



Determinants of Financial Reporting Quality: Evidence from Local Governments in Sumatera Island

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<https://dx.doi.org/10.24815/jdab.v11i1.31788>

ARTICLE INFO

Article history:

Received date: 17 April 2023

Received in revised form: 02 January 2024

Accepted: 16 February 2024

Available online: 15 March 2024

Keywords:

Capital expenditure, financial reporting quality, local government, mayor characteristics

Citation:

Aurelia, C., Nurmayanti, P., Afifah, U., & Setiawan, D. (2024) Determinants of Financial Reporting Quality: Evidence from Local Governments in Sumatera Island. *Jurnal Dinamika Akuntansi dan Bisnis*, 11(1), 175–190

Kata Kunci:

Kualitas pelaporan keuangan, pemerintah daerah, belanja modal, karakteristik walikota

ABSTRACT

This study aims to investigate determinants of financial reporting quality (FRQ) local government in Sumatera Islands, Indonesia. The FRQ local government is proxied by audit opinion from the Indonesian Supreme Audit Board (ISAB) for each local government sample. The tested independent variables are capital expenditure, characteristics of local governments (size, financial independency, and local government status), and mayor's characteristics (experience and age). Data were obtained from the summary of semester audit results of ISAB, official website of the ministry of finance and the local governments in Sumatera Island. Total samples are 143 local governments and the period of study is 5 years (2016 – 2020, or 715 observations). Using the multinomial logistic regression, this study found that a lower ratio of capital expenditure, smaller local governments, local government in city areas, and local governments led by older and experienced mayor are associated with higher financial reporting quality. This study also uncovered that mayor education level and mayor graduated from the Institute of Public Administration (or IPDN) have positive influence of financial reporting quality of the local governments.

Determinan Kualitas Pelaporan Keuangan: Bukti dari Pemerintah Daerah di Pulau Sumatera

ABSTRAK

Penelitian ini bertujuan untuk menguji determinan kualitas pelaporan keuangan pemerintah daerah di pulau Sumatera. Kualitas pelaporan keuangan pemerintah daerah diproksikan dengan opini audit dari Badan Pemeriksa Keuangan (BPK). Variabel bebas yang diuji adalah belanja modal, karakteristik pemerintah daerah (ukuran, kemandirian keuangan, dan status pemerintah daerah), dan karakteristik walikota (pengalaman dan usia). Data diperoleh dari ringkasan hasil pemeriksaan semesteran oleh BPK, situs resmi kementerian keuangan dan situs resmi pemerintah daerah di Pulau Sumatera. Sampel penelitian adalah 143 pemerintah daerah dengan periode pengamatan 5 tahun (2016-2020, 715 observasi). Dengan menggunakan regresi logistik multinomial, penelitian ini menemukan bahwa rasio belanja modal yang lebih rendah, pemerintah daerah yang lebih kecil, pemerintah daerah di wilayah kota, dan pemerintah daerah yang dipimpin oleh walikota yang lebih tua dan berpengalaman berhubungan dengan kualitas pelaporan keuangan yang lebih tinggi. Penelitian ini juga menemukan bahwa tingkat pendidikan dan walikota alumni IPDN memiliki pengaruh positif terhadap kualitas pelaporan keuangan pemerintah daerah.

1. Introduction

The increasing of public demand for good government has encouraged government to realize accountability and transparency in financial management (Xu et al., 2018). Although the government operates in a public sector that is not

profit-oriented, the quality of financial government reports is needed. The quality of financial government reports are prepared to meet the needs of information user, especially the public. The quality of government financial reports is needed by the government to achieve credibility or public trust

(Tavares & da Cruz, 2020). Stewardship theory states that there is a positive relationship between government and the quality of financial reports. The government act as a manager has an obligation to present information that is useful for users (Donaldson & Davis, 1991). The government that is able to maintain public credibility by making mandated financial accountability, so that public welfare can be achieved to the maximum. If the public welfare can be achieved by the government, then the public as the principal will feel satisfied with the government's performance. The credibility of public can be achieved by provide the high-quality of government financial reports (Thoha, 1999).

The high-quality of government financial reports is essential to ensure that government's fiscal decisions are up-to-date and accurate understanding of its financial position. Its also the mechanism through which public, auditors, and legislators to hold governments accountable for their financial performance. Its a critical source of information for markets and other stakeholders to understand the government's financial operations and their implications for their own economic decisions (OECD, 2017).

