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Budget Process of Local Government in Indonesia

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ABSTRACT

It has been a decade since Indonesia started to reform the budget system in line with the implementation of local autonomy, but it still failed to satisfy the financial information needed by the majority voters. This study attempts to explain the local government budget in Indonesia in three perspectives: government, political and public interest. Using a hierarchical multiple regression method, this study found that the local autonomy, which has long history of Indonesia reforms, still far from succeeded. This is due to the existence of violation and not complies with the commitment of implementing reliable accounting system and accountability.

Keyword: Local Fiscal Capacity, Budget Discipline, Budget Approval, and Budget Performance

1 Introduction

There have been considerably amount of studies on local government financial management, especially since Indonesia conducted the government reforms. It is not only domestic institution like Smeru (2004), Bappeki (2006), Brojonegoro (2004), Sidik and Kajatmiko (2004), Bahl (2002), and Lewis (2005), but also international institution like World Bank (2003-2005), ADB (2006), UNDP (2005) and others. However, these studies were only descriptive in nature and contributed little to the development of theory of public finance and government financial accounting. Their findings are only for the consultative purpose and therefore, is temporary and for

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special interest.

The reality of Indonesia local autonomy seems to stumble with the implementation of national legislations. Law No. 22/1999 and 25/1999 have been used for the local autonomy. Law no. 22/1999 was about autonomy of local government, while Law No. 25/1999 is about financial relationship between national to local government. However, both laws had not been for long, because in 2004 there had been an alteration to both laws. Law No. 22/1999 has been replaced with Law No. 32/2004, and Law No. 25/1999 has been replaced with Law No. 33/2004. Therefore, both of these laws had been established only for four years.

With regard to the government accounting as supporting implementation of government financial reforms, the reforms should follow the main law that is Law No.33/2004. Consequently, there had been another low-level regulation, such as regulation for budgeting systems (PP 58, 2005), government standard accounting (PP No24, 2005), and financial reporting systems (PP No.28, 2005). These government regulations are in the national level. According to Bappeki (2008), until 2006, only 60% of local legislations have fulfilled the national requirement. It is also found that 601out of 4419 local legislation have been rejected due to the violation of the national law and order or not suitable for local legislation.

This study attempted to explain the phenomena of Indonesia government financial reform from 2005 to 2009, by combining conceptual framework and model used by others (Luder, 1994, Spiller and Tomassi, 1996 and Santiso, 2006).

2 Literature Review

Based on discussion above, even though many studies have observed Indonesia government financial management, but most of the studies used descriptive analysis and little attention have been made to contribute to the theory especially on political, economy, and government accounting. However, this studies show there is a relationship between political institution and government institution with the interest of public as the voters toward budget process. Therefore, these factors can be explained by using some theories and concepts. Firstly, the relationship between government and public in a democratic country can be explained by using agency theory (Lupia, 1996). To seek the more valuable explanation of government and public relationship, it can be based on accountability concept (Santiso, 2006). Secondly, the contingency model can be used to explain the financial phenomenon (Luder, 1994).

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2.1 Agency Theory

Agency theory is a theory that explains principal and agent relationship, which stems from economics theory, decisions theory, sociology, and organizations theory. Principal-agent theory explains the construct structure of two or more individual, group, or organization (Lupia, 2001). One party could be considered as a principal who make a contract, both implicitly and explicitly, with other party called agent with the expectation that agent will act to do activities as expected by the principal. Lupia and McCubbins (2000) pointed out that the delegation of authority happens since person or a group of people act as principal elect person or group as agents to do activities for the interest of the principal. According to Ross (1973) examples of principal-agent relationship has been used extensively.

Principal-agent relationship occurs when one activity affects to others or when one depends on other's activities (Stiglitz, 1987, Pratt and Zeckhauser, 1985 in Gilardi, 2001). The affects or dependencies are being shape in agreements within institutional structure in various levels, like behavioral norms and contracts.

