

# Factors That Leads to Financial Management and Their Implications to Local Government Performance: What Should Be Done?

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**Keywords:** Control, Accessibility, Transparency, Accountability, Performance.

**Abstract:** The aims of this paper is to examine the factors that leads to transparency and accountability financial management and their implication to local government performance. Type of this paper was causative research. The population in this study are internal and external stakeholders, with purposive sampling technique, and involving 50 respondents. The result of this test using Smart PLS 3.0 shows that Government internal control system and financial report accessibility has positive effect to transparency. Government internal control system has positive effect to accountability, while accessibility has no effect. Local financial management accountability has implication to local government performance, while transparency has no implication. The results of this study can contribute to knowledge and development of accountancy literature especially public sector accountancy associated with local financial management and their implication to local government performance.

## 1 INTRODUCTION

The performance of government agencies is closely linked to accountability and transparency. The implementation of various existing laws and regulations related to the application of the concept of accountability and transparency in financial management is expected to realize the management of good local government and stand on its people. Implementation of accountability and transparency in local financial management is expected to improve the performance of local governments. Local governments need to implement an internal control system in local financial management, and facilitate accessibility for stakeholders in obtaining information on local financial report to create transparency and accountability in local financial management. This can add to the trust and support from various parties including the local government apparatus working more vigorously and discipline.

Based on the Evaluation Result Report (ERR) of the Ministry of Administrative Reform and Bureaucracy Reform (PAN-RB) on the accountability performance of the Civil State Apparatus (ASN) in 2016, the Government of Central Lombok regency obtains the CC title. "The CC / Less score indicates that there are many things that do not in sync

between the program / activity and the results achieved. That is, there are still many implemented activities that are useless. This is a challenge for local governments to keep improving their performance," Abnur (2017).

The CC predicate is not in line with the opinion of the audit of LKPD by the Supreme Audit Agency (BPK), that the government of Central Lombok regency obtains unqualified opinion in 5 (five) consecutive years from 2012 until 2016. The Government of Central Lombok Regency must continue to improve internal control system, compliance with statutory regulations, and accessibility of financial statements to maintain WTP opinion.

The current phenomenon of financial accountability is the Audit Result Report (LHP) of BPK for fiscal year 2016, there are 4 (four) weaknesses of the internal control system and there are 6 (six) findings of non-compliance with laws and regulations. This has a financial impact resulting in a loss to the financial statements of the local government of Central Lombok Regency.

One of the efforts of the local government of Central Lombok Regency in realizing transparency and accountability of regional financial management is through website <http://lomboktengahkab.go.id/>. On the website there are some important data's related to

the management of regional finances such as APBD report of Fiscal Year 2016, LPSE link (e-procurement) which still cannot be accessed until now. (Accessed Friday 30 June 2017).

Several studies have been conducted to ex-amine the effect of SPIP and the accessibility of financial statements on transparency and accountability of local financial management. Researchers testing SPIP's influence on transparency of local financial management are Rakhman (2013) proving positive results, while Azizah (2014) concludes that SPIP has no effect on transparency. Hehanusa (2015) proved empirically that the accessibility of financial statements has a positive and significant impact on the transparency of financial statements. Re-searchers who examine the influence of SPIP on the accountability of local financial management that are Kartika (2013), Aramide et al (2015), Lelly and Kewo (2017) show different results. The influence of financial statement accessibility to the accountability of local financial management is done by Sande (2013) that the accessibility of local financial report has a positive and significant influence on the accountability of local financial management.

Research on the effect of transparency and accountability of local financial management on local government performance by Auditiya (2013) proves that transparency and accountability of local financial management have a positive and significant impact on local government performance. In the other hand, Astuti (2013) concluded that the transparency and accountability of local financial management do not bring effect on the performance of local governments.

The difference of this study with previous researchers is that there is no researcher who explores the factors that influence transparency and accountability of regional financial management that is the internal control system of government and accessibility of financial report and its implication to local government performance.

The motivation to do this research is because there is still a research gap from previous research and the phenomenon of BPK auditor's findings on the weakness of internal control system, non-compliance with legislation from internal stakeholder perspectives and external stakeholders on the application of government internal control system and financial statement accessibility.

Based on the explanation above, the problem in this research are formed as follows: the factors that leads to transparency and accountability financial management and their implication to local government performance?

