

The development of good governance model for performance improvement

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Good
governance
model

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Received 25 September 2018
Revised 31 December 2018
Accepted 28 January 2019

Abstract

Purpose – The purpose of this paper is to re-test the determinant factors of the quality of financial statements and performance of the government by adding contextual factors, such as the personal factor, system/administrative factor and political factor, that may affect the quality of financial statement information and performance of the government. The personal factor is proxied to the competencies that affect the quality of financial statements and performance. The social administrative factor is proxied on the regulations and presentation of quality financial statements.

Design/methodology/approach – The analysis unit in this study was conducted at the organizational level. The research object was in the South Sulawesi Province. This was a descriptive and verificative research with a survey technique. Based on the objectives of the research, this is an explanatory study. The research method used was an explanatory survey with a quantitative approach. The population of this research was proxied to the Regional Unit Organization (Organisasi Perangkat Desa/OPD) which compiled the financial statements in the South Sulawesi Provincial Government and consisted of 803 units of local government agencies (Satuan Kerja Perangkat Daerah or SKPD). The purposive sampling technique was chosen under the following criteria: the regional government whose financial statement has been audited by the BPK, the regional government whose financial accountability report has been evaluated by Indonesia's Agency for Financial, and Development Supervision (Badan Pengawasan Keuangan dan Pembangunan or BPKP). In line with the criteria mentioned above, the minimum samples required for 26 observations/indicators are $5 \times 26 = 130$ respondents. The sample size met the minimum sample requirement of five for each group (cell) (Hair *et al.*, 2006, p. 112).

Findings – The personal factor “competence” affects the financial statements’ quality. The high personal factor “competence” will affect the high financial statements’ quality. The system/administration factor “regulation” affects the financial statement quality. The high system/administration factor “regulation” will affect the high financial statements’ quality. Political factors affect the financial statements’ quality. The high political factors will affect the high financial statements’ quality. The personal factor “competence” has no direct effect on the performance. The high personal factor “competence” will not affect the high or low of the performance. However, there is a significant indirect effect between the personal factor “competence” on performance through the financial statements’ quality, which means that the higher personal factor “competence” will lead to higher performance through financial statements’ quality. The system/administration factor “regulation” does not directly affect the performance. The high system/administration factor “regulation” will not affect the high or low of the performance. However there is a significant indirect effect between the system/administration factor “regulation” on performance through the financial statements’ quality which means that higher system/administration factor “regulation” will lead to higher performance through financial statements’ quality. The political factor does not directly affect the



performance. The high political factors will not affect the high or low of the performance. However there is a significant indirect effect between political factors on performance through the financial statements' quality which means that the higher political factor will lead to higher performance through the financial statements' quality. Financial statements' quality affects the performance. The high financial statements will affect the performance.

Originality/value – The research issues raised are the increasing public demands for the government services and accountability, while on the other hand, the government is faced with the report and financial quality that are below the expectation. This issue is a national strategic issue, leading this research to aim at providing guidelines that can help the regional government to formulate operational policies and strategies for the quality improvement of financial statement and performance of the regional government.

Keywords Good Development of Government Management, Performance improvement, Quality of Financial Statement

Paper type Research paper

1. Introduction

The implementation of regional autonomy in Indonesia has been running for ten years. However, the main goal of the regional autonomy has not been able to significantly improve the welfare of people in the region, including the one by improving the performance of regional government. The term “performance” is very familiar in the implementation of governance of the Indonesian government institution today, both at the central and regional levels. It is apparent especially because the issuance of various regulations related to the governance reformation. The governance reformation was marked by the issuance of President Instruction No. 7 of 1999 on Performance Accountability Report of Government Institution, Government Regulation (PP) No. 105 of 2000 (jo. PP No. 58 of 2005), Law (UU) No.17 of 2003, UU No. 25 of 2004, UU No.32 of 2004, UU No.15 of 2004 and PP No. 6 of 2008. Various regulations and other supporting policies have also been issued to improve the government institution's performance.

Referring to such various regulations, it is necessary to conduct a proper financial management in the Indonesian government institution. All activities within the government institution will be measured in terms of performance accountability, including individual performance, unit performance and institution performance, and even overall government performance at both central and regional levels.