According to Lane (2003), agency theory is implemented in public organization. Lane (2000) explained that in a modern democratic country, occurs a set of principal-agent relationship. Similarly, Moe (1984) explained the use of agency theory in the economics of public sector organizations. Therefore, principal-agent relationship framework is an important approach to explain and to analyze public policies commitment. Implementation of public policies, which is related to the contractual problems, includes asymmetric information, moral hazard, bounded rationality, and adverse selection (Lupia, 2001).

A simple agency model by Carr and Brower (2000) assume that there are two options in occurrence of contract that are 1) behavioral based that is the principal should monitor the behavioral of the agents, and 2) outcome-based, that is there is an incentive to motivate the agent in order to achieve principal's interests. Therefore, the authors have agreement toward agents behave opportunistically toward principals. This opportunistic behavior occurs since agents emphasize on their interests while principal may lose the objectives.

According to Andvig, Fjedldstad, Amundsen, Sisener, Soreide (2001), principal agent model is an analytical framework, which is useful for explaining an incentive for public institution. This has two possibilities condition: 1) some principals with respective objective may not coherent to each other, 2) principal is also able to emphasis objectives that may be away from public interests due to a narrow self-interests.

In general, it can be stated that delegations is certainly problematic and entails danger

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(Lupia and McCubbins, 2000). In a modern democracy, it contains at least, four characteristics delegation of authority that are:

1) the existence of principal-agent relationship,
2) possible conflict of interest occur,
3) existence of asymmetric information, and
4) principal may reduce agency problems.

Principal itself should pay agency costs to obtain information needed for monitoring agent performance and to determine incentive structure efficiently (Petrie, 2002).

2.2 Accountability

Accountability is a concept in ethics and governance with several meanings. It is often used synonymously with such concepts as responsibility, answerability, blameworthiness, liability, and other terms associated with the expectation of account giving. In respect of governance, it has been central to discuss problems related to the public sector, nonprofit and private (corporate) worlds (Mulgan, 2000).

In the role of leadership, accountability is the acknowledgment and assumption of responsibility for actions, products, decisions, and policies including the administration, governance, and implementation within the scope of the role or employment position. It is also encompassing the obligation to report, explain, and be answerable for resulting consequences (Carman, 2005).

Accountability theory is in line with agency theory which explains about how one party have an obligation to account for what one have done as regulated in a contract between both parties (Mulgan, 2000). Accountability refers to a relationship between parties, which one hold accountability and has the rights to investigates information regarding activities conducted by another party (Mulgan, 2000). Accountability also brings about the rights to make remedy and sanction. As the relationship between principal and agent, agents are being accountable to principals.

Accountability is not merely a compulsion to report about what have already been done but even to prevent and reduce probability about one party who have been trusted to conduct their tasks but have abused this authority delegated to them. If this happened, then accountability costs will incur. This is because the information reported should be investigated so as to make sure activities have been done correctly. On the other hand, party entrusted with accountability should prepare abundant information to make sure that the accountable-party is satisfied (Mulgan, 2000).

Based on the explanation above, it is possible to state that accountability has two functions (Mulgan, 2000). First, they are trust and goodwill. This refers to the existence of complying with certain rules, and an obligation to present sufficient

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information for one party to another. Second, the activities are assigned in an effective and efficient manner.

2.3 Budgeting as a Political and Managerial Dimension

The thoughts of behavioral aspects of budgets have been developed since 1952. Argyris (in Macintosh, 1985) conducted a study about the role of budget in the manufacturing company and it is found that the budget were use as:

a) a pressure device
b) a source of motivation
c) a means of isolating problems, and
d) a basis for instituting improvements.

Formerly, Argyris (in Macintosh 1985) pointed out that traditional budget were perceived by management and the workers in different ways. From the management side, they perceived that budgets are able to motivate the workers to increase their productivity and to achieve greater efficiency.

In addition, different individuals in organizations have different perceptions about the budgets. Argirys' study (in Macintosh, 1985) showed that budgets were viewed differently by budget people, factory supervisor, and frontline supervisors and workers. To the budget people, budgets are viewed as a device to motivate the work of force to increase productivity and to achieve greater efficiency. They also believed that budgets present a challenging goal to front-line.

