

## DETERMINANT FACTORS OF FINANCIAL REPORTING QUALITY IN LOCAL GOVERNMENT: THE EVIDENCE FROM PUBLIC SECTOR IN INDONESIA

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### ABSTRACT

*This study aims to examine the effects of spending plan composition elements, regional wealth, local government features, and the characteristics of regional government leaders on the quality of local government financial reports in Indonesia, as well as the moderating effect of financial performance. The research utilized Multinomial Logistic Regression with Pooled Data for hypothesis testing. This analysis draws on 1089 Regional Government Financial Reports from around Indonesia in 2021-2023. We utilize the audit opinion type as an indicator of reporting quality, where an unqualified opinion signifies the highest level of quality, and a disclaimer of opinion indicates the lowest quality. Two ratios were developed based on the financial budget by local government to measure financial performance, which are the Routine Ability Index Ratio (RAIR) and Budget Effectiveness Ratio (BER). The findings of this study, the regional wealth factor, and the proficiency of regional government officials affect the quality of regional financial reporting (FRQ). This research has implications for central government policies in examining the quality of regional financial reporting. The first implication of this study reveals that the wealthier a regional government is, the higher the quality of its financial reporting tends to be. Second, a leader's years of experience in governing a region influence the quality of his regional financial report. This implies a longer leadership period influences better performance.*

**Keywords:** Financial Reporting Quality; Financial Performance; Regional Government; Public Sector

### INTRODUCTION

The financial reporting quality is linked to the organization's overall performance (Fanani, 2009). It's widely accepted that Financial Reporting Quality (FRQ) is part of organizations' widespread and beneficial features (Gjorgieva et al., 2017). Previous studies reported that the lack of quality in financial reports negatively impacts an organization's survivability and growth, which causes yearly losses for many institutions (Jara et al., 2011; Tarus et al., 2015).

Studies of the literature have shown that FRQ is a widespread issue in economics, finance, accounting, and governance-related areas. Research on this issue focuses on corporations (Lo, 2008; Dechow et al., 2010) or non-profit organizations (Hofmann & McSwain, 2013). From the standpoint of corporate management, there are two major factors of a well-structured FRQ which are excellent managerial (Francis et al., 2008; Rakhman, 2009; Huang et al., 2012; Habib & Hossain, 2013; Jiang et al., 2013), effective audit committee and directory board (McDaniel et al., 2002; Klein, 2002; Vafeas, 2005; Krishnan & Visvanathan, 2008; Badolato et al., 2014).

Furthermore, certain company-specific elements influence the quality of financial reporting, including audit quality (Stanley & DeZoort, 2007), business arrangements and capital structure (Rahman et al., 2010), employee quality (Call et al., 2017), reporting incentives (Christensen et al., 2015) and company reputation (Cao et al., 2012). Furthermore, certain inherent elements, like investor safety, culture, and financial reporting standards have an impact on FRQ quality (Nabar & Boonlert-U-Thai, 2007; Barth et al., 2008; Houque et al., 2012; Wijayana & Gray, 2019). Each regional government publishes its annual financial report. The annual report is regulated by the Indonesian government law number 71 of 2010 to replace the previous law number 24 of 2005. The Indonesian government changed its basic law to raise the standard and accountability of financial reports from regional governments. Some significant factors of well-reported financial paper are the accounting standards, human skills, and accounting system establishment.

The Indonesian government has announced transformational laws related to the regional government financial reports. Law no 17 of 2003 is about the regulations of the national budget drafted by the local government and central government budget. The central government also issues law number 32 of 2004 about the local government budget system. According to law number 71 of 2010 about the Government Accounting System (GAS), the articles regulate how each local and central government should report the annual budget.

The goal of this transformation is to establishment of governmental accountability and transparency in financial report, both central and regional (Badjuri & Trihapsari, 2004). In their paper, Badjuri and Trihapsari (2004) also mentioned that

transparency and accountability are intended to ensure the government's financial management system is running well. This complies with public demands that public sector entities raise the standard, level of professionalism, and transparency of their financial management practices.

Stakeholders will base many decisions pertaining to citizen welfare as well as significant economic decisions on the financial reports prepared by the local government. Therefore, information in the Regional Government Financial Report (LKPD) should be informative and able to meet the user's requirements. Huang et al. (2012; 2017) explain that a good report provides data thus, stakeholders could make decisions based on that data. Therefore, Local governments must carefully consider the information provided in financial reports for planning, controlling, and decision-making. Local government financial statements must conform to specific qualitative requirements as specified in Government Regulation No. 71 of 2010 and should comply with Presidential Instruction Number 4 of 2011 on enhancing the quality of state financial accountability and Presidential Instruction Number 1 of 2013 on anti-corruption measures.