Several questions then arise whether or not the issuance of various regulations in this reformation era has indicated an improvement of performance of the regional government. This reformation costs a huge amount of money with regard to formulating and socializing the law (UU), as well as for providing human resources and supporting infrastructure. Thus, the questions will be: How are the concrete results of the policy on the management improvement in the government institution? How are the planning, implementation, controlling and supervision, performance measurement, performance reporting and performance evaluation carried out in the management cycle of government institution? Are these policies/regulations being supported by a good management system that can support the implementation of such policies/regulations?

The fact is that government performance and its financial management are below the expected quality and are generally poor or weak. Various evaluation efforts on the performance management and accountability of Indonesian regional government show unsatisfactory results. This phenomenon leads to the lack of public trust to the government, characterized by the emergence of various public demands for the improvement of government services and accountability. This phenomenon increases the gap between expectation and reality. It is expected that the regulation improvement in the regional

financial management results in quality financial statement and satisfactory performance. However, the performance and quality of financial statement information have not shown a significant improvement, for instance in the South Sulawesi Province.

The gap that occurs raises questions on the quality of financial statement information of the regional government, as well as the government performance, such as why the Indonesian regional government has low performance and poor quality of financial statement, what factors are causing it and how to solve it? It is important to answer such questions because they are presumed to have great impacts on the improvement of public services. On the one hand, the regional government that achieves good evaluation results will receive special allocation of funds for the development program, irrigation, roads, fertilizers and seeds. On the other hand, the regional government with poor accountability performance will not receive such allocation of funds. Therefore, it is very reasonable that the community is unsatisfied with the performance of local government. The paradigms of most regional government institutions remain circling in the amount of activities rather than the results of the proposed activities that can be enjoyed by the community. Moreover, the government activities with huge amount of budget do not mostly correspond to the needs of the community.

To answer the above questions, it is important to find out the factors affecting the performance. Conceptually, Amstrong and Baron (1998, in [Wibowo, 2007](#)) suggest that the factors affecting performance include:

- personal factors, indicated by the skill level, competence, motivation and commitment of the person;
- system factors, indicated by the presence of systems, both administrative system and political system; and
- contextual/situational factors, indicated by the high level of pressure and environmental or political change.

In addition to these factors, several indicators are often used to assess the performance of the regional government. One of the indicators often used is the accountability of regional finance as reflected in the quality of the financial statement issued by the regional government.

Various research on the relationships between financial statement quality and government's performance has been conducted, one of which is conducted by [Thansi \(2004\)](#). By using the information characteristics (relevant, reliability, comparability, consistency and understandability) to measure performance, the study shows the presence of relationship between the characteristics of financial statements' information used and performance of the organization. The research conducted by [Juniarti and Evelyne \(2003\)](#) also show that there is a significant relationship between the characteristics of financial statement information (scope, aggregation, timeliness and integration) and the performance of the organization. Moreover, [Setiana \(2004\)](#), by the similar variables and indicators used by [Juniarti and Evelyne \(2003\)](#), also shows that there is a relationship between the characteristics of financial statement information and performance of the organization. However, other researchers suggest that there is no direct relationship between the characteristics of financial statement information and performance of the organization ([Gul, 1991](#); [Chia, 1995](#); [Nazzaruddin, 1998](#)). They conclude that, even if there is a relationship, it is affected by contextual variables.

Based on the phenomenon mentioned above, the researcher re-tests the determinant factors of the quality of financial statements and performance of the government by adding

contextual factors, such as the personal factor, system/administrative factor and political factor, that may affect the quality of financial statement information and performance of the government. The personal factor is proxied to the competencies that affect the quality of financial statements and performance. The social administrative factor is proxied on the regulations and presentation of quality financial statements.

Therefore, the research issues raised are the increasing public demands for the government services and accountability, while on the other hand, the government is faced with the report and financial quality that are below the expectation. This issue is a national strategic issue, leading this research to aim at providing guidelines that can help the regional government to formulate operational policies and strategies for the quality improvement of the financial statement and performance of the regional government.

2. Literature review

The issues mentioned in last sub-section of the previous section are, indeed, summarized from various research and arguments. One of the arguments states that a quality financial statements is a product of accounting field. Therefore, it takes competent human resources (HR) to produce a quality financial statement. [Amran \(2009\)](#) states that human resource is one of the factors that determine the success of an institution. The presence of qualified HR will certainly affect the quality of financial statements and impact the performance of government.

