The Impact of Financial Condition on Public Governance Among Provincial Government in Indonesia

by Handoko Arwi Hasthoro

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THE IMPACT OF FINANCIAL CONDITION ON PUBLIC GOVERNANCE AMONG PROVINCIAL GOVERNMENT IN INDONESIA

Handoko A Hasthoro
handoko_arwi@janabadra.ac.id

Henry Sarnowo
hensnine@gmail.com

Nurwiyanta
nurwiyanta@janabadra.ac.id
Universitas Janabadra Yogyakarta, Indonesia

ABSTRACT

This study aims to investigate the impact of financial condition on public governance among provincial government in Indonesia. Short-term solvency and financial flexibility were used as a proxy for financial condition. Meanwhile, public governance was measured by The Index of Governance published by The Partnership for Governance Reform of Indonesia. Local Government's age was used as a control variable. Thirty three provincial governments indexed by The Partnership for Governance Reform of Indonesia 2012were used as a sample. Results from multiple regression analysis show that short-term solvency has a positive and significant association with the Governance Index (Public Governance), but financial flexibility does not. Meanwhile, F-Test shows that financial condition variables simultaneously affect public governance among provincial government in Indonesia. The result implies that a good financial condition will make it easier for provincial government to implement good governance. Hence, good public governance need a good financial conditions.

Keywords : Financial Conditions, Local Government, Public Governance, Local Autonomy

INTRODUCTION

Regional autonomy in Indonesia is implemented under Law No. 32/2004, which was then revised to No. 23/2014 on Local Government Act. The law strictly separates the functions of local government (executive) and the function of the Regional Representatives Council (legislative). The delegation of authority from Central Government to the government of autonomous regions in setting up and administer all governmental affairs called decentralization. Regional autonomy as stipulated in the Regulation of Minister of Home Affairs No. 13/2006and Regulation No. 59/2007 confirms that local governments have the authority to determine the allocation of resources including the expenditure along with the principles of compliance, needs, and capabilities of the region. Therefore it is a challenge for local government to manage the resources efficient and effectively

In accordance with law number 32/ 2004 on local governments, local governments were given an authority in conducting all government affairs including planning, implementation, monitoring, control, and evaluation. However, it is excluded the authority in foreign affairs, defence and security, justice, monetary, fiscal, religious and other matters as stipulated in the government regulations. The autonomy of local government in determining the income and expenditure budget (APBD) as according to their needs and potential will lead to the local government fiscal policy which affect economic growth (Mardiasmo, 2009).

Changes in the political and social system as a result of the current reforms have been demanding for better governance, i.e. good government governance or good public governance. Public governance focuses on how public policy is implemented and public services is performed (Osborne, 2010). It also concerns to the behaviour of how to contribute to the government's performance (Hill and Lynn Jr. 2004). Financial transparency in the regional autonomy era requires the development of accounting system which allows the availability of reliable and accurate information, performance measurement system, and benchmarking in providing public services, as part of the process of public accountability (stewardship accountability process).

In Indonesia, good public governance (GPG) is required in order to achieve national objectives; that are to protect the whole Indonesian nation and the entire homeland of Indonesia, to promote the general welfare, to build the intellectual life of the nation, as well as to participate in maintaining a world order based on the sovereignty of the state, peace and social justice (NCG 2010). To achieve these objectives, there must be a power state with high-healthy competitiveness that can create a sustainable value added through responsible resource management; thereby the credibility of the country both nationally and internationally can be recognized.

Low performance of local governments has leaved a serious homework to the heads of central and local government. The perception of society regarding the successes and failures of government agencies in carrying out the

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mandate given shows the public expectations and concerns. These expectations must be addressed by the local government. However, there are differences between public expectations of local government performance and what is actually done by the managers and government officials. This gap, i.e. expectation gap may cause disharmony between government agencies and the direct users in the community. Akbar, Pilcher, and Perrin (2012) conducted a study using the Partial Least Square to investigate the use of performance measurement systems by local governments in Indonesia. The result documented that local governments develop performance indicators in order to meet regulations rather than to make the organization more effective and efficient for public service.

Expectation gap is the gap that occurs because of differences between people's expectations with what is actually guiding the quality of a management of an organization that provides public services (Mardiasmo 2009). It is as a result of the lack of formal performance measurement system that can inform the level of success of a government agency. In terms of performance, little is known about how to measure the performance of the public sector in the context of developing countries (Neem, Helden and Tillema 2007). An entity, including government entities need to recognize the signs of bankruptcy and make various improvements to increase revenue for prevent potential bankruptcy. To ascertain the financial health of an entity, a financial health analysis needs to be done. Results of financial ratio analysis are then used as benchmarks to assess the financial health of the region and to measure the degree of independence of a region.

