



Implementation of Discretionary Accrual in Local Governments and Motivation of Local Government Incentives: Literature Review

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Authors' contributions

This work was carried out in collaboration among all authors. All authors read and approved the final manuscript.

Article Information

DOI: 10.9734/AJEBA/2022/v22i2230730

Open Peer Review History:

This journal follows the Advanced Open Peer Review policy. Identity of the Reviewers, Editor(s) and additional Reviewers, peer review comments, different versions of the manuscript, comments of the editors, etc are available here: <https://www.sdiarticle5.com/review-history/91651>

Review Article

Received 05 July 2022
Accepted 14 September 2022
Published 17 September 2022

ABSTRACT

This study is a literature review aimed at exploring the application of discretionary accruals and the motivation of Regional Incentive Funds (DID) received by local governments. 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. Ferreira, Carvalho and Pinho [1] stated that there have not been 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 [2].

Keywords: *Discretionary accrual; local government incentives; DID; depreciation; earning management; nonprofit organization.*

1. INTRODUCTION

The application 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, Kuruppu and Wynne, 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 its changes, how the government finances its activities according to its funding capacity so that the actual government capacity can be measured. With the implementation 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 [3].

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 [4-9]. 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.

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 [8,9]. Incentives can motivate management in public organizations to manipulate financial statements to approach zero deficit/surplus [10]. The results of the study of Ferreira, Carvalho and Pinho, [1] concluded that the target of the management of public organizations in presenting financial statements is with a surplus/deficit close to zero. Furthermore, Ferreira, Carvalho and Pinho, [1] 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, [2]. Therefore, research on this topic is still interesting for further study and is still relevant for research.

**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

2. LITERATURE REVIEW

2.1 Stewardship Theory

Donaldson and Davis [11] state 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 the executives as stewards are motivated to act in accordance with the wishes of the principal. 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 Kluevers and Tippett [12] 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 [13].

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 [12]. 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, Kluevers and Tippett [12] 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 [14-16]. 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 [17].

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 [17].

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.

2.3 Depreciation as a Discretionary Accrual

Scott [18] 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 and Zahn [10] 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 [19] that local governments use fixed asset depreciation for discretionary accruals. Furthermore, Stalebrink [19] 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 [20]. 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:

$$UDEP_{j,t} = [DEP_{j,t} - (DEP_{j,t-1} * GPPE_{j,t} / GPPE_{j,t-1})] / TA_{j,t-1}$$

Where:

$UDEP_{j,t}$ = Unexpected depreciation expense of local government j in year t

$DEP_{j,t}$ = Expected local government depreciation expense j in year t

$DEP_{j,t-1}$ = Expected local government depreciation expense j in year $t-1$

$GPPE_{j,t}$ = Expected gross value of fixed assets other than local government land j in year t

$GPPE_{j,t-1}$ = Expected gross value of fixed assets other than local government land j in year $t-1$

$TA_{j,t-1}$ = Total assets reported by local government j in year $t-1$

3. METHODS

This research is a literature review to examine the application of discretionary accruals to local governments and the motivation of incentives that will be 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

Leone and Horn (2005) examined discretionary accounting adjustments (accruals) and discretionary expenditures for charitable care in 1204 for-profit hospitals (8179 hospital-years) for the period 1990–2002. Using multiple measures of discretionary accruals (adjustments for discretionary income), they find evidence that hospital CEOs (1) manage earnings toward zero, (2) manage earnings to avoid losses, and (3) do not manage earnings to avoid negative earnings changes. Leone and Horn (2005) assume that non-profit hospitals seek to maximize their philanthropic objective function subject to the zero profit constraint. Specifically, they studied the role of revenue in for-profit hospitals and tested whether earnings management occurs in this setting. they found that although for-profit hospitals did not have a profit-making goal, revenue played an important role. A variety of stakeholders including bondholders, the public, regulators and potential donors, as well as the market for CEOs use revenues to evaluate hospital performance. This constituency creates a situation where reporting costs increase in both reported losses and reported profits. As a result, the CEO minimizes reporting costs by managing earnings toward zero after previously managed earnings are observed.

Stalebrink [19] examines whether Swedish cities use accounting measurement discretion associated with discretionary accruals to manage reported financial performance. This examination is based on a multivariate analysis of the relationship between changes in reported write-offs and depreciation expense for 288 Swedish municipalities between fiscal years 2000 and 2004. The findings show support for the hypothesis that (1) Governments tend to increase depreciation and write-off costs in the reporting period when they report surpluses. and reduce it when they report a deficit. (2)

Governments tend to increase depreciation and write-off costs in reporting periods when they report large deficits.

