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The Political Economy of Accounting Reform in Developing Countries: The Case of Indonesia

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INTRODUCTION

Over the past two and a half decades, many developing countries have strengthened their accounting regulations as part of broader programs of market-oriented regulatory reform. Whilst the extent to which they have done this has varied from country to country—the capitalist economies of East Asia (South Korea, Taiwan, Singapore, Hong Kong, Indonesia, Thailand, Malaysia, and the Philippines), for instance, have gone much further than their socialist neighbours (China, Vietnam)—there has nevertheless been a broad shift towards accounting reform throughout the developing world (Nobes 1995; Ma 1997; PACTER 1998; Roberts et al 1995). In most cases, the central element of this process has been the introduction of international accounting standards (IASs), although in some countries—such as the Philippines—it has been the introduction of US standards. At the same time, some developing countries have introduced changes to company and capital market laws which have given these standards legal backing and provided mechanisms by which minority shareholders can seek damages from public companies if they produce misleading financial information.

How can these developments be understood? Have they been driven by a technical concern to reduce the cost of capital, promote economic development and improve the efficiency with which global resources are allocated? Have they been driven by Western governments and multinational corporations as part of a neo-colonial project aimed at subordinating developing countries? Or have they been related to structural changes in global and domestic economies that have shifted power and influence away from elements opposed to reform and towards those in favour of reform? In addition, are these developments part of a process of rationalisation, the end point of which is the emergence of Western-style accounting systems in developing countries? Or are pressures for reform being accommodated within existing systems of power and interest?

In explaining accounting reform in developing countries, accounting researchers have generally relied on explanations that emphasise the economic rationality of accounting policymakers. Anglo-Saxon accounting policies, it is argued, represent a “logical guide” for developing countries because they reduce the cost of capital, lower investment risk and promote a more efficient allocation of economic resources and higher rates of economic growth (Graham and Wang 1995: 150; see also Han 1994). At the same time, traditional accounting systems in developing countries are seen as being incompatible with the changing business environment and in conflict with the goal of economic development (Chow et al
In this view, then, accounting reform is simply a matter of accounting policy-makers making rational choices. The only precondition for reform, it is implied, is the existence of policy-makers who are able to overcome the cultural obstacles to reform that exist in many developing countries and put considerations of efficiency above all else.¹

The problem with these explanations is that, like the neo-classical and modernisation theories on which they are based, they portray accounting reform as a purely technical process in which politics and power play no role. It is assumed that accounting policy-makers make their decisions solely on the basis of considerations of efficiency and growth. Yet, as several scholars have pointed out, it is less a technical concern to improve efficiency and growth that drives the process of economic policy reform than a desire to protect, reinforce or gain social and economic power (Chaudhry 1993; 1994; Bardhan 1989; Robison et al 1997; Rosser 1998; Sargeson and Zhang, forthcoming; Tinker, Merino and Neimark 1982; Tinker 1984). Economic policies, they have argued, not only influence the efficiency with which resources are allocated but also their distribution within society—that is, they influence “who gets what, why and how” (Chaudhry 1993: 247). As such, they are embedded in systems of power and interest and reform will only occur when there has been a prior shift in the balance of power away from elements who are opposed to change and towards those who are in favour of change.

One approach that does take issues of power and interest seriously is that associated with scholars such as Briston (1978), Samuels and Oliga (1982), Johnson (1982), Hove (1986) and Annisette (1997). According to this approach, accounting reform in developing countries should be understood not in terms of rational choices by wise policy-makers but rather as the result of a colonial heritage and continued neo-colonial domination. Accounting policies in developing countries, it is argued, have, for the most part, been imposed by developed countries initially through colonialism and then through the influence of transnational corporations, foreign aid donors, and professional accounting institutes. Foreign governments and capitalists, it is claimed, have promoted Western accounting policies in developing countries because such policies have helped to expand the frontiers of international business and thereby contributed to the wealth of shareholders back at home. At the same time, it is argued that these policies have been “inappropriate” for developing countries because they have reduced these countries’ ability to deal with several important development-related issues, including environmental protection and transfer pricing (Samuels and Oliga 1982; Hove 1982).
This “dependency” approach improves on the neoclassical/modernisation theory approach because it brings issues of power and interest into the analysis. But, it is nevertheless limited by its focus on external dynamics. According to this approach, states in developing countries are mere agents of metropolitan government and business interests. It is assumed that domestic political forces are relatively weak vis-à-vis these interests and hence play little role in the policy-making process. Yet, as several studies of economic policy formation in developing countries have shown, domestic class and bureaucratic forces can and do play an important role in economic policy-making in these countries, one that at times is clearly more important than the role of foreign interests (Evans 1979; Robison 1986; Hewison 1989; MacIntyre 1994; Silva 1993; Jomo 1988; Doner 1992). What is needed to properly understand the dynamics of accounting reform in developing countries, then, is an approach that takes seriously the role of domestic as well as foreign interests in the policy-making process.