Contrary to the budget implemented in government organizations, the budget can be seen as products of law, and government should implement the budget under a regulated environment (Hogye, 2002). In such working environment, managerial decision for decision-making depends on what kind of budget concept is believed. Mostly, governments are likely to use line item budget, so that government with the wide organizations can easily control financial transactions within the organization (Santiso, 2004).

Many countries have a history of budgeting as a process driven by technocrats, with minimal political involvement and parliamentary oversight (Santiso, 2006). Nevertheless, in the need of increased allocation efficiency, the importance of political input is essential (Santiso, 2006). Basically, to promote efficiency in delivering public service, legislative play an important role. When the elected people in parliament are not involved in the budget process, then the budget contains just a wish list, however, when the parliament involved too deep into the budget preparation, then the budget becomes difficult to implement (ADB, 2007).

While politics and the sensible stewardship of public resources may often conflict in

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the short run, in the long run they are both absolutely essential in achieving the goals of government in a sustainable and legitimate manner. Ideally, both politicians and the public should realize that unconstrained and non-prioritized expenditure would ultimately undermine these goals (Del Valle and Morron, 2001).

The central issue therefore is establishing appropriate institutional and legal frameworks to ensure that political involvement is harnessed to promote reprioritization, while maintaining fiscal discipline (Acosta, 2007). Budget reform should ideally address not only the efficacy of public sector managers in attaining operational efficiency in service delivery, but should also consider the interface between budgeting and politics to ensure outcomes, which are efficiently allocated, and fiscally responsible (Acosta, 2007).

3 Conceptual Framework

Accountability concept related to Government Accounting is an explanation of relationship between Budgetary Institution, Political Institution, and Society (Santiso, 2006). Budget process is the inner circle of the environment of government financial accountability. This process is covered by the government institution in which the government is directly appointed through election process. The outer circle of this accountability is a legislative accountability. Finally, the ultimate accountability in democratic country is people as the voters.

According to Spiller and Tomassi (2003), Socio Economic and Political Background will affect the political institution and budgetary institution toward budget process, and together with exogenous factor, like donor and aid from international involvement, these might affect the budget performance. Both Spiller and Tomassi (2003) and Santiso (2006) study mostly are used to explain political behavior of budget process. However, Luder's model (1992) is frequently used by others (Chan, Jones, and Luder, 1996; Saleh, 2007) to explain the government financial process.

Luder Contingency Model is used to explain the demand to conduct a government accounting reforms. According to this model, three aspects are highly related to encourage the change of government accounting systems:

1. Expectation of General Public as the users of information
2. Expectation and behavior of political actors
3. Behavior of administration actors

The Contingency Model pointed out by Luder (1994) refers to an identification of a set of contextual variables and behavioral variables that were found to be potentially relevant in explaining the outcome of the governmental accounting innovation process. The contextual variables consisted of several categories as follows:

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(1) Stimuli that consists of situation of financial stress, scandal, and dominating doctrine.

(2) social environment of the government,

(3) characteristics of the political administrative system, and

(4) implementation barriers.

It was hypothesized that the first three types of contextual variables would positively influence the attitudes and behavior of users and producers of government financial information. A combination of contextual conditions and favorable attitudes/behavior would facilitate the innovation process.

This study combined both the framework and the model to develop a framework to test the hypotheses. The framework emphasizes the relationship of the budget process with the budget performance. Since the budget process is affected by the political and government institution (Spiller and Tomassi, 1993; Santiso, 2006), social environment of government (Luder, 1994). it can established the framework that explain the relationship between government behavior that underline the management orientation of the budget process.

3.1 Political Dimension of the Budget

Political institution is an institution that consists of electoral and party system rules which formed various political configuration and policy coalitions (Acosta, Albornos and Araujo, 2007). This political institution gives more space for the Politician to establish coalition for stipulating and achieving the political purpose via the construction of public policies. In the budget process, elected politician who have seat in the parliament, strives to maximize budget allocation for the interest of the constituent, for instance reducing tax burden, income distribution and public infrastructure development. In addition, political institution plays an important role to promote the political party interest by struggling to make budget allocation rules in favor of constituent aspiration to attract them for next election period.

