# The Accounting Environment in Indonesia

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## I　Introduction

On December 23, 2008, the Indonesian Institute of Accountants (IAI) as accounting standards setter in Indonesia issued a formal statement announcing a plan to have Indonesian GAAP fully converged with the International Financial Reporting Standards (IFRS) by January 1, 2012. Moreover, the announcement has also required, as of January 1, 2012, both listed and unlisted companies in Indonesia to comply with IFRS-based PSAK in their financial reports.

Motivated by such a caveat in mind, the objective of this paper is to investigate the factors that are likely to influence the compliance with IFRS requirements and disclosures in Indonesia, and provide an understanding of why this practice might differ from other countries.

Gray's (1988) work has much been referred to describe the relationship between cultural and accounting values. He initiated the building of a theoretical model of this relationship. Through the model, he explained that there were the possible reciprocal relationships among the constructs by suggesting that since accounting values represent a subset of societal values, accounting values would reflect a microcosm of the broader societal values. In turn, these values are translated into

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the practice of financial reports and accounting standards (Sudarwan, 1995). On this perspective, accounting is likely to be influenced by a much broader range factors than what is often assumed in the literature (Perera & Baydoun, 2007).

Gernon & Wallace (1995) then expanded the Gray's (1988) work and provided taxonomy of accounting ecology that was designed to reflect the association between accounting and its environment in a holistic manner. According to them, the concept of accounting ecology encompasses five separate but interacting slices of the environment, i.e., social, organizational, professional, individual, and accounting. This perspective differs from that Gray's (1985; 1988) framework in term of its taxonomy. While Gray's taxonomies rely on a causal theory that sees accounting as strictly dependent on the environment, Gernon & Wallace's (1995) taxonomies incorporates both causes and effects of accounting. Moreover, the additional taxonomy, individual and accounting slices, recognizes the notion of the environment not only as a source of ideas and concepts but also as an animate repository of causes and effects. In addition, under the organizational, professional, and accounting slices, Gernon & Wallace (1995) include the narrow regulatory focus of recent international research, which consists of all mandated constraints such as regulations, accreditation, legal development, professional code of conduct and so on (Perera & Baydoun, 2007).

## Ⅱ The Republic of Indonesia

Astronomically, Indonesia is situated between 6° 08' North latitude and 11° 15' South latitude, and between 94° 45' and 141° 05' East longitude and straddles the equator line located at 0° latitude line. Indonesia is the world's largest archipelago consisting of 17,504 islands with an area of ocean 3,544,743.9 km$^2$ and land

1,910,931.32 $km^2$. With more than 243.74 million (BPS, 2012) people of population and approximately 86 percent (KMPG, 2012) of them are Muslims, making Indonesia as the world's fourth largest population as well as the world's largest Islamic country, respectively.

Under controlling of colonial Dutch for almost 350 years has influenced on the socio-economic and political development in Indonesia. A large power distance, a considerable dependence of subordinates on superiors (Hofstede, 1980, p. 5), is a colonial heritage that continues to involve in various behavioral aspects society including in legal system. As regards, Indonesian legal system is based on the Roman-Dutch system, characterizing the regulation with a large extent of a law branch and only seeks to formulate a general rule for the future than provide answer to a specific case. Otherwise, the rule tends to be separated from the law and deals with a precise case in the common law countries (Nobes & Parker, 2012, pp. 28-29).

Nowadays, after experiencing with crises, Indonesia's economy is stable with GDP in 2012, at current market prices, reaching IDR 8,241,864.3 billion, or grow up around 6.2 percent compared to those on the previous year. By using a unique capitalist approach, the government continues to reform its economy aiming at deregulating it.

## Ⅲ The Framework of Accounting Ecology in Indonesia

Gernon & Wallace (1995) define the concept of accounting ecology as follows:

> A national accounting ecology is a multidimensional system in which no one factor occupies a predominant position and in which the perception held by actors on some unfolding accounting phenomena, as well as the accounting phenomena themselves, are the objects of study and analysis. Such a synthesis would emphasize the interrelationships of the environmental factors, which

influence and are influenced by accounting and would focus on the importance of perceptual as well as non-cultural factors such as population and land area.