The objectives of this research are: The aims of this paper is to examine the factors that leads to transparency and accountability financial management and their implication to local government performance.

## 2 LITERATURE REVIEW

### 2.1 Literature Review

According to Jensen and Meckling (1976) describes the agency relationship (Agency Theory) is a contract made by the shareholders (principals) and managers (agents) in which the shareholders (principal) authorizes the manager (agent) decision making to the agent. Furthermore, Zimmerman (1977), agency problems, occurred also in government organization, not just occur in the private sector. Society regarded as principles that mandate / authority to the government as an agent, in performing the duties of government to improve people's welfare.

Spence (1973) as the inventor of the signalling theory (Signalling Theory) states that by providing a signal, the sender (owner of the information) seeks to provide relevant information utilized by the recipient. The receiving party will then adjust his behavior according to his understanding of the signal.

According to Mahsun (2006: 77): "Performance is a description of the level of achievement of the implementation of an activity / program / policy in realizing the goals, objectives, mission and vision organization contained in strategic planning of an organization.

According to Chabib (2010: 10), the financial management needed to control the local financial policy include: 1. Accountability 2. Value for money 3. Honesty in managing public finances 4. Transparency 5. Control.

Transparency is to provide open and honest financial information to the public based on the consideration that the public has the right to know openly and thoroughly the government's accountability in the management of the resources entrusted to it and its compliance with legislation, Nordiawan (2006: 131).

Accountability of local financial management is the responsibility of financial integrity, disclosure and compliance with laws and regulations. The targets are financial statements that include the receipt, storage and financial expenditures of local government agencies (LAN and BPKP, 2003).

PP 60 of 2008 establishing the existence of the internal control system control that should be

implemented at the level of central and local government. COSO (2013); Arenas et al (2014: 315); Kamath (2002:205); Whittington (2001:242) mentioned components of internal control consist of five components, namely: 1. Environmental control; 2. Risk Assessment; 3). Activity Control; 4) Information and Communication; 5) Supervision. This opinion is also supported by Government Regulation No 60 of 2008; Dinapoli (2007:9); Harison (2013:235).

In Law Number 33 Year 2004 regarding Financial Balance between Central Government and Local Government article 103, it is stated that the information mentioned in Regional Financial Information System (SIKD) is open data which can be known, accessed and obtained by the citizen.

In an open democracy, this access provided by the media, such as newspapers, magazines, radio, television stations, and websites (internet); and forums that provide direct attention or incentives that encourage government accountability to the citizen. (Shende and Bennet, 2004).

## 2.2 Conceptual Frame

Signal theory is used to explain the effect of SPIP on transparency and accountability of local financial management. Application of SPI is a form of government (agent) to the people (principal). Implementation of a good internal system, can be used as a means to provide a good signal to the citizen. The control system is designed to gain sufficient confidence in achieving the objectives of financial statement reliability and compliance with laws and regulations. Moreover, this theory explains the effect of transparency and accountability of financial management to government performance. To reduce asymmetry information, the government creates integrity and reliable and financial statements. The financial statements are then audited by the Inspectorate and BPK to be submitted to the DPRD as a form of accountability to the people.

Agency theory also states that agents are opportunistic and tend to dislike the risk of stakeholder trust toward government. The responsibility that local governments show as the executive is how they are able to provide access for users of financial statements. Using financial reports reported by the agency as their responsibility, the principal may assess, measure, oversee transparent and accountable local financial management.

The conceptual framework of this research can be drawn as follows:

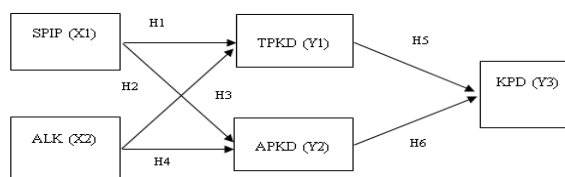


Figure 1: Research method.

Note:

- SPIP : Government Internal Control System
- ALK : Accessibility Financial Report
- TPKD : Local Financial Management Transparency
- APKD : Local Financial Management Accountability
- KPD : Local Government Performance

## 2.3 Hypothesis Development

In the signal theory, the government (agent) will try to give a good signal to the citizen (principal) with the implementation of control systems to achieve goals. The research conducted by Azizah et al (2014) and Rakhman (2013) conclude different results. Rakhman (2013) proves the influence of the government's internal control system on the transparency of local government financial statements is significant and positive. Based on the description, it can be put hypothesis as follows: H1: The government's internal control system has a positive effect on the transparency of local financial management.

