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# **Budgetary participation effect, budget emphasis, and information asymmetry on budgetary slack**

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## **Abstract**

It is important for a management team to participate in the review and approval of a budget. Without their active participation in the approval process, there will be a substantial temptation for budgeters to “play around” with the budgetary system. To obtain empiric evidence for the assumption that budgetary participation, budget emphasis, and information asymmetry influenced the budgetary slack arising in the Organization of Gresik Local Government (OPD Gresik). The research results show that budgetary participation had a positive effect, budget emphasis had no effect, and information asymmetry had a negative effect on the budgetary slack arising within Gresik administration.

**Keywords:** Budgetary participation, Budget emphasis, Information asymmetry, budgetary slack.

El efecto de la participación presupuestaria, el énfasis presupuestario y la asimetría de la información sobre la holgura presupuestaria

## **Resumen**

Es importante que un equipo de gestión participe en la revisión y aprobación de un presupuesto. Sin su participación activa en el proceso de aprobación, los presupuestadores tendrán una tentación sustancial de "jugar" con el sistema presupuestario. Para obtener evidencia empírica de la suposición de que la participación presupuestaria, el énfasis presupuestario y la asimetría de información influyeron en la holgura presupuestaria que surgió en la Organización

del Gobierno Local de Gresik (OPD Gresik). Los resultados de la investigación muestran que la participación presupuestaria tuvo un efecto positivo, el énfasis presupuestario no tuvo ningún efecto y la asimetría de la información tuvo un efecto negativo en la holgura presupuestaria que surgió dentro de la administración Gresik.

**Palabras clave:** Participación presupuestaria, Énfasis presupuestario, Asimetría de información, Holgura presupuestaria.

## 1. INTRODUCTION

In Indonesia, accounting ethics have been garnering a considerable interest. Without ethics, the accounting profession would not exist as it serves as an information provider for business players' decision-making. This profession has also been the object of fairly harsh criticism. Such criticism is attributed to the ethics violations or conflict of interest involving those working in accountancy, whether they are public accountants, corporate accountant interns, or government accountants.

Budgetary slack is defined as a dysfunctional, even dishonest, behavior, in that managers attempt to satisfy their personal interests, and this act is responsible for increased organizational costs (STEVENS, DOUGLAS, 1996) (SCHIFF, M., 1970) (ANTHONY, ROBERT N, and GOVINDARAJAN, 2003) (KREN, 1997). Budgetary slack commonly takes the form of overstated expenses, understated revenues, and underestimated performance (APRIWANDI, 2012).

A public-sector budget is an accountability instrument over the management of public funds and the implementation of public-funded programs (MARDIASMO, 2009). A budgeting process can either be top-down or bottom-up in nature. Unlike the top-down approach, bottom-up preparation of budgets allows managers from a lower level or budget implementers to participate in determining the size of the budgets (ANTHONY, ROBERT N, and GOVINDARAJAN, 2003). Indonesia has been applying the bottom-up system from 2014 to date following the Government Regulation Number 20 of 2004 on the Indonesian Government's Work Plan.

Budget preparation period has a direct impact on human behavior. A range of human behaviors, positive or negative, will be effected by a budget. Positive behavior will be generated if the personal goals of each manager are in harmony, aligned, and proportionate with the firm's goals (i.e., goal congruence) and the managers have the ability to accomplish them (WARINDRANI, 2006)

However, high degrees of subordinates' participation in the budget preparation process will open a wider opportunity for them to be engaged in budgetary slack. Contrarily, when the degree of their participation is low, the chance for them to commit budgetary slack will be small. For this reason, it becomes necessary to apply limitation to participation, that is, in preparing a budget, subordinates should stick to the plan and strategy devised in order to reduce budgetary slack.

In a study by (BASYIR, 2016), it is stated that budgetary participation positively affects budgetary slack. However, the study by (SALLY, VALANNISA., 2016) found budgetary participation to exert no influence on budgetary slack.

Results of a number of research studies indicate that budgetary slack arises as a result of superiors' demanding subordinates to obey their orders, stressing that these subordinates are occupying lower levels of management. The reality in life and work reflects that many of those at lower levels in the hierarchy tends to abide by and observe what is ordered by those above as a form of obedience to authority in organization.