This study explored more deeper into the factors influencing Financial Reporting Quality (FRQ) in local governments in Indonesia. Some reasons why such a study needs to be conducted, especially in the Indonesian context. First, as an archipelago country, consisting of 34 provinces, Indonesia is considered a young country. Each province consists of districts and cities. According to data from the Indonesian Ministry of Internal Affairs, Indonesia has around 514 districts and cities. It is a major democratic nation that supports fiscal decentralization and reform in the public sector. Since 2004, under Law Number 17 of 2003 about State Finances, almost 500 local governments in Indonesia must annually create and provide financial reports for auditing by the Audit Board of the Republic of Indonesia. Mandating annual reports for all local governments is crucial for enhancing transparency and accountability. Despite the necessity of these rules and criteria, achieving effective accountability and transparency is challenging without addressing the issue of FRQ. There is a limitation of empirical research on the factors influencing FRQ in the public sector, particularly in Indonesia.

Second, many corruption cases occur at the governmental level. Corruption represents a significant obstacle to public management change in a country and must be dealt with thoroughly. Financial transparency from local governments is essential for acquiring top-notch data on budget stability (Beckett, 2009) and the sustainability of government finances (e.g., Chen et al., 2016). Conducting this study would enhance transparency and accountability in the local government FRQs.

Third, a smaller number of studies rely on secondary data to evaluate the quality of financial reporting in the public sector. Rakhman and Wijayana (2019) found that a low FRQ is linked to a high capital expenditure to total budget ratio. Additionally, they discovered that local governments with higher FRQ were wealthier and larger. This finding also proves that local governments with experienced regional heads have higher reporting quality. It leads to the conclusion that governmental quality, audit efficiency and financial incentives could accelerate the financial report quality.

Fourth, prior research has sought to identify the challenges in producing high-quality financial reports for local governments. The literature highlights significant issues, including limited organizational resources and insufficient managerial capabilities. One study emphasized the struggle to adapt to adverse economic conditions, aggravated by the excessive transfer of responsibilities from central to local governments without accompanying financial incentives for preparing financial reports. Fanani (2009) noted that factors such as sales volatility, performance, and industry classification strongly influence the quality characteristics of financial reporting. Improved government performance is expected to enhance the accuracy of local government financial reports

Fifth, in the profit-oriented perspective work performance is determined by financial ratios (Azhar, 2008). Although this research was conducted on a local organization level, it is also possible to use financial ratios to measure some local government financial performance. Mardiasmo (2002) describes four benchmarks in assessing the local government's financial performance: [1] deviations between budget realization and targets set in the Local Financial Draft, [2] cost efficiency, [3] program effectiveness, and [4] equity and justice. For the sake of transparency, honesty, democracy, effectiveness, efficiency, and accountability of local government financial management, it is urgent to conduct an analysis of its financial ratios despite its unique characteristics. The Indonesian government must make a concerted effort to motivate local governments to report their financial activities transparently and uphold accountability.

As a result, an in-depth analysis is necessary to identify the factors affecting the quality of financial reports (RFQ) prepared by Indonesian local governments. Based on the challenges, our study formulated several hypotheses, which are discussed in the following section.

The study's research question is whether budget composition, regional wealth, The qualities of local governments and the attributes of local government leaders are crucial elements that influence the standard of financial reporting (FRQ) in local governments across Indonesia. Our research also seeks to answer the research question of whether financial performance moderates these factors on financial reporting quality (FRQ). Based on this, we intend to investigate the moderating effect of local government financial performance on the relationship between budget composition, regional wealth, characteristics of local governments, and characteristics of regional government leaders on financial reporting quality (FRQ). There are several financial ratios based on local government financial reports that have been formulated by the Directorate General of Fiscal Policy, Ministry of Finance in Indonesia ([djpk.kemenkeu.go.id](http://djpk.kemenkeu.go.id)) as follows: [1]

Routine Ability Index Ratio (RAIR), which is a measure that can describe the extent to which the potential financial capacity of a regional government to pay routine regional expenditures. [2] Budget Effectiveness Ratio (BER), which can characterize the contrast between the local government's capacity to execute the local revenue budget as planned and the goal established in accordance with the region's actual potential.

This study's structure is set up as follows: Reviewing the literature and formulating hypotheses are covered in Section 1. Research methods are covered in Section 2. The discussion and an explanation of the empirical results are provided in Section 3. The study's constraints and findings are outlined in the concluding section 4.

### **NEW PUBLIC MANAGEMENT (NPM)**

Since 1980, the application of NPW has been a part of corporate governance standards. The public accountability and administration doctrine was the primary focus of the transformation (Hood, 1993). According to the New Public Management theory (NPM), private sector management approaches are considered better than those applied in the public sector. Certain private sector techniques, such as market procedures, compulsory competitive bidding, and the privatization of public corporations, can be implemented to improve public sector performance (Atreya & Armstrong, 2002).