Indonesia also has to provide the accountability and transparency in regional financial reports. Regional financial management in government regulation number 12 of 2019. Government regulation number 12 of 2019 is all activities from planning to regional financial accountability. The accountability for implementation of local government is by provide the quality of financial reports. Financial report quality is regulated in government regulation number 71 of 2010 about government accounting standards. Government accounting standards assert that the quality of government financial reports must have qualitative characteristics that are relevant, reliable, comparable, and understandable. The practice of these characteristics means that the financial statements presented by the government can indicate

the transparency and accountability of government's financial reports.

The quality of government financial reports is a central issue in the accounting and government literature. Previous research on the quality of financial reports focused on the corporate sector and non-profit/non-government organizations (Dechow et al., 2010; Rakhman & Wijayana, 2019), while it is still less on the government sector. In addition, most researchers use different variables to measure the quality of financial reporting in government and corporate or non-government (Rakhman & Wijayana, 2019). This is because the nonprofit sector managing their financial disclosure to improve performance measures is influenced by market motivations of donations and contracts (e.g., Bhattacharya & Tinkelman, 2009), political costs, regulatory and tax motivations (Krishnan & Yetman, 2011), where this not occurs in the government sector. Therefore, it is interesting to dig deeper into the factors that influence improving the quality of local government financial reporting by using the same measurements in the private sector.

This study investigates the determinants of government financial reporting quality in local governmental, especially in Sumatera Island. Investigating the determinants of financial reporting quality in Sumatera Island context is interesting for following reasons. First, Sumatera Island is one of the larger islands in Indonesia that have 10 provinces with 154 local government regional and city. As an island with the largest provinces and local government, certainly Sumatera Islands has more complex problem. Sumatera Islands are still marred with corruption through the local government. Based on Corruption Eradication Commission in 2020, North Sumatera is ranked 4th as the province with the highest corruption cases in Indonesia. Furthermore, Riau and Riau Islands are ranked 6th, Lampung is ranked 9th and South Sumatera and Bengkulu are ranked 10th with 240 cases. It shows that corruption poses a serious challenge to public management reforms in Sumatera Islands and needs to be addressed comprehensive (Rakhman &

Wijayana, 2019) and it relates to financial reporting quality. SAB has audited 154 local government financial statement of Sumatera Island from 2016 until 2020. Table 1 reports the opinion SAB for audited financial statement of Sumatera Island local government.

Overall, SAB audit results in Sumatera Island local government shows that 623 financial statement has unqualified opinion. This indicates that local government in Sumatera Island report high financial

reporting quality, even though on the one hand the local governments on the island of Sumatra still have high corruption cases. Furthermore, there are 14 local government still has disclaimer opinion. This implies that there are still local governments that have low quality financial reporting. Thus, it is interesting to investigate the factors that influence improving the quality of financial reporting in Sumatera Island.

Table 1. Audit opinion

No	Opinion	Total
1	Unqualified	623
2	Qualified	133
3	Adverse	0
4	Disclaimer	14
	Total	770

Source: Supreme audit board-processed data (2022)

Second, Avis et al., (2017) find that governmental audits mitigate the level of future corruption explain that a lower number of audit irregularities is associated with a lower level of corruption. Casadesús de Mingo & Cerrillo-i-Martínez (2018) suggest that higher transparency is associated with a lower corruption level. Based on that prior research, Unqualified opinion on financial reports enhances the accountability in public sector and can be seen as increasing transparency in governmental financial statements.

Third, prior research examine the influence of top management characteristics on the quality of financial statements have been carried out mostly in the corporate context (e.g Qi et al., 2018; Nurmayanti et al., 2022; Jiang et al., 2013; Nurmayanti M & Rakhman, 2017). However, little is known about affecting characteristics of mayor on financial reporting in governmental (public sector) context (Rakhman & Wijayana, 2019). As the reporting environments differ significantly, the determinants of reporting quality in governmental setting are likely to be different from in the corporate setting.

Pratiwi & Aryani (2017) suggest that local government financial independence affects the quality of financial statements. Large revenues demand high accountability therefore the government will be careful in managing locally generated revenues. Meanwhile, Nuraeni & Martani (2017) state that locally generated revenues has no effect of financial reporting quality. Regional status is the national recognition in Indonesia of an area as a city or regency. The difference between cities and regencies is generally that city areas are more developed and appealing to competent individuals. Human resources tend to be attracted to cities because of the better quality of life and facilities, and career opportunities (Rakhman & Wijayana 2019). Rakhman & Wijayana (2019) show that city local governments tend to have higher financial reporting quality.

