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PERFORMANCE MEASUREMENT IN THE PUBLIC SECTOR: THE CASE OF LOCAL GOVERNMENTS IN EAST JAVA, INDONESIA

BY

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ABSTRACT

Public organisations have been scrutinised and enforced to provide better services, particularly after the emergence of the New Public Management (NPM). After the 2001 decentralisation, local governments in Indonesia have been granted with much greater amount of budget and mandated to improve public services provision and accountability. As a result, measuring performance of local governments has become prominent. Several regulations have been enacted to force local governments to utilise performance measurement (PM) systems and to regularly report their performance. Drawing upon management accounting in the public sector and extant literatures on public sector reform, this study seeks to (i) identify factors affecting PM utilisation that could explain the case of local governments in Indonesian context, (ii) examine current practices of PM in local government, and (iii) examine the perceived impacts of PM utilisation on accountability. Those issues were tested using a mixed method approach with collection of data from self-administered survey questionnaires and a series of post-survey interviews. Stronger emphasis was put on the quantitative approach as the objective of this study is to develop generalised findings of PM utilisation in local governments. This study was conducted in East Java – a province which has the highest number of local governments, the second most populous, and in total received the highest amount of block grants. The underpinning theories used for developing the research model include contingency theory, institutional theory (new institutional sociology), and knowledge utilisation theory. Contingency factors hypothesised to affect the utilisation of PM are *RBM commitment* (goal orientation and management commitment to utilising PM), *government regulations* (on performance measurement, mandatory performance auditing, compulsory competitive tendering, and public private partnership initiative) and *supporting factors* such as decision authority, parliament support, availability of resources for utilising PM, and related training on PM. Based upon knowledge utilisation theory (Beyer and Trice, 1982), utilisation of PM is framed as consisting of two stages: adoption and implementation. Those three groups of contingency factors are hypothesised to affect the two stages of utilisation. This study found a model of PM utilisation which is different from that in the developed countries. The results indicate that there are different factors affecting PM adoption and PM implementation. In general, this study clarifies that PM utilisation in local governments are regulatory driven. PM adoption is driven only by regulatory factors, i.e. regulation on PM and mandated performance auditing, which is also regulatory based. On the other hand, PM implementation is directly influenced by goal orientation and top management commitment to utilising PM. This finding magnifies the central role of RBM in the implementation of PM. Goal orientation mediates the influence of PM regulation, mandated performance audit, decision making authority, and the availability of resources to PM implementation. Similarly, management commitment also mediates the influence of PM regulation, regulation on procurement, mandated performance audit, decision making authority, parliament support, and the availability of resources to PM implementation. It is also shown that the implementation of PM enhances accountability. While qualitative analysis indicate that compliance with regulations merely appeared to producing performance reports, the implementation of PM emerged to be superficial, indicating that the PM is 'decoupled' from the essential goal of local governments. Finally, this study concludes by discussing its theoretical and practical implications and proposing several recommendations for future research.