Research in the area of public sector accounting in Indonesia which study the performance of local government, both financial performance and non-financial performance are abundant. But there is relatively little researches which focuse on governance (public governance) and financial health. Studies that specifically examine the financial health of local governments have been done by Ritonga et.al. (2012), Kurniawati (2015), and Hasthoro and Septianto (2015). The next research opportunity is to test financial health variables and governance in Indonesia. This study attempts to prove empirically whether financially healthy local governments also implements good governance. Is a good financial health of provincial government can affect governance? This study aims to empirically examine the effects of the financial health of the provincial government on governance in Indonesia.

THEORETICAL REVIEW

Financial Health

The financial condition is the organization's ability to resolve its financial problems, which include cash issues, budget issues, long-term liabilities, and service issues (Wang, Dennis, and Tu, 2007). Health financial condition greatly affects the motion governmental organizations in implementing the work program that has been set. This is a consequence of the implementation of a program which always need funding. Autonomy enables local governments to find out the financial potential in each region and have greater autonomy in managing finances. Good financial health allows local governments to run the program works well, too.

Conceptualization definition of a healthy financial condition of local government in Indonesia was developed by Ritonga, Clark, and Wickremasinghe (2012). The concept includes evaluating the financial condition of local government, namely: short-term solvency, budgetary solvency, long-term solvency, financial flexibility, financial independence, and service level of solvency. Thus, the definition of financial conditions in the local government according to Ritonga, Clark, and Wickremasinghe (2012) is the financial ability of local government to meet its obligations, to anticipate unexpected events, and to use the funds effectively and efficiently. Ratios to assess the financial condition of local government based on the information presented in the financial statements of local government, arranged on government accounting standards. The local government in Indonesia is obliged to use government accounting standards contained in Regulation No. 71 Year 2010.

Government Governance

Public policy implementation and service process to the public has been through the stages of some regimes, namely: (1) public administration; since the beginning of the 19th century until the late 1970s, (2) the era of new public management (New Public Management / NPM) from the early 1980s until the beginning of the century 21st, and a new era of public governance (New Public Governance / NPG) today (Osborne, 2010). According to Bovaird and Loffler (2003), public administration learned about the work of government officials and public servants, including its relationship with the politicians involved in the issuance of public policy and legislative process. NPM discusses budget management, contract culture, entrepreneurial spirit, and accountability for performance. NPG is a discussion about how the stakeholders interact with each other in pursuing the benefits of public. Public governance policies focus on how public policy is implemented and public services is performed (Osborne, 2010), which concerns to the behavior in shaping the government's performance (Hill and Lynn Jr. 2004).

In the context of public administration repositioning, Federickson (2004) states that governance refers to the merging of a number of organizations or institutions, both the government and private sector together to handle public affairs. It also refers to the merger of stakeholders to formulate public policy and its implementation. Hence, networking among organizations is performed in order to achieve public purposes thereby governance is seen as an acceptable publicly system, which is more creative and more responsive.

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Performance on public sector organization, particularly government, is complicated. Characteristics of organization, whose goal is not profit-oriented, tend to be bureaucratic and highly regulated has made the performance is more difficult to achieve than in a business organizations or companies. Efforts have been made by local governments in order to improve the performance of the government, is such as creating a performance measurement system (Mahmudi 2010). Public sector performance measurement system is a system that aims to help public managers assess the achievement of a strategy through financial and non-financial measurement tools. Performance measurement is critical to assess the accountability of an organization and / or a manager in generating a better public service. Mardiasmo (2009) stated that accountability is not just the ability to show how public money is spent but includes the ability to demonstrate that public money had been spent economically, efficiently and effectively. The role of Responsibility center is to create performance indicators as a basis for assessing performance. The use of reliable performance measurement system is one of the key success factors of an organization.

Public sector performance measurement is a system that aims to help public managers in assessing the achievement of a strategy through financial and non-financial measurement tools. According to Mahmudi (2010) performance measurement system can be used as a means to control the organization, by setting reward and punishment system. Performance measurement of public sector aims to help improve the performance of the government. It is also used for resource allocation and decision-making, and to realize public accountability and to improve institutional communication.

The concept of performance measurement which has much been studied on government organization is Value for Money. Value for Money is the core of performance measurement in a government organization. Government performance cannot be assessed in terms of output produced only, but also should consider the inputs, outputs and outcomes altogether. The problem often faced by governments in measuring performance is the difficulties in measuring output, because the output produced is not always tangible, but more in the form of intangible (Mardiasmo 2009). The criteria underlying the implementation of public management desired by the community include accountability on the implementation of value for money, namely: economic (saving carefully) in the procurement and allocation of resources, efficient (efficient) in the use of resources in terms of its use is minimized and results are maximized, and effective (effective) in the sense of achieving goals and objectives.