**ARGUMENT**

We argue that accounting reform in developing countries is best understood in terms of the extent to which structural changes in global and domestic economies shift the balance of power between competing interests (both foreign and domestic) and thus create a political climate conducive to accounting reform. States in developing countries, we argue, are not mere agents of metropolitan interests, but rather complex entities that respond to a range of political and social interests. On the one hand, they respond to the particularistic interests of the dominant political and social coalitions in these countries—typically coalitions consisting of the strata of politico-bureaucrats that occupy the state apparatus and the dominant fractions of capital. On the other, because they exist within a capitalist context, they are also structurally compelled to provide a legal, political and fiscal environment conducive to the reproduction of capital-in-general (Robison 1986; Rueschmeyer and Evans 1985; Robison et al 1993; Rosser 1998). Hence, they are compelled to ignore the interests of the dominant political and social forces and make concessions to other fractions of capital or organisations such as the World Bank and IMF if this will ensure the continued health of the capitalist economy. This in turn means that structural changes in global and domestic economies often translate into policy change because they strengthen the position of certain groups vis-à-vis other groups.

To illustrate the usefulness of this framework, we examine the dynamics of accounting reform in Indonesia since the mid-1960s. In this case, we argue that accounting reform was
not the product of rational choices by wise technocrats or neo-colonial domination but rather of structural pressures generated by periodic economic crises. These crises, we argue, dramatically strengthened the position of elements—such as international financial investors, the IMF and the World Bank—that favoured accounting reform because they significantly increased the country’s need to attract greater amounts of foreign aid and investment. Within this context, influence over economic policy (and accounting policy in particular) shifted away from the politico-bureaucrats and their corporate clients and towards liberal technocrats within the government. At the same time, however, these crises did not dislodge the politico-bureaucrats and their clients from their position of political and social dominance—even in 1997-1998 when the Indonesian economy virtually collapsed, they were still able to cling to power. The result was that the technocrats were only able to push through a partial range of accounting reforms: whilst they were able to completely revamp the country’s accounting regulations, they were unable to ensure the proper enforcement of these regulations through auditing and judicial reform.

In arguing this case, we begin by identifying the main actors and interests that have shaped accounting policy-making in Indonesia since the New Order came to power in 1965. The next three sections then examine in detail the way in which political and social dynamics have shaped the process of accounting reform in Indonesia during this period. The final section examines the implications of this analysis for the future development of accounting systems in developing countries.

**ACTORS AND INTERESTS**

Broadly speaking, two main sets of actors have played a role in shaping accounting policy in Indonesia during the New Order period. The first of these has been the liberal technocrats who have run key economic departments such as the Ministry of Finance and Bank Indonesia, the central bank. Drawn almost exclusively from the Faculty of Economics at the University of Indonesia and in many cases educated overseas in orthodox economics, the technocrats have been strong supporters of neo-liberal economic reform and accounting reform in particular. In their view, accounting reform has been essential for the country to create a more market-oriented and competitive economy. “Good accounting standards”, they have argued, “generate confidence among investors that is absolutely essential to stimulate the flow of capital. Further, good accounting also helps insure (sic) the continued efficient use of capital once it has been accumulated” (Prawiro 1991; See also Suta 1993; 1994; *Jakarta Post*, 22 September 1990).
The technocrats’ influence over accounting policy has had less to do with the technical merits of their arguments, however, than with the fact that their policies have received strong support from foreign investors and international aid agencies such as the World Bank and the IMF. Foreign portfolio investors, for instance, have supported the technocrats’ push for accounting reform because they have desired more reliable information on which to base their investment decisions and greater control over how Indonesian companies use the funds they give them. In short they have wanted to reduce the risk associated with Indonesian investments. The amount and reliability of financial information from Indonesian companies, they have argued, has been low compared to developed countries and has consequently increased the risk associated with Indonesian investments. They have thus called on the government to introduce tougher disclosure rules and harmonise accounting practices with Western ones (See, for instance, The Tokio Marine and Fire Insurance Company 1994; Asian Wall Street Journal (hereafter AWSJ), 28 September 1989; Neraca, 15 November 1995).

For their part, the international aid agencies have supported the technocrats’ calls for accounting reform because of the neat fit between the technocrats’ ideas and their own broader agenda. As Western governments and business groups have become increasingly concerned about the quality of governance in developing countries, these agencies have placed increased emphasis on the institutional foundations of economic growth. Markets, they have argued, require a broad array of institutional supports, including sound accounting and auditing systems, to operate efficiently and promote economic growth (World Bank 1997; Camdessus 1997; World Bank 1993; IMF 1999). Because Indonesia’s accounting and auditing regulations have been weak and its professional organisation under-developed, they have advised the Indonesian government to make reform in this area a priority (see, for instance, World Bank 1993). Their views have carried considerable weight, not because they have been correct in any technical sense, but rather because they have embodied the interests of foreign governments and investors and their control over aid money has given them enormous leverage over governments, especially at times of economic crisis.