الخلاصة

أن الشركات العاظهور النظام الجديد للإدارة العامة. تحسن القاطع العام في عدد من الدول و لوحظ في الدول الأعضاء في (OECD) التي تطبق النظام الجديد للإدارة العامة و الذي بدوره يؤكد على أهمية عملية قياس الأداء. ضمن الدول الأعضاء في (OECD) قياس الأداء مطبق (PM) في أطار نظام الإدارة المستندة على النتائج (RBM). بعد تطبيق الامركزية بشكل كبير عام 2001 قامت الحكومة المحلية في أندنوسيا بتخصيص موازنة أكبر و أقررة تحسين و تطوير الخدمات العامة و المسألة. نتيجة لذلك قياس الأداء في الحكومات المحلية أصبحت مهمة جدا. تم سن العديد من التشريعات و القوانيين التي تجبر الحكومات المحلية على تطبيق نظم قياس الأداء و رفع تقاريرعن الأداء بصورة دورية. بالأعتماد على المحاسبة الأدارية في القطاع العام و الدراسامة أصبحت تحت الرقابة و واجهة ضغوط كبيرة لكي تحسن من خدماتها خصوصا بعد ت السابقة في مجال إصلاح القطاع العام و التي تعد واحدة من الأهتمامات الرئيسية في محاسبة القطاع العام. هناك ثلاثة أهداف لهذه الدراسة. أولاً: الأطلاع على الممارسة الحالية لعملية قياس الأداء في الحكومة المحلية. ثانياً: تحديد العوامل المؤثر في عملية تطبيق قياس الأداء و التي قد تفسر الوضع في الحكومات المحلية في السياق الأندنوسي. ثالثاً: الأطلاع على التوقعات لمدى تأثير عملية قياس الأداء في عملية المسألة. هذه الأهداف تم قياسها من خلال أستخدام أسلوب مختلط مع تجميع البيانات عن طريق أستبيانات تدار ذاتياً و من ثم أجراء سلسلة من المقابلات في مرحلة ما بعد الأستبيانات.تم التركيز بشكل كبير على النهج الكمي في هذه الدراسة حتى تكون النتائج لهذه الدراسة قابلة للتعميم في ما يخص تطبيق قياس الأداء في الحكومات المحلية. أجريت هذه الدراسة في جاوة الشرقية في أندنوسيا. حيث و فيها يوجد أكبر عدد للحكومات المحلية و تعتبر المدينة الثانية من حيث الكثافة السكانية و ايضاً تحصل على أكبر تمويل من قبل الكتلة. النظريات المستخدمة في هذه الدراسة هي كالتالي: نظرية الطوارئ و النظرية المؤسسية (مؤسسية علم الأجتمام الجديد) و أخيراً نظرية معرفة الأستخدام. أفتراض العوامل الطارئة تؤثر في عملية قياس الأداء(PM) و الألتزام بنظام الإدارة المستندة على النتائج (RBM) (أتجاه الهدف و ألتزام الإدارة بتطبيق قياس الأداء) القوانين الحكومية (في قياس الأداء، ألزامية مراجعة الأداء، ألزامية المناقصة التنافسية، الشراكة بين القطاع الخاص و العام المستحدث) و عوامل الدعم مثل سلطلة القرار و دعم البرلمان و مدى توفر الموارد لتطبيق عملية قياس الأداء و التدريب على قياس الأداء. بالأعتماد على نظرية معرفة الأستخدام (Beyer & Trice, 1982) عملية تطبيق قياس الأداء فيها مرحلتين: التبني و التنفيذ. بأفتراض العوامل الطارئة الثلاثة تؤثر على مرحلتي الأستخدام. هذه الدراسة وجدت نمذجً لتطبيق قياس الأداء مختلف عما هو موجود في الدول المتقدمة. هذه النتيجة تدل على أن هناك عوامل مختلفة تأثر في مرحلة التبني لعملية قياس الأداء و مرحلة التنفيذ لقياس الأداء. بشكل عام، أوضحت الدراسة الحالية أن عملية تطبيق قياس الأداء في الحكومات المحلية تعتمد على العوامل التشريعية. بينما تبني قياس الأداء يعتمد فقط على العوامل التشريعية مثل قانون قياس الأداء و ألزامية مراجعة الأداء الذي يعتبر أيضاً من العوامل التشريعية. في المقابل تنفيذ قياس الأداء يعتمد بصورة مباشرة على أتجاه الهدف و ألتزام الإدارة العليا بالنسبة لتطبيق قياس الأداء. هذه النتيجة تأكد على الدور المحوري الذي يلعبه نظام الإدارة المستندة على النتائج (RBM) في تنفيد قياس الأداء. أتجاه الهدف يتوسط التأثير في قوانيين قياس الأداء و تكليف مراجعة الأداء و سلطة القرار و مدى توافر الموارد اللازمة لتنفيذ قياس الأداء. بالمثل، التزام الإدارة تتوسط أيضاً قوانيين قياس الأداء و قوانيين المشتريات و تكليف مراجعة الأداء و سلطة أتخاذ القرار و الدعم البرلماني و أخيراً توافر الموارد اللازمة لتنفيذ قياس الأداء. أيضاً نتائج هذه الدراسة تظهر أن عملية تنفيذ قياس الأداء تعزز من المسألة. في حين أظهر التحليل النوعي أن الامتثال للقوانيين و اللوائح مجرد تقديم تقارير للأداء. و أن عملية تنفيذ قياس الأداء تعتبر سطحية. و أن قياس الأداء منفصل عن الهدف الأساسي للحكومة المحلية. اخيراً، من خلال مناقشة الجوانب النظرية و العملية و التطبيقية تقترح هذه الدراسة عدد من المقترحات و التوصيات في البحوث المستقبلية في هذا المجال.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Nurkholis