In the regional autonomy, local governments are given the full authority to manage the region. One of the performance parameters of local government finance is the degree of fiscal decentralization. This size indicates the authority and responsibility given by central government to local government in the independence to explore and manage revenue. Azhar (2008) proves that there are differences in financial performance in fiscal decentralization before and after autonomy is enforced. After autonomy era, the financial performance of local governments in fiscal decentralization decreases.

The Indonesian government has now developed instruments for local government performance by giving a score on an evaluation of the performance of the regional administration based on Government Regulation No. 3 of 2007 and Government Regulation No. 6 of 2008. The implementing institution of this evaluation is the Ministry of Home Affairs. As stated in PP No. 3 of 2007, the head of the region is required to give a description of accountability and submit the report of regional governance.

Hypotheses Development

The hypothesis developed in this study is based on the assumption that a healthy financial condition will make it easier for local governments in implementing work programs so that governance can be improved. The increase of assets and experience in running the government allows local government to run the program in a synergic with stakeholders (Federikson 2004). This study uses financial health variables as predictors of improved quality of governance of local government. To the best of our knowledge, it has not been studied yet in Indonesia.

Short-term Solvency and Government Governance

Asset can be a potential asset, human resources, technology tools, and customer served. The higher the assets, it is easier for local governments to create a program to the community and provide adequate infrastructure for economic ventures by society (Patrick 2007). Government governance will also be able to be implemented properly if government institutions have sufficient funds beyond funds held for routine expenditure, especially personnel expenses (Syurmita 2014).

H1: Short-term Solvency is positively associated with the governance of local government.

Financial Flexibility and Government Governance

Autonomy authorizes local governments in allocating their resources to explore potential areas for increasing revenue. The increased revenue will increase the coffers of cash into local government coffers. Sufficient cash makes local government has more flexibility in running programs of community service and improving governance (Hill and Lynn Jr. 2005).

H2: Financial Flexibility is positively associated with the governance of local government.

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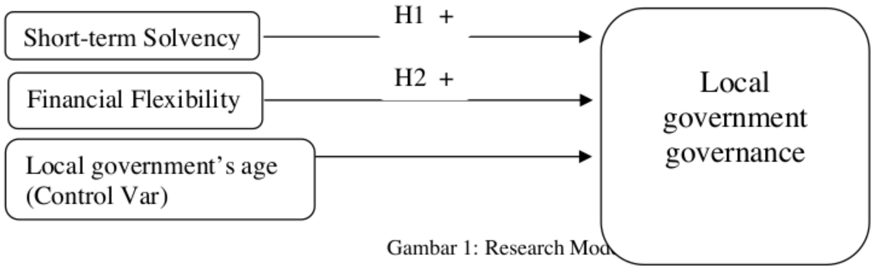

Gambar 1: Research Mod

RESEARCH METHOD

Sample and Population

The population in this study is the provincial government in Indonesia. The sample used in this study was all provincial governments in Indonesia in 2012. The sampling method is census that means the entire population is also a sample.

Operational Definition and Measurement of Variables

Dependent Variable

The dependent variable in this study is the index of governance of local government in Indonesia (Indonesia Governance Index / IGI). IGI is a framework to measure the performance of local government governance. Governance index is expressed in a score performed by The Partnership for Governance Reform in Indonesia. The lowest score is 1 and the highest is 10.

Independent Variable

The independent variables in this study is the financial condition of local government (Ritonga, Clark, and Wickremasinghe 2012) which are measured by (1) Short-term Solvency. Short-term solvency is the ability of local governments to settle obligations in the short term. This ratio is calculated by the formula (Cash and cash equivalents + short-term investments) / (Liabilities). (2) Financial Flexibility. Financial flexibility is a condition in which the local government can increase its financial resources to respond to the commitments that arise. This ratio is calculated by the formula (Total Revenue - Special Allocation Fund - personnel expenditures) / Total Liabilities).

Data Collection Method

Data is secondary data, which was obtained from the pages of the Ministry of Home Affairs, Ministry of Finance, and The Partnership for Governance Reform in Indonesia. The other data needed in this research is in the form of documents or information of each provincial government that is obtained from the Central Statistics Agency branch office in Yogyakarta. The data obtained included data to calculate Short-term Solvency and Financial Flexibility, as well as Indonesia Governance Index in 2012.