The second set of actors that have played a role in shaping accounting policy in Indonesia has been the “politico-bureaucrats”, a small cadre of senior state-officials who have controlled many other sections of the state apparatus. The central characteristic of these actors has been their ability “to appropriate the offices of the state apparatus and in their own right exercise authority over the allocation of resources and access” (Robison 1996: 82). In contrast to the technocrats, they have been opposed to accounting reform because of their fear that, by making business enterprises more transparent, it could limit their opportunities to engage in...
rent-seeking activity. In the absence of adequate transparency, senior government and military officials have been able to secure lucrative positions within SOEs for themselves, ensure that supply contracts for these enterprises are awarded to companies with which they have close connections, and use SOEs to raise extra-budgetary revenue for sections of the military and government departments (Robison 1986; Crouch 1988). One of their main concerns about accounting reform has thus been that—by making business enterprises more transparent and accountable—it could limit their ability to use SOEs as “milche cows”.

Another has been that accounting reform could have negative implications for the private domestic conglomerates with which they are connected. Prior to the revival of the capital market and the introduction of accounting reforms in the 1980s and early 1990s, it had been commonplace for private companies in Indonesia to keep three sets of books—one which showed the “true” state of the business and which was used for management decision-making; one which showed a positive result and which was used for raising loans from foreign and local banks; and one which showed a loss or small profit and was used for taxation purposes (Kwik 1994). The politico-bureaucrats have thus been concerned that, by increasing and standardising the amount of financial information that is publicly available, accounting reform could reduce the ability of companies to avoid tax and manipulate lenders and other financial statement users. Another concern has been that, by exposing more information about these companies’ wealth, it could also fuel populist criticism of their activities.

The relative influence that these groups have exercised over Indonesia’s accounting policies during the New Order period has fluctuated according to the country’s need for private capital inflows and inflows of foreign aid. When the country’s need for these inflows has been high (as it was during the late 1960s-early 1970s, the period since the mid-1980s, and again during 1997-1998), the New Order has had to be responsive to the needs of foreign investors and the international aid agencies. The technocrats have thus been able to promote the process of accounting reform. When the country’s need for these inflows has been low (as it was during the oil boom years of 1973-1981), however, the New Order has been able to ignore the demands of these groups and act in a relatively autonomous manner. Within this context, the influence of the technocrats over accounting policy has declined and that of the politico-bureaucrats has risen. The result has been a significant slowdown in the process of accounting reform.
THE POLITICAL ECONOMY OF ACCOUNTING POLICY-MAKING IN INDONESIA: 1965-MID-1980S

When the New Order came to power in 1965, Indonesia was in the midst of the worst economic crisis that it had experienced since independence. Between 1961 and 1965, the economy virtually ground to a halt, with Net Domestic Product rising only slightly from Rp407 billion to Rp430 billion (figures in 1960 prices). At the same time, the country’s export earnings fell dramatically from $US750 million to $US450 million, making it virtually impossible for the country to meet its burgeoning foreign debt commitments. Spiralling inflation, caused by excessive printing of money, provided the most obvious sign of economic distress. In 1960, inflation stood at 20 percent per annum but by 1965 it had risen to almost 600 percent (Arndt 1967; Hill 1996). In this context, private capital either fled overseas or was diverted into activities with quick returns such as trade and currency exchange. The result, as Emil Salim, one of New Order’s most important economic ministers has pointed out, was that “Normal long-term investment stopped” (as quoted in Winters 1996: 47).

With the economy in disarray, the technocrats were to emerge as the most influential economic policy-makers within the government. The leader of New Order, General Suharto, recognised that the survival of his government depended at least in part on its ability to renegotiate debt, secure foreign aid, promote investment and stimulate economic growth. None of these goals could be achieved, however, unless his government could attract foreign capital back into the country and gain the support of the IMF, the World Bank and other international donors. He thus had little choice but to shift away from the radical populist and nationalist interventionism of the previous regime and towards the sort of policies advocated by the technocrats (McDonald 1980; Winters 1996; Thomas and Panglaykim 1973).

Within this context, the government was to give increased attention to accounting reform as part of a broader attempt to revive the Indonesian capital market. The previous government’s decision to nationalise all Dutch companies in 1958 and to suspend trading in shares of Dutch firms in 1960 had effectively made it impossible for the country’s capital market to survive and it was eventually closed down in 1968. The technocrats realised that the country needed a properly functioning capital market if it was to attract foreign capital back into the country and, consequently, took steps to revive it. In 1968, they established the Money and Capital Markets Preparation Team under the Governor of Bank Indonesia to make recommendations to the central bank concerning money and capital market policy. In 1970 and 1972, they established another two bodies, again under the central bank Governor, to begin the process of reactivating the capital market and to supervise its activities. As part of
these bodies’ work, they were to be responsible for producing, in conjunction with the professional accounting institute—the Indonesian Accounting Association (IAI)—Indonesia’s first set of accounting standards in 1973 (Sumantoro 1990).

