

# Financial Budgeting, Financial Governance, and Conflict of Interest: A Critical Challenge to Good Financial Reporting

Idhar Yahya and M. Zainul Bahri Torong  
*Universitas Sumatera Utara, Medan, Indonesia*

**Keywords:** Finance Report Quality, Budget Planning, Budget Planning, and Conflict of Interest

**Abstract:** This study aims to analyse the quality of finance report as an act of finance responsibility from North Sumatera Province to the public, using budget planning, finance administration, and conflict of interest as independent variables. Data that are being used are premier data. The data are then analysed using warpPLS software, with 106 respondents consisting of the head of working unit, finance and accounting staff, treasurer of expenditure, and treasurer of income. Data testing is conducted using validity convergent test, average variance extracted, composite reliability, cronbach's alpha, and R-Squared test. This study's result shows that budget planning, finance administration, and conflict of interest positively and significantly affect finance report quality. It can be concluded that budget planning and finance administration are accountability of government finance management, by keeping interest free of conflict, in order to maintain the objectivity of finance report.

## 1 INTRODUCTION

Regional government's finance report is an integral part of national finance administration, hence finance report on government entity must follow the rules of law and the implementation of government standard accounting. Finance report is of quality when it gives information regarding company operation, in particular cash flow and investor equity (Biddle, Hilary dan Verdi :2009), whereas (Tang, Chen dan Zhijun :2008) defines quality finance report as a report that give the reliable information regarding performance and finance position. Meanwhile, (Jonas dan Blanchet:2000) defines that quality finance report must give information about financial information completely and transparently, not to mislead or confuse the user. All these are in line with the rules of PP No.71/2010; quality finance report becomes very important when government performance is evaluated.

Budgeting is imperative in public sector management, as it is part of government finance administration, which still receives critic and input, (Milewska, Jozwik :2014; Usui, Alisyahbana :2003; Posseth, Nispen:2006; Zarinah, et al: 2016). Budgeting is the final government struggle for rare resource, showing the priority of government. Budgeting is considered as the most important

economic tool of any government (Olurankinse: 2011). Budgeting is paired with finance report to assess the succeed rate and realisation in one-year budget. Budgeting is a financial plan about what will and should be done (Musgrave:1961), while (Wildavsky:1961) say that budgeting is life source for government, meaning that budgeting is very important to conduct public services. Some variants of budgeting system are developed to meet many purposes, including finance control, management planning, fund using priority, and public accountability. (Schick:1966) stated that basically budgeting has three function, i.e. planning, supervising, and managing, yet in early modern budgeting, the emphasis is on government supervising. However, this emphasis is reduced in the next stage of development, as accounting technique, audit technique, and other technique are found (UU No.17 tahun 2003).

Increasing demand from society regarding public service, especially in the early stage of regional autonomy implementation, with limited income, force government to improve its effectivity and efficiency due in many aspects, including public expenditure. The alternative of for improvement is better budgeting. Other improvement taken is to implement performance-based budget, which is believed to give great benefits for more party (government, legislative, and society).

Belief of good budgeting and conflict of interest always becomes the bet in preparing the budget, which effect can be seen clearly in its operation and in finance report. Finance administration becomes the main centre in finance accountability, so that finance report quality can be maintained.

Finance report must be free from all conflict of interest. Conflict of interest can reduce public belief, integrity belief, and non-siding with public officials. (Mafunisa, M J: 2002) Conflict of interest is a condition where some government officials, who have authority, act to gain profit for personally or other people, which can affect neutrality and decision quality. Conflict of interest will invite problem when an institute or organisation is involved in a program implementation or activity; this can ruin motivation and cause unethical or improper act. (UU No 30/2014). In work place, it can be seen that staff members with less conflict of interest work better and more productive than those with more conflict of interest. However, (Ushie, et al: 2015), stated that conflict can also bring positive impact, when proactive conflict management strategy and dialogue are used to stop bad, low productivity performance.

Based on such problem, the purpose of this study is to analyse and give empirical evidence regarding the effect of budget planning, finance administration, and conflict interest on finance report quality of regional government.

## 2 LITERATURE STUDY

National finance system improvement starts from the implementation of UU No.17/2003, giving the rise to good governance in managing national finance, which is professional, open, fair, honest, and responsible. This rule implementation is expected to be the powerful law in enforcing the application of finance management which is clean, dignified, and free from corruption (Halim: 2012). With this policy, the quality of regional government' finance report can be trusted and believed (PP No.71/2010).

Budget is a finance plan made in a detailed and systematic way, containing the plan of income and expenditure in a certain period. Budget is also a statement regarding performance estimation which will be achieved in an organisation, measured in terms of monetary unit. In public organisation, budget becomes accountability instrument in executing and conducting a program or an activity funded by public fund.

Government in completing national finance management implement budget based performance,

in order to improve transparency and accountability of public services, as well as effectivity from implementation of policy and program (Istianah: 2010). The success indication of this budget based performance is when improvement happens in public services, social welfare, democracy, fairness, equality, and good relation between central and regional government.

