qualitative data analysis process (King 2012; Waring and Wainwright 2008). The ability to apply parallel coding in the template analysis, whereby a certain segment of text can be classified into two or more themes, provided opportunities to further maintain the richness of the data interpretation that was relevant to the research questions (King 2012; Saunders et al. 2012). A computer software package, NVivo (version 10) also was used to support the analysis, especially in the management of such large quantities of data. It is argued that the use of a software package such as NVivo enables a more comprehensive analysis during the interpretation of qualitative data (Waring and Wainwright 2008).

The application of the above-mentioned data analysis process can be further broken down into four main stages, as follows:

1. Familiarisation with the data

This stage of data analysis mainly covers the transcribing process of the interview recording files, which was mostly done by the researcher. To expedite the transcription process, 17 out of 49 interviews were transcribed by a professional transcription service. As interviews were conducted in the Indonesian language, the transcripts were also in Indonesian. The transcription process followed a clean verbatim approach. Hence, the interview transcript does not necessarily capture the exact spoken words; instead, it captures the fundamental meaning of the interviewees' responses. The clean verbatim technique helped the researcher, especially in the presentation of the analysis results, because the coded text could easily be quoted as a direct entry into the report. Before the coding process took place, the researcher reviewed and checked all of the interview transcripts, at least twice, to ensure their accuracy. While this process was very time-consuming, it allowed the researcher to gain a far more thorough understanding of the data, which assisted in the interpretation of the data in the later stage of the analysis.

2. Generation initial codes

At this stage, the researcher identified any segments of the interview transcripts that were to be coded. The coding process attached the "meaningful bits or chunks" (Saunders et al. 2012) of the original transcripts to a certain category, label or theme. The data analysis adopted both the inductive (data-driven) and deductive (theory-driven) approaches, given that they are highly relevant to the research questions. Hence, the labels were generated from any of the three sources proposed by Strauss and Corbin (1998) which are: a) the terms that emerge during the data analysis process, b) the actual terms used by the respondents or 'in vivo' codes, and 3) the terms used in the existing theory and the literature.

As the transcripts were in Indonesian, the coding process was also conducted in the Indonesian language. There was no technical problem in conducting the coding process in a language other than English because the NVivo software has the ability to manage and analyse data in different languages. The coded text was then translated into English, while the label was allocated directly in English. This practical approach was selected to enable a more efficient data analysis process while maintaining the details of the relevant segments of the interview transcripts for further analysis and external review.

3. Development of the template

While the first two stages were derived from a general thematic analysis technique, the development of the template followed King's (2012) template analysis model. The original template analysis model starts with the development of an initial template based on a subset of the data (i.e. transcripts) before modifying the template by systematically continuing the coding process with the remainder of the transcripts, based on the initial template. Insertion, deletion and merging of the labels are common during the modification process before producing the final template for the interpretation and presentation of the analysis.

Differing from the original template analysis model mentioned in the previous paragraph, this study developed the initial template based on the whole set of data. Therefore, instead of going back and forth between the second and third stages of the data analysis process, the researcher developed the initial template after completing the coding process with all interviews transcripts. This practice allowed a more open coding process because the researcher was only guided by the research questions and was not restricted to any *a priori* labels or categories.

The key characteristic of template analysis is its hierarchical coding presentation (King 2012). In the template development stage, the researcher analysed the coded text at various levels of detail, as required. Groups of similar codes or labels were then aggregated together to produce more general higher order themes. The expansion of the top-level themes into a number of sub-themes displayed the richness and depth of the analysis in providing insights relevant to addressing the research objectives appropriately.

The advantage of using software for the data analysis is its ability to produce automatic counting figures for the coded text on each label, which was quite helpful during the modification process of the initial template. Frequencies of label coding were further examined to modify the initial template. The higher frequency of particular coded text in a label might reflect the importance of that label in the views of the respondents toward addressing the research question. Any label that seemed insignificant, for example, with only one instance of coded text, was evaluated further to simplify the hierarchical presentation of the template. These labels were either simply deleted from the template or inserted into other similar labels. In another instance, labels which looked similar were merged. These three procedures (i.e. deletion, insertion and merging) were used iteratively throughout the modification of the initial template to generate a final template that was representative for the

presentation of the data analysis in this thesis. During the template modification process, careful attention was paid to ensure that any insignificant label that had theoretical and/or literature support was not deleted without proper examination.

4. Interpretation and presentation of the template

This stage was a crucial one because it characterises the way the data analysis result was written in this thesis. One major issue that needed to be addressed in this stage was to avoid a simple listing of themes with a summary of main findings under each theme (King 2012). Hence, a number of strategies suggested by King (2012) were applied, including the examination of the frequencies of coded text, identification of key themes that needed to be examined in depth, open interpretation to ensure all direct relevant themes were discussed, and the incorporation of integrative themes and/or other lateral links. A thematic presentation based on the themes included in the final template was used to guide the presentation of the thesis. To support the relevance of the themes to the research question, direct quotes from the interviewees were included in order to illustrate the theme, to support understanding of the specific interpretations and to give readers a sense of the original responses of the respondents.

3.3.5. A Limitation

The limitation that applied to the data gathering design was mainly practical in nature and could not be avoided. In the FGD, due to staff rotation in BPK's office, the participants were only auditors who had recently conducted the audits on West Lombok District. As a result, most of the discussions covered the audit findings in a more recent time scale. Nevertheless, some respondents were able to trace audit findings that had been continuously reported in previous audit reports due to inadequate follow-up actions from the local government causing the continuity of the problem. The same practical issue was also found during the interview process since the selection of the respondents was based on their current job position. As a result, some of the respondents might not have been directly involved in the financial management problems reported the BPK audit reports of previous years. Nevertheless, the purposive sampling method that was used for interviewee selection ensured the knowledge and experience of the respondents in regard to the financial problems reported in their units. Most of the respondents had experience working with BPK's auditors during various stages of the audit processes.

3.4. Ethical Issues

This research involved human participants through the FGD and interview activities during the data collection stage. It adhered to the National Statement on Ethical Conduct in Human Research by following the ethical protocol requirements at Curtin University. Approval of the research methodology and instruments had been obtained from the Curtin University Human Research Ethics Committee before conducting the data gathering processes. However, formal letters to the institutions (i.e. BPK and West Lombok District government) asking permission for conducting the research and collecting the information within their institutions were sent before the ethic approval was issued.

Participants of the FGD and interviews were invited to take part in this study on a voluntary basis. Information and consent letters requesting participation were distributed to the potential participants, and only participants who signed the consent letter were invited to the FGD and interview sessions. A brief explanation regarding the objectives of the study, the benefits of the research to the participant and the potential impact upon the participant were conveyed before the FGD and interviews took place. The researcher discussed any concerns and questions from the participants before proceeding to the actual FGD and interviews. For documentation purposes, the researcher asked permission from the participants to record the FGD and the interview sessions. To maintain confidentiality, all personal information gathered during data collection is not displayed in any report, including this final thesis.

Secondary data, such as audit reports and local government documents, were requested through formal procedures, as required by the institutions.

3.5. Chapter Summary

This chapter has explained the justification for adopting a qualitative research methodology in this study. The nature of the research questions has guided the development of a two-stage research design that is specifically relevant for this study. The first stage provided explanations in regard to the appropriateness of applying a content analysis of BPK's audit reports, published between 2009 and 2014, to address the first research question of this study. The method applied in this stage allowed this study to encapsulate the PFM operational problems that had occurred in all local governments in Indonesia that had been reported in BPK's audit reports. The second stage considered the appropriateness of a single case study method, through interviews with a number of PFM actors who were involved in the PFM operational

practices, in order to address the second and third research questions. West Lombok District was selected as the single case in this study through a number of relevant selection criteria to ensure its typicality, thereby allowing the findings of this study to be utilised for assessing the occurrence of non-compliance in PFM operations in other local governments.

Following this research design and methodology chapter, Chapter 4 provides a description of the legal framework of PFM operations in Indonesia's local governments, which is essential for gaining an understanding of the expected behaviours of the PFM actors in regard to all components and stages of PFM operations.

Chapter 4

Legal Framework of PFM Operations in Local Governments

This chapter reviews the current framework of PFM operations in Indonesia's local governments. It commences with a brief history of the local government system in Indonesia since its independence, in 1945, unfolding trivial attempts to decentralise the central government's authority to local governments and highlighting the stagnant development of PFM operations before the major PFM reform in 2004. It is followed by an elaboration on the legal framework of current PFM operations for local government, which establishes the benchmark for the expected PFM operational practices across all local governments in Indonesia. This chapter commences the application of the first research stage. It aims to provide a foundation to adequately analyse the contents of BPK's audit reports by providing a reference to understand the expected behaviour and actions from those who are involved in the PFM operational processes.

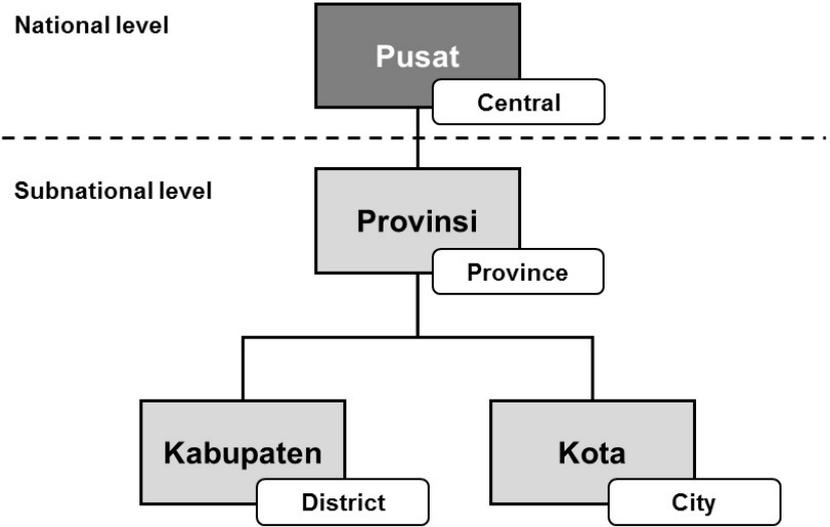
4.1. History of Local Government

From legal, fiscal and political viewpoints, Indonesia has a three-tier system of government (see Figure 4-1). The first tier, at the national level, is the central government. The subnational level refers to local government, consisting of the second tier of provincial government and the third tier of district and city governments. The regional autonomy and fiscal decentralisation policy of 1999, which was then reorganised in 2004, formally devolved many authorities (including financial authorities) to the local government level, primarily to the district/city level (Djohan 2014). Districts and cities must deliver most basic public services including health, education, environmental services, infrastructure and other services not legally provided by central and provincial governments (Fedelino and Smoke 2013). A province, on the other hand, is responsible for coordination of services among multiple districts and cities within its territory and it functions as the representation of the central government in the region (Djohan 2014).

In a country like Indonesia, where diversity in geographic, economic, social and cultural factors, natural resources and human resources is obvious, decentralisation is an attractive option for the government to be able to effectively respond to a large variety of the communities' requirements for government services. Attempts to formulate and operationalise its decentralisation policy, including fiscal

decentralisation in Indonesia, have been made continuously since its independence, through the enactment of a series of regional government-related laws. However, the unstable political situation after independence, the perceived threat of decentralisation to national unity, and the trend toward centralisation of political power during the first fifty years after the independence, have made those efforts fail.

**Figure 4-1
Tiers of Government in Indonesia**



The first law enacted after the Constitution 1945, Law 1/1945, caused the establishment of a Regional National Committee as a temporary local government institution and called for the enactment of a local government law within a unitary framework. General provisions regarding self-government in autonomous regions were then introduced through the enactment of Law 22/1948. In regard to local government fiscal capacity, the Law included provisions for local governments' revenues through their authority to collect local taxes and levies, to establish local-owned companies, to receive shares of national tax revenue, and to collect other income in the forms of loans, subsidies, sales of local government assets, etc. In the meantime, the Dutch who were reluctant to recognise the independence of Indonesia in 1945, attempted to maintain their influence on Indonesia. In 1949, they were involved in the creation of the United Republic of Indonesia, a federal state within a commonwealth of the Netherlands, and it injected a significant degree of regional autonomy into the Federal Constitution in order to gain support from the regions. The federal state, however, did not last for long. Indonesia's national government was restored to a unitary state and recentralised its political power in 1950. The threat to national unity that was a result of Dutch support of the adoption of a federal state had limited the implementation of Law 22/1948. A fiscal balance regulation, which was

essential to support the fiscal capabilities of local governments, was not established until the enactment of Law 32/1956. Tinker (1963) argued that Law 48/1948, supposedly designed to establish a system of local autonomy, was treated as “a dead letter”. The deviation of the actual political and administrative practices from the formal legal requirements was apparent, without any serious efforts to ensure the application of regional autonomy.

In 1957, the rising pressures from regions against the central government had forced Sukarno’s government to revitalise the adoption of regional autonomy. The new regional government law, Law 1/1957, was enacted to allow for much greater local autonomy. However, in 1959, this effort was aborted when Sukarno issued a presidential decree that marked the adoption of a political system of “guided democracy” where political power was concentrated and centralised in the hands of the president. Law 18/1965 was then enacted, stipulating some aspects of regional autonomy under the “guided democracy” model. Nonetheless, Law 18/1965 was never put into practice because Suharto and his new order regime took power in 1967.

The issue of regional autonomy was silenced following the reinforcement of centralised political power under the new order regime. In 1974, Suharto’s administration frivolously brought back the decentralisation policy through the enactment of Law 5/1974 regarding the General Provisions of Regional Government. The Law adopted a conditional autonomy principle by which only limited functions were assigned to local government. A set of criteria that characterised the capacity of a local government to manage its own affairs was strictly applied. Local autonomy status could only be granted if the local government could meet those criteria. Under this Law, regional autonomy was perceived as an obligation instead of a right. Nevertheless, in practice, Law 5/1974 was never fully implemented (World Bank 2003). Further, Eckardt and Shah (2006) opine that the enactment of Law 5/1974 did not shift the inclination of the new order regime toward a centralised financial power. The implementing regulations for Law 5/1974 were not available until 1992, while a regional autonomy pilot project in 1996 was unsuccessful because of inadequate support from the central government, especially in terms of personnel and facilities. Finally, in 1998, a major Asian financial crisis caused the fall of Suharto’s regime and the experimental project of regional autonomy under the 1974 regional government law ceased.

The crisis in 1998 had provided momentum to reform Indonesia’s political and government system. A substantial application of a democratic framework, including the devolution of authority from central government to local government, was also

established (McLeod and MacIntyre 2007; Tjiptoherijanto and Rowan 2010). The enactment of Law 22/1999 decentralised power to local governments in all aspects of government except in the areas of foreign policy, national defence, police, law enforcement, monetary and macroeconomic policies, and religious affairs. The devolution of those functions was also followed by the devolution and transfer of the required funds, infrastructure and human resources from central government to local governments (GoI 1999a). The old fiscal balance law, Law 32/1956, was abolished through the enactment of Law 25/1999, which offered a more democratic, just and transparent fiscal balance framework that would take into account the different needs, priorities, potentials and conditions of each regional government. The new fiscal balance law regulated a financial system that clearly segregated the authorities, roles, functions and responsibilities among different jurisdictions in order to support the implementation of the decentralisation program (GoI 1999b).

Much of the literature refers to the decentralisation program in Indonesia in 1999 as “Big Bang” decentralisation because the program was prepared, enacted and implemented within an extraordinarily short period of time and covered the whole of Indonesia’s local governments. At that time, this consisted of 26 provinces, 59 cities, and 234 districts¹⁹. Though it was not the first decentralisation program attempted by Indonesia, many viewed Big Bang decentralisation as one essential transition element for Indonesia to embark upon a more democratic form of government (Alm et al. 2004; Hofman and Kaiser 2004). It was stated that regional autonomy gave wider authorities to local governments in accordance with democratic principles and accommodated the necessity for civil engagement, the principles of equity and justice, and recognition of the diversity of regional characteristics (GoI 1999a). Decentralisation allowed the emergence of democratic practices at local government level and helped to improve local governments’ performances in terms of government operations, service delivery, economic development, standards of living and the fight against corrupt practices (GoI 1999b). Even so, studies of the decentralisation program in Indonesia have shown mixed results in the achievement of those objectives (Suharyo 2009; Hofman et al. 2009; Djohan 2014; Smoke 2015).

Brodjonegoro (2009) claimed that the implementation of the 1999 decentralisation policy had gained a “mild success”. However, as an ambitious program, the implementation of Big Bang decentralisation could not escape from a number of

¹⁹ By 2014, Indonesia had 34 provinces, 93 cities and 415 districts (Direktorat Jenderal Otonomi Daerah 2014), experiencing an exactly 70% increase compared to the number of local governments at the initiation of the decentralization program.

problems that had not been anticipated before. The problems started with the initiation of the policy because the recommendation for decentralisation was not supported by adequate information, especially in relation to the fiscal conditions of the local governments (Alm et al. 2004). Further, Hofman and Kaiser (2004) also highlight that the continuous demands from regions to strengthen their positions created more pressures for President Habibie²⁰ to accommodate a premature and ambitious proposal for decentralisation. During the implementation of Law 22/1999, a number of problems also arose due to lack of understanding, supports and monitoring mechanisms (Djohan 2014). Broad authorities were defined by the local governments as the freedom to develop and implement any local policies without considering the impacts upon other jurisdictions and national interests. The institution that handled the implementation of regional autonomy (i.e. Ministry of Regional Autonomy) was abolished and was replaced by only an echelon I unit²¹ (i.e. Directorate General of Regional Autonomy) within the Ministry of Home Affairs (MoHA). Given the broad coverage of the regional autonomy program, such institutional arrangements were not able to provide adequate support and monitoring functions during the implementation of the policy. Moreover, the issuance of derivative regulations of Law 22/1999 that did not align with the spirit of decentralisation indicated the resistance and ambiguity of central government in regard to the implementation of decentralisation policy. In addition, the dynamics of the national political situation following the emergence of the reformation era, which caused the amendment of the Constitution of 1945 and the enactment of a number of new regulations, for example, the trilogy of financial laws, forced a number of changes in the design of the decentralisation policy. As a result, Law 32/2004 and Law 33/2004 were promulgated to replace Law 22/1999 and Law 25/1999, respectively.

4.2. The Transformation of the PFM Legal Framework

The Indonesian Constitution of 1945 stipulated the inheritance of colonial laws in all matters of public administration during the transition period following the independence of Indonesia. As a result, for PFM at the national level, three major regulations were in operation at that time: the *Indische Comptabiliteits Wet* (ICW), originally established in 1925, and the *Regelen voor het Administratief Beheer* (RAB)

²⁰ President Habibie took over from Suharto, who resigned in 1998. Habibie initiated the regional autonomy policy to accommodate pressure from the regions that had been exploited by the centralist policy during the New Order government regime.

²¹ The Indonesian Public Service is organised in echelons, with echelon I indicating the highest and echelon V the lowest management levels.

and *Instructie en verdere bepalingen voor de Algemeene rekenkamer (IAR)*, both established in 1933. They were adopted by the newly established nation, whereas the general provisions for financial management at local government level followed the *Beheersvoorschriften Stbl. 1936 No 432 (Gol 1973)*. In addition, the provinces had specific provisions for their financial management, as stipulated in *Provincie Ordonantie, Stbl. 1924 No. 78*; while districts and municipalities adopted *Regentschaps Ordonantie, Stbl. 1924 No. 79* and *Stadsgemeente Ordonantie, Stbl. 1924 No. 365 (Gol 1972)*. The application of the colonial system, which was characterised by a lack of transparency and accountability, displayed a lack of effective legal framework for PFM in Indonesia prior to the Asian crisis in 1998 (Blondal et al. 2009). ICW, for example, as the organic law concerning PFM in Indonesia, had major flaws in its narrow scope of a small closed economy with no adequate public accountability (ADB 2004). Nevertheless, for roughly 50 years after independence, no solemn attempts were actually made to modernise the Indonesia's PFM legal framework, regardless of a number of political changes that occurred throughout the period (Karianga 2013).

In regard to local government, the old colonial arrangement was still in place until the 1970s, when derivative regulations of Law 18/1965, Government Regulation (GR) 36/1972 and GR 48/1973 were implemented, although they were not used in practice because Suharto enacted a new regional autonomy law in 1974, Law 5/1974. In 1975, derivative regulations of Law 5/1974, namely GR 5/1975 regarding the Management, Accountability and Monitoring of Local Government Finance and GR 6/1975 regarding Procedures for the Preparation of Local Budget, Financial Administration Execution and Preparation of Budget Execution Report, were established to provide guidance on local government financial management. During this period, Bastari (2004) concludes, a centralised approach through top-down planning and budgeting processes was maintained. In addition, a dual-budgeting model, differentiated by routine and development budgets, was employed but the preparation of budget still adopted the incremental budgeting approach. A balanced and dynamic budget was also used, leading to the absence of budget surplus or deficit since the equilibrium of revenue and expenditure in the budget had to be maintained. Financing activities were not explicitly disclosed in the budget. As a result, loans were recorded as local government revenues. In financial administration, the Local Government Financial Administration Manual, commonly known as MAKUDA, was established in 1981 and it adopted the single entry bookkeeping method and cash basis accounting method. The financial accountability arrangement was only reflected in the budget execution

report. The limitation of MAKUDA had constrained local governments to provide information about their assets, liabilities and cash flows (Bastari 2004). The lack of proper financial reporting requirements was also hampered by the absence of an external auditing mechanism. Heads of local government had the authority to assign financial monitoring and auditing roles to their officials (GoI 1975), threatening the independence principle of the auditing processes. Inadequate public accountability arrangements also existed since local governments were not required to table budget realisation reports to local parliaments. The strongly centralised financial management model adopted during this period requested local governments to only report their budget realisation reports to central government.

In 1999, the implementation of Big Bang decentralisation devolved a major part of authority for government spending to local governments, especially for the mandatory sectors such as education, health and infrastructure. In the revenue stream, while taxation was still centralised, local governments enjoyed a broader authority to manage their locally-generated income. The decentralisation of this fiscal authority certainly requires a proper governance mechanism in the financial management area because the euphoria of decentralisation tends to direct new local heads to start acting like little kings (*raja kecil*) with no accountability to either central government or local constituencies (Hofman and Kaiser 2004). Hofman and Kaiser (2004) further state that there is no clear evidence that decentralisation can automatically improve local governance. Therefore, it is critical to inject a proper financial management arrangement into the PFM framework of local governments.

To accommodate that need, GR 105/2000 regarding Local Government Financial Management and Accountability was implemented. It replaced the adoption of the top-down, dual-budgeting and incremental budgeting approach with a participative, unified, and performance budgeting approach. The structure of the budget was reconstructed so that financing activities from the loan and sale of local government assets, for example, could be included in the budget structure should a local government experience a budget deficit. In regard to financial management procedures, a decentralisation policy provides regions with the autonomy to enact local regulations regarding the general provisions of local financial management, along with the local government's financial management procedures in the form of the head of the region's decrees, to accommodate the specific needs of the regions.

Other improvements in financial administration practices were made through the implementation of the double entry bookkeeping method, along with the adoption of the modified cash basis, for local governments' accounting systems. These changes

were introduced to improve the accuracy of the recording processes for financial transactions and to support local governments in the preparation of more comprehensive financial accountability reports, which included the budget realisation report, balance sheet and cash flow statement (MoHA 2000). Public accountability in regard to local government financial management also was strengthened. A new accountability system at local level required quarterly budget realisation reports and annual financial statements to be submitted to the local parliament. Nevertheless, an adequate independent external auditing mechanism was still lacking. Supervisory and monitoring roles were mainly observed by the MoHA, although the internal audit function was also introduced.

In 2003, a major PFM reform in Indonesia's history was commenced through the enactment of Law 17/2003 regarding State Finance. The Law extends the definition of state finance to include local finance, and explicitly states that it does not only provide a reference for the PFM reform at central government level but also intends to strengthen the foundation for implementing the decentralisation policy in Indonesia. Law 1/2004 regarding State Treasury and Law 15/2004 regarding State Audit were then enacted to form a trilogy of financial laws that serves as the regulatory framework governing the basic rules for managing public finances at both central and local government levels. Achmad (2012) explains that the introduction of a trilogy of financial laws was a priority selected by the Indonesian government to develop adequate controls and to overcome the operational, structural, and systemic weaknesses that were present in the old PFM arrangements and practices in Indonesia.

4.3. Current PFM Operations (After 2004)

By 2004, a comprehensive set of legislation that laid down the current framework for PFM practices of local governments in Indonesia had already been established. It covers all financial management processes from the planning stage until the performance evaluation of the local government (Mahmudi 2010). The trilogy of financial laws establishes a modern PFM arrangement in Indonesia, adopting the principle of good governance. They are the organic PFM laws (Schiavo-Campo 2007a) that define PFM coverage, objectives and principles. They provide a description of the powers and authorities of the key actors, the main processes, the accountability mechanism, the financial oversight process, etc. Local government laws, on the other hand, devolve central government financial authority to local governments in order to improve the quality of public service delivery and to establish

a robust framework for ensuring the fiscal capabilities of local governments to support the implementation of the decentralisation program. Table 4.1 lists the current legislation that shapes the PFM framework at local government level in Indonesia.

**Table 4-1
Local Government PFM Regulatory Framework**

Law/Regulation	Description
State Finances Law 17/2003	The State Finances Law 17/2003 introduces a new paradigm in state finance through the adoption of a performance-based financial system and public accountability and transparency principles. It expands the definition of state finance to include local finance, details the constitutional provisions for the budget process, and mandates specific milestones and dates for the preparation and adoption of the budget, specifies general principles and authorities for the management and accountability of state finances. It also establishes the financial relationship between the central government, local governments and other institutions.
State Treasury Law 1/2004	The State Treasury Law 1/2004 lays out the management of state treasury in both central and local governments. It outlines the responsibilities of the Treasury and articulates the creation of treasurers in government ministries and agencies, together with general principles of the management and accountability of public funds.
State Audit Law 15/2004	The State Audit Law 15/2004 outlines the operational framework of BPK as the Supreme Audit Institution of the Republic of Indonesia and mandates it as a professional and independent institution required to submit its audit reports to Parliament.
Local Governance Law 32/2004	The Local Governance Law 32/2004 outlines the responsibilities of local governments for a range of public services, including education, health, public infrastructure, agriculture, industry and trade, investment, the environment, land, labour and transport.
Fiscal Balance Law 33/2004	The Fiscal Balance Law 33/2004 outlines the responsibility of local governments for managing their own public finances, their revenue-raising and the system of transfers from the central government.

Adapted from: Blondal et al. (2009); (USAID 2007)

The description, in this section, regarding the current PFM operational framework at local government level is based on the above-mentioned local government PFM regulatory framework, along with its derivative regulations in the form of government regulations, presidential regulations and ministerial decrees. The details of the system and procedures regarding local government financial management are established by each local government to accommodate any essential local content and diversity

among different local governments, as long as they do not violate the general principles described in the PFM regulatory framework mentioned above (GoI 2005). The comprehensive and detailed arrangements of the PFM legal framework for local governments, based on the hierarchy of regulations in Indonesia, are presented in Appendix 1.

4.3.1. General Principles and Objectives

In accordance with good governance principles, PFM operations within local governments hold the general characteristics of being united, universal, annual and specialised (GoI 2004a). The basis of unity requires the presentation of all local government revenues and expenditures in the budget document. Universality entails full disclosure of every financial transaction within the budget document. The annual basis of budgets limits their validity to a particular year. The basis of specialty requires a detailed allocation for every budget appropriation. The framework also contains provisions that encourage professionalism and ensure the transparency and accountability of budget implementation. In addition, the framework also accommodates any financial management innovations and local contents that are unique to any specific local government, as long as they do not contradict the general principles and norms introduced by the relevant laws and regulations imposed by the central government.

The local government PFM framework holds multiple objectives. The framework aims to establish an orderly management of local finance through compliance with relevant rules and regulations while also maintaining its economy, efficiency and effectiveness. In addition, the framework ensures the transparency and accountability of local government financial management by providing access to financial information for the public, the expectation of ethical behaviour, a balanced distribution of authority and resources, and personal or working unit responsibilities in regard to resources management and program implementation for achieving the intended objectives that will support the attainment of the broader goals of local government (GoI 2005).

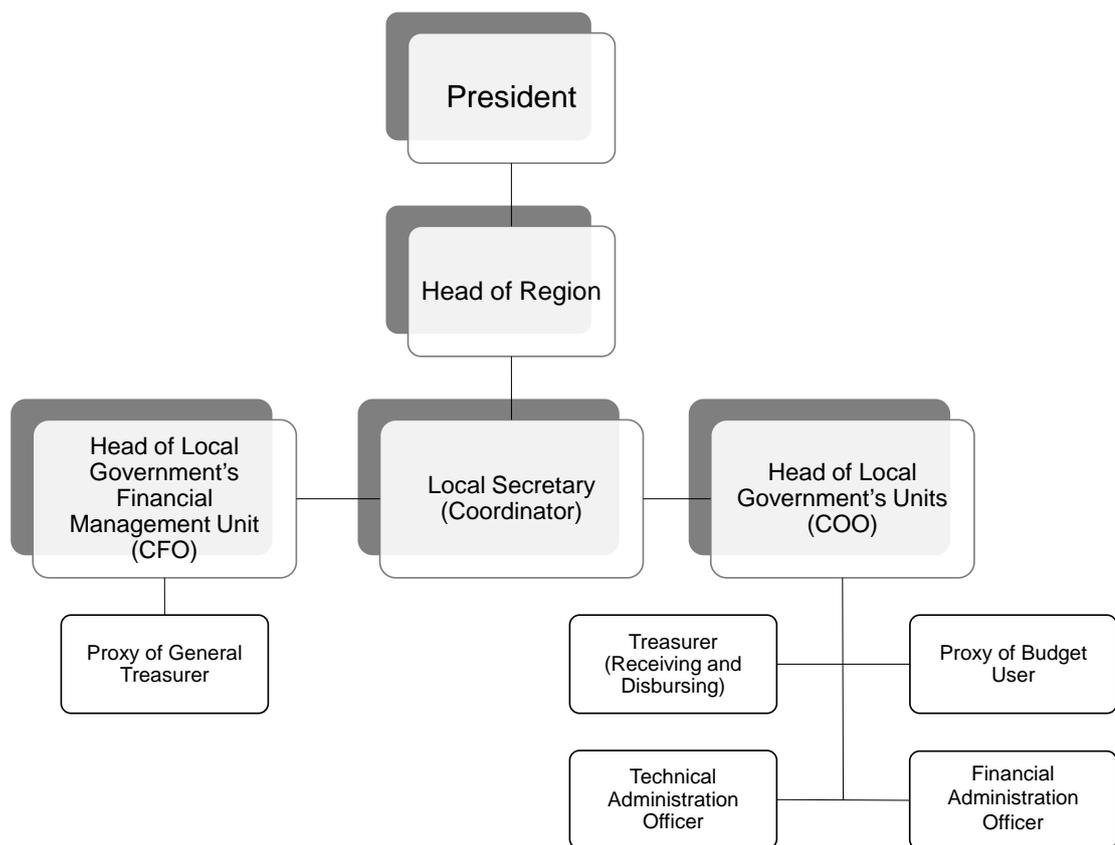
The State Treasury Law includes provisions for the initial execution of the approved budget up to the preparation of financial statements, with further detailed arrangements set by GR 58/2005 in regard to the Local Financial Management and

Minister of Home Affairs regulation, or *Permendagri* 13/2006, regarding Local Financial Management Guidance²².

4.3.2. Key Actors

Figure 4-2 depicts the key actors in the PFM of local government, based on their hierarchical relationships. Incorporating the spirit of decentralisation that was stipulated in the regional autonomy laws, the PFM regulatory framework devolves the highest financial management authorities of the President to the Heads of Region²³. These authorities are further devolved to each Head of Local Government's Financial Management Unit (FMU) and to the Head of Local Governments' Units. In essence, the Head of Local Government's FMU serves as a Chief Financial Officer (CFO), while the Heads of Local Government's Units each have the role of Chief Operational Officer (COO) for his/her unit.

Figure 4-2
Key Actors in PFM Operations



²² Two amendments of *Permendagri* 13/2006 have been made through *Permendagri* 59/2007 and *Permendagri* 21/2011.

²³ A province is headed by a Governor (*gubernur*), while a district and a city are led by a Regent (*bupati*) and a Mayor (*walikota*), respectively.

The separation of CFO and COO functions is a new principle adopted in the current PFM framework to provide clarity in the division of authority and responsibility, to establish a proper mechanism for checks and balances, and to increase professionalism in the administration of local government management (Gol 2003). In addition to that, the Local Secretary has a coordination role within the financial management of local government. The arrangement of financial authorities at local government level is established based on the segregation of authority among those who are responsible to authorise, verify, receive and disburse the money (MoHA 2006).

The subsequent subsections provide a brief description of each role and the authorities of each key actor.

4.3.2.1. Head of Region

As the financial authority holder in local government, the Head of Region issues policies regarding budget execution and asset management, appoints officials who are responsible for a number of budget execution functions, such as collecting revenue, administering accounts receivables/payables, administering assets, authorising budget spendings, verifying invoices, ordering and making payments. The policies and appointments of officials are prepared in writing in the form of a decree.

4.3.2.2. Local Secretary

The Local Secretary is the public financial management coordinator within a local government. He/she provides assistance to the Head of Region in the preparation and implementation of budget management policies, including the development and implementation of guidelines in budget execution and asset management, drafts regional regulations concerning the annual budget, the budget amendments, and the accountability of budget implementation, and coordinates the implementation of budgeting and financial management policies, especially in areas where the FMU and Local Government Units are working together, such as the preparation of annual budget and financial statement. During annual budget formulation and preparation processes, including budget amendments, the Local Secretary leads the Local Government Budgeting Team, which consists of the Local Planning Board, the Head of FMU and other relevant local government officials. In the preparation of the budget execution document, after the approval of the document proposals from each local government's units by the Head of FMU, the Local Secretary endorses the document to ensure commitment from both the FMU and the local governments' units for executing the budget as stipulated in the budget execution document. The Local

Secretary also coordinates the tasks of the Local Planning Board, the FMU and the Inspectorate.

4.3.2.3. Head of Financial Management Unit

As a CFO, the Head of FMU manages and administers the overall budget execution and also serves as the Local General Treasurer. He is responsible for the development and implementation of financial management policies, the preparation of the annual budget and its amendment, the collection of local revenues stipulated in local regulations, and the preparation of the local government financial report. Those responsibilities are assigned to a number of departments within the FMU. As the General Treasurer, he develops and ensures the application of budget implementation policies and guidelines, authorises the budget execution document for each spending unit, monitors the overall budget execution processes, collects local taxes, arranges loans and investments on behalf of local governments, establishes technical guidance on cash receipting and disbursement procedures, develops and implements policies and guidelines on asset management, and maintains a proper accounting and reporting system to support the presentation of financial information and the preparation of financial reports.

4.3.2.4. Proxy of General Treasurer

The Head of FMU, as the General Treasurer, with written consent from the Head of Region, appoints a Proxy of General Treasurer to perform his duties in general treasury areas including preparing cash budgets, issuing warrants of fund provision and warrants for disbursement of funds, making payments based on payment orders from budget users, monitoring the collection of revenue and budget disbursements performed by other appointed institutions, ensuring the availability of funds for budget implementation, managing local government investments, administering the original proofs of ownership for local government assets, carrying out local government lending, and collecting receivable arrears.

4.3.2.5. Head of Local Government's Unit

As a COO, the Head of a Local Government's Unit is the budget user and is responsible for exercising and implementing the agency's budget. He/she prepares the budget and its execution document, verifies invoices and payment requests, authorises and issues payment orders, collects non-tax revenues, administers account receivables/payables, utilises assets, monitors budget realisation progress and prepares the financial statements of the agency. As part of this role, in order to

implement the agency's programs and activities, a Head of Local Government's Unit may also serve as the Commitment-Making Official (CMO) who can carry out contractual agreements with other parties for the provision of goods and services within the budget ceilings.

4.3.2.6. Proxy of Budget User

To assist with day-to-day activities, the Head of Local Government's Unit may assign authority as a budget user, with the written approval of the Head of the Region, to any subordinates as a Proxy of Budget User. Criteria, such as the size of the unit's budget, its workload, capabilities, competencies, span of control, etc., must be considered to justify the appointment of any official as a Proxy Budget User. The Proxy of Budget User has the authority to conduct actions that result in budget disbursement, to verify invoices, to authorise and issue payment orders, to carry out contractual agreements, to oversee the execution of the unit's budget, and to perform other duties assigned by the particular Head of a Local Government's Unit.

4.3.2.7. Receiving and Disbursing Treasurers

The treasury roles in a local government's unit are conducted by treasurers. The Head of the Region appoints both a receiving and a disbursing treasurer to carry out tasks in relation to budget execution of each local government's unit. A receiving treasurer executes the revenue budget and is responsible to receive, store, deposit, administer and account for the local revenue money that has been collected. A disbursing treasurer executes the spending budget and is responsible to receive, store, pay, administer and account for the disbursement of the budget. Treasurers hold functional positions and are responsible to the Head of FMU as the General Treasurer.

4.3.2.8. Technical Administration Officer

A technical administration officer is an official within a local government's unit who is appointed by, and responsible to, the Head of that Local Government's Unit. He/she has responsibilities to control and manage the implementation of programs and activities, including reporting on the progress of program implementation and preparing documentation required for the administration of the program and for the fulfilment of the payment terms as stipulated in the statutory provisions.