These standards, which were called Indonesian Accounting Principles (Prinsip Akuntansi Indonesia or PAI), were a compilation of basic accounting principles, practices, methods and techniques. Based on the American Institute of Certified Public Accountants’ 1965 research study “Inventory of Generally Accepted Accounting Principles for Business Enterprises”, they were intended to address general accounting issues rather than provide detailed prescriptions for accounting practice (Prawit 1988). Even in their revised 1984 form, they did not deal at all, for instance, with accounting practices for specific industries such as banking, insurance or mining and their coverage of specific topics such as consolidations and the creation of allowances and provisions was either extremely limited or non-existent (Briston et al 1995; Yunus 1988). At the same time, they were not given legislative backing. At that time, Indonesia’s company law, which had been inherited from the Dutch colonial period, simply required that “adequate accounts” be kept (World Bank 1993). It did not contain a specific requirement that financial reporting be done in accordance with the PAI or any other prescribed set of standards. For this reason, and because the PAI permitted companies to refer to other countries’ accounting regulations where the PAI did not deal with a particular accounting issue, companies still had enormous latitude in the way they could account for their financial affairs.

Despite the technical weaknesses of the PAI, however, the government was to do nothing to further the process of accounting reform over the next decade. The main reason for this was the onset of the oil boom in the mid-1970s. International oil prices rose dramatically between 1973 and 1974 and again between 1979 and 1981, on both occasions more than tripling in value. As a result of this rise, Indonesia’s oil and gas exports leapt from $US1.6 billion, or 50.1 percent of total exports, in 1973 to $US18.4 billion, or 82.6 percent of total exports, in 1982. At the same time, the government’s oil and gas revenues rose from Rp382 billion, or 39.5 percent of total government revenues, in 1973/74 to Rp8.6 trillion, or over 70 percent of total government revenues, in 1981/82. Within this context, the conditions that had made accounting reform possible during the early New Order period evaporated. With vast sums of petrodollars flowing into government coffers, it was no longer necessary for the government to design capital market policies that would attract foreign capital back into the country. Furthermore, the politico-bureaucrats’ control over much of the government’s new oil wealth meant that they, rather than the technocrats, came to exercise the dominant
influence over economic policy (Rosser, forthcoming). In this context, accounting reform was simply dropped from the agenda.

When the government eventually re-established the Indonesian capital market in 1977, it did not introduce accompanying accounting reforms. Indeed, the main purpose of re-establishing the capital market as far as the government was concerned had changed entirely. The mid-1970s had seen a series of demonstrations by students, small businessmen and other marginalised groups at which the government’s economic policies were criticised and appeals were made for an end to foreign and Chinese domination of the economy. For this reason, the government decided to re-establish the capital market, not as a mechanism for raising foreign capital, but rather as a mechanism for redistributing wealth from large (especially foreign) companies to ordinary Indonesians (Rosser, forthcoming). In this context, there was no need for the government to address issues of accounting reform. Redistributing wealth through the capital market required the introduction of a range of restrictive regulations that in turn had the effect of reducing demand for Indonesian stocks. With low demand for Indonesian stocks, there was also low demand for good accounting information and therefore for accounting reform.

It was to take the collapse of international oil prices in the early to mid-1980s—and the enormous structural pressures that it generated—to put accounting reform back on the agenda. The oil price collapse dramatically reduced both Indonesia’s oil and gas exports and the government’s revenues from the oil and gas sector. By 1986, the country’s oil and gas exports had fallen to $US8.3 billion, or 56 percent of total exports, and by 1986/87 government revenues from the oil and gas sector had fallen to Rp6.3 trillion or 39.3 percent of total government revenues. Within this context, the government had little option but to reinvigorate the Indonesian capital market. The capital market had grown extremely slowly between 1977 and the mid-1980s—only 24 companies had listed their shares on the Jakarta Stock Exchange (JSX) by late 1988—largely because of the restrictive capital market regulations imposed by the government at its inception (Rosser, forthcoming). With the country in desperate need of new sources of investment funds, it was no longer possible for the government to continue with capital market policies that restricted the flow of portfolio capital into the country. Instead it was forced to pursue the capital market strategy advocated by the technocrats: deregulation and the introduction of measures, such as tougher financial accounting requirements, that would improve the institutional infrastructure of the capital market.
THE POLITICAL ECONOMY OF ACCOUNTING POLICY-MAKING IN INDONESIA SINCE THE MID-1980s

Initially, the government was to focus on deregulation of the capital market rather than accounting and other institutional reforms. Its main concern following the collapse of oil prices was to revitalise the capital market and it was consequently reluctant—at least at first—to introduce any measures, such as tougher financial accounting requirements, that might discourage the conglomerates from going public (Mackie and Sjahir 1989). Between December 1987 and September 1989, when it introduced its first major capital market reform packages, then, it did nothing in the area of accounting. The main purpose of these packages was to deregulate the capital market by eliminating restrictions on share price movements, granting permission for foreign investors to purchase shares in publicly-listed companies, establishing a new over-the-counter market, simplifying procedures for issuing and listing securities, equalising the tax treatment of interest and dividends, and reducing the role of the state-owned investment trust in buying and selling shares, underwriting and operating mutual funds.

