

IMPACT OF EARNINGS MANAGEMENT IN MODERATING THE INFLUENCE OF INTELLECTUAL CAPITAL ON THE QUALITY OF REGIONAL GOVERNMENT FINANCIAL REPORTS

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Abstract

The quality of Local Government Financial Reports (LKPD) in Indonesia can be measured by assessing the suitability of the application of Government Accounting Standards and the results of the State Independent Auditor, namely the Supreme Audit Agency (BPK) in the form of the best opinion called Unqualified. (WTP). Although since 2015 the local government's target to achieve WTP opinion has reached 485 out of a total of 542 (89.5%) provincial/district/city governments throughout Indonesia, this increase has not been able to reduce the number of non-compliance with Government Accounting. . Standards and potential misappropriation of state finances. This study aims to examine whether there is an effect of applying Intellectual Capital in presenting quality Local Government Financial Reports and trying to include Revenue Management as a moderating variable. The results of this study are expected to open the interest of researchers to develop Intellectual Capital in the local government sector to the information search stage. The study used a survey method by distributing questionnaires to officials from the Financial Management Agency with the positions of administrator, supervisor and general functional analysis in provincial, district and city governments in South Sumatra and Lampung. Data analysis using Structural Equation Modeling (SEM) through Partial Least Square (PLS) approach.

Keywords: Public Sector Accounting, Local Government, Intellectual Capital, Earning Management, Quality of Local Government Financial Reports, Indonesia.

INTRODUCTION

The change in government authority in Indonesia from a centralized to a decentralized system has resulted in a change in the delegation of authority for the management of Central Government affairs to Regional Governments. As a public sector organization, local government also has the main goal of improving *social welfare*, so that in this change they are given full authority to directly manage resources or the economy in their territory to achieve these goals. For this reason, the Regional Government receiving the delegation is strongly required to implement *good governance* and *clean government*. Good governance is a way of managing the state and administering government that meets the characteristics of *transparency, responsiveness, consensus orientation, equity, efficiency and effectiveness, and accountability*. (Mardiasmo, 2006; UNDP, 1997)

The Central Government also seeks to maintain *good government governance* and *clean government* through Undang-Undang Number 17 of 2003 concerning State Finances and Undang-Undang Number 32 of 2004 concerning Regional Government, which emphasizes that efforts to achieve transparency and accountability in government management, both the central government and local government is to submit an accountability report in the form of a Regional Government Financial Report (LKPD). Government Regulation Number 71 of 2010 also states that the quality of financial statements must meet 4 (four) normative prerequisites of qualitative character required so that government financial reports can meet the desired quality, namely relevant, reliable, comparable, and understandable. Several studies related to SAP also state that the application of accrual-based accounting has a positive effect on the quality of regional financial reports. (Agustus & Razak, 2017; Ayu & Kusumawati, 2020; Eveline, 2017; Jati, 2019; Rahman & Permatasari, 2021; Tawaqal & Suparno, 2017)

After the end of the fiscal year, LKPD must be examined by an Independent State Auditor, namely the Indonesian Supreme Audit Agency (BPK RI). In the Regulation of the Financial Audit Agency of the Republic of Indonesia Number 01 of 2007 concerning Financial Audit Standards, it is stated that the Regional Government Financial Reports (LKPD) must be audited with the aim of providing *reasonable assurance* whether the financial statements are presented fairly, in all respects. material in accordance with generally accepted accounting principles in Indonesia or a comprehensive accounting basis other than generally accepted accounting principles in Indonesia. BPK will provide 4 (four) types of opinions on the results of the audit conducted, Unqualified (WTP) is the best opinion on the audited Regional Government

Financial Statements (LKPD), this means that materially the contents of the financial statements have been presented and disclosed fairly and quality in accordance with applicable regulations. (BPK Regulation 2007).