The application of NPM is considered as the manifestation of managerial reformation and it encourages democracy. The regional government has received authority from the central government. There are risks associated with this change, and it necessitates a complicated process (Warren & Jack, 2018).

Implementing NPM is viewed to promote democracy through management reform, depoliticization of power, or decentralization of authority. Changes start with rethinking government and continue with reinventing it, including local government, which alters the role of government, particularly regarding the relationship between the government and society. Though the specifics of the reforms differ, theoretical shifts such as the shift from public administration to public management, the reduction of government red tape, and the use of contract systems have proliferated globally. In practically every nation, accrual accounting, performance-based budgeting, and outcome-based management are becoming more and more popular. Although NPM is a worldwide phenomenon, local circumstances can affect how it is applied (Mardiasmo, 2006).

### **THE IMPACT OF REGIONAL GOVERNMENT WEALTH ON FINANCIAL REPORTING QUALITY (FRQ)**

Growth in local government is fueled by capital investments, which also support IT and financial reporting infrastructure, raising FRQ. However, based on at least two factors, most of the literature suggests a negative association between FRQ and capital spending. First, compared to commercial counterparts, government contracts are generally linked to lower levels of efficiency and transparency in their oversight (Berrios, 2006; Evenett & Hoekman, 2005). Additionally, capital expenditures usually entail procurement and construction, which are notoriously corrupt and bribery-prone (Neu et al., 2015; Sikka & Lehman, 2015). Public procurement costs governments around the world an average of \$9.5 trillion a year, of which \$2 trillion is wasted from procurement budgets (Kuhn & Sherman, 2014). The presence of corruption, which regrettably still frequently occurs among Indonesian local governments, makes the accountability process more difficult and prevents openness when financial accounts are being prepared. Second, capital project investing is risky by nature and typically entails a complicated process (Warren & Jack, 2018). Audit findings will be irregular if financial administration guidelines are not followed. Moreover, one of the most common audit concerns in institutional governance is the production of assets by long-term capital expenditure projects (Rivenbark, 2000). The issues are undervalued long-term assets on the balance sheet, unrecorded new asset purchases, and written-off long-term assets nevertheless included in the asset register of local governments. In actuality, the Supreme Audit Agency (BPK) discovered that many audit qualifications and conclusions had to do with local governments' long-term asset management practices (BPK, 2013). Rakhman and Wijayana (2019) added that the FRQ would decrease as the capital expenditure budget increased.

Local governments with a higher ratio of capital expenditure in their budgets are anticipated to have higher levels of complexity, lower openness, and inadequate accountability—will decrease FRQ based on the literature and the arguments presented above. The following is the first hypothesis put forth in this research:

**H1:** Capital expenditure adversely impacts Financial Reporting Quality (FRQ).

### **THE IMPACT OF REGIONAL GOVERNMENT WEALTH ON FINANCIAL REPORTING QUALITY (FRQ)**

The two main sources of income for Indonesian local governments are transfers from higher levels (provincial or central government) and revenue produced independently by the regional government. Because they are less dependent on transfer revenues and generate more revenue from local sources, Wealthy municipal governments are those with better financial independence. Richer local governments are better able to manage their accounting systems with information technology and by hiring consultants, both of which enhance the quality of their financial reporting. Tavares & da Cruz

(2017) stated that more transparent local governments are typically those with higher local revenue. Additionally, if local taxes collected from citizens account for most of the regional revenue, then citizens will supervise their local government more closely. Geys et al. (2010) concluded that when local governments are highly financially independent, citizen involvement improves local government performance. Higher FRQ was also linked to wealthier local governments, according to Rakhman & Wijayana (2019).

In another hand, local governments whose main income relies on provincial and governmental transfer, are considered independent financial governments. The sum of money transferred may vary depending on each local government characteristic. Transfers by provincial and central governments may be lower than the local governments proposed budget. Moreover, the funding availability is not always on time. The timing uncertainties affect the local government programs and raise problems in the financial report. In some cases, local governments were forced to postpone their programs till the end of the fiscal year. This delay caused them to have a rushed period to allocate the budget and run their plans. This also affects the financial reports.

This problem can lead to lower FRQ for local governments. Based on these arguments and literatures, The second idea suggested in this study is as follows:

**H2:** The Regional government's wealth has a beneficial impact on the Financial Reporting Quality (FRQ)

### **THE IMPACT OF REGIONAL GOVERNMENT LEADER'S CHARACTERISTICS ON QUALITY OF FINANCIAL REPORTING (FRQ)**

Research has demonstrated the beneficial effect of a top-notch management system on the firm's financial ratio. CEO experience has been found to influence the quality of reporting and disclosure (Matsunagaga & Yeung, 2008). Aier et al. (2005) also found that a lower likelihood of financial restatements can be linked to a CFO with greater experience.