Regulation is very important because it is the foundation to initiate reformation in a public sector organization, especially the government. In fact, there are many problems associated with the implementation of a regulation. These problems are caused by many factors, one of which is the low synchronization and harmonization of one regulation to others. Several colliding regulations also contribute to the poor quality of financial statements and performance of the regional government. As a result, the regional government is sometimes confused as whom to follow: the Ministry of Home Affairs or the Ministry of Finance. Additionally, inconsistent material content with the regional condition leads to difficulties in implementing the regulations. A regulation should be suited to the regional condition in the form of regional regulations for easier implementation. A pilot area is also necessary to demonstrate the usefulness of the regulation.

Another problem is the frequently changing regulation. The previous regulations often have not been optimally implemented when suddenly the novel ones are issued. As a result, the government cannot perform the policy conductively. This creates confusion and inconvenience for the regional government which leads to the non-functioning of regulation as how it is intended to be. This is in line with the research conducted by [Karim *et al.* \(2006\)](#) in Bangladesh, stating that during the post-regulations period and post-SER period change, significant timeliness has shown that the regulation changes have failed to bring about improvements in the quality of financial statements on timelines. Regulation changes cause the timeliness to even worsen.

The phenomenon mentioned above is suspected to be the reason why the regulatory function has not been able to function optimally. This is in line with the research conducted by [Freeman and Craig \(1999\)](#); [Verlun *et al.* \(2011\)](#); [Karim *et al.* \(2006\)](#), [Latridis \(2010\)](#) and [Parker \(1999\)](#). Generally, these studies argue that there is a relationship between regulation and quality reports that can affect the performance of regional government. Therefore, the regulation needs to be reviewed further to be implemented and obeyed.

If the policies and activities of the regional government are inconsistent with the regulation, it will leads to regional losses, potential shortcomings, lack of revenue, administrative weakness, inefficiencies and ineffectiveness. Indonesia's State Audit Body

(*Badan Pemeriksa Keuangan* or BPK) found and recorded that there were 7,282 cases of non-compliance to the regulations at IDR7,826,780.01m values. Moreover, it was also found that there were 4,117 other cases of non-compliance resulting in state/regional losses and lack of revenue at IDR6,666,051.68m (56 per cent of non-compliance to the regulations cases) (BPK, 2013, p. 9).

Another important factor influencing the quality of a financial statement and performance is political process. We believe that this factor has a great influence due to the fact that the distinctive characteristic of public sector in Indonesia, especially government, is strongly influenced by political circumstances. Political factors can be in the form of political intervention in the financial area and the absence of synergy between political process and political institution to the domain of government administration. Various political behaviors that potentially influence the government include withholding key information from the decision makers, joining coalitions, spreading rumors, leaking confidential information to the media, as well as lobbying for or against the interest of certain individuals or for alternative decisions. As a result, the preparation, implementation and reporting of the public policy implementation are far below the indicators measured. It has become a major hindrance for the region because in every end of the planning year, the planning target prepared at the beginning of the year is mostly not achieved or failed. Therefore, the Head of Region along with its staff and Regional People's Representative Council (*Dewan Perwakilan Rakyat* or DPRD) must complement, coordinate, synchronize and partner with each other in the process of composing the financial statement.

Various research on political influence in the relationships between the quality of financial statements and performance are conducted by Barber and Sen (1984); Barber (1983); Ingram (1984) and Robbin and Austin (1986). Barber and Sen (1984) as well as Barber (1983) conduct an explanatory research to find out the effect of political process in the decision to report the financial information in a financial statement. The research suggests that political factors affect the related decision in the financial information to be reported. Ingram (1984) conducts a research on the state accounting practice in the USA and concludes that the wider disclosure quality, with regard to the GAAP (financial statements quality factor), is related to the voter coalition (political factors).

From the above description, the following hypothesis and conceptual framework can be derived:

- H1. Competence affects the financial statements' quality.
- H2. Competence affects the regional government performance.
- H3. Competence affects the regional government performance through the financial statements' quality.
- H4. Regulations affects the financial statements' quality.
- H5. Regulations affects the regional government performance.
- H6. Regulations affects the regional government performance through the financial statements' quality.
- H7. Politics affects the quality of financial statements.
- H8. Politics affects the performance.
- H9. Politics affects the performance through the financial statements' quality.
- H10. Financial statements' quality affects the regional government performance.

Based on the logic of the above description, a conceptual framework of this research is developed, as illustrated in [Figure 1](#).