Capital expenditure encourages local government growth which supports financial reporting infrastructure and in turn increase the quality of financial reporting (Andirfa et al., 2016). Indonesian President, Joko Widodo (2015) states that the absorption of capital expenditure realised by government was still very slow. Rakhman &

Wijayana (2019) support the negative relationship between capital expenditure and financial reporting quality, because it involves procurement where bribery and corruption often occur (Neu et al., 2014). Kühn & Sherman (2014) revealed that public procurements account for \$9.5 trillion in annual spending on average for governments worldwide, of which \$2 trillion unaccounted for in procurement budgets. Corruption makes accountability more difficult and prevents transparency in the preparation of financial reports. However, Firmansyah, et al., (2022) in their studies proves that capital expenditure has a positive influence of financial reporting quality.

Furthermore, the mayor plays a key role in leadership in local government. The mayor is responsible for regional financial management and accountability. Mayor as CEO in corporation, is considered to have a significant effect on local government outcomes (Hambrick & Mason, 1984). This study focus on experience and age as mayor characteristics (Huang et al 2012) that have influence on financial reporting quality in local government context. Meanwhile, Pratiwi & Aryani (2017) show that mayor's age and experience no effect on financial reporting quality.

Thus, this study aims to investigate the determinants of financial reporting quality in Sumatera Island with local government context through upper echelon perspective. The rest of the paper is organized as follows. Section 2 provides theoretical framework and hypothesis development. Section 3 describes the research method, then section 4 presents discussions and analysis. Section 5 summarizes the results findings and provides conclusion, limitations of this study, and suggestion for future research.

2. Literature review and hypothesis development

Stewardship theory

The grand theory underlying this study is stewardship theory (Donaldson & Davis, 1991). This theory argues that the managers as the steward have

work for the interest of the owners. Therefore, managers do not pursue their self-interest in the first place, but rather work for the interest of the company and the owners. It is expected that the managers use their discretion to pursue the best interest of the owners. In the case of the public sectors, the principal is people and the steward is government. Specifically, the stewards are the civil servants in the governments. The stewards have work for the best interest of the public interest. Also, in the public sectors, the main objective in the public sector is not for profit oriented, but rather on the interest of the public. Referring to the stewardship theory for public sector accounting argue that the focus is more concerned to public credibility. The stewards are expected to use their discretion to provide the best outcome from the government. In case of the financial statement of the local government, stewardship theory argue that steward have effort to provide reliable information. Therefore, stewardship theory predicts that local government provide better quality of the financial statements.

Previous study shows the application of stewardship theory in the public sector (Schillemans & Bjurstrøm, 2020; Cuganesan et al., 2017; Schillemans & Busuic, 2015). Schillemans & Bjurstrøm, 2020 provide evidence that stewardship theory is worked in the public sector agency, the satisfaction of governance model is increased with the elements of stewardship theory. Thus, the application of the stewardship theory have positively affect governance satisfaction.

Further, Cuganesan et al., 2017 show that managers use their discretion to be more active on the providing information to the public interest. The stewards have active role on information sharing the public sectors. Lee et al (2020) provide evidence that stewards in the public sectors prefers to achieve the best interest of the public sectors rather than their own interest. Stewards work to provide the best outcome for the public, such as the best information to the public. Thus, it is expected that the quality of financial statements in the local government is better.

Financial reporting quality

Local governments must be accountable for managing local financial to contributors (IFAC, 2014:13). The purpose of local government financial statements is to show accountability for resource management and provide information for decision makers. Therefore, local governments are required to present financial reporting quality. In this study, financial reporting quality is proxied by SAB opinion follows previous research (Rakhman & Wijayana, 2019). These opinions is classified by unqualified, qualified, adverse, and disclaimer opinion. Audit opinion serves as a measure of financial reporting quality for the several reasons. First, the audit policies applied and audit quality for local government financial report audits will be consistent. Every local government in Indonesia has the same audit opinion. Second, SAB does not collect an audit fee from the local government. It anticipated that the SAB will be less more independent to client pressure to provide a clean opinion. SAB will not hesitate to express disclaimer opinion of financial statements when SAB believe the financial statement not deserve unqualified opinion. Thus, this study establishes an ordinal scale for each audit opinion. Better financial reporting quality indicates the highest score.

Capital expenditure and financial reporting quality

Capital expenditure is a price agreement for the purchase of fixed assets that provide long-term benefits such as the construction of infrastructure, roads and bridges. Capital spending drives local government growth which will support financial reporting infrastructure and information technology systems. Based on Stewardship theory, the government is expected to be able to maintain public credibility by making accountability for the use of capital expenditures which in turn can improve the quality of financial reports.

However, Rakhman & Wijayana (2019) support a negative relationship between capital spending and

the quality of financial reports based on two arguments. First, capital spending usually involves procurement where corruption and bribery are common (Neu et al., 2014). The presence of corruption complicates the accountability process and hinders transparency in the preparation of financial reports. Second, spending capital generally involves complex processes (Warren & Jack, 2018) and risks of failure. Strict capital expenditure guidelines that result in audit findings and are classified as deviations. In addition, capital spending generates long-term assets, which is one of the most common problems encountered by government audit agencies (Warren & Jack, 2018). This causes transparency problems and reduces the quality of financial reports. Based on the arguments, the first hypothesis is stated as follows.

