Review Article

THE EFFECT OF IMPLEMENTATION OF DISCRETIONARY ACCRUAL ON LOCAL GOVERNMENT INCENTIVES : LITERATURE REVIEW

ABSTRACT

This study is a literature review aimed at exploring the effect of the application of discretionary accruals on the Regional Incentive Funds (DID) received by local governments in Indonesia. Depreciation of fixed assets was chosen as a profit management technique used by local governments because fixed assets are the largest component of the balance sheet and involve the operational activities of local governments. There are not many studies that discuss the application of Discretionary Accrual by linking the incentives received in non-profit organizations, especially in Indonesia. Fereira et al. (2013) stated that there are not many earnings management studies conducted by non-profit organizations so that there are still many research opportunities in this area, moreover there is no research related to earnings management in order to obtain subsidies or grants from the government, (Verbruggen et al., 2008).

Keywords: Discretionary Accrual, Local Government Incentives, DID, Depreciation, Earning Management, Non Profit Organization.

1. INTRODUCTION

The implementation of the accrual-based accounting system in Indonesia began in 2015 as regulated in Government Regulation of the Republic of Indonesia Number 71 of 2010 concerning Government Accounting Standards. The accrual-based accounting system is considered a 'best accounting practice' and an 'accounting innovation' (Adhikari et al., 2019). The benefits of accrual-based accounting for the government, in this case local governments, are: (1) providing a complete picture of the financial position of local governments; (2) presenting true information regarding the rights and obligations of local governments; (3) better control of the budget deficit and the accumulation of government costs; and (4) financial statements reflect the balance between generations. With accrual-based reporting, users can identify the government's financial position and changes, how the government finances its activities according to its funding capacity so that the actual government capacity can be measured. With the application of accrual-based accounting in local government financial reporting, it is hoped that the government will have sufficient information to make decisions, especially regarding the funding of services provided, accountability for asset management, including fundraising plans. for the maintenance and procurement of assets (Mulyana, 2009).

The Regional Incentive Fund (DID) is an incentive-based funding scheme allocated in the State Revenue and Expenditure Budget (APBN) to certain regions based on certain criteria with the aim of rewarding certain performance improvements in the areas of regional financial governance, basic public services, and welfare. Public. The amount of DID is determined by the improvement of certain performance indicators in the areas of regional financial management, basic public services, and community welfare. Certain performance indicators in the field of regional financial governance are indicators that can be used as an assessment of performance improvements in the field of regional financial management, which can be in the form of large infrastructure spending in the Regional Revenue and Expenditure Budget (APBD), budget absorption performance, fiscal independence performance, BPK RI's opinion on local government financial reports, as well as the use of e-government. DID from the central government to local governments motivates local governments to improve performance trying to get DID allocations that are achieved with criteria in the form of Unqualified Opinion opinions from the BPK RI, timeliness of Regional Budgets and based on performance criteria. A significant increase in DID allocation was seen in FY 2016 to FY 2020. The 2016 fiscal year is the second year in the application of the accrual basis to government accounting in Indonesia.

Table. 1: DID Allocation Increase
(In Billion Rupiah)

Before the application of the accrual basis				After the application of the accrual basis					
2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
1.387,8	**1.387,8**	**1.387,8**	**1.387,8**	**1.664,5**	**5.000**	**7.500**	**8.500**	**10.000**	**15.000**

Source: DJPK – Ministry of Finance of the Republic of Indonesia

As in profit organizations, the application of earnings management is carried out to improve the company's financial performance. A significant increase after the application of the accrual basis may indicate the possibility of managing discretionary accruals by local governments to achieve targets or incentives desired by local governments. Incentives can motivate management in public organizations to manipulate financial statements to approach zero deficit/surplus (Pilcher et al., 2010). The results of the study of Ferreira et al. (2013) concluded that the target of the management of public organizations in presenting financial statements is with a surplus/deficit close to zero. Furthermore, Fereira et al. (2013) stated that there are not many earnings management studies conducted by non-profit organizations so that there are still many research opportunities in this area, moreover there is no research related to earnings management in order to obtain subsidies or grants from the government, (Verbruggen et al., 2008). Therefore, research on this topic is still interesting for further study and is still relevant for research. Based on this description, this study was conducted to examine the effect of discretionary accruals on DID received by local governments.