The mechanism of local parliament budget process is to establish general policy and budget direction together with policy for budget priority and ceiling before the budget is initiated (Firdausy, 2004). After finished initiating the budget draft, the government will submit the budget draft that later become budget proposal. The budget proposal will then pass through the parliament for approval (ADB, 2007).

The critical works is on the budget approval process. Before any approval is given by the parliament, the parliament has to do a recess time first (ADB, 2007). In the recess time, parliament will collect information concerning constituent aspiration for budget planning. After the recess time, the parliament will debate about the content of the

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budget. This is usually tough because information collected is mostly about a wish list, and incorporate self-interest of the parliament for the political purposes (ADB, 2007).
Most government system deals with the tension between short-term political interest and the need for fiscal stability and public services delivery in the long term, which is in line with the government policy (Lassen, 2001). Public expenditures should concentrate on the need for short term and long term purposes so that public could accept and give their support. In the short term public expenditures could be an operational budget while the long term could be a capital investment or capital budget.
It is possible to note that financial management and budget are not insulated from political influence. The challenge is to manage the interface between budgeting and politics by designing and implementing institutional and legal frameworks, which will improve the quality of political participation and promote fiscal responsibility (ADB, 2007). Political decision-makers should be held responsible for the authority conferred on them. While institutional arrangements vary from country to country, in general, Cabinet is collectively accountable for the objectives of the government as a whole, for policy co-ordination across government, and for legitimizing budget decisions, which reconcile competing claims on limited public sector resources (Campos and Phradan, 1996). Ministers are individually accountable for programmatic decisions in budget formulation.
The executive should be accountable to the parliament for implementing the approved budget. In developing countries, especially, parliaments tend not to exercise effective fiscal oversight, but merely rubberstamping the actions of the executive (Hogye and McFerren, 2002).

3.2 Managerial Dimension of the Budget

The thoughts of behavioral aspects of budgets have been developed since 1952. Argyris (in Macintosh, 1985) conducted a study about the role of budget in the manufacturing company and it is found that the budget were use as:
a) a pressure device, b) a source of motivation, c) a means of isolating problems, and d) a basis for instituting improvements.
Formerly, Argyris (in Macintosh 1985) pointed out that traditional budget were perceived by management and the workers in different ways. From the management side, they perceived that budgets are able to be used to motivate the workers to increase their productivity and to achieve greater efficiency. On the other hand, the workers perceived that the budgets will no compromise things (Argirys, in Macintosh, 1985).

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

While politics and sensible stewardship of public resources may often conflict in the short run, in the long run they are both essential in achieving the goals of government in a sustainable and legitimate manner. Ideally, both politicians and the public should realize that unconstrained and non-prioritized expenditure would ultimately undermine these goals (Del Valle and Morron, 2001).

The central issue therefore is establishing appropriate institutional and legal frameworks to ensure that political involvement is harnessed to promote reprioritization, while maintaining fiscal discipline (Acosta, 2007). Budget reform should ideally address not only the efficacy of public sector managers in attaining operational efficiency in service delivery, but should also consider the interface between budgeting and politics to ensure outcomes, which are efficiently allocated, and fiscally responsible (Acosta, 2007).

In a democratic system, the role of government, its objectives, policies, priorities and the specific programs it runs are fundamentally political and not managerial issues (Hogye, 2002). However, since budgeting is about resourcing government's strategic objectives and priorities, it has a considerable policy dimension (especially in resource allocation during budget preparation) but also has technical or managerial elements (Flack, 2007), for example, the budget execution certainly needs a financial management mechanism.

3.3 Public Interest Dimension of the Budget

In Indonesia, political institution related to budgeting process takes almost a half-year process. The first stage is to pervade people aspirations by conducting local meeting. Local meeting is called "development planning conference". The conference is held in village, sub regency, and regency level. The conference involves societies, non-government organizations, and local government in regency/city level. This stage is schedule in January to March prior to the budget year.

The second stage is a development plan conference at the province level. In this stage all the budget report from the first stage conferences are compiled and communicated to the provincial level to accommodate provincial planning that will take effect at the regency/city levels. This stage has been schedule in March to May prior to the budget year.