4.3.2.9. Financial Administration Officer

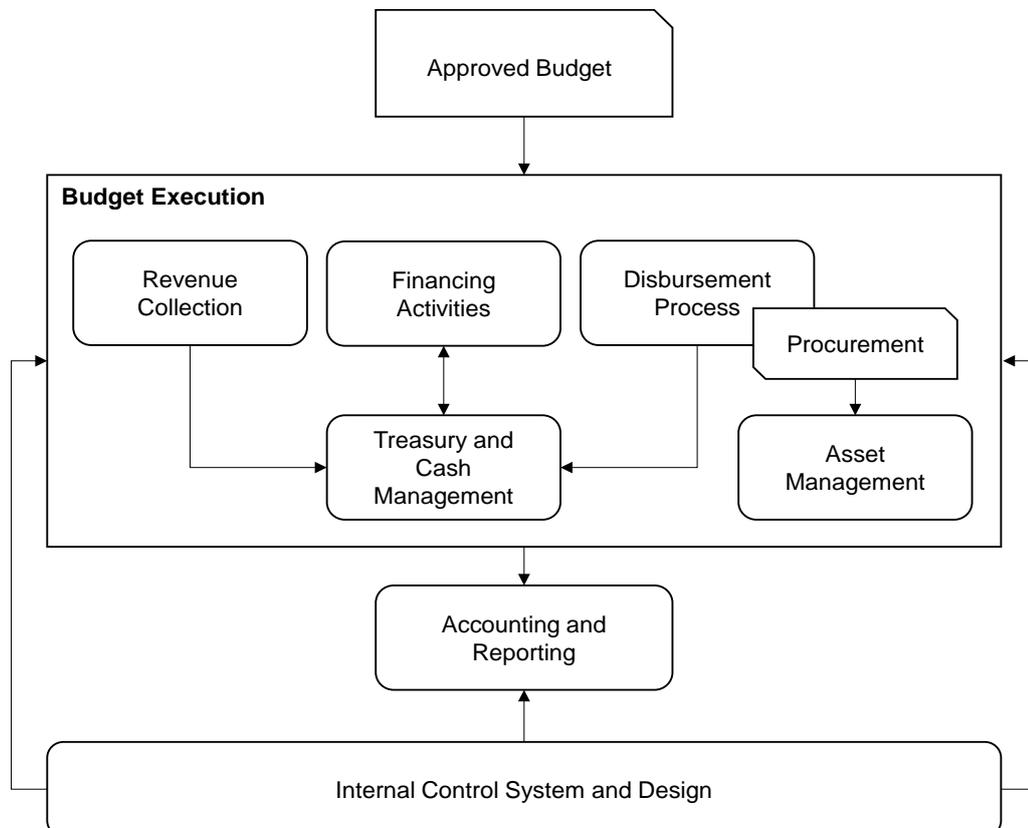
To exercise the authority for utilising the agency's budget, as stipulated in the budget execution document, the Head of Local Government's Unit appoints a financial

administration officer for examining and verifying the accuracy and completeness of payment requests, preparing payment orders and preparing the local government unit's financial statement.

4.3.3. PFM Operations: Components and Processes

The main PFM operational components in local government are depicted in Figure 4.4. The PFM operations start after the approval of the local government budget, which provides authorisation for local government to carry out programs and activities stipulated in the budget according to their appropriation. That includes all revenue and disbursement transactions in the form of monies, goods and/or services. Budget approval is enacted through the legal documentation of Local Regulations and Head of Region's Regulations. Drafts of both legal documents must be submitted and evaluated by the higher level of government (i.e. the Governor for a district's/city's budget and the Minister of Home Affairs for a provincial budget) before they can be enacted. The enactment of those legal documents should be made not later than 31 December, before the start of the next fiscal year²⁴.

**Figure 4-3
PFM Operational Subsystems**



²⁴ The budget year in Indonesia starts on 1 January and ends on 31 December.

After the legal approval of the budget, before the budget can be fully executed, a budget execution document should be prepared. The document elaborates more detailed information regarding each local government unit's budget, which includes the outcomes, objectives, functions, programs, activities and allocated budget for each program/activity/unit, including a cash utilisation plan that describes the estimated schedule of cash withdrawal and/or cash reception. The execution document must be authorised by the Head of FMU and endorsed by the Local Secretary before any revenue collection and spending activities can be executed.

In regard to any deviation from the budget assumptions, an amendment to the budget can be made at least three months before the end of the current fiscal year. The above-mentioned process for gaining approval on budget changes should include any required changes in the budget execution document.

4.3.3.1. Revenue Collection

Revenue collection deals with the collection of local government income, which consists of own-source income, transferred funds from central government and other lawful income. Local taxes, charges and fees represent the main components of own-source income. All own-source income must be stipulated in the proper regulations before they can be included in the budget and collected during the budget execution phase. Transferred funds come from three main sources: national tax revenue-sharing, natural resources revenue-sharing and both general allocation and special allocation funds. Other lawful income may come from central government (i.e. grants, emergency funds, adjustment and special autonomy funds), provincial tax revenue-sharing and financial assistance funds from other local governments.

In regard to the revenue collection process, the regulatory framework specifically stipulates the requirement for every local government unit that has the authority to collect revenue to intensify their collection efforts and deposit the collected monies into the local treasury account on the next business day. The regulatory framework also prohibits local government units from directly spending the collected revenue to pay their expenses. Monetary benefits and other forms of benefits that are a result of local government financial transactions, including the procurement of goods and services such as interests, fines, commissions, discounts, etc., should also be collected and reported as other local revenues.

The local government's FMU is responsible for the overall revenue management of a local government. Nevertheless, while the actual collection processes for local taxes, transferred funds and other lawful income are carried out by the FMU, non-tax local

income can be carried out by local government units that have been given the authority to collect it. All local revenue must be transacted through the local treasury account. Any banks, post offices or other financial institutions utilised for revenue collection processes, generally for non-tax local income collection, must be nominated and approved by the Head of Region. The actual collecting of money is carried out by a receiving treasurer officer. The Head of Region appoints receiving treasurers, both within the FMU and the local government units that have the power to collect non-tax own-source income. Receiving treasurers and other collection agencies are not allowed to hold the collected revenue money for more than 24 hours and must deposit the money to the local treasury account by the next day. Revenues from the transfer of funds and other lawful income are directly transferred to the local treasury account, reducing the potential for uncollected revenue problems.

4.3.3.2. Disbursement Processes

In the disbursement process, any spending cannot be made before the enactment of the annual budget law. The amount stated in the budget is the maximum ceiling for each type of expense and can only be disbursed for the intended purpose. On the basis of the budget execution document, a local government's unit can implement its programs and procure goods and services that trigger the disbursement of funds from the budget. The Head of Region appoints disbursing treasurers to each local government's unit to handle the operational activities in relation to the budget disbursement process.

Disbursing treasurers verify the validity, accuracy and completeness of invoices and other relevant documentation before initiating the payment process by issuing a payment request. The Budget User or Proxy of Budget User must confirm the availability of funds and verify the payment request, along with its supporting documentation, before authorising and issuing a payment order. A payment order cannot be issued before the delivery of goods and services is completed and it is prohibited to issue a payment order after the end of the current fiscal year. The Budget User then submits the payment order to the General Treasurer through the Proxy of General Treasurer. After verifying the completeness and the accuracy of the payment order and confirming the availability of the funds, the Proxy of General Treasurer issues a warrant for disbursement of funds to accomplish the payment process through the local treasury account.

In the procurement process, the main actors involved are the Budget User or Proxy of Budget User, a central procurement unit, a CMO and a committee for handover of

goods and services (Gol 2010). Depending upon the policy of a local government, a central procurement unit may carry out the tendering process for procurement of goods and services of all local government units. A CMO is appointed by the Budget User or Proxy of Budget User as the officer who is responsible for the overall procurement process in each local government's unit. At the beginning of the procurement process, the CMO is responsible for preparing the technical specifications of the goods/services required, an owner's estimate and a draft contract or agreement. Once the provider is selected by the central processing unit, the CMO is responsible for signing a contract/agreement, monitoring the execution of the contract, reporting the progress of the work and handing over the goods/services to the Budget User, upon the completion of the contract, by preparing a handover report. A committee for handover of goods and services is appointed by the Budget Users and is authorised to examine the adherence of procured goods and services to the specifications stipulated in the contract, to accept the procured goods and services upon carrying out a thorough inspection/examination and to prepare and sign the handover reports. Upon the handover, the procured goods and construction projects become the local government's assets and must be administered according to the asset management provisions specified in the PFM regulatory framework.

4.3.3.3. Financing Activities

Financing activity is related to the receipt of funds that must be repaid later and to the disbursement of funds to be received back later, either in the current fiscal year or in subsequent fiscal years. It includes the utilisation of unspent funds (budget surplus) from previous fiscal year, the establishment and disbursement of reserve funds, the selling of local government-owned enterprises, lending and borrowing activities and long-term investments (Gol 2005). Generally, approval from local parliament must be acquired and the stipulation of a certain financing activity within the local regulations must be established before financing activities can be included in the budget. Additional restrictions may also apply for financing activities. For example, the issuance of a bond must meet the following requirements: 1) there must be compliance with capital market regulations, 2) the balance of a local government loan must not exceed 75% of its actual local income in the previous year, and 3) the aggregate loan of central and all local governments must not exceed 60% of the national GDP (Gol 2005). Thus, endorsement from the Ministry of Finance may also need to be acquired before a local government can make any loans and/or issue any bonds. All financial transactions in relation to financing activities must be processed directly through the local treasury account.

4.3.3.4. Treasury and Cash Management

In line with the requirements to establish sound financial management of local government, its treasury and cash management function is considered to be one vital component in the PFM operational subsystem. Its role is essential to efficiently utilise the limited financial resources of local government and to address the uncertainty of fund availability because the timing of local revenue collection and availability, most of the time, cannot be predicted accurately. The current regulatory framework that separates the authority to issue a payment order from the authority to execute the payment creates a challenge for local government's treasury and cash management practices. Hence, it is mandatory for every unit within a local government to prepare and report its revenue and expenditure projection to the FMU on a regular basis. This practice assists the FMU to develop and implement a sound cash planning system to anticipate the possibility of cash shortages that may impede the execution of local government programs and activities, including its public service delivery.

The current PFM regulatory framework also emphasises the adoption of the Treasury Single Account (TSA) approach for local government cash and treasury management. Hence, all financial transactions in relation to revenue collection, disbursement processes and financing activities must be processed through the local treasury account managed by the Local Treasurer. The implementation of TSA allows the Local Treasurer to identify any idle cash that can be invested in short-term investment instruments, which can generate additional revenue for local government. It also assists the Local Treasurer to develop a sound cash planning system.

A flexible arrangement for cash management, especially to accommodate daily operational expenses at each local government agency, is also established. This involves the allocation of revolving cash advances to disbursing treasurers. Disbursing treasurers verify the validity, accuracy and completeness of the payment orders before making payments from the revolving cash balance. Any unused revolving cash balance at the end of the fiscal year must be returned to the local treasury account, along with a fund utilisation report and valid documentary evidence. Disbursing treasurers are also required to withhold applicable taxes from every payment they make and to deposit the amount of tax withheld to the state treasury account according to the applicable regulations.

4.3.3.5. Asset Management

The head of a local government's unit is also an asset user and is required to appropriately manage and monitor local government assets under his/her authority

according to the asset policy set up by the Head of Region (GoI 2006). It includes a series of actions that cover needs analysis and planning, budgeting, procurement, utilisation, maintenance, administration, appraisal, write off, ownership transfer and security of assets. Assets that are used to run local government operations are not allowed to be transferred without consent from the local parliament. In terms of security, asset users must maintain the quality, quantity and accessibility of their assets. They should also certify their assets with proof of ownership in the name of the local government. Bookkeeping, physical inventory and reporting arrangements for local government assets should be administered in an orderly manner.

4.3.3.6. Accounting and Reporting

Accounting and reporting is one component of a PFM operational system that was heavily impacted by the PFM reform. The new arrangement of this component aims to enhance accountability and transparency of the financial management of local governments. Before the reform, local governments were only required to prepare a budget realisation report and to submit the report to the central government, without any adequate external auditing process. The new PFM regulatory framework requires local governments to prepare financial statements that consist of a budget realisation report, balance sheet, statement of cash flow and notes to financial statement. The financial statement must be completed within three months after the end of the financial year and submitted to BPK for audit (GoI 2004a). BPK's audit serves as an external audit mechanism to assess the local government's financial management. Local government is required to report its audited financial statements to the local parliament, instead of central government. The financial accountability cycle of a local government's budget is finalised when the local parliament accepts the local government's audited financial statement and stipulates this in a local regulation.

Other than the annual financial audit, the new PFM regulatory framework also stipulates the in-year reporting mechanism whereby local governments are required to prepare the first-semester budget realisation report and submit the report to the local parliament by the end of July of the current budget year. While this requirement is part of the monitoring process by local parliament, it also serves as a means for local governments to propose any amendments to the budget as a result of (1) change in their circumstances that are not aligned with the budget assumptions, (2) the necessity for transfers between line items, spending units or activities, and (3) the necessity to utilise the previous year's budget surplus. The PFM regulations also give flexibility to local governments, should any emergency or extraordinary situation

emerge, to disburse the funds from the budget even though those amounts are not allotted in the budget. Such emergency spending, however, should be reported in the budget realisation and included in the budget revision proposal in order to gain approval from the local parliament and be stipulated in the local regulations.

While there was no proper accounting standard in place before the reform, the new PFM regulatory framework requires the conformity of the financial statement preparations with the Government Accounting Standard (GAS). The first GAS was implemented through the enactment of GR 24/2005. It marked the adoption of more modern accounting practices for local governments in Indonesia by replacing single entry bookkeeping with a double entry system. GAS 2005 accommodated a modified cash basis to bridge the adoption of a full accrual basis in the financial year 2008, as required by the PFM regulatory framework. Nevertheless, the GAS that adopted the full accrual basis was not available until 2010 when GR 71/2010 was enacted to replace GR 24/2005. GAS 2010, however, still allowed the adoption of the cash toward accrual basis during the transition to the accrual basis. This provision has caused further delay in the application of the accrual basis in local governments. MoHA (2013) stipulated that the accrual basis was not mandatory in the preparation of local governments' financial statements before financial year 2015.

Local government sets its own accounting policy and establishes a local government accounting system, which refers to the GAS. All local government units are required to prepare a financial statement for their financial transactions, which are then consolidated by the FMU. To enable the preparation of an accurate financial statement, both local government units and the FMU must maintain proper records of all transactions. Consistency of transaction recording, including the conformity of the transaction recording to the applicable accounting standard, should also be maintained.

4.3.3.7. Internal Control System

To enhance the performance, transparency and accountability of local government PFM, the Head of Local Government arranges and establishes an internal control system according to the relevant regulation²⁵. A local government's financial internal control system encompasses a process that provides adequate assurance for the achievement of the local government's objectives, as reflected in the reliability of its

²⁵ GR 60/2008 regarding the Government Internal Control System sets the guideline for the development and establishment of internal control systems in Indonesia, both for central and local governments.

financial reporting, the efficiency and effectiveness of its program implementation, and its adherence to the laws and regulations.

According to GR 60/2008, an internal control system in a government institution, including local government, consists of five elements: 1) control environment, 2) risk assessment, 3) control activities, 4) information and communication, and 5) internal control monitoring. The control environment requires the Heads of Regions to create and maintain working environments that can induce positive behaviours among the employees through strengthening their integrity and work ethics, maintaining an effective leadership style, actualising a strong commitment to competence, establishing well-suited organisational structures, having appropriate procedures for delegation of authority, implementing a sound policy on human resource management, performing an effective internal audit function and maintaining decent relationships with other relevant government institutions. The risk assessment element requests that the Heads of Regions develop strategic objectives according to the responsibilities of the institutions, as stipulated in the relevant regulations. It deals with the formulation of a statement of vision and mission that can be specifically measured, and is achievable, realistic and time-bound. Effective dissemination of the strategic objectives to all employees, and a more detailed operational strategy at activity levels, should be established to ensure the effectiveness of the risk assessment element.

Heads of Regions are also required to carry out control activities according to the size, the complexity and the nature of their roles, functions and responsibilities. More emphasis should be given to the main activities of the local government's institutions, based on the result of the risk assessment processes. This element also specifies the necessity for local government to establish written policies and procedures and to ensure the implementation of those written procedures in their actual practices. Control activities must be periodically evaluated to ensure their appropriateness and effectiveness. In regard to the information component of the internal control system, Head of Regions are obliged to identify, record and communicate any relevant information in an appropriate form and in a timely manner. The last element of monitoring requires the Head of Regions to establish continuous monitoring activities, including routine managerial activities, supervision, reconciliation and other measures related to the execution of roles and functions. A separate evaluation could also be undertaken by an internal audit function, or other external bodies, to review and examine the effectiveness of the internal control system. A proper follow-up

mechanism on the audit findings' recommendations and any review/evaluation of the audit findings are also part of the monitoring element of an internal control system.

Other than those major elements of PFM operations, the PFM operations of local governments in Indonesia also covers the arrangements for settlement of state losses and financial management of public service agencies (GoI 2004a). State losses can occur as a result of the unlawful acts or omissions of a person. The PFM legal framework sets provisions regarding the settlement process for the state losses, and stipulates that treasurers, non-treasurer civil servants or other officials who inflict state losses by breaching the law or neglecting their duties are responsible for compensating the government for the amount of the losses (GoI 2004a). The Head of the Region must report any state losses that have occurred in his/her local government to BPK. The imposition of compensation for state losses upon a non-treasurer civil servant and/or local government officials is decided by the Head of the Region, while BPK is responsible for imposing compensation for state losses upon the treasurers. The amount of state loss that is refunded is reported in the local government financial report as other own-sourced revenue (GoI 2004a).

To manage its affairs, local government may establish public service agencies, commonly known as *Badan Layanan Umum* (BLU). These agencies are in charge of providing services to the public, especially in relation to the local government's affairs, to improve public welfare and education. The PFM legal framework provides autonomy for a BLU to manage its activities, with the aim of improving the quality of public service delivery. A BLU also has a more flexible arrangement in terms of its financial management. For example, a BLU is allowed to directly use its revenue to fund its expenses. Nevertheless, a BLU remains a local government unit whereby its financial resources must be included in the local government's budget and its financial statement must be consolidated in the local government's financial statement.

In this study, however, these two elements, the settlement of state losses and the financial management of BLUs, are exempted from the analysis.

4.4. Chapter Summary

This chapter has elaborated upon the legal framework of local government PFM operations in Indonesia as the reference for local governments to exercise their roles in budget execution and preparation of financial statements. It has also exposed the three main elements of local government PFM operations in Indonesia: (1) budget execution, (2) a financial accounting and reporting system, and (3) an internal control system. These main elements have encompassed the typical PFM operations

stipulated in the major PFM literature and technical references as have been discussed in the literature review chapter. This chapter has provided a foundation and references for gaining adequate understanding in regard to the expected behaviours from the PFM actors under the current legal framework of PFM operations. Any deviations in the actual PFM practices display the problems of non-compliance, which has the potential to create systemic problems in the local governments' PFM operational processes.

The following chapter, Chapter 5, continues the application of the first research stage of this study by presenting the results of the content analysis on BPK's audit reports in order to directly address the first research objective in this study.

Chapter 5

Systemic Problems in Local Governments' PFM Operations

This chapter discusses the results of the content analysis of BPK's audit reports and presents a number of identified systemic problems in order to address the first research question of this study. In this thesis, systemic problems are defined as deficiencies that are a result of the non-compliant behaviour of public employees in one or more of the PFM operational sub-systems, which lead to the inability of the PFM operational practices to achieve the objectives stipulated in the trilogy of financial laws: to improve the accountability, transparency, efficiency and effectiveness of government activities without undermining the principles of orderly conduct, compliance with regulations and appropriateness. The proposed definition of systemic problems led to the development of three criteria for their identification, as described in the research methodology chapter (see Section 3.2.3), consisting of the magnitude or frequency of the audit findings items, the locus of the problems and the impacts upon PFM objectives.

This chapter begins with a general overview on the quality of PFM operations within local governments after the reform, focusing on the timeliness and the quality of the financial statements. A brief description of the statistics related to the audit reports and the audit findings reported during the period of study is then discussed, followed by the presentation of the main segment of this chapter, the systemic problems in local government PFM operations in Indonesia.

5.1. Overview of the Quality of Local PFM Operations

One of the immediate problems with the application of the new PFM system was the unpreparedness of the local governments to produce financial statements (FS) in a timely manner. Before the PFM reform, no government institution in Indonesia had experience in preparing a financial statement based on a certain acceptable accounting standard. Regulatory frameworks before the reform had only requested local governments to prepare a budget realisation report according to MAKUDA, the financial administration guidelines for local government. Then, the reform in 2004 required all government institutions to prepare financial statements that consisted of a budget realisation report, balance sheet, cash flow statement and notes to financial statement (Gol 2003). These financial statements must be submitted to BPK within three months after the end of each fiscal year (Gol 2004a). As a result, it is easy to

predict that some local governments might have difficulty in complying with this requirement, even though the regulatory framework allowed a two-year interlude before the actual implementation of this provision in the financial year of 2006.

**Table 5-1
Delay in the Finalisation of Local Governments' Financial Statements**

Financial Year (FY)	Number of LGs Not Timely in Submitting FS to BPK	Number of LGs Required to Submit FS to BPK	Percentage of Delay
2006	101	463	21.81%
2007	194	469	41.36%
2008	192	485	39.59%
2009	156	504	30.95%
2010	164	522	31.42%
2011	98	524	18.70%
2012	109	524	20.80%
2013	68	524	12.98%
2014	35	539	6.49%

Table 5-1 breaks down the statistics on local governments which could not finalise their financial statements within the timeframe required for each financial year from 2006 until 2014. In financial year 2006, there were 101 local governments, or about 21.81% of the total local governments required to submit, that could not finalise their financial statements within the timeframe. This number soared in financial year 2007 when 194 local governments, or 41.36%, were not able to prepare a timely financial statement. This trend continued until financial year 2011, when the number of local governments that were able to finalise their financial statements in a timely manner began to increase. By financial year 2014, only 35 local governments could not finalise their financial statements within the timeframe, or only 6.49% of the total number of local governments.

Delay in the preparation and finalisation of financial statements impacts upon the audit process and, ultimately, hampers the quality of the PFM accountability mechanism under the current PFM regulatory framework. Each Head of Region is required to prepare a local regulation draft regarding the accountability of budget execution. Along with the audited financial statements, the local regulation draft is submitted to Local Parliament within six months after the end of each financial year (Gol 2003).

The financial management cycle is finalised when a local regulation regarding the accountability of financial management is enacted. Therefore, any delay in the finalisation of financial statements has a flow-on effect to the financial accountability mechanism of the PFM regulatory framework.

Another obvious problem in regard to the implementation of the new provisions for preparing financial statements, especially during the early years, is in regard to the quality of the financial statements. One major component for assessing the quality of financial management in a local government is the fair presentation of financial information in its financial statements according to the relevant accounting standard. Under the current local government PFM framework, upon the submission of a financial statement, BPK conducts a financial audit to assess its fairness. BPK has two months to finalise its audits before issuing its opinions regarding the fairness of the information presented in the financial statements, according to the applicable GAS, and tabling the audit reports to the Local Parliaments (Gol 2004b).

There are four types of audit opinion issued by BPK (BPK 2015a). An unqualified opinion is issued when the financial statement presents a true and fair view of the auditees' financial position and it does not contain any material misstatements that could significantly impact upon the decision-making process. Under certain conditions, BPK may modify its unqualified opinion with an explanatory paragraph, although it does not affect the unqualified opinion of the financial statement. The second type of opinion is a qualified opinion. It means that the financial statement generally gives a true and fair view of the auditee's financial statements, however, there are a number of aspects and/or accounts that fail to meet the required standard. In the situation where the auditor is unable to reach a conclusion or opinion on the financial statement, BPK issues a disclaimer of opinion. A disclaimer of opinion can be issued due to a variety of reasons, such as restrictions in the scope of the audit. The fourth audit opinion is an adverse opinion. This type of opinion is given when the financial statement is not prepared in accordance with the required standards and the auditee is unwilling to make any necessary adjustments or corrections that have been proposed by the auditors.

Table 5-2
Audit Opinions on Local Governments' Financial Statements

F/S Audit Opinion	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Unqualified	3	4	13	15	34	67	120	156	252
	0.65%	0.85%	2.68%	2.98%	6.51%	12.79%	22.90%	29.77%	46.75%
Qualified	327	283	323	330	341	349	319	311	247
	70.63%	60.34%	66.60%	65.48%	65.33%	66.60%	60.88%	59.35%	45.83%
Disclaimer	105	123	118	111	121	100	79	46	35
	22.68%	26.23%	24.33%	22.02%	23.18%	19.08%	15.08%	8.78%	6.49%
Adverse	28	59	31	48	26	8	6	11	5
	6.05%	12.58%	6.39%	9.52%	4.98%	1.53%	1.15%	2.10%	0.93%
Total LGs	463	469	485	504	522	524	524	524	539
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

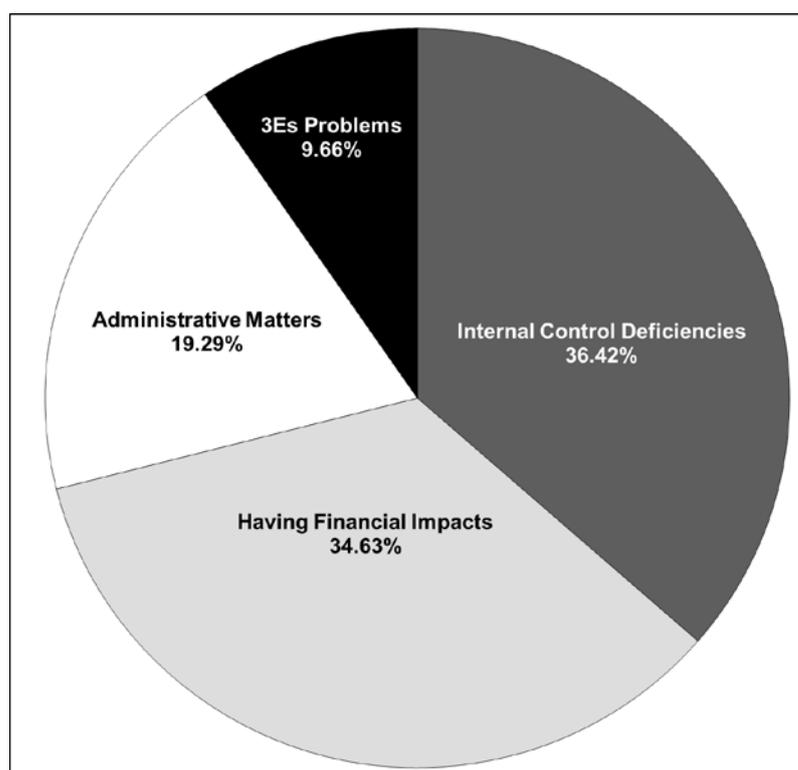
Table 5-2 highlights BPK's audit opinions on all local governments' financial statements from financial year 2006 to 2014. It is quite understandable that for financial year 2006 there were only three local governments that received an unqualified audit opinion, the highest ranking of BPK's audit opinions, because most local governments might not have possessed adequate capability in preparing financial statements. For financial year 2006, most of the local governments (327, or 70.63%) received a qualified opinion, while the remainder received a disclaimer of opinion (105, or 22.68%) or an adverse opinion (28, or 6.05%). As the capabilities of local governments have increased, the number of local governments receiving unqualified audit opinions also has increased. For financial year 2014, almost half of all local governments were able to receive unqualified audit opinions. While this achievement is positive, a lot of effort is still required to enhance the accountability of local governments as reflected in their financial statements.

5.2. Statistics on Local Government Audit Findings

Throughout the period of analysis, between 2009 and 2014, a total of 5,463 audit reports on local governments were published, both by BPK's Headquarters and BPK's Regional Offices. Content analysis conducted in this study covered 5,141 audit reports published by BPK's Regional Offices throughout Indonesia, or about 94.11% of the total number of audit reports. The coverage of the analysis included 3,064 financial statement audit reports (59.60%), 1,647 special purposes audit reports

(32.04%) and 430 performance audit reports (8.36%). Content analysis on those 5,141 audit reports exhibited 104,903 audit finding cases for local governments that had been reported throughout the period 2009 to 2014. Figure 5.1 summarises the 104,903 audit finding cases based on the four audit findings groups of: 1) exhibiting internal control deficiencies, 2) having financial impact, 3) pertaining to administrative matters, and 4) existence of 3Es problems (i.e. economy, efficiency and effectiveness).

Figure 5-1
Statistics on Audit Findings within Local Governments



Overall, most of the problems disclosed in the audit reports were about internal control deficiencies, followed closely by findings that highlighted financial impacts (i.e. shortfall of revenue and state losses), with administrative matters and, especially, 3Es deficiencies being reported less often. This trend may be driven by the emphasis of the external auditing process on assessment of the government institutions' internal control systems and their actual implementation as stipulated in the Government Auditing Standard (BPK 2007). An auditor is required to have enough understanding of the institution's internal controls to be able to properly plan and conduct the audit. In a financial statement audit, for example, a separate report regarding internal control weaknesses should be prepared to disclose any reportable conditions. Even in performance and special purpose audits, the audit reports must disclose any significant internal control weaknesses identified within the scope of the audit. Any

insignificant internal control weaknesses can be excluded from the performance and special purpose audit reports but they still have to be reported to the management of the audited entities.

Audit findings in the financial statement audits showed a similar pattern to the overall audit findings. This pattern is understandable because the majority of the audit reports included in the analysis were the financial statement audit reports. Nevertheless, different patterns were found among the other audit types. Performance audits reported more cases of 3Es problems, followed by the internal control weaknesses. Only a small proportion of performance audit findings exposed problems in administrative matters and weaknesses that caused financial impact. On the other hand, special purpose audits highlighted a major problem in the financial impacts of the audit finding cases. The different objectives and focus of each audit type may have caused the dissimilarity of the audit finding patterns among different types of audit.

5.3. Identified Systemic Problems

The application of the three criteria for identification of systemic problems is summarised in Table 5-3. The application of the first criterion resulted in 20 audit finding items being identified as potential systemic problems. Criteria 2 and 3 were then used to elaborate upon and link each potential problem to determine the relevant PFM operational subsystems in which the problems occurred and to evaluate the impacts of the problems upon the overall PFM objectives.

**Table 5-3
Identified Systemic Problems of Local Governments**

No.	Audit Findings Item	Criterion 1		Criterion 2 Locus of the Problem	Criterion 3 Impact upon PFM Objectives			
		Frequencies of audit finding cases			Accountability	Transparency	Efficiency	Effectiveness
		Number of cases reported	% of cases					
	Total audit finding cases reported	104,903	100.00%					
	Total audit finding items identified as systemic problems	93,035	88.69%					
1	Uncollected revenue and delays in revenue collection processes	11,384	10.85%	Revenue Collection				√
2	Overpayment of expenses	10,337	9.85%	Disbursement Process			√	
3	Inadequate and weak implementation of standard operations and procedures	7,407	7.06%	Internal Control	√			√
4	Inadequate and inaccurate transaction records	6,927	6.60%	Accounting and Reporting	√	√		
5	Incomplete documentation of expenses payments	6,760	6.44%	Disbursement Process	√			
6	Lack of asset safeguarding	6,138	5.85%	Asset Management	√			
7	Irregularities in the implementation of technical and/or internal regulations	6,086	5.80%	Internal Control	√			
8	Volume shortages	5,907	5.63%	Disbursement Process			√	
9	Lack of planning for activity	5,221	4.98%	Internal Control			√	√
10	Inappropriate financial reporting processes	4,290	4.09%	Accounting and Reporting	√			
11	Low performance and quality of service delivery	4,053	3.86%	Internal Control				√
12	Improper policy implementation	3,633	3.46%	Internal Control			√	√
13	Disbursement on fictitious activities/transactions	2,710	2.58%	Disbursement Process	√		√	
14	Higher acquisition cost of inputs	2,118	2.02%	Disbursement Process			√	
15	Inadequate financial management, accounting and reporting system	2,101	2.00%	Accounting and Reporting	√			
16	Improper cash handling	1,868	1.78%	Treasury/Cash Management	√			
17	Improper procurement processes	1,679	1.60%	Disbursement Process			√	
18	Non-compliance with regulations in other specific areas	1,667	1.59%	Internal Control	√			
19	Misallocation of budget	1,617	1.54%	Internal Control	√			√
20	Direct use of revenue	1,132	1.08%	Revenue Collection	√	√		

The following paragraphs in this section further evaluate these identified systemic problems in more detail, including the relevant PFM operational components in which the problems occur and how they may hinder the effectiveness of the PFM operational processes. The discussion also provides some examples extracted from the IHPS to describe the nature of the problems.

5.3.1. Uncollected Revenue and Delays in Revenue Collection

The most frequent problem identified in this study was the inability of local governments to optimally collect the rightful local government revenues within the specified timeframe stipulated in the PFM regulations. Throughout 2009 to 2014, there were 11,384 cases of uncollected revenue or delays in revenue collection, or about 10.85% of the total audit findings reported in BPK's audit reports on local government. Those occurrences of uncollected revenue and delays in revenue collection highlight the systemic problem in the revenue collection component of PFM operations and they mostly involve the failure of local government to collect local taxes, levies and late charges on third party construction work. While the financial management regulations do stipulate the requirement for local government agencies that have the authority to collect local revenue to perform their powers optimally, in practice the optimal efforts are still lacking.

“The exploitation of marble stone by 19 mining licensed companies in Pangkajene Island District was not subject to mineral resources tax, resulting in a shortage of local government revenue in the fiscal year 2010 that amounted to Rp30.55 billion.” (IHPS I/2011)

A number of local governments also still maintain a cash collection method, especially for their local taxes and levies. They assign a receiving treasurer to collect local revenue in cash, especially where the individual amounts collected are relatively small and the collection area is quite dispersed and isolated. The receiving treasurer is required to deposit the collected monies to the local treasury account within 24 hours after being collected. In actual practice, however, delays in depositing the money often occur due to the carelessness of receiving treasurers and other practical issues, resulting in the potential misuse of the monies by the receiving treasurers.

“In 2011, there were delays in depositing health care levies from the Karimun District local hospital into the local government bank account. The delays ranged between 1 to 60 working days and resulted in local government revenues amounting to Rp3.87 billion that could not be immediately utilised.” (IHPS II/2014)

In general, most local governments in Indonesia still heavily rely on the transfer of funds from central government (Djalil 2014). Hence, the inability to optimally collect the rightful local revenues and to deposit the revenue monies in a timely manner further impedes the ability of local governments to finance their programs and activities, as stipulated in the budget, in the most effective way.

5.3.2. Overpayment of Expenses

Overpayment of expenses constituted the second most frequent audit findings reported at local government level, mostly in the forms of payments for cost items that were not stipulated in the contract, payments of emolument and travel allowances exceeding the applicable standard, payments of expense items that were not in accordance with and/or exceeded the provisions, and payments for unfinished third party's work. There were 10,337 overpayment cases, or about 9.85% of the total audit findings, reported in BPK's audit reports on local government between 2009 and 2014.

“Overpayment for purchase of materials and work equipment, labour wages, non-physical work, equipment rental and diesel fuel in two new road construction projects amounted to Rp3.90 billion in West Tanjung Jabung District.” (IHPS II/2014)

This problem exposes systemic problems in the disbursement processes where a lack of verification procedures exists. Even though the PFM regulatory framework does include the requirement for disbursing treasurers, budget users and general treasurer or a proxy of the general treasurer, to verify the validity and accuracy of the payment requests and invoices, the actual practices of the verification procedures could not prevent the overpayment problems. The problem demonstrates that the actions of the officers who were responsible for verifying the validity and accuracy of the invoices before making the payments were still lacking, resulting in inefficiencies in the overall PFM operational processes.

5.3.3. Inadequacy of Standard Operations and Procedures

The internal control element that deals with the actual day-to-day operational practices of PFM is its control activities, which include the establishment of written policies and procedures to guide the actual practices of the operations. Detailed directions in the form of SOPs are generally established to ensure the adherence of the PFM operational practices to the higher regulatory requirements. SOPs also are important to ensure the operational accountability and effectiveness of the actual practices through the establishment of clear separation of duties and functions, adequate authorisation for transaction and/or decisions, the establishment of a sound control mechanism over access to information and utilisation of resources, timely and accurate transaction recordings, and proper documentation of internal control systems, transactions and other significant events.

“In Rote Ndao District, East Nusa Tenggara, the local government did not have adequate standard operations and procedures (SOPs) for the management of revenue collection processes potentially causing irregularities in the process of receiving cash by the treasurer.” (IHPS I/ 2011)

Such SOPs are inadequate either because they are informal or ineffectively implemented. There were 7,407 instances, or 7.06% of the total audit findings reported during 2009 to 2014, in which this problem was disclosed. This fact, as a result, may jeopardise the effectiveness and accountability of the PFM operations of local governments.

5.3.4. Inadequate and Inaccurate Transaction Records

Another systemic problem identified in this study is the inadequacy and inaccuracy of financial transaction records. This problem occurs in the accounting and reporting component of PFM operations and mainly deals with non-conformity and inconsistency in accounting treatments and recording of financial transactions, which may cause understated or overstated figures in local government financial statements. Throughout the period of the study, there were 6,927 cases of inadequate and inaccurate transaction records reported in the audit reports, or about 6.60% of the total audit finding cases.

In Bima District, West Nusa Tenggara Province, the presentation of inventory figures in the balance sheet was not based on a physical inventory check, meaning that the value of medicines inventory amount of Rp2.93 billion in the balance sheet might not display the actual figure.” (IHPS II/2012)

Inaccurate figures and inadequate disclosures, as a result of improper transaction recording and accounting processes, weaken the ability of local governments to fairly present their financial statements according to the accounting standard. As a result, this weakness may impact upon the accountability and transparency of the financial statements.

5.3.5. Incomplete Documentation of Expenses Payments

Incomplete documentation of expenses payments is another systemic problem identified in the disbursement process. It was reported 6,760 times in the audit reports, which was about 6.44% of the total audit findings items reported during the period of this study. This problem mainly occurs in relation to the disbursement of grants and other social aid funds to a number of external institutions, such as non-government organisations (NGOs), political parties and other community-based organisations. Under the current PFM regulations, the recipients of grants and other social aid funds are required to provide an accountability report on how the funds were managed and spent. Nevertheless, most local governments struggle to ensure that the recipients submit proper accountability reports in a timely manner and in an appropriate format.