H₁: Proportion of the capital expenditures associated with the lower financial reporting quality

Local government size and financial reporting quality

The size of the local government is marked by the size of the assets owned. Prior studies, in the corporate setting, provide competing evidence on the association between size local government and financial reporting quality. According to Rakhman & Wijayana(2019), large entities typically have more current assets, which gives them greater flexibility in managing earnings because they are under more pressure to meet or exceed analyst expectations. Consequently, the provide in accurate earnings information and thus lower the quality of financial reporting (Lo, 2008)

Kim et al(2017) suggest that large entities tend to control their results less because investor s and analysts pay greater attention to them. Cohen et al (2004) shows that larger entities have more competent internal auditors and more sophisticated internal control systems. Thus, large firm are likely to have better corporate governance mechanisms, leading to improved quality of financial reporting (Cohenet al., 2004).

Guillamón et al(2011)found that a larger area is associated with greater transparency. Regions with a large size have a tendency to realize steward responsibility, namely greater transparency (Rakhman & Wijayana, 2019). However, Nuraeni(2017) and proved that the larger the size of the local government, the more likely it is to receive opinions bad from SAB.

Local governments with large sizes are less able to manage large amounts of assets (Nuraeni 2017). The larger the size of the regional government, the greater the findings, which means that there are errors that can affect the quality of the information presented. Liu & Lin (2012) provides empirical evidence that the number of irregularities detected in government auditing is positively related to the corruption level in China's government that has the greater government. This finding means that the more severe the corruptions is in a China province, the more irregularities in government accounts are found by local audit institutions. This finding is in line with Avis et al (2017) shows that deviations from audit findings are more common in areas with larger sizes. Based on the argument above, the second hypothesis is stated as follows.

H₂: Local government size has influence on financial reporting quality

Financial independence and financial reporting quality

Financial independence shows that the local government can rely on local revenue to finance government activities. Regional Original Revenue (PAD) is one of the main sources for the government to obtain funding sources. The main sources of PAD are taxes and fees from the community. The higher public participation in paying regional taxes and fees, thus the local government will be encouraged to realize steward responsibilities by presenting quality financial reports. Local governments with better independence tend to have better performance in terms of timely submission of financial reports. The higher the financial independence of the local government, the more independent the government

is in financing public activities and services. However, Tavares & da Cruz (2020) in their research prove that local governments with greater locally generated revenues (i.e Pendapatan Asli Daerah) tend to be more transparent. Based on the arguments, we propose the following hypothesis:

H₃: Independent local government is associated with higher financial reporting quality

Local government status and financial reporting quality

Local government status is an acknowledgment of an area as district or city. Differences in the status of local governments related to the quality of human resources and other resources owned in the effort implementation of government. Rakhman & Wijayana(2019)proves that City local governments tend to have higher quality financial reports. Glaeser & Resseger(2010)proves that resources people with good abilities are more in urban status areas. Urban areas are more attractive because of their salaries, career prospects and quality of life better and more job opportunities. Accordingly, availability better resources will monitor and demand a good quality of financial report. Community social control over the government becomes stronger, so that the government is compelled to compile and present quality financial reports in order to create steward accountability to the principle. Based on the arguments, we propose the following hypothesis:

H₄: City - local government is more likely to have higher financial reporting quality

Experience mayor and financial reporting quality

The mayor's experience is experience of the mayor in leading the regional government. Experience is measured by the time a major has held the position. Upper echelons theory predicts that top management outcomes are influenced by individual experience (Hambrick & Mason, 1984). Xu et al., (2018) suggest that top management experience improves the outcome which is quality and disclosure of reporting. The top management has

varying abilities in responding to the problems it faces (Hambrick and Fukutomi, 2015). Each critical situation will be responded to differently by top management. Their responses are influenced by the reflection of their cognitive values and individual characteristics which will affect organizational outcomes.

