

The Effect of Budget Ratcheting on Financial and Non-Financial Performance

Endang Tri Pratiwi*

Department of Accounting, Faculty of Economic
 Universitas Muhammadiyah Buton
 Baubau, Indonesia
 *endang.tripratiwi@umbuton.ac.id

Rudi Abdullah

Department of Management, Faculty of Economic
 Universitas Muhammadiyah Buton
 Baubau, Indonesia

La Ode Dedi Abdullah

Department of Law, Faculty of Law
 Universitas Muhammadiyah Buton
 Baubau, Indonesia

Asrianti Dja'wa

Department of Development Economic, Faculty of
 Economic and Business
 Universitas Halu Oleo
 Baubau, Indonesia

Abstract—Performance-based budgeting on the local government focuses on achieving public sector performance that is not only assessed from its financial aspects such as ratios and budget realization, but also includes non-financial aspects such as the use of performance indicators and assessment of community satisfaction levels. One of them is budget ratcheting. This study aims to determine the effect of the budget ratcheting on the performance of the local government of Baubau City in terms of financial and non-financial aspects. The population was the local government of Baubau City that published financial statements from 2014 to 2016 and sampling method was through judgment sampling, namely the selection of samples with consideration of convenience. Data collection was done through direct observation and nonparticipant observation. This study uses descriptive and inferential analysis. The results indicate that Correlation Coefficient (R) was obtained at 0.871 meaning there is a correlation between budget ratcheting on the performance. It was due to increase in the planned budget and expenditure based on the realization of the costs obtained in the budget and expenditure in the previous period. Thus, the local government performance of Baubau City during 2014 to 2016 from the financial and non-financial sectors showed good conditions.

Keywords: *budget, budget ratcheting, financial performance, non-financial performance*

I. INTRODUCTION

The central government gives authority to the district / city government to explore the potential and financial resources that exist in the region in order to realize financial independence in the administration of government and regional development [1]. Regional development aims to empower the community as a whole, through increasing the capacity of regional governments so as to be able to utilize available resources both from government services, community socio-economic capacity, and natural resources in the region. Local governments strive effectively in achieving these goals through

regional autonomy. Thus local governments can reduce their dependence on aid or subsidies from the central government.

Along with the fluctuating economic, social and political conditions, the implementation of regional autonomy has not yet run optimally. Most districts / cities in Indonesia are still unable to fund the administration of government independently. General Allocation Funds and Special Allocation Funds in several districts / cities are still high, and public services still do not touch all levels of society. This condition shows that the implementation of regional government and regional development still cannot be fully funded by Regional Revenue.

Budgeting is the most important part of government financial management and can be explained from various perspectives, such as politics, economics, finance, and accounting [2,3]. Decisions in budgeting are influenced by many factors, including politics, economics and technology, but the impact of these influences is not known to be factually realized [4]. The annual budget periodization, which is assumed to be the standard time-frame of government budgeting, must be dynamic and flexible in its implementation, without sacrificing control and accountability [5,6]. In the budgeting process, budget changes (re-budgeting) are common things and at the same time an important factor in local government. The local government financial report itself is a form of accountability for the implementation of the budget which contains information about the amount of the budget after the change, its realization for one fiscal year, and the difference between the two, which is called a difference or variances.

Budget Ratcheting is a condition where the annual budget allocation will continue to increase, based on the amount of the budget in the previous year. This condition affects the pattern of government spending, where there is a tendency for government spending to increase each year. Budget ratcheting in the government environment involves ratcheting expenditure

rather than income, and is consistent with inefficiencies. The implications of increasing this expenditure can have positive or negative impacts. The positive impact of increased government spending is improving the performance of services to the community, increasing the procurement of public goods and services, increasing community satisfaction. While the negative impact is waste of budget, and the gap in the occurrence of acts of corruption. This indication of budget waste is contrary to the concept of value for money in managing government budgets that must meet the 3E concept, namely efficient, economical, and effective.

The results of study show that the Ratcheting budget consistently occurs in three expenditure categories, namely operating, instructional and non-instructional spending, and is more dominant in non-instructional expenditure [7]. Although it is found that ratcheting is consistent with inefficient expenditure and self-serving administrator behavior, it cannot be ruled out that some of these effects may be due to inherent costs or administrator confidence that higher levels of spending have high social values.