Signature…… Date…….

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PERFORMANCE MEASUREMENT IN THE PUBLIC SECTOR: THE CASE OF LOCAL GOVERNMENTS IN EAST JAVA, INDONESIA

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LIST OF ABBREVIATIONS

ACCTBLT	Accountability
ADB	Asian Development Bank
AOOF	Accrual-based Outcomes and Outputs Framework
APBD	*Anggaran Pendapatan dan Belanja Daerah* (Local Government Budget)
ATM	Automatic Teller Machine
AusAID	Australian Agency for International Development
AVE	Average Variance Extracted
Baperjakat	*Badan Pertimbangan Jabatan dan Pangkat* (Consultative Body for Staff Promotion)
BAPPEDA	Badan Perencanaan Pembangunan Daerah (Local Planning Agency)
BOT	Built Operate Transfer
BPK	*Badan Pemeriksa Keuangan* (Supreme Audit Body)
BPKP	*Badan Pengawasan Keuangan dan Pembangunan* (State Agency for Financial and Development Oversight)
BSC	Balanced Scorecard
CCT	Compulsory Competitive Tendering
CE	Chief Executive
CIDA	Canadian International Development Agency
CSR	Comprehensive Spending Review
DECAUTH	Decision Authority
Depdagri	*Departemen Dalam Negeri* (Ministry of Home Affairs)
DFR	Departmental Forecast Report
Dinas Kominfo	*Dinas Komunikasidan Informasi* (Communication and Information Sevices Unit)
DPD	*Dewan Perwakilan Daerah* (Regional Representative Council)
DPR	*Dewan Perwakilan Rakyat* (House of Parliament)
DPRD	*Dewan Perwakilan Rakyat Daerah* (Local Parliament)
DPA	*Dokumen Pelaksanaan Anggaran* (Budget Execution Document)
EA	Executive Agencies

FMI	Financial Management Initiative
FMIP	Financial Management Initiative Programs
FMR	Financial Management Reform
FY	Fiscal Year
GAO	Government Accountability Office
GDP	Gross Domestic Product
GOALORI	Goal Orientation
GOI	Government of Indonesia
GPRA	Government Performance and Results Act
GR	Government Regulation
IIA	Institute of Internal Auditors
IIUM	International Islamic University Malaysia
INTOSAI	International Organization of Supreme Audit Institutions
Juknis	*Petunjuk Teknis* (Technical Guidance)
Kepmen	*Keputusan Menleri* (Miniterial Decree)
Kepmendagri	*Keputusan Menleri Dalam Negeri* (Minister of Home Affairs' Decree)
Keppres	*Keputusan Presiden* (Presidential Decree)
KPI	Key Performance Indicators
LA KIP	*Laporan Akuntabilitas Kinerja Instansi Pemerintah* (Governmental Agencies' Performance Accountability Reports)
LAN	*Lembaga Administrasi Negara* (State Administration Agency).
LG	Local Government
MAS	Management Accounting Systems
MBS	Modified Budgeting System
MBO	Management by Objective
MCS	Management Control Systems
Menpan	*Menleri Penertiban Aparatiir Negara* (Minister of State Apparatus Empowerment)
MNGCOM	Management Commitment
MOF	Ministry of Finance
MOHA	Ministry of Home Affairs
MTEF	Medium Term Expenditure Framework
NHS	National Health Service
NPFM	New Public Financial Management