The seriousness and strong desire of the Central Government to realize and ensure the success of decentralization is none other than to accelerate the achievement of the country's goals, namely social welfare for the community and also to ensure transparent and accountable use of resources and finance through quality LKPD, then in the State Medium Term Development Plan (RPJMN) in 2015-2019 one of which is to determine the achievement of WTP opinion by BPK RI to all Provincial Governments, 29 out of 34 (85%); District Government, 249 out of 415 (60%); and the City Government, 61 of 93 (65%) in 2019.

The government's efforts to exceed the target of the 2015-2019 RPJMN, in the 2019 LKPD Examination Results Report (IHPS I, 2020), it is known that local governments receiving WTP opinions have increased, from the original only 58% in 2015 to 90% in 2019. The results of the BPK examination of 541 LKPDs in 2019, issued a Unqualified Opinion (WTP) on 485 (90%) LKPD, a Qualified Opinion (WDP) on 50 (9%) LKPD, and Disclaimer of Opinion (TMP) on 6 (1%) LKPD.

However, in line with the success in increasing the opinion of the BPK, which should have been able to meet the qualitative characteristics, it turns out that this is not the case. In the 2019 Regional Government Financial Report (LKPD) which received WTP and WDP opinions, there were still 6,160 findings containing 10,499 problems consisting of 5,175 SPI problems and 5,324 non-compliance with statutory provisions amounting to Rp. 1.52 trillion.

The government has also stipulated Government Regulation number 60 of 2008 concerning the Government Internal Control System (SPIP) which states that the Internal Control System is an integral process for actions and activities carried out continuously by the leadership and all employees to provide adequate confidence in the achievement of organizational goals. through effective and efficient activities, reliability of financial reporting, safeguarding state assets, and compliance with laws and regulations.

The author assumes that SPI problems and non-compliance problems are basically based on human resources who are suspected of not having a good understanding and knowledge (*intellectual*). Human resources as financial managers are required to have an adequate level of understanding and accounting expertise or at least have the ability to continue to learn and hone skills in the field of accounting. (Eveline, 2017; Rohmah et al., 2020; Wungow et al., 2016)

Intellectual capital or intellectual capital is often used as an organizational measurement tool, one of the reasons is because in determining organizational performance, *intellectual capital* does not only focus on financial measurements but considers non-financial measurements, such as *ability human resources, organizational work support, as well as good and effective communication*. Intellectual capital represents a valuable resource and the ability to act based on knowledge (Steward, 2010). Public organizations tend to have many goals of a non-financial nature (Ramírez, 2010). moreover, the public sector is always human capital intensive in its production process (Serrano Cinca et al., 2003) and in the end, public sector organizations focus on intangible results (Wall, 2005).

Intellectual Capital or intellectual capital is widely studied in the context of the private sector (Kong, 2010) but with the emergence of a new management paradigm in public sector organizations (Hood, 1995) and the special characteristics of the public sector, it began to trigger research initiatives to investigate *Intellectual Capital* in the context of the public sector. The new public management (NPM) provides a theoretical rationale for *intellectual capital*, as a private sector-oriented metaphor, to be applied as a new conceptual framework for public strategic management (Kong, 2007; Kong & Prior, 2008; Kong & Thomson, 2006). Some researchers *intellectual Capital* in the public sector, also shows the results of research that intellectual capital has a positive effect on the productivity of local government officials (Agustus & Razak, 2017; Cohen et al., 2019; Pellicer et al., 2016), if the intellectual capital increases, Employee productivity also increases and vice versa if intellectual capital decreases, productivity also decreases. (Indrawati & Sembiring, 2019)

In addition to the factor of *Intellectual Capital*, especially Human Resources in this case the apparatus, the author also assumes that in financial management that has implemented SAP based on accrual accounting, the government is very likely to carry out (*earnings management*) for certain purposes. As a community agent, the government wants to be seen as performing well in managing resources and the management is good, so to realize this desire, it is suspected that local governments can manipulate financial reports.

The term profit is not known in the government sector but in theory profit is management related to income and costs, where the government also manages income and expenditure, so that in this study the

term profit will be seen in the value of the Over/Less of Budget Financing (SiLPA/SiKPA), Surplus/(Deficit).