“In Banten Province, based on examination of grant and social aid fund allocation, 92 organisations that received the money in fiscal years 2010 and 2011 had not submitted their accountability reports [on fund utilisation] resulting in the situation where the proper utilisation of budget spending on grant and social aid funding totalling Rp68.30 billion cannot be ascertained and causing a risk that the grants and social aid funds were not used in accordance with their intended purposes.” (IHPS I/2012)

This problem, in addition to the potential diminishment of the accountability of fund utilisation, also raises suspicion about the validity and effectiveness of the grant and social assistance funds allocations.

5.3.6. Lack of Asset Safeguarding

In asset management, lack of asset safeguarding was also frequently reported in BPK’s audit reports on local government, mostly in the form of inadequate supporting documentation for land ownership and breach of public asset management regulations. The total of 6,138 such cases that were reported during the period of study reflects about 5.85% of the total audit finding cases reported in the audit reports. This problem also involves incidents where public assets have gone missing and/or are being used or physically occupied by unauthorised parties.

“City of Bukit Tinggi did not have certificates of ownership for 520,424 square metres of its land assets, valued at Rp58.66 billion, causing uncertain legal status and weakening the legal position of the city in the event of a dispute.” (IHPS II/2009)

This situation displays the accountability issues in local government asset management. In addition, this problem may limit a local government’s ability to optimally utilise its assets. Hence, it potentially impacts upon the effectiveness of local governments in running their operations and delivering services to the public.

5.3.7. Irregularities in the Implementation of Regulations

Distortions in the implementation of regulations involve non-compliance with technical and other local government regulations in relation to financial management and administration. This problem belongs to the internal control component of the PFM operations, mostly in relation to both revenue collection and disbursement processes, and it may lead to other items of audit findings that include administrative weaknesses, inefficient and ineffective activities, shortages in revenue and state losses. Overall, this problem displays the lack of accountability of local governments in the management of their public financial resources. Throughout the period of study, this problem was reported in 6,086 instances, or about 5.80% of the total audit findings.

One example of distortion in the revenue collection mechanism deals with revenue monies that were not transacted properly through the local treasury account as stipulated in the PFM regulatory framework.

“In Bombana District, revenue sharing funds from land and building taxes were not transacted through the local treasury account in the Regional Development Bank of Southeast Sulawesi, causing unreported local revenue of Rp9.98 billion and undeposited revenue monies of Rp8.77 billion.” (IHPS II/2010)

In the disbursement process, a number of issues in relation to improper authorisation, and inappropriate requests and orders, for expense payments also highlight the problem.

“In Special Capital Province of Jakarta, inadequate fuel management in the Department of Fire and Disaster Management resulted in irregular disbursement processes for fuel expense payments worth Rp4.09 billion. Fuel consumption in each working unit was not approved by the authorised official. [In addition], there were no control cards to monitor the fuel consumptions of each fire engine.” (IHPS II/2009)

5.3.8. Volume Shortages

Volume shortage is a specific case of overpayment of expenses. It mainly occurs in the delivery of procured goods and services, especially in construction projects. Volume shortages are reported when constructions or procured goods and services are received in less than the volumes stipulated in the contract agreements, both in terms of quantity and quality. This case occurs when the payment of the full amount of the contract has been made while the procured goods or services have not been fully delivered according to the contract. In general, inaccurate verification during the handover of procured goods or services has triggered the problem.

“Volume shortage on procured works and goods amounted to Rp2.22 billion occurring in Bojonegoro District and City of Tidore Island. They involved the physical completion of the work that did not match with the contract but the payments had been made in full. There was a loss in regard to the discrepancy between the amount paid and the value of works and goods received, among others, for the procurement of office furniture and generator engine maintenance work.” (IHPS II/2013)

This problem highlights another systemic problem in the disbursement process when the project supervisors do not perform their roles optimally in the provision of goods and services. Between 2009 and 2014, there were 5,907 volume shortage cases reported in the audit reports on local governments, causing inefficiencies in the overall PFM operations. For a construction project, this type of problem raises another concern because the shortage in volume may jeopardise the overall quality of the construction work.

5.3.9. Other Systemic Problems

While previous paragraphs have listed and elaborated upon the major systemic problems²⁶ identified in this study, the rest of this section discusses the remaining, less-frequently identified, systemic problems based on the components of PFM operations.

5.3.9.1. Revenue Collection and Management

Another systemic problem in revenue management is the practice of using the collected revenue monies to directly pay the local government units' expenses. This problem occurred 1,132 times during the period of study, representing about 1.08% of the total audit findings. This practice violates the requirement to deposit all local revenue monies into the local treasury account and the requirement of paying the expenses through the budget mechanism. This non-compliant practice mainly occurs for non-tax local revenues where the authority to collect the revenue is devolved to a number of local government spending units that provide the services.

“In Dairi District, North Sumatra, revenues from public health insurance claims, social welfare insurance claims, birth delivery guarantee claims and regional health insurance claims, amounting to Rp6.35 billion, were directly spent for the operational costs of local hospitals and local health centres.” (IHPS I/2012)

Transparency and accountability are the two PFM objectives that are negatively affected by this practice. The impact upon these objectives is twofold; the first is concerned with the omission of revenues and expenses figures from the financial statements, and the other is related to improper disbursement processes since the payments of expenses do not follow the budget mechanism.

5.3.9.2. Disbursement Processes

Among the disbursement processes, there were an instances where the local government budget was illegally used. They involved the disbursement of budget for the personal use of employees and for fictitious activities such as fictitious official travel. There were 2,710 cases of payments for fictitious activities, or about 2.58% of the total audit findings, reported in local government audit reports between 2009 and 2014. This problem displays the lack of verification procedures for the payments and the corrupt mentality of the public employees and officials involved. It is one source

²⁶ A major systemic problem is defined as an identified problem that represents more than 5% of the total audit findings cases reporting during the period of the study.

of inefficiency in PFM operations at local government level, which also affects the accountability of local government in the management of public finances.

“There were 51 fictitious business travel expenditures worth Rp44.35 billion. It involved trips were not actually conducted and improper documentation, such as the absence of travel activity reports and fraudulent airline tickets. These cases occurred in 45 local governments, including West Papua Province (Rp11.41 billion), East Kutai District (Rp4.35 billion), Deli Serdang District (4.18 billion) and South Nias District (Rp3.28 billion).” (IHPS II/2013)

Another contributor to waste and inefficiency in the disbursement process is improper processing in the procurements of goods and services. It involves the omission of some prerequisite procedures during the procurement process, for example, the procurement team does not prepare an owner’s estimate. It also includes instances when the procurements have been split into a number of smaller contracts to avoid the requirement for carrying out a bidding process and when there are pro forma procurements by which the winner of the bidding process has been arranged in advance. Improper procurement processes were reported 1,679 times, or about 1.60% of the total audit findings reported in BPK’s audit reports on local government published between 2009 and 2014.

“The central procurement unit in Sigi District didn’t exercise its authority to evaluate its owner’s estimate and the technical specifications [of the procured goods] causing the failure to have an accurate value of owner’s estimate.” (IHPS II/2014)

The last identified problem in the disbursement process, especially in relation to the procurement of goods and services, deals with the acquisition cost of inputs being higher than the applicable standard market price. It also includes the acquisition of substandard quality of inputs. This problem obviously contributes to inefficiency in the PFM operations of Indonesia’s local governments. Inaccuracy in the preparation of an owner’s estimate, where the owner’s estimate is set higher than the market price, is the most common cause of this problem. Between 2009 and 2014, there were 2,118 cases of higher acquisition cost of inputs, as reported in BPK’s audit reports, representing about 2.02% of the total audit findings.

In Kutai Kartanegara District, East Kalimantan Province, there were purchases of laptops, which were not from the authorised dealer, causing waste worth Rp11.93 billion.” (IHPS II/2012)

5.3.9.3. Cash and Treasury Management

One problem that was identified in the cash management component related to the failure of disbursing treasurers to return the cash balance in their possession at the end of the fiscal period to the local treasury account, as required by the regulations.

The problem, even though not very significant in terms of the monies involved, may reduce the accuracy of the cash balance figures in the financial statements and could potentially trigger the misuse of the money by the disbursing treasurers.

“In Aru Island District, a cash balance of Rp26.10 million in the District Secretariat’s treasury for the fiscal year 2010 was not used in accordance with the provisions and had not been returned to the local government bank account, resulting in an indication of state loss.” (IHPS I/2012)

During the period of the study, there were 1,868 incidents regarding this problem representing about 1.78% of the total audit findings reported in the audit reports during the period of study.

5.3.9.4. Accounting and Reporting Processes

The accounting and reporting component is concerned with the preparation of local government financial statements on budget implementation. Any systemic problems identified in this component lead to the inability of local governments to prepare fair financial statements according to the accounting standards. Hence, it impacts the quality of financial management accountability of local governments.

Other than inaccurate accounting treatment and recording processes, inappropriate reporting processes in financial statement preparation also point to this systemic problem in PFM operations. It concerns the establishment of accounting units and reporting procedures that are not in accordance with relevant regulations. It also involves the input of invalid transactional evidence into the accounting system. During the period of study, 4,290 inappropriate financial reporting processes were reported, accounting for about 4.09% of the total audit findings.

“In East Sumba District, East Nusa Tenggara Province, the financial transactions of four working units were not recorded in the general ledger of cash and no reconciliation had been made between the bank statement and general ledger of cash.” (IHPS II/2009)

Another problem in the accounting and reporting component is related to an unreliable accounting and reporting information system. This indicates the inability of the particular accounting and reporting information system to provide accurate, reliable and timely accounting and reporting information. It may lead to a potentially unfair presentation of the financial figures in the financial statement. This problem was reported 2,101 times, or about 2% of the total audit findings reported throughout 2009 to 2014.

“In Keerom District, Papua, accounting and reporting information systems were inadequate. The fixed asset figure in the financial statement, amounting to Rp34 billion, could not be traced adequately because the spending units did not

prepare asset inventory cards and the Head of Asset Department did not compile the periodical assets inventory report. This resulted in the value of assets [in the financial statement] possibly not being presented fairly.” (IHPS I / 2010)

5.3.9.5. Internal Control System

In relation to budget execution, the internal control system also covers efforts to ensure both effectiveness and efficiency in the implementation of a local government's programs and activities. Other than problems in relation to the inadequacy of written procedures, or SOP, lack of planning is also seen as a systemic problem in the internal control system component. It was reported 5,907 times in BPK's audit reports covered in this study, or about 4.98% of the total audit findings. It involves, for example, misclassification of expense items in the budget and budget execution document, causing a potential problem in the implementation of programs and activities, as well as in the accounting and reporting processes. Misclassification of expense items may require a revision of the budget before they can be disbursed, causing delay in the execution of the local government's programs. It may also lead to inaccurate presentation of financial information in the local government's financial statement.

“In Mojokerto District, East Java, inaccuracy in capital expenditure budgeting processes amounted to Rp70.48 billion in its annual budget for the financial year 2011, resulting in misclassification of goods and services expenditure, grant expenditure and capital expenditure.” (IHPS I / 2012)

In other instances, lack of planning can be directly linked to the inefficiency and ineffectiveness of a local government's programs and activities.

“In Bali Province, procurements of ICT-based instructional media for education in the Office of Education, Youth and Sports during 2010 to 2012 were not prepared and executed based on proper planning, causing a financial waste of Rp69.02 billion.” (IHPS II/2012)

A sound internal control system also requires the Head of Local Government Agency to carry out a mechanism to manage the overall performance of the agency. This includes the establishment, measurement, monitoring and evaluation of the agency's performance indicators. BPK's audit reports found that, while the establishment and measurement of performance indicators were developing, the actual performance of the local government agencies was not particularly successful. A number of agencies, for example in health services, struggled to achieve their minimum service standard. These problems were reported 4,053 times, or about 3.86% of the total audit findings on local governments reported by BPK during 2009 to 2014, leading to ineffectiveness in local government financial management, especially in public service delivery.

“The service performance of Andi Makkasau hospital [in Pare-Pare City] did not meet the minimum service standards. Performance indicators [targets] for inpatient, outpatient, emergency, pharmacy and hospital maintenance services did not fully meet the minimum service targets.” (IHPS II/2012)

Another systemic problem in the internal control system component is the inability of local government to properly implement and execute government policies. In such cases, local government may have failed to optimally collect potential revenue or may have to bear unnecessary expenses. Hence, this problem has the potential to threaten the efficiency and effectiveness of the overall PFM operations of the local government. During the period of study, 3,633 improper policy implementation cases were reported, accounting for 3.46% of the total audit findings disclosed in the local government audit reports.

“Optimisation of the collection of hotel, restaurant and advertising taxes has not been properly implemented in order to support the increase in local tax revenues. Some issues related to this problem include that the policy and work plan for the tax optimisation program has not been prepared, dissemination of tax rules has not been fully conducted, and coordination among local tax authorities, the local licensing units and other relevant agencies in regard to the taxpayers’ database has not been carried out optimally.” (IHPS II/2013)

In regard to improper policy implementation, other than causing inefficiency from the perspective of local government, it may also cause inefficiency from the perspective of the community.

“Dr. M. Yunus hospital [in Bengkulu Province] did not have adequate commitment to carry out the government’s policy [to] intensify the utilisation of generic drugs for health services to the community. A high percentage of non-generic drugs were prescribed for outpatient, inpatient and emergency treatment from 2010 to the first semester of 2011. Non-generic drugs were also given to patients who were covered by social health insurance fund.” (IHPS II/2011)

Budget misallocation was also quite common in spending activities, highlighting another systemic problem in the local government internal control system. There were 1,617 reported cases on budget misallocations, or about 1.54% of the total audit findings reported during the period of the study. This involves, for example, the allocation of social assistance funding to inappropriate recipients. While this type of problem does not deal with any alteration to expenditure items in the budget, it does impact upon the overall outcomes of the disbursement of funds. Social assistance funding is allocated selectively to a small number of recipients to protect them from social risks, including for social rehabilitation, social security, social empowerment, social insurance, poverty reduction and disaster management programs and activities (MoHA 2011). Hence, allocation of social assistance funding outside those areas may

threaten the effectiveness of fund allocation and further jeopardise the accountability of public resources management.

“In Rejang Lebong District, Bengkulu Province, grant and social assistance funding for the financial year 2011 worth Rp2.99 billion was granted to local government agencies to finance unbudgeted operational expenses of the agencies, leading to inappropriate use of monies and ineffective disbursement of funds.” (IHPS I/2012)

Another example of this problem deals with the allocation of special allocation funds from central government.

“In Mamasa District, West Sulawesi Province, budget allocations from the special allocation fund worth Rp32.78 billion were spent on activities outside the scope of special allocation fund allotment, causing the intended use of special allocation funding to provide financial resources for improving basic physical infrastructure not to be achieved.” (IHPS II/2012)

The application of an internal control system in a local government should ensure its compliance with external regulations, both in relation to local government financial management and other non-financial aspects such as, for example, specific regulations in forestry, fisheries and environment. This study also exposes the inability of local governments' internal control systems to detect and prevent the non-compliant practices of local governments in regard to those specific regulations. While this problem is mainly administrative in nature, it underlines the lack of accountability in regard to the overall local government activities. BPK's audit reports on local government between 2009 and 2014 have reported 1,667 cases where local government did not comply with a number of non-financial management regulations. This figure represents about 1.59% of the total audit findings reported for that period.

“A number of IUP (Mining Exploitation Permit) holders that do not have approval on their feasibility studies of environmental impact have constructed special jetties [for their mining activities] without approval from the Ministry of Transport, have not submitted reclamation and mine closure planning documents and have carried out mining activity in forest areas without having permission from the Ministry of Forestry.” (IHPS II/2014)

5.4. Chapter Summary

This chapter has discussed and examined the audit findings reported in BPK's audit reports on local government that were published between 2009 and 2014. Despite this examination of the local governments' PFM operational practices being made several years after the PFM reform was started in 2004, most local governments were still struggling to fulfil the requirements stipulated in the PFM regulatory framework. BPK's audit reports disclose a number of systemic problems in relation to the three

major PFM operational components: internal control system, budget execution, and financial accounting and reporting.

The implementation of internal control systems was characterised by the lack of proper standards, procedures and guidelines of action for local government employees that had led to some common problems in the budget execution and financial accounting and reporting processes. In budget execution, local governments have been struggling to optimise their local revenue collection efforts; while on the disbursement side, overpayment of expenses has contributed to inefficiencies in the management of local government budgets. This chapter also has revealed problems in other components of budget execution, including procurement, asset management and treasury management. In financial accounting and reporting, systemic problems were mainly related to the lack of adequate, complete and proper documentation of transactions, inaccurate transactional recordings, inappropriate financial reporting processes and inadequate financial information systems. It is plausible to conclude that those identified problems disaffirm the achievement of the PFM objectives to establish efficiency and effectiveness as well as to ensure the accountability of local government operations in public goods and services provisions.

The presentation of the analysis in this chapter concludes the first research stage of this study. It has addressed the first research question by identifying systemic problems in the PFM operations of Indonesia's local governments. Its coverage included all local governments' audit reports from all types of audit published by BPK's regional offices throughout Indonesia. The next chapter, Chapter 6, begins the second research stage of the single case study to describe a number of relevant PFM operational contexts within the selected local government for addressing the second and third research questions of this study.

Chapter 6

Case Study (Part I): PFM Operations and Their Systemic Problems

This chapter commences the application of the second research stage of this study. It forms the first part of the single case study report to investigate the relevant PFM operational contexts that are essential for addressing the second and third research questions, especially in the guidance of the development of the semi-structured interview questions and the analysis of data gathered from the interviews. The selection of West Lombok District as the single case study has been discussed in Section 3.3.1. This current chapter describes and elaborates on relevant aspects, mainly regarding the PFM operational arrangements in West Lombok District, to also provide the background and context for the case study. It is divided into three major sections, commencing with a brief profile of West Lombok District, including its historical background, organisational structure, budget performance and economic development. The next section describes the PFM operational design employed by West Lombok District, based on the more detailed PFM framework that is stipulated in its regulations. The final section discusses a number of PFM operational problems that were identified in BPK's audit reports on West Lombok District published between 2009 and 2014.

6.1. Profiles of West Lombok District

Geographically, West Lombok District is located in Central Indonesia. The district occupies the western part of Lombok Island and is part of West Nusa Tenggara Province²⁷. First established in 1958, West Lombok District has undergone two regional expansions (Pemkab Lombok Barat 2014d). Mataram, which was originally the capital of West Lombok District, became a city in 1993 and enjoyed the status of an autonomous local government. The capital of West Lombok District was then moved to Giri Menang, Gerung in 2000. In 2008, North Lombok District was established as a new district, separated from West Lombok District. Currently, West Lombok District has a total area of 1,053.92 square kilometres consisting of 10 sub-districts, 3 urban villages, 119 villages and 841 sub-villages (Badan Pusat Statistik 2016).

²⁷ See Appendix 3 for the geographical location of West Lombok District.

6.1.1. Leadership

Law 32/2004 stipulates that a direct general election must be held to elect the Head of the region. The first direct election in West Lombok was held in 2009, resulting in Zainy Arony being elected as West Lombok Regent for 2009 to 2014. He was able to secure his position in the following direct election held in 2014, confirming his second term as West Lombok Regent for 2014 to 2019. In the first period of his leadership, Zainy Arony launched West Lombok's Vision for 2010-2014 to establish an advanced, independent and dignified West Lombok society by articulating the values of "*Patut Patuh Patju*" (Pemkab Lombok Barat 2014a). *Patut* portrays goodness, commendation, balance and modesty; *Patuh* represents the values of harmony, peace, tolerance and mutual respect; and *Patju* signifies diligence and encouragement²⁸. The strategy to achieve this vision includes the development of a democratic society that upholds the spirit of *akhlakul karimah*²⁹ and local culture, by providing high quality educational and health services; accelerating economic growth, based on local resources, to improve public welfare in accordance with the principle of sustainable development; accelerating infrastructure development throughout the region; and strengthening law enforcement through the establishment of an honest government and active public participation (Pemkab Lombok Barat 2014a).

Upon the successful achievements of his first term, Arony added the attainment of a wealthy society in West Lombok as another aspect of his vision for 2014 to 2019. In 2015, however, he involved in a corruption case that resulted in prison sentences (Surya 2015) causing him to resign from his post. The Vice-Regent, Fauzan Khalid, was then inaugurated as West Lombok Regent for 2016 to 2019 (Saleh 2016). This change, however, has not diverted the strategic direction of West Lombok since the West Lombok Vision for 2014-2019 has been incorporated into local regulation (Pemkab Lombok Barat 2014c).

6.1.2. Economic Development

One main indicator to measure the economic growth of a region is the regional gross domestic product (RGDP). Table 5.1 displays the economic growth rate of West Lombok between 2009 and 2013, based on 2000 constant price. During that period, the economic growth of West Lombok increased steadily. Agriculture and tourism are the leading industries in West Lombok, contributing approximately 25.33% and

²⁸ From <http://lombokbaratkab.go.id/sekilas-lobar/makna-lambang>, accessed 14 August 2014.

²⁹ *Akhlakul karimah* is an Islamic-based value meaning "high noble morality".

23.42%, respectively, to the aggregate RGDP in 2013 (Pemkab Lombok Barat 2014a).

Table 6-1
West Lombok Regional GDP Trend

Year	Regional GDP (in million Rupiah)	RGDP Growth (%)	RGDP per Capita Growth (%)
2009	1,690,045	6.26	4.79
2010	1,770,784	4.78	6.82
2011	1,875,977	5.94	4.88
2012	1,970,465	5.04	3.82
2013	2,070,967	5.10	3.87

Source: Badan Pusat Statistik (2013; 2014)

The situation in which economic development in West Lombok has been boosted by these two leading industries is aligned with the MP3EI³⁰ economic development strategy of the Indonesian Central Government. The Bali and Nusa Tenggara Economic Corridor, consisting of Bali, West Nusa Tenggara and East Nusa Tenggara provinces, is one of the five corridors under the MP3EI program, which aims for them to become *“the gateway for tourism industry and national food support”* (Coordinating Ministry for Economic Affairs 2011). Located near Bali, the major tourist destination in Indonesia, and supported by its geographic conditions, the development of the tourism industry in West Lombok has been very successful. A total of 389,000 tourists visited West Lombok in 2014, which was a great increase on the 212,000 people who visited in 2010 (Badan Pusat Statistik 2016). Additionally, to support national food security, the majority of West Lombok’s utilised land, approximately 78.39% of the total 86,182 hectares, is used for the agricultural sector (Badan Pusat Statistik 2016).

6.1.3. Human Resources

Home to over 700,000 people, West Lombok’s population has the potential to support further economic growth, with the majority of its population, more than 75%, being categorised within the productive age range of 15 to 64 years (Pemkab Lombok Barat

³⁰ MP3EI stands for Masterplan Percepatan dan Perluasan Pembangunan Ekonomi Indonesia. It is the Masterplan for Acceleration and Expansion of Indonesia’s Economic Development 2011-2025. It represents the main strategy of the central government to develop and improve the economic development of local governments throughout Indonesia based on their potential and strategic resources. For the Bali and Nusa Tenggara regions, including West Lombok District, the tourism industry and food security are the focus of economic development under the MP3EI program.

2014a). Nevertheless, as almost half of its population do not finish primary education and only less than 5% have enjoyed studying at colleges and universities (Pemkab Lombok Barat 2014a), West Lombok faces a big challenge in how to capitalise on its human resources potential. Similar to the majority of the population in Lombok Island, Sasak is the majority ethnic group in West Lombok, with other ethnic groups such as Balinese, Javanese, Sumbawa and Bugis also residing in West Lombok. In terms of religion, approximately 93.84% of West Lombok's residents are Moslem, with a small proportion of Hindus, about 6%, and a tiny proportion of Christians and Buddhists making up less than 0.17% (Badan Pusat Statistik 2016).

During 2009-2013, West Lombok identified problems in its human resources, economy and infrastructure. To address those problems, West Lombok has been focusing its development on: 1) its education facilities, specifically to support vocational studies in fisheries, mining, tourism, agriculture, automotive and information technology; 2) its public health facilities, including the establishment of a community health centre in each village; 3) local economy infrastructure, through the revitalisation of traditional and art markets; and 4) its public infrastructure facilities such as roads, bridges and irrigation³¹. This development strategy has enabled West Lombok to also improve the capacity of its people. The human development index³² of West Lombok has increased from 60.61 in 2010 to 63.52 in 2014, although it is still below the national average of 68.9 (Badan Pusat Statistik 2015).

6.1.4. Budget Overview

The efforts to establish West Lombok's vision require a resilient fiscal capacity to finance its policies, programs and activities. An overview of its budget realisation between 2009 and 2014 (see Table 6.2) reveals two major issues that could hinder the effectiveness of West Lombok's budget to further foster its economic development and support the achievement of West Lombok's vision.

The first issue deals with its revenue side. Even though West Lombok experienced an increasing trend in its budget realisation figures, it still relied heavily on the Central and Provincial Government transfers to finance its programs and activities. The proportion of Central and Provincial Government transfers to total revenue was 84.42% in 2014, higher than the average figure for all cities and districts in Indonesia,

³¹ West Lombok video profile, <https://www.youtube.com/watch?v=sSO8yvNKLBA>, accessed on 21 August 2014.

³² The Human Development Index was introduced by the UNDP in 1990 to capture many dimensions of human capacity consisting of indicators to measure life expectancy, literacy and access to income (UNDP, 1990).

which was 73.15%³³. However, this percentage is lower than in 2009, displaying progress toward greater fiscal autonomy and implying the success of the local revenue mobilisation strategy, which has the potential to further enhance its economic capacity.

Table 6-2
West Lombok District's Budget Realization

(in million rupiah)

Items	2009	2010	2011	2012	2013	2014
Revenues	513,605	649,615	864,044	852,082	994,525	1,142,644
Local Revenues	32,327	49,993	133,284	94,444	110,062	169,109
Revenue from Transfers	427,196	583,041	726,243	754,316	853,791	964,571
Other Revenues	54,082	16,581	4,517	3,322	30,672	8,964
Expenses	526,059	649,889	837,256	866,048	949,076	1,115,214
Operational Expenses	468,094	541,858	658,019	711,918	799,938	911,466
Capital Expenses	56,950	106,460	176,505	151,605	148,217	202,898
Unexpected Expenses	500	850	2,239	1,982	188	57
Transfer Spending	515	721	493	543	733	793
Surplus/(Deficit)	(12,454)	(274)	26,788	(13,966)	45,449	27,430

Source: BPK (2010a; 2011b; 2012; 2013a; 2014b; 2015c)

Another issue is in relation to the expenditure side of the budget. During 2009 to 2014, more than 80% of the budget was allocated to the operational components of West Lombok's expenses, leaving less than 20% for capital expenditure. The majority of operational expenses were consumed by personnel costs, mainly consisting of the district employees' salaries, and other financial allowances and incentives for the employees. It is suggested that the ideal number of employees for West Lombok, given its general allocation fund figure, is only around 4,000 employees³⁴, but, in 2015, West Lombok employed 8,309 employees (Badan Pusat Statistik 2016).

6.1.5. Organisational Structure

As part of the decentralisation policy, local governments in Indonesia have been granted autonomy to manage their local affairs. According to Law 32/2004, the mandatory affairs that must be managed by local government are regional planning, land management, public safety, infrastructure, health, education, social issues, manpower and employment, cooperatives and small and medium enterprises

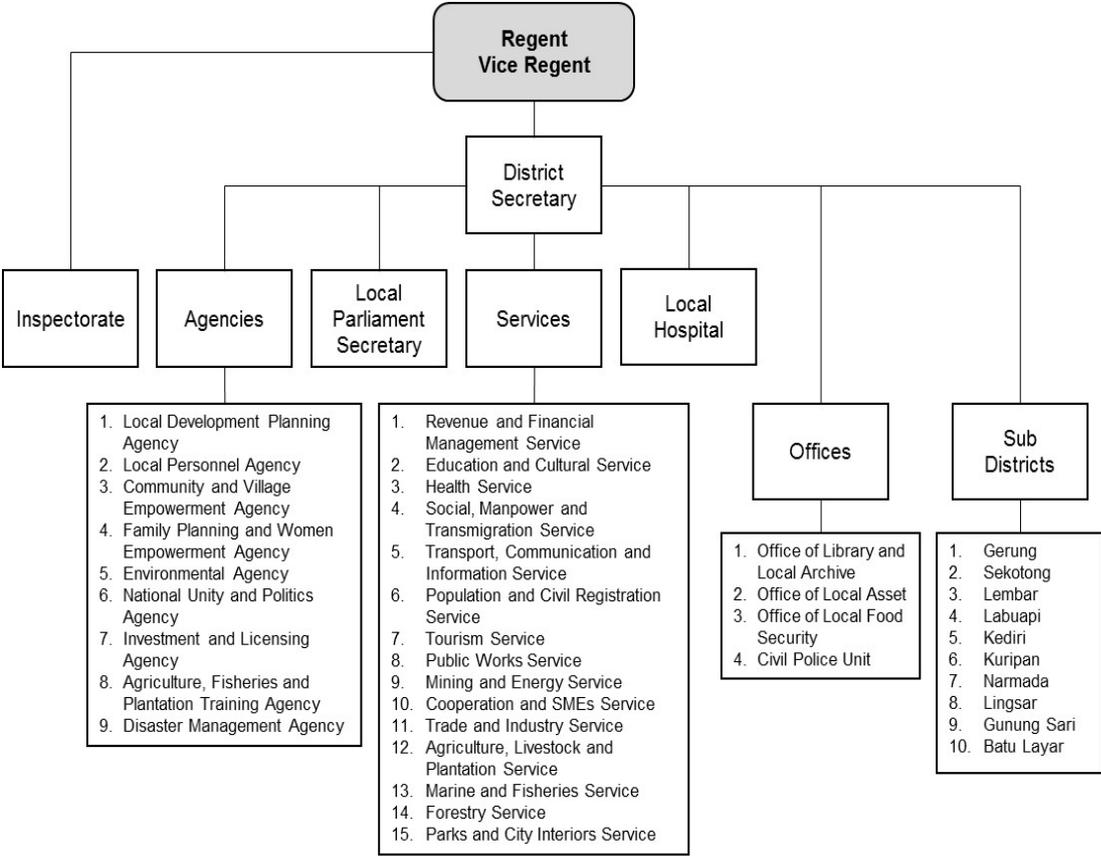
³³ See <http://keuda.kemendagri.go.id/datin/index/1/2014>.

³⁴ Interview with West Lombok's Local Secretary Assistant on 15 July 2015.

(SMEs), environment, civil registry, investment, public administration and other basic public needs. In addition to those mandatory affairs, West Lombok District has included a number of optional affairs that have potential to improve the prosperity of the region. Those optional affairs include maritime and fisheries, agriculture, forestry, energy and mineral resources, tourism, industry, trade and transmigration (Pemkab Lombok Barat 2008a).

To organise the above-mentioned affairs, West Lombok District has established 42 local government units that include a District Secretariat, a Local Parliament Secretariat, an Inspectorate, 9 Agencies, 15 Services, 4 Offices, 1 Local Hospital, and 10 Sub-Districts (Pemkab Lombok Barat 2011). Services (or *Dinas*) are the implementing units of regional autonomy responsible for the delivery of goods and services to the public, while Agencies (or *Badan*) and Offices (or *Kantor*) serve as supporting units of the district. The Secretary, the Inspector, Heads of Services, Heads of Agencies and the Head of the Local Hospital all hold echelon II positions; while Heads of Office and Heads of Sub-Districts (or *Camat*) hold echelon III positions. The overall organisational structure of West Lombok District is depicted in Figure 6-1 below.

**Figure 6-1
Organisational Structure of West Lombok District**



6.2. Arrangements for PFM Operations

The legal framework for PFM operations, as already described in Section 4.3, serves as the general model that is applied to all local governments in Indonesia. Adjustment to the general model is permitted to accommodate any specific need of each local government. For example, in West Lombok District, its local revenue collection procedure allows receiving treasurers to delay depositing the collected revenue monies into the local treasury account for up to two working days (Pemkab Lombok Barat 2013). This adjustment has been made to accommodate the lack of transportation means and communication media in remote areas across West Lombok. In the area of local tax revenue collection, in cooperation with one major national bank, West Lombok District has recently initiated an online payment process to make it easier for local taxpayers to pay their tax obligation (Romiadi 2016).

There are two main regional regulations that govern the financial management of West Lombok District; they are Local Regulation 5/2007 regarding General Provisions of Local Financial Management and Regent Regulation 31/2013 regarding Local Financial Management System and Procedures. Local Regulation 5/2007 serves as an omnibus of regulations that provides a comprehensive and integrated interpretation of the higher PFM regulations. It encompasses the three main stages of financial management: budget preparation; budget execution; and accounting and reporting. Regent Regulation 31/2013 provides a more detailed system and set of procedures for each financial management stage, as presented in its appendices that consist of: Appendix I regarding System and Procedure for Budget Preparation, Appendix II regarding Budget Execution Guideline, and Appendix III regarding Financial Reporting and Accounting System.

In relation to PFM operations, the budget execution and the accounting and reporting process, the 42 local government units in West Lombok District are the spending units or *satuan kerja perangkat daerah* (SKPD). They have separate budgets and are responsible for their execution, including the preparation of their own unit's budgetary report and financial statement. Apart from its role as a spending unit, the Revenue and Financial Management Service or *Dinas Pendapatan dan Pengelolaan Keuangan Daerah* (DPPKD) also serves as the FMU that is responsible for the overall financial management of the District.

The Regent, as the Head of the District, is the financial authority holder in West Lombok and represents the District in regard to the ownership of local-owned companies. He issues a Regent Regulation to establish the devolution of his financial

management authority to the District's Secretary (as the Financial Management Coordinator), the Heads of SKPD (as the COOs and budget users), and the Head of DPPKD (as the CFO) who also serves as the District's General Treasurer (Pemkab Lombok Barat 2013).

In executing his role as local financial management coordinator, the District Secretary is also supported by three Assistant Secretaries as the Vice-Coordinators. Meanwhile, any Head of SKPD may delegate his role as the budget user to his subordinate, an echelon III officer within the SKPD, as the Proxy of Budget User. A Budget User/Proxy of Budget User is authorised to carry out actions that can trigger the disbursement of the SKPD's budget, including conducting the verification of invoices, issuing payment orders and signing of contracts/agreements with suppliers regarding the provision of goods and services³⁵. The day-to-day activities of the Head of DPPKD, as the General Treasurer, are carried out by the Head of the Financial Management Department, an echelon III officer within DPPKD, who serves as the Proxy of General Treasurer.

In spending units, Heads of SKPD are also responsible for appointing an echelon III within his SKPD as a technical administration officer who is responsible for the monitoring of programs and activities, reporting the progress of programs and activities, and preparing the budget administration documentation required for the disbursement of funds to execute programs and activities. He also appoints a financial administration officer within his SKPD who is responsible for the verification of the completeness, validity and accuracy of payment requests, the preparation of payment orders, the verification of daily revenue deposits, the recording of financial transactions and the preparation of the SKPD's financial statements.

As the General Treasurer, the Head of DPPKD assigns the Head of Financial Management Department, an echelon III officer within DPPKD, as the Proxy of General Treasurer by appointment of the Regent. The Regent also appoints the disbursing and receiving treasurers, including assistant treasurers who are responsible for treasury management within each SKPD. Receiving treasurers and assistants of receiving treasurers are established within DPPKD for the collection of local taxes, transfer of funds from the central/provincial government and gathering of other lawful incomes. Receiving treasurers and assistants of receiving treasurers are also established within some SKPDs that have the authority to collect non-local tax revenue, such as the Investment and Licensing Agency, the Mining and Energy

³⁵ Signing a contract for the provision of goods and services is the responsibility of a CMO who is appointed by the budget user or the Head of SKPD. Regent Regulation 31/2013 stipulates the possibility of a Proxy of the Budget User to also be appointed as the CMO.

Service, the Population and Civil Registration Service and the Parks and City Interiors Service. Disbursing treasurers and assistants of disbursing treasurers are established within all SKPDs by appointment of the Regent. Treasurers and assistant treasurers are functional positions that are responsible administratively to their Head of SKPD and functionally to the General Treasurer.

6.3. PFM Operations Problems

While a number of local governments were struggling to prepare timely financial statements at the beginning of the PFM reform, West Lombok District was able to finalise its audited financial statements within the required timeframe. Only two non-significant delays for the completion of audited financial statements occurred during the period of the study, which were for for FY 2006 and FY 2008. In terms of external auditor's opinions on financial statements, West Lombok District had managed to attain a qualified opinion from BPK for eight financial years consecutively, before it finally attained an unqualified opinion for its 2014 financial statement.

Table 6-3
Audited Financial Statements of West Lombok District

Financial Year	Completion of Audited Financial Statement	Auditor's Opinion
2006	10 July 2007	Qualified
2007	14 June 2008	Qualified
2008	9 July 2009	Qualified
2009	2 June 2010	Qualified
2010	25 May 2011	Qualified
2011	28 May 2012	Qualified
2012	28 May 2013	Qualified
2013	30 June 2014	Qualified
2014	25 May 2015	Unqualified

As previously mentioned, the preparation of financial statements for FY 2006 until FY 2014 had still adopted the modified cash basis. The full accrual method began to be adopted for FY 2015. Despite the change to the full accrual method, West Lombok District has been able to maintain an unqualified opinion for its 2015 financial statement, which was completed on 10 June 2016 (BPK 2016) and its 2016 financial statement, which was completed on 31 May 2017 (BPK 2017).

6.3.1. Statistics on Audit Findings

The analysis of PFM operational problems in West Lombok District was based on BPK's audit reports published between 2009 and 2014³⁶. There are a total of 222 audit findings items disclosed in the audit reports during that period. Figure 6-2 summarises the classification of those audit findings based on the four main audit finding groups. As shown in the pie chart, most of the audit findings deal with deficiencies in the internal control design and its implementation, which were disclosed 125 times in the audit reports or more than half of the total audit findings. The problems that led to state losses and shortfalls in revenue were reported 41 times, representing 18.47% of the total audit findings. The rest of the findings were about 3Es problems and administrative matters, which were reported 31 times (or 13.96%) and 25 times (or 11.26%), respectively.