Rakhman & Wijayana (2019) stated the experience of regional government leader has a significant influence on the quality of regional financial reports (Financial Reporting Quality or FRQ). Good quality financial reports reflect transparency, accountability, and reliability of financial information presented by the regional government. Several factors that influence the quality of regional financial reports include the professionalism, competence, and experience of government officials, including the mayor. The regional government leader's experience in dealing with various situations and challenges in regional financial management can improve the ability to make the right decisions related to budget management, internal supervision, and financial reporting. Thus, the experience of a regional government leader plays an important role in ensuring high-quality regional financial reports, which ultimately supports transparency and accountability of regional government.

Rakhman & Wijayana (2019) also stated that within the field of municipal administration, an experienced leader is closely linked to a favorable audit opinion. Regional government leaders who have more experience (served in a long period) can organize regional financial management and prepare financial reports with better quality. Thus, the proposed hypothesis is as follows:

**H3:** The regional government leader's experience has a beneficial impact on the Financial Reporting Quality (FRG)

According to earlier research, a CEO's age is linked to better reporting quality (Huang et al., 2012). Additionally, Rakhman & Wijayana (2019) found a correlation between the quality of regional financial reports and the age of the regional government leader. It's commonly known that the regional government leader is not directly involved in the financial report preparation. However, the experienced leader tends to have a greater awareness in producing high-quality financial reports. When the head of a regional government voices serious concerns about financial reports quality, subordinates (such as treasurers) are more likely try harder to ensure that cash management is well managed and financial reports are well prepared according to standards and regulations. The age of the regional government leader can affect management ability, where younger leaders may have more energy and innovation, while older leaders may have more experience and wisdom in decision-making.

The following hypothesis is put forth considering the arguments and earlier research:

**H4:** The age of the regional government leader has a positive effect on the Financial Reporting Quality (FRG)

### **FINANCIAL PERFORMANCE OF LOCAL GOVERNMENT**

The financial performance of local authorities can be characterized by how they effectively and efficiently manage their revenues and normal expenses. According to Dwiranda (2008) the primary indicator of a region's financial capacity is its ability to implement regional autonomy. Regional financial capacity relates to a region's capacity to explore monetary capacity, manage, and employ its own resources in a way that is sufficient to pay for the operation of its government. There are two ratios that were developed based on the financial budget by local government to measure financial performance, which are (1) Routine Ability Index Ratio (RAIR) and (2). Budget Effectiveness Ratio (BER).

RAIR demonstrates regional financial capabilities through a regional financing perspective (Sijabat, 2014). RAIR is

a measurement that shows how much a region's regular expenditures can be covered by its original revenue. Regional government routine expenditures can be described as personnel expenditures, goods expenditures, subsidies to autonomous regions, subsidies to regional companies, interest payments and debt installments, as well as other routine expenditures. The higher the RAIR value means that the local government is considered to have good financial performance.

BER demonstrates how well local governments plan for and realize regional original revenue during a fiscal year. The ability of local governments to achieve the goals established based on the region's actual potential is compared to the planned regional original revenue to determine the BER.

Theoretically, capital expenditures are anticipated to adversely affect the quality of the financial report. This is possible because the regional governments that carry out large capital expenditures mostly get findings by the Audit Board in Indonesia after conducting an audit (Rakhman & Wijayana, 2019). On the other hand, it is possible that the quantity of capital expenditures made by local governments does not invariably have an adverse impact on financial reporting excellence by regional governments. The amount of capital expenditure can have a positive effect on the quality of regional government financial reporting. A local government with large capital expenditures can maintain a standard financial report. Whereas local governments with problematic financial management resulted in poor quality financial reports. Local government performance reflects efficiency, effectiveness, and accountability in managing local finances, including capital expenditures. When local government performance is good, the positive influence of capital expenditures on FRQ will be stronger because local governments with high performance tend to have an effective internal control system, so they can ensure that capital expenditures are managed well and reported accurately.

Good performance indicates superior financial management capabilities, which ensure that financial data from capital expenditures are translated correctly into financial reports. Conversely, if local government performance is low, capital expenditure management may be ineffective, reducing the quality of financial reports. This can occur due to low transparency, weak internal supervision, or inefficient use of the budget. Mahmudi (2019) stated that good governance strengthens the relationship between public spending and the quality of financial reporting. Thus, local government performance is a key element in ensuring that investment through capital expenditures not only drives physical development but also produces transparent and reliable financial reports.