(AFRIYANTI, 2016) in her study states that budget emphasis had a positive impact on budgetary slack. But unlike her finding, Buckland (1999) found that budget emphasis did not influence budgetary slack.

Other than budgetary participation and budget emphasis, another variable that is predicted to influence budgetary slack is information asymmetry. For preparation purposes, the budget reported must be consistent with the performance expected. However, if the subordinates hold a greater amount of information than the superiors do, they will be allowed a chance to take advantage of the budgetary participation entrusted to them by giving biased information. Budgetary slack takes place when they understate the budget target (by reporting the budget below the performance expected).

Budgetary slack practice will rise in a state of information asymmetry as this asymmetry provides subordinates/budget implementers with an incentive to engage in budgetary slack. This implies that budgetary slack does have a relationship with information asymmetry as stated by (SUARTANA, 2010) and (LATIF, 2013). Reduction of this asymmetry can be made by improving monitoring and quality of disclosure.

Information asymmetry can be explained by the agency theory, which underlies the contractual relationship between a principal and an agent. According to this theory, the agent holds more complete information as well as better understanding of the firm than the principal do, suggesting that information asymmetry exists between the two. A problem emerges in the agency relationship when the principal adopts a neutral attitude toward a risk, while the agent is aversive (IKHSAN, ARFAN DAN ISHAK, 2005). As a result, the agent will attempt budgetary slack to avoid such risk by providing biased information. It can be said, then, that information asymmetry can cause budgetary slack.

## **2. METHODOLOGY**

This research is a causal-explanatory study with a quantitative approach (MALHOTRA, 2004). The dependent variable examined in this research was the budgetary slack in the budget reporting and direct spending budget realization of the District of Gresik for the years

2012–2016 (UMAR, 2008). Meanwhile, the independent variables included budgetary participation, budget emphasis, and information asymmetry.

Data were collected through a questionnaire survey and analyzed by the multiple linear regression analysis technique. The data analysis was assisted by the software WarpPLS ver. 5.0. PLS (partial least square) is a variant-based structural equation model (SEM) that is capable of running testing of measurement model and structural model simultaneously.

### 3. RESULTS AND DISCUSSION

The results of discriminant validity testing in this research are presented in Table 1.

Table 1: Results of discriminant validity testing (Processed Data, 2017)

<b>Variables</b>	<b>Original Sample (O)</b>
Budgetary slack	0.568
Budgetary participation	0.576
Budget emphasis	0.561
Information asymmetry	0.61

Based on Table 1, all variables gained discriminant validity scores of more than 0.30. It can be concluded, then, that all variables were valid and allowed confidence. Being declared valid, all of the variables were then subjected to reliability testing by the composite

reliability technique. Whether or not a variable was reliable would be determined based on the coefficient of reliability, which was required to be higher than 0.70. The results of the testing are presented in Table 2.

Table 2: Results of composite reliability testing (Processed Data, 2017)

<b>Variables</b>	<b>Original Sample (O)</b>
Budgetary slack	0.797
Budgetary participation	0.843
Budget emphasis	0.862
Information asymmetry	0.818

Based on Table 2, all variables gained composite reliability scores of more than 0.70. It can be concluded, then, that all variables in this research were reliable to be used in further analyses. Based on the adjusted R2 value, a model can be classified as either strong ( $\leq 0.70$ ), moderate ( $\leq 0.45$ ), or weak ( $\leq 0.25$ ).

Table 3: Adjusted R-squared values (adjusted R2). (Processed Data, 2017)

<b>Variables</b>	<b>Original Sample (O)</b>
Budgetary slack	0.797
Budgetary participation	0.843
Budget emphasis	0.862
Information asymmetry	0.818

Based on Table 3, the variable budgetary slack had an adjusted R-squared value of 0.052 (5.2%). This suggests that the variable budgetary slack could be explained at 5.2% by the variables budgetary



participation, budget emphasis, and information asymmetry and at 94.8% by the variables not tested in this research.