Figure 6-2
Classification of Audit Findings in West Lombok District

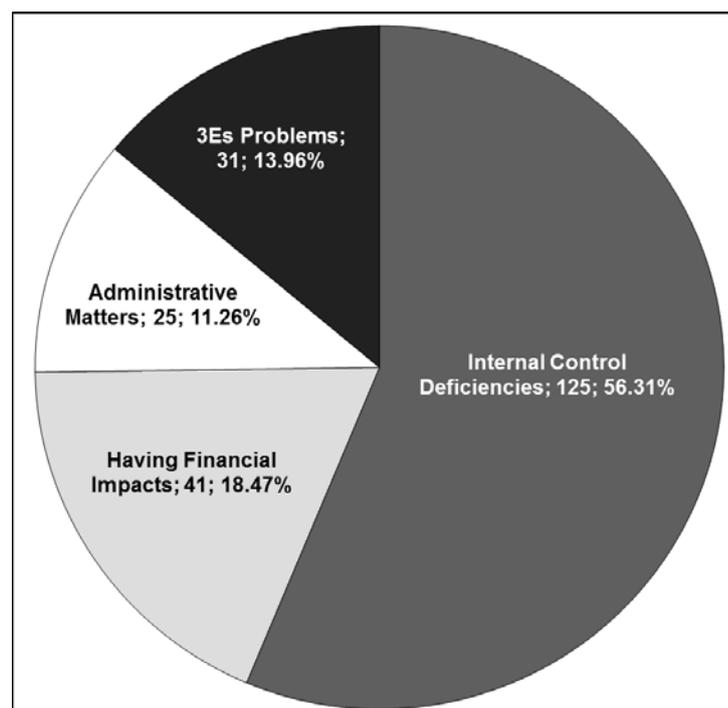
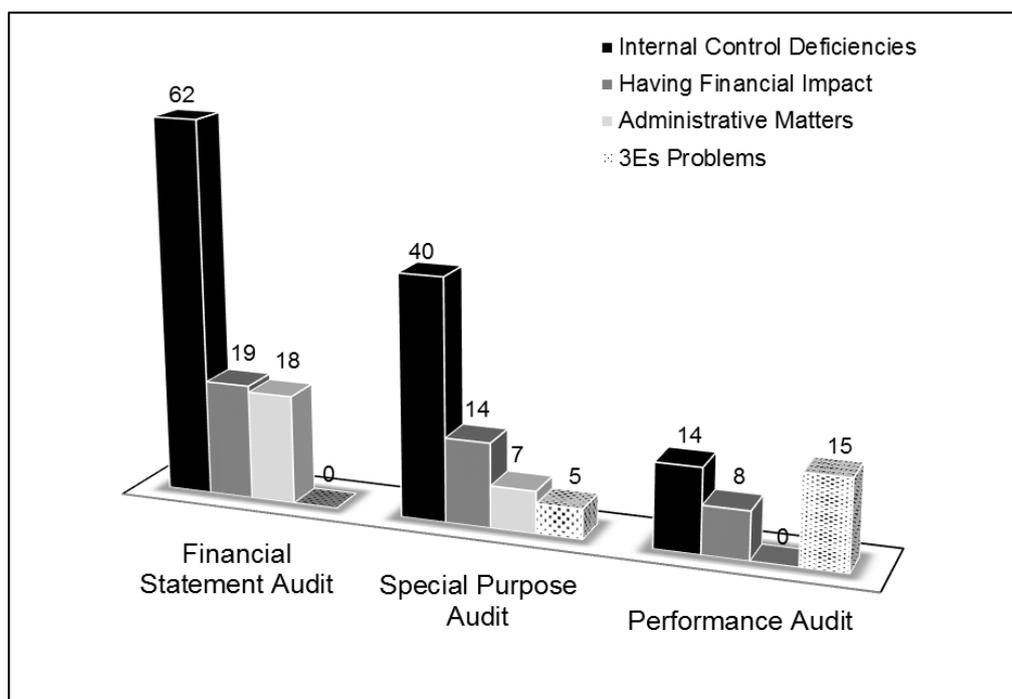


Figure 6-3 further displays the statistics of audit findings based on audit types. The figure shows that financial audit reports did not disclose any 3Es problems, while performance audits did not disclose any problems that were administrative in nature. Special purpose audit reports were quite comprehensive because they exposed findings in all four audit finding categories. In general, the audit findings statistics in

³⁶ See Appendix 6 for the list of audit reports on West Lombok District published between 2009 and 2014.

West Lombok District are relatively similar to those of the overall findings for local governments in Indonesia, as have been discussed in Section 5.3. The similarity of audit findings in terms of their statistics and pattern, compared with the overall local government situation for PFM operational problems, displays the typicality of West Lombok District and enhances its appropriateness as the case study for this research.

Figure 6-3
Audit Findings in West Lombok District per Type of Audit



6.3.2. Identified Systemic Problems

The previous chapter has discussed the systemic problems identified in the PFM operational practices throughout all local governments in Indonesia. This section specifically discusses the presence of those problems in West Lombok District, based on its PFM operational components as displayed in Table 6-4. Out of 20 systemic problems identified for the whole local governments, there were 18 problems that also occurred in West Lombok, consisting of 194 audit findings or 87.39% of the total 222 audit findings.

6.3.2.1. Revenue Collection

An overview of its budgets since FY 2006 shows that West Lombok District has struggled to optimise its local own-sourced revenue collection efforts. One of the audit findings highlighted inadequate local tax collection management, in this case the collection of hotel and restaurant service taxes, in West Lombok District (BPK 2014b). DPPKD, the SKPD that is responsible for hotel and restaurant tax collection, makes

minimal effort to ensure timely payment of hotel and restaurant service taxes. There were cases where hotels and restaurants did not pay their taxes on time and delayed the submission of their periodic tax returns. This circumstance was compounded by a slow response for DPPKD to conduct an audit on taxpayers and issue a Notice of Tax Underpayment Assessment. To further complicate the problem, the BPK's audit report discovered the failure of DPPKD to issue a Notice of Tax Collection, increasing the risk of uncollected taxes. In 2013, a minimum Rp4.30 billion of hotel and restaurant taxes, including any penalties and interest, were not collected (BPK 2014b).

Table 6-4
Systemic Problems in West Lombok District

No.	Audit Findings Item	Number of cases reported	% of cases
	Total audit findings reported	222	100.00%
	Total identified systemic problems	194	87.39%
	<i>Revenue collection</i>	14	6.31%
1	Uncollected revenue and delays in revenue collection processes	10	4.50%
2	Direct use of revenue	4	1.80%
	<i>Disbursement process</i>	36	16.22%
3	Overpayment of expenses	13	5.86%
4	Incomplete documentation on expenses payments	13	5.86%
5	Volume shortages	7	3.15%
6	Improper procurement processes	3	1.35%
7	Disbursement on fictitious activities/transactions	-	-
8	Higher acquisition costs of inputs	-	-
	<i>Asset management</i>	14	6.31%
9	Lack of asset safeguarding	14	6.31%
	<i>Treasury and cash management</i>	1	0.45%
10	Improper cash handling	1	0.45%
	<i>Accounting and reporting</i>	36	16.22%
11	Inadequate and inaccurate transaction records	20	9.01%
12	Inappropriate financial reporting processes	14	6.31%
13	Inadequate financial management, accounting and reporting system	2	0.90%
	<i>Internal control</i>	93	30.63%
14	Low performance and quality of service delivery	25	11.26%
15	Irregularities in the implementation of technical and/or internal regulations	23	10.36%
16	Inadequate and weak implementation of SOPs	20	9.01%
17	Lack of planning for activity	17	7.66%
18	Non-compliance with regulations on other specific	3	1.35%
19	Improper policy implementation	3	1.35%
20	Misallocation of budget	2	0.90%

The practice where revenue monies were directly used to pay the SKPD's expenses was also reported quite frequently. From FY 2008 to FY 2011, direct use of revenue was one of the items causing the qualified opinions of BPK on West Lombok's financial statements. The amount of revenue monies directly spent were Rp2.79 billion in 2008, Rp28.77 billion in 2009, Rp9.35 billion in 2010 and Rp7.14 billion in 2011 (BPK 2009; 2010a; 2011b; 2012).

While this practice provides more flexibility to each SKPD to manage its revenue, as discussed earlier, it weakens the accountability of the disbursement processes. Direct use of revenue potentially involves the omission of expense items in the budgeting processes. Hence, those expense items have not been authorised by local parliament or have been explicitly stipulated in the local government's annual budget. It also involves non-compliant payment procedures for the expenses because proper procedures for the verification and issuance of payment requests, payment orders and warrants for disbursement of funds have not been followed.

An area where flexibility in financial management is important is health services. West Lombok converted the status of its Local Hospital to a public service agency or BLU in 2012 (BPK 2012). This change provided autonomy to the Local Hospital in managing its financial affairs, including use of its revenue to directly fund its operational expenses (Gol 2004a). Nevertheless, its annual budget and financial statement were still required to be consolidated within the District's budget and financial statement (Gol 2004a).

6.3.2.2. Disbursement Processes

Systemic problems in the disbursement process mostly deal with the overpayment of expense items due to lack of verification procedures. In West Lombok, this problem had caused, among others, double payment of expenses because of reissuance of warrants for disbursement of funds, payment of official travel allowances that exceeded the prescribed limit and payment of inappropriate cost components that were not in contract agreements.

“The result of a sampling test on the contract agreements and proofs of payment for consultancy services showed that sixteen under 6-month consultancy payments, which included the [allocation of] non-personnel direct expenses in the contract agreement, were billed for prohibited items, i.e. for office equipment rental. The result of documentation analysis showed that the consultant already had the office equipment required [to carry out the consultancy work].” (BPK 2011a)

In addition, there were payments of grants and social assistance funding to inappropriate recipients and for inappropriate purposes. Permendagri 13/2006 stipulates the conditions whereby social assistance in the form of money and/or provision of goods can be allocated, with the aim of improving public welfare. Nevertheless, in West Lombok, there were payments from social assistance funds that were made to other government and quasi-government institutions, such as the Indonesian Sports Committee, that did not match with the objectives of the social assistance fund (BPK 2011a).

In administrative matters, the recipients of District's grants and social assistance funding, including political parties that received financial assistance, mostly failed to submit their fund utilisation reports within the specified time-frame and format. This failure raises suspicions and increases the risk of misuse of such funds. Inadequate documentation, in fact, had occurred since the commencement of social assistance funding, for example, in the form of missing proposals of activities.

"The issuance of a warrant for disbursement of funds (SP2D) was not accompanied with complete documentation. The examination of the issuance mechanism of SP2D for the social assistance fund disclosed that the submission of payment requests and payment orders for social assistance funding amounting to Rp22.47 billion was not supported by required documentation. The disbursing treasurer prepared and submitted payment requests and payment orders to the Head of DPPKD as the Budget User without attaching receipts from the recipients and other required documentation such as proposals [of activities]. Payment requests and payment orders were prepared in four copies but were not administered and archived properly by the Budget User and the Proxy of General Treasurer." (BPK 2010a)

In the disbursement process, there were also cases where there was a volume shortage in the completion of construction work, where the delivery of goods and services were not in accordance with the contract agreement and where improper procurement processes, such as contract splitting, had occurred.

6.3.2.3. Asset Management

Lack of asset safeguarding, in the form of inadequate documentation of asset ownership, non-compliance to public asset regulations and missing assets had triggered BPK to issue a qualified audit opinion on the West Lombok financial statements for FY 2008 until FY 2013.

"Based on the examination of the documentation of the ownership of land, there were 8.58 million square metres of land area owned by West Lombok District that did not have a certificate of ownership. Further examination of the land's ownership certificates and a list of fixed assets that supported the presentation of the monetary value of land in the Balance Sheet showed that these two forms of documentation could not be compared, causing [the auditor's] inability to adequately determine how many parcels of land had not been equipped with a certificate of ownership. In addition, there were parcels of land covering an area of 115,148 square metres that were in legal dispute as they were not supported by sufficient evidence of ownership." (BPK 2012)

"Based on physical examination of eight SKPDs, there were problems as follows: (1) district's vehicles amounting to Rp4.74 billion were missing, (2) licences of district's vehicles amounting to Rp5.62 billion were missing, (3) certificates of vehicles' ownership amounting to Rp6.74 billion were missing, and (4) 120 vehicles were not recorded in the vehicle inventory." (BPK 2014b)

A number of FGD participants also viewed weakness in asset management as the most prominent problem in West Lombok's management of financial operations. Regional expansion through the establishment of a new district, North Lombok, in 2008, worsened the problems when inaccurate verification of assets caused inaccurate records of assets in the database. Assets which were physically located in North Lombok were recorded and presented in West Lombok's financial statement, and vice versa. The absence of proper accounting treatments, especially for capitalisation of expenses, had further prohibited the proper presentation of assets in West Lombok's financial statements.

The policy of West Lombok District to provide grants in the form of equipment and assets, instead of a pecuniary grant, was not followed by proper bookkeeping and procedures on the transfer of assets. In 2009, BPK's audit report on its financial statement stated that procured assets valued at Rp1.66 billion in Agriculture Services from the Livestock and Plantation Productivity Improvement Program had been granted and handed over to farming and fishing communities in West Lombok. The handover report of those assets had been signed by both Agriculture Service officials as well as the representatives of the farming and fishing communities, but there was no approval or authorisation for the transfer of those assets from the Regent (BPK 2010a).

6.3.2.4. Cash Management

In regard to cash management, there was only one audit finding that disclosed the presence of delays in depositing the cash balance in the possession of the disbursing treasurers at the year's end. Though it is considered to be a systemic problem at the whole local government level, the presence of this practice in West Lombok District was minimal and was only identified in the early years of the PFM reform. This type of problem was reported on West Lombok's financial statement audit reports for the FY 2008 and FY 2009, and involved the cash amounts of Rp39.28 million and Rp133.58 million, respectively (BPK 2009; 2010a). Nevertheless, this problem reveals a risk of misuse of cash balances by the treasurers and, potentially can lead to inaccuracy in the presentation of cash account balances in the financial statements.

6.3.2.5. Accounting and Reporting

Problems in the accounting and reporting component of PFM operations in West Lombok were mainly in relation to inaccuracies in transaction recording, improper financial reporting processes and an inadequate financial information system. Inaccuracies in transaction recording refers to errors in bookkeeping processes

whereby valid source evidence for financial transactions must be collected, sorted and recorded accurately into the proper accounts. There were frequent instances where accurate financial transaction recording could not be maintained due to, for example, the absence of a bank reconciliation procedure for cash accounts, the absence of a physical inventory check for fixed assets and inventory accounts, mistakes in calculating accumulated depreciation values of fixed assets and the like (BPK 2011b; 2012; 2014b). In another instance, inaccuracy in transaction recording was simply caused by the unavailability of valid sources of evidence for financial transactions. For example, the presentation of the local tax receivable figure in the financial statement was not supported by Notices of Tax Underpayment Assessment and Notice of Tax Collection (BPK 2011b) that would serve as valid sources of evidence for recording local tax receivable transactions. This indicates that the nature of the accounting and reporting problems stemmed from inadequate administration of the underlying transactions by the relevant SKPDs.

In regard to financial statement reporting process, until FY 2012, the processing of financial information for the preparation of the District's financial statement was not carried out properly (BPK 2013a). In general, West Lombok maintained two separate accounting systems, one at District level carried out by the Accounting and Reporting Division within the DPPKD and the other one at the level of SKPD carried out by Finance Section within each SKPD. The accounting procedures of those systems were limited to only cash receipting and cash disbursement. Accounting procedures for assets and non-cash transactions were not available. This limitation impeded the SKPDs in the optimal preparation of reliable financial statements. Consequently, West Lombok could not prepare its own financial statement by consolidating the financial statements of all accounting units (i.e. SKPDs) within the District. Instead, the financial statement reporting process was carried out centrally and manually by the Accounting and Reporting Division. Each SKPD was required to submit all its evidence of financial transactions to the Accounting and Reporting Division for the preparation of West Lombok's financial statement, which consisted of a Balance Sheet, Budget Realisation Report and Cash Flow Statement.

The problem in the financial statement reporting processes was exacerbated by the lack of financial information and appropriate accounting system. The implementation of *Sistem Informasi Pengelolaan Keuangan Daerah* (SIPKD), an information system for local government's financial management developed by the MoHA, was not effective. Out of six SIPKD modules that had been implemented in West Lombok District (i.e. Planning, Budgeting, Payroll, Bookkeeping, Accounting and Reporting,

and Assets), only two modules had been fully utilised (i.e. the budgeting and bookkeeping modules). Exchange of financial information between DPPKD, as the FMU, and all SKPDs as the accounting units, did not occur through SIPKD, forcing the adoption of a manual process in the preparation of financial reports, as explained in the previous paragraph.

6.3.2.6. Internal Control System

The main problem in the internal control system component was low performance and lack of quality in service delivery. West Lombok District, as a local government, has a responsibility to carry out its public service delivery effectively. An internal control system, among other things, ensures adequate assurance of the effectiveness of a District's program implementation and achievement of its overall objectives in public service delivery.

Lack of human resources and the absence of a clear policy, for example in the management of scholarships for poor students, were the two main factors that retarded the effective delivery of such programs and the achievement of West Lombok's public service objectives (BPK 2014a). In the management of advertising tax, West Lombok has not yet developed and implemented a clear service standard governing the process and timeline for the application of a tax on billboard advertising (BPK 2013b). In addition, even though Regent Regulation 06B/2013 regarding Billboard Management has streamlined the entire process for the installation of billboards/advertisements under one agency, the Parks and City Interiors Service, in practice, the issuance of permits and the payment of advertising tax are still handled by DPPKD (BPK 2013b). This practice decreases the quality of service delivery to the public because it is necessary to go to both agencies to finalise their obligations in relation to billboard advertising.

The other systemic problem in the internal control component that was identified in West Lombok District relates to irregularities in the implementation of technical and/or internal regulations. In the management of social assistance funds, for example, the decision to allocate funding and the authorisation of fund disbursement preceded the submission of social assistance proposals from the recipients (BPK 2011d). In the scholarships program for poor students, the actual allocations of the scholarships funds were not in accordance with the list of recipients that had already been stipulated in the Regent's Decree (BPK 2011d). In the management of special allocation funding for school rehabilitation, according to the Minister of Education's Regulation, the Local Government's Education Service prepares a fund allocation

plan and carries out a selection process to determine the schools that will receive the rehabilitation fund. Schools that are severely damaged and located in remote areas must be given priority. Nevertheless, BPK found that West Lombok's Education Service failed to conduct a proper survey, causing a number of schools that were severely damaged and located in remote areas not to be allocated rehabilitation funding (BPK 2011e). While these irregularities may not directly cause any state losses, they display inadequate administrative procedures that could impede the effectiveness of fund allocation to achieve the intended objectives.

Another problem in the internal control system component relates to the absence, inadequacy and ineffective implementation of SOPs. In the financial assistance for poor students program, for example, West Lombok's Education Service applied the procedure used by West Nusa Tenggara Province for the administration of educational sharing grants for disadvantaged students at junior and senior high school levels (BPK 2014a). While it did specify the criteria for poor students to be eligible to receive the scholarship, the mechanism of scholarship allocation, the terms of use of scholarship funds, and the accountability and reporting mechanism of the utilisation of funds; it lacked the requirement for reliable supporting documentation in order to determine the recipients of the scholarship funds. There were no criteria used to prioritise potential recipients and no requirements for verification of whether or not the potential recipients had already been granted a scholarship from other sources. The procedure also did not set a clear timeline and schedule for the implementation of the scholarship program, from the dissemination of information, the submission of proposals and the distribution of scholarship funding, up to the reporting of the utilisation of those funds. Neither had the format of the accountability report from the schools or the requirement for submitting an overall accountability report from the Education Service to the Regent been set. This demonstrates that the adoption of an external procedure requires a number of adjustments to ensure its suitability for local needs and characteristics.

Inadequate planning of a program or activity highlights another systemic problem in the internal control system component. It might occur very early during the budgeting process where certain expense items were not budgeted in the appropriate budget accounts. In FY 2012, West Lombok District initiated a policy to give grants to its communities in the form of assets (BPK 2013a). Permendagri 22/2011 regarding a Guideline for the Preparation of Local Government Annual Budget 2012 stipulated that the budget for procurement of assets that would be granted to the communities should be classified in the goods and services expenditure component. Nevertheless,

West Lombok's Annual Budget classified those expenses as capital expenditures. While the misclassification of expenditure items, in this instance, might not impede the disbursement of grants, it did impact the presentation of both capital expenditure and goods and services expenditure figures in the financial statement.

On another occasion, lack of planning also occurred in the preparation stage of an activity or program. For example, in its strategic planning document, the Health Service failed to include two performance indicators that were required by the Technical Guidance for Minimum Service Standard on Nutrition Improvement Program (BPK 2010b). Failure to include adequate performance indicators might divert the focus of the program, causing ineffectiveness in the achievement of the program's objectives. The Health Service also did not include the requirement to carry out an annual evaluation of the program's implementation in its annual work plan. At the level of Health Community Centres, a number of centres did not have reliable planning documents because they failed to include an assessment of the current health situation in the area, which was stipulated in the Planning Guidance for Community Health Centres issued by the Directorate General of Community Health, Ministry of Health, in 2006.

Infrequent systemic problems in the internal control component, such as improper policy implementation, non-compliance with regulations in a specific area and budget misallocations, were also found and reported in the audit reports on West Lombok District. Improper policy implementation deals with, for example, the application of outdated mineral tax rates and garbage collection fees, causing potential revenue shortages (BPK 2011c). Non-compliance with specific regulations involves non-conformity of local tax collection management to the general provisions of taxation and operational guidelines for local taxes (BPK 2014b). Misallocation of budget took place in the distribution of financial assistance to the public, such as via the scholarship funds for poor students. In one such instance, a junior high school had disbursed the scholarship funding for school facilities including computers and classroom renovations (BPK 2011d; 2014a).

6.3.2.7. Other Identified Problems

To provide a complete picture of the weaknesses in West Lombok's PFM operations, the rest of the audit findings reported in audit reports are also discussed in this section. Table 6-5 displays the other 28 audit findings, or 12.61% of the total audit findings, that have been reported during the period of the study between 2009 and 2014.

**Table 6-5
Other PFM Operations Problems in West Lombok District**

No.	Audit Findings Item	Number of cases reported	% of cases	PFM Operation Component	Impact to PFM Objectives
1	Ineffective internal audit function	12	5.41%	Internal Control	Accountability
2	Expenditure outside the budget mechanism	6	2.70%	Disbursement Process	Accountability
3	Ineffective utilisation of budget	4	1.80%	Internal Control	Effectiveness
4	Investments are not supported by adequate documentation	1	0.45%	Financing Activity	Accountability
5	Others	5	2.25%	-	-
	Total other weaknesses	28	12.61%		

Lack of an effective internal audit function is obviously one of the problems present in West Lombok. The Inspectorate is the unit within the District that carries out the internal audit function. One of the FGD participants talked about the shortcomings faced by the Inspectorate because it only has a limited number of staff. This condition was compounded by the failure of the Inspectorate to effectively deploy its already limited resources in monitoring the more crucial local government activities. For example, in 2010, the Inspectorate had conducted an internal audit assignment in the Health Service. While the audit work did include the assessment of a number of institutional and administrative issues in the Health Service, it did not include a review of the implementation of minimum health service delivery standards (BPK 2010b). Since the Inspectorate is directly responsible to the Head of the Region or the Regent (GoI 2008; Pemkab Lombok Barat 2011), the limited resources of the Inspectorate also suggest a lack of awareness by the District's leaders, specifically about the importance of the internal control environment and activities and, in general, about the overall internal control system of the District. A lack of internal audit function aligns with the conclusion made by the World Bank in its own assessment report on Indonesia's public financial assessment report and performance indicators, in which it mentioned the sub-optimal performance of local government inspectorate generals being due to their limited focus on risk-based auditing and their lack of trained internal auditors (World Bank 2012).

Typically, the second problem among the other PFM operations problems, expenditure outside the budget, relates to the issue of the direct use of revenue in a number of SKPDs that have the power to collect non-tax local revenues. The collected monies were disbursed to pay their operational costs. From the revenue side, this practice has caused understatement of local government's revenue figures in their

financial statements. On the other hand, from the disbursement side, this practice weakens the accountability of the disbursement process because the expenditures are not included in the budget and the payment process does not follow the fund disbursement process that is stipulated in the PFM operational regulatory framework. Expenditure outside the budget might also occur when, for example, capital expenditure costs were incorrectly classified as goods and services expenses in the budget document and also were reported as goods and services expenditures in the budget realisation report (BPK 2009). Nevertheless, these problems were mostly reported in the early implementation of the new accounting standard.

Other PFM operational problems identified in West Lombok involved ineffective utilisation of budget disbursement and improper capital investment mechanisms. One of the audit findings highlighting ineffective utilisation of budget was involved in the procurement of goods and services using the special allocation funds for the education sector. In one instance, the procured goods, for example, books for library collection, were reported missing. In another instance, a library building was being used for classroom activities. Both instances displayed the ineffective utilisation of the special allocation fund for the education sector (BPK 2011e). Among the financing activities, there was one instance where capital investments in a number of local government owned corporations had not been granted appropriate formal approvals from the local parliament (BPK 2014b).

6.4. Chapter Summary

This chapter has discussed the general profile of West Lombok District, especially in terms of its PFM operational system and practices, including its systemic problems. There are no major differences, in terms of PFM design, structure, procedures and processes, between West Lombok District and the general framework stipulated in the trilogy of financial laws that were already highlighted in Chapter 4. In terms of the audit findings on West Lombok District, the pattern and statistics of the systemic problems identified were relatively parallel to those of all local governments that were already presented in Chapter 5. The consistency of systemic problems identified in West Lombok District with those of overall local governments in Indonesia confirms the typicality of West Lombok District in terms of its PFM operations and strengthens its appropriateness as the single case selected for this study.

The following chapter, Chapter 7, continues the case study report by presenting a discussion regarding the motives of PFM actors in West Lombok District and the

influences of those motives upon the emergence of non-compliance in the actual PFM operational practices.

Chapter 7

Case Study (Part II): Public Employees' Motives and Non-Compliance in PFM Operations

Chapter 5 discussed a number of systemic problems in PFM operations throughout all local governments in Indonesia as a result of the non-compliance of those who were involved in the PFM operations. Chapter 6 further elaborated upon those systemic problems in the context of West Lombok District, the selected local government examined in this study. This chapter further extends the discussion of those systemic problems to form the second part of the case study report. It discusses non-compliant behaviour that leads to the emergence of systemic problems in PFM operational practices from the perspectives of West Lombok District's employees and officials. The discussion in this chapter is derived from the interviews with PFM actors (i.e. public employees and officials who were involved in various PFM operational stages and processes) in West Lombok District.

This chapter is separated into three sections. It commences with the presentation and analysis of the general perspectives among the respondents of this study regarding the main objectives of PFM operations, as well as their understandings about the requirement to comply with the PFM operational rules and regulations. The second section discusses various motives at work that emerged from the respondents' responses, which drove their decisions to join the public sector and influenced their actual behaviour in carrying out their official duties in PFM operations. An analysis of the respondents' responses about the manner in which the identified motives facilitate PFM actors to commit non-compliant behaviour is presented in the third section of this chapter. The results discussed in this chapter mainly address the second research question of this study.

7.1. Perspectives of PFM Actors on PFM Objectives and Compliance

This section attempts to expose the PFM actors' understanding regarding the overall objectives of PFM within the local government sector. Various aspects of PFM objectives, according to the local government PFM legal framework that was discussed in Chapter 4, are supported in a number of respondents' responses, confirming the PFM actors' comprehension of what is expected from them in exercising their roles in PFM operations.

Literature in the field of public bureaucracy has emphasised public accountability as the main principle in public sector administration and management, including the area of financial management. This principle emerges extensively in the various responses from the respondents of this study. Most of the time, PFM actors in West Lombok District clearly link the objective of financial management to their responsibility to be accountable for their roles in the PFM operational processes. An echelon IV employee in the District Secretariat mentions the importance of maintaining accountability throughout the PFM stages, from the planning stage through to implementation and the reporting and monitoring processes (R#22, Q#3). He further asserts that the ultimate goal of local government's PFM processes is to improve people's welfare. The emphasis on the attainment of people's welfare as a form of accountability seems also to be well understood by a section head in the Investment and Licensing Agency when he states: *"the goal of local government financial management is to ensure that all revenues are recorded and spent for the greatest benefit of people in West Lombok."* (R#15, Q#35). Another respondent, an echelon III officer in DPPKD, specifies the manner in which accountability is attained through maintaining the conformity of local government's financial management to the programs and objectives that are already stipulated in the local government budget, despite the fact that, in actual practice, deviations from what have been described in the budget may also occur. Another theme that emerged regarding the measurement of accountability in PFM was the attainment of an unqualified audit opinion from BPK for the local government's financial statement. Another echelon III worker in DPPKD highlighted this theme by mentioning that:

"I guess the bottom line of our financial management is that we can prepare and generate a good [financial] report. We're audited by BPK. We must prepare a reliable financial statement in accordance with applicable rules and standards. This year (e.g. 2015), we've prepared the [financial] statement [for financial year 2014] and we obtained an unqualified opinion from BPK. Of course, we feel happy [with it]. That's actually the outcome [of financial management] that we expect." (R#03, Q#31&32)

Other than accountability, the need for efficiency in financial management was also understood by the respondents across different working units. In the management of assets, for example, a section head in the Local Asset Office commented on the necessity for all working units to focus on the optimisation of their assets' utilisation. Further, she mentioned that:

"The district must not purchase any useless assets that are not relevant to the roles of the units. If we still have good equipment that can be used, we do not need to allocate money to buy new equipment. The optimum utilisation of assets

is our main priority. We should prevent waste. We don't need to buy any unnecessary goods.” (R#40, Q#79)

Nevertheless, some respondents mentioned that more detailed rules and procedures are required to ensure that employees work more efficiently and reduce any unnecessary spending. This practice is typical in a bureaucratic organisation that relies heavily on formal legal authority in terms of its regulations and procedures, which are applied to all of its members. The inefficient practice of providing additional money to employees by creating a temporary team to perform ad-hoc tasks has been prominent in West Lombok District. Despite the impact of the obvious inefficiency of those practices, they can only be stopped by the stipulation of more stringent criteria and procedures for the establishment of ad-hoc teams.

“Now we have been more efficient. No more waste in our spending. Everything now has rules. In the past there was waste. We provided an additional honorarium for our employees [through the establishment of ad-hoc teams], while there was no [budget] allocation for the community [development]. It is now more regulated. The establishment of ad-hoc teams is now limited to only work that spans across sectors or agencies, such as a financial administration team and development assistance team.” (R#46, Q#81)

One respondent from the Health Service further restricted the definition of efficiency only in terms of following rules and regulation. This understanding forces the necessity for establishing good quality rules that can accommodate the requirements for both accountability and efficiency.

“It is not good if it wasn't properly managed according to the rules. I guess the purposes are for efficiency and effectiveness, certainly following the corridor which has been set in the existing regulations.” (R#42, Q#80)

Another objective of PFM reform is the effective utilisation of public money. Regarding this objective, respondents related effectiveness to the impact of financial management in improving people's welfare, accommodating public needs and contributing to regional development. One of the officials in the Education Service mentions the achievement of a minimum standard of service delivery in the education sector as the main criterion for effective financial management in the educational sector (R#26, Q#46). A respondent from the Parks and City Interiors Service highlights the responsibility of local government for providing comfortable and convenient public spaces and facilities. He mentions that:

“The budget allows us to not only provide green open spaces but also city planning and decorations to maintain the beauty of the city. Leisure parks and amusement parks are also needed, including the arrangement of street lighting. A budget is needed to cover the operational and maintenance costs of the street lighting.” (R#30, Q#55)

Some respondents commented on the obligation for the District to be transparent in its financial management. Adequate publication of the budgeting process, the budget execution process and the reporting of financial statements are considered important to ensure the transparency and accountability of the District's financial management (R#2, Q#83). Another respondent succinctly comments that *“the goal of local financial management is to provide accurate information to everyone”* (R#16, Q#88).

Despite the PFM objectives in Indonesia's local government being multiple in nature, which includes compliance, economy, efficiency, effectiveness, accountability and transparency, the emphasis on compliance with relevant PFM rules and regulations including the annual budget laws is frequently mentioned by the respondents of this study. However, respondents also identified the tension caused by trying to accommodate efficiency and effectiveness while, at the same time, being bound by the rules and regulations. One example regarding the emphasis on the compliance aspect of the PFM objectives is provided by the Head of DPPKD when he comments:

“[...] the first important aspect is the adherence [of financial management] to the provisions stipulated in the rules. Then the second aspect is related to effectiveness but, at least, we have to overcome the non-compliance problem first. If compliance is met, God willing, our financial management will be better off.” (R#01, Q#628)

The perspective of the highest PFM authority holder in the District seems also to have been very well understood by most of the PFM actors in West Lombok District. A number of respondents across various hierarchical positions who participated in this study also displayed their personal perspectives toward the importance of adherence to rules and regulations while carrying out their roles and responsibilities in PFM operations. They believe that the attainment of efficiency and effectiveness is bounded by the requirement to comply with rules and regulations. One of the section heads in the Health Service confirms this perspective by stating that:

“Certainly financial management aims for efficiency and effectiveness [of the local government's activities]. However, it is not good if it isn't properly managed according to the rules. In my opinion, the purposes are for efficiency and effectiveness by following the boundary which has been set in rules and regulations.” (R#42, Q#48)

Further analysis of the respondents' responses reveals that the emphasis on compliance among the PFM actors emanates from their personal commitments and the fact that their work is already highly regulated. The echelon III officer who is responsible for local tax collection processes mentions his commitment to follow the rules by stating that:

“As much as possible I will try to do the job according to what I should do and, of course, the existing rules because we cannot escape from the rule of law in conducting our work, and we will make every effort to remain within the corridors of these regulations.” (R#06, Q#91)

In another instance, the perspective on compliance emerged from the feeling to repay what the local government has given to its employees. A section head in the District Secretariat supports this perspective as he considers that the position he holds currently is a trust from the District that needs to be repaid by carrying out his duties according to the rules and regulations (R#22, Q#136). He also stipulates that the financial compensation he has received in the form of salary, honorarium, allowances, etc., including the facilities to perform his duties, such as computers, office supplies, etc., must also be acknowledged through his compliance with rules and regulations that are applied to his duties. Even a small item such as not coming late to the office is considered as one compliance aspect that employees need to follow strictly (R#01, Q#132).

The emphasis on compliance with rules and regulations in the operations of PFM supports the bureaucratic characteristic of PFM operations as a public administration tenet. Members of a public bureaucracy are forced, by the pressure to fulfil their accountability to the public, to conduct their duties in accordance with rules and regulations. Nevertheless, this case study observed that the understanding of the PFM actors that they must comply with rules when carrying out their duties does not necessarily direct them to always follow the rules in their actual day-to-day activities. The discussion in the previous chapter has confirmed this observation, whereby the BPK audits frequently reported a number of problems in various PFM operational processes in West Lombok District that were a result of the non-compliant behaviour of its employees. This observation also confirms the argument discussed in the literature that the strong image of public bureaucracies adhering to rules rarely emerges in reality.

The discussion in the rest of this thesis can be expected to provide explanations on why the public employees' perspectives on the importance of compliance are not actually evident in their actions. Specifically, the discussion focuses on the two major themes that have emerged from the respondents' responses. These two major themes are the motives of PFM actors in the workplace and the shortcomings of bureaucratic structures in West Lombok District's PFM operational practices. The latter theme will be discussed further in Chapter 8, while the former is discussed further in the rest of this chapter. However, to gain an understanding regarding the various motives of the PFM actors in the workplace, before the discussion on how the

motives in the workplace facilitate non-compliant behaviour, the following section discusses the motives that are visible at work among the PFM actors in West Lombok District who participated in this study.

7.2. PFM Actors' Motives at Work

In Chapter 2, literature regarding public bureaucracy highlighted motivational factors for work, in the context of the public sector, in the form of a spectrum ranging from purely self-interested to public-interested motives. The analysis of the interviews with the respondents of this study has confirmed the presence of both extremes of motives among PFM actors in West Lombok District. In addition to this finding, the interviews also highlighted the influences of the social and economic contexts of the respondents upon their motivations to join and remain working as public servants. While, in general, the results of analysis of the interviews display the tendency of respondents towards self-interested motives at the early stages of their careers in the public sector, including their initial decisions to join the public sector, later, it is the public-interested motives that emerge as they start to exercise their roles in the organisation and gain more understanding about the nature of local government as a public institution. In conclusion, regarding the work motivational factors of public employees, this study confirms Perry and Wise's (1990) assertion that people in the public bureaucracy possess a mix of motives. They may exhibit a combination of different motives when conducting their various roles in the public sector throughout their careers.

7.2.1. Having a Job and Earning a Living

The majority of respondents mentioned that, at the time of first joining the public sector, they had practical, self-interested reasons for applying, such as to have a job and to earn a living. A senior employee who joined the district after finishing her bachelor degree, and has been working in the the Accounting and Reporting Division for about nine years, mentions that:

"Initially, there was no desire to become a civil servant. When I graduated from university and also my contract at my old workplace lapsed, there was a vacancy for a civil servant. I decided to just give it a try. Importantly, I just wanted to look for a job." (R#11, Q#252)

Another respondent, who holds an echelon II position and has a very long tenure as a public servant in West Lombok District, also reinforces the absence of public-interested motives when he first applied for a vacancy in the public sector by stating that *"I applied for this job [as a public servant] because I wanted to earn a living. Frankly, in my answer to the questions asked during the recruitment test, I said that I*

don't want to serve for the district, but I want to earn money from this job.” (R#1, Q#176)

7.2.2. Social Status and Influence of Relatives

The practical motive of having a job and earning a living inevitably displays the obvious self-interested motives for financial income among the respondents of the study. Other than these money-related self-interested motives, the prestige of a civil servant's occupation, as perceived by the community, and the influence of parents and relatives who had worked in the public sector also inspired some of the respondents to join and remain working in the public sector. A section head in the Investment and Licensing Agency mentions that:

“Actually my motivation [to work in the public sector], I am sorry for this, because when we were little kids, a civil servant was considered as an honourable occupation. Certainly we wanted to become a civil servant [.....] Parents are also certainly proud if they have children who became a civil servant.” (R#17, Q#273 and 274)

A family that has most of its members working in the public sector tends to influence other family members to follow their paths and look for a job in a public institution. Such motivation applied to a division head, an echelon III official, in the Parks and City Interiors Service when he stated: *“What was my motivation at that time? Maybe [it was] because I had a lot of relatives who were also working as civil servants.” (R#30, Q#149)*. A staff member in DPPKD also expresses a similar motivational factor for joining the public sector by commenting that *“Initially, I saw my parents, my mother and my father who used to work as civil servants. I also have brothers and sisters who currently work as civil servants. I also want my children to become a civil servant just like me” (R#5, Q#164 and Q#148)*.

