

Non-compliance to SAP on local governments in Indonesia: The impact of internal control weaknesses in internal control in accounting and financial reporting and regional complexity

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Abstract

This study attempts to analyze the impact of internal control weaknesses in accounting and financial reporting as well as local government complexity on the non-compliance with Government Accounting Standard (SAP) implementation in Indonesian local governments. Using secondary data from the audit results from the Supreme Audit Board (BPK) on Local Government Financial Reports (LKPD), this study finds that there are still non-compliance with SAP in a number of local governments in Indonesia since the application of accrual-based accounting was required in 2015. On the bright side, the number of non-compliance continues to decrease from year to year. Further, this study reveals that the weakness of internal control in accounting and financial reporting as well as regional complexity has a positive effect on non-compliance with SAP implementation. This research encourages local governments to evaluate and make improvements to the existing internal control weaknesses and accommodate the high complexity level through the development of adequate accounting competencies as well as effective and efficient accounting and financial reporting systems. Thus, local governments can produce LKPD that are compliant with SAP with more reliable and relevant financial information.

Keywords: Indonesia; Local government; Non-compliance with SAP implementation; Internal control weaknesses in accounting and financial reporting; Local government complexity

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1. Introduction

The accounting revolution is one of the main agendas in increasing government accountability in Indonesia (Prabowo et al., 2017). Implementing post-reform and regional autonomy, Indonesia has established a series of policies to improve governance of local level, particularly related to financial management to achieve an accountable and transparent government (Adiputra et al., 2018).



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The implementation of accrual-based accounting is one of the most important steps in an effort to realize accountability and transparency in various countries (Salato et al., 2022) so that Indonesia participates in following this step by issuing Government Regulation Number 71 of 2010 concerning Government Accounting Standards (SAP). In this case, accrual-based accounting can provide financial information that is more relevant, reliable, comparable, and understandable (Karunia et al., 2019). Therefore, accrual-based accounting must be practically applied to the local government level starting in 2015 following the mandate of the Minister of Internal Affairs Regulation Number 64 of 2013 (Indriani et al., 2018). However, a number of local governments are still experiencing various obstacles on implementing accrual-based accounting which lead to non-compliance with the application of SAP.

There are many cases of non-compliance with the application of SAP by local governments in Indonesia (Pamungkas, 2018) because the quality of accrual-based accounting practices applied by local governments in Indonesia is still relatively not ideal (Ritonga, 2018). Local governments have not been able to implement accrual accounting practices accurately starting from recognition, measurement, assessment, presentation, and disclosure so that the information presented in the Regional Government Financial Report (LKPD) is not in accordance with SAP. As a result, there are still a number of local governments that are still unable to obtain an Unqualified Opinion (WTP) due to the obstacles they face (Sutaryo et al., 2020). In practice, the public sector accounting revolution in Indonesia through the implementation of accrual-based accounting is still facing many obstacles and challenges due to several significant things (Harun & Robinson, 2010). Specifically, the institutionalization of accrual-based accounting practices has not been implemented optimally in government institutions in Indonesia (Harun et al., 2013).

From the point of view of institutional readiness and capacity, Indonesia has not yet reached the optimal level for the implementation of accrual-based accounting in government institutions (Harun & Kamase, 2012; Suparman et al., 2015), especially in local governments with all the dynamics in it. Accrual-based accounting practices have not been followed by adequate internal controls in accounting and financial reporting. Furthermore, McLeod & Harun (2014) criticize the low accounting competence of human resources in local governments in Indonesia in the field of finance and internal control. Even though this aspect is one of the most crucial and needed (Basri et al., 2016). These obstacles will further hamper the practice of applying accrual-based accounting in local governments with a high level of complexity because it involves more reporting entities (Cagle et al., 2017). In the end, there are still many cases of local government non-compliance with SAP. These issues underlie the need for a study that examines the factors that influence the non-compliance of SAP implementation, especially in local governments in Indonesia.