Several researchers have conducted empirical tests on *earnings management* in the public sector, providing findings that local governments are involved in earnings management. In some foreign countries, the main factor is the election cycle, earnings management seems to be more likely to be carried out when regional heads are re-elected than when they are elected for the first time. (Cohen et al., 2019) while (Pellicer et al., 2016) find that there is no clear trend between the increase and decrease in income. Local governments use accounting practices to achieve "(surplus) / deficit" for the current year close to zero.

Based on the above background, this study tries to find empirical evidence about the effect of the application of *Intellectual capital* on the quality of financial reports where *earnings management* is used as a moderator. This study is expected to provide new contributions related to the implementation of *Intellectual capital* and *Earning Management* in local governments

LITERATURE REVIEW

Based on *agency theory*, the government as an *agent* has an obligation to provide *accountability* for all activities and activities that are its responsibility to the *principal* who has the right to demand accountability (Mardiasmo, 2009).

In public sector organizations, the benefits provided to society are mostly built by their intangible assets (Del Bello 2006), so that intangible assets will be the main source of competitive advantage for public sector organizations, becoming the main source of competitive advantage for public sector organizations. Included in these intangible assets are skills, competencies, procedures, and information systems, which will ultimately result in public welfare, quality of life, as well as protection for the environment and reputation of an area (Indriasari & Nahartyo, 2008). Accountability of the government's performance in implementing programs and activities whose purpose is to account for the success and failure of public services, apart from being measured in monetary terms, non-monetary measurements of are also carried out *output* and *outcome*.

In the government sector, especially in Indonesia, the performance of financial management is often associated with the size of the remaining budget spending close to zero, meaning that government management has performed well in manage the absorption of the budget that has been agreed and determined at the beginning of the year by the government (executive) and the people's representative council (legislative). If there is still a budget that has not been spent (remaining), the government is considered not to have carried out its program of activities in serving the community. For this, the government seeks to regulate the absorption of the value of spending so that the remaining value of the budget can be close to zero. A politician and government bureaucrat pursue their own goals and act according to their preferences, i.e. they have rational behavior (Muller, 1997). Public sector management is facing increasing pressure from various stakeholder groups (eg, elected officials, media, public, special interest groups) to satisfactorily account for the use of funds received and assets under management (Pilcher & Van Der Zahn, 2010).

Management actions in regulating certain profit/income/income figures from the results of management behavior in manipulating the number of numbers in account items in the financial statements with the aim of providing a desired financial information or to achieve a performance achievement in budget management by manipulating the size of the percentage of the number required. desired. This behavior can be considered reasonable if management takes advantage of the authority in determining the choice of accounting policies that are in accordance with their activities or business character from all the rules set out in generally accepted Accounting Standards. This action became a discussion that gave rise to two thoughts, where some thought that this behavior was management's creativity in choosing and setting accounting policies. Meanwhile, others think this is management fraud because it intentionally manipulates the number of numbers to achieve certain goals by setting accounting policies. The two behaviors that are considered contradictory can be carried out by management after he studies and understands all the regulations contained in generally accepted Accounting Standards. Local governments are not for profit; they seek to provide services to citizens by maintaining a reasonable balance between expenses and income. Consequently, in this context the appropriate term is "accounting numbers management" rather than earnings management (Pellicer et al., 2016).

Entwistle and Phillips (2003) suggest that earnings quality should be in accordance with the core objective of financial reporting which is to provide relevance and reliability for users of financial

statements. Dechow (1994) asserts that profit is very important for various stakeholders because it provides company information.