The third stage is to conduct a national development conference. This conference is bigger because it is participated by all provinces, regencies, and cities from the whole country. The aim of the conference is to provide development-planning coordination for the whole country.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

After the budget has been approved by the parliament, a regulation will be established and the budget will be implemented. In the implementation process, the government's role is to maintain and control the budget.

4 Hypotheses Development

The hypotheses have been developed based on the theoretical framework discussed above. Some theoretical backgrounds have pointed out that budgetary process is pervaded by the budget institution itself, and by the political institution (Campos and Phradan, 1996; Santiso 2005; Acosta and Renzio, 2008). Agency theory explains that the ideal situation occurs when principal and agent have similar interest to perform an agreement. Most agency relationship in a public institution tends to encourage agency loss. Therefore, in empirical study, it can inevitably accommodate factors that may impede the budgetary process and affect the budget performance. Budgetary process includes 1) Programming 2) Formulation 3) debate and approval 4) execution 5) monitoring 6) evaluation (Del Valle, 1990).

4.1 Managerial Dimension

Some researchers (Gustafson, 2003; Acosta, 2007; Santiso, 2006) highlighted that in the implementation of Budget Discipline policy, the Budget Discipline might be too tight that may cause the government to have difficulties to allocate the expenditures effectively. This will in turn affect a low level of accountability. Similarly, when fiscal policy is considerably voluminous the expenditures allocation, this may not reach the objectives and accountability may be lower.

Budget process started from the determination of a Budget Discipline (Government Regulation No.58, 2005). Budget Discipline refers to a set of regulations with a purpose to match the revenue and expenditures (Acosta and Renzio, 2007). The factors that may affect the Budget Discipline are local fiscal capacity, local budget ceiling, priority, and the national priority. Local fiscal capacity is the revenues that is collected and controlled by the local government (Law No.17, 2003). In addition to tax and revenue sharing from national government, the budget ceiling can be determined.

Therefore, since a budget is expected to achieve a better outcomes will depend upon how the budgetary process works and is supported by the effective Budget Discipline. Therefore, it is reasonable to derive the first hypothesis as follows:

> *(H1) Local fiscal capacity, budget ceiling and priorities, and national priority with budget discipline as the mediating factor significantly affect budget performance.*

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

4.2 Political Dimension

Another factor that has an important role within the budget institution is the prerogative of local government and national government. Local government is the key player to formulate the budget in the first stage. All the information for formulating the budget is in the hand of local government. Therefore, to complete the budget draft or the budget proposal will rely on the local government.

Moreover, the budget process cannot be stopped because the budget contains resources for the public services and development purposes to take place. If the budget is stopped, then public services cannot be delivered, local development might not be conducted and government activities will be stuck. Therefore, there is prerogative for the local government to continue the budget process without any agreement or approval from the local parliament (Government Regulation No.58, 2005). Based on this notion, the hypothesis is:

(H2): Intergovernmental transfer, local government prerogative, and the role of local legislative, with mediated by budget approval significantly affected budget performance.

4.3 Public Interest Dimension

Public watch refers to the concern of public toward budget execution and participative from the public to analyze the budget execution process (Del Valle and Morron, 2001). Even though public or people have limited access to litigate the budget abuse to the court, however, pressure from their analysis may affect the budget process (Asian Development Bank, 2007).

Therefore, without effective parliament oversight, the budget may be corrupted (Puente, 2006), and if there is a lacking watch from the public regarding the budget process, this might lead to moral hazard (Lupia, 2001; Peters, 2002). Based on this reasons, the hypothesis is:

(H3): Financial reporting system, external and internal audit system, and public oversight, with accountability as the mediating factor significantly affect budget performance.

5 Research Methodology

The basic research design utilized in this study is a survey design. The collection of primary data is accomplished by using mail survey instrument. It is sent by hand to the government employees, legislative members and non-government organizations.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

Multiple regression analysis is used to test the hypotheses. In addition, Sobel test is used to test and analyze the effect of the mediating variables.