This study examines the effect of the weakness of internal control in accounting and financial reporting and regional complexity on local government non-compliance with SAP. There are various limitations in previous research, especially regarding the low scope of research because it is limited to one or several local governments so that the research results are not comprehensive (Aswar & Saidin, 2018; Basri et al., 2016; Indriani et al., 2018; Ratifah & Mulyani, 2015; Ritonga, 2018). This study contributes to the development of the literature by providing empirical evidence with a high coverage of all local governments in Indonesia.

2. Hypotheses Development

Agency Theory

Agency theory was introduced by [Jensen & Meckling \(1976\)](#) and is commonly used in public sector research by adopting the concepts of principal-agent relations and agency conflict. This theory is very applicable in any context, including local government ([Lane, 2005](#)). In general, local governments act as agents of the community to provide public services and social welfare where the public delegates the authority to manage public financial resources to local governments. [Halim & Abdullah \(2006\)](#) stated that the agency relationship also applies in the context of local government financial management in Indonesia. As a principal, the community demands transparency and accountability in financial management. Therefore, local governments need accountability media, namely financial reports ([Yusuf & Jordan, 2015](#)) called LKPD. Furthermore, the LKPD will be audited by The Audit Board of the Republic of Indonesia (BPK) as an external auditor to obtain an audit opinion. Local governments are required to compile financial reports as mandated in Law No. 17 of 2003. The financial reporting standards that must be met by local governments are accrual-based SAP. [Jensen & Meckling \(1976\)](#) mention that agents need to be monitored to ensure best practice. In the process, the role of internal control becomes very important to oversee the preparation of financial statements in order to comply with SAP.

Implementing Accrual-Based Accounting in Local Governments in Indonesia

Indonesia applies accrual-based accounting for government institutions as one of the most important reforms in managing state finances ([Mcleod & Harun, 2014](#)). Accrual-based accounting can provide more reliable financial information and improve the quality of financial reports as a medium for government accountability ([Mir & Sutiyono, 2013](#)). The commitment to apply the full accrual basis in local government accounting practices is embodied in Government Regulation Number 71 of 2010 ([Yuliati et al., 2019](#)). For local government institutions, Permendagri Number 64 of 2013 was issued to regulate accrual-based accounting practices at local government institutions ([Savitri & Fanani, 2017](#)).

In its development, accrual-based accounting practices in government institutions in Indonesia are implemented gradually ([Hassan, 2015](#)). Starts from the implementation of cash towards accrual accounting until the 2014 fiscal year. Then, from 2015 onwards, full accrual-based accounting practices become mandatory for all government institutions in Indonesia by following accrual-based SAP ([Mulyani et al., 2018](#)). Through the implementation of full accrual-based accounting standards, it is expected to provide more benefits for users of financial information and various stakeholders ([Karunia et al., 2019](#)). Every year, BPK conducts an audit of LKPD. One of the results of audit activities carried out by BPK is the disclosure of local government non-compliance with SAP ([Muhtar et al., 2020](#)). In the audit report, BPK mentions accounts that have not been treated adequately according to SAP which are divided into 10 major accounts, namely current assets, fixed assets, other fixed assets, long-term investments, liabilities, regional income, operating expenditures, capital expenditures, expenses, other accounts.

Weaknesses of Internal Control in Accounting and Financial Reporting and Implementation of Accrual-Based Accounting in Local Governments in Indonesia

Internal control is very important in overseeing the process of accounting and financial reporting ([Doyle et al., 2007](#)) in realizing local government financial accountability mechanisms to the public. Adequate internal control will support the

reliability of financial statements and the level of compliance with regulations (COSO, 2013). Specifically, internal control in the field of financial reporting will help improve the quality of LKPD as part of public accountability (Afiah & Azwari, 2015). However, internal control in local governments in Indonesia still has significant weaknesses (Yurniwati & Rizaldi, 2015), including in the areas of accounting and financial reporting.