Pilcher and Zahn [10] explore the potential existence of management and manipulation of financial accounting information through discretionary accruals in local government settings. Data were collected from the local government of New South Wales (NSW) with a usable final sample of 410 observational data points spanning three fiscal years (ie, 2003/04, 2004/05 and 2005/06). The findings show that there is a significant relationship between higher capital contributions and higher unexpected depreciation rates. Significant associations were consistent regardless of the direction of unexpected depreciation. Findings suggest that NSW local governments may use unexpected depreciation (both an increase in revenue and a decrease in income) to adjust financial performance to allow for a higher capital contribution.

Martini, Agustin, and Sari [21] analyzed the excess/shortage of the financing budget (SILPA/SIKPA) as the impact of discretionary accruals. Discretionary accruals are proxied by total accruals, changes in income, and plant, property, and equipment (PPE) according to the Modified Jones model. The data used is LHP LKPD Province in Indonesia. Data testing is done by using multiple regression analysis method. The results of this study indicate that the provincial government in Indonesia applies normal discretionary accruals and is in accordance with SAP and laws and regulations. This can be seen from the appropriate relationship pattern for each variable total accruals, changes in income, and PPE to SILPA/SIKPA. The higher the total accruals, the more difficult it is for these accruals to be realized as income, so SILPA will decrease. On the other hand, if the total accrual is low, it means that the accrual is easier to realize as revenue which causes state revenues to increase and even exceed the target, thereby increasing SILPA.

Gamayuni [22] examines whether there is manipulation or management of accounting numbers (abnormal accruals) in Government Financial Reports (LKPD), and what factors cause abnormal accrual practices in Indonesian LKPDs. Observations were made with a sample of the entire population, namely 34 provincial governments for 4 years of observation, so that

there were 136 objects of observation. The findings explain that there is a positive and significant relationship between AA (abnormal accruals) and SD (Surplus/Deficit) on LKPD in Indonesia. The higher AA indicates that local governments tend to manage SD by increasing SD to near zero. With the management of accounting numbers by increasing SD in LKPD in Indonesia, it is close to zero, with the motivation for the benefit of the local government to show better financial performance than the local government. This proves the existence of information asymmetry in local government that supports agency theory. AA that occurs in local governments in Indonesia is positive AA. A positive AA indicates that the local government's financial statements are in deficit (expenditures are greater than revenues), but local governments tend to manage it by increasing it close to zero, which is indicated by an increase in AA. In this case, there is a local government's motivation to set the calculation of the APBD surplus/deficit close to zero. Other empirical evidence from this study shows that the characteristics of AA (management of accounting numbers) in LKPD that occur are caused by managing depreciation costs by reducing depreciation costs. This reduction in depreciation expense aims to increase the deficit so that SD is closer to zero so that local government performance looks more efficient and effective. However, the characteristics of AA or the management of accounting numbers in LKPD in Indonesia are not caused by the significant management of receivables, debts, and leverage.

The studies above support previous research [23-25] which prove 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 [19], Pilcher and Van der Zahn [10], Drew and Dollery [26], 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 [10]. This statement supports the thinking of Stalebrink [19]. Nonprofits may not only avoid deficits, they may also benefit from reducing reported surpluses. Most nonprofit organizations benefit from substantial government subsidies [27]. Incentives are the reason why non-profit organizations carry out earnings management (Leone and Horn, 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' [26].

Previous research by Teoh, et al. [28,28]; Vander Bauwhede and Wilekens, 2002; and Marquardt and Wiedman, [20] 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" [26].

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 [10] this statement supports the thinking of Stalebrink [19]. Nonprofits may not only avoid deficits, they may also benefit from reducing reported surpluses. Most nonprofit organizations benefit from substantial government subsidies [27]. According to (Leone and Horn, 2005) Incentives are the reason why non-profit organizations carry out earnings management, but to prove that local governments make discretionary accruals to get incentives or wider DID allocations, empirical evidence is needed.

There are not many studies that discuss the application of Discretionary Accrual by linking the incentives received by non-profit organizations, especially in Indonesia. Ferreira, Carvalho and Pinho [1] stated that there have not been many earnings management studies conducted by nonprofit 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, [2]. 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.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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Peer-review history:
The peer review history for this paper can be accessed here:
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