

## CHAPTER I

### INTRODUCTION

#### **A. Research Background**

Many nations have made substantial changes to accounting practices and, consequently, to the financial reporting of information by governmental entities over the past few years (Nogueira, 2013). The latest accounting procedures addressed the availability of information on the effective use and supply of public resources and the legitimacy, legality, and compliance with regulations (Nogueira, 2013). In addition to other directives, the local government financial reporting system has been aimed at the transmission of appropriate and relevant information, enabling its users to judge and make decisions more clearly and sensibly written by (Chan, 2003; Lee, 2008; Hookana, 2008) in (Nogueira, 2013). The local government accounting reforms aim to enhance the decision-makers financial reporting and promote transparent, accurate financial reports for public accountability. The quality of financial reports produced by the Sleman local government in Yogyakarta is greatly impacted by a number of important aspects. These include the efficacy of internal audit and control mechanisms, as well as the accounting skills of people who created and reviewed the reports. With ratings ranging from 73.08% to 83.59%, Windarsih and Ritonga (2017) report that there is a notable diversity in the review quality of LGFS among various local administrations. This emphasizes how crucial it is to have competent people managing financial reporting in addition to putting in place powerful internal procedures to guarantee accuracy and dependability. Recognizing the value of financial reports, the Sleman Yogyakarta local administration has taken a number of steps to guarantee their usefulness. An essential component is the internal audit, which is an impartial examination of financial documentation and procedures in order to identify any strange phenomena or possible fraud (Loudoe and Fardinal 2021).

Additionally, this modification local governments throughout Indonesia to provide financial reports with greater transparency compared to previous (Nor, 2019). In order to determine how well the local government in Sleman Special Region of Jogjakarta manages public finances, it is crucial to examine the

usefulness of financial reporting in local government. Every local government in the globe is required by law to provide transparent financial reports. Financial reporting can increase public trust and confidence in fulfilling this legal need by displaying responsible financial management and guaranteeing the effective use of taxpayer (Nogueira , 2013).

Moreover, financial reports provide knowledge that aids interested parties in making wise resource allocation decisions by revealing information about revenue sources, spending trends, debt levels, assets, and liabilities (Nogueira, 2013). The purpose of these studies is to respond to the questions and to see how increased reporting of final financial openness helps the administration of local government practices. Primary data source was analysed, including questionnaires with internal auditors, accounting capability, internal control system, and finance directors from various municipalities in the Jogjakarta Sleman's Special Region.

It is challenging to underestimate how vital financial reporting is to local government since it helps increase accountability and transparency in managing public money. That is similarly crucial in the Special Region of Jogjakarta Sleman since it guarantees that the assets owned by the government are properly handled and put to use for the reasons they were created. Jatmiko (2019) assert that the financial report planning, implementation, administration, reporting, accountability, and regional financial oversight are all part of management, the head of the region is in charge of managing regional finances (Jatmiko et al., 2019).

It is one responsibility in a transparent and accountable system to all users of local government financial statements, the community, legislators, regulatory bodies, audit institutions, and the local government itself (Bambang & Handi, 2016). According to Pratolo and Jatmiko (2017) in Jatmiko(2019), the power to oversee each local government's budget will also come with the possibility of abuse of power, such as corruption, collusion, and nepotism (KKN).Claims that "financial reporting in local government plays a crucial role in encouraging openness and responsibility with funding from the government," emphasizes how crucial accurate financial reporting is to guarantee effective governance(Jatmiko etal.,2019).

Taxpayers can receive data on whether their income taxes are spent via routine financial reports, giving them the power to hold their leaders accountable for any accounting misuse (Dinapoli, 2016). By assuring openness and accountability, incorporating sound financial reporting systems promotes a culture where officials are cautious about their spending decision (Dinapoli, 2016). Encourages moral conduct among those in charge of overseeing the public purse while simultaneously protecting from any corruption. Internal auditors who frequently check these reports will find it simpler to pinpoint any potential weak points or inconsistencies that need to be fixed (Nogueira et al., 2013). At all levels of government, appropriate financial reporting methods must be implemented.