The weakness of internal control in accounting and financial reporting is related to the inadequacy of accounting policies and practices in local governments. The existence of non-compliance in application of accounting standards illustrates that local governments are not able to carry out good accounting practices for their activities both related to income, expenditure, and assets (Yuliati et al., 2019). Therefore, the weaker internal control in accounting and financial reporting will increase the possibility of non-compliance with SAP implementation. This argument is supported by the research of Bimo et al. (2019) which found that the weakness of internal control in the field of financial reporting can reduce the quality of financial reports. In addition, weak control over accounting and financial reporting may trigger corruption, causing misstatements in financial statements (Jeppesen, 2019) which makes the presentation of reports not in accordance with SAP. This is supported by Donelson et al. (2016) who get empirical evidence that internal control weaknesses trigger financial reporting fraud. Based on the explanation above, the hypothesis is formulated as follows:

H₁: weaknesses of internal control in accounting and financial reporting have a positive effect on non-compliance with SAP implementation

Regional Complexity and Accrual-Based Accounting Implementation in Local Governments in Indonesia

The complexity of local government is an important factor in regional financial management (Setyaningrum & Syafitri, 2012). Regional complexity describes how local governments divide government functions and delegate them to certain (Ewens & van der Voet, 2019) by considering a series of factors such as area, population, as well as regional demographics. In practice, regional heads act as leaders in regional financial management and are responsible for LKPDs. Regional heads delegate government functions and affairs to Regional Work Units (SKPD) so that SKPDs must carry out good financial management (Sutaryo et al., 2020) which includes accounting practices and financial reporting in accordance with accrual-based SAP. SKPD is required to prepare financial reports. The financial reports of all SKPD within the local government are then consolidated into LKPD. The higher the level of complexity of the local government will increase the risk of errors in the financial reporting process. Cagle et al. (2017) found that a higher level of local government complexity would hinder the preparation of financial statements due to the increasing number of reporting entities involved. Furthermore, the higher complexity of local government also has the potential to require a wider level of disclosure in the Notes to LKPD Financial Statements (Hardiningsih et al., 2019). Referring to the references available in the literature, the hypothesis is formulated as follows:

H₂: the complexity of the local government has a positive effect on non-compliance with the application of SAP

3. Method, Data, and Analysis

This research is a causality study that examines the determinants of non-compliance in the application of SAP using a quantitative approach. The scope of this research is all district/city-level local governments in Indonesia in the 2015-2018 period considering the

accrual-based SAP implementation which began in 2015. This study seeks to maximize all existing observations to cover all local governments in Indonesia, except local governments with data incomplete. The data in this study uses secondary data sourced from the results of the audit on LKPD obtained from the BPK.

The dependent variable of this research is non-compliance with SAP implementation as measured by the number of accounts that do not comply with SAP. The independent variable of the study is the weaknesses of internal control in accounting and financial reporting as measured by the number of BPK findings. This study also uses the characteristics of regional finance as a control variable consisting of regional assets, regional income, operating expenses, and capital expenditures. In detail, the operational definition of variables is presented in the following Table 1.

Table 1.
Variable Operationalization

Variable	Measurement	References
Dependent variable		
Non-compliance with SAP implementation (<i>KT_SAP</i>)	Number of accounts that do not comply with SAP stated by BPK	Muhtar et al. (2020), Pamungkas (2018)
Independent variables		
Weaknesses of internal control in accounting and financial reporting (<i>ICW_AKT</i>)	Number of BPK audit findings on weaknesses in internal control in accounting and financial reporting	Pamungkas et al. (2018)
Complexity of local government (<i>SKPD</i>)	Number of SKPD	Sutaryo et al. (2020), Winarna et al. (2021)
Control variables		
Regional assets (<i>LN_ASET</i>)	Natural logarithm of regional assets	(Saragih, 2022; Sutaryo & Sinaga, 2018; Utama et al., 2019)
Regional income (<i>LN_PEND</i>)	Natural logarithm of regional income	(Saragih, 2022; Sutaryo & Sinaga, 2018; Utama et al., 2019)
Operating expenses (<i>LN_OPEX</i>)	Natural logarithm of operating expenses	(Saragih, 2022; Sutaryo & Sinaga, 2018; Utama et al., 2019)
Capital expenditure (<i>LN_CAPEX</i>)	Natural logarithm of capital expenditure	(Saragih, 2022; Sutaryo & Sinaga, 2018; Utama et al., 2019)