2.1 Performance

Performance can be defined as achieving results or the degree of accomplishment. According to Gaspersz quoted by [Adisasmita \(2006\)](#), in the government sector, performance can be interpreted as providing productive, effective and efficient services and in the form of continuous control of government management so that it can improve the smoothness and accuracy of government and development tasks. [Armstrong and Baron \(1998\)](#) in [Wibowo \(2007\)](#) state that the factors that influence performance include: personal factors, system factors, contextual/situational factors. Other than these factors, there are several indicators that are often used to see the performance of local government, but one of the indicators that is often used to see the performance of local governments is the regional financial accountability reflected in the quality of local government's financial statements.

2.2 Quality of financial statements

Research on the quality of financial statements is done by [De Jesus and Airado \(2012\)](#) and [Hardiman et al. \(1985\)](#). Their research uses opinion on examination results as a basis for conducting research to analyze one of the qualitative characteristics of financial statement information, namely, reliability, relevance and integrity. The [Institute of Indonesia Chartered Accountants \(1994, p. 9\)](#) states that: "The qualitative characteristics of financial statements are a characteristic that makes information in financial statements useful to users. There are four basic qualitative characteristics, namely: understandable, relevant, reliable and comparable".

2.3 Competence

HR competence is one of the critical problems faced by organizations, an element that determines efforts to develop organizational performance and is a prerequisite for employees to form specific perspectives on their work ([Widyasari, 2004](#)). Without competence, it will be difficult for organizations to create or produce superior performance when facing the challenges of the global economy. Competence is a characteristic of someone who has training/skills, education/knowledge and ability, as well as work experience to carry out a job ([Hevesi, 2005](#)). Employees who do not have sufficient knowledge in work will face many obstacles that result in waste of material, time and energy. Competence can be developed through knowledge/education, experience and training.

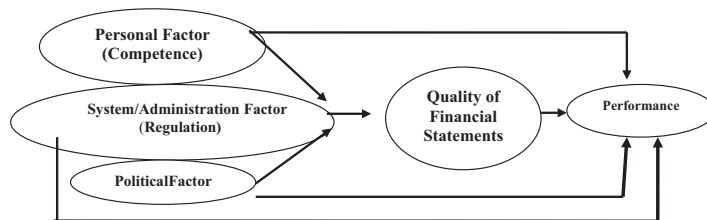


Figure 1.
Conceptual
framework

2.4 Regulation

Building trust in regulations can be seen from several aspects, namely, the level of usability, ease, use, confusion and adherence to these regulations. This is in line with the view of [Ranggawidjaja \(1998, p. 43\)](#) who states that a good statutory regulation must have at least three foundations, namely, a philosophical foundation, a sociological foundation and a juridical basis. Some people even add a political foundation as one of the important foundations for good statutory regulation.

2.5 Politics

The term of politics was polarized by Aristotle (384-322 BC) through his observations about humans whom he called *zoon politikon*. With this term, Aristotle explained that the essence of social life is politics, namely, the interaction between two or more people. Aristotle saw that politics was a natural thing and could not be avoided by humans. The implementation of the political process to achieve personal or organizational goals involves various dimensions or indicators including: coordination, networking and coalitions, as well as negotiation, collaboration or consensus. These indicators can unite the vision, mission and work program so that personal or organizational goals can be achieved optimally.

3. Research methodology

3.1 Method and site

The analysis unit in this study was conducted at the organizational level. The research object was in the South Sulawesi Province. This was a descriptive and verificative research with survey technique. Based on the objectives of the research, this is an explanatory research. The research method used was explanatory survey with quantitative approach.

The population of this research was proxied to the Regional Unit Organization (*Organisasi Perangkat Desa/OPD*) which compiled the financial statements in the South Sulawesi Provincial Government and consisted of 803 units of local government agencies (*Satuan Kerja Perangkat Daerah* or SKPD). The purposive sampling technique was chosen under the following criteria:

- the regional government whose financial statement has been audited by the BPK; and
- the regional government whose financial accountability report has been evaluated by Indonesia's Agency for Financial and Development Supervision (*Badan Pengawasan Keuangan dan Pembangunan* or BPKP).

In line with the criteria mentioned above, the minimum samples required for 26 observations/indicators are $5 \times 26 = 130$ respondents. The sample size met the minimum sample requirement of five for each group (cell) ([Hair et al., 2006, p. 112](#)).

