Determinant of Indonesia Government Financial Reporting Quality

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ABSTRACT

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This study aims to examine the factors that determine the quality of financial statements in the central government in Indonesia at Ministries/Agencies, namely audit findings and follow-up of audit recommendations. This study uses quantitative methods with secondary data from 74 of 88 Ministries/Agencies in the Central Government in Indonesia. The sampling method is purposive sampling with financial statements starting from 2015-2019 which are processed using the STATA. This study shows that audit findings and follow-up of audit recommendations affect the quality of financial reporting. The more audit findings can have a negative impact on the quality of financial reports and the more follow-up on audit results recommendations can have a positive impact on the quality of financial reporting. This study only analyzes audit findings and follow-up of audit recommendations without any other variables that can support the quality of financial statements and can lead to accuracy in this study. Research is important for the central government in maximizing efforts to maintain the quality of financial reports in the context of accountability to stakeholders, especially to the community through the House of Representatives. This study provides new insights into the factors that determine the quality of central government financial reports in Indonesia.

Introduction

The Government Financial Report is the responsibility for the management of state finances by the Ministry/Agency and prior to submission to the House of Representatives, it is examined by the Supreme Audit Agency of the Republic of Indonesia (BPK RI). The results of the examination by BPK RI are in the form of an audit opinion, namely: unqualified, qualified, adverse, and disclaimer of opinion. The audit opinion given by BPK RI is influenced by audit findings (Furqan et al. 2020; Johnson et al. 2012). Audit findings describe violations that occur in the management of revenues and expenditures by Ministries/Agencies (Liu and Lin 2012), the higher the audit findings, the more negative the audit opinion (Furqan et al. 2020; Pamungkas, Avrian, and Ibtida 2019). In addition, the audit opinion is also influenced by the follow-up to the recommendations of the examination results, the higher the follow-

up to the recommendations of the examination results has a positive impact on the quality of government financial reports ([Pamungkas, Avrian, and Ibtida 2019](#)).

The results of the examination by BPK RI, showed that in general there was an increase in the achievement of unqualified opinions on the Financial Statements of Ministries/Institutions, namely in 2019 it had reached 97.30% or 85 of 88 Ministries/Institutions. However, there is a phenomenon, namely an increase in the quality of financial reports followed by an increase in the number of audit findings ([Pamungkas, Avrian, and Ibtida 2019](#)) and recommendations for audit results that have not been followed up. This shows that there are other factors or indicators that affect the measurement of the quality of government financial reporting.

The results of previous studies used indicators of BPK RI audit opinion to measure the quality of financial statements, namely the size of the BPK RI audit opinion dummy variable, "1" for unqualified audit opinions and "0" for others ([Agustina and Setyaningrum 2020](#); [Furqan et al. 2020](#); [Pamungkas, Avrian, and Ibtida 2019](#)). In this study, in line with the phenomenon that occurred, adding a new measurement, namely using a composite index consisting of the opinion of the BPK RI, the level of disclosure of the Notes to the Financial Statements, and the Statement of having been reviewed by the Government's Internal Supervisory Apparatus.

For this reason, this study aims to analyze the factors that are expected to be able to better measure the quality of financial reports and provide input to the government, especially Ministries/ Agencies to optimize the achievement of financial report quality as a form of accountability to the public.

Literature Review

Agency Theory

The theory of the relationship between the principal and the agency agent has a role in providing or disclosing accounting information, where the agent submits an accountability report on resource management to the principal. However, it is possible that there are different interests, resulting in information asymmetry. With such accounting reporting, it is expected to reduce conflicts of interest between the parties ([Johl et al., 2013](#); [Vanstraelen, 2002](#)). The results of the study [Efendi, Dewi, and Gamayuni \(2018\)](#) show that financial reporting information has not been utilized by the government in decision making. In the context of this research, agency theory is used to explain how much the indicators of the level of disclosure in the financial statements of Ministries/Institutions affect the quality of financial reports, so that disclosure can produce reliable information that can be used by stakeholders in decision making.

Stakeholder Theory

Stakeholder is any group or individual who can influence or be influenced by the results achieved by an organization in order to achieve goals (Freeman 2015). Thus, all

stakeholders have the right to obtain information regarding the organization's activities that may influence decision making. The application of the accounting system in public financial reporting is in the context of transparency and accountability in financial management and is the fulfillment of accountability for the relationship between public authorities and stakeholders ([Biancone, Secinaro, and Brescia. 2016](#)).