The moderating effect of regional financial performance on capital expenditure levels and the quality of financial reporting by regional governments will be investigated in this study. Considering the theory's explanation and the conceptual framework presented above, the following additional hypothesis pertains to this study:

**H5:** FRQ will be positively impacted by regional financial performance, and it will moderately influence the capital expenditure.

Good-quality financial reports are expected from locally governed entities that are financially independent (Rakhman & Wijayana, 2019). This study does, however, point to a plausible variable that might either improve or worsen performance. Financially struggling local governments might not be capable of generating a high-quality financial report.

Wealthy local governments may not be able to provide higher-quality regional government financial reporting in cases where their finances are performing poorly, and their impact over the high standard of regional government financial reporting may be strengthened in cases where their finances are performing well. It is anticipated that financial performance will moderate (strengthen or weaken) the impact of regional government wealth on FRQ. The research hypothesis is based on the explanation of the theory and the argumentation framework provided above.

**H6:** Regional financial performance will act as a mediator between regional financial performance and regional government wealth, and it has a considerable enhancement on the quality of financial reports.

The current research, however, finds that several factors other than the duration of a leadership period impact the accuracy of financial statements. Because they have more experience managing regional finances, regional government leaders (executives) with longer tenure will produce financial reports of a higher caliber (Rakhman & Wijayana, 2019).

It is plausible that in regional governments with subpar financial performance, the correlation between the experience of the regional government leader and the quality of financial statements has shifted. Conversely, in regional governments with strong financial performance, the impact of the leader's experience on the caliber of financial reporting can be amplified. It is conceivable for seasoned executives to produce subpar financial results. It is anticipated that the influence of regional government leaders' experiences on FRQ will be moderated, either strengthened or weakened, by financial performance. The following hypothesis is put forth in this research based on the explanation of the theory and the arguments presented above.

**H7:** Regional financial performance will act as a mediator between regional financial performance and regional government leaders, and it has a considerable beneficial effect on the financial report quality (FRQ).

The quality of regional government financial reporting may improve with a more experienced and older regional

government leader, as such leaders are believed to possess the wisdom and knowledge necessary for effectively overseeing and guiding regional financial management (Rakhman & Wijayana, 2019). However, this study suggests that as regional government leaders become older, their influence may not necessarily enhance the accuracy of financial reporting. This could be attributed to the need for local governments to assess whether their financial performance is a significant factor. It is expected that financial performance will act as a moderating variable, either amplifying or diminishing the effect of a leader's age on financial reporting quality (FRQ). Based on this theoretical framework and reasoning, the study proposes the following hypotheses.

**H8:** Regional financial performance will enhance the quality of financial reporting, and it will have a moderate impact on the age of regional government leaders.

## METHODS

### DATA AND SAMPLE

This research implemented purposive sampling and used the local government financial report as the main data. The standard criterion for the data used for analysis is all the financial reports should pass the Indonesian Supreme Audit Agency 's Standard. Based on these criteria, 363 regional governments for three consecutive years from 2021-2023, with a total of 1089 reports have been obtained for data analysis.

### VARIABLE MEASUREMENT AND MODEL SPECIFICATION

This study aims to find the determinant factors of Financial Reporting Quality (FRQ). The research utilized Multinomial Logistic Regression with Pooled Data for hypothesis testing. It integrates cross-section sample data and time series data. The following is the regression equation model:

$$FRQ_{it} = \beta_0 + \beta_1 CAPEX_{it} + \beta_2 WEALTH_{it} + \beta_3 EXP_i + \beta_4 AGE_{it} + \beta_6 CAPEX_{it} * PERFORM_{it} + \beta_7 WEALTH_{it} * PERFORM_{it} + \beta_8 EXP_i * PERFORM_{it} + \beta_9 AGE_{it} * PERFORM_{it} + \beta_{10} METRO_i + \beta_{11} JAVA_i + \beta_{12} SIZE_{it} + e \dots\dots\dots (1)$$

Where:

**FRQ<sub>it</sub>** :  
Financial Reporting Quality for the regional government *i* in the period *t* that is marked as 1 if the financial statements with disclaimer of opinion, marked as 2 for adverse opinion, marked as 3 for a qualified opinion and marked as 4 for unqualified opinion.

**CAPEX<sub>it</sub>** :  
Capital expenditure ratio for regional government *i* in the period *t*.

**WEALTH<sub>it</sub>** :  
Level of Regional Independence Ratio for regional government *i* in the period *t*.

**EXP<sub>i</sub>** :  
Parameter for the number of years a regional government leader has held their position, which is used to measure their experience.