The performance based budgeting has been applied in Indonesia focusing on achievement of the performance of public sector which is not only assessed on the financial aspect of it like ratios and realization of the budget, but also includes non-financial aspects such as the use of performance indicators and assessment of the level of community satisfaction. Therefore, a performance appraisal system with a more comprehensive basis that includes aspects of financial performance and nonfinancial performance becomes part of an information system that will be useful for decision making. Increased sustainable budgeting (budget ratcheting) is also expected to be accompanied by improved performance. However, not much research has been done regarding ratcheting budgets, especially in Indonesia.

One of the regional governments that tends to do a budget ratcheting is the local government of Baubau City. The formulation of the Regional Revenue and Expenditure Budget of the Baubau City Government is carried out annually through estimation and forecasting of the budget which is reflected in the realization of the previous year's income and expenditure. Therefore, this study entitled "the effect of budget ratcheting on the performance of the Baubau City Regional Government in terms of financial and non-financial aspects".

II. RESEARCH METHOD

A. Population and Sample

Population is a generalization area consisting of objects or subjects that have certain qualities and characteristics set by researchers to be studied and then drawn conclusions [8]. The population in this study was the government of Baubau City that published financial reports from 2014 to 2016.

The sample is part of the number of characteristics possessed by the population. The sample is the Baubau City Government financial report obtained through judgment sampling method, namely the selection of samples with consideration of convenience. The sample criteria are: (1) Local governments that present reports on budget realization

from 2014 to 2016; (2) Presenting information about income and shopping in full; and (3) The budget of the Local Government of the City of Baubau which has experienced an increase in sustainable budgets (budget ratcheting).

B. The Data Collection and Analysis

The data collection is done through direct observation and nonparticipant observation. Direct observation was carried out by survey directly to the research location. The technique of collecting data by survey was conducted by researchers with interviews and questionnaires. Whereas non-participant observation is done through observing notes, documents and some literature related to research. Data collection is also carried out through library research, documentation and published journals and other reports that support this research.

The data analysis technique used in this study consisted of descriptive analysis and inferential analysis. Inferential analysis techniques in this study were carried out with the help of SPSS version 20 software. Testing of hypotheses one and two uses simple regression analysis. The simple regression analysis formula is as follows:

$$Y_{KF} = \alpha_0 + \beta_1 BR + \epsilon_1 \quad (1)$$

$$Y_{KNF} = \alpha_0 + \beta_2 BR + \epsilon_2 \quad (2)$$

Note:

BR = Budget Ratcheting/ Independent Variable

KF = Financial Performance/ Dependent Variable

KNF = Non-Financial Performance/ Dependent Variable

β_1, β_2 = Coefficient Value β

ϵ_1 = Matters not identified in equation 1

ϵ_2 = Matters not identified in equation 2

III. RESULTS AND DISCUSSION

Budget ratcheting is an increase in the budget for income and expenditure this year compared to the budget for income and expenditure in the previous year. Variable measurement is carried out by comparing the current budget of income and expenditure with the previous year. While measurements on financial and non-financial performance were carried out on each measurement and simple regression analysis was carried out.

A. The Effect of Budget Ratcheting on Financial Performance

The measurement of financial performance is done by measuring the value of the Regional Independence Ratio, PAD Effectiveness Ratio, Activity Ratio, Expenditure Management Ratio, and Growth Ratio as well as simple linear regression analysis. The following are the calculation results for each financial performance ratio in Table 1.