Quality of Financial Reporting

The objectives of financial reporting in the public sector include accountability and decision making ([Mack and Ryan 2006](#)). Accountability is the responsibility for managing resources and implementing policies entrusted to stakeholders in achieving the goals that have been set periodically through transparency and disclosure ([Nurdiono et al. 2016](#); [Nurdiono and Gamayuni 2018](#)). The provision of financial statement information must meet the qualitative characteristics of financial statements, namely normative measures that need to be met to meet quality financial reports ([Herath and Albarqi. 2017](#)).

Measurement of the quality of financial reports in previous studies using external auditor examination results indicators ([Johnson et al. 2012](#); [Pamungkas, Ibtida, and Avrian 2018](#); [Agustina and Setyaningrum 2020](#); [Furqan et al. 2020](#)). In the context of previous research on the quality of financial statements in Indonesia, the indicator used is the audit opinion of BPK RI, by using the dummy variable of BPK RI's audit opinion, "1" for unqualified opinion and "0" for others ([Agustina and Setyaningrum 2020](#); [Furqan et al. 2020](#); [Pamungkas, Avrian, and Ibtida 2019](#)).

In this study, to analyze the factors that are estimated to be able to better measure the quality of financial reports, the indicators used are the results of the opinion of the Audit Board of the Republic of Indonesia, the level of disclosure of the Notes to the Financial Statements, and the results of the supervision of the Government Internal Supervisory Apparatus in the form of a Review Statement. on the Financial Statements.

Audit Findings & Quality of Financial Reporting

Audit findings reflect the implementation of government institutions that are not in accordance with applicable regulations or indicate fraud in the management of state finances ([Nguyen et al. 2017](#); [Setyaningrum 2017](#)). Audit findings have proven to be able to identify potential misuse of state money management in several countries ([Bo, Wu, and Zhong 2020](#); [Liu and Lin 2012](#); [Schelker and Eichenberger 2010](#)).

Research results [Baber et al. \(2011\)](#) on municipal governments in the United States concluded that the role of governance, especially regarding the implementation of audits, is a determinant of the quality of local government financial reports. Therefore, the audit findings in this study are interpreted as indicators that can be used to assess the condition of financial management, conformity with accounting standards

([Johnson et al. 2012](#)) and compliance with applicable regulations ([Cohen and Leventis 2013](#)), as well as to describe violations in the management of state finances. Previous research has shown that the higher the number of audit findings, the more violations that occur so that it has a negative impact on the quality of financial statements ([Baber et al. 2011](#); [Johnson et al. 2012](#); [Liu and Lin 2012](#); [Nguyen et al. 2017](#); [Pamungkas, Avrian, and Ibtida 2019](#); [Prabowo 2015](#)) In the context of this research, audit findings are grouped into two categories, namely audit findings on the internal control system and audit findings on compliance with laws and regulations.

Based on this, the hypotheses in this study are: (H1) Audit Findings have a Negative Effect on the Quality of Financial Reporting.

Follow-Up of Audit Recommendations & Quality of Financial Reporting

Follow-up of audit recommendations are corrective steps implemented by Ministries/ Agencies on recommendations based on the findings of the examination by BPK RI (Article 1 of Law 15 of 2004). The follow-up to the recommendations of the examination results shows the level of commitment of the Ministry/Agency to overcome weaknesses or non-compliance that occur in the implementation of government activities ([Liu and Lin 2012](#); [Pamungkas, Avrian, and Ibtida 2019](#)). [Liu and Lin \(2012\)](#), to help reduce corruption in order to improve governance, and to increase government accountability ([Bo, Wu, and Zhong 2020](#)).

If the follow-up to the recommendations on the results of the examination can be carried out effectively and in accordance with the recommendations or suggestions for improvement, then the government's financial management in the next period will be more accountable ([Liu and Lin 2012](#)). Financial management for the next period that is more accountable will reduce the findings of the audit conducted by BPK RI, so that it will have a positive impact on the quality of financial reports ([Setyaningrum, Wardhani, and Syakhroza 2017](#)).

Based on this, the hypotheses in this study are: (H2) Follow-Up of Audit Recommendations Has a Positive Effect on Quality of Financial Reporting.