7.2.3. By Chance

One of the respondents who joined the public sector in the mid-1980s specifies that the economic condition of West Lombok, which at that time was mainly dominated by its agricultural sector, with only a few industries, had limited the options for new graduates from universities to look for a proper occupation outside the public sector (R#38). Public employment, in such a situation, is often used by the government in developing countries to reduce the unemployment level because it is easier than implementing a policy to create job vacancies in the private sector (Rodrik 2000). As a result, public sector employment attracts many individuals from various backgrounds. Due to the poor recruitment process and patrimonial culture that can be

found easily in the public bureaucracy of developing countries, it is unlikely that any public institution could recruit individuals who already possess public-interested motives. As an extreme case, a number of respondents in this study mentioned that they did not have any specific motives to enter the public sector. They viewed their admission to the public sector as their destiny, a fate that had already been predetermined for them. They did not see the fitness of their competency, capacity or public-interested motives as important elements when making the decision to take on roles in public institutions. A staff member in the Investment and Licensing Agency who graduated from high school specifically states that *“Initially I never imagined that I could become a civil servant because, basically, I was a poor person and only graduated from a senior high school. It is maybe my fate to become a civil servant.”* (R#18, Q#142). Even an echelon III who joined West Lombok District after finishing his bachelor degree from the Institute of Public Administration (under the management of the MoHA) also mentions that *“[...] it could be said that I actually wasn't motivated to become a public servant. Maybe it was just my destiny, my fate.”* (R#36, Q#147).

7.2.4. Convenience

Apart from the motivation to enter public employment, respondents of this study also highlighted other self-interested motives as the main factor that encouraged them to remain working in the public sector. These include convenience in terms of flexible working hours and security of income in the form of fixed and continuing monthly salaries, as well as retirement benefits.

The flexible working hours influenced a respondent who also practises as a vet outside the office. He is able to utilise his spare time at work, especially during his lunch break from 12pm to 1 pm, to leave the office and provide treatment to his patients. While he understands that his action is not appropriate and can be considered as a type of corruption, he stated that his low workload as an echelon III employee has provided him with an opportunity to have a side job and earn extra income outside his salary as a public servant. Female employees, on the other hand, often prefer to work in the public sector due to its flexibility in working hours, enabling them to also adequately carry out their domestic responsibilities as housewives. One of the female respondents specifically mentions her enjoyment in working as a civil servant by stating that:

“I viewed working as a civil servant to be enjoyable. Previously, when we still worked for six days a week, we went to the office in the morning and could return home in the early afternoon at 2 pm. We have a lot of time for our family.”

I was motivated by that. As a civil servant, I can have a balance between my career and my role as a housewife.” (R#40, Q#241)

In terms of security of income, despite public sector employment providing a relatively lower salary than the private sector, it has an advantage in terms of the certainty of always earning a certain income on a monthly basis. There was a strong perception among the respondents that once they joined the public sector, it was hard for them to be sacked or fired unless they made an extraordinary mistake (R#42). The private sector, on the other hand, is prone to lay-offs, especially when there is financial distress. An echelon III worker in DPPKD, when asked about her motivation to work in the public sector, commented that:

“[...] because of security reason of having a fixed income. In the private sector, the income may be higher, but it is uncertain. It's different for civil servants. In the public sector, we have certainty about our income. Maybe the amount is smaller but we certainly receive it every month.” (R#13, Q#265)

Another feature of income security in public sector employment, the surety to receive a retirement benefit, has motivated an echelon IV female respondent (who also holds a master's degree qualification) to work in West Lombok District and she mentions that *“In fact, I was keen to become a civil servant because I would definitely have a peaceful life after retiring. That's my actual motive - to feel secure when I retire.”* (R#42, Q#263)

Another echelon IV respondent with a master's degree qualification also specifies that, despite the drawbacks of the bureaucratic system practised in the District, which limit him from exercising his skills and knowledge optimally, he feels it is more convenient to work in a public institution due to the security of income after he retires (R#46). The same motive of retirement benefits also emerges among respondents who are younger, with less than 10 years of tenure in the District, prompting their intention to remain working in the public sector until they reach the retirement age.

7.2.5. Financial Compensation

While conducting their duties, the existence of other self-interested, monetary-based motives is also evident from the employees' perspectives. The structure of financial compensation in public sector employment in Indonesia may contribute to this conclusion. In addition to the basic salary, which is stipulated on the basis of job rank, job grade and tenure, and which is applied consistently to all public institutions in Indonesia, civil servants at local government level may also earn other income in the form of additional allowances (MoHA 2006). In the era of decentralisation, according to Permendagri 13/2006, local governments could provide additional allowances to

their employees as long as the allowances were given based on objective criteria and they had adequate fiscal resources. In the case of West Lombok District, the components of income received by its employees in addition to the basic monthly salary include monthly allowances, honorarium and incentives.

All employees are entitled to earn monthly allowances. Similar to their basic salaries, monthly allowances are calculated based on job ranks and grades. Although the amount of allowances has not increased since 2009, a respondent in this study who serves as a section head in the Public Works Service views monthly allowances as a positive factor in his motivation to work.

“My motivation to work is driven by my responsibility as a civil servant. I have to fulfil my responsibilities whatever the consequences. I don't prioritise money, but I do need additional income. Luckily the local government has paid [a monthly] welfare allowance in addition to our monthly salary. I feel grateful for that.” (R#49, Q#208)

Employees who are carrying out specific roles, beyond their routine duties outlined in their job descriptions, may also be entitled to an honorarium. For example, for the fiscal year 2014, the Regent had issued a decree that stipulated the assignment of certain officials and employees to a number of PFM operational positions such as budget users, receiving treasurers and disbursing treasurers in all working units in the district (Pemkab Lombok Barat 2014b). The decree also stipulated the honoraria for those officials and employees as a result of their involvement in the PFM operational processes. A female employee in the Public Work Service, who had been assigned an additional responsibility within a procurement work group outside her main duties as a section head, displays her gratitude for the district's attention to her financial needs by stating that:

“I am also assigned to a working group in the procurement service unit. There is an honorarium paid because of my involvement as a member of the working group. If there is a project, we are also involved in a contract review committee for which we are also entitled to separate honoraria. Thus, we get compensation for our overtime or sometimes we also need to work at home. I am glad that there is attention from the local government by providing an additional honorarium for the involvement in a working group or for the additional tasks outside our job description.” (R#47, Q#206)

While the first three components of income illustrate the financial compensation scheme available in West Lombok District, the last component of financial incentives is considered as part of a performance management and reward system. Financial incentives are offered to motivate employees to carry out a specific duty with a certain performance target. In tax collection activities, for example, employees who are involved in tax collection processes might receive financial incentives if they can

achieve the tax revenue target (Pemkab Lombok Barat 2012). Such performance-based incentives have stimulated employees to work harder in order to achieve the target. One of the staff members in DPPKD who was involved in tax collection processes stated that *“we are motivated [to work] here because there is additional income. Apart from the salary, I also get an extra incentive when collecting taxes. [Employees at] other units do not have extra income [like that].”* (R#05). Officials at a higher hierarchical level in DPPKD who were involved in tax collection activities also expressed similar feelings. An echelon IV official who served as a section head mentioned, *“If we achieved the target, we would get [financial] incentives. It boosted our motivation to work [harder]”* (R#10), while an echelon III official who served as a division head stated, *“We were motivated by the pressure to achieve the revenue target.”* (R#6).

7.2.6. Power and Promotion

Other than money-related motives, another self-interested motive, that of gaining power through promotion and career advancement, also appeared in respondents' responses when they were asked about their motives for carrying out their roles and responsibilities in PFM operational processes. The motive to gain more power through promotion emerges once employees are satisfied with their income but still need recognition from the organisation and their colleagues. An echelon IV officer at the District Secretariat states his view on this matter by mentioning that:

“[...] once we've already achieved the level [of income] that we want, there is another thing in a non-material form which is also expected: career recognition. Throughout our career, if we never get any promotion, for example, it would negatively impact our motivation to work.” (R#22, Q#220)

Promotion can be viewed as a recognition of an employees' capability and provides an opportunity for career advancement in the organisation, which eventually leads to increased income. In addition, a higher position in the district's hierarchy seems to gain more respect from superiors, colleagues and other employees. Recognition and respect as a result of promotion were viewed by a female respondent, who was promoted after she finished her master's degree, as one factor that motivated her to perform better work. She stated that:

“When we were promoted, based on my personal experience, it actually motivated us to work better. I felt appreciated. Someone has observed and assessed our work and we feel our work is recognised. It motivates us to work better. Other than that, we also feel respected by our bosses and colleagues. When we are asking for help, they respond to it promptly. It motivates us to not to be lazy.” (R#47, Q#229)

Interestingly, another perspective of this power-related motive shows an inclination toward a more public-interested motive for work. In this case, the motivation for gaining promotion comes from the employees' perceptions that, to be able to fulfil public interests, they need to have power and authority. This perception persuades employees to look for promotion and attempt to attain a higher hierarchical position in the organisation. More power and authority, as a result of promotion, enable them to implement their ideas on how to provide better services to the community and to accommodate public needs. A respondent who was a section head in the Public Works Service specifically mentioned the difficulty of implementing his good idea for assisting development in the region. He stated that:

"I hope before I retire I still can get a better position. I still have 13 years more before my retirement. So it is reasonable to expect a promotion in my career. I have three years' experience in the current job rank (i.e. III/D) and I already hold a master's degree qualification, so I have potential to keep improving my career. It means that I want to devote, to contribute optimally, to my community. Now, even though I have good ideas on how to develop my region, I don't have an opportunity to implement them. If I had a higher position in the office, of course, it would be easier for me to share and implement my ideas." (R#46, Q#228)

7.2.7. Display of Work Proficiency

There was also feedback from respondents that highlighted their motivation to display a high quality of work. The motivation to display proficiency at work is partly driven by the self-interested expectations that it will lead to a higher salary, a positive personal reputation and/or career advancement (R#27, R#28 and R#45), although those expectations are not explicitly stated. Interestingly, the majority of responses regarding displaying work proficiency came from respondents who already held higher echelon positions within the hierarchy. An echelon III employee who was also a division head in the Health Service mentioned: *"It is important for me to display a good performance. I never think about rotation or promotion. I will get it if that is my fate. The main thing is to show our performance."* (R#45, Q#331). A similar idea was also expressed by an echelon II officer in the District Secretariat in regard to his income-oriented motive. He mentions that:

"I have a principle that working is not only about looking for money. [They're a] hypocrite if anybody says that he is working not for money. Of course, it is for money. But we get the money through our professionalism and proper manner. Professionalism is displayed in our good work. Then, money will follow later [as a result of our good work]." (R#27, Q#324).

In contrast, the motivation to display good work could also be driven by the intention to be able to contribute to the public's needs. For example, a division head in the District Secretary states that:

"[...] I have no other motivation except to improve my performance. That's the only thing I can do to contribute to regional development. In a smaller scope, the development of the district and, in a larger scope, the development of the province." (R#39, Q#328)

7.2.8. Loyalty to the Organisation

Some respondents felt grateful for being able to work in local government offices. Becoming a public servant has provided them with a noble social status in the community and adequate livelihood to support their needs. They hold a view that their status as public servants and the financial compensation which they have earned have to be recompensed by displaying responsibility in carrying out the roles and functions that have been assigned to them. Such a view stimulates their loyalty to the organisation, motivating them to be responsible for their duties by accomplishing their tasks completely and performing better in their jobs. Hence, the feeling of responsibility to their duties as public employees motivates them to carry out their tasks as specified in the detailed job descriptions. A female staff member in the Accounting and Reporting Division mentions that: *"In the office, I am the property of the government. I would try to work with full responsibility. I am already paid here. I have to do my duties."* (R#14, Q#308). A similar response was also provided by a section head in the Public Works Service who stated that:

"[...] we have to work because the government has paid our salaries. We don't consider other additional income as the compensation for our work. So even if we didn't get any additional allowances, it doesn't matter for us. We have assumed our monthly salaries as the financial compensation for our work as a civil servant, thus we have to do all the tasks that have been assigned to us. That is my motivation to work." (R#49, Q#298)

One interesting characteristic of the loyalty motive to the organisation emerged from the respondents who had experienced working in West Lombok District for more than 30 years. Their long tenure as public employees has shaped a very strong feeling of loyalty to the organisation, causing them to neglect self-interested motives of financial income and power or promotion as motivational factors that influence their behaviour. One of them, a staff member at the Parks and City Interiors Service, who is also a member of a procurement committee, mentions that: *"It never came to my mind to fulfil my duty because of money. I carry out my duty, because it is my responsibility, it is my obligation to do my job. Sometimes I continue my work at home, yet I expect nothing from that."* (R#37, Q#295). While another one, an echelon III officer in the Health Service highlights this characteristic by commenting that:

"I am not ambitious and don't have any ambition. I had a very long experience as an echelon IV. I was working as head of a section in the Health Service for about fourteen years. I never had any ambition for getting a promotion and

becoming a higher level officer. I just kept trying to do my best. [...] The most important thing is that I already get paid by the government, and I have to commit to do my duties". (R#41, Q#317)

7.2.9. Presence of Public-interested Motives

It is also evident from the interviews that, over time, some respondents gain more understanding in regard to their expected contributions while exercising their roles in the District. This normative understanding has then changed the personal motives of public employees and they have become more motivated to perform their duties in the public's interest. Such a transformation has been displayed by a number of respondents who have held quite long tenure working in West Lombok District. For example, a female staff member who has a tenure of more than 22 years in the District mentioned that her initial motive to work in the public sector was merely to have a job but, over time, she gradually gained more understanding about her main roles in the organisation being to provide service to the community. She states that:

"Now, I feel more 'into' the community. I want to provide the public with better services. When I started working here, I felt that it was important to have a job rather than just be unemployed. We couldn't be unemployed while our parents had paid our education and were working hard for us. Apparently, as the time went by, I found out that the community requires excellent services from the [local] government." (R#4, Q#357 and Q#358).

A similar pattern of gradual change from self-interested to more public-interested motivation for work was also experienced by a male respondent who held an echelon IV position and had 13 years of experience working in West Lombok District. He mentions that:

"In the end, my motivation now is to take part in the development of West Lombok. At least, to have the same economic level and growth with other districts. I want to provide a good service to our community. Such motivation was formed after many years of being a civil servant. Now I have more concern on how I can contribute to the development of our district and our society." (R#30, Q#372)

The presence of public-interested motives does not only emerge from such a gradual transformation as a result of the employees' attachments to their roles in public institutions. In some cases, public employees have already possessed motives of public-interest since the first time they joined the public service. Their decision to work in the public sector was significantly influenced by their inclination to provide service to the community and to contribute to regional development within the district. They understand the normative consequences of becoming a public servant and maintain their commitment to serve the public throughout their career in the public service. A division head in the Health Service touches upon this issue by mentioning that: "I

initially intended to serve the public. Just that. Until now I am still committed to it.” (R#41, Q#380). Another respondent who also served as a division head in the Health Service revealed his intention to devote himself to the community by deciding to work in local government. He expresses his public-interested motive to join the public sector by mentioning that *“I wanted to dedicate myself to my region. I was born here. After I finished my education in Yogyakarta, I came back here to serve my community. My motivation for becoming a civil servant was to devote myself to my district.”* (R#45, Q#397). A similar motive is also displayed by an echelon II official who explicitly mentions his dedication to serve the community. He states that:

“My motivation [to work in the public sector] is to serve [the community] because I embrace a personal motto to dedicate my life to the people. That is my motivation to work. [...] Because my motto is to serve people, I work for the people. It becomes my motivation to work.” (R#33, Q#374)

Officials in higher level positions within the hierarchy also display a tendency to possess dedication to serve the public. The responsibility attached to their positions seems to direct their personal perspectives toward seeing the functions of PFM operations as providing services to the public, hence influencing their motives at work to also prioritise people’s needs and interests. A number of responses from respondents who held positions in higher echelons supported this conclusion. For example, an echelon IV officer who served as a section head in the Public Works Service mentioned that:

“It is our priority as a civil servant to provide service to the community: to ensure that people feel convenient and safe, and the economy also grows quickly. [...] So we try our best to allocate our limited amount of budget into urgent projects such as for natural disaster recovery and improvement on the road network to connect residential centres to government centres and economic centres, and the connections between villages. So we have to focus to provide adequate infrastructure for the people.” (R#47, Q#63)

Other than attachment to higher level positions, some interviewees’ responses also linked the possession of public-interested motives to the nature of the local government units which they worked. Respondents who worked in local government units that directly provided service to the community tended to better understand the normative consequences of a public servant’s role and were more inclined to have public-interested motives while carrying out their duties. A comment from an official in the Parks and City Interiors Service, who was responsible for waste collection, may represent such a conclusion when he mentions that:

Since the beginning of my work as a civil servant, I always interact with the public directly. [...] I always work hard. I need to be available at any time. [...] So I always prioritise the public needs. For me it is not unusual. If I don’t put my

interests into public needs, I would become confused because I always think about the public. It is my main responsibility and indeed my job. And I personally have passion in it. (R#28, Q#369)

Several other respondents who worked at Education Service and Health Service also delivered similar messages. In showing his inclination towards public-interested motives, a respondent who was an echelon IV official in the Investment and Licensing Agency criticised the local government's policy which, in his view, did not represent the public needs, by mentioning that:

"[The monies] were used for ceremonial purposes only; for example, for a New Years' Eve fireworks display. Tens of millions of rupiah might be spent on that. That money can actually be used to build a community health care centre in a village." (R#15, Q#364)

Unfortunately, the presence of public-interested motives is not shared equally among all employees working in local government. A department head in the Parks and City Interiors Service expressed this matter by commenting that:

"In my opinion, for a service delivery agency with a limited budget, creativity is needed. That's first. Secondly, we need people who have strong passions, who have principles to assist the community, and who have high social values. Otherwise it would be difficult for us. In fact, not all of my staff have such characteristics." (R#28, Q#371)

7.3. Implications of PFM Actors' Motives in Causing Non-Compliance

The previous section has highlighted a number of motives at work that were found among PFM actors in West Lombok District. The main finding from the previous section displays the complexity of public employees' motivations for work, ranging from self-interested to public-interested motives. Hence, both types of motive play a role in contributing to, or have implications in, the emergence of non-compliance problems in PFM operations. The first theme that emerges from an examination of the interview data is related to the impact of self-interested motives upon non-compliant behaviours of the PFM actors in the PFM operational practices. The following section discusses this theme in more detail.

7.3.1. Self-interested Motives

The analysis of the interview transcripts of this study has revealed the implication of the self-interested motives of the respondents in the emergence of non-compliance in the PFM operational context. Along with the failure of local government to establish proper institutional instruments, motives of self-interest have caused a deviation in the actual behaviour of the respondents from the expected behaviour as stipulated in rules and regulations. One of the institutional instruments that is lacking in West

Lombok District is an attractive financial compensation system. An unattractive financial compensation system demotivates the employees in the workplace, causing them to ineffectively carry out their organisational duties, which potentially leads to non-compliance. A staff at Accounting and Reporting Division who had been working in West Lombok District for about nine years put forward the inadequate financial compensation system in West Lombok District as one factor that leads employees to become undisciplined in regard to their responsibilities. He mentioned that:

“[...] because the financial compensation is not good, the employees become undisciplined. They fail to prepare timely and complete reports, fail to attend meetings, and fail to accurately input the financial [transaction] data to the system. [...] In my opinion, [an adequate] financial compensation is necessary to improve employees’ motivation to work. Often, it is not because we cannot do the tasks, but often because there is no [financial compensation] policy that can motivate us to do and accomplish those tasks appropriately. There are disappointments [among employees].” (R#12, Q#854 and Q#856)

As already mentioned earlier in this chapter, the two major components of income for West Lombok District’s employees are basic salary and monthly allowances. Both components are calculated based on job ranks and grades, including tenure of work for basic salary. As a result, employees who are still at the lower level receive less income compared to those who have longer tenure and hold higher job ranks or grades. In addition, most of the lower-level staff do not have access to the other two components of income, which are an honorarium (only given to certain employees who conduct additional duties outside their main job descriptions) and a financial incentive that is given to employees at certain local government units with specific public service duties, such as tax collectors, doctors, midwives, and teachers. Thus, the propensity for non-compliant behaviour is higher at lower-level employees because the financial compensation system for them seems to be unattractive.

7.3.1.1. Having a Side Job

The lack of an attractive income scheme, especially for those who are in a lower-level position, has led some employees to take other employment outside their main occupation as public servants. Unfortunately, this comes with negative consequences for the organisation because, frequently, they have to perform their side job during office hours, distracting them from their duties as a public employee in PFM operations. A respondent who worked in the Accounting and Reporting Division confirmed the poor financial compensation system, especially for staff like him, in West Lombok District. He further explained his decision to seek additional employment and how that decision was damaging his commitment to deliver his duties as a public servant. He states:

“Finally, I decided to have a side job to fulfil my domestic [financial] needs and to improve my standard of living, at least to a more reasonable standard. We cannot rely on our income as a civil servant here. I am forced to do it although it affects my job here. [...] Sometimes I’d got a phone call while I was doing my work here causing me to leave the office for a while and, ultimately, it delays my work [here]” (R#12, Q#438 and Q#439)

The phenomenon of having a side job was also present among respondents who held echelon IV and III positions. However, their motives were mainly to utilise their spare time while in public sector employment. They kept their occupations as public servants as their main priority and allocated only their after-hours or weekend time for doing their side jobs. Despite their higher hierarchical levels in the organisation, the practice of having other employment outside their occupations as public employees could potentially degrade the quality of their work, including the possibility for non-compliance in PFM operational processes.

In an extreme case, however, the unattractive financial compensation system may lead to an employee’s decision to leave public sector employment. One of the respondents of this study was considering leaving the public service completely and looking for a job in the private sector. After working with the government for almost nine years, she believed that what she was earning as a public servant was not adequate to fulfil her family’s financial needs, and that working in the public sector was no longer attractive for her in the long run. While the instance of public servants leaving for the private sector is quite rare in Indonesia, it may have an impact on the performance of the public organisation such as a local government. The cumbersome, time-consuming and very bureaucratic process of recruiting new employees may cause difficulties for the public organisation when trying to find new employees to replace the experienced employees who have resigned from their public service jobs.

7.3.1.2. Getting a Personal Loan

Another phenomenon arising from the unattractive income model in West Lombok District is the practice where employees borrow monies from a bank by pawning their letter of employment as a public servant, which is also quite common among lower-level staff. They mention that they cannot rely on salaries and welfare allowances as a public servant to finance their family’s needs for housing, transportation, education, etc. A female employee of the Education and Cultural Service says that: *“I hope that I can pay back my debt as soon as possible because I pledged my public servant’s employment letter to the bank. I can’t rely on my salary [here], it won’t be sufficient [to cover my household needs].” (R#21, Q#419)*. While another staff member at the Investment and Licensing Agency mentions that: *“My wife and I have applied for a*

loan from the bank to finance our small house. When the loan is paid off, I hope we can save some of our income to send our children to a university.” (R#18, Q#418).

The practice of owing money to a bank comes with the consequence of reducing the employee’s monthly income because the repayment to the bank is directly deducted from his/her salary. The disbursing treasurer who is responsible for administering employees’ salaries sometimes faces a difficult situation in rejecting his colleagues’ requests for applying for a bank loan. A respondent of this study who was also a disbursing treasurer in the Investment and Licensing Agency mentioned that:

“It was difficult when they asked [my approval] for their loan application to the bank. I told them, ‘You already passed your limit. You only have 30% of your salary while the bank only allows a minimum 40% of your salary’. But they insisted and sometimes they escalated the issue to their superiors.” (R#16, Q#417)

This practice has been identified as one critical factor that may diminish the motivation of the public employees to be responsible for their duties. However, West Lombok District does not have any policies that can address and scale down this practice to minimise its impacts on employees’ motivation for work. There were incidents where public employees who had pawned their salary lost their motivation to perform their responsibilities as public employees. They were reportedly absent from regularly coming to the office because they might have been busy doing other business outside the office to earn extra income to pay off their bank loans (R#27, Q#422).

The presence of these two phenomena (e.g. employees having side jobs and employees pawning their salaries to the bank) highlight the existence of self-interested motives in terms of financial income and money issues in public sector employment, particularly among lower-level employees in the context of this study in West Lombok District. The absence of an attractive income scheme, however, does not always lead the employees to decide to resign their jobs as public servants. The failure of local government to provide an adequate financial compensation scheme has caused them to look for alternative financial resources. They struggle to fulfil their self-interested motives of gaining more income to be able to meet their household needs. Their struggles, in the end, potentially create a negative impact on the overall performance of the organisation, including the possibility of the employees to committing non-compliant behaviour while they are carrying out their responsibilities.

7.3.1.3. Unfair Financial Compensation

In another instance, the unattractive income scheme can be viewed as unfair by the employees, especially in relation to the workloads and responsibilities attached to

their jobs. A respondent who had been working as a treasurer in the Investment and License Agency for more than four years highlighted this issue by commenting that:

“I am tired of being a treasurer. [I have] too many tasks and more responsibilities. But [unfortunately] I do not receive any significant additional income. I was appointed as a treasurer because of the discretion of the head of the agency. I have no other option except to fulfil this responsibility.” (R#18, Q#921)

Another respondent who was appointed as a CMO in the procurement process of the Education and Cultural Service also expressed a similar concern. He mentioned that the honorarium he received as a CMO was relatively small compared with his responsibilities. To make it worse, he did not receive any extra monies to cover his costs for visiting sites to monitor construction progress as part of his responsibilities as a CMO. As a result, he had to cover the operational costs of performing his role as a CMO from his honorarium.

In this case, the emergence of non-compliant behaviour does not come from the distractions to compensate the lack of income by having other employment or borrowing money from the bank; instead, it comes from the accumulation of disappointment among the employees. They manifest their disappointments in the form of resistance to properly carry out their duties, increasing the possibility for the occurrence of non-compliance. One of the respondents specifically highlights this risk of employees' accumulated disappointments in the workplace leading to non-compliant behaviour by mentioning that:

“Sometimes they were told to do something, they said yes but they never did it. It was a form of resistance after the accumulation of disappointment at work. I see [that it is because] the distribution of financial compensation is not in accordance with their responsibilities and their actual contributions [to the organisation].” (R#12, Q#912)

7.3.1.4. Lack of Reward System

The disappointment in the unfair financial compensation system has been further exacerbated by discrepancies in the implementation of an individual performance-based reward system. In West Lombok District, an individual performance-based reward system is still absent in most local government units except in units that are carrying out certain public service provisions to the community. In the Health Service, for example, annual awards are presented to individual employees in a number of categories including doctor of the year, dentist of the year, nurse of the year, midwife of the year, sanitarian of the year, etc. Those who are selected are entitled to a reward in the form of prize money or a religious trip, to Mecca for those who are Moslem or other holy places for those who are not Moslem. However, such a reward system is

not applied to employees whose duties are administrative in nature, including those who work in the PFM operations of related areas. One of the echelon III officials who participated in this study mentioned that West Lombok District does not have an instrument that can provide valid performance measures for all individual employees. This situation often extends the feeling of disappointment among the employees and further decreases their motivation to perform well in their duties, thereby increasing the risk of non-compliance problems. One of the respondents, who was responsible for financial administration in the Parks and City Interiors Service, specifically addressed this situation by mentioning the lack of appreciation from the District for her hard work in conducting her duties. She stated that:

“Often we have worked very very hard, but we feel very disappointed because our works were not appreciated. There is no fair individual performance measurement system that is implemented, thus we feel very disappointed. We have been struggling to perform our work, but no reward for that.” (R#32, Q#892)

The disappointment may also come from an unclear policy on employees' promotion. Similar to their income need, promotion also represents a self-interested motive because it can be seen as a reward or appreciation for the qualification and dedication of the employees. It displays career advancement for the employees that, in most cases, has consequences on their incomes because a higher position usually comes with higher job/grade allowances. A section head in the Investment and Licensing Agency expressed his view that the impact of the unfair policy on employees' promotion has led to more disappointment for the employees. He mentions that:

“I am sorry to say, a lot of employees are disappointed [here] in the sense that they are already qualified but they do not get any promotion [to a higher position]. It is a pity. The district is oppressing its employees. On the other hand, employees who are not qualified are getting promoted. There are qualified employees who get nothing, while the unqualified ones can get a promotion.” (R#17, Q#931)

This situation shows the failure of West Lombok District to empower its promotion and career advancement policy as a reward instrument to motivate its employees. The impact of unclear career and promotion policies upon the feelings of disappointment among public employees, potentially, influences the employees to commit non-compliant behaviour while carrying out their duties.

7.3.1.5. Resistance and Ignorance Factors

Apart from lacking a proper financial compensation and reward system, another theme that can explain occurrences of non-compliance in PFM operations, which can emerge as a result of self-interested motives, is the resistance among West Lombok

District's officials and employees to see the importance of PFM operations. Resistance indicates the efforts of employees to make personal gains in the form of less difficult work by allowing them to have some idle time at the workplace. Idle time can provide the employees with the opportunity to get away from their jobs and responsibilities to accommodate other personal needs.

In the early stages of PFM reform, resistance was represented in the form of employees' reluctance to change and to follow the new PFM practices (R#08, Q#523). They kept following the old habits that had been practised for a long time and did not want to learn the requirements of the new PFM rules and regulations. In cash management for example, instead of preparing a cash disbursement plan based on the schedule of each program and activity, as required by the new PFM regulations, they kept allocating cash disbursements equally for every quarter, resulting in a number of unavoidable non-compliant practices in the actual cash disbursement processes (R#23, Q#528).

Another example of resistance was found in asset management, one of the major non-complaint PFM areas in West Lombok District that has been frequently disclosed in BPK's audit reports. However, in this area, employees were not aware of the presence of regulations that they needed to follow when carrying out their responsibilities in asset management. A respondent who worked at the Office of Local Assets, the unit that is responsible for managing and administering assets across all SKPDs, stated that:

"West Lombok actually already has a Regent Decree that regulates the management of assets. Assets transactions including acquisition, change of ownership, utilisation, write-off, security and access are regulated by the decree. But most units do not know about it. Their ignorance slows down the effort to develop the awareness that we have regulations for guiding our asset management." (R#40, Q#736)

A similar perception was also mentioned by a respondent who was responsible for specifically administering assets in the Health Service. He believed that the majority of audit findings regarding asset management were mainly caused by the negligence of the previous West Lombok District's employees and officials who were responsible for managing and administering the assets. Their ignorance had resulted in an inaccurate assets database, which made the efforts to safeguard local government's assets more complicated. In the end, non-compliance such as the failure to possess valid and proper legal ownership evidence of the assets or assets being listed as missing were frequent problems that were found and disclosed in BPK's audit reports. The implication of ignorance among West Lombok District's employees in the past

put pressure on him, as the current assets administrator in the Health Service, to find a solution for improving asset management in his unit, especially to rectify any inaccuracies in the assets database.

Sometimes ignorance of PFM operations in West Lombok District can also be attributed to employees' unwillingness to learn any PFM-related rules, regulations and procedures that are relevant to their roles and responsibilities. A staff member in DPPKD explicitly stated that he rarely opens and reads the standard booklet that provides detailed guidelines and information regarding his duties due to its thickness and large size. He further argued that the problems that are present in the financial management processes might be caused by employees' negligence and reluctance to learn the guidelines. In other units, especially in the units that have responsibilities for providing services directly to the public, there is a tendency among their employees to disregard any regulations and procedures regarding financial management and administrative matters. They certainly know how to perform their roles and execute their main activities in delivering the services to the public and community. However, they often neglect the financial management implications of their activities. One of the division heads in the Health Service admits his staff's ignorance of financial administration matters by commenting:

"I could say that often we underestimated our job. Maybe the job was only to record [financial] transactions for example. It happened a lot in the public health centre – we didn't promptly record our activity or our [financial] transaction. We kept delaying to record it and suddenly we forgot about it. As a result, it became an audit finding." (R#45, Q#498)

Employees' unwillingness to learn and understand PFM operational rules, regulations, procedures and standards certainly increases the risk of non-compliance in PFM operational processes in West Lombok District. In the local revenue collection process, a number of bank accounts had been used to deposit revenues collected from local taxes, without proper authorisation from the Regent as required by the PFM regulations. This problem of non-compliance has been reported in BPK's audit findings and, according to the Head of the Treasury Division, the problem was mainly caused by the failure to include those bank accounts into the Regent's Decree in a timely manner. The officials who were responsible for local tax collection activities simply did not know that a proper authorisation from the Regent must be obtained before any bank accounts could be used in PFM operational processes, including the depositing of tax revenue monies.

Another example of ignorance was also highlighted by one of the section heads in the Accounting and Reporting Division who was responsible for the preparation of

consolidated financial statements for West Lombok District. She was upset by the attitude of most officials in West Lombok District who did not have appropriate respect for the accounting processes. In their view, accounting is only seen as the final process in the financial management cycle for the presentation of the end result in the form of a financial statement. She felt that this misleading perception has caused most spending units not to care about accounting and to consider the preparation of a financial statement as the responsibility of the accounting division only.

“I have an expectation that they respect accounting. We all know that accounting is the end of the financial management process. The main feature of accounting is that it has no influence to the implementation of the financial management procedures because it just presents the end result. Nevertheless, because it just presents the end result, accounting is often ignored by most of the spending units.” (R#19, Q#477)

The situation where spending units do not pay attention to the accounting processes can explain the inability of spending units to prepare their own financial statements that will allow the preparation of West Lombok’s financial statement through the consolidation process. As disclosed in BPK’s audit reports, instead of preparing a final financial statement by consolidating financial statements from all spending units, the preparation of the financial statement in West Lombok District was carried out centrally by the Accounting and Reporting Division (BPK 2013a).

Another non-compliance issue in the accounting component that was reported by BPK relates to the failure to maintain valid evidence of financial transactions. This problem could also be caused by the carelessness of the accounting staff in SKPDs to properly archive the relevant documentation. A respondent of this study who worked at the District Secretariat and was responsible for administering documentation regarding procurement processes complained about his own negligence to do a simple task of archiving financial transactional evidence. In this case, he confirms his carelessness by commenting:

“We were worried because some of the findings were caused by our negligence. I feel disappointed that we couldn’t even meet a very simple requirement. There was a case of audit findings where we couldn’t provide the receipt [of a financial transaction] because it was tucked somewhere.” (R#22, Q#489)

In other cases, the ignorance of employees who were involved in PFM operational processes could lead to non-compliance that has a financial impact upon the local government, for example, causing a state loss. A financial administration officer in the Parks and City Interiors Service provided an indication of this issue. She pointed out that inaccuracies in the administration of official travel expenses had caused employees to receive greater travel allowances than they should (R#32). She

admitted that one reason for this non-compliance issue in the past was her carelessness to examine closely the applications for travel expenses from each division. She failed to observe a risk in the official travel planning process where an employee from one division who had been assigned to an official travel duty in his/her division could also be potentially assigned to a different official travel duty in another division at the same time. In other cases, non-compliance in official travel areas involved the attempt by employees to take the advantage for earning more travel allowances by falsifying official travel documents to create fictitious trips (R#27).

Problems of non-compliance as a result of administrative ignorance and personal motives to gain more income from official travel have led to the overpayment of travel allowances in the disbursement process and have resulted in inefficiencies in overall PFM operations in West Lombok District. In BPK's audit report, inefficiency as a result of non-compliant behaviour is classified as a state loss. BPK recommends that the individuals who receive ineligible travel allowances must return the overpaid amount to the local government's bank accounts. In most cases, overpayment of travel allowances that are disclosed in BPK's audit findings would be required to be returned soon after it has been verified that the regulations have been violated and the amount of state losses have been validated by the State Losses Board. Follow-up on BPK's recommendation for requesting the individuals to return the money seems to be very well executed in West Lombok District.

A section head in the Parks and City Interiors Service confirms the effective follow-up action by commenting:

“According to BPK's audit report, you have caused a 10 million rupiah state loss. How would you resolve it? He said that it would be returned, then the money was returned. Often, our employees here were just trying their luck. If it has been declared that they have violated the rules and have caused state losses, they would return the money.” (R#27, Q#457)

While the interview data does provide evidence of how the employees' carelessness in the management of official travel has caused overpayment of travel allowances, the similar carelessness of employees and officials could also be blamed for other expense overpayment problems such as in the area of grants/social funds management and volume shortages in construction work.

7.3.1.6. Control Mechanism

The establishment of a proper internal control mechanism for monitoring and direct supervision of actions by immediate superiors is important for reducing the risk of individual employees to remain ignorant or to take advantage of others' ignorance at

the expense of the organisation. The effectiveness of direct supervision by an immediate supervisor was mentioned by a respondent who served as section head in the Public Works Service when she said that:

"[...] although I have a clear job description, sometimes I forget and neglect to adhere to it. So, I am very happy to have a boss who has detailed records about my performance. He keeps reminding me to follow the guidance, to achieve the target and to set priorities on the tasks that I need to accomplish. I am really glad about that. It prevents me from committing any mistakes [at work]." (R#47, Q#500)

The importance of direct supervision and control by a superior, as part of the internal control system to effectively prevent non-compliant behaviours among PFM actors, was also highlighted by the Head of DPPKD who was responsible for managing and administering the overall PFM operations in West Lombok District. He specifically commented that:

"If the internal control system works, God willing, it will support compliant practices from our employees. Compliance could not be achieved if the bureaucratic process through an internal control system was not taking place. Why do we have a section head if he/she does not perform proper supervisory activities against his/her staff?" (R#1, Q#964)

Discussion in the previous sections has been dominated by the presence of self-interested motives among public employees who are involved in PFM operational processes and how these motives allow PFM actors to commit non-compliant behaviours, causing inefficiencies in the overall PFM operations in West Lombok District. Lack of an adequate incentives system and effective control mechanism seem to have allowed PFM actors in West Lombok District to pursue their self-interested motives. The findings discussed in this section, so far, support the proposition derived from the political economy perspective of a public bureaucracy theory, which assumes that the behaviour of individual public employees is influenced by their needs to fulfil their rational self-interested motives. From this perspective, to ensure the behaviour of individual public employees is consistent with the behaviour stipulated in rules and regulations, public organisations have to establish an effective incentives system and a proper control mechanism (Beetham 1996; Downs 1967).