3.2 Determination of data collection technique and data source

The data used in this study were primary data obtained from the field survey results. Data collection period was cross-sectional and collected through a closed model of questionnaire. The data collection procedure was performed by the following process:

- Primary data, obtained through interviews and questionnaires to each respondents. Primary data were specifically collected by the researcher to answer research questions.
- Secondary data, obtained through textbooks, journals, reports or publications published periodically and from the internet related to this research.

This study analyzed the exogenous variables, namely, competence, regulation and politics. Endogenous variables in this study are financial statement and performance quality. Meanwhile, the quality of financial statement in this research serves as an intervening variable. All variables in this research are latent or construct variables (unobserved variables) with the scale of the research used was the interval scale.

3.3 Variable

3.3.1 Independent variable of research.

- *Competence variable (X1)* referred to in this research is a combination of knowledge/education, skills/expertise and attitudes needed to be able to carry out a work (Bontis *et al.*, 1999, p. 30).
- *Regulation variable (X2)* referred to in this research is an action that must be done or should not be done. Regulation variable in this research is reviewed from the aspect of sociology to build trust in regulations so that they can be adhered to and be implemented, namely the level of usability, ease, use, confusion and adherence to regulations in presenting quality financial statements and performance achievement.
- *Politics variable (X3)* is an effort or way to obtain something that is desired or can be called a goal, both personal goals and organizational goals. Political factors in this research use political considerations proxy in the presentation of quality financial statements and performance achievement.

3.3.2 Dependent variable (endogenous) of research.

- *Quality of financial statements variable (Y1)* is the level (quality) or fulfillment of criteria or expectations inherent in financial statement information. The criteria used to measure the quality of the financial statement information adopt the criteria used by Bodnar and Hopwood (2003), GASB (1999), FASB (1980), FASB (2010). These criteria use four indicators, namely, relevant, reliable, comparable, understandable.
- *Performance variable (Y2)* is the provision of services/activities that are productive, effective and efficient from government management so that they can improve the smoothness and accuracy of the implementation of government tasks. Performance is measured using the Gasperz indicator cited by Adisasmita (2006), namely, economics, efficiency and effectiveness.
- Determination of analysis methods.
- The data analysis method used is descriptive statistical analysis and inferential statistical analysis. In descriptive statistical analysis, the data that have been collected is tabulated in the table and discussion is carried out descriptively. Descriptive measure is giving numbers, both in the number of respondents (people) and with the average value of the respondents' answer and percentage. Inferential statistical technique is used because this research analyzes sample data. The results or conclusions taken can be applied to the population. The inferential statistical technique used is partial least square (PLS), which is the best analysis method in the past five years.

4. Results and discussion

The results of the inner model test for the direct effects are summarized in [Table II](#) and [Figure 2](#) ([Tables I](#) and [II](#)).

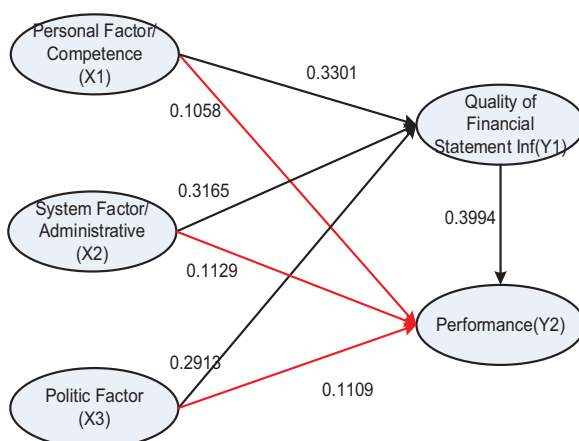


Figure 2.
PLS structural model

No.	Relationship	Coefficient	<i>t</i> -statistic	<i>p</i> -value
1	Personal factors (competence) (X1) on financial statements' quality (Y1)	0.3301	4.3585	0.000
2	System/administration factors (Regulation) (X2) on financial statements' quality (Y1)	0.3165	4.5932	0.000
3	Political factors (X3) on financial statements' quality (Y1)	0.2913	3.4168	0.001
4	Personal factors (competence) (X1) on performance (Y2)	0.1058	0.8793	0.379
5	System/administration factors (regulation) (X2) on performance (Y2)	0.1129	0.8989	0.369
6	Political factors (X3) on performance (Y2)	0.1109	0.8052	0.421
7	Financial statements' quality (Y1) on performance (Y2)	0.3994	2.2384	0.025

