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Do Political Factors Affect Financial Performance in Public Sector?

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ABSTRACT

Purpose: The implementation of regional autonomy in Indonesia has been regulated based on Laws of the Republic of Indonesia No 23 of the year 2014 concerning the responsibility given by the central government of the regional government to govern its own region. This is defined as regional autonomy. The government has appointed the members of Regional Legislative Councils (Dewan Perwakilan Rakyat Daerah - DPRD) to perform monitoring function on the regional government. There are several political factors which affect this monitoring function, one of which is due to the members of Regional Legislative Council originating from various parties. There is one component which makes up financial performance, which is the Locally-Generated Revenue (Pendapatan Asli Daerah - PAD). High locally-generated revenue gives us a clear description on a region's success in improving its regional income and therefore being independent from the central government. In the year 2015, the composition of the party supporting the regent / mayor was equal. Whereas in the year of 2016, the composition has changed, due to regional elections taking place on some cities or districts in Indonesia

INTRODUCTION

In the government regulation, Laws of the Republic of Indonesia No 17 Year 2014 explains that DPRD possesses (1) legislative function which is the member of The Local People's Representative Council (DPRD) and Regent / Mayor which creates the regulation on Regional Income and Expenditure Plan (*Rancangan Anggaran Pendapatan dan Belanja Daerah - RAPBD*), (2) the implementation of the budget function, concerning the finance of APBD. (3) the implementation of control function over supervision performed by DPRD. The research of Harun (2008) displays a result showing that the implementation of policies have been governed based on the regional autonomy. This means all authority is entrusted to the regional government. Therefore, the government has appointed DPRD members to supervise the regional government, particularly the policies created by the regional government. Rusmayadi et al. (2019) stated that one political component is the good political implementation by DPRD will create good governance because DPRD as the trustee of the people is doing the monitoring function to the regional government. The main function of DPRD that needs to be conducted is related to monitoring function because DPRD has to perform its function according to the Constitutional Laws. Gourevich (2003) stated that the need of good governance implementation is connected with 3 things such as relationship related to groups such as involved political parties, connections related with the involved political parties, connections established between one citizen to another, and connections established between the legislative and the executive party.

Ashworth et al. (2014) researches on the local government finance in Flanders. The research shows that local government budget is based on 4 main points: (1) tax income, (2) the implementation of accountability grants (3) the measurement of government debt. This explains that the implementation of good performance is an effective factor to manage finance. Politics is not only the main fuel of the government, but plays a significant role in future decision making. Garcia et al. (2013) conducted a research in Spain. The research resulted in the political implementation can be focused on certain parties, such as the dominant leading party as well as the implementation of ideology in the government. Prado et al. (2012) researched on the transparency management in the government.

The research includes resource taking (political figure) who has an important role and is able to formulate a wise decision for the society. This explains that political factor has a role in propelling the government system. This is not only limited to the administrative conditions to sign up for politics, but also being a figure who can demonstrates a transformation.

In Indonesia, performance and politics are two related things, because the improvement and degradation of performance is affected by how the regional government is able to exercise its rights and obligations in order to establish an independent government. Law of the Republic of Indonesia No 17 Year 2014 clearly states that DPRD also takes part in financial management, defined as the "Regional Income and Expenditure Plan (*Rancangan Anggaran Pendapatan dan Belanja Daerah - RAPBD*)" with the regent / mayor. One component in financial performance is "Locally-Generated Revenue (*Pendapatan Asli Daerah - PAD*)". High PAD measures the success of one region in increasing its income and the independence of the region from the central government. PAD is obtained through internal revenue from cities/regions. The source of the revenue comes from the retribution revenue, tax and other incomes in the scope of regional government. High number of PAD is commonly found in big cities and cities which has valuably high resources (such as tourism and mining), cities which are densely populated (such as big cities in Java).

The change of political structure might take place when regency / mayor government officials made a change of position in General Election. This will also generate a change in the supporting party in DPRD, not only as a political member which holds a significant role, but also will possibly create a politic fragmentation. Maeda (2010) stated that good political fragmentation consisted of equal position between opposition and coalition, in order to give a positive impact towards the political development.