Analysis of research data begins with descriptive statistical analysis to see the general picture of research variables as a whole followed by analysis of correlations between research variables. The main analysis was performed using multiple linear regression to examine the effect of internal control weaknesses in accounting and financial reporting as well as the complexity of local governments on non-compliance with SAP implementation. The regression equation used is stated as follows:

$$KT_SAP = a + \beta_1 ICW_AKT + \beta_2 SKPD + \beta_3 LN_ASET + \beta_4 LN_PEND + \beta_5 LN_OPEX + \beta_6 LN_CAPEX + e \dots\dots\dots (1)$$

4. Results

Descriptive Statistics and Correlation

Analysis of research data begins with descriptive statistics to obtain a general description of the research phenomenon. The results of the analysis revealed that the average value of the SAP application non-compliance variable was only 0.806. This means that on average, there is only less than one account that is not presented in accordance with SAP each year. However, the maximum value reaches 8 which means that there are still local governments with a high level of non-compliance with SAP with 8 out of 10 accounts

that are not presented according to SAP. The minimum value and mode are 0 so that the majority of local governments have a WTP opinion with a high level of compliance with SAP. The variable of internal control weakness in accounting and financial reporting has an average value of 3.884. Thus, on average, there are still at least 3 cases of weaknesses in internal control accounting and financial reporting in local governments in Indonesia. The highest number of findings reached 18 cases while the minimum value was 0 which means there were no findings. The statistics of the local government complexity variable show a mean value of 51.947 so that the average number of SKPD in local governments in Indonesia reaches 51 SKPD, with the minimum number of SKPD being 20 SKPD and the most reaching 209 SKPD. Descriptive statistics can be seen in the following Table 2.

Table 2.
Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
<i>KT_SAP</i>	2032	0.806	1.489	0	8
<i>ICW_AKT</i>	2020	3.884	2.316	0	18
<i>SKPD</i>	2030	51.947	20.968	20	209
<i>LN_ASET</i>	1998	28.459	0.662	25.495	34.529
<i>LN_PEND</i>	1996	27.858	0.509	24.484	29.732
<i>LN_OPEX</i>	1999	27.444	0.57	21.095	29.392
<i>LN_CAPEX</i>	1998	26.361	0.51	23.508	28.554

Trend analysis was conducted to determine the trend of research phenomena, especially local government non-compliance with accrual-based SAP. The research findings show that there has been significant progress in the implementation of accrual-based accounting in local governments in Indonesia with a decrease in the number of local governments with cases of non-compliance with SAP implementation since the mandatory implementation of accrual-based SAP from 2015 to 2018. For the 2015 fiscal year, there are still 211 local governments with cases of non-compliance with SAP implementation. The number continued to decline to 158 local governments in 2016, 127 local governments in 2017, and 97 local governments in 2018. The results of analysis are presented in Figure 1.

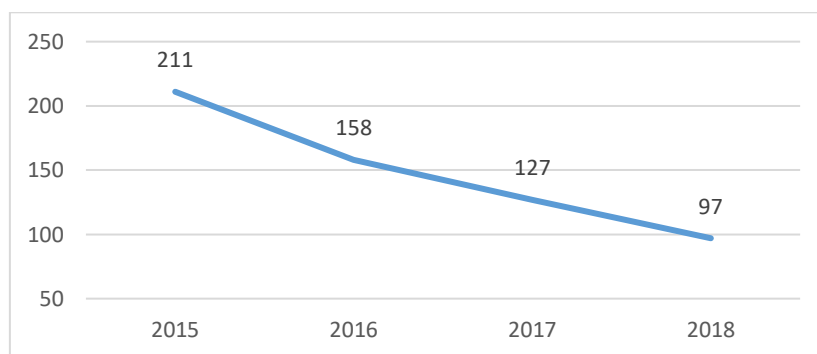


Figure 1. Number of local governments with cases of non-compliance with SAP implementation