TABLE I. CALCULATION RESULTS OF FINANCIAL PERFORMANCE RATIOS

RATIO	2014	2015	2016
Regional Independence Ratio	99.85	99.24	100.00
PAD Effectiveness Ratio	115.89	115.75	116.21
Operating Expenditure Activity Ratio	72.26	68.46	69.28
Capital Expenditure Activity Ratio	16.80	31.72	34.52
Expenditure Management Ratio	112.29	99.82	96.34
PAD Growth Ratio	55.46	4.58	20.55
Revenue Growth Ratio	8.84	15.21	8.01
Operational Expenditure Growth Ratio	16.06	9.15	9.30
Capital Expenditure Growth Ratio	(17.67)	117.56	17.55

Source: Data processed, 2019

Table 1 shows the ratios that measure financial performance on the Budget Realization Report Baubau City Government for Fiscal Year 2014-2016 are at the high criteria (for Regional Independence Ratio) and effective (for PAD effectiveness ratio), while the ratio of the activity, the ratio of expenditure management and the growth ratio there is no standard criterion that states the good or bad ratio. Therefore, the three ratios are expressed tend to fluctuate on the Budget Realization Report Baubau City Government for Fiscal Year 2014-2016. Furthermore, the regression test on the value of each of these ratios to see a ratcheting effect on the performance of financial budget. The following are the results of a simple linear regression analysis in table 2.

TABLE II. THE RESULTS OF SIMPLE REGRESSION ANALYSIS ON THE EFFECT OF BUDGET RATCHETING ON FINANCIAL PERFORMANCE (REGIONAL INDEPENDENCE RATIO)

Model	Unstandardized Coefficients		t	Sig.	R	R ²	F	Sig.
	Beta	Std. Error						
A		0.65	172.35	0.00	1.00	1.00	330.39	0.04
BR	-10.62	0.58	-18.18	0.04				
table	12.71							

Source: Data processed, 2019

Table 2 shows budget ratcheting has an effect on financial performance in the aspect of regional independence ratio can be seen from the significance value of a, namely sig = 0.035

<0.05. This proves that budget ratcheting has a negative and significant effect on financial performance.

TABLE III. THE RESULTS OF SIMPLE REGRESSION ANALYSIS ON THE EFFECT OF BUDGET RATCHETING ON FINANCIAL PERFORMANCE (REVENUE GROWTH RATIO)

Model	Unstandardized Coefficients		t	Sig.	R	R ²	F	Sig.
	Beta	Std. Error						
A	-104.42	3.10	-33.69	0.02	1.00	1.00	1380.42	0.02
BR	104.01	2.80	37.15	0.02				
table	12.71							

Source: Data processed, 2019

Table 3 shows budget ratcheting has an effect on financial performance on the aspect of revenue growth ratio can be seen from the significance value of a, namely sig = 0.017 <0.05. This proves that shows budget ratcheting has a positive and significant influence on financial performance. Therefore, it can be concluded that the Ratcheting budget has an effect on financial performance both positively and negatively only on the regional independence ratio and revenue growth ratio.

95% confidence level, then the instrument (questionnaire) is declared valid. All indicator items that measure each indicator variable produce a number of validity coefficients that are more than 0.3 ($r > 0.3$). Thus it can be stated that the data collection instruments used in this study are valid.

B. The Effect of Budget Ratcheting on Non-Financial Performance

The measurement of non-financial performance is done through tabulation of questionnaires with several indicators, namely tangible evidence, reliability, responsiveness, certainty, and empathy, and simple linear regression analysis is also carried out. Validity test is done by using Pearson product moment statistical method with criteria if r is obtained >0.30 at

Instrument reliability test at a trust rate of 95% ($\alpha = 0.05$) shows that all indicator items used to measure each indicator variable have a number of coefficients greater than 0.60. Therefore, the instruments used in collecting data can be declared reliable at a trust rate of 95% or $\alpha = 0.05$. Simple linear regression analysis through SPSS version 20 software about the effect of Budget Ratcheting on non-financial performance results obtained are presented in the following table 4:

TABLE IV. TABLE 4. RESULTS OF SIMPLE LINEAR REGRESSION ANALYSIS

	Regression Coefficient (β)	Standard Error	t Calculate (Stat)	Significant t	R Correlation
Y	0.725	2.114	2.521	0,000	0,699
Constant = 5.123 Adjusted R Square = 0,701 R Square = 0,642					

Source: Data processed, 2019

Table 4 shows a simple linear regression equation for the effect of the budget ratcheting on non-financial performance is:

$$Y = 5.125 + 0.725 X$$

The equation can be interpreted as follows:

- The value of the correlation coefficient (R) of 0.699 can be interpreted that the correlation of the relationship between the independent variable Budget Ratcheting (X) on non-financial performance (Y) is positive.
- The coefficient of determination (R²) of 0.642 can be interpreted that 64.2% of the variation in the increase in budget ratcheting is influenced by nonfinancial performance and the remaining 35.8% is influenced by other variables outside the model, so it can be concluded that budget ratcheting has a large contribution to performance non-financial.