In the agency theory, agents are usually opportunistic and tend to dislike risk (risk averse). The responsibility of the government represents as an agent is how they are able to provide access for users of financial statements. According to Mardiasmo (2009: 171): "the citizen as a trusting party toward the government has the right to know and the right to be informed financial report." Hehanussa (2015) empirically prove that the accessibility of financial statements has a positive and significant impact on the transparency of local financial management. Based on the explanation, the hypothesis would be: H2: The accessibility of financial statements has a positive and significant impact on the transparency of local financial management.

The signal theory can help the government (agent), the citizen (principal), and outsiders reduce the asymmetry information by producing a financial report with integrity to believe the reliability of information submitted by the agent, need to get opinions from others who freely give opinion about the financial statements. Research on the influence of internal control system on financial accountability was conducted by Kartika (2013) that SPI does not has direct effect on the accountability of local

financial management, in contrast to conclusion of Aramide et al (2015), Lelly and Kewo (2017). The results showed that the internal control system has a significant positive effect on financial accountability. Based on the description, it can be made a hypothesis: H3: Internal Control System has a positive and significant effect on the accountability of local financial management.

In agency theory, there is an assumption that agents act opportunistically against principals. Sande (2013) concluded that the accessibility of financial statements has a positive and significant impact on the accountability of local financial management. Based on the description, it can be made a hypothesis: H4: Accessibility of local financial reports has a positive and significant impact on the accountability of local financial management.

The signal theory explains that the government as a party given the mandate of the citizen de-sires to show the signal to society by means of transparency of local financial management through the website that can be accessed by users of local financial statement information. Auditiya (2013) concluded that the transparency of financial management has a positive and significant impact on performance. This is a different result with researchers Astuti's (2013). Based on the description, then made a hypothesis: H5: The transparency of local financial management has a positive and significant impact on the performance of local government.

The Signal Theory can help local governments as agents in reducing the asymmetry information of local financial by producing good and integrity financial information. This signal indicates that the local government has carried out its duties and responsibilities as the citizen's caretaker (Puspita and Martini, 2010). Auditiya's research (2013) states that the accountability of local financial management has a positive and significant influence on the performance of the local government work unit. Unlike Astuti's (2013). Based on the description, it can be made a hypothesis: H6: The accountability of local financial management has a positive and significant impact on the performance of local government.

### 3 METHODS

The type of research used is associative re-research. The population in this test is 200 people, consisting of all SKPD in Central Lombok District Government, which is referred to as internal stakeholders. Those included 31 SKPD, Auditor Inspectorate and external

stakeholders consisting of members of DPRD, NGO/foundation, and entrepreneur. The study was conducted in March 2017 to April 2017. Sampling technique is taken based on purposive sampling technique. Sample in this re-research are Sub-Head of Finance Unit of SKPD 9 people, Finance Staff of SKPD 9 people, Auditor Inspectorate 8 people, 8 members of DPRD, 8 NGOs, and Entrepreneur 8 persons, therefore the sample number is 50 people.

Methods of data collection is done by filling the questionnaire. The variable, measured by Likert scale. Data analysis used in this research is Smart PLS program version 3.0.

## 4 RESULTS AND DISCUSSION

### 4.1 Outer Models Evaluation

The outer model evaluation is done to assess the validity and reliability of the model. The result of the evaluation of the first phase outer model is 18 statements declared that it does not to meet the convergent validity because it has the loading factor value  $<0.6$  and 46 statements stated to meet the convergent validity because it has a loading factor value  $>0.6$ . Statements that do not meet convergent validity are 12 of the SPIP Variables, 6 of the Variables APKD. The invalid statement is excluded from the model, PLS Algorithm analysis is performed again for phase II of testing. The result of outer evaluation of phase II model shows that all statements have loading factor value above 0.6, therefore, that stated convergent validity.

Moreover, to fulfil the required loading factor value, the AVE value of the construct also meets the requirements of convergent validity is AVE value  $>0.5$ . PLS algorithm report also shows that all variable constructs have good reliability because they have composite reliability value  $>0.7$ .

### 4.2 Inner Model Evaluation

Based on the R-square value generated from the inner model evaluation, it was concluded that the variable of transparency of local financial management (TPKD) can be explained by SPIP variable and 60.7% financial statement accessibility, while 39.3% is explained by other un-researched variables.