7.3.2. Public-interested Motives

Other than from self-interested motives, non-compliance could also emerge as a result of employees' efforts to prioritise service delivery to the public. In this case, public-interested motives may have driven the employees to deviate from the requirements already stipulated in the regulations in order to better serve the public. These typical non-compliance problems are commonly found in local government

units that deliver services directly to the community. One example is the direct use of local revenues within a particular local government unit to finance its own operational expenses for carrying out its service delivery functions. In West Lombok District, this non-compliant practice of direct use of revenues has been reported in BPK's audit reports on a number of local government units including the Education and Cultural Service, the Health Service, the Population and Civil Registration Service, the Forestry Service, the DPPKD, and the Parks and City Interiors Service (BPK 2009; 2010a; 2011b; 2012; 2013a; 2014b). Another example is found in the local revenue collection processes when receiving treasurers do not deposit the collected local revenue amounts to the local treasury bank accounts in a timely manner, according to the provision stipulated in the Regent Regulation. Both instances are further discussed in the following two subsections.

7.3.2.1. Rules Preventing Timely Public Service Delivery

Complex, bureaucratic and time-consuming processes of certain budget mechanisms are often considered as the main reasons that cause local government units to directly use their collected local revenues to finance their operational expenses for providing public services. They do not want the complexity of the budget mechanism for paying operational expenses to prevent them from providing timely, efficient and effective public service deliveries. Comments from respondents of this study who worked in the Health Service provide evidence to support this point of view. They criticise the requirement to follow the budget mechanism for the disbursement of expenses related to the provision of health services to the community and view the requirement as the main obstacle for them to provide better health service to the public. One of the respondents, who was a division head in the Health Service, mentions this complexity by stating that:

“Under the Minister of Home Affairs’ regulations, the administration of public health care centre revenues must follow the budget mechanism. Our revenue [from providing health services to the public] must be transferred to the local government bank account. The revenue monies can't be directly used [to pay our expenses related to the provision of health services]. After we ask for reimbursement, we then can spend it to pay our expenses. The time span from when the revenue was received until it is actually spent [to pay our expenses] was quite long. Such bureaucratic procedures are quite complicated to follow.”
(R#41, Q#634)

Further, on a specific occasion in 2015 when the interview was conducted, he mentioned that the total revenues from public health care centres across the District for the first semester (e.g. until June 2015) had not been fully reimbursed to the centres (R#41, Q#635). The District had only reimbursed the revenues from January

and February 2015. Such a situation complicates the financial administration of public health care centres because they need to immediately cover their operational expenses such as fees for the doctors and paramedics and the costs of purchasing medicines, medical equipment and other medical consumables.

The pressure to maintain the level of health service delivery to the public while, at the same time, facing the rigid reimbursement process of the operational budget has forced officials within the Health Service to violate the rules by directly using its own revenues to finance its operational expenses. Such non-compliant practices, in fact, provide flexibility for them to continue providing health services to the community without being impeded by the bureaucratic process of the operational budget reimbursement processes. However, allowing such practices in the actual delivery of health services jeopardises the accountability of, and control over, the overall financial management of the Health Service. The typical tension in a public bureaucracy between having flexibility in the actual practice of its service delivery and maintaining an adequate public accountability level has resulted in a policy to upgrade the status of public health care centres across West Lombok District. In 2015, after being assessed thoroughly, the status of all public health care centres in West Lombok District had been changed into BLUs, despite several recommendations from the assessment committee still have to be followed up (Pemkab Lombok Barat 2015). Under the BLU model, local government units that provide services to the public are given the authority to manage their own financial affairs and administration, including the ability to directly utilise their own revenue to cover their expenses, hence improving their flexibility in service provision. However, they still need to consolidate their annual financial statements into the District's annual financial report.

7.3.2.2. Rules That Do Not Support Efficient Practices

Another situation to emerge from this study, in which public-interested motives potentially have driven non-compliant behaviour, is when the requirement stipulated in regulations has not been efficient in its actual practice. The collection process for local revenues including taxes and levies, especially in remote areas across West Lombok District, which still maintains manual cash collection provides an example to this non-compliance problem. To accommodate the remoteness and lack of transportation and communication media, West Lombok District has allowed the receiving treasurer in some rural areas to deposit the collected local revenue monies into the local government's bank account within two days after the collection date, rather than the 24 hours that is stipulated in the PFM regulation. Nevertheless, there

were instances where receiving treasurers did not follow the rules to deposit the collected revenue monies within the specified timeline. This reluctance to follow the rules in the revenue collection process was also highlighted by a respondent from the Investment and Licensing Agency, who used to be a receiving treasurer in a remote area, in his comment that *“it was just a little bit bothering and not efficient if we have to deposit only 300 or 400 thousand rupiahs³⁷ of the revenue monies. The bank is also quite far from here. I see [that] the regulation is too rigid and is not flexible”*. (R#17, Q#619). He further mentioned that he often delayed depositing the monies for a few days even though he knew that it was not permitted. He defended his practice by commenting that it could improve the efficiency of the revenue collection task because he did not need to frequently visit the bank to deposit very small amounts of revenue monies.

Problems of non-compliance that are a result of employees' public-interested motives do not occur frequently, especially in the main scope of this study, that is the financial management and administration of a local government. Interviews with the respondents of this study displayed the occurrence of this kind of non-compliance problem only on the two examples mentioned above (e.g. the direct use of local revenue and the delay in depositing revenue monies). Those two non-compliance problems were driven by the perspectives of the respondents about the rigidity of rules that hindered them from being more responsive to the public's needs and from being more efficient in accomplishing their tasks.

The nature of BPK's audit findings that focused on the negative consequences of non-compliant behaviour, such as causing state losses, inefficiency and ineffectiveness, has also prevented the identification of non-compliant behaviour among PFM actors that are driven by public-interested motives. Lack of identification, in BPK's audit findings, of non-compliant behaviours that have the potential for positive impacts upon PFM operational processes has limited this case study to further examine the influences of those public-interested motives on the non-compliant behaviours of employees.

7.4. Chapter Summary

This chapter has discussed the general perspectives of the PFM actors in West Lombok District about the PFM objectives. It also has identified the PFM actors'

³⁷ Approximately equal to A\$30 to A\$40.

motives in carrying out their official duties and analysed the roles and influences of those motives to their inclination to be involved in non-compliance.

In general, this chapter has shown that the PFM actors in West Lombok District possess adequate understanding about the objectives of the PFM operations, which places compliance with rules and regulations as the main objectives of the PFM, along with other objectives of economy, efficiency, effectiveness, transparency, equity and ethics. It has also revealed the variety of PFM actors' motives in the workplace, ranging from a simple financial-related, self-interested motive to a more community service-oriented, public-interested motive. Further, it has been shown that both self-interested and public-interested motives can facilitate PFM actors to commit non-compliant acts and contribute to PFM operational problems. Lack of an adequate incentives system and effective control mechanism seemed to have allowed PFM actors who were motivated by their self-interested motives to be involved in non-compliance. For PFM actors who possessed a public-interested motive, their involvement in non-compliant behaviour was mainly triggered by their perspective about the rigidity of rules that hindered them from being more responsive to the public's needs and from being more efficient in accomplishing their tasks.

Chapter 8 continues the discussion regarding shortcomings in the bureaucratic structures of West Lombok District's PFM operational practices, which is another theme that emerged from this study that also facilitates the PFM actors to commit non-compliant acts.

Chapter 8

Case Study (Part III): Bureaucratic Structures and Non-Compliance in PFM Operations

The discussion in the previous chapter has focused on the personal motives of PFM actors in West Lombok District and how those motives could have influenced them to commit non-compliant behaviours that triggered the emergence of the systemic weaknesses disclosed in BPK's audit reports. In addition to the personal motivation of PFM actors, this study also reveals another theme – the shortcomings in bureaucratic structure – which has allowed the PFM actors in West Lombok District to breach the rules and regulations while exercising their PFM operational duties.

The first section of this chapter investigates the shortcomings in the qualities of the PFM operational rules and regulations that have influenced the enthusiasm, knowledge and ability of PFM actors to comply with those rules and regulations. In the second section, the impact of dysfunctional vertical and horizontal divisions of labour arrangements in PFM operations upon non-compliance is elaborated and discussed. Meanwhile, the third section explores the conditions whereby human resources management practices have failed to actualise another prominent feature of bureaucracy: the establishment of expertise among the employees. In addition to the three major sections on bureaucratic structures, the last section of this chapter discusses the influences of parties external to West Lombok District in relation to the problems of non-compliance in its PFM operations.

8.1. Ineffectiveness of Rules

The impersonal nature of a bureaucracy is characterised by over-reliance on the application of rules and regulations to force the actions of its members toward specific behaviours in order to attain its objectives. PFM operations in West Lombok District, and also in all other local governments within Indonesia, certainly meet this criterion. Appendix 1 listed rules and regulations that govern the operational components of PFM, confirming the presence of impersonal character of bureaucracy in PFM operations within local governments in Indonesia. Other than the major organic PFM laws, numerous rules and regulations are also set by the central government in the form of government regulations and presidential regulations. More detailed guidance is also provided by the Ministry of Home Affairs, which plays a very significant role in the arrangement of PFM operations within local governments in Indonesia. At local

government level, local regulations together with the head of local government decrees further regulate the PFM operational processes. SOPs are also applied to each specific process across the operational components of PFM in every local government unit.

In general, including at local government level, Indonesia has a proper and adequate PFM legal framework (World Bank 2007; 2012). Some respondents of this study, especially those who were at higher echelon levels confirmed the adequacy of the PFM rules and regulations in the context of local government. They believed that the current PFM rules and regulations support the establishment of good financial management in local governments. Therefore, efforts from the PFM actors to comply with those rules and regulations could assist the attainment of the PFM objectives. The Head of DPPKD specified his point of view regarding the adequacy of PFM rules by commenting:

“So the rules have been established to [ensure] good financial management. Now, we all strive to make financial management in accordance with the mechanism, in accordance with the procedure, and in accordance with the rules. When this is done, this will inevitably generate good financial management. As we follow the rules, automatically the financial management objectives will be achieved.” (R#1, Q#573 and Q#574)

Nevertheless, at the implementation level, several issues have emerged that inhibit the PFM actors from fully complying with PFM rules and regulations. These issues deal with the qualities of the rules and regulations that make them ineffective in influencing and directing the behaviours of the PFM actors to comply with the requirements.

8.1.1. Contradictory Rules

One of the major problems that have led to the ineffectiveness of rules deals with the contradictory regulations set by central government, especially in relation to accounting and financial reporting processes. Respondents who were involved in accounting and financial reporting processes frequently mentioned the differences between the requirements stipulated in the Permendagri and the GAS in regard to the presentation of financial statements. A section head in the DPPKD highlighted this contradiction by mentioning:

“[...] regulations for the preparation of financial statements are also ambiguous. To date (i.e. 2015), there are two [versions of the] financial statements. One refers to the Permendagri and the other one refers to the Government Accounting Standard. The report [sent] to the Ministry of Home Affairs conforms to the code of accounts in budgeting. [While] the financial report that refers to the accounting standard fulfils the requirements stated in the public finance laws

and has to be reported to the Ministry of Finance and be audited by BPK.”
(R#08, Q#584)

The overlapping roles of the MoHA and the Ministry of Finance in regard to local governments' financial management have resulted in some confusion among local governments' PFM actors. The Head of Accounting and Reporting Division raised her concerns regarding this issue. She viewed that the involvement of the MoHA in local government financial management has differentiated the arrangements for budgeting and financial reporting between local governments and central government agencies. It also has contributed to ambiguity in terms of which central government authority has the primary responsibility for local government financial management. To overcome this ambiguity, her preference would be for local government financial management to follow the regulations stipulated by the Ministry of Finance, which represent the derivative regulations of the trilogy of PFM laws and have been implemented adequately throughout central government agencies (R#13, Q#589). This choice is supported by the quality of financial management at central government level after the reform in 2004, which surpasses that of local governments³⁸. The MoHA, on the other hand, should focus only on administrative matters of local governments. An accounting staff member in West Lombok District, however, explained that contradictions in the regulations for the preparation and presentation of financial reports relate to minor differences in the classification of accounts. Nevertheless, that has impacted upon the way she carried out her duties because of the need to present two different reports for the same financial transactions, hence increasing the risk of misstatement of financial information in the financial reports.

8.1.2. Misinterpretation of Rules

Other than ambiguity in regard to the procedures for the preparation and presentation of financial information in financial statements, misinterpretation of the requirements stipulated in the rules and regulations that govern local government's PFM operations was also mentioned by a number of respondents of this study. Failure to correctly interpret the rules and regulations increases the risk of non-compliance among the PFM actors. In most cases, misinterpretation emerges from the absence of more detailed rules in the form of local government regulations, SOPs and other technical guidelines, which allow each PFM actor to have a different interpretation of how to implement the PFM rules (R#36). One of the accounting staff in DPPKD lamented the

³⁸ For financial year 2014, the percentage of central government agencies that achieved an “unqualified” auditor opinion for their financial statements was 70.93%; while the percentage of local governments achieving that was only 46.75% (BPK 2015b).

lack of initiatives from West Lombok District to establish more detailed PFM operational rules even though, in the decentralisation era, local governments are being given the authority to develop policy for their own regions, including for PFM operations. He stipulated his disappointment by stating that:

“In the midst of [this] regional autonomy era local governments are given the authority to make policy for their regions; still we didn't dare to take the initiatives [...] Rules which haven't been made are rules which are based on local government initiatives. It means initiatives to develop rules which could facilitate the work without waiting for any instruction from the legislation. Local government may prepare its own local regulation to simplify the processes. This kind of initiative still can't be seen here.” (R#12, Q#675 and Q#677)

In an extreme situation, the absence of more detailed regulations inhibits PFM actors from gaining knowledge of how to properly implement the PFM rules. However, well-established detailed rules may also result in the same outcome because they do not necessarily guarantee proper comprehension among the PFM actors regarding the requirements stipulated in the rules. One factor that has emerged from the respondents' comments in regard to the inability of well-established and detailed PFM operational rules to be properly followed by the PFM actors is the failure to effectively disseminate those rules to all relevant units and PFM actors, thereby increasing the risk of PFM actors misinterpreting the rules while conducting their duties. In asset management, for example, the stipulation of a local regulation regarding asset management in 2012 was not followed by a proper dissemination of the regulation. A section head in the Office of Local Assets commented on this problem by stating:

“Efforts to disseminate the requirement for all local government units to report their assets [to the Office of Local Assets] periodically, to propose asset write-offs, and to conduct physical stock-taking were not performed adequately. Hence, units didn't know what to do [in regard to their asset management responsibilities]. They didn't know where to submit the report. That was the main reason. In addition, local government didn't have a system for administering the assets, causing its units to not report their assets.” (R#40, Q#739 and Q#726)

SOPs in regard to schools' financial management and administration, to give another example, were not adequately disseminated due to the very large geographical area of West Lombok District constraining heads of schools and relevant schools' financial administrators from attending any dissemination sessions of SOPs (R#26, Q#738). There were also cases when the dissemination of rules, regulations and SOPs was ineffective because they missed the targeted audiences. The PFM actors who were affected by those rules, regulations and SOPs did not receive invitations and, thereby, failed to attend the dissemination sessions (R#14, Q#846). Dissemination of PFM-related regulations in the paper form was also not effective. In many cases, the distribution of regulations in paper form, as an attachment to an official letter to the

heads of local government units, remained stuck on their desks (R#8, Q#770). They might have been busy and simply forgot to forward the regulations to the relevant divisions, sections or individual employees within the unit. As a result, relevant PFM actors may not have read or even known about the existence of certain regulations that were relevant to their roles and functions. Another factor that has contributed to the difficulty of effectively disseminating the regulations is the mobility of the employees due to the nature of their responsibilities. In the Health Service, for example, one of the section heads mentioned this factor by commenting:

“I found the difficult part was the dissemination [of the regulation]. Once the new regulation is issued, we have to disseminate it to our employees. Equal dissemination to all employees is something which can't be ascertained. Our employees are also often outside their offices because of having external activities.” (R#42, Q#595)

In another case, as already discussed in Chapter 7, misinterpretation of rules may come from a lack of understanding among the PFM actors due to their unwillingness to learn the relevant directions and instructions provided in the rules, regulations, SOPs and other technical guidelines before they carry out their duties and responsibilities in PFM operations. A staff member in the Accounting and Reporting Division admitted her reluctance to read and learn the guidelines by stating, *“I rarely read the guidelines; very rarely. [Usually] I just asked my superior if there was any problem and I need any clarification on what I should do”* (R#03, Q#731).

8.1.3. Defective Rules

The ineffectiveness of rules is also indicated by the failure of the PFM actors to gain correct interpretations of the rules and regulations simply because they are unclear, causing potential multi-interpretations of rules among the PFM actors. An echelon III in the Parks and City Interiors Service highlighted this theme as one of the factors that inhibits his staff from appropriately conducting their duties according to the intended objectives of the rules. He mentioned that:

“If rules and regulations were made properly, automatically we could ensure that they (e.g. my staff) were doing their job appropriately. But some rules were unclear; there would be different interpretations and perceptions in their implementation. That inhibited us from moving forward.” (R#36, Q#608)

A section head in the Public Works Service also mentioned his experience, in regard to the presence of multi-interpretations of rules in the disbursement process, when he submitted documentation to the local treasurer for processing payment to a third party for completion of a construction project. He believed that he had properly interpreted the requirements stipulated in the relevant rules for the submission of such payment

requests. However, frequently he had to make amendments because the local treasury staff found that his payment requests did not comply with the regulations. Specifically he commented that:

“Interpretations can be different because each division has a different perspective. I found this situation quite often even though we have read the regulations again and again. We submitted a payment request to the local treasury, but they returned it back to us because of different interpretations between us in regard to payment request guidance and procedures. So we have to carefully check our [payment] request before we have any problems.” (R#46, Q#613)

Multi-interpretation of rules displays an inherent defect in the rules and regulations, which leads to non-compliant actions as a result of the failure of the PFM actors to correctly interpret the rules according to their intended objectives. In another example, the inappropriateness of SOPs for the actual situation is an indication of defective rules because it would be difficult for the PFM actors to adjust their practices to the requirements stipulated in the SOPs. A section head in the DPPKD who was responsible for the local tax revenue collection process mentioned, *“Indeed, we could still find weaknesses in our SOPs in the sense that SOPs do not reflect the actual situation we face. Consequently, they cannot be properly followed and executed.”* (R#10, Q#740)

Other than revealing a number of problems that display the shortcomings of PFM rules and regulations, which have led to their improper implementation, responses from respondents of this study also highlighted one positive finding in relation to the approach for improving the compliance of PFM operations with relevant PFM rules and regulations. The positive finding occurred in the accounting and financial reporting component of PFM operations and was triggered by the adoption of information technology within the accounting processes.

Before 2013, there was no effective accounting information system for West Lombok District to use in the preparation process of its financial statements. The financial statement processes were carried out centrally and manually by the Accounting and Reporting Division. The financial statement of West Lombok District did not come out of a consolidation process from each local government unit’s financial statement; instead, each unit was required to submit all financial transaction evidence to the Accounting and Reporting Division. As time went by, with assistance from a proper FMIS, West Lombok District gradually improved the way it managed its accounting and financial reporting practices.

Since 2013, West Lombok District has adopted *Sistem Informasi Manajemen Daerah* (SIMDA)³⁹ for its FMIS (R#24, Q#656). This has not only helped the accounting staff across local government units to record financial transactions and prepare financial reports, but has also established better controls in other PFM operational components. In the disbursement process, SIMDA rejects any payment authorisation requests that would exceed the budget ceilings (R#02, Q#640). Via the payment method of bank transfer, SIMDA enables cashless payment transactions by the disbursing treasurers, reducing the risk of unauthorised use of money by the treasurers (R#20, Q#654). In asset management, SIMDA has effectively assisted the Office of Local Assets to develop an accurate record and database of the District's assets (R#44, Q#658). In the accounting process, SIMDA has allowed timely reconciliation procedures throughout the year, improving the accuracy of accounting data and information (R#14, Q#645). One of the accounting staff in DPPKD convincingly concluded that "*SIMDA has forced us to comply with regulations. That's the benefit of having SIMDA. It can also cut off the opportunities for any non-compliant behaviour*" (R#5, Q#643 and Q#644). According to BPKP (2016), SIMDA has been designed in accordance with central government PFM laws and regulations that are relevant for local government. Hence, the proper adoption and implementation of SIMDA is expected to improve local government's compliance with those rules and regulations.

8.2. Dysfunctions in Division of Labour

Apart from the shortcomings in rules as the rational legal authority instrument, another major feature of a bureaucratic organization in the PFM operations, the division of labour arrangements, has also suffered from a number of drawbacks. In this study, the drawbacks in division of labour have emerged both vertically, along the hierarchy, and horizontally, among the units.

³⁹ SIMDA or *Sistem Informasi Manajemen Daerah* is an application that is adopted by West Lombok District for its financial management and information system to assist the accounting process and the preparation of financial statements. There are two FMIS applications that are available for local governments in Indonesia: (1) SIPKD and (2) SIMDA. While SIPKD is developed and maintained by the Directorate General of Local Government Financial Management within the MoHA, SIMDA is developed and maintained by BPKP (*Badan Pengawasan Keuangan dan Pembangunan*) or the Development and Financial Supervisory Agency, a presidential unit that has the task of supervising the national development program and financial management of central and local governments. About 78.41% of local governments have adopted SIMDA as their FMIS, while the rest are using SIPKD (BPKP 2016).

8.2.1. Personal Loyalty to Superior

A hierarchical structure that represents vertical division of labour in a bureaucracy requires superiors to give commands and instructions to their subordinates, while subordinates have to obey the instructions from their superiors (Blau and Meyer 1987). This study has uncovered a strong commitment among the PFM actors to be loyal to their superiors by following their orders. A staff member in the DPPKD mentioned that he maintains a loyalty to his superior and always attempts to carry out his duties scrupulously to secure his position in the workplace (R#5, Q#137). A member of the procurement committee in the Public Works Service specifically emphasised the requirement for public employees to be loyal to their superior by commenting “[...] as a civil servant, we don't have other options except to be loyal to the policies and instructions from our leader. If we don't, we'd better resign [from the public sector].” (R#38, Q#112)

A strong personal loyalty to superiors, however, does not necessarily increase the level of compliance with the organisational rules or ensure the achievement of the organisational objectives. The impersonal nature of the authority attached to the superiors, which limits the provision of commands and instructions from the superior only to matters that are relevant to their official functions in the organisation (Blau and Meyer 1987), does not always exist in actual practice. Superiors may give instructions that deviate from the rules and fall outside their institutional functions that have been established for them. In such situations, the existence of personal loyalty to a superior among subordinates may potentially spoil the normative function of a hierarchy to efficiently deliver the rational-legal authority mandate. Instead, a hierarchy may contain ingrained non-compliance problems that can emerge when those who are in the higher hierarchical levels have a lack of concern for the interests of the organisation. One comment from a respondent of this study, a section head in the Public Works Service, provides an illustration of the inherent non-compliance risks when subordinates have a significant level of personal loyalty to their superiors. She mentioned that:

“If the head of agency had supported and agreed to accommodate a request from the parliament, for example, I had only one option, which is to follow his decision because I am just a subordinate. When our leader at the top has asked me, I know that he has already considered a lot of factors before he made the decision. I don't know and I don't need to know what his consideration is. But, the decision certainly changed the budget layout and it happened frequently.”
(R#47, Q#141)

Interestingly, from the perspective of the PFM actors who hold higher hierarchical positions, there is no desire from themselves to force their subordinates to be loyal to every single instruction from them. For example, an echelon III officer at the District Secretariat expressed the importance of adhering to the rules and always asks subordinates to examine the appropriateness of any instructions from their superiors to the applicable rules, procedures and mechanisms. In great detail he specifies that:

First, we have to do our job according to the rules. That's the most important one. We must know the rules. If our boss proposes to do a certain thing, we must study it. We should examine whether the proposal is allowed or not allowed. Then, we report it to him according to the applicable mechanism. If it is allowed, it is clearly stated that the proposal is okay. But if it is not allowed, we must reject the proposal. We are working by a system where the mechanisms and regulations inside the system are the important things to adhere to. We shouldn't break any rules or regulations in our work. Compliance to the regulations, in my opinion, is very important.” (R#39, Q#114)

Another respondent, a higher level officer who held echelon II position in the District Secretariat, also articulated his demand to every subordinate to challenge any instruction from their superiors that seems to be irrelevant and not to comply with the rules and regulations. He specifically mentions that:

“[...] in our work, especially with the boss, do not always justify what he said. Any disagreement with the boss shouldn't always be interpreted as disloyalty. What we must do is to tell the truth to him, to let him know what the rules are. Our boss is also a human being who has limitations and can make any mistakes. It is just coincidental that he currently has a position as our superior.” (R#27, Q#100)

The reliance of bureaucracy upon legal instruments has resulted in the importance of establishing loyalty to the organisation, manifested in the form of compliance with the organisational rules and objectives. This organisational loyalty has been acknowledged by Weber as the only type of loyalty that exists in a bureaucratic organisation as a rational attitude to buttress the hierarchy and to establish expertise (Souryal 2011). Yet, in the workplace, Souryal and McKay (1996) have identified personal loyalty to superiors as another type of loyalty that is commonly found in an organisation.

Personal loyalty to superiors is defined as *“the unspoken actions, words, or signals by subordinates to submit to the person of superiors, rather than to the organization they serve [...]”* (Souryal 2011, 122). According to Souryal (2011), personal loyalty to superiors generates a dysfunctional hierarchical system within the bureaucracy. It emerges from the assumption held by subordinates that the display of personal loyalty to their superiors may secure their future careers. Personal loyalty to a superior can generate a significant deviation from the normative function of a public bureaucracy

within the society. It has potential to diminish the occurrence of every member of bureaucracy, regardless of rank or status within the hierarchy, performing their duties according to the rules, regulations and work standards. Hence, personal loyalty to superiors may predispose employees to be non-compliant in the actual performance of their duties.

8.2.2. Silo Mentality

In regard to the horizontal division of labour, the separation of employees through departmentalisation within a bureaucratic organisation aims to establish specialisation and to develop expertise among the employees. Nevertheless, it also comes with a potential negative side-effect when the employees tend to think and work in a silo. They may narrow their focus on their own department or unit, allowing the occurrence of non-compliance if they neglect the attainment of the overall objectives of the organisation.

One of the negative outcomes of this silo mentality that has emerged from this study is the phenomenon where there is a lack of coordination and communication among the relevant units of the organization. Often, in the planning stage of a program or activity within a spending unit, there is no communication between the functional section that exercises the actual activity and the finance section that prepares the cash disbursement plan. A respondent who worked in the finance section of the Education and Cultural Service illustrated this problem by highlighting the unsynchronised planning of an activity when, for example, the actual activity is scheduled to be exercised in the first quarter but the disbursement plan shows that the schedule for cash disbursement of that specific activity is in the third quarter (R#24, Q#537). He also mentioned a frequent practice in West Lombok District whereby the cash disbursement plans allocate the budget outflows equally for every quarter and do not reflect the implementation schedules of the programs and activities (R#23, Q#528). This typical, unsynchronised practice in the planning stage of a program or activity displays the lack of communication and coordination among the relevant units and could potentially disrupt the implementation of the program or activity. The money required to fund the program might not be available when the program is scheduled to be implemented. A section head in the Education and Cultural Service, who worked in the finance section and was involved in the disbursement process, often received complaints from the employees who worked in the functional units about why the money was not available to enable them to exercise their programs. They did not understand that the problem was actually caused by their

own lack of planning, resulting such an unsynchronized cash disbursement. She illustrated the situation by commenting:

“When they started the activity and found the problem, they always blamed the finance unit. They didn't want to understand the situation and the inconsistency between the schedule of the activity and the cash disbursement plan.” (R#23, Q#536)

Another case that illustrates this lack of coordination and communication also occurred in treasury management. The implementation of the TSA system as part of the treasury's function has resulted in the requirement for all local government units to report the bank accounts that are used in their operations to the Local Treasurer. Nevertheless, there was an instance where the lack of coordination and communication between spending units and the Financial Management Division, that managed the overall treasury function within West Lombok District, had caused a number of bank accounts used in the PFM operational process not to be recognised as West Lombok District's official bank accounts (BPK 2013a). In a specific case, the Health Service had notified the Financial Management Division regarding the use of certain bank accounts for handling its health care services revenue. However, the Financial Management Division failed to include those bank accounts in the Regent Decree as official bank accounts of West Lombok District. As a result, the Bank was not aware that those accounts were used by a government institution and, hence, treated them as personal accounts, imposing tax on the interest incomes derived from those accounts. This condition does not comply with the provision stipulated in Law 36/2008 regarding Income Tax. Article 2.3.b of Law 36/2008 specifically stipulates that government units, which are established by government's rules and regulations, are financed by the government's budget, report their income in the government's budget and are subject to government auditing, are exempt from income taxes requirements. The response from the Head of the Financial Management Division, who was also one of the respondents of this study, regarding this non-compliance issue, was to point out that the focus of his staff on their own work had resulted in failure to maintain adequate coordination and communication with other units. He simply stated that *“[...] maybe there was lack of coordination and communication. Each one of us was too busy with our own work and forgot to follow up on those things.” (R#09, Q#535).*

In another PFM operational area – the accounting and financial reporting process – the silo mentality has resulted in the perception among the spending units that the responsibility to maintain proper accounting practices and to prepare a fair financial statement is the responsibility of the accounting and financial management unit only.

Most of the spending units focus on their technical responsibilities for delivering public goods and services and neglect their other responsibility to properly manage their financial affairs. The spending units are not aware that their silo mindset has created issues and problems in the Accounting and Reporting Division. Mistakes from spending units, such as slow reporting and frequent errors in their reports, most often are accumulative and culminate in the Accounting and Reporting Division (R#12, Q#544) threatening the overall quality of West Lombok District's financial statements⁴⁰.

A similar silo attitude among the employees in the Accounting and Reporting Division has further complicated the problems. Instead of collaborating and coordinating with other units to formulate solutions to overcome these problems and to improve the overall process of accounting and financial reporting, staff in the Accounting and Reporting Division defend their unit and explicitly blame other units for causing the problems. The Head of the Accounting and Reporting Division displays this silo mentality by commenting that “[...] *accounting is only responsible for recording the transactions based on the evidence we receive. The validity of the evidence is the responsibility of the spending units.*” (R#13, Q#546). She also pointed out that the treasurer in each spending unit is the other party who should be responsible for any inaccurate, inadequate and inappropriate financial transaction evidence. She mentioned that:

“The key is the treasurer. He must accurately administer his financial transactions. Accounting only receives the transactional evidence. [It is the] treasurer who does the examination to ensure the validity of the transaction and the completeness of the documentation.” (R#14, Q#547)

The institutional arrangement of asset management, which is quite similar to that of accounting and financial reporting, also displays a similar silo effect problem. The failure to create and maintain a comprehensive and reliable asset database at the district level has been caused by the attitudes of the spending units that do not consider asset management to be one of their responsibilities. Separation of functions under the division of labour concept has fragmented the understanding of the employees at the spending units regarding asset management. They put more focus on their public service duties and leave the responsibility of asset management to the Office of Local Assets. As a result, spending units have failed to prepare timely, complete and accurate periodical reports regarding assets in their possession,

⁴⁰ See Table 6-3 for the quality of West Lombok District's financial statements, as represented by BPK's audit opinions during the period of this study.

including updating of the assets database (R#40, Q#548). Staff members at the Office of Local Assets have viewed this situation, the lack of timely, complete and accurate assets databases within each spending unit, as a limitation that hinder them to perform their roles optimally for overseeing the overall asset management in West Lombok District (R#40, Q#548). Such a limitation has generated reluctance among the staff at the Office of Local Assets to be more active in collaborating with the spending units to ensure that the organisational objective in asset management, which is to provide and maintain a proper assets database for the whole district, is achieved.

The cases which have been discussed in this section have illustrated the outcomes of a silo mentality, one of the dysfunctions commonly found as a result of horizontal division of labour within a bureaucracy, in the emergence of various PFM operational problems in West Lombok District, especially in cash planning and disbursement, accounting and reporting, and asset management.

8.2.3. High Workload

Another source of non-compliance in PFM operations that has emerged in this study comes from the flawed design of the division of labour in West Lombok District to optimally distribute the workloads to each unit and each employee. It has created an imbalanced distribution of workload whereby employees in one unit may have more work than employees in another unit. Employees who have a low workload may have plenty of time to be meticulous and cautious when carrying out their duties. Other employees view the low workload as an advantage because it provides an opportunity for them to have side jobs outside their official duties as public servants. One of the respondents who worked in the Parks and City Interiors Service mentioned, *"I could not just sit here at the office doing nothing. It is not useful for me to just stay here."* (R#28, Q#239). As a result, he often left the office during office hours, usually from 11 am to 1:30 pm, to perform his side job (R#28, Q#239).

On the other hand, employees at the Public Works Service who are supervisors of construction projects often have an enormous workload. They have a main responsibility to ensure the quality and quantity of construction works. They must closely monitor the projects to avoid any deviation from the plans. They also need to further examine the construction works to ensure that the efficiency and technical specifications of the project are being met in accordance with the contracts. In sum, they have to monitor the overall progress of the projects. These already overwhelming responsibilities of construction project supervisors are further exacerbated by the

common practice of assigning more than one construction project to each supervisor. One of the respondents who was also a member of the procurement committee mentioned that *“often, a supervisor has a lot of construction projects to monitor. He couldn't focus on monitoring [all] the projects, causing delay in the completion of a project.”* (R#38, Q#558).

The assignment of monitoring more than one construction project to a supervisor is not without a valid reason. A scarcity in the number of employees who have adequate and valid certification to fulfil the role of a construction project supervisor has hindered the District in assigning those responsibilities to other employees. As a result, it is quite common for an official in the Public Works Service to have multiple positions. One respondent who was a section head in the Public Work Service highlighted this common practice by stating:

“Honestly, I feel overwhelmed with the workload here. I am working as a planner, a supervisor, and I am also involved in the procurement committee. I am assigned in the procurement committee through a Regent Decree that stated my additional role within the procurement service unit.” (R#47, Q#566)

Hence, it is clear that a heavy workload has hindered the employees from properly executing their roles and duties under the division of labour arrangement. Discussion in the previous paragraph has shown that when construction project supervisors are assigned monitoring tasks beyond their normal capacity, the quality of work is often diminished. In this specific instance, the substandard monitoring work has resulted in delay in project completion.

Another factor that emerges from the analysis of the responses from respondents who worked in the Public Works Service shows the reluctance of supervisors to control and oversee their staff's project monitoring tasks. A comment from a respondent who held an echelon III position and served as a division head in the Public Works Service stated that he was reluctant to oversee the works of the construction project's supervisor. He mentioned that such reluctance had contributed to the frequent volume shortage problems in construction projects. Specific to this instance, he mentioned that:

“Technically, audit findings regarding volume shortage were usually committed by the contractor. Nevertheless, the auditor always warned us and accused us with lack of supervision. In reply, I honestly argued that I didn't closely rebuke my subordinate because their workload had been overloaded with fieldwork supervision work here and there.” (R#48, Q#561)

He further confirmed that the PFM operational problems in construction projects were mostly caused by the intense and demanding workload. He specified that *“[...] based*

on what I have seen and what I have felt so far, I admit that the drawbacks [in construction projects] are because there are too many things to be monitored.” (R#48, Q#562).

A similar scenario where a high volume of workload may diminish the effectiveness of division of labour within a bureaucratic organisation is also displayed in another component of PFM operations in West Lombok District. It is in the disbursement process, especially regarding the roles of the treasury section in the verification process of payment requests. An increase in the volume of payment requests may go beyond the normal capacity of the employees to perform the proper verification procedures. In that situation, mistakes and errors may occur unknowingly. A respondent who worked as the Head of the Treasury Section within the DPPKD admitted the failure of his staff to properly verify the payment orders. He mentioned that:

“[...] probably because there were a lot of documents to be reviewed and verified, they forgot. [...] Often, when we prepared and were about to submit the payment orders for approval, we thought they were all correct. But when we did request the final approval from the general treasurer, the payment orders were returned back to us because they were still some mistakes found”. (R#9, Q#569)

He also mentioned that mistakes may already have been made during the preparation of the payment requests by the spending units (R#9, Q#570). Those mistakes and errors are then accumulated within the treasury section. That creates pressure for the treasury staff because they need to rectify the errors while, at the same time, they are also required to complete the verification process as soon as possible. As a result, in the condition where there is a heavy volume of payment transactions, tiredness and fatigue among the verification staff in the treasury section may result in other errors and mistakes. In one of his comments regarding the issuance of warrants for disbursement of funds, he further illustrated how difficult it was for his staff to carry out a flawless verification process when there is a high volume of transactions.

“It is stated that the warrant disbursement must be issued within 2x24 hour [after a complete payment order submission]. But, was it possible? The documentation is thick and a lot. Yesterday, we had 17 payment order submissions from the Public Works Department in just one single day. All of them should be verified and examined within one day”. (R#09, Q#571)

The above cases of construction projects and disbursement processes show the importance of considering the workload and volume of transactions being allocated to the individual members of a bureaucracy within certain divisions of labour arrangements. In other words, an optimum balance between the division of labour

arrangements and the human resources allocated to carry out the roles and functions attached to those arrangements is required to ensure the functionality and effectiveness of division of labour within any bureaucratic organisation. The failure to establish such optimum balance contributes to the dysfunctional division of labour that, among other things, can lead to a number of problems including non-compliance, as has been shown in the above-mentioned cases.