In the implementation of the budgeting function and surveillance function, it shows the need of DPRD involvement in the political implementation. The implementation of surveillance and control functions performed by DPRD is highly related to the implementation of draft laws. A research conducted by Melki (2018) stated that the main function of DPRD is to be people's representative who has the mandate and connection with other executive parties

(other officials in the government). DPRD as a government established institution is expected to form political stability. DPRD must actively involved in giving counsels and correcting the implementation of activities in order to strengthen legitimation. Budgeting function and surveillance function related to APBD has to be in accordance with the principle of transparency by not adding or reducing the financial management in a region so the establishment and the development of a city/regency will be in the accordance with reality. The role which is visible is the one that takes place in the implementation of plenary session on the regional regulation plan regarding budget. The obligation of DPRD includes performing to check on the budget and funding performed by the regional government. If any problems or errors occurred, DPRD is able to issue an information regarding on a revision and possibly giving a disapproval. Transparency is beneficial to create a development priority, the implementation of financial responsibilities and creating public accountability. Krafchik dan Wehner (1999) explained that parliament is significant in the government, one of which is to determine the budget influenced by the commission in the legislative and is also able to give a decision. It is expected that decision can be made by the present government.

Literature Review and Hypothesis Development Agency Theory

The writer uses agency theory by Jensen dan Meckling (1976) in this research. This theory is connected with the implementation of authority and responsibility between two parties (principal – agent). The previous research on performance has been explored by Setyaningrum & Martani (2018). This research explores on how the legislative (DPRD) implements the agency theory as the executor of monitoring function. This is similar to a board position in a company. A previous research by Fenewick (2012) mainly discusses about performance and politics. Less conducive political influence might limit good leadership. Norris (2004) gives an information on how politics gives a “ligament” in determining party strategy in politics. According to the strategy, parties attempt to give loyalty to its political supporters and listen to other party’s opinion for the interests of the party itself. This strategy is considered more effective and beneficial in government implementation. A study by Goeminne & George (2019) in Belgia explores on the implementation of the performance

determinants in the local government. The study shows that the finance in the previous year has a positive impact on the future financial performance.

Financial Performance

The performance can be measured financially or non-financially. Non-financial performance can be measured by Performance Evaluation of Government Administration (*Evaluasi Kinerja Penyelenggaraan Pemerintah Daerah - EKPPD*), which is measured yearly. Financial performance is based on the financial report in the regional government report. In financial performance, the ratio can be seen from the revenue in the regional government. This is in line with a study conducted by Adi (2006) which shows that financial performance is the measurement of PAD. The local government is able to be independent to manage its own finance and do not require much involvement from the central government.

Opposition

Opposition in politics, one of which, can be seen from the composition of DPRD members in the government. Maeda (2010) stated that political fragmentation equality is essential as well as the equality of political distribution. Opposition might give opinions in fair decision-making. The definition of political opposition is taken from the research of Garcia et al. (2013) by using the percentage of DPRD members who are the second winning party. In 2016, the composition of the party also changed. Opposition as comparison gives a more effective implementation of activities, as viewed by the society.

Coalition

Members of DPRD inside the government who originate from the supporting party is defined as DPRD coalition. DPRD coalition might consist of various kinds of combined parties which supports the elected regent / mayor, such as what happens in Bandung. The city has a mayor which consists of supporting parties also taking position in DPRD. The implementation of party, political journey, as well as power holder has been explained in the study by Garcia et al. (2011) in Spain. This research mainly discusses about the regional government decision can be related to ideology as well as power in the current government. The implementation of policies, which is about to be taken and implemented by the regional government might possibly provide a unique leadership style. This is

a policy perceived to be supporting the citizen and create a high trust in the society. Law of Republic of Indonesia No 2 year 2011 provides explanation on political party. It states that more or less the implementation of politics must be guided by the rules and laws. Political parties which formed a coalition in Indonesia are legalized parties. The existence of supporting parties in the government, such as the mayor-regent supporting parties can give various impacts to the government, both positively or negatively. Rusmayadi et al. (2019) perceives that politics is a means of achieving the goals.

Legislative Size

Previous studies by Setyaningrum & Martani (2018) measures the legislative size based on the number of DPRD members from a city/regency in a certain period of time. The result of a study conducted by Marfiana & Kurniasih (2012) demonstrated that the number of DPRD members negatively impact the financial performance in Java region. In Indonesia, PAD is perceived as improving if it positively impacts the financial performance. Suhardjanto dan Yulianing (2011) explained that the more members in DPRD is able to positively impact the financial disclosure. On the other hand, one study by Marfiana & Kurniasih (2012) seemed to prove otherwise by stating by the more members of DPRD can negatively impact the financial performance in Java region.