Pengujian Hipotesis

Multiple Regression is used to test the hypotheses. The formula is as follows (Gujarati and Porter2010):

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3}$$

Where:

Y	=	Governance (*Governance Index*)
β_0	=	Constant
$\beta_1 \ldots \beta_4$	=	Regression Coefficient
X_1	=	*Short-term Solvency*
X_2	=	*Financial Flexibility*
X_3	=	Local government's age (Control Variable)

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RESULTS AND DISCUSSION

Discussion of results of hypothesis testing begins by presenting a statistical description of each variable. Statistical description shows an overview of the variables used in this research model. The following discussion is a result of the multiple linear regression using SPSS software tools V.16.

Descriptive Statistic

Descriptive statistic is presented in Table 1.

Tabel 1. Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
StS	33	9.40	97.59	47.7248	26.97861
FF	33	4.53	43.20	23.0476	8.77518
Age	33	12.00	66.00	49.0303	18.31407
Governance Index	33	4.45	6.80	5.6997	.57930
Valid N (listwise)	33				

The provincial government in Indonesia has a good Short-term Solvency, 47.72 on average. This because each province has sufficient funds from the General Allocation Fund (DAU) and Special Allocation Fund (DAK). The provincial government seldom owes in large numbers so that the funds or cash held sufficient to pay its obligations. The financial condition of financial flexibility which is supported by earned income can settle the obligation and commitment, with an average value of 23.04. Hence, in overall health or financial condition of the provincial government was in good condition, liquid and flexible.

The Indonesia Governance Index mean score is 5.69 which show still far from the maximum score of 10. In the era of regional autonomy, local government is the locomotive of development at the local level and no longer dependent on the central government. As we all know that there is a high slack among local governments in terms of public services, poverty, human development, income level, and other welfare indicators. This picture reminds us that there is still a lot of "homework" to be done in improving the governance of the provincial government.

Multivariate Regression

Results of Multivariate Regression are presented in Table 2.

Tabel 2. Results of Multivariate Regression

Variabel	Koefisien	T	Sig
(Constant)	4,531	10,982	0,000
Short-term Solvency (StS)	0,010	2,889	0,007
Financial Flexibility (FF)	-0,008	-0,748	0,461
Local Gov's age	0,017	3,299	0,003
R Square	0,325		
Adjusted R-Square	0,255		
F	4,650		
Sig	0,009		

As presented in the table, Short-term Solvency is positively associated with government governance, significant at the 1 per cent level (0.007). The result indicates that the higher the short-term solvency, the government governance is likely to increase. Government at the provincial level is just like a bridge between the central and district / city governments. The capacity of the provincial government in bridging the slack between district / city governments in the region is crucial. In other word, province plays an important role in ensuring that there is no significant slack between districts / cities in the region. According to Ritonga et.al (2012), local governments have a strong ability to settle obligations or commitments incurred in running its operations. This is evidenced by a high score of the ratio.

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As can be seen in Table 2, financial flexibility ratio has a negative association with government governance; however it is not statistically significant. It means financial flexibility has no influence in government governance. Meanwhile, p value of local government's age variable is 0,003 and the regression coefficient is positive. It means that the age of provincial governments has a positive relationship with government governance, significant at 1 per cent level. The result indicates that the older the provincial government, the governance of the government is better. This may be due to the reason that province's long-standing has more experience in providing service to the community and bureaucratic arrangement. The phenomenon of regional expansion proved to give adverse implications for the governance of the provincial government, where the new autonomous regions have the ability to manage worse than the region's long-standing (Syurmita 2014).

F-Test p value in this study shows the value of 0009 which means the whole of independent variables (short-term solvency, financial flexibility, and the age of the province) affect the governance of the provincial government in Indonesia. Strength financial condition and experience of the organization may improve governance for the better. Good governance indicates that governmental organizations have adequate capability in serving the community and improving the welfare of community. According to Morrell (2009) autonomous management and governance is closely linked to financial performance, where the government has sufficient funds to run the program for the welfare of the community.

CONCLUSION

Good public governance requires serious efforts from various parties. Government, including the executive and legislative are expected to have a strong political will to improve the welfare of society. It is not only done in the political aspects, but also economic, social, cultural, legal, and defence. Civil society and economic (business / business) has also plays an important role for the public governance. The priorities of the program and government regulation will be achieved properly if there is an interaction of all the three parties. In the economic aspect, a good financial management provide sufficient space for the government to run a program for improving the welfare of society.

This study provides empirical evidence on the impact of financial conditions and experience on public governance. Good financial management can generate sufficient funds for the government in order to run the program for improving the welfare of society. The data in this study only 33 governments, so that the results cannot be generalized to other levels of government such as the district / city.

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