**AGE<sub>it</sub>** :  
Age of regional government leader for regional government *i* in the period *t*.

**PERFORM<sub>it</sub>** :  
Dummy variable for regional government performance which is marked as 0 for high-performance regional government clusters and marked as 1 for low-performance regional government clusters for regional government *i* in the period *t*.

**CAPEX<sub>it</sub> \* PERFORM<sub>it</sub>**:  
Interaction moderating variable between CAPEX and PERFORM. Variables for regional government *i* in the period *t*.

**WEALTH<sub>it</sub> \* PERFORM<sub>it</sub>**:  
Interaction moderating variable between WEALTH and PERFORM variables for regional government *i* in the period *t*.

**EXP<sub>i</sub> \* PERFORM<sub>it</sub>**:  
Interaction moderating variable between EXP and PERFORM variables for regional government *i* in the period *t*.

**AGE<sub>it</sub> \* PERFORM<sub>it</sub>**:  
Interaction moderating variable between AGE and PERFORM variables for regional government *i* in the period *t*.

**METRO<sub>i</sub>** :  
Control variable in the form of dummy variabel for regional government status which is marked as 0 for district status and marked as 1 for municipality status (metro) for regional government *i*.

**JAVA<sub>i</sub>** :  
Control variable in the form of dummy variabel for regional government status which is marked as 0 for district status and marked as 1 for municipality status (metro) for regional government *i*.

Control variable in the form of dummy variabel for regional government location which is marked as 0 for outside of Java and marked as 1 for Java for regional government i.

SIZE<sub>it</sub> :

Control variable that indicates the extent of the regional government's wealth by describing the size of its total assets. The natural log of the regional government's total assets as shown on the balance sheet is used to calculate this parameter.

PERFORM is a dummy variable that separates local governments into high-performing and low-performing groups. The grouping is based on the Routine Ability Index Ratio (RAIR) and the Budget Effectiveness Ratio (BER) (djp.kemenkeu.go.id).

RAIR is obtained by the formula of total the regional government original revenue divided by routine regional government expenditures. BER is obtained by the formula of realization of regional government original revenue divided by the target of regional government original revenue.

Based on the two ratios, grouping is carried out using hierarchical cluster analysis techniques to obtain groups of high-performing regional governments and low-performing regional governments.

## ANALYSIS

### DESCRIPTIVE STATISTICS

The results of descriptive statistical tests on all research variables based on 363 observations are displayed in Table 1 above. The JAVA variable ranges from 0 to 1, with an average value of 0.26. The deviation is 0.442.

Table 1. Descriptive Statistic

	N	Min	Max	Mean	Std. Dev.
JAVA	363	0	1	.260	.442
METRO	363	0	1	.290	.454
FRQ	363	3	4	3.900	.303
CAPEX	363	.044	.621	.216	.074
WEALTH	363	.002	1.000	.182	.157
EXP	363	0	14	3.550	2.690
AGE	363	31	70	53	7.656
SIZE	363	24.979	33.879	28.845	.940
PERFORM	363	1	2	1.350	.477
CAPEX*PERFORM	363	.052	1.242	.274	.136
WEALTH*PERFORM	363	.002	2.126	.234	.297
EXP*PERFORM	363	.000	25	4.628	4.056
AGE*PERFORM	363	31.000	210.000	70.223	27.467
Valid N (listwise)	363				

Source: Author

The METRO variable ranges from 0 to 1, with an average value of 0.29. The standard deviation value is 0.454. The FRQ variable ranges from 3 to 4, with an average value of 3.900. The standard deviation value is 0.303. The CAPEX variable ranges from 0.044 to 0.621 with an average value of 0.216. The standard deviation value is 0.074.

The WEALTH variable has the lowest value of 0.002 and the highest value of 1,000, the average value for the WEALTH variable is 0.182. The standard deviation value is 0.157. The EXP variable has the lowest value of 0 and the highest value of 14, the average value for the EXP variable is 3,555. The standard deviation value is 2,690. The AGE variable has a minimum value of 31 and a maximum value of 70, the average value for the AGE variable is 53. The deviation is 7,656. The SIZE variable has a minimum value of 24,979 and a maximum value of 33,879, the average value for the SIZE variable is 28,845. The standard deviation value is 0.940. The maximum and minimum values of the PERFORM variable are 2 and 1, respectively. The Std value and average value of the PERFORM variable are 1,350. It deviates by 0.477.

The CAPEX\*PERFORM variable has the lowest value of 0.052 and the highest value of 1.242, the average value for the CAPEX\*PERFORM variable is 0.27485. The standard deviation value is 0.136116. The WEALTH\*PERFORM variable has a minimum value of 0.002 and a maximum value of 2.126, the average value for the WEALTH\*PERFORM

variable is 0.234. The standard deviation value is 0.297. The EXP\*PERFORM variable has a minimum value of 0.000 and a maximum value of 25, the average value for the EXP\*PERFORM variable is 4.628. The standard deviation value is 4056. The AGE\*PERFORM variable has a minimum value of 31 and a maximum value of 210, the average value for the AGE\*PERFORM variable is 70,223. The standard deviation value is 27,467.