Over the next few years, however, the government was to come under increasing pressure to push ahead with the process of accounting reform. First, the World Bank was to become increasingly critical of the government’s accounting policies, arguing that reform in this area was necessary if the country was to continue the process of economic development and capital market development in particular. In its 1993 report on the Indonesian economy, for instance, it argued that the country needed “a sound accounting and auditing system...to instill financial discipline” (World Bank 1993: xxi). With the Bank’s structural leverage greatly enhanced by the country’s need to mobilise more private investment and foreign aid, the government was under enormous pressure to heed its advice. Second, the capital market was to be shaken by a series of financial reporting scandals that seriously undermined investor confidence. Although a large number of conglomerates rushed to go public following deregulation—by the mid-1990s, there were more than 200 local companies listed on the JSX—few of them were willing to provide the level of disclosure and transparency that investors were demanding. The result was that the capital market was only able to attract highly volatile, speculative flows of capital. In the wake of these scandals, it became clear to government policy-makers that the government had to do something to improve the quality of financial reporting within the country if the capital market was to be transformed from a casino into a mechanism for mobilising long-term investment flows.
The first and most serious of these scandals involved revelations that Bank Duta, a private national bank owned by three charitable foundations controlled by President Suharto, failed to disclose several hundred million dollars in foreign exchange losses when it went public in the first part of 1990. Since the trading which had led to the losses had begun in August 1989, the bank's prospectus should have made some mention of its extraordinary foreign exchange exposure. However, it contained no mention of this at all. Nor does it appear that Bank Duta fully informed the capital market regulator (Bapepam), its auditors, or its underwriters about its problems (AWSJ, 11 September 1990). Both Bapepam and its auditors gave it a clean bill of health just prior to its going public. Even once its losses had been publicly exposed, Bank Duta was still reluctant to report them properly in its financial accounts. In its first set of published financial accounts following the scandal, Bank Duta reported a pre-tax profit of Rp22.6 billion. According to finance journalist Richard Borsuk: “The only indication of the losses was a footnote stating that the accounts reflect the bank’s financial standing after receiving a ‘grant’ of $US419.6 million from majority shareholders” (AWSJ, 25 October 1990). This grant had been necessary to cover the losses incurred through its foreign exchange dealings.

Shortly after the revelation of Bank Duta’s losses, there was a massive withdrawal of funds from the Indonesian capital market, triggering a sharp drop in the JSX Composite Index. By the end of 1990, the Composite Index had fallen to 417 points after being more than 600 points in the middle of the year. A whole range of factors contributed to this collapse including nervousness over the intensification of the Gulf Crisis and higher bank interest rates as a result of the government’s tight monetary policy. But the fact that the collapse followed closely on the heels of the Bank Duta affair suggests that it was a key factor in triggering the collapse.

A second scandal occurred in mid-1992 and involved Plaza Indonesia Realty, a real estate company part-owned by one of Suharto’s sons, Bambang Trihatmojo. According to informed sources, a conflict arose between Plaza Indonesia Realty and its underwriter, Jardine Fleming Nusantara, over the valuation in its accounts of one of its subsidiaries. There were also concerns that the IPO was overpriced. Because Bambang Trihatmojo part-owned the underwriter, however, he was able to ensure that that company dropped its objections and that the IPO went ahead. Disgusted by the outcome, several top executives at Jardine Fleming resigned. This scandal did not have the same impact on the capital market as the Bank Duta case because it received relatively little media attention but it nevertheless contributed to the
general view amongst investors that financial reporting practices within the country were highly suspect.

A third scandal involved the well-connected forestry company, Barito Pacific Timber, which decided to go public in 1993. From start to finish, Barito’s float was dogged by widespread concerns about the company’s level of transparency. There were doubts amongst investors that the funds raised from the float would be used as indicated in the prospectus. Whilst the company maintained that the funds would be used to retire some of its debts and expand its interests in the pulp and paper industry, many observers suspected that they would actually be channeled to other companies within the same group. In particular, it was feared that they would be injected into Chandra Asri, a dubious petrochemicals joint venture part-owned by Barito’s boss, Prajogo Pangestu, which was rumoured to be desperately short of funds. There were also concerns about Barito's debt position. Barito had topped an unofficial list of state bank bad debtors which had begun circulating in Jakarta in June 1993, after apparently having been leaked by the technocrats. Despite the fact that Barito's financial statements portrayed the company as healthy and free of bad debts, many observers were not convinced that they were telling the truth. Even when Barito produced letters from three state banks stating that it was up to date on its loan repayments, many observers remained unconvinced. The widespread credence given to the bad debtors list persuaded them that Barito was not being entirely honest in its reporting of its debt position (Sjahrir 1993; Tempo, 17 July 1993; Asiaweek, 1 September 1993).