System and procedure of administration in regional treasurer relates to performing tasks and authority of government treasurer in administration, and also responsibility of conducting regional government budget. Administration cannot be separated from finance report unit. Work unit as administrativeoperator has an authority to make connection, resulting in regional income or expenditure, and also testing and giving the bill to the user of the budget, meanwhile the operator of treasurer is given to general regional treasurer. All of these must be supported by good finance management (PP No.58 /2005, Permendagri No.13/2006 and No.59/2007).

Quality finance report must be free from conflict of interest. Conflict of interest can be defined as quarrel, dispute, or opposition that happen from a person or a group of people in daily life (Coser: 1967). Conflict of interest can be a threat to national government in conducting its function lawfully. Conflict may be positive and improve performance, although most are negative in nature and may prove to be fatal. In short, not all conflict situation is bad (Omisore and Abiodun: 2014).

### 2.1 Conceptual Body and Hypothesis

Based on background and theory study, conceptual body developed in this study is shown on Figure 1. Independent variables are budget planning, finance administration, and conflict of interest, whereas dependent variables are finance report quality

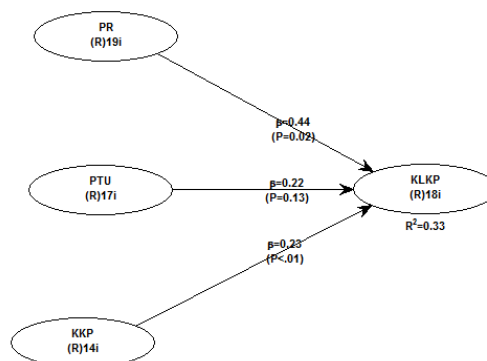


Figure 1: Theoretical Framework

Hypothesis from this study is that budget planning, finance administration, and conflict of interest affect finance report quality

## 2.2 Population and Sample

Population from this study is Provincial Government of North Sumatera. Study procedure is conducted using survey method and data are obtained from questionnaire given to respondents. The respondents are Head of Regional Work Unit, finance/accounting staff, income treasurer, and expenditure treasurer, with 106 samples in total.

## 2.3 Data Analysis Method

For data analysis method, WarpPLS software is used. PLS (Partial Least Square) is a structural equation method (SEM), which is variant based, can simultaneously perform measurement model test and structural model test.

# 3 RESULT AND DISCUSSION

## 3.1 Data Testing

Data testing is done using convergence validity test, which shows that all variables (outer loading) give proper value, meaning that all questions on each indicator are valid (ranging between 0.59 until 0.909). Other tests performed are Average Variance Extracted (AVE) test, Composite Reliability (CR) test, and Cronbach's Alpha (CA) test; all three tests show valid value, i.e. higher than the critical number of 0.5 and 0.7. Finally, R-Squared test is performed with number of 0.334, meaning that 33.4% of finance report quality in regional government is explained by budget planning variables, finance administration, and conflict of interest, while the remaining 76.6% is explained by other factors outside of this study.

## 3.2 Budget Planning Effect on Finance Report Quality

Based on the result of data analysis, budget planning positively and significantly affects finance report quality. This means that good budget planning is the most important aspect in compiling finance report. Budgeting aspect is planned by work unit almost a year prior to its execution, therefore some miscalculation in budgeting may happen (Abdullah, 2012).

Problem that always arises is the inability to use budget properly and fairly due to conflict of interest or other technical problems that are hard to avoid. Obeying rules and executing the planned budget accordingly will greatly affect financial report of regional government. However, in reality, budget is often used to achieve a certain purpose, such as opportunistic behaviour made by legislative or executive (Abdullah, Asmara: 2006). Performance-based budget in regional government has been implemented since 2002, although in its development this has not been implemented properly, awareness for this matter should be improved to cultivate dutiful character.

## 3.3 Administration Effect on Finance Report Quality

Data analysis shows that finance administration positively and significantly affects finance report quality. This means that administration's function is both for accountability and controlling the execution of local government budget. Accountability function means good administration is a requirement for good finance report quality. Administration's controlling function is organised in regional regulation and legalised by a certain authority. In short, this administration body is important since all organisation activity are written and compiled (Permendagri 13/2006).

## 3.4 Conflict of Interest Effect on Finance Report Quality

Conflict of interest positively and significantly affect finance report quality. Conflict of interest must be avoided in all organisations, so that every decision taken can remain objective. Transparency and accountability must exist each time finance report is compiled. In this study, finance report conveyed that there are still some parts of control division, which are not working properly, affecting finance report quality. Control function effectivity is greatly affected by the organisation structure complexity and how it is designed. The more complex an organisation's structure becomes, the tighter supervising and control function needs to be.