An essential component of local government operations is the reporting of finances (Dinapoli, 2016). It is a tool for reviewing and tracking financial results, allowing government officials to spot future development opportunities. According to Oktyawati & Fajri (2019) "the value of financial reporting in local government goes beyond ensuring that regulations are met since it offers crucial information about the health and long-term reliability of local government's finances (Oktyawati & Fajri, 2019). This claim emphasizes how financial reports are valuable tools that can give stakeholders a better understanding of their organization's financial situation in addition to being the documentation that satisfies legal requirement (Dinapoli, 2016). Additionally, these reports allow internal and external users to evaluate whether an authority has met its goals while staying within its financial restrictions. They also guarantee accountability among elected officials who handle public monies by recording all transactions made by the organization. As a result, complete financial statements can provide information on various financial issues of local governments, such as revenue sources, spending patterns, and debt management techniques (United States Department of Défense, 2022). In summary, using reasonable accounting procedures through thorough financial reporting is crucial for making informed decisions in any business or political organization. It benefits local governments by offering data on their effectiveness and long-term viability, leading to beneficial outcomes for residents and politicians. Financial Reporting on finances, including accurate data, needs more substantial omissions and incorrect data (DiNapoli, 2016). They are deemed trustworthy. Responsibility calls for decisions to be made in line with their objectives. Since handling financial

records involves some transparency, this is true. Mandate. So, one way to be accountable for managing the finances is through financial reports (United States Department of Défense,2022). According to the same legislation, financial reports must be pertinent, trustworthy, comparative, and reasonable. Financial reports are deemed trustworthy if they contain accurate data, are free of substantial inaccuracies, and are not misrepresented. Financial reporting is reliable when it contains accurate data and is free of significant omissions and inaccurate information.

The concluding product of the accounting procedure is the financial report. The state of finances during a particular period is explained in a financial report. The Statement of Financial Accounting Standards states the main objective of financial reports (Zitte, 2012). Financial reporting is an essential component of financial management in local government. According to Zitte (2012), “state that a financial report, providing financial data about the business reports that may be used by current and future citizens, investors, lenders, and other creditors to decide whether to commit resources to the entity is the goal of general-purpose financial reporting (Zitte,2012). These choices relate to granting or clearing off debts while re-establishing credibility by purchasing, selling, or holding equity and debt instruments. Organized and simple-to- comprehend presentations of pertinent financial data are made like Stakeholders, including citizens, investors, lenders, and regulators. Local governments' financial reports typically include financial statements, notes to financial statements, and management's discussion and analysis sections (Wahyu & Zulma, 2023).

A continuously exciting topic in accounting study, particularly in government accounting, is the utility of the financial report. The usefulness of financial reporting in local government can be tested from different perspectives (Setyaningrum, 2020). As reported by ‘Wahyudin Nor, Muhammad Hudaya, and Rifqi Novriyandana”, Nor (2019) says that financial reporting in order to support corporate responsibility, the local head's commitment to accountability and transparency is crucial. Local government leaders are more dedicated to their financial reports and receive better assessment opinions, encouraging them to disclose their financial accounts for public consumption to gain the people's favor,

which is critical for building trust and confidence in local government (Nor et al., 2019). By providing stakeholders with accurate, reliable, and timely financial information, local governments can demonstrate their commitment to transparency and accountability and improve public perception of their financial management practices (Di, 2023).

According to Setyaningrum (2020), financial reports have to be usable in making decisions processes in local government. Financial reports can provide decision-makers with the necessary information to make informed financial decisions, such as identifying areas where resources need to be allocated, evaluating financial performance, and assessing financial sustainability. Financial reporting can also help decision-makers to communicate financial information to stakeholders and facilitate stakeholder engagement. Secondary financial reports can promote enough allocation of local government resources. Based on Setyaningrum (2020), the users may utilize the data from the financial statement's usefulness to examine and propose policies for the government. For objective analysis, the government has to use third parties. Users include citizens, academics, and members of parliament (van Helden & Reichard, 2019). By providing stakeholders with comprehensive financial information, local governments can increase the efficiency and effectiveness of resource allocation and improve their ability to meet the needs of their citizens.

Nevertheless, there are also difficulties with the financial reporting in local government. For instance, the financial state of the nation and the user's lack of information both have an impact on the usefulness of financial reporting can be complex and time-consuming, and local governments may lack the necessary resources and expertise to produce high-quality financial reports (Edition, n.d.). Likewise, it could be challenging to compare financial data with the local government due to variations in financial reporting standards and procedures between different regions' requirements and practices across different

jurisdictions, making it difficult to compare financial information between local governments (Yusuf, 2013).