Another transparency problem for Barito related to its ownership structure. In mid-July it was revealed that the leading US investment bank, Salomon Brothers Inc., had declined to act as lead underwriter for the foreign portion of Barito's float because it could not get access to enough reliable information to complete a “due diligence” report on the offering and to meet U.S. regulatory requirements for shares sold to that country’s investors (AWSJ, 21 July 1993). In particular, it was allegedly unable to obtain reliable information concerning Barito’s two major shareholders, Barito Pacific Lumber and Tunggal Setia Pratama, which between them owned almost 65 percent of the company. According to Prajogo, Salomon Brothers was unwilling to accept his explanation that he owned all the shares in these companies. Why it did not accept this explanation is not entirely clear, but it may have had something to do with widespread rumours that it was in fact members of the Suharto family, and not Prajogo, who controlled these companies (Indonesia Business Weekly, 3 September 1993; Australian Business Asia, 20 October 1993).
The controversy created by these scandals significantly increased pressure on the
government to tighten financial reporting requirements in the capital market. Whilst the Barito
float was eventually many times oversubscribed, the widespread criticism of that company’s
financial statements together with the concern expressed about the other scandals revealed the
fragile nature of many investors’ confidence in the Indonesian capital market. It was thus
clear to the technocrats that if investors were to continue investing in Indonesian stocks, the
quality of financial reporting in Indonesia had to be dramatically improved. If it was not, the
large number of local conglomerates lining up to go public may be unable to attract the equity
capital they required. Such a situation presented the conglomerates with an ironic dilemma.

In this context, the technocrats were able to push through a series of measures aimed
at overhauling the country’s financial accounting regulations. In late 1994, the government
introduced a new set of financial accounting standards, known as Financial Accounting
Standards (PSAKs), to replace the old PAI. Issued formally by the IAI, they represented the
product of a cooperative project between that organisation, Bapepam, Arthur Andersen, and
the World Bank which had funded their production.\textsuperscript{6} In contrast to the PAI, they were based
largely on IASs and consequently were a much more comprehensive set of accounting
regulations (Diga and Yunus 1996). Around the same time, the government also launched a
joint project with the World Bank to further develop Indonesia’s accounting regulations and
train accounting professionals. Known as the “Second Accountancy Development Project”,
this project required almost $US34 million to be spent over a six-year period on improving
the quality of financial reporting both within government and the private sector. A key
objective of the project was to be the production of another 40 financial accounting standards
(World Bank 1994).

In March 1995, the government continued the process of reform when it introduced
several provisions related to accounting in its new Companies Code. Article 58 of the new
Companies Code made it mandatory for all companies to prepare their annual accounts in
accordance with PSAKs, except where they had just cause not to do so. Article 59 required
publicly-listed companies to have their accounts audited by a public accountant. Article 60
made company directors and commissioners personally liable for any losses incurred by any
persons as a result of untrue or misleading information contained in financial reports (Cole
and Slade 1996). Later that year, the government introduced further legal requirements for
accounting as part of its Capital Markets Law. This Law contained general provisions
specifying the format of financial reports and forbidding public companies from providing
untrue or misleading information to the public. It also contained provisions that dealt with
more specific disclosure matters. Public accountants who discovered that a company was breaching the law or felt that a company was in financial crisis were required to report their concerns to Bapepam. And company directors, commissioners and major shareholders were required to report important events that may affect share prices or else incur a fine of up Rp100,000 per day. The law also introduced a requirement for bond issuers to report how funds raised from going public were to be used (Info Finansial, October 1995; Jakarta Post, 18 January 1996).

THE 1997-1998 ECONOMIC CRISIS AND FURTHER REFORM

With the collapse of the rupiah during 1997-1998, pressure on the government to improve the quality of financial reporting in Indonesia increased even further. The rupiah crisis virtually destroyed the political and economic bases of the New Order. By early 1998, most of the country’s conglomerates were technically bankrupt, the banking system was on the verge of collapse, a serious fiscal crisis was looming, rising inflation and unemployment had driven millions of people into poverty, and the government had been forced to call in the IMF and negotiate a rescue package. At the same time, political and social unrest was spreading rapidly as a result of rising prices and growing opposition to President Suharto (Robison and Rosser 1998). Within this context, influence over economic policy-making was to shift even more decisively in favour of the technocrats and their supporters at the IMF and the World Bank. Only by pursuing a more market-oriented economic agenda, it was realised, would the country have any chance of stemming capital flight and securing critically-needed foreign aid.