Pratiwi & Aryani (2017) and Rakhman & Wijayana (2019) prove that the experience of regional heads has a positive effect on the quality of financial reports. Mayor with longer tenure will have experience in carrying out public administration and be able to report the higher financial reporting quality (Nurmayanti et al., 2022). Mayor will use his/her experience to make decisions, so that the results are better than the newly appointed mayor. Based on the arguments, we propose the following hypothesis:

H₅: Longer experience mayor is associated with higher financial reporting quality

Age mayor and financial reporting quality

Age is a measurement of the top manager when he occupies a leadership position. In general, age is a measure of a person's maturity so that they will be more careful in every decision. According to the upper echelons theory, younger manager will like challenges and more innovative in improving

corporate strategy. In the public sector context, Rakhman & Wijayana (2019) supports the positive relation between the mayor age and financial reporting quality. Older mayor have better maturity and experience. Thus, decisions made by mayor have a positive effect on FRQ. Based on the above arguments, we propose the following hypothesis:

H₆: Older mayor is associated with higher financial reporting quality

3. Research method

Data collection

This study used archival data that is obtained from the overview of semester audit results of the Indonesian Supreme Audit Board (ISAB, 2021). Data of local government characteristics are obtained from www.djpk.kemenkeu.go.id information about mayor characteristics is obtained from official website of the local government. Data collection of local government characteristics and mayors' profiles is held by hand collected manually.

Sample criteria

The population in this research is all of local government in Sumatera Islands from 2016-2020. We determine the sample with purposive sampling technique. The sample criteria are presented in Table 2 below.

Table 2. Sample criteria

No	Sample criteria	Total
1	Local governments located of Sumatera Island from 2016-2020	154
	Less:	(11)
2	Mayor who don't have a complete profile in accordance with the research variables	143
	Sample	143
	Total of observation periods	5
	Total of observations in years and firms	715

Source: Data processed (2023)

Table 3. Operational variables

No	Variable	Operational definition	Variable measurement
1	Financial reporting quality (FRQ)	Financial reporting quality is proxies by BPK opinion	Ordinal scale 1 = Disclaimer 2 = qualified 3 = unqualified

2	Capital expenditure (CAPEX)	Capital expenditure is the cost that incurred in the procurement of assets that have a benefit of more than a year (Governments Regulation Number 12 of 2019)	Capital expenditure ratio = total capital expenditure/total budget of local government budget
3	Local government characteristics		
a.	Local government size (SIZE)	Local government size shows how big the local government (Mutiha, 2017)	Total government size = total assets (Mutiha, 2017)
b.	Financial independence (FINDEP)	Financial resources derived from local own revenue (PAD) can be used in accordance with regional government initiatives for smooth running of affairs (Julitawati et al., 2012)	Financial independence = PAD/total government revenue
c.	Local government status (METRO)	Local government status as differences between city and district there are differences in human resources and facilities	Ordinal scale 0 = district 1 = city
4	Characteristics mayor		
a.	Mayor experience (EXP)	CEO experience contributes greatly to the financial reporting quality (Matsunaga & Yeung, 2011)	Mayor experience= number of years the mayor tenure
b.	Mayor age (AGE)	Older of CEO associated with higher FRQ (Huang et al., 2012)	Mayor age = mayor age when in office in year t

The data analysis technique in this research with multinomial logistics regression with the following formula:

$$FRQ_{it} = \mu_0 + \mu_1 CAPEX_{it} + \mu_2 SIZE_{it} + \mu_3 FINDEP_{it} + \mu_4 METRO_{it} + \mu_5 EXP_{it} + \mu_6 AGE_{it} + e$$

FRQ_{it} = Financial reporting quality, proxied by BPK opinion

$CAPEX_{it}$ = Capital expenditure, calculated by proportion of capital expenditure/total local government budget

$SIZE_{it}$ = Local government size, estimated by logarithma natural of total assets

$FINDEP_{it}$ = Financial independence, estimated by regional original revenue/total regional revenue

$METRO_{it}$ = Local government status, estimated dummy variable (District = 0 and City = 1)

EXP_{it} = Experience, measured by the mayor tenure (year)

AGE_{it} = Mayor age (year)

Additional analysis

Additional analysis was used to strengthen the results of the main test is multinomial logistic regression. Multinomial logistic regression is used to explain the relationship between one nominal dependent variable and one or more independent variables. We use multinomial logistic regression test through adding three additional variables such as the mayor educational background (mayor education level and mayor department/study program), mayor gender, and mayor case/irregularities. In Indonesia, cases of corruption still a serious challenge for public management (McLeod & Harun, 2014). Based on Corruption Eradication Commission (*Komisi Pemberantasan Korupsi/ KPK*) no less than 148 mayors have been prosecuted by the KPK.

4. Results and discussion

Panel A, Table 3 shows that there are 155 local governments with city status. Panel B, Table 3 describe that on average local government allocate their budget 21% to capital expenditure. The average local government has total assets of IDR 2.5116 trillion. The average local own-source revenue is 9.6% (the other revenue comes from the provincial

government or central government). Mayor served an average of 4.64 years, the average of mayors is 51 years old. The correlation matrix is presented in table

4 below. Spearman's correlation matrix shows that correlation variable the financial reporting quality and independent variables.