Local Government Financial Management Accountability (APKD) can be explained by Government Internal Control System (SPIP) and Accessibility of Financial Statement (ALK) as much

as 62,3%, while 37,7% is explained by other unexamined variables. Local Government Performance Variables (KPD) can be explained by variable TPKD and APKD equal to 27,0%, while equal to 73,0% explained by other unexamined variables.

Besides R-Square, inner model evaluation through the bootstrapping menu also generates T-statistics values that will be used to test the hypothesis. The criteria are  $T\text{-statistic} > 1.64$  (5% alpha value, one tail).

### 4.3 Discussion

#### 4.3.1 Interpretation of Results

##### 4.3.1.1 Effect of Government Internal Control System on Transparency of Regional Financial Management

The results of the first hypothesis testing, through PLS shows that the value of  $T\text{-statistics} > t\text{-table}$  is  $7,170 > 1.64$ . This shows that the internal control system has a positive and significant impact on the transparency of local financial management. The Government of Central Lombok Regency has implemented SPIP integrally and thoroughly so that local financial management can be implemented transparently.

##### 4.3.1.2 Effect of Accessibility of Financial Statements on Transparency of Regional Financial Management

Results of testing the second hypothesis, through PLS shows that the value of  $T\text{-statistics} > t\text{-table}$  is  $4.371 > 1.64$ . This shows that the accessibility of financial statements has a positive and significant impact on the transparency of local financial management. By providing easy access for users of financial statements, it will enable the operation of a good control function on the accountability of the use of local assets as well as control over the financial policies taken by the government, whether controlled by external user or internal financial statements.

##### 4.3.1.3 Influence of Government Internal Control System on the Accountability of Regional Financial Management

The result of the third hypothesis testing, through PLS shows that the value of  $T\text{-statistics} > t\text{-table}$  is  $12,870 > 1.64$ . This shows that the government's internal control system has a positive and significant effect on the accountability of local financial management. The Government of Central Lombok Regency has implemented SPIP integrally and thoroughly so that

the financial management of the region can be accounted for.

##### 4.3.1.4 Effect of Financial Statement Accessibility to Local Financial Management Accountability

The results of the fourth hypothesis testing, through the PLS shows that the value of  $T\text{-statistics} < t\text{-table}$  is  $0.915 < 1.64$ . This shows that ease of accessing financial statements does not affect the accountability of local financial management. The results of this study due to the publication of financial statements through the Internet media is less effective. This is caused by the society's apathetic condition toward information technology. While the publication of the principle of easy and cheap through the newspaper media is not published by the government.

##### 4.3.1.5 Influence of Transparency of Regional Financial Management to Local Government Performance

The results of the fifth hypothesis testing, through the PLS shows that the value of  $T\text{-statistics} < t\text{-table}$  is  $0.262 < 1.64$ . This shows that the transparency of local financial management does not has implications for local government performance. The result of this research is caused by untransparency of local financial management which is published through newspaper media. Newspaper media is the most inexpensive and easy media. Public ignorance of financial statements causes a lack of community control over local government performance.

##### 4.3.1.6 Effect of Regional Financial Management Accountability on Local Government Performance

The results of testing the sixth hypothesis, through PLS shows that the value of  $T\text{-statistics} > t\text{-table}$  is  $3.153 > 1.64$ . This indicates that the accountability of local financial management has implications for the performance of local governments. This can be proved from the opinion of the WTP from the BPK that the Central Lombok Regency Government achieved 5 times in a row.

## 5 CONCLUSIONS

The conclusions that can be drawn from this study is the government's internal control system and the accessibility of financial statements have a positive and significant impact on financial management, which in turn has implications for the performance of local governments. The results of this study can contribute to knowledge and development of

accountancy literature especially public sector accountancy associated with local financial management and their implication to local government performance. And the results of this study can be used as a consideration for decision makers in the local government.

The proposed suggestions are: Indonesian Government has to be aware of applied the role and regulation toward evaluation of local government performance. This is cause by different part of local government will have different approaches. As result of this research found that was not all of 58 determinant factors could be used as an evaluation for performance of local government. Result of this research will be precisely acceptable if these determinants factor been found has to test further by using bigger respondent and loading factor score > 0.7 as suggested by Chin (1998).

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