According to Jones (2010: 4), *earnings management* is a condition in which managers manage accounts in the financial reporting process to achieve certain goals. While Scott in (Cohen et al., 2019) "*Earnings management is the choice by a manager of accounting policies, or actions affecting earnings, so as to achieve some specific reported earnings objective.*"

Intellectual capital

Intellectual capital is defined as intellectual material knowledge, information, intellectual property, and experience that can be used to create wealth (Stewart, 1997). *The International Federation of Accountants* (IFAC) classifies intellectual capital into three categories, namely: *human capital, Structural Capital or Organizational Capital and Relational Capital or Customer Capital* (Sawarjuwono & Kadir, 2003). (Bossi, 2003) proposes a public sector intellectual capital model by emphasizing five perspectives, namely *human resources, internal processes, external relations, transparency, and quality.*

Quality of Financial Reports

In providing quality information, financial reports must be able to provide accountable and transparent information, and as an endogenous variable quality will be measured referring to Government Accounting Standards (SAP) stipulated in Government Regulation Number 71 of 2010, which is Relevant, Reliable, Understandable and Accountable.

Earnings management

In Jones (2010: 4), *earnings management* is a condition in which managers manage accounts in the financial reporting process to achieve certain goals. Than Scott in (Cohen et al., 2019) "*Earnings management is the choice by a manager of accounting policies, or actions affecting earnings, so as to achieve some specific reported earnings objective.*"

The intellectual ability of the apparatus is needed in compiling quality information from the planning process to reporting, for that intellectual *capital* in the public sector plays an important role for public sector organizations to present information to the public (*principals*) so that they can know the value of economic resources used to carry out activities. government operations (*agent*), evaluate the effectiveness and efficiency of a reporting entity, and help determine its compliance with laws and regulations (Del Bello, 2006).

H₁ = Intellectual Capital (IC) has a positive and significant effect on the Quality of Government Financial Reports (FRQ)

To date, several articles have been interested in examining earnings management in the public sector and the results of their research on earnings management in non-profit organizations; research on local government (Ferreira et al., 2013; Pellicer et al., 2016; Stalebrink, 2007); research on National Health Service hospitals and trusts (Leone and Van Horn, 2005; Ballantine et al., 2007 and 2008), and charitable organizations (Trussel, 2003; Jones and Roberts, 2006; Verbruggen and Christiaens, 2012). According to (Ferreira et al., 2013) in Portuguese local government, politicians are motivated to use earnings management in reporting positive but near-zero earnings.

H₂ = Earning Management (EM) has a positive and significant effect on the Quality of Government Financial Reports (FRQ)

Moitahedi (2013) in his research found that Intellectual Capital/IC has a positive correlation with earnings quality which is proxied by accrual earnings management. Galdipour et al, (2014) in their research found that Intellectual Capital/IC has a significant positive correlation with earnings management, where the proxy used for earnings management is accrual earnings management. Darabi et al (2012) about the significant role of IC on Earnings Quality (*Discretionary accruals*).

H₃ = Earning Management (EM) can have a positive influence in moderating the relationship between Intellectual Capital and the Quality of Government Financial Statements (FRQ).

RESEARCH METHOD

Population and Sample

This research is a quantitative study using an approach *explanatory research* to explain research phenomena and test hypotheses.

The population of this study is the state civil apparatus in the Financial Management Agency in each provincial, district and municipal government in South Sumatra and Lampung, Indonesia, as many as 215 people. Sampling used *purposive sampling* with certain criteria so as to produce 136 officers as respondents.

Data collection technique

Data collection techniques by distributing questionnaires using questions and answer choices are weighted or scored on a Likert scale, namely Strongly Agree (SS) score 5, Agree (S) score 4, Doubtful (RR) score 3, Agree (S) score 2, and Strongly Disagree (STS) score 1. Data analysis in this study used *Structural Equation Modeling (SEM)* using *Smart Partial Least Square (PLS)*.

Analysis Method

Data analysis techniques in this study used the Structural Equation Model based on variance or component, namely Partial Least Square (PLS). SEM analysis with PLS, has two components of a structural equation model with latent construction, namely the measurement model or often called the *outer model* and the structural model or often called the *inner model*. PLS SEM only allows recursive relationships in the structural model (i.e., no causal loops) (Hair et al., 2011).