Hierarchical Cluster Analysis between-groups linkage was carried out to obtain 82 local governments with characteristics of low performance and 39 local governments with high performance.

### POOLED LEAST SQUARE (PLS) REGRESSION

To prove the hypothesis, this study used multiple regression analysis pooled least square with panel data. The factors used in this research were a combination of several years times series with cross-section data from various local governments. Table 2 below displays the multiple regression analysis results.

Table 2. Pooled Least Square (PLS) Regression

Variable	Coefficient	t-Statistic	Prob
C	2.1920	3.2810	0.0010
CAPEX	-0.2170	-0.6480	0.5170
WEALTH	0.2650	2.0060	<b>0.0460*</b>
EXP	0.0410	2.9510	<b>0.0030***</b>
AGE	-0.0020	-0.7300	0.4660
CAPEX*PERFORM	0.0100	0.0450	0.9640
WEALTH*PERFORM	-0.2990	-3.0800	<b>0.0020***</b>
EXP*PERFORM	-0.0260	-2.5750	<b>0.0100**</b>
AGE*PERFORM	0.0000	-0.0860	0.9320
METRO	0.0820	1.9680	<b>0.0500**</b>
JAVA	0.0530	1.2350	0.2180
SIZE	0.0600	2.5440	<b>0.0110**</b>

Dependent Variable: FRQ

The superscript \*, \*\*, and \*\*\* indicate significance at 10%, 5%, and 1%

Source: Author

Table 2 shows that capital expenditure (CAPEX) against FRQ (H1) indicates the *t*-statistic value of -0.648 which is lower than the *t*-table and the *p*-value is 0.517 above alpha 5%. This shows that Hypothesis 1 result is a negative and significant impact of capital expenditure on FRQ is statistically rejected. In a regional government context, capital expenditure typically includes spending on infrastructure, facilities, and long-term assets that are essential for public services. These expenditures do not directly influence short-term financial performance metrics. Regional FRQ often emphasizes operational efficiency, budgetary compliance, and the accurate representation of annual revenue and expenditures. Capital expenditure, being an investment activity, does not directly affect operational or budgetary reporting.

Meanwhile, the regional wealth variable (Wealth) to FRQ (H2) shows that the *t*-statistic value is 2.006 which is greater than the *t*-table and the *p*-value is 0.046 below the 5% alpha. This demonstrates that Hypothesis 2, according to which regional wealth (Wealth) has a statistically significant positive impact on FRQ, is accepted. This suggests that the quality of local government financial statement increases with local government wealth. The two main sources of funding for local governments are typically local tax revenue and money transferred from higher levels of government (provincial or central). Greater financial independence among local governments is attributed to their increased revenue generation from internal sources as opposed to intergovernmental transfers. Richer local governments are more likely to produce financial reports of a higher quality because they can afford to hire consultants to support accounting systems or use information technology. This result is in line with Tavares and da Cruz's (2017) finding that more locally generated revenue generally translates into more transparency for local governments. Furthermore, when local taxes account for a larger portion of the government's revenue, the public is more motivated to keep an eye on their local government. According to Geys et al. (2010), local government performance is only enhanced by voter involvement when there is a high degree of financial independence. Furthermore, funding may be provided in amounts and at times that vary according to local government preferences in relatively less wealthy local governments where revenues are primarily transferred from the central government. The amount might be less than what the local government had anticipated, or it might not always be available when needed. These issues then lead to a lack of certainty regarding the start and end dates of projects or activities, which makes financial reporting more difficult. Local governments frequently must wait until almost the end of the fiscal year to start programs or activities, which leaves them with very little time to spend before having to prepare financial reports. Local governments may receive reduced FRQs because of this issue.



In relation to FRQ (H3), the Mayor/Regent's (EXP) experience yields a t-statistic value of 2,951, exceeding the t-table and p-values of 0.003 below alpha 5% and 1%. This demonstrates that Hypothesis 3, according to which the Mayor / Regent's (EXP) experience on FRQ is positively and significantly influenced, is statistically supported. This is corroborated by research on corporate governance, which shows that a firm's FRQ is impacted by the qualities of its top executives. Executive experience enhances the quality of reporting and disclosure, according to Matsunaga and Yeung (2008). CFOs with more experience are linked to a lower likelihood of financial restatements, according to research by Aier et al. (2005). The study's findings show that regional financial reporting is of higher quality when regional heads have more experience overseeing their respective areas. Thus, there is a greater chance that regional heads with greater experience—that is, those who have held mayor or regent positions for longer—will be able to submit financial reports of a higher quality.