At the same time, much public analysis of the Asian economic crisis was to blame poor accounting practices for fueling the crisis. Foreign investors, it was argued, had “risked their money on deals that wouldn’t have looked so appealing had the books been prepared to international standards” (AWSJ, 20 October 1998). The head of the US Federal Reserve, Alan Greenspan was to be amongst the most important critics of Asian accounting practices, telling the US Congress that the Asian crisis would not abate until countries within the region adopted better and clearer accounting rules (AWSJ, 3 May 1999). The World Bank was also to make accounting a major issue by calling on the Big Five international accounting firms—Price Waterhouse Coopers, Deloitte and Touche, Arthur Andersen, KPMG Peat Marwick and Ernst and Young—to withhold their brand name imprimaturs if their affiliates in developing countries did not meet international accounting and auditing standards (AWSJ, 20 October 1998). With the country desperately needing to restore investor confidence in the economy
and attract foreign aid, the government had little choice but to pay attention to these criticisms.

Within this context, the government was to push ahead with the process of accounting reform. In February 1998, it announced that all limited firms with assets of Rp50 billion or more would be required to publish financial statements and have them audited by external auditors (Jakarta Post, 23 February 1998). In July 1999, this was followed by a decision by the nominally private but effectively government controlled Jakarta Stock Exchange Company to introduce a new set of corporate governance regulations for publicly-listed companies. Among the main provisions of these regulations were a requirement for publicly-listed companies to reserve at least 30 percent of positions on their Boards of Directors for “independent” individuals and for these individuals to form and lead companies’ internal audit committees. “Independent” individuals were defined as those who had no connections to majority shareholders, other directors or other companies within the group.

RESISTANCE TO REFORM

Despite the enormous structural pressures for accounting reform that emerged after the mid-1980s, however, the government was prevented from pursuing a number of key accounting reforms. Although the collapse of oil prices in the mid-1980s and the dramatic fall in the rupiah in 1997-1998 severely weakened the politico-bureaucrats and the conglomerates, by mid-1999 they had not dislodged them from power. Even after Suharto was forced to stand down as President in May 1998, the government remained dominated by figures associated with his regime. Many of the country’s new leaders, including the President, Habibie, the senior economics minister, Ginandjar Kartasasmita, and the head of the Armed Forces, Wiranto, were products of the political and institutional structures of the New Order. Within this context, the politico-bureaucrats and the conglomerates were to retain sufficient authority to prevent the introduction of reforms that threatened to seriously undermine their political and social dominance.

One important area in which they were able to block reform was auditing. In the mid-1980s, the government had officially prohibited foreign accountants from practising in the country, forcing international auditing firms to operate through domestic affiliates rather than set up their own offices. This situation suited the conglomerates because it meant that they could have their books audited by firms that, although they operated under the names of major international firms, were not directly controlled by them and consequently did not always apply the same standards. In early 1997, following World Bank calls for Indonesian auditors
to be more independent, the government was forced to permit foreign accountants to practice within the country on an individual basis. It refused, however, to allow them to establish their own auditing firms, effectively forcing international firms to continue operating in Indonesia through their affiliates. This in turn dramatically reduced the scope for a significant improvement in the quality of auditing services within the country (Media Akuntansi, June 1998).

At the same time, the government also did nothing to reform the country’s notoriously corrupt judiciary. In the absence of an independent judiciary Article 60 of the Companies Codes concerning the personal liability of company directors and commissioners for losses incurred as a result of misleading information was effectively unenforceable. Any minority shareholder who launched legal proceedings against a director or commissioner of a major conglomerate would have little hope of winning given that the judiciary would probably side with his or her opponent. This also suited the conglomerates for obvious reasons. As with auditing, the reason for the government’s inaction in this area was that it was simply too difficult politically. The authority of the politico-bureaucrats and the conglomerates was based to a considerable extent on their ability to control judicial outcomes (Bourchier 1998; Thoolen 1987; Lubis 1993; Amnesty International 1994). Judicial reform would have given their political opponents a much stronger chance in court and thus severely undermined their own political and social position.

Not surprisingly, then, serious concerns continued to be expressed about the quality of financial reporting in Indonesia during the mid to late 1990s. Business consultants and analysts continued to claim that Indonesian financial reports were unreliable and misleading. Even figures associated with the IAI acknowledged that manipulation of financial reports was still widespread despite the regulatory changes. At the same time, more financial reporting scandals were exposed. In May 1997, for instance, it was revealed that a leading listed property company, Summarecon, had produced two sets of financial accounts which reported contradictory results for one of its subsidiaries. The first set of accounts, which had been prepared to fulfil legal obligations in case the subsidiary was liquidated, reported that the subsidiary had made a loss of Rp70 billion. The second, which had been prepared for public shareholders, reported that the subsidiary had made a large profit. Concerned that the company had doctored its accounts to mislead investors, both Bapepam and the IAI announced that they would launch investigations into the matter (Gatra, 21 May 1997).