NPG	New Public Governance
NPM	New Public Management
MPR	*Majelis Permusyawaratan Rakyat* (People's Representative Assembly)
OECD	Organization for Economic Cooperation and Development
ORBA	*Orde Baru* (New Order)
PA	Public Administration
PAKTO	*Paket Oktober* (October Package, a policy of banking deregulation)
PARLSUP	Parliament support
PART	Program Assessment and Rating Tool
PBB	Performance Based Budgeting
PC	Personal Computer
PERFAUD	Performance Audit
PEMS	Policy and Expenditure Management System
Perda	*Peraturan Daerah* (Local Regulation)
Permen	*Peraturan Menteri* (Ministerial Regulation)
Permendagri	*Peraturan Menteri Dalam Negeri* (Ministry of Home Affair's Regulation)
PFA	Public Finance Act
PI	Performance Indicator
PLS	Partial Least Square
PM	Performance Measurement
PMADOPT	Performance Measurement Adoption
PMIMPL	Performance Measurement Implementation
PMREG	Regulation Mandate on Performance Measurement
PMS	Performance Measurement System
PP	*Peraturan Pemerintah* (Government Regulation)
PPBS	Planning, Programming and Budgeting System
PPP	Public Private Partnership
PSA	Public Service Agreement
PSC	Public Sector Comparator
Qual	Quantitative
QUAN	Quantitative
RAB	Resource Accounting and Budgeting

RASK	*Rencana Anggaran Satuan Kerja* (Budget Proposal of Local Agencies)
RBM	Results-Based Management
RKPD	*Rencana Kerja Pemerintah Daerah* (Local Government Work Plan)
RKA-SKPD	*Rencana Kerja dan Anggaran Satuan Kerja Perangkat Daerah* (Work Plan and Budget Proposal of Local Government Agencies)
RPJMD	*Rencana Pembangunan Jangka Menengah Daerah* (Medium Term Development Plan)
SAB	*Standar Analisa Belanja* (Standard Spending Assessment)
SEM	Structural Equation Modeling
SKPD	*Satuan Kerja Perangkat Daerah* (Local Government Agency)
SOEs	State-Owned Enterprises
SPJ	*Sural Pertanggung-Jawaban* (Formal Accounting/Financial Evidential Documents)
SPM	*Standar Pelayanan Minimal* (Minimum Service Standards)
STAR-SDP	State Audit Reform - Sector Development Project
TBS	Treasury Board of Canada
TOR	Terms of Reference
TQM	Total Quality Management
TRAINING	Training on Performance Measurement
UK	United Kingdom
USA	United State of America
USAID	United State Agency for International Development
UUD	*Undang-undang Dasar* (State Constitution)
VFM	Value for Money

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The public sector has long been criticised as being 'inefficient', 'non-productive', 'not-innovative' and riddled with 'poor-performance'. Such criticisms have given rise to the emergence of the New Public Management (hereafter NPM) as the new paradigm in public sector management (Osborne and Gaebler, 1992) emphasising the importance of performance measurement (hereafter PM). In the UK, PM appeared to be prominent way for improving public sector governance since the time of Margaret Thatcher came to power in 1979 (Chapman, 1991; Lapsley, 1996). According to Lapsley (1996, p. 110) there are four major reasons why PM emerged as a central feature of the UK's public sector: (1) fiscal pressures, (2) the perceived inefficiency of the public sector, (3) the absence of managerial incentives and clearly defined commercial objectives, and (4) the dependency culture of a nation too reliant on the public purse.

This study focuses on performance measurement of local governments in East Java, Indonesia. The local governments are being reformed concurrently with the implementation of regional autonomy. A long with the reforms of Indonesian public sectors, the reform of local governments, to a certain extent, adopt the ideas of NPM (Djamhuri, 2009). The utilisation PM and NPM have become "Siamese twins" both in thinking and practice (Van de Walle and Van Dooren, 2008). The public sector reformed based on the NPM doctrines was coined by Hood (1995) as the "new" public sector. Holloway et al. (1999) coined the word "new" public sector to refer to the

public sector reformed by adopting new management approaches such as reformed budgeting and costing systems, benchmarking and performance measurement. They used the term when reporting their study based on surveys and longitudinal case studies of NHS and public sectors in the UK (Holloway et al. 1999). Jackson and Lapsley (2003) also used the term "new" public sector to refer to those being reformed by the ideas of NPM which focuses on results and measurement in which accounting has a central role.