According to Gernon & Wallace (1995), the concept of accounting ecology encompasses five separate but interacting slices of the environment, *i.e.*, social, organizational, professional, individual, and accounting. The social environment refers to the structural (economic system, political system, and legal system), cultural and non-cultural (geographic and demographic features) elements within a society. The organizational environment refers to organizational size, technology, complexity and culture, and human and capital resources. The professional environment refers to such aspects of the profession as education, training, registration, discipline, and ethics. The individual environment refers to the total setting in which reporting enterprises, professionals, and other non-professional members of society lobby standard setters and use accounting numbers to their respective advantage. The accounting environment refers to the disclosure and measurement requirements and practices, types and frequency of accounting reports, and accounting infrastructure [1] (Perera & Baydoun, 2007).

## 1 Social Environment

Indonesia is a country with a large power distance and small individualism (Hofstede, 1980, p. 5). These values in turn have an effect on societal behavior particularly that deals with economic, political, and legal systems.

### (a) The economic systems

Indonesian economy has experienced several reforms since independence,

1 Accounting infrastructure includes producers and users of information, information intermediaries, laws and regulations that govern the production, transmission, and usage of information, and regulatory bodies (Lee, 1987, pp.75-86).

particularly during the New Order regime. A major program of economic reforms aimed at deregulating the economy consisting of capital investment (domestic and foreign), taxation systems, and financial services was taken. In the world investment, capital market was re-established and foreign investors were allowed to have 100 percent of ownership in certain areas. This development continues to the current government, introducing significant reforms in the financial sector, including tax and customs reforms, the use of Treasury bills, and capital market development and supervision. Nevertheless, in this market-based economy, the government still plays a significant role by administering prices on several basic goods, including fuel, rice, and electricity.

In addition, as a country with large Muslim population (KMPG, 2012; Perera & Baydoun, 2007) in the world, the influence of this religion on Indonesian economic activities was significant. Even, many businesses with Islamic basis nowadays are more and more increasing in this country. In banking sector, the growth of Sharia banking asset reaches 38 percent, exceeding the national banking growth of around 18 percent (Tempo, 2013). This community has required a specific rule to run its business based on *Sharia* (Islamic law), which sometimes differs from general rule. For example, Islam advocates good behavior in conducting business and discourages Moslems to advertise the fact that they have behaved that way, at the same time. This is likely to cause challenges in enforcing the disclosure requirements of IFRS.

(b) The political systems

The political system in Indonesia is based on legislative, executive, and judicative powers (*Trias Politica*), which are the power of supremacy held by the People's Consultative Assembly, the President, and the Supreme Court, respectively. The governmental system of Indonesia follows a presidential system with parliamentary characteristics. The President and Vice-president are elected by direct popular vote. The president is the Chief Executive, the Head of State, and Commander-in-Chief of the Armed Forces, as well as appoints Cabinet Ministers who are responsible to him/her.

(c) The legal systems

Indonesia is the Roman-Dutch law country with a complex legal system. In term of the main sources it is a confluence of three distinct systems, *Syari'ah* or Islam laws (a form of *adat*), *adat* (the traditional customary laws of many ethnic and religious groups in Indonesia), and the Dutch colonial law and European jurisprudence. These three strands of the laws still co-exist in Indonesian modern law, including commercial law (Tabalujan, 2002) for which this justice concept is different from the Anglo-Saxon concept for which it may be likely to cause challenges in enforcing the disclosure requirements of IFRS.

## 2 Organizational Environment

*Gotong royong* and *musyawarah untuk mufakat* are the unique features of Indonesian culture underlying various organizational aspects. Indeed, Rahardjo (1994) states that Individualism is frowned on when explaining one of the main features of the indigenous mode of organization in Indonesia. Further, he asserts that Indonesia state is a joint venture of the people based on the principle of *gotong royong* – "all works should be accomplished in a spirit of togetherness" (Rahardjo, 1994, p. 495). In addition, McLennan (1980) sees that *musyawarah untuk mufakat* (consensus through decision-making) is central to Indonesian way of life. In this case, this concept differs from that of majority view that is prevalent in the Anglo-Saxon countries (Perera & Baydoun, 2007).

There are a number of different businesses' types in Indonesia ranging from private to public sector enterprises. *Perseroan Terbatas* or PT Company that is equivalent to the British limited liability is the common type of business organization though. According to the Foreign Investment Law No. 25/2007, foreign investment shall be in the form of a limited liability Foreign Investment Company or "PMA" incorporated in Indonesia, in which the investor goes into partnership with an Indonesian person or entity as shareholders. Moreover, foreign investors can hold up to 100 percent ownership, or between 45 – 95 percent of ownership in certain industries, but this will vary within sectors and business fields.