Conflict may arise due to differences in background, culture, and experience from each member. These differences are sometimes deliberately made as a strategy for the leader to make some changes or happen naturally, as stated by Hocker and Wilmot. Conflict may happen due to people involved have different purposes or similar

purpose but different way of achieving it (Wirawan, 2010: 8).

## 4 CONCLUSION

### a. Budget

Regional government budget is tool of accountability, management, and regional economy policy as part of good and clean governance. Government is expected to improve efficiency in using the budget through good budget planning, so that society expectation can be met by conducting some government programs. Performance-based budget has been implemented, yet improvement needs to be continued.

### b. Administration

The activity of finance administration has the power to control the budgeting, since there exists authorised body to supervise as settled in regional regulation. Administration is often considered as an important part of comprehensive document or part of legal proof. Administration must always be conducted properly because work volume increases each year.

### c. Conflict of Interest

Conflict of interest exists when assignments and responsibilities of an employee have a potential to be compromised with individual or group interest. Conflict of interest is real and can be felt (Staff Guidance note: 2007). There is always a possibility for conflict of interest to rise or be perceived. Both possess potential to be problematic, as conflict may disrupt harmony and balance in organisation. Objectivity can be affected if conflict arise and conflict will definitely affect finance report quality. These problems should be avoided, so that independency and objectivity can be maintained.

## REFERENCES

- Abdullah, Syukriy (2012), Perilaku oportunistik legislatif dan faktor-faktor yang mempengaruhinya: bukti empiris dari penganggaran Pemerintah Daerah di Indonesia, Disertasi, Universitas Gajah Mada Yogyakarta (*unpublished*)
- Abdullah, Syukriy & Jhon Andra Asmara (2006), Perilaku oportunistik legislatif dalam penganggaran daerah, bukti empiris atas aplikasi agency theory di sektor publik, Simposium Akuntansi 9, Padang
- Biddle, C, Hilary, G and Verdi, R (2009), 'How does financial reporting quality relate to investment efficiency?', *Journal of Accounting and Economics*, 48: 112-131
- Conflict of interest staff guidance note - Approved by the Council of Ministers, April 2007 - <https://www.gov.im/media/622901/conflictsofinterestguidancenot.pdf> akses Januari 28, 2018
- Coser, L.A. (1956). *The Functions of Conflict*. New York: Routledge and Kogan Paul
- Isti' anah, 2010. "Penerapan dan Implementasi anggaran berbasis kinerja", *jurnal informasi perpajakan dan keuangan publik*, Vol.5, No.1, Edisi Januari
- Jonas, G & Blanchet, J 2000, 'Assessing quality of financial reporting', *Accounting Horizons*, 14(3).
- Staff Guidance note: 2007 - Chief Secretary's Office - May 2007
- Tang, Q Chen, H & Zhijun, L (2008), 'Financial reporting quality and investor protection: a global investigation', *Working Paper*
- Milewska, Jozwik: 2014; Usui, Alisyahbana: 2003; Posseth, Nispen: 2006; Zarinah, et, al: 2016; Kleiman: 2001
- Milewska, Anna and Małgorzata, Jozwik (2014), Organization and changes of local government finance system in view of implementation of participation budgeting, *Scientiarum Polonorum (ACTA) Oeconomia* 13 (4) 2014, 125-134
- Musgrave R.A. (1969) *Fiscal Systems* New Haven: Yale University Press
- Musgrave R.A. (1974) *Expenditure Policy for Development* in D.T. Geithman (ed) *Fiscal Policy for Industrialisation and Development in Latin America*, University of Florida Press, Gainville
- Mafunisa MJ (2015), Conflict of interest ethical dilemma in political administration. *Academic Research International* Vol. 6(2) March 2015
- Olurankinse, F, 2010, Inter Local Government Capital Budget Execution Comparism, *American Journal of Economics and Business Administration* 3 (3): 506-510, 2011, ISSN 1945-5488, © 2011 Science Publications.
- Omisore, Bernard Oladasu and Abiodun, Ashimi Rashidat (2014), Organizational conflicts causes, effect and remedies, *International Journal of Academic in Economics and Management Sciences*, Vol.3 No.
- Posseth, Johan J.A and Frans.K.M.van Nispen (2006), *Erasmus University- Performance Budgeting in The Netherlands: From Policy Budget to Accounting for Policy*, A performing Public Sector, Lauven, June, 1-3, 2006.
- Usui, Norio and Armida, Alisyahbana (2003), Local development planning and budgeting in decentralization Indonesia: update, *International symposium on Indonesia's decentralization policy*, September 4-5, Jakarta, Indonesia.
- Ushie, E. M., Igbaji, P. M., Agba, A.M. Ogaboh (2015), *Conflicts Management in the Administration of Local Government Councils in Cross River State, Nigeria*, International ISSN: 2223-9944, e ISSN: 2223-9553 [www.savap.org.pk](http://www.savap.org.pk) 428 [www.journals.savap.org.pk](http://www.journals.savap.org.pk)