Researchers also conducted a correlation analysis between research variables with the following results:

Table 3.
Correlation Matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>KT_SAP</i>	1.000						
<i>ICW_AKT</i>	0.051	1.000					
<i>SKPD</i>	0.014	0.010	1.000				
<i>LN_ASET</i>	-0.204	-0.027	0.153	1.000			
<i>LN_PEND</i>	-0.228	-0.024	0.235	0.757	1.000		
<i>LN_OPEX</i>	-0.239	-0.012	0.244	0.750	0.923	1.000	
<i>LN_CAPEX</i>	-0.156	0.015	0.131	0.683	0.740	0.677	1.000

Multiple Linear Regression Analysis

The main analysis in the research in order to test the hypothesis using multiple linear regression test through the Ordinary Least Square (OLS) approach. The findings from the regression analysis show that the weakness of internal control in accounting and financial reporting and the complexity of local governments have a positive effect on non-compliance with SAP implementation. Thus, the increasing number of internal control weaknesses in accounting and financial reporting will increase the number of accounts in LKPD that are not presented according to SAP. The higher the level of complexity of the local government also increases the tendency of non-compliance with the application of SAP. The results of the analysis are presented in Table 4.

Table 4.
Multiple Linear Regression Analysis

KT_SAP	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
<i>ICW_AKT</i>	0.028	0.014	2.02	0.044	0,001	0,056	**
<i>SKPD</i>	0.005	0.002	3.41	0.001	0,002	0,009	***
<i>LN_ASET</i>	-0.13	0.08	-1.62	0.104	-0,288	0,027	
<i>LN_PEND</i>	-0.198	0.183	-1.08	0.280	-0,557	0,161	
<i>LN_OPEX</i>	-0.493	0.157	-3.14	0.002	-0,8	-0,185	***
<i>LN_CAPEX</i>	0.134	0.099	1.35	0.176	-0,06	0,328	
<i>Constant</i>	19.621	1.885	10.41	0.000	15,923	23,318	***
Mean dependent var		0.811	SD dependent var			1.492	
R-squared		0.067	Number of obs			1981	
F-test		23.531	Prob > F			0.000	

*** p<0,01, ** p<0,05, * p<0,1

5. Discussion

Multiple linear regression analysis revealed the positive effect of internal control weaknesses in accounting and financial reporting on non-compliance with SAP implementation. This finding is in line with the research results of [Bimo et al. \(2019\)](#) which found that the weakness of internal control in the financial reporting sector will reduce the quality of financial reporting. Furthermore, these findings emphasize the importance of adequate internal control, particularly in the areas of accounting and financial reporting in local governments ([Yaya & Suprobo, 2019](#)). The existence of control weaknesses will increase the risk of errors in the accrual-based accounting process in local governments starting from recognition, measurement, assessment, presentation, to disclosure. As a result, this weakness in internal control will prevent local governments from obtaining WTP opinions from the BPK on the LKPDs that are prepared ([Prasetyaningsih et al., 2014](#)). Reflecting on these results, local governments can evaluate the weaknesses of existing

internal controls in accounting and financial reporting and make the necessary improvement efforts to support the financial reporting process. Internal control in accounting and financial reporting will help improve the quality of LKPD as part of public accountability (Afiah & Azwari, 2015). Local governments can apply information technology in internal control activities related to accounting and financial reporting so that they become more effective and efficient in minimizing risk and detecting accrual-based accounting errors in accordance with SAP. Thus, local governments can produce LKPD that are compliant with SAP with more reliable and relevant financial information.