Type of Government

Type of government describes the size of city/regency which consists of city/regency assessment. A previous study by Fenwick & Miller (2012) uses the measurement of government type as the main position, which is districtally / urbanly. The result of the study shows that government impact gives positive impact with the performance score based on dummy variable (1 and 0).

This research has 2 main hypotheses, which are as followings:

A research by Moe (1984) is related to agency theory: politicians are agents, bureaucrats are agents. This gives a responsibility according to one's own interests. A study by Kusumawardani (2012) shows that the level of surveillance is related to the willingness to perform tasks. This willingness can give improvement on the government performance in the form of score. Sumarjo (2010) discusses that

more surveillance results in better performance of regional government. Wenny, C. D. (2012) elaborated that the financial performance is related to financial liability issued by the government (on a fiscal basis) such as the management of locally-generated revenue, in the form of tax, retribution and other forms of incomes. This will help promote better development to the government year by year. **H1: Political coalition has negative impacts on financial performance of the regional government.**

Maeda (2010) discusses on the impacts of opposing party can impact the general election, particularly if the opposing parties are in a great number. Opposition is perceived as more credible and effective as a means to control and implement politics by the citizens. Storm (1990) explains that the implementation of opposition power is possible to be weakened especially due to less supports being received, and losing position from the majority legislative members.

Storm (1990) also discusses on the opposition having weak power. This opposition is able to perform 2 actions which are: (1) opposition party can give supports to the government, (2) opposition parties can give disapproval/ blocking the government. Therefore, the influence of outgoing opposition both in parliament and political conditions can be overcome. Maeda (2010) in Japan states that political opposition in a country is a main characteristic that can be impactful, especially in the accountability part, in the form of responsibility (actions).

H2: Political opposition has a positive impact towards the financial performance of the regional government.

RESEARCH METHODS

This research uses Local Government Financial Reports (Laporan Keuangan Pemerintah Daerah - LKPD) from cities and districts in Indonesia for 2 years (2015-2016) as its data. The dependent variable in this research is financial performance. To define political coalition, the writer uses the measurement from the number of DPRD members originating from government supporting party. Political opposition is measured by the second winner of DPRD members originating from non-government supporting party. The formula used in this research is:

Cities/regencies not involved in General Election (2015-2016):

$$KK_{pml} = KO_{it} + OP_{it} + LS_{it} + TA_{it} + TP_{it} + \text{eit} \dots \dots \dots (1)$$

Cities/regencies involved and not involved in General Election (2015-2016):

$$KK_{gbg} = KO_{it} + OP_{it} + LS_{it} + TA_{it} + TP_{it} + \text{eit} \dots \dots \dots (2)$$

Explanations:

KK= Financial Performance, KO= Coalition, OP= Opposition, LS= Legislative Size, TA= Total Assets, TP= Government Type.

Table 1a. Samples (City/ District : No Election Period 2015-2016)

Cities	Sample
City/ District	262
Total Observation	524

Table 1b. Samples (City/ District : No Election+ Elections Period 2015-2016)

Cities	Sample
City/ District	429
Total Observation	858

Table 1a and Table 1b consists of the samples of this research. Table 1a is 524 observations (262 samples x 2 years) and table 1b is 858 observations (429 samples x 2 years).

The two tables shows the difference on the samples (cities and regencies involved in the election of regent and mayor causing the party composition to change).

Table 1c. Dummy Variable

Cities	Dummy Score
City	1
District	0

Table 1c gives explanation on the measurement of a city and regency through dummy variable by giving 1-0 score. Score 1 is a city governed by a mayor, e.g Medan city, North Sumatra. Score 0 for regency governed by a regent, e.g Musi Rawas regency, South Sumatra.

RESULTS AND DISCUSSION

Table 2. Description Analysis

Var	Mean	Min	Max
KK	.1107665	.0068996	2.227849
KO	.3375016	0	1
OP	.1632931	0	.4222222
LS	32.71026	0	65
TA	28.37548	25.57805	32.6051
TP	.1933868	0	1

Table 2 gives an analytical description consisting of dependent variable (financial performance) and independent variable (political opposition and political coalition). The control variables are legislative size, total assets, dan government type. The highest mean rate is the legislative size (LS) (32.71026).