Table 3. Descriptive statistic results

Panel A : Dummy variable						
	N	Value 1		Value 0		
METRO	715	155	21%	560	79%	

Panel B : Continue variable						
	N	Mean	Median	Max	Min	St. dev
CAPEX	715	0.21160	0.2014	0.5800	0.0600	0.0740
SIZE (trillions Rp)	715	2.5116	2.0200	33.8900	0.1300	1.5240
FINDEP	715	0.0960	0.0780	0.4950	0.0040	0.0650
EXP (years)	715	4.6400	4	10	1	2.6730
AGE (years)	715	51.2500	53	71	27	10.9460

These results show that the financial reporting quality is weakly positive correlated with variables of capital expenditure, size, financial independence,

local government status, and mayor experience. Meanwhile, it is weakly negative correlated with the mayor age.

Table 4. Correlation matrix

	FRQ	CAPEX	SIZE	FINDEP	METRO	EXP	AGE
FRQ	1						
CAPEX	0.030	1					
SIZE	0.231**	-0.071	1				
FINDEP	0.134**	-0.134**	0.248*	1			
METRO	0.058	-0.001	0.093*	0.085*	1		
EXP	0.029	0.031	0.003	0.098**	0.069	1	
AGE	-0.103**	-0.107**	0.041	0.032	0.055	-0.233	1

Notes: ***, **, * respectively indicate significance at the 1%, 5%, and 10% levels.

Table 5 reports that the result of BPK audit of 715 local government financial statements in Sumatera Island from 2016-2020, found that unqualified opinion on 576 local government (80.5%), qualified opinion on 125 local government (17.5%), and disclaimer opinion on 14 (2%) local government.

The financial reporting quality has improved from year to year. The most visible improvement is related to changes in the proportion in unqualified and disclaimer opinions. Local government that has received unqualified opinion increase from 67.1% in 2016 to 75.6% in 2017 and continues to increase. The proportion increased of local government

financial statements with disclaimer opinion decrease from 3.6% in 2016 to 2.1% in 2017 and continued to decline until in 2019 and 2020 there was only 1 (one) local government that received disclaimer opinion.

Multinomial logistic regression results

Table 6 presents the coefficients and the t-values of the multinomial logistic regression analyses. The multinomial logistic regression analyses consist of the logit of qualified versus unqualified and the logit disclaimer versus unqualified. The comparison of two logit can be seen in the coefficient value and significance value of the multinomial logistic regression.

Table 5. Distribution of SAB audit opinion in Sumatera Island from 2016-2020

Panel A: Distribution of BPK opinion from 2016-2018						
	2016		2017		2018	
	Value	(%)	Value	(%)	Value	(%)
Unqualified	96	67.1%	108	75.6%	117	81.8%
Qualified	42	29.3%	32	22,3%	22	15.4%
Adverse	0	0%	0	0%	0	0%
Disclaimer	5	3.6%	3	2.1%	4	2.8%
Total	143	100%	143	100%	143	100%
Panel B: Distribution of BPK opinion from 2019 – 2020						
	2019		2020		Total	
	Value	(%)	Value	(%)	Value	(%)
Unqualified	125	87.4%	130	90.9%	576	80.5%
Qualified	17	11.9%	12	8.4%	125	17.5%
Adverse	0	0%	0	0%	0	0%
Disclaimer	1	0.7%	1	0.7%	14	2%
Total	143	100%	143	100%	715	100%

Discussion

Capital expenditure and financial reporting quality

H1 shows significant value of 0.065 with a significance level of 10% and coefficient of -2,812. Thus, there is a negative effect of capital expenditure on the financial reporting quality, meaning that H1

is supported. This finding indicates that local government with has a large proportion of capital expenditure have lower financial reporting quality. Our finding is consistent with Neu et al., (2014), Rakhman & Wijayana (2019) and Pranestianegara & Sari (2021).

Table 6. Multinomial logistic regression

Variable	Predicted sign	Qualified versus disclaimer	Qualified versus unqualified	Result
Intercept		-5,875	-0.787	
CAPEX	-	4.595 (0,171)	-2.812* (0.073)	H1 Supported
SIZE	+/-	-0.615* (0.077)	-0.547*** (0.000)	H2 Supported
FINDEP	+	-1,068 (0.842)	-3.784 (0.125)	H3 Not Supported
METRO	+	-19.733 (0.855)	0.429* (0.090)	H4 Supported
EXP	+	0.166 (0.111)	0.075* (0.065)	H5 Supported
AGE	+	0.035 (0.195)	0.030* (0.090)	H6 Supported
Nagelkerke			0.141	

***, **, * indicate significance at the 1%, 5%, and 10% level, respectively.

The negative relation is due to the proportion of capital expenditure involving complex processes (Warren & Jack, 2018) where bribery and corruption

often occur (Neu et al., 2014). Corruption that still occurs complicates the accountability process and transparency in the preparation of financial reports.