6 Analysis of Budget Process and Performance

6.1 Managerial Dimension (H1)

It is found (see exhibit 1) that in model 1 R = 0.634, and R^2 = 0.402. The R^2 change of 0.402 and F=57.219 the change is significant at α = 0.001. In the model 2 R = 0.651, and R^2=0.423. The R^2 change is 0.021 with F = 9.228, the change is significant at α = 0.05. Therefore, both Model 1 and Model 2 is significant and fit.

The overall independent variables (local fiscal capacity, national priority, and budget ceiling and priority), and the mediating variable (budget discipline) are significant to the dependent variable (budget performance). In Model 1, the local fiscal capacity, and budget ceiling and priority is significant to the budget performance at α = 0.05. The national priority is significant at α = 0.001 In Model 2, budget ceiling and priority is not significant to the budget performance. However, the local fiscal capacity is still significant at α = 0.05, and the national priority is still significant at α = 0.001. Budget discipline as the mediating variable is significant to the budget performance at α = 0.05. These results indicate that budget discipline as the mediating variable plays a complete role to the local fiscal capacity and budget ceiling and priority. However, for the national priority, budget discipline plays only as a partial mediator.

6.2 Political Dimension (H2)

The finding (see exhibit 2) shows that, in Model 1, R = 0.366 and R^2 =0.134. This indicates that the model can only explain 13.4% of the variation with R^2 change of 0.134, and F is 19.767, the change is significant at α = 0.001. This indicates the model is significant and fit.

In the model 2, the R is changed rapidly to 0.644, and the R^2 = 0.415. The R^2 change is 0.128 and the F is 122.439, and the change is significant at α = 0.001. This indicates that the model is significant and fit.

Exhibit 2 shows the regression coefficient of every independent variable (intergovernmental transfer, government and legislative roles, and budget approval process). In Model 1, all the independent variables (intergovernmental transfer and government and legislative roles) are significant to the budget performance. The intergovernmental transfer is significant at α = 0.05, and the government and legislative roles is significant at α = 0.001. In Model 2, the independent variables are still significant to the dependent variable. Similar to the mediating variable budget

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approval, it is significant to the budget performance at α = 0.001.

Based on the analysis of Model 1 and 2, it can be said that budget approval as the mediator variable play a partial mediation towards budget performance. Therefore, there is no reason to reject the second hypothesis.

6.3 Public Interest Dimension (H3)

Exhibit 3 shows that Model 1 has the R = 0.724 and R^2 =0.524. This indicates a high correlation, and the model can be used to explain 53.4% of the variation. R^2 change is 0.524 and F change is 93.497, and the change is significant at α = 0.001. The model is considered significant and fit.

Model 2 produced R = 0.730 and R^2 = 0.525. This indicates that the correlation is high, and the model can be used to explain 53.2% of the variation. The R^2 change is 0.009 and the F change is 4.724, and the change is significant at α = 0.05. This model is considered significant and fit.

Exhibit 3 presents the coefficient of regression for every independent variables based on the two models. Model 1 shows the independent variables of financial information and audit systems are significant at α = 0.001.However, the budget oversight is not significant to the budget performance.

Model 2 shows that the mediating variable (accountability) is significant to the budget performance at α = 0.05. This indicates that accountability plays a partial role as the mediator between the independent variables and the dependent variable.

7 Discussion

7.1 The Managerial Dimension of the Budget

Budget priority and ceiling are local government policies that complemented each other (UNDP, 2006). This means that budget priority is used as a control tool to determining the amount of ceiling being allocated to every local government's unit. Without this policy, it is difficult to determine how much ceiling is enough for every unit. However, it seems that the local government has not used this policy as the control policy to the budget ceiling allocation (World Bank, 2004). Current situation shows that the determining of the ceiling still used the conventional policy as in the previous system. In the previous system, the ceiling is determined based on the last year ceiling.

Agency theory has explained that the agent will tend to hide information to the principal (Lupia, 1996). Local Government agency also has a principal agent relationship. Therefore, in the managerial aspects of organization-units of local government, it is likely they also hide information about their capacity and performance,

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

and benefit in determining the budget ceiling.