2. LITERATURE REVIEW

2.1 Stewardship Theory

Donaldson et al. (1991) stated that stewardship theory is a theory that describes a situation in which managers are not motivated by individual goals but rather are aimed at their main outcome goals for the benefit of the organization, so this theory has a psychological and sociological basis that has been designed in which executives are stewards. motivated to act in accordance with the principal's wishes. Stewardship theory describes the relationship between the success of organizational goals with principal satisfaction. Stewards will protect and maximize the benefits that can be obtained by the organization by maximizing organizational performance. According to Kluvers et al. (2011) Stewardship Theory provides a better and richer picture of employee motivation in Not For Profit (NFP) organizations. The ability of stewardship theory, compared to agency theory, to explain staff motivation in NFP (Not-for-Profit) organizations (Puyvelde et al., 2012)

Parties who are motivated by higher orders and intrinsic factors are better suited to be stewards in principal–stewards relationships. Stewardship theory is focused on motivation, identification and use of power in the context of hierarchical relationships (Kluvers et al, 2011). In this study, the Regional Government as a steward is motivated by incentives allocated in the APBN by the Central Government to provide the best basic services for the community as principals. Furthermore, Kluvers et al (2011) stated that the motivational effect of extrinsic rewards - which is considered important in the business sector - is highly irrelevant in NFP organizations.

2.2 The Regional Incentive Fund (DID)

In Article 1 of the Law of the Republic of Indonesia Number 33 of 2004 concerning Financial Balance between the Central Government and Regional Governments, it is stated that the financial balance between the Government and Regional Government is a system of financial distribution that is fair, proportional, democratic, transparent, and efficient in the framework of funding the implementation of Decentralization, taking into account the potential, conditions, and needs of the region, as well as the amount of funding for the implementation of Deconcentration and Co-Administration. Balancing Funds are funds sourced from APBN revenues allocated to regions to fund regional needs in the context of implementing Decentralization. The system of intergovernmental fiscal relations in Indonesia is essentially equity-based. The most important transfer, the General Allocation Fund (DAU), is a fiscal balancing grant, where allocations are made as a positive function of fiscal need and a negative function of local government fiscal capacity. The Special Allocation Fund (DAK) focuses on distributing funds to local governments with few fiscal resources, particularly those that are geographically isolated. However, Indonesian government policymakers, like those in many countries, became dissatisfied with what they saw as a result of weak services emanating from the current intergovernmental system and began experimenting with alternative, performance-based mechanisms (Lewis, 2014).

Regional Incentive Funds (DID) are balancing funds allocated from the APBN by the Central Government to Regional Governments starting from Fiscal Year 2012 which is regulated in the Regulation of the Minister of Finance of the Republic of Indonesia Number 242/PMK.07/2011 concerning General Guidelines and Allocation of Regional Incentive Funds for Fiscal Year 2012 used in the context of implementing the education function allocated to the regions by considering certain criteria. The DID allocation aims to encourage regions to make efforts to manage their finances better, as indicated by the acquisition of the Supreme Audit Agency's opinion on local government financial reports and to encourage regions to always try to stipulate their APBD in a timely manner. In the Regulation of the Minister of Finance of the Republic of Indonesia Number 141/PMK.07/2019 concerning the Management of Regional Incentive Funds, it is stated that DID is part of the Transfer to Regions and Village Funds (TKDD) originating from the State Revenue and Expenditure Budget to certain regions based on certain category criteria. with the aim of awarding the improvement and or achievement of certain performance in the field of regional financial governance, public government services, basic public services, and public welfare. Incentives that are intentionally provided between governments can help boost regional performance in various dimensions, including those related to governance, fiscal, or service outcomes (Lewis, 2014).

Based on PMK No. 50/PMK.07/2017 calculation of DID allocation based on main criteria and performance category. The main criteria consist of: (1) the opinion of the Supreme Audit Agency on the Financial Statements of the Regional Government is Unqualified; (2) timely stipulation of Regional Regulations concerning APBD; (3) implementation of e-government. Performance categories are grouped into: (a) regional financial management; (b) categories of general government services; (c) categories of basic public services; (d) Welfare.