NPM has inspired public sector reforms in a number of countries in which the essence is to improve the performance of public services (OECD, 1993, 1995, 2001). Under NPM, development of performance measurement system (PMS) is highly regarded and widely adopted as a recipe for improving public sectors' low performance caused by bureaucratic government (Mwita, 2000). This has been evident by various performance measurement initiatives in a number of countries (OECD, 1993). Value for Money (VFM), as one of the model constituting measures of economy, efficiency and effectiveness (Lapsley, 1996), is widely adopted and it has been regarded as a concept that applies almost exclusively to the public sector (Small, 1996, p. 129). In OECD member countries, PM is implemented within the framework of results-based management (hereafter RBM) (OECD, 1993, 1995, 2001; Saldanha, 2002; Treasury Board of Canada, 2002; Try and Radnor, 2007).

In the USA, for example, under the Government Performance and Results Act (GPRA) of 1993, all federal government agencies have been required to implement performance measurement systems and to submit annual performance report (Lindblad, 2006; Cavalluzzo and Ittner, 2004). GPRA in the US and other related initiatives in other countries are based on the assumption that mandated reporting of results-oriented, using strategic performance indicators can improve government

efficiency and effectiveness by increasing accountability of public managers (Cavalluzzo and Ittner, 2004; Jones and McCaffery, 1997).

In Indonesia, such an initiative was started in 1999 through the promulgation of Presidential Decree No. 7/1999. Based on the decree, all government agencies, including local governments were required to report their performance annually. Local governments, more specifically, have been further enforced to implement PMS since the implementation of regional autonomy based on Law No. 22/1999 (which was then replaced by Law No. 32/2004 on Local Governments) and Law No. 25/1999 (which was then replaced by Law No. 33/2004 on Fiscal Balancing between Central and Local Governments). This has been further strengthened through the promulgation of Law No. 17/2003 (on State Finance) and Government Regulation No. 58/2005 (on Government Financial Management), obligating all local government agencies to implement performance-based budgeting and to produce annual performance report. Recently, efforts to improve the performance measurement systems have further been initiated by promulgating Government Regulation No. 8/2006 on financial and performance reporting of government agencies. More specifically, for assessing the successfulness of regional autonomy and decentralisation policy, Government Regulation No. 6/2008 (on the guidance for evaluation of local governmental services accomplishment) was issued.

1.2 MOTIVATION OF THE STUDY

PM in the public sector is more complicated than that in the private sector (Lapsley and Mitchel, 1996). Considering that the debates on public sector PM will most likely to continue (de Lancer Julnes, 2006), it is imperative to conduct a study to know the

situation at hand and gain familiarity with and understanding of the phenomena in the context of local governments. The notion of performance measurement brought by the "new" public sector from the cases of developed countries might not be compatible with those of developing countries. As such, this study contributes to providing the perspective of PM utilisation in the public sectors in developing countries, especially Indonesia.

When addressing the issue of PM in governmental agencies, Ittner and Larcker (1998, p. 233) suggest that future research in this area address the question of whether new PM systems will actually improve governmental performance. More importantly, future research also needs to address the most fundamental question, are the private sector notions of PM and accountability applicable in the public sector? Given the imposed decentralisation policy, studies on PM in local government gain its prominence. A series of government regulations imposed on local governments in Indonesia as mentioned in the previous section may instil better approach in governance or may result in new problems in local governments.

This study draws upon management accounting in the public sector and current literature on public sector reforms, which is one of the main concerns of public sector accounting. The main reason for exploring this area is that Indonesian local governments, as autonomous entities, have recently been granted with much greater budget than ever before and mandated to improve public services provision and accountability. As such, measuring performance would be the central issue in local government management.