Other than the dysfunctional division of labour arrangements, this study also revealed a case where West Lombok District introduced an adjustment to its organisational structure to accommodate the increasing workload and volume of transactions in one of its PFM operational components, namely asset management. A lack of asset safeguarding in the form of missing assets, an inaccurate asset database, the absence of adequate legal ownership documentation and inadequate asset transactional recording had been identified as one of the major non-compliance problems in West Lombok District. Concerns about the importance of asset management and wide coverage of the efforts to enhance asset management triggered a major institutional and structural change in West Lombok District. In addition, a substantial number of audit findings regarding asset management that had been disclosed in BPK's audit reports were required to be addressed and followed up appropriately. This situation further increased the volume of work that needed to be handled by asset management.

The structural change that was implemented in 2012 represented an adjustment to the division of labour arrangements for asset management in West Lombok District. Before 2012, asset management throughout West Lombok District was under the authority of DPPKD. A division within the DPPKD was established to carry out the overall asset management functions in West Lombok District (Pemkab Lombok Barat 2008b). However, that arrangement seemed not to be working properly. The inclusion of a local assets division within the DPPKD, which had other important roles, was not effective for overseeing asset management for all local government units. The respondent who held a position as a section head in the current Office of Local Assets specified this inadequate institutional arrangement in the division of labour for asset management as one of the reasons that had contributed to a number of audit findings in asset management. She mentioned that:

"[...] it was because of the institutional arrangement. Previously, assets were managed by a small unit within the DPPKD, which also had other more important roles than only managing the assets. As a result, they couldn't focus on asset management, causing a number of problems in asset management."
(R#40, Q#559)

To enhance its asset management functions, in 2012, West Lombok District reorganised its organisational structure. A new independent unit, the Office of Local Assets, was established to anticipate the increasing workload in asset management functions (R#40, Q#572). Instead of being responsible to other agencies or services, the new independent office was directly responsible to the Regent even though, administratively, the new office is under the authority of the District Secretariat (Pemkab Lombok Barat 2011). This new arrangement has resulted in improvements in asset management in West Lombok District. A staff member in the Health Service who was responsible for administering local assets within the Health Service has confirmed this progress and mentioned that the improved management of assets has enabled West Lombok District to attain an unqualified external auditor opinion in 2015. Specifically, he stated that:

“[...] asset management was previously not well organised. West Lombok District only started to have awareness to improve their asset management in 2012 when we established a new Office of Local Assets. And finally we could get an unqualified audit opinion for the first time this year (i.e. 2015). Now we have begun to improve the governance of our asset management.” (R#44, Q#793)

Findings in this study in relation to the improvement of asset management in West Lombok District highlight the necessity to examine and adjust the division of labour arrangements continuously. Failure to accommodate changes in the processing of financial transactions within the optimum division of labour arrangements may risk the overall effectiveness of division of labour within a bureaucracy. Hence, it can be concluded that division of labour does not need to be implemented in a rigid manner. However, as the division of labour within a bureaucracy is established through the legal instrument of its rules, its flexibility would depend on how the bureaucracy can effectively anticipate any changes in its operations and accommodate those changes into its rules and regulations in a timely manner.

8.3. Failure to Develop Expertise

A derivative feature of bureaucracy from the division of labour principle is the development of expertise among the individual members of the bureaucracy. Expertise, in terms of both the ability to perform functional responsibilities and knowledge about the rules that govern the overall operation of a bureaucratic organisation, would contribute to the effective performance of a member's duties (Blau and Meyer 1987) thereby assisting in achievement of the organisation's goals. Nevertheless, even though the separation of employees through departmentalisation aims to establish specialisations and develop expertise, it does not automatically

result in the attainment of the intended objectives. In addition to division of labour arrangements, the establishment of expertise among the employees also requires proper human resources and personnel management policies. Failure to effectively implement those policies may impair the division of labour arrangement in its development and establishment of employees' expertise.

BPK's audit reports on West Lombok District's financial statements have disclosed a number of issues pertaining to the inadequacy of the human resources management policies in West Lombok District. The audit reports revealed that the placement of personnel across various PFM operational processes, from budgeting to financial reporting, was not adequate. Personnel in the Accounting and Reporting Division, for example, had limitations in terms of their capabilities and competencies to exercise their roles properly, engendering challenges for West Lombok District in its efforts to establish sound financial administration functions (BPK 2014b). West Lombok District also had not prepared extensive descriptions regarding the skills and competency requirements for any positions across its various PFM operational processes (BPK 2013a). The absence of descriptive requirements of employees' skills and competencies to carry out certain PFM operational functions indicated a drawback in the procedures for employees' placement, rotation and promotion because there was no adequate evidence that an employee had been placed in a job position that matched his/her expertise and knowledge (BPK 2013a). Most treasurers, who were responsible for revenue collection, budget disbursement and asset management did not have proper understanding pertaining to their main duties, roles and responsibilities as treasurers (BPK 2013a). In general, BPK had highlighted the failure of West Lombok District to maintain proper human resource management policies and practices, including the lack of clear procedures on employees' recruitment, training, promotion, rotation and payroll, and noted the absence of periodical review of employees' performances (BPK 2013a).

BPK's assessment discussed in the previous paragraph shows that one of the prominent features of bureaucracy, which is the actualisation of expertise among its members, was at risk and potentially not well-established in the PFM operational processes of West Lombok District. Responses from the respondents of this study further confirmed the lack of human resource management policies and practices in West Lombok District for ensuring the capability, skills and competencies of those who were involved in the PFM operational processes and were responsible for them. The following sections discuss a number of themes that emerged from the interviews with respondents of this study and highlight the failure of West Lombok District to

ascertain whether the expertise and competency levels of its PFM actors matched their roles in the PFM operational processes.

8.3.1. Inappropriate Employee Placement Policies

A number of respondents of this study found that they were placed in roles that prevented them from optimally contributing to the overall performance of local government. The genuine public interest motives of public employees do not necessarily result in the fulfilment of public needs if they are not placed in the positions and jobs that match their competencies. An echelon III in the Parks and City Interiors Service describes this circumstance by mentioning:

“So my motivation is to build West Lombok: to improve people's welfare. Unfortunately, often we are placed in the position where we couldn't make an optimal contribution because it doesn't match our capability and educational background.” (R#30, Q#392)

Employee placement practices in West Lombok District have been associated with a failure to consider the employees' competencies, such as their educational background. A section head in the Investment and Licensing Agency highlighted this situation and expressed his personal opinion that factors other than human resources-related matters have been dominating the decisions made by West Lombok District in regard to its employee placement policies. He mentioned that:

“It can be said that staff competency is not considered as the main factor for employees' placement decisions. Maybe, it is only considered about 30% [of the time]; the other 70% are from other factors outside human resources matters. As a result, a lot of staff placements are not in accordance with their educational backgrounds.” (R#17, Q#759)

He further mentions that it is essential for the District to consider educational background as the main factor for decisions regarding placement and rotation of employees. Such considerations may create a positive correlation between the employees' performances in their working units and the establishment of expertise in all local government units. From the perspective of a head of a local government unit, it is also important to ensure that every position in the unit is filled by a competent individual. The Head of Financial Management Division within the DPPKD, for example, urged that the *“financial management functions cannot be filled by just any person because it requires certain skill and competency”*. (R#02, Q#756). A section head in the DPPKD also raised his concern that failure to match the educational background of the employees with their roles in the unit may hinder the overall performance of the unit. Further, he mentioned that employees without relevant educational backgrounds may require more time to understand the nature of their jobs

before they could properly carry out their roles and contribute to the overall performance of the organisation. He specifically addressed this issue by stating that *“sometimes a new employee is placed here, but he doesn't have a financial education background. He must learn hard [before he can perform]. It certainly has an impact on ur performance.”* (R#8, Q#757).

With regard to the findings reported in BPK's audit report, the absence of a clear employee placement policy being implemented in West Lombok District seems to have resulted in the omission of staff competency, including educational background, being one of the major factors that have to be considered by the District as part of its employee placement decisions. In addition to the incongruity of employees' educational backgrounds in respect to their roles and responsibilities in the workplace, a division head in the Parks and City Interiors Service also blamed the personnel policy of West Lombok District, especially after the implementation of the decentralisation policy that tended to lead to more frequent employee rotation, thereby hindering the formation of expertise among the employees. He clearly stated that:

“It was difficult for us and other people to understand and carry out our jobs within a short period of time. Since the implementation of regional autonomy, I found that employees' rotations were almost routinely carried out every year. We didn't have enough time to learn and master our new roles because we were transferred again to different positions. It has constrained us.” (R#30, Q#753)

More frequent employee rotations do have a negative impact on the ability of the employees to develop their knowledge, skills and expertise for exercising their duties in an effective and efficient manner and in compliance with relevant rules and regulations. A division head in the Education and Cultural Service asserted that at least one year of working time in a certain position is required to gain sufficient knowledge and understanding of how to properly carry out the duties attached to that position (R#26, Q#752). Meanwhile, based on his experience, a section head in the Parks and City Interiors Service believed that even one year was not adequate to master a certain job. He mentioned that *“only after three years here, I feel that I can work properly and begin to understand and follow the rules here.”* (R#31, Q#776).

The effort to maintain the expertise level of each employee under the current condition where frequent employee rotations are taking place is also exacerbated by the absence of an adequate knowledge transfer process between the former and the new employee. A section head in the DPPKD raised this argument as one of the reasons for a number of audit findings reported in local tax management. He mentioned that:

“In the past, other than missing documentation and data, the problems in the management of local taxes were also caused by staff rotation. For example, the staff who managed [tax] receivable was transferred to another unit. Ideally, there should be a proper knowledge transfer process when we have a staff rotation. Unfortunately, staff usually only pay attention to their own responsibilities when they are transferred. They don’t care about the needs of their successors who require preliminary information that can help them to understand their duties promptly. Commonly, they only leave their files and documents [without transferring their knowledge on how to properly manage the jobs] to their successors.” (R#7, Q#768)

8.3.2. Lack of Appropriate Promotion System

The lack of proper employee placement practices in West Lombok District seems to also include practices in relation to decision about employees’ promotion. In this study, the presence of a patronage system of promotion has been mentioned by the respondents, despite the implementation of a merit-based promotion system according to the formal human resources policies⁴¹. Mueller (2009) argues that expertise, as one of the basic characteristics of bureaucracy, refers to establishment of a meritocracy system in the civil service and it has been commonly linked to the establishment of efficiency within the organisation. Nevertheless, in actual practice, a patronage system whereby the allocation of positions in the bureaucracy is based on political influences also exists and hinders the establishment of competent civil servants (Huber and Ting 2016). Mueller (2009, 1) specifically mentions that *“patronage-based bureaucrats typically lack the skills, experience and especially the incentives to produce public goods”*.

One respondent who worked as a section head in the Parks and City Interiors Service indicated the presence of patronage practices in relation to employees’ promotion decisions by commenting that *“[...] sometimes promotion involves politics. It has become a phenomenon in every local government as an implication of the implementation of regional autonomy. I think everywhere is also like that.”* (R#35, Q#936). A staff member in the Education and Cultural Service who had been working for thirteen years and was expecting promotion to an echelon IV position also expressed her disappointment. She restated and emphasised a comment from one of the senior officials in West Lombok District who mentioned that employees who did

⁴¹ Law No. 43 Year 1999 regarding Civil Service General Provision stipulates the implementation of a merit-based human resources management policy. It mentions that the appointment of a civil servant to a position should be made based on the principle of professionalism in accordance with the applicant’s competence, performance and seniority as well as other objective considerations. In addition, it also states that to ensure objectivity, employees’ promotions should be decided based on the appraisal of their performances at work. The adoption of the merit system has been further stipulated in Law No. 5 Year 2014 regarding Civil State Apparatus that replaces Law No. 43 Year 1999.

not have any political connection would find it impossible to get promotions in their careers (R#21, Q#933). Meanwhile, an echelon III officer in the Health Service stated that external intervention had made it more difficult for the District Personnel Board to implement a meritocracy system for employees' promotion (R#45, Q#941). He further mentioned that *"[...] politics have affected many personnel management policies including for career advancement and promotion. It diminishes the competencies of our officials and provides us [with] no assurance on our career here."* (R#45, Q#941).

Another theme that was highlighted by the respondents, which challenges the implementation of a merit-based system for employees' promotion, deals with the practice of nepotism. A section head in the Public Works Service discovered that her friend was promoted because he had a relative in the personnel board, despite the fact that he did not exhibit outstanding performance (R#47, Q#948). She also mentioned that one of her other friends was promoted because he had a very close relationship with her own superior, even though he did not perform well at work. An echelon III in the Health Service also highlighted a similar issue by stating, *"It's not what I want, but the general situation here is whoever is close to the boss, they can get a promotion."* (R#46, Q#945).

Despite the presence of patronage and nepotism in employee promotion practices, respondents in this study also specified instances where the District had made employees' promotion decisions based on merit, even though it was not applied consistently and uniformly (R#21, Q#933). An echelon III in the District Secretariat mentioned that *"there are still one or two occasions where people are promoted because of political or personal factors. But nowadays employees who perform well will certainly have a good career."* (R#39, Q#939). This situation shows that there is a growing concern about an individual's capacity in formulating employee promotion policies in West Lombok District (R#47, Q#948).

8.3.3. Problems in Training Activities

Other than the dissemination of PFM rules and regulations, which has been discussed in the previous section as part of the effort to ensure effectiveness of rules, training has also been utilised by West Lombok District as one of the human resource management practices. Training activities are adopted to empower PFM actors with knowledge, skills and competencies that are relevant for exercising their roles and functions in accordance with the requirements stipulated in relevant PFM rules and regulations. This study revealed that respondents who carried out local tax collection processes felt the positive contribution of training in improving their skills and

capabilities. Their participation in a number of training activities assisted them to gain proper understanding about the relevant rules and improved their competencies to better exercise their roles. However, the benefits of training activities were not evenly shared across all local government units in West Lombok District. Constraints in budget allocations for training activities have inhibited equal distribution and effectiveness of training activities in other PFM operational components. A section head in the Investment and Licensing Agency highlighted this situation by commenting:

“Frankly, we hope that local government could at least provide training to support us for carrying out our roles. [However], in my opinion, local government only pays a little attention. They do not allocate a budget for training even though it is important to support our work.” (R#17, Q#827 and Q#847)

From the perspective of lower level employees, the subject matters covered in training sessions sometimes do not match with their actual needs. They feel that training courses are not sufficient to equip them with adequate knowledge and skills because they may cover a very general and broad topic or, in other case, they may be too technical. A staff member in the DPPKD was disappointed with the general topic covered in her training and asked for more time to be spent on training activities to ensure they covered more detailed topics relevant to specific roles and duties. She mentioned, *“We did get training, but the training was insufficient because it was only for one week. It would be better if training can be provided more frequently with more time allocated to the training so it can be very detailed”*. (R#04, Q#840).

In another case, in the specific area of the accounting and financial reporting process, training mostly covered only a very technical detail of SIMDA and failed to empower the PFM actors or provide them with the appropriate skills and knowledge to better exercise their overall roles and functions. A treasurer in the DPPKD mentioned this limitation by stating that *“there was training on how to use SIMDA, but [it was] only limited to the technical application of SIMDA, not specific training about, for example, treasurers' roles and duties.”* (R#20, Q#848).

Problems in the provision of training also exist in the leadership skill training of structural level officials or those who hold echelon positions within the hierarchy. An echelon IV officer who served as a section head in the Public Works Service admitted that she had not attended the level 4 leadership training that is required for all echelon IV officials. She further mentioned that *“there are also a number of other echelon level officers in West Lombok District who have not attended the leadership training relevant to their echelon level positions.”* (R#47, Q#803). In her opinion, the District

Personnel Board lacked attention to the importance of leadership skills. The Board failed to arrange and carry out leadership training for those who had the potential to occupy echelon positions within the organisation. As a result, structural officials were struggling to perform their leadership roles.

For example, the leadership roles of echelon IV officers that should empower their staff to carry out their functions are being spoiled by their reluctance to delegate the work to their subordinates. An echelon IV officer in the Public Works Service further expressed her difficulty in performing her leadership role to improve the capabilities of her subordinates. She preferred to complete tasks by herself and was reluctant to delegate the jobs to her subordinates (R#47, Q#805). She felt that she had not provided adequate supervision and feedback to her subordinates for them to improve their performances (R#47, Q#806). It can be assumed that the District had not provided her with the adequate leadership skills to carry out her leadership functions within the organisation as an echelon IV officer.

Similar to the dissemination of rules, in general, training activities in West Lombok District also suffer from the PFM actors' self-interested motives that led to their ignorant behaviour of not having commitment to improve their own skills, knowledge and competencies. The Head of the Accounting and Reporting Division owned a personal belief that one of the shortcomings hindering the development of expertise among employees in West Lombok District was their unwillingness to learn. A section head in the DPPKD supported this belief by commenting, *"I feel that the awareness and willingness of my colleagues in spending units to improve their knowledge and skills are still lacking. Motivation among my colleagues for that is almost none."* (R#13, Q#845).

8.3.4. Lack of Work Facilities

Other than the inherent characteristics of individual employees, the establishment of expertise among public employees to efficiently and effectively carry out their roles and functions within the organisation is also influenced by external factors in their work facilities. In this study, some respondents found that inadequate office facilities had inhibited them from properly carrying out their duties. In the preparation of financial statements, a staff member in the Accounting and Reporting Division complained that the unreliability of the internet connection in his office, and the obsolete computer and laptop specifications, had prevented him from preparing a timely financial report (R#12, Q#667). A treasurer in the Investment and Licensing Agency also complained about the lack of storage facilities for document archiving,

which resulted in problems of missing transactional evidence (R#16, Q#668). In general, lack of facilities of work was confirmed by a comment from a section head at the Office of Local Assets who stated:

“There are complaints about the facilities at work. There are differences in work facilities from one unit to another. We haven't analysed this issue yet, but several units have complained about their work facilities. There are gaps between the employees' duties and the availability and quality of the work facilities for supporting their roles. From their reports, therefore, we can conclude that a lot of units do not have adequate work facilities that meet the [required] standard.” (R#40, Q#673 and Q#674)

In another PFM operational area, local revenue collection processes, the Parks and City Interiors Service was struggling to achieve its local revenue target from waste management activities due to the limitations of its facilities for waste collection. A staff member in the Parks and City Interiors Service stated that they did not have adequate garbage trucks for waste collection (R#34, Q#671). The trucks were old and, in terms of quantity, were not enough to collect the increasing volume of rubbish across West Lombok. Complaints were frequently received from communities stating their disappointment in regard to delays in waste collection. In most cases, lack of facilities for waste management had diminished the quality of waste collection activities, resulting in reluctance by community members to pay the waste management levies and, thereby, causing difficulty in achieving the revenue target for waste management. To overcome this issue, he further mentioned that:

“We have to improve our facilities so that we can achieve our target. The quantities of [garbage] trucks and levy collectors should be increased. That's all. Because the main problem is in our resources: the equipment and the human resources.” (R#34, Q#672)

8.4. External Parties and Non-Compliance

Other than the public employees' dispositions (as discussed in Chapter 7) and the bureaucratic environment in which the PFM operates (as discussed in the previous sections of this chapter), from the perspective of the PFM actors, there are also situations where the behaviours and the characteristics of other parties external to the organisation could instigate the emergence of non-compliance problems. In this study, some respondents mentioned the influences of local parliament members, contractors, suppliers and NGOs upon a number of non-compliance problems that had occurred in West Lombok District's PFM operations.

While the local parliament members are not necessarily involved in the operational components of PFM, they do have significant and very important roles to play in the budget preparation process. The PFM legal framework stipulates the requirement for

ongoing discussion and consultation between the local government and the local parliament (Gol 2005). This discussion and consultation results in general provisions for the preparation of the local government's annual budget, including the selection of priority programs and the ceiling of the budget. At the end of the budget preparation process, the annual budget proposed by local government must be approved by the local parliament. Following the approval of the annual budget, the local government prepares a budget execution document for each spending unit that details the allocation of the spending unit's budget to a number of programs and activities. One of the respondents in this study, an echelon III in the Investment and Licensing Agency, mentioned an occasion where a member of local parliament had pressured the agency to accommodate his request during the preparation of the budget execution document. Regarding this occasion, he stated:

"There were pressures that really disturbed me that came from the local Member of Parliament. We had tried to listen and honour them, but often we faced a difficult situation where they asked us to include this or that [into the budget], which quite often triggered a conflict [...]". (R#25, Q#1023)

In the end, the reluctance of the agency to accommodate such requests often resulted in delays in the authorisation of budget execution documents, preventing the agency from promptly implementing its programs and activities.

In construction works, non-compliance problems could also be triggered by the incompetence of external contractors. A section head in the Public Works Service revealed the fraudulent practices of some contractors when they participate in the procurement process of construction works. The emphasis of the current procurement procedures upon the administrative requirements has provided an opportunity for the contractors to manipulate their documentation to increase their chances of being awarded the contracts. She mentioned that:

Often, we already follow the procurement procedures according to the regulations. We first evaluate the administrative requirement, before we evaluate the technical aspect and the bid price. Thus, bid price is the last item to be evaluated. There are some "ingenious" contractors who try to exploit the sequence of evaluation by preparing their best documentation on their bid proposal. I heard that they even hire a professional consultant to prepare the proposal. They exaggerate the administrative and technical aspects of their proposal and then slash their bid price by twenty to thirty percent [to increase their chance to win the contract]." (R#47, Q#1034)

Another respondent, who worked as a member of a procurement committee in the Education and Cultural Service and had extensive experience in supervising various construction projects throughout his 30-year career in West Lombok District, provided an example where the selected contractors did not have the financial competency to

carry out the construction project effectively, efficiently and timely manner. He commented that:

"[...] there are a number of contractors that are actually not bona fide. They only start the work once they receive the contract's advance payment. Upon signing the contract, they would get a maximum 30 percent of advance payment. Even so, after they receive the advance payment, they still borrow money from the bank to get additional working capital to start the works. They pledge the contract document to the bank as the loan collateral. Thus, I think they should have adequate working capital to start the construction works. Nonetheless, after we issue the [instruction] letter to start the work, they still delay the start of their activities." (R#38, Q#1033)

The situation that has been described above displays the financial incapability of the contractors to be able to carry out the construction works properly. Along with a lack of monitoring activities due to the heavy workload among the construction project supervisors, as has been discussed in Section 8.2.3, the appointment of incompetent contractors as a result of an ineffective procurement system has a higher probability for triggering non-compliance problems such as delays in project completion, substandard quality of works and shortages in the volume of the completed works. From the Education and Cultural Service, the head of the finance section mentioned that *"delay in project completion was mainly due to the incompetent contractors that could not finish the project on time."* (R#23, Q#1029).

Interestingly, there was also an instance where the commencement of a construction project did not comply with the schedule already stipulated in the contract and had to be delayed because of intimidation from an individual on behalf of a so-called NGO that had requested money from the contractors to start work. A section head in the Education and Cultural Service raised this example by commenting:

"[...] there are individuals from NGOs who are trying to get money for themselves. Often, when the project is about to start, they blackmail the contractor. They are asking for money. If they don't give them the money, they don't allow them to work. The contractor is also afraid of being fined by us because of not working for a day, so they finally gave some money to them. Yes, there is pressure from the NGOs and it is a pity for the contractor." (R#38, Q#1012)

8.5. Chapter Summary

This chapter has highlighted many shortcomings in the bureaucratic structures of PFM operations in West Lombok District. It has also explored and discussed the perspectives of the PFM actors in West Lombok District on how those shortcomings have allowed the occurrence of non-compliant behaviours among them. In addition, examples of how specific shortcomings are linked to and influence the occurrence of

certain systemic problems that have been identified in the PFM operations of West Lombok District have also been discussed and elaborated.

The shortcomings exist in all the major bureaucratic structures. Rules that govern the PFM operations of West Lombok District still contain a number of undesired characteristics, such as contradictory, misinterpreted, and defective, that diminish their effectiveness within the organisation. Meanwhile, hierarchical arrangements failed to support the development of organisational loyalty. The division of labour has suffered from silo mentality and improper distribution of workloads. Another structure, the establishment of expertise, could not be established due to inappropriate human resources management and inadequate office facilities. These shortcomings have caused dysfunctional bureaucratic structures in PFM operations allowing the emergence of various non-compliance problems that have been identified in Chapter 6. Other than shortcomings in bureaucratic structures, this chapter has also identified the roles of the other parties external to the organisation (i.e. members of local parliament, NGOs and contractors) in instigating non-compliance problems in the PFM operations.

This chapter ends the presentation of the case study reports to examine factors that influence and trigger the PFM actors to commit non-compliant behaviour and actions in various PFM operational processes in West Lombok District. The following chapter, Chapter 9, present the overall summary and conclusion of this study.

Chapter 9

Summary and Conclusions

This chapter presents a summary of the overall thesis. It demonstrates the logical sequence of the discussion and analyses that have been elaborated upon in the preceding chapters of the thesis. It includes a discussion regarding the overall findings and the implications of the findings in relation to the problems of non-compliance in PFM operations in Indonesia's local governments. Contributions of the study to the theoretical discussion and the operational practices of PFM at the local government level in Indonesia, and in developing countries in general, as well as the limitations of this study are also presented before the concluding remarks that end the presentation of this thesis.

This study has been driven by the concern for the effectiveness of the implementation of the recent major PFM reform in Indonesia. The reform was initiated in 2003 through the enactment of Law 17/2003 regarding State Finance. This law was then followed by two further laws, enacted in 2004, which were Law No. 1/2004 regarding State Treasury and Law No. 15/2004 regarding State Audit. Together, they compose the Trilogy of Financial Laws. Those laws set a new legal framework for PFM practices in Indonesia, which had not been changed since the independence of Indonesia in 1945. The enactment of these laws has invited a number of studies that aim to assess various aspects of the PFM reform in Indonesia.

In general, this thesis assessed the implementation of Indonesia's PFM legal framework following the PFM reform in 2004. It focused on assessment of the operational components of PFM that commence with the preparation of a budget execution document and conclude with the preparation and finalisation of the government's financial report. The context of the PFM reform, which was established to also support the implementation of a decentralisation policy in Indonesia, has led to the scope of this study being at the local government level. This thesis, in particular, looked at the problems of non-compliance in the actual PFM operational practices within local governments. Emphasis on non-compliance was driven by the results of previous studies that have highlighted the impediments to attaining the PFM objectives despite the robust design of the PFM legal framework after the reform.

The implementation of a regional autonomy policy and the recent PFM reform in Indonesia have established new arrangements for the PFM operational practices in local government. Under the new arrangements, most of the authority regarding

financial management have been devolved from the central government to local governments. The devolution of financial management authorities has been equipped with proper separation of functions, roles and responsibilities among local government officials and units. The arrangement of financial management within PFM operations has also accommodated the principles of good governance, whereby the principles of unity, universality, annual budgeting and reporting, and allowance for specialty have been adopted in the budgeting and budget execution processes. Other important features of modern PFM principles, including professionalism, transparency, accountability, innovation and accommodation of specific local content, also have been adopted to support a sound and robust legal framework for PFM within Indonesia's local governments.

According to the current PFM legal framework, there are three main elements of local government PFM operations in Indonesia: (1) budget execution, (2) a financial accounting and reporting system, and (3) an internal control system. Budget execution commences with the preparation of budget execution documents. They provide a more detailed arrangements on how to properly carry out the major budget execution processes that include revenue collection, disbursement, procurement, financing, treasury and cash management, and asset management, in accordance with the approved local government budget. The financial accounting and reporting system has been improved through the requirement to prepare annual financial statements that enhance the accountability and transparency of the local governments' financial management. The adoption of a modern government accounting standard that follows the accrual basis approach, along with the establishment of in-year monitoring by local parliament and post-auditing by an external and independent audit agency, further enhance the accountability and transparency of the local governments' financial management. The internal control system sets preventive measures to guarantee that budget execution processes and financial accounting and reporting procedures are taking place in adherence to the provisions stipulated by the PFM regulatory framework, and that they align with the public sector goals of efficiency, effectiveness, transparency and accountability. These main elements have encompassed the typical PFM operations stipulated in the major PFM literature and technical references.

Unfortunately, the sound and robust legal framework of PFM operations in local governments have not necessarily been manifested in the actual practices. BPK's audit reports on local governments have disclosed a significant number of audit findings that display compliance gaps in the actual PFM operational practices. Those

gaps represent the existence of non-compliance practices by the PFM actors in carrying out their duties in the PFM operations.

9.1. Problems of Non-Compliance

The first part of the findings of this study, presented in Chapter 5, discussed non-compliance in Indonesia's local government PFM operations. The discussion aimed to identify any systemic problems resulting from non-compliance. In this study, systemic problems have been defined as non-compliance problems that have occurred frequently within various components of PFM operations and that have hindered the attainment of the overall PFM objectives to establish efficiency, effectiveness, accountability and transparency in the PFM operations of local government. Content analysis of BPK's audit reports was applied to address this research objective. The analysis covered all audit reports on local governments that were published by BPK's regional offices throughout Indonesia between 2009 and 2014.

The general overview of BPK's audit reports on local governments revealed that most local governments were still struggling to fulfil the requirements stipulated in the PFM legal framework. The percentage of local governments that could not finalise their financial statements within the specified timeline was quite high in the early years of the PFM reform. In addition, the quality of local governments' financial management was disappointing. Most local governments had failed to attain "*unqualified*" opinions from BPK for their financial statements. Nevertheless, throughout the period of the study, the trend of delay in finalisation of the financial statements had been decreasing, while the trend in BPK's favourable audit opinions on local government financial statements had been increasing.

Despite the improvement in regard to the timeliness and the quality of financial statements, a more detailed analysis of BPK's audit reports indicated unfavourable statistics regarding the compliance levels of many PFM operational practices with the PFM rules and regulations. Content analysis of 5,141 audit reports on local governments showed that a total of 104,903 audit findings had been reported during 2009 to 2014, signifying a substantial number of non-compliance incidents in the actual practices of local government PFM operations. In general, audit findings represent compliance gaps that refer to the deviation of the actual behaviour of the PFM actors – the public employees who are involved in PFM operational processes – from the expected behaviours that are stipulated in PFM rules and regulations. The results of the content analysis of BPK's audit reports further displayed that those non-

compliance practices have led to a number of systemic problems in various components of PFM operations.

The internal control system component of the local governments' PFM operations has been characterised by a lack of proper standards, procedures and guidelines of action for local government employees. It also has been characterised by a lack of planning, low performance, improper policy implementation, non-compliance with non-financially related regulations, and budget misallocations, all of which have disrupted the role of the internal control system, which is to set preventive measures for ensuring the achievement of efficiency, effectiveness, transparency and accountability in local government PFM operations.

In budget execution, local governments have been struggling to optimise their local revenue collection efforts. Uncollected revenue and delays in revenue collection processes have been reported as the most frequent audit finding items that were disclosed in BPK's audit reports covered in this study. On the disbursement side, overpayments of expenses also have been reported frequently, contributing to inefficiencies in the management of local government budgets. Other systemic problems identified in the budget execution processes included: a lack of assets safeguarding, volume shortages in construction work, improper cash handling, fictitious activities, improper procurement processes and the direct use of revenue to fund operational expenses without proper allotment in the budget. Hence, it is plausible to conclude that those identified problems disaffirm the establishment of efficiency and effectiveness in overall local government operations.

The other PFM objectives, to ensure the accountability and transparency of local government financial operations, has been hampered by a lack of adequate, complete and proper documentation of transactions, inaccurate transactional recordings, inappropriate financial reporting processes and inadequate financial information systems. These problems underline the weaknesses in the local government financial accounting system that have affected the ability of local governments to prepare fair financial statements according to the applicable accounting standard.

9.2. Factors Leading to Non-Compliance

In this study, further examination was undertaken to identify and analyse factors that influence the PFM actors to commit and be involved in non-compliant behaviour. Review of the literature suggested that PFM operates within the broader context of public sector management. Despite the recent global trend toward the NPM approach, which views that the public bureaucracy model in the public sector is dysfunctional

and inefficient, and should be replaced with private sector practices, management within the public sector, especially in developing countries, has still been characterised by the traditional model of bureaucracy.

Literature in the field of PFM has also shown that the adoption of an NPM-based PFM model does not eliminate the existence of the recognisable structural characteristics of bureaucracy (e.g. impersonality, division of labour and hierarchical structure) in the area of PFM, including in its operational components. The reliance on budget laws and other PFM rules and regulations to govern the PFM operational processes demonstrates the impersonal nature of PFM operations. In addition, the fragmentation of PFM operations into several components displays the presence of division of labour to establish specialisation and develop expertise. In the disbursement process, the several layers of hierarchical structure involved in the verification process for payment requests provide an example of the existence of a hierarchical delegation of authority. This thesis, therefore, has justifiable support from the literature to examine the problems of non-compliance in PFM operations by utilising the lens of public bureaucracy theory.

Literature on the theory of public bureaucracy indicates that there are three major factors that influence the emergence of non-compliant behaviour among public employees: the individual dispositions of public employees, the structural characteristics of public bureaucracy itself and external environmental factors. The 'individual dispositions of public employees' refers to the employees' motives that drive their actual behaviour and actions in carrying out their duties within the public organisation. The 'structural characteristics of bureaucracy' relate to their tendency to become dysfunctional and influence the behaviour of the public employees. 'External environmental factors' refers to the social contexts of politics, technology, economy, law, demography, ecology, and culture that have impacts upon the behaviour of the public employees.

Derived from the first two major factors of non-compliance from the viewpoint of public bureaucracy theory (i.e. the public employees' motives and the dysfunctional bureaucratic structures), the second part of the findings of this study (Chapters 6, 7 and 8) further elaborated upon both factors in the specific context of local government PFM operations in Indonesia. A single case study method has been utilised to gain the perspectives of PFM actors regarding the influences of those factors upon their decisions to commit and be involved in any non-compliant behaviour. The case study was conducted in West Lombok District, which is a typical local government in Indonesia in terms of its PFM operational characteristics. The study utilised content

analysis of BPK's audit reports and FGD with BPK's auditors, presented in Chapter 6, to gain an understanding of the nature of non-compliance problems in West Lombok District's PFM operations. Further, the case study also utilised interviews with PFM actors in various components of West Lombok District's PFM operations to gain their perspectives on how the employees' motives (presented in Chapter 7) and bureaucratic structures (presented in Chapter 8) influence non-compliant behaviour of the PFM actors.

9.2.1. PFM Actors' Motives

From the interviews with the PFM actors in West Lombok District, it was found that their motives in joining the public sector and carrying out their duties were varied, ranging from simple financially-related, self-interested motives to more community service-oriented, public-interested motives. This finding has exemplified that a mixture of motives can influence the behaviour of people who work in public bureaucracies. In relation to the examination of the non-compliant behaviours of PFM actors that led to the emergence of a number of PFM operational problems in West Lombok District, the findings provided illustrations of how both self-interested and public-interested motives can facilitate PFM actors to commit non-compliant acts and contribute to PFM operational problems.

Further analysis of the results of interviews with the PFM actors in West Lombok District revealed that failure to establish proper institutional arrangements, especially for its lower-level employees, has allowed non-compliant behaviours to occur among them. Lack of financial compensation and a reward system has encouraged employees to pursue their own self-interested motives in order to maximise their monetary incomes by having side jobs and by obtaining loans from banks, which eventually led to disruption of their performance in carrying out their duties. In other instances, these self-interested motives caused some PFM actors to remain ignorant in the workplace, weakening their ability to carry out their duties according to the provisions stipulated in the rules and regulations. Other than the lack of a financial compensation and reward system, this thesis also found that, from the interviewees' perspectives, proper control and monitoring, especially from immediate superiors, could prevent them from becoming involved in non-compliant behaviours. In addition to the above, rules and regulations that do not support the provision of more effective, efficient and timely public services have also influenced the employees, particularly those who possess public-interested motives, to break the rules and be involved in non-compliant practices.

9.2.2. Bureaucratic Structures

In regard to the bureaucratic structures of PFM operations in West Lombok District, this thesis has identified many shortcomings that exist in all the major bureaucratic structures: rules, division of labour, hierarchy and expertise. Firstly, at the implementation level, rules and regulations that govern the PFM operations of West Lombok District still contain a number of undesired characteristics that diminish their effectiveness within the organisation. According to Green Tape Theory (De-Hart Davis 2008), effective rules improve the stakeholders' co-operation, thereby increasing the compliance level among the stakeholders. Therefore, conversely, the ineffectiveness of rules may decrease the compliance level and make the organisation prone to non-compliance problems. This thesis found that non-compliance in PFM operational practices in West Lombok District was characterised by the ineffectiveness of PFM rules and regulations because they were contradictory, easily misinterpreted or simply defective.

Contradictions among derivative regulations of the PFM legal framework, especially in the accounting and financial reporting processes, have been in existence throughout the period of the study, due to the overlapping roles between the MoHA and the Ministry of Finance within local government's financial management system. The lack of more technical detail, in the form of SOPs and other technical guidance, and the inadequacy of the dissemination efforts to convey the requirements stipulated in the rules and regulations, has caused the misinterpretation of rules among the PFM actors. Misinterpretation of rules has led to practices that were not compliant with the requirements stipulated in the rules and regulations. There were also situations where rules were defective, ambiguous and/or unclear. In such situations, rules could be interpreted in multiple ways, causing confusion among the PFM actors about how to appropriately comply with the rules.

Secondly, another bureaucratic structure, the division of labour, has also become dysfunctional in the actual PFM operational practices of West Lombok District. Vertically, the hierarchical arrangement does not support the development of employees' loyalty towards organisational goals. Instead, there were instances among the PFM actors where personal loyalty to their direct superiors was upheld, neglecting their obligations to comply with the rules and regulations in order to attain the organisational goals. From a horizontal perspective, the division of labour has fragmented the mindset of the PFM actors into a silo mentality. Instead of maintaining proper co-ordination and communication with other units, the PFM actors have been constrained by a focus on their responsibilities within their own units, causing a

number of non-compliance problems at the organisational level. A dysfunctional division of labour was also derived from improper distributions of workloads, causing imbalances in workloads among individual employees. In this specific instance, employees who had greater workloads were more prone to make errors and mistakes.