Method

This study uses quantitative data methods with secondary data through technical regression analysis, namely measuring the relationship between the dependent variable and the independent variable. The research data consisted of 74 of 88 Ministries/Institutions in the Central Government in Indonesia from 2015-2019 which were processed using the STATA tool. The purposive sampling method is used to obtain complete data. The variables in this study are audit findings and follow-up of audit recommendations as independent variables, quality of financial reporting as dependent variable, and ages, government complexity; budget expenditure as a control variable.

Audit Findings uses an indicator of the number of findings on the Internal Control System and compliance with laws and regulations and for follow-up of audit recommendations uses an indicator of the number of follow-ups in accordance with the recommendations of the results of the examination divided by the total recommendations of the results of the audit up to the previous year. Furthermore, the quality of financial reporting uses a composite index value indicator, which consists of an opinion indicator on the results of the BPK RI examination, the level of disclosure of the Notes on Financial Statements, and the results of the supervision of the Government Internal Supervisory Apparatus.

Measurements for each control variable, namely (1) ages are the number of years since the establishment of the Ministry/Agency up to the year of research; (2) government complexity is the number of work units formed up to the year of the study; and (3) budget expenditure is the natural logarithm of the total budget ceiling.

Result and Discussion

Descriptive Statistics and Classical Assumption Test

Table 1 Descriptive statistics

Variable	Min	Max	Mean	Std. Deviation
QFR	.67	1.00	.9381	.05755
AF	.00	141.00	23.0054	18.64575
FolupR	30.21	100.00	74.8468	16.95911
Ages	1.00	74.00	46.1892	24.42714
GC	1.00	7034.00	326.8324	836.25405
BE	4469.55	123956996.0	11544361.32	24422937.71

note: QFR=Quality of Financial Reporting; AF=Audit Findings; FolupR=Follow-Up of Audit Recommendations; GC=Government Complexity; BE=Budget Expenditure; N=370

Source: Data Processing Results

The QFR variable with an average value of 0.9381 out of 1 indicates that most of the samples used in this study have good quality financial statements. The average number of AF is 23 with a maximum value of 141 indicating that there is a fairly large gap in AF in the Ministries/Agencies. In general, the average FolupR of the total sampling for 5 periods is 74.84%. As for ages, it shows that there are Ministries/Institutions having an age from its establishment to the research period, at least 1 year and at most 74 years. The average number of GC is 326 from the maximum value of 7034 work units, indicating that there is a fairly large gap in AF in the Ministries/Agencies. The minimum and maximum values for BE are 44,629.55 and 123,956,996.2, indicating the least and the highest budget expenditure for the Ministry/Agency.

Table 2 Classic Assumption Test Results

Test	Indicator	Score	Results
Normalitas	P-Value >0.05	0.2153	Normal
Multikolinieritas	VIF < 10	1,15 - 2,50	Pass
Heteroskedastisitas	Prob>chi2>0,05	0.4781	Pass

note: N=370

Source: Data Processing Results

The results of the normality test of the data used the Jarque Bera Probability value of $0.2153 > 0.05$, which means that the data is normally distributed. The results of the multicollinearity test show that the data is free from multicollinearity problems because the mean vif is below 10, precisely 1.62. The results of the autocorrelation test show that the Wooldridge test for autocorrelation shows the results of Prob F = 0.1194 which means that the data is free from autocorrelation problems because the Prob > F is above 0.05. The results of the heteroscedasticity test using the Breuch Pagan method show the value of Prob > Chi2 = 0.4781, which is greater than 0.05, which means that there is no heteroscedasticity problem.

Table 3 Hypothesis Test Results

Variable	Coef.	t-stat	P>(t)	Results
AF	-0,0006839	-2,09	0,038	Accepted
FolupR	0,0015649	4,43	0.000	Accepted
Ages	0.007378	2,80	0,005	Accepted
GC	6,41e-07	0,03	0,976	Rejected

note: QFR=Quality of Financial Reporting; AF=Audit Findings; FolupR=Follow-Up of Audit Recommendations; GC=Government Complexity; BE=Budget Expenditure; N=370

Source: Data Processing Results

Audit Findings & Quality of Financial Reporting

Based on the table above, it is known that AF has a t value of -2.09 greater than -1.65 and a P value of $0.038 < 0.05$, meaning that the audit findings have a significant effect on the quality of financial reports. The effect given is a significant negative effect. This means that the more audit findings, the lower the quality of the financial statements. On the other hand, fewer audit findings indicate that the quality of financial reports is getting better. Thus the first hypothesis (H1) is accepted.