Because the indicators that make up the latent variables in this study are reflexive, then in the evaluation of the measurement model (*outer model*), the measurement of validity and reliability uses *convergent validity*, *discriminant validity*, and *composite reliability*. For the evaluation of the structural model (*Inner Model*), measurements were carried out to evaluate the level of accuracy of the model in the research as a whole, which was formed through several variables along with their indicators (Hair et al., 2011).

Operational Variables

1. **Dependent variable:** *Intellectual capital*
2. **Independent variables:** *Quality of Financial Reports*
3. **Moderating variables:** *Earnings management*

RESULTS AND DISCUSSION

The respondents in this study were high-ranking officials, middle-level officials (administrators), lower-level officials (supervisors), and functional analysts at the Financial Management Agency in every provincial, district, and municipal government in South Sumatra, and Lampung, Indonesia. . The results obtained from questionnaires distributed through social media networks (online), obtained 121 answers from the 136 officers expected answers (sample) or 89%. From the 121 answers obtained, after analyzing the validity, 116 answers were obtained which could be processed. According to (Hair et al., 2011) recommends a minimum sample size ranging from 100 to 150, meaning that the sample value can meet the minimum requirements in the test.

Evaluation of the Measurement Model (Outer Model).

The measurement model (*outer model*) is a process of evaluating the relationship between the construct and the indicators that make it up. This evaluation was carried out in two stages, namely evaluation of *Convergent Validity* and *Discriminant Validity*.

a. Convergent Validity Evaluation Stage

An indicator is said to be valid, it can be seen from the *Loading Factor* (LF) value, it is said to be valid if the indicator value is 0.7. In the stage of examining *cross loading* the indicators of latent variables in the three constructs in this study, the value was found to be *loading factor* more than (above) 0.7, this means that all exogenous, endogenous and moderating constructs have validity and reliability. (see table 1).

Table 1. Loading Factor test Convergent Validity

	Earnings Management	Financial Report Quality	Intellectual Capital
EM1	0,881		
EM2	0,841		
EM3	0,866		
EM4	0,826		
EM5	0,854		
EM6	0,847		
EM7	0,845		
FRQ1		0,780	
FRQ2		0,735	
FRQ3		0,753	
FRQ4		0,799	
FRQ5		0,816	
FRQ6		0,829	
FRQ7		0,851	
FRQ8		0,850	
FRQ9		0,823	
IC1			0,792
IC2			0,821
IC3			0,806
IC4			0,798
IC5			0,799
IC6			0,782
IC7			0,814
IC8			0,814
IC9			0,780

Source: Smart PLS 3.2 . output

The next stage of examination in *convergent validity* is to see the value of *Cronbach's alpha* and *composite reliability*, the results obtained are as follows:

Table 2. Reality Construct test Convergent Validity

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Earning Management	0,937	0,945	0,949	0,725
Financial Report Quality	0,934	0,944	0,943	0,648
Intellectual Capital	0,931	0,949	0,941	0,641

Source: Smart PLS 3.2 . output

values *Cronbach's Alpha* and *Composite Reliability* (Table 2) show that all exogenous, endogenous, and moderating constructs are very reliable. The validity status can also be seen from the *average variance extracted* (AVE) results. The construct is said to have good validity and is required to have an AVE value > 0.50 (Hair et al., 2014). Based on Table.2, we can see the results show the AVE value > 0.50.

b. Discriminant Validity Evaluation Stage

In testing *Discriminant Validity*, it is seen from the root value of AVE and then compares it with the relationship/correlation between constructs.

Table 3. Comparison of the AVE value with the AVE root

	AVE	AVE' Root
Earning Management	0,725	0,852
Financial Report Quality	0,648	0,805
Intellectual Capital	0,641	0,801

Source: Smart PLS 3.2 . output

From Table 3, it is known that the AVE root value is higher than the relationship/correlation between constructs, meaning that the *discriminant validity* of the construct values is said to be good.

c. Evaluation Phase Composite Reliability

Evaluate *Composite Reliability* is a measurement of the reliability of inter-block process indicators in the research model. If *composite reliability* and *Cronbach's alpha* have a value of > 0.70, then the measurement results can be said to be reliable.