The financial system in Indonesia is dominated by banks. As of December 31, 2012, there were 120 commercial banks in Indonesia (of which four were state owned), 1653 rural banks, 401 *sharia* bank office networks with total assets of all banks is IDR 4,525,215 billion (BI, 2012). Among these, 37 commercial banks have listed on the Indonesian Stock Exchange (IDX), and therefore their financial statements are reviewed by *Bapepam-LK*. Further, there are 140 insurance companies operating in Indonesia, consisting of 46 life insurance companies, 90 non-life insurance companies, and 4 reinsurance companies.

Indonesia Stock Exchange (IDX) was established in 2007 after merging between Jakarta Stock Exchange (JSX) and Surabaya Stock Exchange (SSX). At the first, the development of capital market in Indonesia slowly grows. However, it turns into rise as a capital source after 1997's financial crisis. As a response to challenges in the wake of this crisis, BEI continues to develop its infrastructures, both in term of information technology and human resources as well as diversity in product. As a result, as of December 2012, there were 459 stock issuers in the IDX with a combined market capitalization of IDR 5,136.7 trillion. It consists of IDR 4,126.99 trillion equity, IDR 820.27 trillion government securities, IDR 187.46 trillion corporate bonds, and IDR 1.98 trillion asset-backed securities (BEI, 2012).

## 3 Professional Environment

The Indonesian Institute of Accounting (IAI), established in 1957, is the professional body of accountants in Indonesia. The body is a self-funded professional organization and it has been a member of the International Federation of Accountants (IFAC) since 1986; and it has responsible for setting accounting standards and organizing programs for continuing professional development for its members.

According to the law No. 34 (1954), *the Use of Accountant Title*, an accountant title is given only to those who have an accountant certificate. In order to become a member of this profession, regular members are required to hold a Bachelor's degree in accounting and successfully complete the IAI approved professional accounting program (PPAk) from an accredited university, and then register with the Ministry of Finance (MoF). Besides those regular members, individuals who hold a Bachelor's degree in accounting, even without registration at the MoF, and who are deemed to be of high caliber with respect to contributing to the development of accountancy profession in Indonesia may enter as extraordinary or honorary members of the IAI, respectively (Worldbank, 2010).

Moreover, regarding to professional education and training, there is a body under IAI called KERPA or the Committee of Evaluation and Recommendation of Professional Accounting Education that is responsible for reviewing and assessing the eligibility of the university program. Based on KERPA's recommendation, the Directorate of Higher Education endorses the PPAk program at the university. The university must also comply with the KERPA-approved syllabus. Furthermore, IAI-organized admission tests for entry into PPAk programs are held at all participating universities using KERPA-prepared materials. The PPAK program covers accounting and auditing standards, taxation, professional ethics, capital market and financial management, and management accounting; and in general, the program covers the core knowledge content of IFAC-issued International Accounting Education Standards (Worldbank, 2010).

## 4 Individual Environment

IAI is responsible for setting accounting standards for both public interest and non-public interest entities. To that, IAI has established standard setter board called DSAK, whose members represent the accountancy profession and various regulatory bodies in the country such as public accountant, academic accountant, public sector accountant, and management accountant. The DSAK performs due process a mechanism to seek views from those interested parties in connection with proposed accounting standards. According to the Capital Market Law, IAI-issued financial accounting standards are mandatory for all entities supervised by *Bapepam*-LK. In addition, the law authorizes *Bapepam*-LK, whenever necessary, to prescribe accounting regulations with respect to financial reporting by capital market participants.

In addition, there were two other standard setters in Indonesia namely, DSAS and KSAP. DSAS is a body under the organizational structure of IAI that is responsible for setting the *shari'ah* (Islamic religious law) accounting standards. KSAP is an independent committee that comprises accounting experts from the IAI, academics, government practitioners, being responsible for preparing the standards for governmental organization.

The following figure is four pillars of accounting standards in Indonesia:

Figure 1 Four Pillars of Indonesian Accounting Standards

| Accounting Standards | Issuer | Users | Remarks |
|---|---|---|---|
| General SAK | DSAK | Public interest entities (i.e. listed companies, banks, non-bank financial institutions, and other entities including SOEs) | - IFRS-based<br>- Issued by due process mechanism involving various stakeholders<br>- Output: PSAK and ISAK |
| SAK ETAP | DSAK | Non-public interest entities | - Adopted from SME<br>- ETAP means 1) Have no significant public accountability, and 2) Publish general-purpose financial statements for external users (i.e. passive owner, creditor, and credit rating institution. |
| SAS | DSAS | Entities is conducting *syari'ah* activities either *syari'ah* institutions or non-*syari'ah* institutions | - Developed similar to general SAK model, however it is based on *syari'ah* law with reference to MUI's *fatwa* (opinion). |
| SAP | KSAP | Governmental institutions | - Non-governmental public sector referred to PSAK No. 45 (*Pelaporan keuangan entitas nirlaba*/NGO) |