These findings generally support the results of previous studies, such as [Litalien et al. \(2009\)](#); [Setyaningrum, Wardhani, and Syakhroza \(2017\)](#); [Din et al. \(2017\)](#); [Pamungkas, Avrian, and Ibtida \(2019\)](#), where the results of the study concluded that there was a negative effect of audit findings on the quality of government financial

reports. In this study, it was found that an increase in the number of violations of the provisions in the practice of managing and reporting government finances could lead to a reduction in the quality of government financial reports. In other words, audit findings can be an indicator of whether or not financial management is good, internal control structures and local government operational efficiency ([Liu and Lin \(2012\)](#); [Nguyen et al. \(2017\)](#); [Prabowo \(2015\)](#)).

Managerial Implication

Based on the table above, it is known that FolupR has a t-value of 4.43 which is greater than 1.65 and a P value of $0.000 < 0.05$, indicating that FolupR has a significant positive effect on the quality of financial reporting. Thus, the second hypothesis (H2) in this study is accepted. This means that the percentage increase in the follow-up to the recommendations of the examination results has an effect on increasing the quality of financial reporting. These findings generally support the results of previous studies, such as [Setyaningrum et al., \(2017\)](#); [Din et al., \(2017\)](#); [Pamungkas et al., \(2019\)](#), which concludes that there is a positive effect of FolupR on the quality of local government financial reports.

Based on the table above, it is known that FolupR has a t-value of 4.43 which is greater than 1.65 and a P value of $0.000 < 0.05$, indicating that FolupR has a significant positive effect on the quality of financial reporting. **Thus, the second hypothesis (H2) in this study is accepted.** This means that the percentage increase in the follow-up to the recommendations of the examination results has an effect on increasing the quality of financial reporting. These findings generally support the results of previous studies, such as [Setyaningrum, Wardhani, and Syakhroza \(2017\)](#); [Din et al. \(2017\)](#); [Pamungkas, Avrian, and Ibtida \(2019\)](#), which concludes that there is a positive effect of FolupR on the quality of local government financial reports.

FolupR is the responsibility of the authorized official at the Ministry/Agency, however, in its implementation in accordance with Government Regulation 60 of 2008 concerning the Government Internal Control System (SPIP), Government Internal Supervisory Apparatus (APIP) or internal auditors have a role to encourage the realization of follow-up and determine the suitability of the follow-up with the recommendations of the examination results given by the BPK RI. Thus, based on this research, it can be stated that APIP participates in efforts to improve the quality of government financial reports. This is in line with the results of research ([Kewo 2017](#)) which concludes that the supervision carried out by internal audit has proven to be one of the media to mitigate risk in the implementation of public sector or government activities.

Conclusion

The results of research conducted empirically prove that audit findings and follow-up of audit recommendations are factors that affect the quality of the Financial Statements of Ministries/Agencies in the central government in Indonesia. The findings of the examination have a negative effect and the follow-up to the recommendations of the examination results has a positive effect.

This research contributes to supporting stakeholder theory, namely that the quality of financial reports at Ministries/Institutions provides added value for stakeholders. Stakeholders include the community, people's representatives, supervisory agencies, audit institutions, parties that provide or play a role in the loan process, as well as the government. Likewise, support for agency theory, namely through the provision and disclosure of accounting information in financial statements, is expected to reduce conflicts of interest between the parties ([Watts & Zimmerman, 2006](#)).

Research is important for the central government in maximizing efforts to maintain the quality of financial reports in the context of accountability to stakeholders, especially to the community through the House of Representatives. In addition, the government can optimize the effectiveness of internal control through the role of the Government Internal Supervisory Apparatus.

This study only analyzes audit findings and follow-up of audit recommendations without any other variables that can support the quality of financial statements and can lead to accuracy in this study. Furthermore, if a study similar to this research is to be carried out, it is recommended to add other independent variables such as the Maturity variable of the Government's Internal Control System, which is a measurement to provide adequate assurance about the ability of the government to implement internal control in achieving increased accountability of state financial management.

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