The complexity of local government proved to have a positive effect on non-compliance with accrual-based SAP implementation. The higher the level of complexity of the local government with the increasing number of SKPD will increase the number of reporting entities. The results of this study confirm the findings of Bimo et al. (2019) which states that organizational complexity has a negative effect on the quality of financial reporting. The number of reporting entities will have significant implications, especially the risk of errors in the accounting process will be even greater. This is inseparable from implementation barriers such as uneven accounting competencies between SKPDs. Besides, local governments potentially do not have adequate local government oversight apparatus to accommodate these risks. Additionally, the potential geographical constraints of the area also increase the risk of accounting errors that are not in accordance with accrual-based SAP. On top of that, the number of reporting entities will also have implications for the level of disclosure required (Hardiningsih, 2019). That being said, the high level of complexity will tend to hamper the financial reporting process (Cagle et al, 2017).

These results emphasize the importance of local government efforts in improving the quality of accrual-based accounting practices in all existing SKPD. Local governments must develop accounting policies that are in accordance with SAP which are socialized to all SKPD followed by training and development activities needed to build accrual-based accounting competencies in each SKPD (Negara, 2015). Local governments must also accommodate a high level of complexity by building a financial reporting system to support an effective, efficient, precise and accurate accounting process. (Muda & Ade Afrina, 2019). This can be achieved by utilizing information technology (Aswar & Saidin, 2018).

Robustness Test

This research is equipped with a robustness test using logistic regression analysis. Measurement of the SAP implementation non-compliance variable was changed by using a dummy variable. Local governments that comply with SAP are given a score of 0 while those with cases of non-compliance with the application of SAP are given a score of 1. Logistic regression analysis provides consistent results for both hypothesis testing on the influence of the independent variables of the study. Local governments with weaknesses in internal control in accounting and financial reporting and a higher level of complexity will tend to have non-compliance with accrual-based SAP implementation.

Table 5.
Robustness Test with Logistic Regression

KT_SAP_D	Coef.	St.Error	t-value	p-value	[95% Conf	Interval]	Sig
ICW_AKT	0,049	0,022	2,28	0,023	0,007	0,091	**
SKPD	0,009	0,002	3,63	0,000	0,004	0,013	***
LN_ASET	-0,392	0,148	-2,65	0,008	-0,682	-0,102	***
LN_PEND	-0,466	0,282	-1,65	0,098	-1,02	0,087	*
LN_OPEX	-0,508	0,243	-2,09	0,036	-0,983	-0,032	**
LN_CAPEX	0,018	0,159	0,12	0,908	-0,293	0,33	
Constant	35,994	3,515	10,24	0,000	29,105	42,883	***
Mean dependent var		0,293	SD dependent var				0,455
Pseudo r-squared		0,068	Number of obs				1981
Chi-square		162,869	Prob > chi2				0,000

*** p<0,01, ** p<0,05, * p<0,1

6. Conclusion

This study is an effort to obtain empirical evidence of the effect of weaknesses in internal control in accounting and financial reporting as well as regional complexity on non-compliance with SAP implementation in local governments in Indonesia. This study found that there are still cases of non-compliance with the application of SAP since 2015 as a momentum for the mandatory application of accrual-based accounting. On the positive side, there is an increase in the implementation of accrual-based accounting with the continued decrease in the number of cases of non-compliance with the application of SAP during the research observation period. This study presents empirical evidence that the weakness of internal control in accounting and financial reporting as well as regional complexity has a positive effect on non-compliance with SAP implementation. Based on the findings obtained, this study recommends that local governments evaluate and improve internal control weaknesses in accounting and financial reporting. Local governments must also accommodate a high level of complexity through increasing adequate accounting competencies and developing an effective and efficient accounting and financial reporting system. Thus, local governments can realize accrual-based accounting practices properly and produce LKPD in accordance with SAP. This is very important in order to maintain accountability for regional financial management through the provision of more reliable and relevant financial information.

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