Table I.
PLS structural
model: direct effects

Source: Processed primary data (2018)

Indirect effect	Coefficient of direct effect	Coefficient of indirect effect	Note
X1 → Y1 → Y2	X1 → Y1 = 0.3301 ^a	Y1 → Y2 = 0.3994 ^a	0.1318 Significant
X2 → Y1 → Y2	X2 → Y1 = 0.3165 ^a	Y1 → Y2 = 0.3994 ^a	0.1264 Significant
X3 → Y1 → Y2	X3 → Y1 = 0.2913 ^a	Y1 → Y2 = 0.3994 ^a	0.1163 Significant

Table II.
PLS result structural
model: indirect effect

Notes: ^aSignificant; ^{ns} not significant

4.1 The effect of personal factor (competence) on the quality of regional government financial statements and performance

This research found that the personal factor (competence) affects the financial statements quality. The high personal factors (competence) will affect the high quality of the financial statements. Thus, *H1* of this research is supported.

Additionally, this research found that the personal factor (competence) has no direct effect on the performance. The high personal factor (competence) will not affect the high or low of the performance. However, there is a significant indirect effect between the personal

factor (competence) on performance through the financial statements' quality. It means that higher personal factor (competence) will lead to higher performance through financial statements' quality. Thus, *H2* of this research is rejected, but *H3* is supported.

Interpretation of the findings of this research indicates that there are relationships between competence and financial statement quality on the work unit of regional government in the South Sulawesi Province. The result proves that the competence of provincial and municipal/city government in South Sulawesi can improve the financial statements' quality. However, competencies cannot improve the performance directly. Competencies can improve the performance in the regional government work unit of South Sulawesi region if it is through the improvement of the financial statement quality.

This finding is in line with the arguments by [Wriston *et al.* \(1996\)](#) that, to improve the quality of financial statements and the audit results for the interest of management and principals, it should receive full assistance from the organization's management/HR, the board of commissioners, as well as the audit committee. This is due to the many changes in the reporting process that require resources suitable to the competencies required, mastering the accounting concept and not only the bookkeeping process. Therefore, the competencies of accounting resources are highly needed to maintain the financial statement quality as the output of the accounting department.

The results of this research support the results of research by [Cheng *et al.* \(2002\)](#) which state that the absence of accounting background will cause the inability of the officer to analyze the financial statement. Such inability will affect the understanding of internal accounting reports used in an effort to manage effective and well-performing government.

This research finding supports the research by [Wichman \(1984\)](#); [Peacock \(1985\)](#) and [Holmess and Nicholls \(1988\)](#). [Wichman \(1984\)](#) states that the problems in accounting implementation occur due to lack of accounting knowledge of the employee. [Peacock \(1985\)](#) concludes that the low accounting knowledge of business owners has led many companies to fail in presenting their report well. [Holmess and Nicholls \(1988\)](#) study the use of accounting information conducted in 928 Australia-domiciled companies. [Holmess and Nicholls \(1988\)](#) analyzed the degree of preparation and use of accounting information by owners or managers of small firms. The results showed that the low education level of company manager caused many company to use the public accountant services in providing accounting information for the preparation of the financial statements.

Additionally, this research result is supported by [Hamel \(1994, 2008\)](#) which adds that, in general, the more frequent a competence used is better and more valuable because it will improve the performance. Thus, the characteristic of people with high competencies value is what they have is in line with what is required by the user (stakeholders). The stakeholder demands a financial liability in the form of quality financial statements. The end results can impact on the overall improvement of organizational performance. Competence is an absolute requirement for all officers both in top or staff level. This is a requirement of an advanced organization to produce quality financial statements, become a bridge to improve the superior performance of an organization. Having a highly competent officer will result in good reporting quality which in turn will improve the overall performance of the organization.

4.2 The effect of regulation on the financial statement and performance quality

This research finds that the system/administration factor (regulation) affects the financial statement quality. The high system/administration factor (regulation) will impact the high financial statement quality. Thus, *H4* is supported.

This research found that the system/administration factor (regulation) does not directly affect the performance. The high system/administration factor (regulation) will not affect the high or

low of the performance. However, there is a significant indirect effect between the system/administration factor (regulation) on performance through the financial statements' quality. It means that higher system/administration factor (regulation) will lead to higher performance through financial statements' quality. Thus, *H5* of this research is rejected, but *H6* is supported.