Local government size and financial reporting quality

The results of the second hypothesis show that local government size has negative influence with financial reporting quality. This is indicated by a significant value of 0.000 with a significance level of 1% and coefficient -0.547. Thus, H2 Supported. This finding indicates that the larger size local government, the lower financial reporting quality tend to be. This research is consistent with previous research by Okfitasari, (2015) which states that the smaller of size local government, the higher financial reporting quality. This is because larger entities have a more complex bureaucracy, thus supervision of asset management will be more difficult. So that it creates the potential for inaccuracy in recording assets (Sasmita, 2021). Conversely, the smaller of size local government entity, the easier it is for local governments to control financial reporting, thereby producing relevant information. Thus, the large size local government does not guarantee that the local government can make higher financial reporting quality (Okfitasari, 2015).

Financial independence and financial reporting quality

The results of the third hypothesis show that financial independence has no effect on financial reporting quality. This is indicated by a significant value of 0.125. Thus, H3 not supported. The results of this study support the research of Simbolon & Kurniawan (2018) and Firmansyah et al., (2022). The fact is that local governments are considered to be less financially independent because most of their revenues are generated from government transfers. Funding is provided in amounts and times that may differ from local government expectations and the availability of funds is not always timely. These issues then create uncertainty about programs and activities. In some cases, local governments are forced to postpone programs or activities until the end of the fiscal year. As a result, local governments have very limited time to realize the money and then

prepare financial reports. Problems like this cause the low quality of financial reports (Rakhman & Wijayana 2019).

Local government status and financial reporting quality

The results of the fourth hypothesis show that there is a positive effect between the status of local government and financial reporting quality. This is indicated by significant value of 0,090 with a significance level of 10% and coefficient 0.429. Thus, H4 supported. This study is consistent with previous research which states that city government improve the financial reporting quality (Rakhman & Wijayana (2019) and Tavares & da Cruz, (2020)). This is due to the different status of the regions in relation to the resources they have to support better governance. Generally, urban areas are more attractive because of better career prospects. Thus, human resources with better abilities are attracted to live in cities (Glaeser & Resseger, 2010). People that live in the cities have more active social control to the government (Shardjanto & Yuliningtyas, 2011), therefore local government provide better information to the public. There is positive relationship between local government status and financial reporting quality. People's social control over the government is stronger (Suhardjanto & Yulianingtyas, 2011).

Mayor experience and financial reporting quality

The result of fifth hypothesis shows that there is a positive effect between the experience of regional heads and the financial reporting quality. This is indicated by a significance value is 0.065 with a significance level of 10% and coefficient value of 0.075. Thus, H5 supported. This study supports previous research Pratiwi & Aryani, (2017) Rakhman & Wijayana, (2019), Tavares & da Cruz, (2020) and Mustapha & Obasi, (2021). This is because top management with a longer tenure will be more experienced in carrying out public administration (Matsunaga & Yeung, 2011). Mayor have more knowledge on his/her job, therefore

he/she can use his/her knowledge to make a better decision. This better decision will have provided positive effect on the financial reporting quality. Through experience and knowledge, mayor better understand the government environment and its work patterns.

Mayor age and financial reporting quality

H6 testing shows that there is a positive influence between the mayor age and the financial reporting quality. This is indicating by significance value of 0.090 with a significance level of 10% and coefficient value of 0.030. Thus, H6 supported. This finding indicates that the older of mayor, more likely to have better financial reporting quality. This result is consistent with previous research which found that the mayor age is related with higher financial reporting quality (Xu et al., (2018) and Tavares & da Cruz, (2020)). Typically, mayors are not directly involved in the preparation of financial reports in local government. However, more experienced

mayors are likely to recognize the significance of high-quality financial reports (Rakhman & Wijayana (2019)). The mayor age indicates maturity in decision making process. With older age, mayor has more experience so that he has advantages in terms of managing information to determine outcomes. The older mayor has a competitive advantage because older mayor has more experience. This result in line with Peni (2014) that found that older CEOs and Chairs reflect better experience of CEOs and Chairs in improving firm performance and more careful to make decisions (Pahlevi & Setiawan., 2017).

Additional analysis results

Descriptive statistics of additional variables is mayor educational background (mayor education level and mayor department/study program), mayor gender and mayor case/irregularities are presented in Table 7.