Table 4. Value of Composite Reliability Indicator Block

	Composite Reliability
Earning Management	0,949
Financial Report Quality	0,943
Intellectual Capital	0,941

Source: Smart PLS 3.2 . output

Structural Model Evaluation (Inner Model).

Analysis at the evaluation stage of the structural model (*Inner Model*), will see the significance of the relationship between constructs from the *t-statistical value*. While the influence between constructs and the impact of interaction (moderation) is measured by the *path coefficient value*, namely the *Path coefficient* has a value *t-statistic 1.96* (can be rounded up to 2.00) or has a **P Value** 0.05 can be stated to have a significant relationship.

Table 5. R Square (R2)

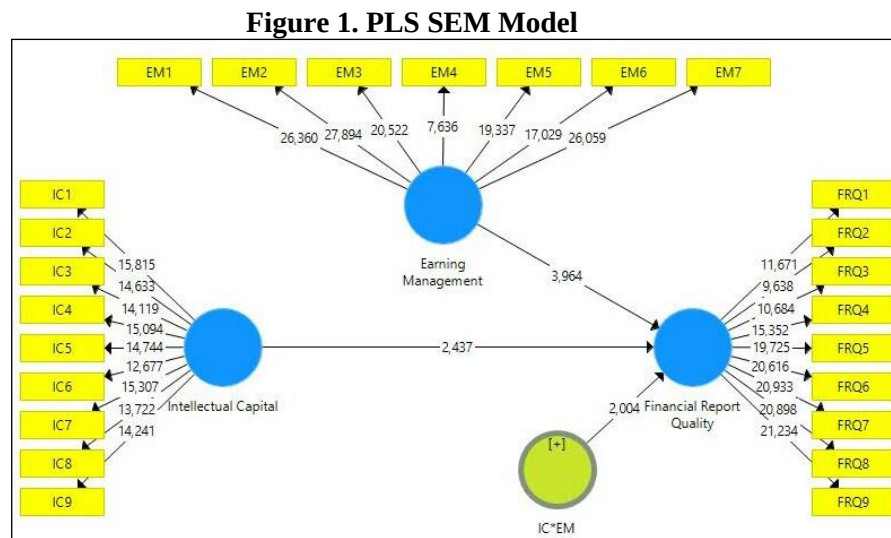
	R Square	R Square Adjusted
Financial Report Quality	0,169	0,147

Source: Smart PLS 3.2 . output

Table 5 shows the R-Square has a value of 0.169 for the variable Financial Report Quality, this means that the variable Financial Report Quality can be explained by variables *Intellectual Capital* and *Earnings Management* of 16.9%, while 83, 1% is explained by other variables not examined in this study.

Hypothesis

Testing the hypothesis is done to see the significance of the effect between exogenous and endogenous variables through the values contained in the output *path coefficients*. The significance of the relationship between these variables will be seen from the parameter coefficient values and t-statistical values. In smart PLS, the *bootstrapped sample* is (Hair et al., 2014).testing *Bootstraps* also intended to minimize the problem of abnormal research data. Figure 1. Shows the tested model and Table 6 shows the *estimated output* for the coefficient test of the structural model.



Source: Smart PLS 3.2 . output

Table 6. Path coefficient values

	Original Sample (O)	Sample Mean (M)	Standard Deviation	T Statistics	P Values	Result
Earning Management -> Financial Report Quality	0,341	0,353	0,086	3,964	0,000	accepted
IC*EM -> Financial Report Quality	0,152	0,150	0,076	2,004	0,046	accepted
Intellectual Capital -> Financial Report Quality	0,171	0,201	0,070	2,437	0,015	accepted

Source: Smart PLS 3.2 . output

Table 6 shows that the influence of *Intellectual Capital* on *Financial Report Quality* is positive 0.171 and significant (P-Values = 0.015 < 0.05), meaning that the higher the value of *Intellectual Capital*, the value. *Financial Report Quality* will increase (quality) and this effect is significant, this is also strengthened by the T-Statistic value (2.437) which is greater than T-Table (1.96), meaning that the relationship (correlation) of these two variables has a positive and significant effect on improve the Quality of Financial Reports (FRQ).