In Table 2, the p-value is 0.466 above the 5% alpha and the t-statistic value is -0.730, which is less than the t-table. This indicates that Hypothesis 4, which posits that the Age of the Mayor/Regent (AGE) has a statistically significant positive effect on FRQ, is not supported. The age of regional leaders may not directly affect Regional Financial Reporting Quality (Regional FRQ) for several reasons, tied to the nature of leadership, institutional structures, and the processes governing financial reporting. Regional leaders often focus on strategic priorities, such as economic development or public welfare, rather than the technical aspects of financial reporting. These priorities may not significantly impact FRQ.

PERFORM strengthens the effect of CAPEX on FRQ (H5), in table 3 shows the t-statistic value of 0.045 lower than the t-table and p-value of 0.964 above alpha 5%. This shows that Hypothesis 5 that PERFORM strengthens the impact of CAPEX on FRQ is rejected.

The effect of PERFORM on FRQ (H6) is stronger than that of WEALTH; table 3 displays a t-statistic value of -3,080, which is higher than the t-table and p values of 0.002 below alpha 5% and 1%. This shows that Hypothesis 6 that PERFORM strengthens the effect of WEALTH on FRQ is statistically accepted, although the directions are different. These results indicate that local governments that have poor financial performance, rich local governments may not be able to provide quality LKPD and vice versa, for local governments that have good financial performance, it can strengthen the influence of rich local governments on the quality of LKPDs. Financial performance is thought to have a moderating impact (strengthen or weaken) the influence of wealth on FRQ.

The effect of PERFORM on FRQ (H7) is strengthened by EXP; table 2 displays a t-statistic value of -2.575 above the t-table and a p-value of 0.010 below the 5% alpha. This shows that Hypothesis 7 that PERFORM strengthens the effect of EXP on FRQ is statistically accepted, although the directions are different. This indicates that in local governments that have poor financial performance, it is possible that the experience of the regional head is no longer directly proportional to the quality of the LKPD, and vice versa. Financial performance is thought to have a moderating impact (strengthening or weakening) the impact of EXP on FRQ.

PERFORM strengthens the effect of AGE on FRQ (H8), in table 2 shows the t-statistic value of -0.086 lower than the t-table and p-value 0.932 above 5% alpha. This shows that Hypothesis 8 that PERFORM strengthens the effect of AGE on FRQ is statistically rejected. Table 2 displays the results of the control variable test, with the p-value of 0.218 above the 5% alpha and a t-statistic value of 1.235 that is less than the t-table. The JAVA variable does not statistically significantly affect FRQ, as demonstrated by this. The t-statistic value of 1,968 in Table 2 is higher than the t-table, and the p values are 0.05 below the 5% alpha. This shows that the METRO variable has a statistically significant effect on FRQ. Table 3 shows the t-statistic value of 2,544 which is greater than the t-table and p values of 0.011 below 5% alpha. This indicates that FRQ is statistically significantly impacted by the SIZE variable.

Table 3. R Square and Adjusted R Square

Model	R	R Square	Adjusted R Square
1	.283 <sup>a</sup>	.080	.049

Source: Author

This study found that R Square number is 0.08 or 8% based on Table 3. This indicates that 8% of the FRQ variables can be explained by all independent variables simultaneously. While 99.2% of the FRQ variables are influenced by other variables outside the research model

## CONCLUSION

This current study concludes that the regional wealth factor and the experience of the regional head leading the region affect the quality of regional financial statements (FRQ). This research has implications for central government policies in examining the quality of regional financial reporting. The first implication of this study reveals that the wealthier a regional government is, the higher the quality of its financial reporting tends to be. Greater financial independence among

local governments is attributed to their increased revenue generation from internal sources as opposed to intergovernmental transfers. Richer local governments will probably produce better financial reports because they can afford to hire consultants to support accounting systems or use information technology more effectively. Consequently, the central government must assist local governments in achieving financial autonomy.

Second, a leader's years of experience in governing a region influences the quality of his regional financial report. This implies a longer leadership period influences better performance. Thus, regional heads with more experience (i.e., leaders with more tenure as mayors or regents) are probably able to provide financial reports of a higher quality. Further, the central government could encourage regional leaders with prior leadership experience to propose to lead their regions independently. Political parties may also nominate regional leaders with prior leadership experience to lead their regions according to the applicable constitution.

This study faces limitations in data access, as not all local government financial reports are publicly available. Indigenous factors may also influence the findings. Future research could include additional variables, such as incentives from the central government and the integrity of regional leaders, as potential factors affecting government financial reports.

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