Whether anything is done to improve the quality of auditing and eliminate corruption within the judiciary in Indonesia in the future will very much depend on the broader course of
Indonesian politics and, more immediately, on the outcome of the parliamentary and presidential elections during 1999. If elements associated with the old regime are able to maintain their political dominance, they are likely to continue blocking attempts to promote reform in these areas, despite broader structural pressures for reform. If reformist elements such as Megawati Sukarnoputri or Abdurrahman Wahid triumph, reform is more likely. These elements draw a large part of their support from groups such as the professional middle class, the urban proletariat, the urban intelligentsia and the student movement which have expressed strong support for the rule of law and the elimination of corruption, collusion, and nepotism. Although they may need to develop their own networks of patronage and influence to consolidate their hold on power, it is unlikely that their constituents will accept continued corruption and abuses of power—at least not on the scale of the previous regime. There will thus be a strong imperative for them to introduce reforms in relation to auditing and the judiciary.

**CONCLUSION**

What, then, does this analysis suggest about the future development of accounting systems in developing countries? Much academic writing on accounting systems in developing countries has tended to assume that accounting systems in developing countries will inevitably become more Western in character. Scholars operating from a neoclassical/modernisation perspective, for instance, have suggested that developing countries will shift away from traditional accounting practices and towards Western ones as the former become incompatible with an increasingly complex and competitive business environment (Chow et al 1995; Han 1994). Scholars operating from a dependency perspective have envisaged the same outcome but for different reasons. Because developing countries occupy a subordinate position within the global economic system, they have implied, they will have little choice but to adopt accounting policies that serve the interests of Western governments and multi-national corporations rather than their own national interests. This in turn will mean continuing to adopt Western accounting policies rather than developing their own (Hove 1986; Briston 1978).

The analysis presented here, however, suggests that there is nothing inevitable about the emergence of Western-style accounting systems in developing countries. It is certainly true that, as in the Indonesian case, many developing countries are adopting Western accounting regulations, particularly IASs, in order to access global financial markets. And it is likely that as long as developing countries need capital from these markets, they will at least
try to look like they are doing something to improve the quality of financial accounting within their borders. But, at the same time, governments within developing countries are embedded in domestic political and social interests that, in many cases, are opposed to the introduction of measures—such as judicial reform—that are essential for accounting systems to operate according to Western standards. As we have seen in the Indonesian case, the introduction of IASs appears to have done little to improve the quality of financial reporting because both the auditing process and the court system have remained severely flawed. What is required in many developing countries for Western-style accounting systems to emerge, then, is not simply the introduction of Western accounting regulations, but also fundamental political change. Only then will the political and social interests that impair auditing and judicial decisions be overcome.
1 Several accounting researchers have argued that cultures in developing countries present a serious obstacle to accounting reform. See, for instance, Chow et al (1995); Hamid et al (1993); and Graham and Li (1997).

2 Many politico-bureaucrats—or more commonly their relatives—have been given minority shareholdings or senior executive positions in major private domestic conglomerates. In other cases, politico-bureaucrats have gone directly into business themselves by establishing family-owned companies (Robison 1997; Schwarz 1994).

3 These regulations included restrictions on share price movements, a ban on foreign investment in the capital market, a requirement for the state-owned investment trust to purchase up to 50 percent of all issued shares and then resell them in the form of cheap bearer certificates.


5 The Barito float was also dogged by other concerns. Perhaps the most significant of these related to the purchase in February of a 20.32 percent interest in the company by PT Taspen, the state-owned civil servants' pension fund. Despite the fact that the purchase took place a few months prior to Barito's decision to go public, it only became public knowledge once Barito opened its financial accounts to attract investors (Sjahir 1993). For this reason, many observers questioned whether the price paid by Taspen for Barito's shares was reasonable or not. As in a similar case involving Indocement a few years earlier (when the government purchased 35 percent of the company's shares), Barito was accused of receiving special favours because of its political connections. Another controversial aspect of the float related to the treatment of Barito's timber concessions in its accounts. As Sjahir (1993: 21) has pointed out: "there was...much concern about whether BPT's timber concessions had been included amongst the company's assets in the balance sheet. Some argued that this would conflict with Article 33 of the Constitution, which states that Indonesia's natural resources are under the control of the state and are to be used to enhance the welfare of the people." In the end, however, little became of this issue because Barito chose not to include its timber concessions in its accounts (See Tempo, 17 July 1993).


7 Previously only publicly-listed companies and certain financial institutions were required to public audited financial statements.

8 I wish to thank Felia Salim, a Director of the JSX, and others at that institution for providing me with information concerning these regulations.

9 Interviews with former employee of a major international accounting firm, 28 August 1998; an official in the listing division of the JSX, 6 October 1998; and two journalists who regularly cover the capital market, 6 October 1998. See also Backman (1999).

10 Comments made by James Castle, a leading business consultant in Jakarta, Centre for Strategic and International Studies, 28 July 1995. See also Backman (1999: 42-51).

11 See, for instance, comments by Soedarjono, the then head of the IAI in Kompas, 14 July 1995.
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