Source: Martani, 2011

## 5 Accounting Environment

### (a) Disclosure and measurement requirements and practices

Financial reporting and disclosure requirements in Indonesia are regulated by several different government regulatory bodies such as Bank Indonesia, Pertamina, Ministry of Finance, Director General of Taxation, and *Bapepam*. As the accounting year, Indonesian companies generally use a period from January 1 to December 31. Companies of identified industries are required to submit their annual audited financial statements to specified government regulatory agencies. Publicly listed companies are required to submit their annual audited financial statement to *Bapepam*-LK and IDX within 120 days after the end of fiscal year, and to the Department of Trade and Industry within 180 days after the end of fiscal year. In addition, even though technically there are no regulatory requirements to submit the reports to the Tax Office, practically some tax officials will expect the taxpayer to attach a copy of audited reports with the annual tax return when lodged (Worldbank, 2010).

Furthermore, according to capital market law no. 8 (1995) article 86(1), all listed companies must publish and fill with *Bapepam*-LK the annual audited financial statements within 90 days of the calendar year-end. They must also publish half-yearly financial statements filling with *Bapepam*-LK within 30 days, 60 days, or 90 days if unaudited, reviewed, or audited, respectively. The IDX also requires interim financial statements to be submitted within the same period as half-yearly financial statements submitted to Bapepam-LK. Then, regarding to publication, all listed companies must publish their annual audited balance sheet and income statement at least in two Indonesian newspapers, one of which of nation-wide circulation, within 90 days of the balance sheet date[2]. Moreover, the half-yearly report must be published in at least one nationally circulated newspaper. The IDX also publishes on its website the full financial statements of all listed companies.

2 Refer to Bapepam-LK Rule No. X.K.2 (Obligation to Submit Periodically Financial Statements) issued in 2003

(b) Accounting Infrastructures

There are three levels of the charter for accounting and financial reporting in Indonesia, presidential decrees, regulations issued by relevant government agencies, and accounting standards issued by the IAI.

(1) Presidential decrees

The outdated Dutch Commercial Code of 1847 was presidential decrees that regulated business activity in Indonesia. It called for business enterprises to keep adequate records to allow in determining individual's rights and obligations. However, this code has only general terms of the record-keeping requirement without specifying how the records must be kept. The enactment of the new Companies Act (Basic Law of Limited Liabilities Companies No. 1 of 1995 [*Undang-undang Perseroan Terbatas*]) which came to effect in March 1996 has provided more detail requirements for financial reporting. The report must be prepared in compliance with Indonesian Financial Accounting Standards (SAK); and for non-compliance, it must be disclosed and the reasons must be provided (Article 58). Further, the report from certain companies[3] must be audited by a public accountant (Article 59). Then, the latest Indonesian Company Law No. 40 (2007) also required corporate entities to prepare annual financial statements in accordance with the accounting standards issued by the professional accounting organization recognized by the Indonesian Government (World bank, 2010).

3 a) Companies in a field connected with the mobilization of funds from the public (i.e., banks, investment funds and insurance companies); b) Companies that have issued debt instruments; and c) Publicly held companies.

(2) Regulations issued by relevant government agencies

The following is regulations in Indonesia regarding the accounting information requirement issued by several different organizations.