2.2 Depreciation as a Discretionary Accrual

Scott (2003) defines earnings management as a choice made by managers in determining accounting policies to achieve certain goals. Earnings management is a policy of both the selection of accounting policies and real actions or actions that affect earnings chosen by managers in order to achieve specific financial reporting objectives (Scott, 2009). Discretionary accruals is one of the categories in the selection of accounting policies. Discretionary accruals are used to manipulate company profits in the financial statements presented. The application of accrual basis in government accounting ultimately creates discretionary accruals and motivation to practice earning management. According to Pilcher et al, (2010) There are incentives/motives for public sector management to manipulate financial statements. Manipulation is carried out with a target surplus/deficit breakeven or approaching breakeven. Based on the stewardship role, income smoothing is carried out on fixed assets, with a target of breakeven or approaching breakeven. This statement supports the opinion of Stalebrink (2007) that local governments use fixed asset depreciation for discretionary accruals. Furthermore, Stalebrink (2007) argues that Discretionary Accrual is focused on depreciation of fixed assets and write-offs.

Depreciation is an adjustment in value in relation to a decrease in the capacity and benefit of an asset is the definition in Statement of Government Accounting Standards (PSAP) 07. Recording of this depreciation is one of the markers of the application of the accrual basis in Government Accounting Standards (SAP). Depreciation is carried out using various systematic methods according to the useful life. The depreciation methods that can be used include: (1) the straight line method; (2) the double declining balance method; and (3) the unit of production method. Depreciation of property, plant and equipment is not a method of cost allocation for the period that receives the benefits of the property, plant and equipment as applied in the commercial/private sector. Adjustment of value in the government sector is more of an effort to show a reduction in value due to the consumption of potential benefits of assets due to use and or reduction in value due to obsolescence and others. There are several problems in recording depreciation, namely determining the type of asset to be depreciated, the amount that can be depreciated, the method of depreciation and determining the economic useful life. The existence of depreciation allows the government to obtain information about the potential state of its assets.

To be able to achieve the desired profit target, a company uses a policy setting (discretion) on depreciation expense (Marquard and Wiedman, 2004). The expected level of depreciation is obtained by multiplying the depreciation expense of the previous year by the addition of fixed assets other than land (gross property, plant and equipment/gross PPE). The unexpected component is the difference between the actual depreciation and the estimated depreciation. Depreciation expense is assumed to be in constant proportion to the gross value of fixed assets other than land. Both define the unexpected component of depreciation expense in period t as:

$$UDEPj,\ t = [DEPj,\ t – (DEPj,\ t\text{-}1*GPPEj,\ t\ /\ GPPEj,\ t\text{-}1)]\ /Taj,\ t\text{-}1$$

Where :

UDEPj, t	= *unexpected depreciation expense of local government j in year t*
DEPj, t	= *expected local government depreciation expense j in year t*
DEPj, t-1	= *expected local government depreciation expense j in year t-1*
GPPEj, t	= *expected gross value of fixed assets other than local government land j in year t*
GPPEj, t-1	= *expected gross value of fixed assets other than local government land j in year t-1*
TAj, t-1	= *total assets reported by local government j in year t-1*

3. METHODS

This research is a literature review to examine the effect of discretionary accruals on incentives received by local governments. The type of data used in this study is secondary quantitative data, namely data from other parties that have been collected or processed into data for analysis purposes. In accordance with the type of data required, namely secondary data, the method of data collection in this study is to use the literature study method where the theory is obtained from journals and books. This method is used to study and understand the literature that contains discussions related to discretionary accruals, transfers between local governments and incentives received by local governments.

4. DISCUSSION

Previous research (Barefield and Comisky, 1971; Dhaliwal et al., 1980; and Penno and Simon, 1986) proves the use of discretion in accounting for depreciation of fixed assets. Typically, this discretion includes considerations about the useful lives of property, plant and equipment and the choice of depreciation method. Research by Stalebrink (2007), Pilcher and Van der Zahn (2010), Drew and Dollery (2015), and Drew (2017) analyzes whether local/regional governments actively use fixed asset depreciation to regulate financial performance and achieve other targets.