The research result indicates that the use of a financial statement will focus on the plans and results of these plans implementations, including the accountability of government performance and its financial condition through the presentation of quality financial statements. Regulation is necessary to achieve a quality implementation of performance accountability and presentation of financial statements. Regulation is important because it is a legal basis or foundation in performing work planning, task implementation and the accountability of what the government institutions have performed. This is in line with the research by [Freeman and Craig \(1999\)](#); [Verlun *et al.* \(2011\)](#); [Iatridis \(2010\)](#) and [Parker \(1999\)](#).

[Freeman and Craig \(1999\)](#) suggest that there is a relationship between legislation and accounting in the public sector, especially the government. Freeman states that the government needs to comply with laws, regulations, contractual requirements and agreement, and all of these may affect the quality management and financial statements. It means there is a relationship between quality accounting report and legislation. Research by [Freeman and Craig \(1999\)](#) is in line with the research by [Iatridis \(2010\)](#) in which it is found that the implementation of regulation can strengthen or improve the accounting quality.

Another research that examines the relationship between regulation and financial statements quality is conducted by [Verlun *et al.* \(2011\)](#). It concludes that the use of regulation improves the accounting quality in terms of value relevance. Value relevance is one of the qualitative characteristics of report information required by Government Regulation No. 71 of 2010. Thus, the information contained in the financial statements prepared by the regional government must be in accordance with the information value criteria required by the legislation. If not, it will cause problems such as regional losses, potential shortcomings, lack of acceptance, administrative weakness, inefficiency and ineffectiveness. This is in line with the findings by BPK that there are 7,282 cases of non-compliance to the regulations at IDR7,826,780.01m values. Moreover, there are 4,117 cases of non-compliance resulting in state/regional losses and lack of revenue at IDR6,666,051.68m (56 per cent of non-compliance to the regulations cases) (BPK, 2013, p. 9).

To reduce the problem, the regulations are then needed to be adhered and implemented. For the regulations to be adhered and implemented, the government needs to foster people's trust on the regulations. Building trusts to the regulations can be reviewed from the sociological aspects. This is in line with the arguments made by [Ranggawidjaja \(1998, p. 43\)](#) who states that a good legislation should have at least three foundations, namely, philosophical, sociological and juridical foundations, and some even add a political basis. Sociological foundation is a factor that can build people's trust to the regulations such as the level of use, usefulness, ease and confusion.

The usage level of regulation is one of the things that can increase the feeling of pleasure, happiness and fun. This is because the usage level of regulation can improve the technical skills of a person in performing his/her duties. Therefore, higher frequency of regulation usage will lead to higher performance generated if it is supported by the adequate report quality. This is in line with the finding by [Parker \(1999\)](#) which states that regulation plays a role in improving the performance.

The usage level of regulations will decrease if the regulation keeps changing, which leads to high confusion. As a result, the regulation cannot function optimally and may worsen the financial statements' quality. This is in line with the research conducted by [Karim *et al.* \(2006\)](#) who state that, during the post-regulation period and post-SER changes period, significant

timeliness has deteriorated, which indicates that regulation changes have failed to bring about improvements in the financial statements' quality in Bangladesh, on timeliness. Regulation changes cause report quality to worsen in terms of timeliness of reporting. Therefore, it is necessary to facilitate the regional government in preparing its officers to face the regulation changes, encouraging the implementation of regional financial governance in accordance with the applicable regulations, efficient, effective, transparent, accountable and auditable. This is important to improve the regional government financial statements quality toward the realization of good governance. Based on the empirical evidence and theoretical studies, it is indicated that, by understanding, obeying and implementing the regulation, it will improve the financial statements' quality that will lead to the performance improvement.

4.3 The effect of politics on the quality of financial statement and performance of regional government

This research found that political factors affect the financial statements' quality. High political factors will affect the high financial statements' quality. Thus, *H7* of this study is supported.

This research also found that political factors do not directly affect the performance. The high political factors will not affect the high or low of the performance. However, there is a significant indirect effect between political factors on performance through the financial statements' quality which means that the higher political factor will lead to higher performance through the financial statements' quality. Thus, *H8* of this study is rejected, but *H9* is supported.

This research results indicate that the public sector environment, including government, is different from the private sector, which can be a consideration in the preparation of government financial statements. This is in line with the statement of Governmental Financial Officers Association in its book *Governmental Accounting, Auditing and Financial Reporting* which suggests that, to understand the model of government financial statements appropriately, it is necessary to consider three things: government structure, characteristics of resources and political process.