Thirdly, inappropriate human resources and personnel management practices and policies in West Lombok District have contributed to its failure to establish expertise among its PFM actors. Those inappropriate practices and policies have prevented the development of employees' skills, capabilities and knowledge, including their understanding about rules that govern their actions and behaviours, hence initiating non-compliance problems. In addition to decisions about employees' placements often not being matched with their competencies and educational backgrounds, frequent rotation among the employees who were working in the PFM operational processes had also hindered the development of expertise among the PFM actors. The employees' promotion system has been influenced by patronage and nepotism practices because the merit-based promotion system was not consistently implemented. Apart from employees' unwillingness to improve their own knowledge and skills, training programs have also failed to provide relevant training materials for employees, including those relating to leadership skills for employees who had been promoted. Lack of adequate office facilities has also contributed to the limitations for employees to improve their performance within the organisation because it hindered them from applying their expertise in the workplace effectively. As a result, the inability to establish expertise among the PFM actors and to fully implement the existing expertise within the actual practices has contributed to non-compliance problems in PFM operations.

9.3. Contributions and Limitations

The findings of this study both provide empirical evidence and enrich the literature within the fields of PFM and public bureaucracy theory. They also have potential policy implication by providing relevant knowledge required for the formulation of practical recommendations within the context of local governments in Indonesia, in particular, and developing countries, in general, to reduce the practice of non-compliance in their PFM operations.

Firstly, in the PFM field, the presence of non-compliance in PFM operations, especially in developing countries, has been widely identified and discussed. In countries such as Lesotho, Ghana, Myanmar, the Philippines and Vietnam, efforts to ensure compliance did not lessen the risk of non-compliance in the actual PFM

operational practices. They have experienced non-compliance issues that have caused a number of problems in all components of their PFM operations. Systemic problems of the PFM operations in West Lombok District, which were identified by this study and have been discussed in this thesis, add more empirical evidence to the PFM literature to confirm the presence of non-compliance problems in the PFM operations of Indonesia, a typical developing country, especially at the local government level.

Secondly, the findings of this study, especially in regard to the PFM actors' motives, have also contributed to the literature concerning public bureaucracy. They provide empirical evidence regarding the presence of both self-interested and public-interested motives among public employees when carrying out their duties, which validates previous findings. Further, the study has confirmed both of the contradictory assumptions applied via two different tenets of public bureaucracy theory, the viewpoints of public administration and political economy. The latter brings the economic point of view into the discussion about public bureaucracy. It assumes the dominance of the self-interested motives of public employees to explain their behaviour within the public sector organisational context. On the other hand, the former assumes that the distinct feature of public accountability within a public bureaucracy has directed public employees to behave according to public-interested motives. This finding, as a result, complicates the effort to examine the behaviour of the individual members of a public bureaucracy. Nevertheless, it justifies Olsen's (2004) suggestion that the area of public bureaucracy demands more studies and models that can accommodate the complex nature of human behaviour (Olsen 2004; in Wise 2004), including, as has been demonstrated by this study, their multifaceted motives that range between self-interested and public-interested motives.

Thirdly, this study has policy implications that potentially contribute to the solution of problems of non-compliance in PFM operations. These implications include the formulation of a proper institutional arrangement and design that can be implemented to adequately address and accommodate various potential combinations of motives of the PFM actors in the workplace and can minimise the dysfunctions within bureaucratic structures. A reward system, for example, should be carefully designed to ensure that it has covered a number of incentive channels, such as financial compensation, conveniences in the workplace, promotion policy, etc., that are aligned with different PFM actors' self-interested motives. The design of the reward system should be fair and based upon the actual performances and contributions of each PFM actor, instead of being based on their level of employment or tenure. A review

of the details of current PFM operational rules, regulations, standards and guidance of practices should be periodically conducted to ensure the correspondence of those instruments with the public's needs and the principles of efficiency, effectiveness, transparency and accountability. In addition, effective monitoring and supervision, especially by immediate superiors, should be consistently performed to prevent the individual PFM actors from being resistant and ignorant about complying with the PFM rules, regulations, standards and guidance.

Efforts to minimise dysfunctional bureaucratic structures should include a policy to revisit the overlapping roles of the MoHA and the Ministry of Finance in regard to the PFM legal framework, the identification of unclear PFM operational instruments (e.g. SOPs and guidance), and a strategy to enhance the effectiveness of the dissemination of those instruments. A strategy to ensure the congruence of the PFM actors' personal goals, especially for those who are at higher hierarchical levels, with the overall organisational goals, along with a policy to improve the co-ordination among workers and the redistribution of balanced workloads to all units within the organisation, should also be considered and established. It is also recommended to carry out a review of the actual practices of the human resources and personnel management policies. Educational background should be considered as an important factor for employees' placements, especially in the early stages of their careers in the organisation. Rotation policies and training programs should be designed to enable the development of expertise among the employees that will support the attainment of the overall objectives of the organisation. Public organisations should also ensure that they have adequate and supportive office facilities to enable the PFM actors to exercise their expertise effectively.

In terms of its limitations, this study mainly utilised the assessment of local governments' PFM operational practices that had been conducted and reported by the BPK. It excludes a number of other assessments and studies that have been conducted by other institutions and researchers. In addition, it has only focused on the final audit reports published, excluding any preliminary findings that were found and discussed during the audit processes. Those preliminary findings might have already been addressed properly and adequately by the local governments during the audits, resulting in the findings not being included in the audit reports. As a result, the examination of non-compliant behaviours of the PFM actors in this study only related to the systemic problems that have been identified and disclosed in the audit reports. Despite this limitation, the coverage of this study, which includes all local governments' audit reports from all types of audit published by BPK's regional offices

throughout Indonesia, has contributed to a comprehensive examination and identification of systemic problems in local governments' PFM operations in Indonesia.

While the identification of systemic problems in the PFM operational practices related to the whole of local governments in Indonesia, the study of the PFM actors' motives and bureaucratic traditions, and how they had contributed to those identified systemic problems, was only conducted within one local government, i.e. the West Lombok District. This limitation may weaken the generalisability of the research findings to other Indonesian local government jurisdictions. Nevertheless, the centralised approach in the implementation of regional autonomy in regard to PFM operations throughout local governments in Indonesia and the similarities in the nature, pattern and statistics of non-compliance problems in West Lombok District with those of all local governments in Indonesia have provided evidence of the typicality and representativeness of West Lombok District. Those facts have increased the probability that the findings of this study can be generalised throughout local government within Indonesia. Similar studies of different local government offices or in other public institutions in Indonesia, such as ministries of central government, public service agencies and state-owned enterprises, may also be considered to have provided more empirical evidence regarding the influence of both public employees' motives and bureaucratic traditions upon the problems of non-compliance in PFM operations in Indonesia's public sector.

9.4. Concluding Remarks

PFM is one essential component of the public sector because finances are one of the essential resources of any country. The government's budget, as the main instrument of PFM, is required to be managed in a proper manner to ensure the achievement of the PFM objectives. At the operational level, both compliance with budget allocations, which have been stipulated in the budget law, and adherence to other PFM rules or regulations that govern the detailed arrangements for managing PFM operations are critical. Emphasis on compliance in PFM operations can prevent corruption, overspending and misallocation of budget from its intended purposes. It can also ensure proper control over the overall budget execution processes. However, the presence of non-compliance problems in PFM operations must not be concealed. The body of literature on PFM, including this thesis, has provided empirical evidence supporting the proposition that efforts to ensure compliance are complicated.

This study has shown that the mixed and complex nature of the PFM actors' motives contribute to the difficulty in ensuring their adherence to the PFM rules and regulations. Non-compliance becomes more apparent in PFM operations when any public institution does not have an adequate reward system and/or control mechanism that can conform and align various PFM actors' motives with the PFM objectives. Further, the ideal bureaucratic structures that are required to attain efficiency and effectiveness in PFM operations, to some extent, are difficult to establish. Therefore, efforts to minimise dysfunctional bureaucratic structures should also be reinforced to help improve the level of compliance within PFM operations and to assist in the attainment of PFM objectives.

For future studies, it would be interesting to discover whether the findings of this study can also be transferred to different public sector contexts outside PFM operations.

Appendices

Appendix 1 – Hierarchy of PFM Regulatory Framework

The State Finance Law 17/2003
The State Treasury Law 1/2004
The State Audit Law 15/2004
The Local Governance Law 32/2004
The Fiscal Balance Law 33/2004

- GR 14/2005 regarding Government Receivable Write-off (revised by GR 33/2006)
- GR 24/2005 regarding Government Accounting Standard (replaced by GR 71/2010)
- GR 54/2005 regarding Local Government Loan
- GR 55/2005 regarding Balancing Fund
- GR 56/2005 regarding Local Government Financial Information System
- GR 57/2005 regarding Grant to Local Government
- GR 58/2005 regarding Local Government Financial Management
- GR 6/2006 regarding Government Asset Management (revised by PP 38/2008)
- GR 8/2006 regarding Government Financial and Performance Reports
- GR 8/2007 regarding Government Investment
- GR 39/2007 regarding Government Cash Management
- GR 60/2008 regarding Government Internal Control System

- Presidential Regulation (PR) 54/2010 regarding Government Procurement (revised by PR 35/2011, PR 70/2012, and PR 172/2014)
- Minister of Home Affairs Regulation (Permendagri) 13/2006 regarding Guideline for Local Government Financial Management (revised by Permendagri 59/2007 and Permendagri 21/2011)
- Permendagri 17/2007 regarding Technical Guideline for Local Government Assets Management
- Permendagri 32/2011 regarding Guideline for Grant and Social Assistance Fund Allocation from Local Government Budget (revised by Permendagri 39/2012)
- Permendagri 20/2009 regarding Guideline for Special Allocation Fund Management

- Local government regulations regarding the general provisions on local government financial management
- Head of local government decrees regarding local financial management system and procedures
- Various SOPs that provide more detailed guidelines for carrying out PFM operations across local government's units

Source: Author's compilation

Appendix 2 – Audit Finding Classification Based on BPK’s Guideline

Audit Findings Group	Audit Findings Sub-Group	No.	Audit Findings Item	
Internal Control Weaknesses	Accounting and Reporting Weaknesses	1	Inadequate and inaccurate transaction records	
		2	Inappropriate reporting processes (not following the guidance/rules/standards)	
		3	Late submission of reports	
		4	Inadequate financial transactions and accounting information support system	
		5	Inadequate human resources	
	Budget Execution Control Weaknesses	1	Inadequate planning of a program/activity/project	
		2	Revenue management (collection, deposit, reporting, and utilisation) do not follow the relevant guidelines	
		3	Inappropriate process of disbursement and/or revenue collection (not following the guidance/rules/standard)	
		4	Expenditure outside the budget	
		5	Policy is not properly managed and implemented (resulted in shortage of revenue)	
		6	Policy is not properly managed and implemented (resulted in increase of expenses)	
		7	Inadequate physical management and safeguarding of assets	
	Internal Control Design and Structure	1	No formal and adequate SOPs	
		2	The implementation of SOPs is weak and not effective	
		3	No internal audit unit/function	
		4	Ineffective internal audit function	
		5	No separation of duties	
	Non Compliance	State Losses	1	Fictitious expenses/payments
			2	Third parties do not finish the work according to contract
3			Volume shortage (of works/goods)	
4			Overpayment (other than volume shortage)	
5			Mark up	
6			Personal use of public money/assets	
7			Travel expenses payments exceed the standard	
8			Third parties do not deliver goods/works according to the contract	
9			Expenses are not in accordance and exceed the provisions	
10			Receivable cannot be collected (bad-debts)	

Audit Findings Group	Audit Findings Sub-Group	No.	Audit Findings Item
		11	Overpayment of tax returns
		12	Improper assets disposal
		13	State losses have not been properly processed according to the rules
		14	Entity has not processed the treasury losses according to the rules
		15	Write-off of receivables is not in accordance with the regulations
		16	Sales discount is given exceeding the regulations
		17	Improper calculation of production costs
		18	Guarantee of contract work, utilisation of goods and the provision of the facility cannot be availed
		19	Fictitious evidence of revenue deposits
	Potential State Losses	1	Overpayment of the unfinished works (goods/services)
		2	Third parties do not replace/fix damaged goods/services during maintenance period
		3	Public assets are not physically in possession
		4	Acquisition of disputed assets
		5	Public assets' whereabouts are not known
		6	Guarantee of works is not in accordance with the regulations
		7	Third parties have not delivered the works/goods yet
		8	Receivables are potentially uncollected
		9	Write-off of receivables is not in accordance with the regulations
		10	Budget has been disbursed for the unfinished works (at the end of financial year)
	Revenue Shortfall	1	State revenues are not yet received
		2	Direct use of revenues (without budget appropriation)
		3	Transfers from central government are not yet received
		4	Revenues are used by unlawful institutions
		5	Lower tax rates are used
		6	Overpayment of subsidy
	Administrative Weaknesses	1	Incomplete documentation for expenses/payments
		2	Works are conducted before procurement/budget approval

Audit Findings Group	Audit Findings Sub-Group	No.	Audit Findings Item
		3	Improper procurement processes (not causing state losses)
		4	Contract splitting
		5	Pro forma procurements
		6	Non-compliance with public assets regulations
		7	Non-compliance with technical/specific regulations
		8	Correction of subsidy/public service obligation calculation
		9	Improper calculation of depreciation/amortisation/bad debts allowance
		10	Delay in depositing state revenues to state accounts
		11	Delay in depositing petty cash to state accounts
		12	Petty cash amount at the year-end is not deposited to state accounts
		13	Investments are not supported by adequate documentation
		14	Public assets are not supported by adequate documentation
		15	No legal bases for budget items diversions
		16	Budget overrun
3E Weaknesses	Waste	1	Procurement more than the needs
		2	Substandard quality of goods/works/services
		3	Higher acquisition cost of inputs
	Inefficiency	1	Quantity of input higher than required
		2	Quality of input higher than required
	Ineffectiveness	1	Budgets are not used for their designated purposes
		2	Goods/works/services procured are not used as planned
		3	Goods/works/services procured cannot be used/utilised
		4	Utilisation of goods/works/services does not impact the achievement of the institutions' objectives
		5	Limitation in the implementation of activity/program hinders the achievement of institutions' objectives
		6	Low quality of service deliveries

Audit Findings Group	Audit Findings Sub-Group	No.	Audit Findings Item
		7	Operations of the institutions is not adequately managed, including revenue target is not achieved
		8	Promotional expenses are not effective

Appendix 3 – Location of Case Study



Appendix 4 – Research Ethics Approval

MEMORANDUM



To:	David Gilchrist Curtin Graduate School of Business (CBS)
CC:	Budi Cahyono
From:	Professor Peter O'Leary, Chair HREC
Subject:	Ethics approval Approval number: RDBS-01-15
Date:	15-Jan-15

Office of Research and
Development
Human Research Ethics Office

TELEPHONE 9266 2784
FACSIMILE 9266 3793
EMAIL hrec@curtin.edu.au

Thank you for your application submitted to the Human Research Ethics Office for the project: 5002

The impact of bureaucrat behaviour on public financial management: the case of Indonesian local government.

Your application has been approved through the low risk ethics approvals process at Curtin University.

Please note the following conditions of approval:

1. Approval is granted for a period of four years from 15-Jan-15 to 15-Jan-19
2. Research must be conducted as stated in the approved protocol.
3. Any amendments to the approved protocol must be approved by the Ethics Office.
4. An annual progress report must be submitted to the Ethics Office annually, on the anniversary of approval.
5. All adverse events must be reported to the Ethics Office.
6. A completion report must be submitted to the Ethics Office on completion of the project.
7. Data must be stored in accordance with WAUSDA and Curtin University policy.
8. The Ethics Office may conduct a randomly identified audit of a proportion of research projects approved by the HREC.

Should you have any queries about the consideration of your project please contact the Ethics Support Officer for your faculty, or the Ethics Office at hrec@curtin.edu.au or on 9266 2784. All human research ethics forms and guidelines are available on the ethics website.

Yours sincerely,

Professor Peter O'Leary
Chair, Human Research Ethics Committee

Appendix 5 – Organisational Consent for Research



**BADAN PEMERIKSA KEUANGAN
REPUBLIK INDONESIA**

Jln. Jenderal Gatot Subroto No. 31 Jakarta Pusat 10210 Telp. (021) 25549000 Ext 1224
Fax. (021) 57854030

SURAT KETERANGAN

No. *24* /S.KET/X.3.1/01/2015

Yang bertandatangan di bawah ini menerangkan bahwa:

Nama : Budi Cahyono
NIP : 197609091996021002
Pangkat : Penata Tk. I
Golongan/Ruang : III/d
Jabatan : Pemeriksa
Unit Kerja : Biro Sumber Daya Manusia

adalah benar pegawai pada Badan Pemeriksa Keuangan Republik Indonesia (BPK RI) sejak tanggal 1 Februari 1996 sampai dengan saat ini.

Surat keterangan ini untuk dipergunakan sebagai surat izin penelitian akademis dan pengambilan data untuk keperluan penyelesaian tesis doctoral dengan topik penelitian "Dampak Perilaku Birokrat terhadap Efektivitas Pengelolaan Keuangan Publik: Studi Kasus di lingkungan Pemerintah Daerah di Indonesia", pada program *Doctor of Business Administration (DBA) Curtin Graduate School of Business, Curtin University, Perth, Australia.*

Demikian surat keterangan ini dibuat, untuk dipergunakan sebagaimana mestinya.

Jakarta, 21 Januari 2015
Kepala Bagian Perencanaan dan Mutasi



Dadang Ahmad Rifa'i
NIP 197301101994011001





**PEMERINTAH KABUPATEN LOMBOK BARAT
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SURAT IJIN PENELITIAN/PENGAMBILAN DATA

Nomor : 070/129/06-Bappeda/2015

Berdasarkan surat dari **Curtin Graduate School Of Business, Curtin University , Perth, Australia** Nomor : 002-R/2014, tanggal 29 Agustus 2014. Perihal Ijin Penelitian, Survey/Pengambilan Data, maka dengan ini diberikan ijin kepada :

Nama : **BUDI CAHYONO**
Pekerjaan : Mahasiswa
Jurusan : Doctor of Business Administration (DBA) S3
Tujuan / Keperluan : Mengadakan Penelitian, Survey/ Pengumpulan Data Dan Informasi/Thesis/KTI/KKN
Judul : **Dampak Perilaku Birokrat Terhadap Pengelolaan Keuangan Publik: Studi Kasus Di Pemerintahan Daerah Di Indonesia**
Lokasi : Kab.Lombok Barat
Lama Penelitian : Januari – Juni 2015

Demikian ijin Penelitian, Survey/Pengumpulan data ini diberikan untuk dapat dipergunakan sebagaimana mestinya.

Gerung, 04 Maret 2015.

**An. Kepala Badan Perencanaan Pembangunan Daerah
Kabupaten Lombok Barat.
Kepala Bidang Penelitian Pengembangan,**



DR. H. SAHABUDIN. MM.
Pembina (IV/a)
NIP. 19660211 198803 1 017

Tembusan disampaikan kepada Yth :

1. Kepala DPPKD Kab. Lobar
2. Kabag Keuangan Setda Lombok Barat
3. Yang Bersangkutan untuk maklum
4. Arsip

Appendix 6 – BPK’s Audit Reports on West Lombok District

No.	Audit Report Title	Financial Year (FY) Covered	Type of Audit	Publication Date	Inclusion in IHPS
1	Financial Statement Audit for FY 2008	2008	Financial audit	9-Jul-09	Semester 1/2009
2	National Program for Community Empowerment (Village Autonomy Program)	2008/2009	Special purpose audit	15-Mar-10	Semester 2/2009
3	Financial Statement Audit for FY 2009	2009	Financial audit	2-Jun-10	Semester 1/2010
4	Malnutrition Prevention Program	2009/2010	Performance audit	22-Dec-10	Semester 2/2010
5	Goods, Service, Grants, and Social Assistance Expenditure	2010	Special purpose audit	4-Jan-11	Semester 2/2010
6	Financial Statement Audit for FY 2010	2010	Financial audit	25-May-11	Semester 1/2011
7	Management of Special Allocation Fund for Education Sector	2007/2008/2009/2010	Special purpose audit	27-Jun-11	Semester 1/2011
8	Local Revenue Management	2010/2011	Special purpose audit	3-Oct-11	Semester 2/2011
9	Revolving Fund Management	2009/2010/2011	Special purpose audit	3-Oct-11	Semester 2/2011
10	Social and Financial Assistance Fund Management	2010/2011	Special purpose audit	20-Dec-11	Semester 2/2011
11	Financial Statement Audit for FY 2011	2011	Financial audit	28-May-12	Semester 1/2012
12	Financial Statement Audit for FY 2012	2012	Financial audit	24-May-13	Semester 1/2013
13	Political Party Assistance Fund Management	2012	Special purpose audit	22-Jul-13	Semester 2/2013
14	Hotel, Restaurant, and Billboard Tax Management	2012/2013	Performance audit	30-Dec-13	Semester 2/2013
15	Capital Expenditure Management	2012/2013	Special purpose audit	30-Dec-13	Semester 2/2013
16	Financial Statement Audit for FY 2013	2013	Financial audit	30-Jun-14	Semester 1/2014
17	Disadvantage Students Assistance Fund Management	2013/2014	Performance audit	15-Dec-14	Semester 2/2014
18	Political Party Assistance Fund Management	2013	Special purpose audit	17-Dec-14	Semester 2/2014

Appendix 7 – FGD Participants Profiles

No	Respondent's Code	Functional Position	Number of Audit Assignments on West Lombok	Age (Years)	Working Experience in BPK (Years)	Gender	Educational Background		Number of Audit Assignments			
							Degree	Field of Study	Financial Audit	Performance Audit	Special Purposes Audit	Total
1	RFGD 1	Senior Team Leader	2	50	19	Male	Master	Economics	23	9	13	45
2	RFGD 2	Senior Team Member	2	28	6	Male	Bachelor	Accounting	7	4	5	16
3	RFGD 3	Senior Team Member	2	40	8	Male	Master	Public Administration	16	7	10	33
4	RFGD 4	Junior Team Member	2	33	8	Female	Bachelor	Law	5	0	4	9
5	RFGD 5	Junior Team Leader	1	44	17	Female	Bachelor	Accounting	12	0	11	23
6	RFDG 6	Junior Team Leader	1	35	12	Female	Bachelor	Accounting	9	2	7	18
7	RFDG 7	Senior Team Member	1	49	26	Male	Bachelor	Public Administration	11	2	6	19
8	RFDG 8	Junior Team Member	1	32	7	Male	Bachelor	Accounting	8	2	4	14
9	RFGD 9	Senior Team Member	1	34	9	Male	Bachelor	Law	14	4	6	24

Appendix 8 – FGD Participant Information Statement and Consent Form

FOCUS GROUP DISCUSSION PARTICIPANTS' CONSENT FORM



Curtin University

The identification of systemic weaknesses in local government's public financial management in Indonesia

This Consent Form has three parts:

- Part I: FGD Information Sheet - to share information about the study
- Part II: FGD Certificate of Consent - for signatures if you choose to participate
- Part III: FGD Group Agreement on Confidentiality

Part I: FGD – Information Sheet

Introduction

I am conducting a study on the identification of systemic weaknesses in local government's public financial management (PFM) in Indonesia and invite you to take part in this study. This study is part of my doctor of business administration (DBA) student research project which examines the impact of bureaucrat behavior on the effective implementation of the local government's PFM framework in Indonesia. Your involvement is voluntarily and you are under no obligation to take part. Before you decide, you can review the brief information about the study as explained below. Upon your decision to participate in this study, you must sign the certificate of consent as attached in Part II before taking part in any of the focus group discussion (FGD) sessions. You may withdraw your consent at any time and there will be no consequence for refusing to or withdrawing from the study.

Purpose of the study

The main purpose of this study is to identify any systemic weaknesses in the implementation of new PFM laws in the Indonesia's local governments. As BPK (the Audit Board of the Republic of Indonesia) has constitutional mandate to audit the management of public money, the identification of any systemic weaknesses will be based on the audit findings reported in the BPK's audit reports published after the implementation of the new PFM framework in 2003-2004¹. Specifically, this study aims to answer the following research questions: *'What are the systemic weaknesses that hinder the effective implementation of the new PFM framework in Indonesia's local governments? And, why do those weaknesses exist?'*

Participant selection

You are being invited to take part in this research because your position in BPK and/or your experience as BPK's auditors is relevant to the topic of the study. You have been involved in a number of the audit process stages of the financial management in various government institutions in Indonesia. Therefore, it is expected that your involvement in this FGD will provide critical insight about the audit processes and the nature of the audit findings which are essential in this study.

Risks and benefits

I have identified that the only risk related to this study is inconvenience as you need to give up your time to participate in the FGD. I will work closely with you to schedule the FGD during the week-day in the most convenient time for you to attend and in the location which is less than 30 minutes travel from your office so it will not disrupt your work.

The benefit of this study is your contribution to building knowledge and gaining insight and understanding about the management of public finance in Indonesia's local governments.

¹ Starting from the audit reports published in 2007.

Procedure

I am asking you to assist me to learn more about the audit findings which may contribute to the existence of systemic weaknesses in the PFM at local governments in Indonesia. You will be asked to participate in a FGD. During the FGD, I will sit down with you and a number of your colleagues from BPK. I will explain the nature of this study and my initial analysis on the existence of systemic weaknesses in the PFM framework in Indonesia based on the academic literature, audit findings reported in the summary of audit reports since 2007, and the technical guidelines on the categorization of audit findings published by BPK before proceeding with a number of discussion themes for the FGD. Your active involvement and honest feedback on each discussion themes are expected to generate valid and reliable information essential to address the objectives of this study.

The FGD will be conducted in a location not more than 30 minutes of travel from your office and will run for about a half-day session with a 30-minute break within the session. The discussion will be note recorded by a note-taking and an audio recording device. One research assistant may be present to assist me with the note taking and audio recording processes. Upon the completion of the FGD, I will transcribe the audio recording of the discussion. The transcript will be analyzed using computer-assisted qualitative data analysis software (CAQDAS).

Confidentiality

All information gathered from this FGD is strictly confidential and intended to use only for this study. The transcript of the audio recording will be anonymized and only the researcher and the research supervisor will know the correlation to your name and your anonymized code. You will not also be able to be identified in any of the reporting of the data or information, including the final thesis and other possible publications. Both the audio recording files and the FGD transcript will be kept in softcopy format and secured in a password-protected laptop and hard drive. Information in other format (i.e. hardcopy) will be kept private and secured under lock and key in Curtin Graduate School of Business. All information, including softcopy files, will be destroyed 7 (seven) years after the thesis completion of this study.

Who to Contact

This study has been approved by the Curtin University Human Research Ethics Committee on 15 January 2015 with approval number RDB5-01-15. The committee is comprised of members of the public, academics, lawyers, doctors and pastoral carers. If needed, verification of approval can be obtained either by writing to the Curtin University Human Research Ethics Committee, c/- Office of Research and Development, Curtin University, GPO Box U1987, Perth, WA 6845 or by telephoning +61 8 9266 2784 or by emailing hrec@curtin.edu.au.

If you have any queries or concerns about any part of the study, please do not hesitate to contact me or my research supervisor, Professor David Gilchrist, at the contact detail below. Thank you very much for your participation and interest in this study.

Kind regards,

Budi Cahyono
DBA Candidate
Graduate School of Business, Curtin Business School, Curtin University
Tel: +61 410 231 674 (mobile)
Email: cahyono.budi@student.curtin.edu.au

Research Supervisor

Professor David Gilchrist
School of Accounting, Curtin Business School, Curtin University
GPO Box U1987, Perth, Western Australia 6845
Tel. +61 8 9266 7771
Email. david.gilchrist@curtin.edu.au

Part II: FGD – Participant’s Certificate of Consent

I, _____, voluntarily agree to take part in the study *“Identification of systemic weaknesses in local governments’ public financial management in Indonesia”*.

I have read and understood the Information Sheet provided. I have been given a full explanation by the researcher of the nature, purpose, location, and likely duration of the study, and of what I will be expected to do. I have been given the opportunity to ask questions on all aspects of the study and have understood the advice and information given as a result.

I understand that all personal data relating to FGD participants is held and processed in the strictest confidence and that any information that might potentially identify me will not be used in any publication resulting from this study. I also understand that I am free to withdraw from the study at any time without needing to justify my decision and without prejudice.

I confirm that I have read and understood the above and freely consent to participating in this study. Adequate time has been given before I sign the consent to participate in this study.

Signed: _____

Date: _____

Name of researcher/person taking consent: _____

Signed: _____

Date: _____

Part III: FGD – Group Agreement on Confidentiality

This form is intended to further ensure the confidentiality of the data gathered during the FGD entitled *"Identification of systemic weaknesses in local governments' public financial management in Indonesia"*. All participants of the FGDs are required to read the following statement and sign their names indicating that they agree to comply with the statement

"I hereby affirm that I will not communicate or in any manner disclose publicly information discussed during the course of this focus group discussion. I agree not to talk about the material relating to this study with anyone outside the participants of this FGD and the researcher."

Participant #1: _____ Participant #2: _____

Signed: _____ Signed: _____

Date: _____ Date: _____

Participant #3: _____ Participant #4: _____

Signed: _____ Signed: _____

Date: _____ Date: _____

Participant #5: _____ Participant #6: _____

Signed: _____ Signed: _____

Date: _____ Date: _____

Participant #7: _____ Participant #8: _____

Signed: _____ Signed: _____

Date: _____ Date: _____

Participant #9: _____ Researcher: _____

Signed: _____ Signed: _____

Date: _____ Date: _____

Appendix 9 – Interview Participant Information Sheet and Consent Form

INTERVIEW PARTICIPANTS' CONSENT FORM



Curtin University

The impact of bureaucrat behavior on public financial management: the case of Indonesia local government

This Consent Form has two parts:

- Part I: Interview Information Sheet - to share general and brief information about the research
- Part II: Interview Certificate of Consent - for signatures if you choose to participate in an interview

Part I: Interview Information Sheet

Introduction

I am conducting a student research project as part of my doctor of business administration (DBA) program at Curtin University, Australia about the impact of bureaucrat behavior on public financial management at local government in Indonesia and invite you to participate in this research. Your involvement is voluntarily and you are under no obligation to participate in this research. Before you decide, you can review the brief information about the research as explained below. Upon your decision to participate in this research, you must sign the certificate of consent to take part in an interview session as attached in Part II. You may withdraw your consent at any time and there will be no consequence for refusing to or withdrawing from the research.

Purpose of the research

The research aims to study the behavior of public sector bureaucrats who are involved in various stages of the PFM at local government level in Indonesia and how those behavior impact the effective implementation of the new PFM framework and practices introduced in Indonesia through the enactment of new PFM laws in 2003-2004. Specifically, this research aims to address the following research questions: *'What are the motives behind the actual actions of those managing public agencies? How do those motives contribute to the existence of systemic weaknesses in the PFM practices in Indonesia's local government? And finally how do these actual behaviors hamper the achievement of the overall PFM objectives?'*

Participant selection

You are being invited to take part in this research because your position, experience, and involvement in the management of public finance in one of the local governments in Indonesia which are very relevant to the topic of this research. It is expected that your participation in this research interview will contribute positively to the objectives of this research.

Risks and benefits

I have identified that the only risk related to this study is inconvenience as you need to give up your time for the interview. I will discuss with you to schedule the interview in the most convenient time and place for you to come so it will not disrupt your work.

The benefit of this research is your contribution to building knowledge and gaining insight and more understanding about the management of public finance in Indonesia's local governments.

Procedure

I am asking you to assist me to learn more about factors which motivates you as public

sector officials/employees especially when you are exercising your role in the various stages of the PFM processes within your institution. Furthermore, I would also like to learn more about your perspective on how such motives direct your behavior and how your behavior impacts the achievement of the PFM objectives.

You will be asked to participate in an interview with me as the researcher. During the interview, I will sit down with you in a comfortable place of your choosing for approximately 60 to 90 minutes. No one else but the interviewer will be present unless you would like someone else to be there. I will ask you a number of questions. If you do not wish to answer any of those questions during the interview, you may say so and I will move on to the next question. Your active participation and honest responses to each of the interview questions are expected to generate valid and reliable information essential to address the research objectives. The interview will be note recorded by an audio recording device. Upon the completion of the interview, I will transcribe the audio recording of the interview. The transcript will be then analyzed using computer-assisted qualitative data analysis software (CAQDAS).

Confidentiality

All information gathered from the interview is strictly confidential and intended to use only for the research objectives as stated in this information sheet. The transcript of the audio recording will be anonymized and only the researcher and the research supervisor will know the correlation to your name and your anonymized code. You will not also be able to be identified in any of the reporting of the data or information, including the final thesis and other possible publications. Both the audio recording files and the interview transcript will be kept in softcopy format and secured in a password-protected laptop and hard drive. Information in other format (i.e. hardcopy) will be kept private and secured under lock and key in Curtin Graduate School of Business. All information, including softcopy files, will be destroyed 7 (seven) years after the thesis completion of this study.

Who to Contact

This research has been approved by the Curtin University Human Research Ethics Committee on 15 January 2015 with approval number RDBS-01-15. The committee is comprised of members of the public, academics, lawyers, doctors and pastoral carers. If needed, verification of approval can be obtained either by writing to the Curtin University Human Research Ethics Committee, c/- Office of Research and Development, Curtin University, GPO Box U1987, Perth, WA 6845 or by telephoning +61 8 9266 2784 or by emailing hrec@curtin.edu.au.

If you have any queries or concerns about any part of the research study, please do not hesitate to contact me or my research supervisor, Professor David Gilchrist, at the detail below. Thank you very much for your participation and interest in this research.

Kind regards,

Budi Cahyono
DBA Candidate
Graduate School of Business, Curtin Business School, Curtin University
Tel. +61 410 231 674 (mobile)
Email: cahyono.budi@student.curtin.edu.au

Research Supervisor

Professor David Gilchrist
School of Accounting, Curtin Business School, Curtin University
GPO Box U1987, Perth, Western Australia 6845
Tel. +61 8 9266 7771
Email. david.gilchrist@curtin.edu.au

Part II: Interview Certificate of Consent

I, _____, voluntarily agree to take part in the research interview to examine *"The impact of bureaucrat behavior on public financial management: The case of Indonesian local government"*.

I have read and understood the Information Sheet provided. I have been given a full explanation by the researcher of the nature, purpose, location, and likely duration of the interview, and of what I will be expected to do. I have been given the opportunity to ask questions on all aspects of this research and have understood the advice and information given as a result.

I understand that all personal data relating to interview participants is held and processed in the strictest confidence and that any information that might potentially identify me will not be used in any publication resulting from this research. I also understand that I am free to withdraw from the research at any time without needing to justify my decision and without prejudice.

I confirm that I have read and understood the above and freely consent to participating in this research. Adequate time has been given before I sign the consent to participate in this research.

Signed:

Date:

Name of researcher:

Signed:

Date:

Appendix 10 – Interview Protocols

INTERVIEWS PROTOCOLS



Curtin University

Interview number/code	:	
Date/time	:	
Location	:	
Department/unit	:	

A. Opening and introduction

- Expressing gratitude for his/her willingness to do the interview.
- Re-explaining the topic and purpose of the interview.
- Collecting the signed consent form.
- Asking permission for recording the interview.
- Gathering some basic demographic/profile information about the interviewee.

Age	:	
Gender	:	
Religion	:	
Education	:	
Year joined the civil servant	:	
Position (current)	:	
Employment history	:	
Tenure in (current) position	:	

B. Interview questions

General questions

1. Could you please describe briefly about your current roles as [his/her current position]?
2. How does your roles intersect with the financial management of your organization?
3. In your own word, how do you define the objective of public financial management?

4. Do you consider those objectives when dealing with your roles in managing the public money?
5. How would you rate yourself and your organization in term of achieving those objectives?
6. What obstacles do you think you or your organization face to achieve those objectives?
7. How do you view pressures from your peers, or superior, and probably other relevant people or units within your organization?
8. How do these pressures affect your actual behaviour?
9. How do you find these pressures align with the financial management objectives?
10. Do you think you have adequate capability to perform your roles?
11. What have you done to improve your competencies to work?
12. How do you find current procedures/guidelines/training etc assist you to behave or act as expected?

Specific questions

13. As you may aware, other parties, such as Inspectorate, BPKP, or BPK conduct a review or an audit on your area regularly. Specific to this, could you please briefly discuss the main findings/problems which were reported by the auditors?
14. How do you find those findings/problems impact the quality of financial management in your institution?
15. What did actually cause the emergence of those findings/problems?
16. What were the (internal) motives which lead you (and the official/staff in your organization) doing activity which is not in accordance with the rules/regulation as interpreted by the auditors? Any other motive/reason?
17. Other than internal motives, were there any external factors (i.e. from the environment) which lead to such deviations?

Critical questions

18. Could you please tell me the process of you joining the public service? What did motivate you, at that time, to join the public service? And what was your expectation, at that time, for being a public servant?
19. Compared to the first time you joined the civil servant, what are your motivation in your current roles now? How does it differ to your initial motivation?
20. To what extent the institutional policies impact your motivation to work in accordance to the rules and regulations?
21. What is your expectation at work now? Do you have any expectation on your future career?
22. To what extent do you think your institution will be able to fulfil your expectation?

23. How do you manage your roles to help you achieve your expectation?
24. How did your motivation and expectation at work affect your behaviour in exercising your roles in the organization?
25. Do you have any other activity outside your work now? How does your activity impact your work? How do you manage it?

Additional/optional questions (if time permits)

26. In what way do you think your behaviour within your roles here will impact or not impact the fulfilment of public interest?
27. How do you rate the effectiveness of your institution's internal control system to achieve the objectives of your local government's financial management?

C. Closing and wrap up

- Expressing gratitude for his/her participation in the research
- Telling him/her about the possible future contact to clarify something (asking his/her contact detail, i.e. email/mobile/phone number).
- A souvenir can be provided as a token of appreciation

◊◊◊◊◊ The End ◊◊◊◊◊

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