The results of inferential analysis indicate that budget ratcheting has an effect on non-financial performance can be seen from the significance value of t on a simple regression analysis, namely sig t = 0.00 < α = 0.05. This proves that budget ratcheting has a positive and significant influence on non-financial performance. Therefore, efforts to use budget ratcheting are very much needed in order to improve non-financial performance in the Baubau City government. The magnitude of the influence of budget ratcheting on non-financial performance can be seen in the regression coefficient of 0.725. This shows that if there is a change in the budget ratcheting dimension of 1 unit, it will cause a change to non-financial performance of 72.5%. Based on the description above, it will apply if it is assumed that the other independent variables in this study are considered to be permanent.

C. The Effect of Budget Ratcheting on Financial and Non-Financial Performance of the Local Government Baubau City

Ratcheting occurs when overspending the previous year (actual expenditure exceeds budgeted) leads to a greater absolute change in current year's expenditure budgeted in the government. Budget ratcheting in the government environment involves ratcheting expenditure rather than income, and is consistent with inefficiencies. Ideally, the government must provide services that people want at the lowest cost (economic concept).

If the administrator increases budgeted expenditures to justify a larger tax income, then the budget expenditure will exceed the actual expenditure (under spending). But it should

be noted that the decision of administrators to increase government spending can be caused because they generally believe that the increase can better meet the interests of the community, and not only for selfish motives.

A model in economic planning by using current period performance as a partial basis for setting the next period target [9]. This trend is referred to as the "ratchet principle" of economic planning. If in government agencies, performance is measured by using expenditures needed to achieve goods and services at a certain level, and lower expenditure is considered to represent better performance. Local governments have flexibility over budgets, including in increasing budgets that include income and expenditure. The increase in the budget itself cannot be separated from the positive and negative impacts, and the most important thing is the management of this budget will affect the performance of the relevant government agencies. The performance of the public sector itself consists of financial performance and non-financial performance.

The financial performance of Baubau City Government, measured through five ratios, namely the regional independence ratio, PAD Effectiveness Ratio, Activity Ratio, Expenditure Management Ratio, and Growth Ratio shows that there are only two ratios affected by the ratcheting budget, namely the regional independence ratio and revenue growth ratio. The regional independence ratio illustrates the regional dependence on external funding sources. The higher the regional independence ratio means that the level of regional dependence on external assistance (especially the central and provincial governments) is getting lower, and vice versa. The regional independence ratio also illustrates the level of community participation in paying taxes and retributions that are increasingly high in community welfare areas [10]. While the Income Growth Ratio measures how much the ability of the local government to maintain and increase the income achieved from the period to the next period. By knowing the growth for each component of the source of income, it can be used to evaluate which potentials need attention from the Baubau City Government.

The Baubau City Government's non-financial performance measured through five statement items, namely tangible evidence, reliability, responsiveness, certainty, and empathy, shows that physical facilities, facilities and infrastructure, information and communication and the availability of access provided by local governments have a high response, certainty of information, and satisfaction with community service.

Therefore, budget ratcheting will lead to increased non-financial performance in the Baubau City local government.

IV. CONCLUSION

Based on the results and discussion of the research that has been described, it can be concluded that Budget Ratcheting will have an impact on efforts to improve Financial Performance in terms of increasing regional independence and income growth and non-financial performance covering aspects of perceptions of service users or the public in the government of Baubau City.

The financial performance of the Baubau City Government in the 2014-2016 fiscal year is still lacking or needs to be addressed, namely the ratio of capital expenditure activities, the ratio of PAD growth, and the Capital Expenditure Growth ratio. The three ratios also had an impact on the realization of the budget in the regional government of the Baubau city.

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