The views of the Governmental Financial Officers Association is in line with [Wolk et al. \(2001\)](#) who suggest that regulators in preparing accounting standards for the preparation of financial statements need to take into account three conditions, namely, economic conditions, political conditions and accounting theory. The effect of these conditions created accounting standards for the preparation of qualified financial statements which will result in regulations. The regulations will become a consensus used as a guide for the preparation of financial statements in a country. It is considered as a consensus because the accounting standards that serve as guidelines for the preparation of financial statements are not purely derived from a theory, but also the standards which are arranged in a political arena through consensus. This is in line with the views by [Solomons \(1978, p. 65\)](#) who states that the process of preparing accounting standards to produce financial statements cannot be avoided from political factors, so Solomons termed politicization of accounting. Thus, the standard that guides the preparation of financial statements is strongly influenced by the political process of a government.

This research results are in line with the studies by [Barber and Sen \(1984\)](#) and Barber (1983) which attempt to find out the effect of the political process in the decision to report financial information in the financial statements. The research found that political factors affect the decisions related to financial information that must be delivered. In addition, the political process can also contribute to the failure or success of regional performance achievements. This is in line with research conducted by [Papadakis et al. \(1998\)](#) which concludes that politics and performance are positively related at government companies. Similarly, studies by [Haryanto et al. \(2013\)](#) show that there is an influence of political

dimension on performance. Similarly, the research conducted by [Haliah et al. \(2014\)](#) shows that there is an influence of political process on the report quality. Based on the empirical evidence and theoretical studies, it is indicated that the political dimension affects the performance of regional government through the financial statements' quality.

4.4 *The effect of the financial statements' quality on the regional government performance*

This research found that the financial statements' quality affects the performance. The high-quality financial statements will affect the high performance. Thus, *H10* of this research is supported.

This research result is in line with the argument by [Lin et al. \(1993, p. 17\)](#) who suggest that measurement and assessment are vital, as improving the quality and comparability of financial statements becomes an important task. Lin emphasized that the main focus of the accounting quality of the government financial statements is to facilitate the supervision made as a manifestation of the public demand for performance improvement.

These research results support the research results conducted by [Thansi \(2004\)](#) who uses information characteristics (relevant, reliability, comparability, consistency and understandability) to measure financial performance which indicates the relationship between financial statement information characteristics used with organizational performance. The research conducted by [Juniarti and Evelyne \(2003\)](#) also shows a significant relationship between the characteristics of financial statement information and managerial performance. A research by [Setiana \(2004\)](#), which uses the same variables and indicators as [Juniarti and Evelyne \(2003\)](#), also shows an effect of financial statement information characteristics on performance. Therefore, the good quality of financial administration will guarantee the overall quality of government performance. Based on those opinions, it is indicated that, with the presence of quality financial statements, the performance of regional government will become better.

5. Conclusions and suggestions

Based on the results and discussions in the previous section, the following conclusions are obtained:

- Personal factors (competence) affect the financial statements' quality. The high personal factors (competence) will affect the high financial statements' quality.
- System/administration factors (regulation) affect the financial statement quality. The high system/administration factors (regulation) will affect the high financial statements' quality.
- Political factors affect the financial statements' quality. The high political factors will affect the high financial statements' quality.
- The personal factor (competence) has no direct effect on the performance. The high personal factor (competence) will not affect the high or low of the performance. However, there is a significant indirect effect between the personal factor (competence) on performance through the financial statements' quality, which means that higher personal factor (competence) will lead to higher performance through financial statements' quality.
- The system/administration factor (regulation) does not directly affect the performance. The high system/administration factor (regulation) will not affect the high or low of the performance. However, there is a significant indirect effect between the system/administration factor (regulation) on performance through the

financial statements' quality, which means that higher system/administration factor (regulation) will lead to higher performance through financial statements' quality.

- Political factors do not directly affect the performance. The high political factors will not affect the high or low of the performance. However, there is a significant indirect effect between political factors on performance through the financial statements' quality, which means that the higher political factor will leads to higher performance through the financial statements' quality.
- Financial statements' quality affects the performance. The high financial statements will affect the performance.

Some of the research recommendations are as follows:

- To improve the performance, it is necessary to improve the financial statements' quality.
- Competence, regulation and politics will optimally improve the performance if they are through the improvement of financial statements.

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