Some researchers have explained the high existence of differences in local revenue capacity in Indonesia (World Bank, 2004, Brojonegoro, 2004). From the pattern of government spending that puts priority to the routine expenditure that does not bring impact to the local revenue, and this will only further aggravate the fiscal situation. However, the government was unable to achieve the goal with the increase of the budget allocation to the regions.

7.2 The Political Dimension

Likewise, for the political dimension, it is found that Local Government Prerogative is not significant to the budget performance. In fact, the local government prerogative and local parliament roles are contrary to one another. Local government prerogative has the right to establish the budget even there is no approval from the local legislative, and the budget can be enacted by the head of local government decree or regulation. This right can be overcome when there is a dead lock between the government and legislative in the debate session for the approval of the budget. This is to ensure that the budget is continuously available for the public.

7.3 The Public Interest Dimension

In the public interest dimension, a similar situation is found. Indonesia employs too many and complicated audit systems. Currently there are three institutions named audit offices that are National Audit Board (BPK), Board of Audit for Development (BPKP) and Local Government Audit Board. The Local Audit Board is an audit office with is established by the local government, and its function as internal audit works. National Audit Board (BPK) is mandated by law as the only a legal audit office. Board of Audit for Development (BPKP), on the other hand is an institution or office, which is established, in the previous regime. Even though it no longer function as a legal audit office (but legal as a government institution), with no audit opinion authority, it still works as audit office without a clear work whether internal or external audit.

In addition, every ministry offices and province governments have sub-offices called inspectorate offices, which are related to audit works. When a local government employed fund from the National Budget such as de-concentration or co-administration fund, then this is subject to partial audit done by these offices. This type of audit is internal to the ministry office but external to the local government. Similarly, if one municipality or regency employed fund that comes from the province budget, it is subject to be audited by the province government.

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8 Concluding Remark

The implementation of the local government budget in Indonesia is yet to be established even though it has long been reform (SMERU, 2006, ADB 2007, World Bank, 2007). This is because both national and local governments have not been consistence with the reforms as discussed below.

Firstly, political and government environment have not developed a conducive way to sustain the autonomy functioning properly. With the changing of national regulation over time, there is no guaranty that the regulated environment will be suspended to establish the system. Since the local legislations have not satisfied with the changing requirement. This condition has been caused by highly centralized thinking of government financial reforms as described by Luder (1994), Chan (1996) and Zakiah (2008) in the setting up the regulations related to the financial management, this never truly involved the wider public and professional perspectives. Even though there is a process of public hearing before a law or regulation is stipulated, however, the process has been just like a “rubber stamps” (Niles, 2001, Thompson, 1999) or “cosmetic of political purposes” (Hogye, 2000).

Secondly, managerial aspect of a budget system underlined the moderating effect of the budget discipline. It should be considered as an important factor that mediates the local fiscal capacity, budget policy, and rule toward budget performance.

Thirdly, intergovernmental transfer, basically, is a managerial aspect of the budget because it is expected to improve the local fiscal capacity. Since the transfer creates a high dependency of local to national, this becomes a subject of political debate, not only the local with the national government, but also the local government with the legislature (Sidik and Kajatmiko, 2006).

Fourthly, complex process of budget to become legitimate may bring hindrance for the accomplishment of the budget performance. According to the World Bank (2007), Indonesian budget is too detail, thus it take time to formulate and discuss. In the formulation process, to determine the budget ceiling in the formulation process, every local working unit has to wait until there is definite information receive regarding the government transfer obtained. This is wasting of time and sometimes the information received is nearing the due date of the budget.

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APPENDIX

Exhibit 1

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-1.711	0.458		-3.740	0.000		
	Local Fiscal Capacity	0.125	0.038	0.159	3.279	0.001	0.999	1.001
	National Priority	1.073	0.093	0.573	11.579	0.000	0.959	1.043
	Ceiling and Priority	0.148	0.060	0.123	2.483	0.014	0.959	1.042
2	(Constant)	-1.748	0.451		-3.880	0.000		
	Local Fiscal Capacity	0.100	0.039	0.126	2.586	0.010	0.951	1.051
	National Priority	1.017	0.093	0.543	10.939	0.000	0.922	1.085
	Ceiling and Priority	0.101	0.061	0.084	1.670	0.096	0.898	1.114
	Budget Discipline	0.133	0.044	0.158	3.038	0.003	0.841	1.189