Figure 2 Financial Reporting and Disclosure Requirements

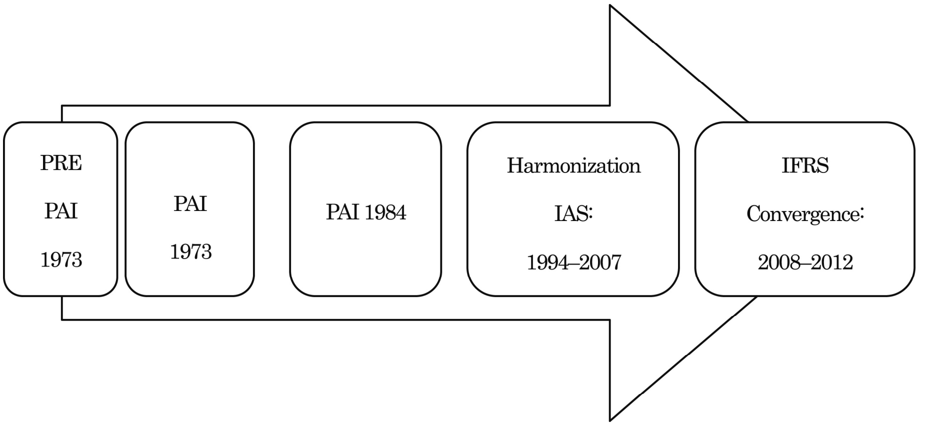
| Organization | Remarks |
|---|---|
| *Bank Indonesia* | Regulation No. 3/22/PBI/2001 provide a legal obligation to all banks and non-bank financial institutions operating in Indonesia to prepare and present semi-annual and annual financial statements to their respective regulator. |
| *Pertamina* | This state petroleum agency is responsible for regulating all aspects of the oil and gas industry in Indonesia, including exploration, production and distribution. *Pertamina* also administers all production sharing contracts involving joint ventures with foreign companies. *Pertamina* prescribes the financial reporting requirements for the industry. |
| Ministry of Finance | This ministry oversees activities of the Directorate General of Taxation and *Bapepam*. |
| Directorate General of Taxation | This agency is responsible for administering tax laws. It prescribes the books of accounts and financial statements required of all corporate taxpayers. |
| *Bapepam-LK* | Capital Market Law No. 8 (1995) article 86(1) requires issuers with effective registration statement or listed companies to publish periodic reports and submit such reports to *Bapepam-LK*, the securities market regulator. |

Source: World bank, 2010

(3) Accounting standards issued by the IAI

Accounting standard in Indonesia experiences a serial development as described in the following figure:

Figure 3 Accounting Standards History in Indonesia




Source: Sinaga, 2011

Before 1973, Indonesia employed the Dutch accounting system as accounting practices. Then, IAI adopted a set of accounting principles, PAI 1973, based on the accounting guidelines published by AICPA in 1965. Along with the rapid business growth in Indonesia, triggered by the development of capital markets, next the board endorsed PAI 1984 consisting of 53 pages and 2 pages of terms. This standard is effective for financial statements ended December 31, 1985. Further, in 1994, the PAI 1984 was totally revised in order to meet the national and global development of business community and accounting profession. Thus, a new set of IAS-based accounting standards called SAK (Indonesian GAAP) was adopted in 1995. From 1995 to 2007, the IAI continues to revise the standards three times on an ongoing basis, whether it is improving the existing standard, adding a new standard, and interpretation of Statement of Financial Accounting Standards (SAK).

Nowadays, the revisions have been made in the context of globalization and IFRS implementation. In this process, the IAI has set up the roadmap of Indonesia's convergence as follows:

Figure 4 Roadmap Indonesia's Convergence

| Adoption stage (2008-2010) | Final convergence stage (2011) | Implementation stage (2012) |
|---|---|---|
| - Adopting all IFRS to PSAK<br>- Preparation for necessary infrastructure<br>- Evaluation and managing the impact of adoption to SAK | - Partial application of the standard<br>- Finishing the standard preparation or necessary infrastructure | - The application of the standard<br>- Evaluation of IFRS adoption impact to business environment<br>- Define strategy for full adoption |

Source: Sinaga, 2011

As of January 1, 2012, all PSAK, except for PSAK 1 and 41, have been converged to IFRS, and the IAI has decided that year 2012 was the time for both listed and unlisted companies to implement local accounting standards that have been converged with IFRS. Corresponding to that change, the Indonesia Capital Market and Financial Institutions Supervisory Board (*Badan Pengawas Pasar Modal dan Laporan Keuangan*, Bapepam-LK) issues regulation No. KEP-346/BL/2011 requiring publicly listed companies to establish financial statements based on the new development of accounting standards in Indonesia. The rule also states that the fiscal periods ending in or after June 2011 is the effective time to implement the policy.

## Ⅳ Conclusion

This paper highlighted the environmental factors that are likely to influence the compliance with IFRS requirement and disclosures in Indonesia, and provide an understanding of why this practice might differ from other countries. By using Gernon and Wallace's (1995) perspective, it can be explained that a number of environmental factors has closely linked with IFRS implementation in Indonesia.

Specific characteristics of Indonesian culture described as a large power distance and small individualism may cause challenges in enforcing the disclosure requirements of IFRS in Indonesia. In addition, the dominance of banks as source for business to raise capital may result IFRS was differently implemented in its orientation. As regards, the financial reporting is presented toward creditor protection.

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