1.3 PROBLEM STATEMENT

In line with the PM initiative, the Indonesian central government has published manual on preparing government performance report (LAN, 2003). In addition to the implementation of the Law on State Finance, local governments have also been equipped with detailed guidance on preparing performance-based budgeting issued by Ministry of Home Affairs (Regulation No. 13/2006 superseding Decree No. 29/2002). However, at the early stage of the reform and due to lack of competent staff (Harun, 2007) local governments in Indonesia were still far from achieving the essence of performance-based budgeting and appropriate PM practices within the framework of RBM. The Minister for Government Officials Empowerment asserted this in 2002 saying that

> "…. There has been wrong perception among government officials that accountability was perceived only as an obligation to produce financial reports. There has been no evaluation on whether the accomplishment of government programs and activities has resulted in improving peoples' wealth or just for disbursing money within budget for the benefits of government's institution and officials."
>
> (*Kompas Cyber Media*, 10 September 2002).

The statement suggests a significant gap between local governments' preference towards rule compliance matters as exerted by the Central government and needs for managerial use. While the value-for-money (VFM) concept (using efficiency, economy, and effectiveness indicators) has been suggested[1] , the extent to which VFM guides public managers is not known. Whether the practices and use of PM system has led to better results as expected is, therefore, still questionable.

Studies on the practices and usefulness of PM in the public sectors which were mostly conducted in developed countries has resulted in different models of PM

[1] Value-for-money concept (measures of economy, efficiency and effectiveness) was introduced in the Guidance for reporting accountability of government agencies' performance (LAN, 2003).

utilisation (see, for example, Jones and McCaffery, 1997; de Lancer Julnes and Holzer, 2001; Wang, 2002; Cavalluzzo and Ittner, 2004). Clearly, the findings have been inconclusive. To address the complexities of public sectors, literature advocates the use of multidimensional performance measures (Brignal and Modell, 2000; Kloot and Martin, 2000; McAdam, Hazlett and Casey, 2005). Hoque (2008, p. 469) asserted that not much is known about "why" and "how" government entities have turned to implementing "modern" performance measures such as balanced scorecard (Kaplan and Norton, 1996). In attempting to fill the gap, Hoque (2008) conducted a case study based on archival documents. However, the study provides limited insight into how public sector managers perceived the relevance and usefulness of performance measurement data.

It is still questionable whether NPM could have real impact on improving the performance of governments in developing countries. One of the main obstacles is the lack of antecedents for contract management. Public sector reforms in developing countries are also constrained by the characteristics of the existing administration. For instance, NPM is difficult to implement in developing countries because of the prevalent problems of mismanagement, incompetent civil servants, and lack of accounting expertise (Mohamad, 2004, p. 81).

Perera (1989) argued that the Anglo-American style of accounting practices may not be relevant in many developing countries and, hence, may not be capable of providing the accounting information needs of these countries in an efficient manner. Therefore, Perera (1989) suggests that an 'inward looking' approach to accounting in developing countries needs to be conducted. Mimba, Helden and Tilemma (2007) contend that there are four features of public sector in developing countries, i.e. (1) a low institutional capacity; (2) a limited involvement of stakeholders; (3) a high level

of corruption; and (4) a high level of informality. These characteristics might cause disequilibrium between the demand for and supply of performance information (Mimba et.al, 2007). In the case of accounting and budgeting reform in Indonesian local government, those characteristics were confirmed by Djamhuri (2009) as the impediments for the institutional process of accounting and budgeting innovation. Budäus and Buchholtz (1996) believed that country specific factors and the concepts of administrative reform specific to its respective communities will affect the practices and use of PM. This could result in different model of PM utilisation within the implementation of RBM.

1.4 OBJECTIVES OF THE STUDY

The objectives of this study are:

(1) To identify factors affecting PM utilisation that could explain the case of local governments in Indonesian context.

(2) To examine current practices of performance measurement in local governments.

(3) To examine the perceived impacts of PM utilisation on accountability of local government.

1.5 RESEARCH QUESTIONS

Based on the above objectives, the research questions to be answered include the following:

(1) What factors affect the utilisation of PM in local governments?

(2) What are the current practices of performance measurement in local governments?