Dependent variable: Budget Performance
Model 1 R = 0.634, R^2 = 0.402. R^2 change of 0.402, F=57.219, Sig. F Change = 0.000
Model 2 R = 0.651, R^2 = 0.423. The R^2 change of 0.021, F = 9.228, Sig. F Change = 0.003

Exhibit 2

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	2.606	0.266		9.799	0.000		
	Intergovernmental Transfer	0.093	0.040	0.137	2.317	0.021	0.969	1.032
	Government and Legislative Roles	0.317	0.059	0.316	5.342	0.000	0.969	1.032
2	(Constant)	-1.574	0.437		-3.604	0.000		
	Intergovernmental Transfer	0.069	0.033	0.102	2.098	0.037	0.965	1.037
	Government and Legislative Roles	0.194	0.050	0.194	3.885	0.000	0.921	1.085
	Budget Approval Process	1.024	0.093	0.546	11.065	0.000	0.941	1.062

Dependent variable: Budget Performance
Model 1, R = 0.366, R^2 =0.134, R^2 Change = 0.134, F of 19.767, Sig. F Change = 0.000; Model 2, R = 0.644, R^2 = 0.415. R^2 change = 0.128, F = 122.439, Sig. F Change = 0.000

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Exhibit 3:

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-2.173	0.397		-5.469	0.000		
	Public Budget Oversight	0.062	0.059	0.049	1.066	0.288	0.881	1.135
	Financial Reporting Systems	1.157	0.082	0.635	14.043	0.000	0.915	1.093
	External & Internal Audit Systems	0.213	0.045	0.213	4.698	0.000	0.912	1.096
2	(Constant)	-2.322	0.400		-5.800	0.000		
	Public Budget Oversight	0.037	0.059	0.029	0.628	0.531	0.847	1.180
	Financial Reporting Systems	1.142	0.082	0.626	13.919	0.000	0.909	1.101
	External & Internal Audit Systems	0.203	0.045	0.203	4.489	0.000	0.903	1.107
	Accountability	0.085	0.039	0.097	2.174	0.031	0.918	1.089

Dependent variable: Budget Performance

Model 1, R = 0.724, R^2 =0.524, R^2 change = 0.524, F change = 93.497, Sig. F Change = 0.000. Model 2, R = 0.730, R^2 = 0.525, R change = 0.009, F change = 4.724, Sig. F Change = 0.031.

Exhibit 4

Testing of Mediating Effect of Managerial Dimension:

a. Local Fiscal Capacity (LFC)
   - Sobel Test: a = 0.2, Sa = 0.057; b = 0.286, Sb = 0.049; Sobel t = 3.007, p=0.003**)

b. Budget Ceiling and Priority (BL)
   - Sobel Test: a = 0.2, Sa = 0.057; b = 0.286, Sb = 0.049; Sobel t = 3.007, p=0.003**)

c. National Priority (NPT)
   - Sobel Test: a = 0.542, Sa = 0.135; b = 0.286, Sb = 0.049; Sobel t = 3.308, p = 0.001**)

d. Intergovernmental Transfer
   - a = 0.09, Sa = 0.034; b = 1.129, Sb = 0.093; Sobel = 2.583, p = 0.01*)

e. Local Government Prerogative
   - a = 0.189, Sa = 0.048; b = 1.090, Sb = 0.091; Sobel = 3.741, p = 0.000**)

f. Local Legislative Roles
   - a = 0.101, Sa = 0.034; b = 1.061, Sb = 0.095; Sobel = 2.871, p = 0.004*)

g. Financial Reporting Systems

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- a = 1.217, Sa = 0.082; b = 0.117, Sb = 0.04; Sobel =2.870, p = 0.004**)

h. Internal and External Audit Systems

- a = 0.316, Sa = 0.058; b = 0.161, Sb = 0.051; Sobel =2.732, p = 0.006**)

i. Public Budget Oversight

- a = 0.291, Sa = 0.078; b = 0.158, Sb = 0.054; Sobel =2.202, p = 0.028*)

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