Discretionary Accrual conducted by local governments aims to manipulate the target surplus or deficit that is close to zero. This is motivated by the existence of incentives that will be given if the local government as a steward can satisfy the wishes of the community as the principal. Based on the stewardship role, discretionary accruals are carried out on fixed assets with a target of breakeven or approaching breakeven (Pilcher et al., 2010). This statement supports the thinking of Stalebrink (2007). Nonprofits may not only avoid deficits, they may also benefit from reducing reported surpluses. Most nonprofit organizations benefit from substantial government subsidies (verbruggen et al., 2012). Incentives are the reason why non-profit organizations carry out earnings management (Leone et al., 2005). According to Stalebrink (2007) there are two strategies in discretionary accruals, namely by increasing depreciation and writing off fixed assets systematically when the burden is still accommodated by a surplus and when the deficit is large. The absence of cash transactions is the key to explaining why depreciation can be an instrument for 'income smoothing', and 'income inflation' (Drew and Dollery, 2015).

Previous research by Teoh, et. Al., 1998a and 1998b; Vander Bauwhede and Wilekens, 2002; and Marquardt and Wiedman, 2004 identify depreciation as the use of specific discretionary accruals in managing or manipulating financial performance. In the local government environment, the depreciation account is one of the specific accrual accounts that can be used in managing financial performance. In the private sector, there are other accounts that can be used to manage accruals such as accounts receivable, inventory and accounts payable. However, in local government operations, the application of discretion to these accounts is not as significant as in depreciation of fixed assets. The use of discretion in accounting for depreciation of fixed assets has previously been successfully demonstrated by Barefield and Comisky, 1971; Dhaliwal et. al., 1982; and Penno and Simon, 1986. Typically this discretion includes considerations regarding the useful lives of property, plant and equipment and the choice of depreciation method. The absence of cash transactions is the key to explaining why depreciation can be an instrument for “income smoothing, surplus/deficit inflation or taking a bath” (Drew et al., 2015). The inaccurate calculation of asset depreciation where there is an accumulated depreciation value of fixed assets that exceeds the asset value found by BPK RI is a problem that can be tested to what extent unexpected depreciation in local governments in Sumatra Island and its relationship with the amount of DID obtained from the central government.

5. CONCLUSION

The application of the accrual-based accounting system in Indonesia began in 2015. Based on the literature described, the application of accrual-based accounting is believed to have an opportunity for local governments to make discretionary accruals, especially in depreciation accounts. The application of discretionary accruals is believed to be carried out with the aim of targeting surplus/deficit breakeven or approaching breakeven. The target of surplus/deficit breakeven or approaching breakeven is set with the aim that financial performance and budget management look good so that they can obtain incentives from the central government. This can be seen from the significant increase in DID allocation seen in FY 2016 to FY 2020. Fiscal year 2016 is the second year in applying the accrual basis to government accounting in Indonesia. The Regional Incentive Fund (DID) is an incentive-based funding scheme allocated in the State Revenue and Expenditure Budget (APBN) to certain regions based on certain criteria with the aim of rewarding certain performance improvements in the areas of regional financial governance, basic public services, and welfare. Public. Based on the stewardship role, discretionary accruals are carried out on fixed assets with a target of breakeven or approaching breakeven (Pilcher et al., 2010). This statement supports the thinking of Stalebrink (2007). Nonprofits may not only avoid deficits, they may also benefit from reducing reported surpluses. Most nonprofit organizations benefit from substantial government subsidies (verbruggen et al., 2012). Incentives are the reason why non-profit organizations carry out earnings management (Leone et al., 2005).

There are not many studies that discuss the application of Discretionary Accrual by linking the incentives received in non-profit organizations, especially in Indonesia. Fereira et al. (2013) stated that there are not many earnings management studies conducted by non-profit organizations so that there are still many research opportunities in this area, moreover there is no research related to earnings management in order to obtain subsidies or grants from the government, (Verbruggen et al., 2008). Therefore, research on this topic is still interesting for further study and is still relevant for research. Further research can conduct empirical tests to examine the relationship between discretionary accruals and incentives received by local governments.

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