The usefulness of financial reporting in local government is a multifaceted issue that requires careful examination (Yusuf, 2013). While financial reporting can enhance transparency, improve decision-making processes, and promote efficient resource allocation, there are also challenges associated with financial reporting that need to be addressed (Working & Marc, 2023). More study is required to determine effective methods in financial reporting for local government and to develop effective strategies for addressing the challenges associated with financial reporting. Many nations have made substantial changes to the public accounting process and, hence, to public agencies' financial data reporting during the past decades (Working & Marc, 2023). The availability of information on the effective use and supply of public resources, in addition to its reliability, legality, and execution of rules, were both addressed by the new accounting procedures (Working & Marc, 2023). In addition to other directives, the public sector's accounting system has been aimed at the transmission of appropriate and relevant information, enabling its users to judge and make choices more logically and sensibly (Nogueira, 2013).

The accounting changes implemented in the local government aim to enhance financial reporting for decision-makers and general accountability objectives (Edition, n.d.). Some people are curious about this local government financial reporting phenomenon and its usefulness (Nogueira, 2013). One reason is the rising complexity of local government operations and the need for greater transparency and accountability in financial management. According to a report by Di (2023), financial reporting plays a crucial role in ensuring that local governments comply with legal and regulatory requirements, including accounting standards and audit procedures.

Financial reporting provides valuable information to stakeholders such as citizens, investors, and government agencies, enabling them to establish smart

choices in distributing assets and managing public funds (Setyaningrum , 2020). Moreover, financial reporting is critical in building openness and responsibility in municipal administration, as it allows stakeholders to monitor local governments' financial performance and stability (Di, 2023). The usefulness of financial reporting in local government cannot be overstated, as it provides crucial information to stakeholders and helps improve local government operations' effectiveness and efficiency. As noted by Helden & Reichard (2019), financial reporting also helps local governments determine problems and make educated choices that may benefit their communities.

according to Di (2023) The research topic of local government financial reporting and its usefulness is focused on examining the financial reporting practices of local government entities and the effects of this approach on financial management and decision-making processes. According to Hasiara (2023) The prominent phenomenon behind this research topic is the need for local government entities to provide financial information that is accurate, timely, and relevant to their stakeholders, including citizens, investors, lenders, and regulators. According to Charles, Galal, Guna, Mohammed, & Contributors (2022) Financial reporting is a crucial component of financial management, and it provides a means for local governments to communicate their financial position, performance, and cash flows to stakeholders.

The usefulness of financial reporting for local government entities lies in its ability to provide decision-makers with the necessary information to make informed financial decisions (South, Stevens & Ketelhut,2017).For example, financial reporting can help local government entities to identify areas where they need to allocate resources, evaluate their financial performance, and assess their financial sustainability.

The research on local government financial reporting and its usefulness is crucial for ensuring local government entities' transparency, accountability, and financial sustainability and enabling effective decision-making processes in the

public sector (Charles, Galal, Guna, Mohammed, & Contributors2022).

This proposal aims to explore the phenomena of local government financial reporting, including its importance, challenges, and opportunities for improvement. The proposal will also examine the benefits of financial reporting for local governments and their stakeholders and identify strategies for enhancing financial reporting practices in local governments.

This study is a compilation from the previous research on Making sense of the users of public sector accounting information and their need has been done by some researchers (Tandirerung.,2022). Analysis of Factors Influencing the Quality of Local Government Financial Reports, at the time the research was done in Politeknik Negeri Samarinda. (Setyaningrum,2020). Factors Affecting the Usefulness of Governments' Financial Statements in Indonesia (Hasiara, 2023) . talked about the Government Management Strategy to Maintain the Quality of Local Government Financial Reporting in East Kalimantan Province, Indonesia (Nogueira,2013). The usefulness of financial reporting for internal decision-making in Portuguese municipalities. In addition, According to Afiah and Azwari (2015) (Afiah & Azwari, 2015) The Effect of The Implementation Of Government Internal Control System (GICS) On The Quality Of Financial Reporting Of The Local Government And Its Impact On The Principles Of Good Governance: A Research In District, City, And Provincial Government in South Sumatera.

If previous research has examined the Making sense of the users of public sector accounting, this study examines the usefulness of the financial report in the local government in the special region of Yogyakarta sleman. Has the smallest units of government (Nogueira,2013). Furthermore, the difference in scope between the local government and public sector accounting, Accounting for local governments encompasses the methods used by state and regional governments to track and report on their spending and revenue (Nogueira,2013). While



government accounting refers specifically to federal, state, and municipal governments, the larger phrase "public sector accounting" encompasses all three.