Table 3. City/ District : No Election (2015-2016)

Var	Hyp	Sign	Coef.	P>t	t
Cons			1.131807	0.000	-4.63
KO	H1	(-)	.0588495	0.029	2.19
OP	H2	(+)	.2929766	0.004	2.91
LS			.0028304	0.000	5.05
TA			.03703	0.000	4.08
TP			.1064306	0.000	9.42

Table 4. All City/ District (No Election + Election) (2015-2016)

Var	Hyp	Sign	Coef.	P>t	t
Cons			1.453579	0.000	-9.26
KO	H1	(-)	.0496751	0.007	2.69
OP	H2	(+)	.2518283	0.000	3.90
LS			.0023512	0.000	6.10
TA			.0493828	0.000	8.44
TP			.10068	0.000	12.28

Table 3 is the result of hypothesis 1 and hypothesis 2 (cities / regencies not performing any elections). Hypothesis 1 is about political coalition. H1 is not approved due to having positive score of (+) 0.029 whereas hypothesis is assumed to be negative. This is different from the hypothesis that political coalition does not negatively impact financial performance. In hypothesis 2 on political

opposition, H2 is approved due to having positive score of (+) 0.0004 (score <0.05) and is in line with the hypothesis. This is a proof that political coalition has positive impacts to financial performance. This gives an image that opposition role is perceived as significant in surveillance function, not only in the scope of DPRD members, but involved in decision making. Therefore, it is hoped that the policy taken will be neutral. Neutral variables such as LS, LA and TP have positive impacts on financial performance. Table 4 is the result of hypothesis 1 and hypothesis 2 (the total number of cities and regencies performing elections). Similar as the table before, political coalition is not approved due to having positive score (+) 0.007 > 0.05. H2 is approved due to having the score less than 0.05 which is 0.000. These two tables proved that when there was no election taking place (2015) compared to when there was an election (2016), the one that changes the political supporting parties have no significant impact on the change of political factor position on financial performance.

Table 5. VIF (City/ District : No Election)

Var	VIF	1/VIF
TA	1.53	0.653020
LS	1.47	0.677986
KO	1.17	0.851780
OP	1.12	0.893412
TP	1.04	0.963660
Mean	1.27	

Table 6. VIF (City/ District : No Election + Elections) (2015-2016)

Var	VIF	1/VIF
TA	1.55	0.645595
LS	1.49	0.672154
KO	1.17	0.851780
OP	1.14	0.873935
TP	1.04	0.957153
Mean	1.28	

Table 5 is the result of (No Election) during 2015-2016. The score result is 1.27. This proves that the highest VIF score is Total Assets (TA) with the score of 1.53 and the lowest one is The Type of Government which scores 1.04. The total VIF score is 1.27. In conclusion, the variable is free from multicollinearity assumptions.

Table 6 has a gap which is not different compared to table 5. The VIF score is 1.28. In conclusion, the variable is free from multicollinearity assumptions.

Table 7. City/ District : Election (2015-2016)

Hyp.	Exp.	Result
H1	(-)	No
H2	(+)	Effect

Table 8. City/ District : No Election + Election (2015-2016)

Hyp.	Exp.	Result
H1	(-)	No
H2	(+)	Effect

Table 7 is the whole conclusion stating that H1 does not produce a negative impact towards financial performance and H1 has positive impact towards financial performance.

Table 8 also shows the similar result. H1 does not produce a negative impact towards financial performance and H1 has positive impact towards financial performance. This shows that there is no difference when regency / mayor election is taking place or when it is not, towards the government-supporting parties, which settles in DPRD. Opposition has a positive impact in financial performance, so that it is expected that monitoring function can be fulfilled.

CONCLUSION

The research is meant to show how the political factor is related to public sector financial performance. This research has main variables which are financial performance (dependent variable), political coalition and opposition (independent variable). The definition of political coalition and opposition is based on the DPRD of regency / city members in Indonesia. Beside that, this research proves empirically whether or not there is a difference between 2015 and 2016, party position changes due to regional elections being held in several cities and regencies. The result of this research shows that the coalition has no negative impact on financial performance. This has been proven by 2 year of conducting a research, with a total sample and a sample that does not follow the elections. The result shows that political factor has significant impact towards financial performance due to other control variables, such as the number of DPRD, total of the assets, and type of government also has positive impact on financial performance. It is hoped that the implementation of DPRD will be better in terms of improving performance, particularly in cooperating with regent / mayor.

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