Furthermore, *Earning Management* on *Financial Report Quality* has a positive and significant effect of 0.341 (P-Values = 0.000 < 0.05), meaning that the more *Earning Management* value increases, the *Financial Report Quality* value will increase (quality) and significantly.

Result

From the results of the statistical calculation of the path above, support (receive) Hypothesis 1 (H_1), the Intellectual Capital (IC) has a positive effect on the Quality of Government Financial Report (FRQ).

Then, those calculations can also provide statistical results, which support (receive) Hypothesis 2 (H_2), is *Earning Management* (EM) positive and significant impact on the Quality of Financial Statements (FRQ), and *Earning Management* (EM) as moderation can strengthen the relationship between *Intellectual Capital* and *Financial Report Quality* of positive 0.152 and significant ($P\text{-Values} = 0.046 < 0.05$). Thus, Hypothesis 3 (H_3) can be supported (accepted).

Discussion

From the test results above, it can be concluded that partially exogenous *Intellectual Capital* and *Earning Management* variables affect the endogenous variables of Financial Report Quality, so that the determined hypothesis can be accepted because it is supported by the test results.

Against *Earning Management* as a moderating variable, provide positive support to the relationship *Intellectual Capital* with Quality of Financial Statements. This illustrates that, in local governments it is possible to out *carry earnings management* with different names because the government does not recognize the existence of profit but is often equated with the management of accounting numbers in determining the format of financial statements with a specific purpose. (Cohen et al., 2019; Ferreira et al., 2013; Pellicer et al., 2016). Although there are many debates that state *Earning Management* as creative accounting that is carried out to manipulate Financial Statements for certain motivations, some researchers also state *Earning Management* as a positive effort to provide a good figure from the company to investors and interested parties. According to agency theory, as a mandate holder, it is very reasonable if he/she applies to provide proof of good performance in managing those under his/her authority (Ferreira et al., 2013; Pellicer et al., 2016; Pilcher & Van Der Zahn, 2010; Stalebrink, 2007).

The three hypotheses can be accepted because they are supported by statistical test data on respondents' answers, where the correlation value is seen from the numbers generated in the P-Values and T-Tables compared to T-Statistics. In the first hypothesis, namely Intellectual Capital (IC) has a positive and significant effect on the Quality of Government Financial Reports (FRQ), this condition is in accordance with the results of several researchers who state that the Quality of Financial Reports, especially in government, is strongly influenced by *Human Capital* as an actor from the planning stage to reporting. . Meanwhile, the organization as their place of work or as an institution that is required to make Financial Statements (*mandatory rules*) must provide support *Structural Capital* that can in the form of infrastructure and a good work culture, as well as *Relation Capital* in the form of good communication to internal and external parties, so that communication is established in improving government performance in providing services as described in the financial statements. This hypothesis is consistent with several studies in other countries that have previously developed *capital* intellectual in the public sector (Kong, 2010; Ramírez, 2010; Sawarjuwono & Kadir, 2003).

CONCLUSION

Starting from the purpose of this study, namely to examine the effect of applying Intellectual Capital in presenting quality Local Government Financial Reports (LKPD) and trying to include Earning Management as a moderating variable. The results of this study provide empirical evidence that supports each hypothesis, that the local government sector has actually implemented *Intellectual Capital* in the form of increasing the ability of the apparatus in this case human knowledge and skills but has not been taken seriously because knowledge and skills of a person will be defeated by emotional relationships. . This research is expected to provide information that can open the interest of researchers to develop *Intellectual Capital* in the local government sector to the disclosure stage. Related to this, associated with the results obtained from this study, it can be concluded that in the public sector, especially local governments, practices have been carried out *Intellectual Capital* and *Earning Management* (accounting numbers management) in government governance, especially in regional financial management. The application of *Intellectual Capital* that is not considered and formulated in a policy needs the support of researchers to research.

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