Accounting for local governments is much more complicated than accounting for other public sectors. Comparatively speaking, public sector accounting, which includes many diverse organizations and activities, is more difficult than local government accounting.

Also distinct is the fact that each entity type is subject to a unique set of rules and regulations when it comes to bookkeeping. Public sector accounting typically adheres to generally accepted accounting principles (GAAP), as set forth by standard-setting bodies like the Governmental Accounting Standards Board (GASB) or the International Public Sector Accounting Standards (IPSAS). However, local government accounting may be subject to different standards and regulations depending on the jurisdiction. By conducting this research on this topic seeks to examine the quality and relevance of financial reporting practices of local government entities and evaluate their usefulness in decision-making processes. Includes analyzing the content and format of financial reports, the level of transparency and disclosure, and the effectiveness of communication with stakeholders.

#### **A. Research Problem Formulation**

By identifying the numerous categories of users of financial report information, their different needs and demands, and the different aspects that have an impact on both usability and actual usability (van Helden & Reichard, 2019). the complicated topic of " Examine the usefulness of financial reporting in local government " is made clear, Considering International Financial Reporting Standards are founded on principles, businesses are encouraged to provide financial data that more accurately represents economic content than form, encouraging more openness (Zitte, 2012). However, the financial performance evaluation is for making informed business decisions. However, financial reports are not significant for the organizations that prepare them but

also, for external users such as investors, clients, customers, suppliers, and local government (Oktyawati & Fajri, 2019). Since accounting regulations should not be built on rules because principles-based guidelines give the direction a greater degree of freedom that could be abused, principles-based standards are characterized by a shortage of clear-cut boundaries, restricted guidance, allowing few exceptions in uses, and a concentration on conceptual explanations (Setyaningrum, 2020).

Followed by the statement that the purpose of this investigation is to analyze the application of financial reporting in local government. This investigation aims to research numerous ways financial reporting may facilitate decision-making processes. Improve openness and accountability, and guarantee the effective administration of public finances. In addition to this, the research will investigate the difficulties that local governments have in terms of financial reporting and will seek to find viable solutions to these issues. The study will be carried out by exhaustively examining the existing literature and analyzing financial reports compiled by several local government organizations. What comes next are issues that the investigations will hopefully answer.

1. Is there any direct effect of internal audit towards the usefulness of financial reporting on the local government?
2. Is there any direct effect on the internal control system towards the usefulness financial on the local government?
3. Is there any direct effect on accounting capability towards the usefulness of financial reporting on the local government?
4. Is there any indirect effect on accounting capability towards the usefulness of financial report through internal control system in the local government?
5. is there any indirect effect on internal audit towards the usefulness of financial report through internal control system in the local government?

## **B. Objectives of the Research**

This research examines the local government income, which must be examined and presented through financial reporting. It can help in the decision-making process and that of the local government. These reports look at cash flow and resource utilization to the local government's financial health. The usefulness of financial reporting in local government, Financial reporting is a critical component of public sector accounting, as it provides information to various stakeholders about the financial performance of local governments. "An Examination of the Usability and Effectiveness of Financial Reporting in Local Government are:

1. to examine the positive effect of internal audit towards the usefulness of financialreporting local government?
2. To examine the positive effect on the internal control system towards theusefulness of financial report in the local government?
3. To examine the positive effect of accounting capability towards the usefulness ofthe financial reporting on the local government?
4. To examine the positive effect on accounting capability towards the usefulness offinancial report through internal control system in the local government?
5. To examine the positive effect on internal audit towards the usefulness of financialreport through internal control system in the local government?

## **C. Research Benefits**

Financial reporting is crucial for the smooth functioning of local government departments, enabling informed decisions about budget distribution, resource allocation, and expenditure management. It improves transparency and accountability, fostering public trust in resource administration. Researching users of financial reports helps understand their data needs and preferences, enhancing the structure and content of financial reports. Understanding individual preferences and reporting practices can create individualized reporting structures that are more applicable and helpful. Evaluating the efficacy of financial reports can help identify areas for improvement, leading to changes in reporting standards

and disclosure requirements. This research serves as a reference for local governments and raises public awareness about the importance of financial reporting as a form of government accountability.

#### 1. Theoretical benefit

This study is expected to provide an explanation of the extent to which the quality of financial report is measured and can be a reference for further research.