Table 7. Descriptive statistics - additional variables

Panel A: Dummy variable						
	N	Value 1		Value 0		
METRO	715	155	21%	560	79%	
STUDY	715	631	88.2%	84	11.8%	
IPDN	715	65	9.1%	650	90.9%	
GENDER	715	698	97.6%	17	2.4%	
CASE	715	660	92.3%	55	7.7%	
Panel B: Continue variable						
	N	Mean	Median	Max	Min	St. Dev
CAPEX	715	0.2118	0.2014	0.58	0.06	0.074
SIZE (trillion)	715	2.5116	2.020	33.89	0.13	1.524
FINDEP	715	0.096	0.078	0.495	0.004	0.065
EXP (years)	715	4.64	4	10	1	2.673
AGE (years)	715	51.25	53	71	27	10.946

IPDN = Mayor from IPDN (no IPDN graduate = 0 and IPDN graduate = 1)

GENDER = Gender diversity (Female = 0 and male = 1)

CASE = mayor case (Mayor has case = 0 and clean= 1)

Table 7 reports that 88.2% of mayor with an S1 education level and above. Only 9.1% of mayor graduated from IPDN¹. Furthermore, there are still

55 mayors involved in cases. This proves that there are still high irregularities committed by mayors in Sumatera Island. The proportion of women as

¹ *Institut Pemerintahan Dalam Negeri (IPDN) is a government-owned higher education institution operating in the civil service sector which aims to produce government cadres who are competent, have character and personality. IPDN

graduates will work as government cadres and will automatically become civil servants.

regional heads is only 2.4%. This shows that there is still a lack of local governments considering the role of women as regional heads.

Table 8 describes additional variables in education level of mayor has weakly positively correlated with financial reporting quality and mayor gender is weakly negatively correlated. Table 9 shows that additional analysis results with additional

variables in multinomial logistic regression. Based on the multinomial logistic regression result, the additional variable has a coefficient of 0.390 with a significant of 0.116. This shows that the mayor education level has a positive effect of financial reporting quality, mayors with level education above S1 tend to have higher financial reporting quality.

Table 8. Spearman correlation - additional analysis

	FRQ	STUDY	IPDN	GEND	CASE
FRQ	1				
STUDY	0.019	1			
IPDN	0.124**	-0.014	1		
GEND	-0.029	0.042	0.049	1	
CASE	0.004	0.099	-0.034	0.045	1

***, **, * indicate significance at the 1%, 5%, and 10% level.

Furthermore, mayor department/study program has a positive effect of financial reporting quality. This is indicated by a significance value of 0.039 and coefficient value 1.526. Mayor who graduates IPDN education tend to have better financial reporting quality. The results of analysis of additional

variables of mayor gender and case show no effect of financial reporting quality significantly. Finally, the main variable with additional variables is able to predict the financial reporting quality by 17.6%, while the remaining 82.4% is explained by other variables not used in this study.

Table 9. Multinomial logistic regression test result - additional variables

Variable	Predicted sign	Qualified versus disclaimer	Qualified versus unqualified
Intercept	?	-22.565	-2.141
CAPEX	-	4.866 (0.155)	-2.813* (0.075)
SIZE	+/-	-0.430 (0.207)	-0.514*** (0.000)
FINDEP	+	-1.042 (0.857)	-2.647 (0.303)
METRO	+	-16.779 (0.995)	0.458* (0.076)
EXP	+	0.157 (0.140)**	0.079* (0.054)
AGE	+	0.031 (0.248)	0.033* (0.076)
STUDY	+/-	-16.578 (0.994)	0.390 (0.116)
IPDN	+/-	16.614 (0.657)	1.526** (0.039)
GEND	+/-	-15.978 (0.998)	-0.450 (0.568)
CASE	+/-	0.241 (0.825)	-0.502 (0.222)

Nagelkerke

0,176

***, **, * indicate significance at the 1%, 5%, and 10% level, respectively.

5. Conclusions

This study investigates the determinants of financial reporting quality local government in Sumatera Island. We find that lower financial reporting quality is associated with higher proportion of capital expenditure and size local government. Further, local governments in city under more experienced and older mayors associated with higher financial reporting quality. Additional analysis by education level and IPDN mayors are increase of financial reporting quality among local governments.

This study has limitation. This study focuses on educational background of mayor using education level. Future studies should add other variables to better results, as an accounting education of mayor.

This study has several implications. First, these findings that lower FRW is associated with higher proportion of capital expenditure. Consequently, the central government ought to provide high public asset spending assistance to local government in order to improve FRQ. Central government should also implement stronger monitoring in order to prevent corruption and improve transparency, which should result in a better FRQ. Second, public is expected to consider age, experience and educational background to make a choice of mayor candidates.

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