In Table 4.17, it can be seen that the adjusted R-squared values of budgetary participation, budget emphasis, and information asymmetry were unknown. This was because budgetary participation, budget emphasis, and information asymmetry were independent variables. In order to see the relationship between all of the variables in the research, the Q-squared value of budgetary slack was counted. It was then found out that the Q-squared value was 0.657, which was above zero, meaning that the predictive validity criterion was met.

This research directly tested three hypotheses as follows.

H1: Budgetary participation has an effect on budgetary slack

The effect of budgetary participation on the budgetary slack arising in Gresik District administration in this research was measured by a t-test, the results of which were analyzed by partial least square at a significance level of 10%. The results of the t-test can be seen in Table 4.

Table 4: Results of T-Test on the Effect of Budgetary Participation on Budgetary Slack (Processed Data, 2017)

Relationship between Variables	Original Sample (O)	P-Value
Budgetary participation effect on budgetary slack	0.156	0.051

Table 4 shows that the variable budgetary participation had a positive effect on budgetary slack. It was as reflected by the p-value, which was  $< 0.10$ , and the regression coefficient (original sample), which was 0.156. A positive regression coefficient suggests that budgetary participation was directly proportionate with budgetary slack. In other words, budgetary participation affected budgetary slack. Based on the p-value and regression coefficient obtained, it can be concluded that the variable budgetary participation had a positive effect on budgetary slack. Hence, the first hypothesis (H1) states, “budgetary participation has an effect on budgetary slack”.

H2: Budget emphasis has an effect on budgetary slack

The effect of budget emphasis on the budgetary slack arising in Gresik District administration in this research was measured by a t-test, the results of which were analyzed by partial least square at a significance level of 10%. The results of the t-test can be seen in Table 5.

Table 5: Results of T-Test on the Effect of Budget Emphasis on Budgetary Slack (Processed Data, 2017)

Relationship between Variables	Original Sample (O)	P-Value
Budget Emphasis Effect on Budgetary Slack	-0.090	0.175

Table 5 shows that the variable budget emphasis had no effect on budgetary slack. It was as reflected by the p-value, which was  $> 0.10$ , and the regression coefficient (original sample), which was -

0.090. A negative regression coefficient suggests that budget emphasis was inversely proportionate with budgetary slack.

Based on the p-value and regression coefficient obtained, it can be concluded that the variable budget emphasis had no effect on budgetary slack. The second hypothesis (H2) states, “Budget emphasis has an effect on budgetary slack,” which was inconsistent with the results.

H3: Information asymmetry has a negative effect on budgetary slack

The effect of information asymmetry on the budgetary slack arising in Gresik District administration in this research was measured by a t-test, the results of which were analyzed by partial least square at a significance level of 10%. The results of the t-test can be seen in Table 6.

Table 6: Results of T-Test on the Effect of Information Asymmetry on Budgetary Slack (Processed Data, 2017)

Relationship between Variables	Original Sample (O)	P-Value
Information Asymmetry Effect on Budgetary Slack	-0.154	0.053

Table 6 shows that the variable budget emphasis had a negative effect on budgetary slack. It was as reflected by the p-value, which was  $< 0.10$ , and the regression coefficient (original sample), which was  $-0.154$ . A negative regression coefficient suggests that information

asymmetry was inversely proportionate with budgetary slack. Hence, the third hypothesis (H3) states, “Information asymmetry has a negative effect on budgetary slack.”

### The Effect of Budgetary Participation on Budgetary Slack

The first hypothesis (H1) states that budgetary participation has a significant effect on budgetary slack. The results of the statistical test employed in this research show that the variable budgetary participation affected budgetary slack, hence H1 was accepted. It can be concluded that budgetary participation serves as one of the essential factors influencing budgetary slack in the OPD Gresik. The higher the budgetary participation, the higher the budgetary slack (ISWATI and ZARKASYI, 2019)

Because budgetary participation influenced budgetary slack, when subordinates’ participation in the budget preparation increased, the likelihood of them engaged in budgetary slack would escalate. Consequently, it would be necessary for superiors to take an active part in the budget preparation process as subordinates tended to engage in dysfunctional acts like budgetary slack during budget preparation. This is consistent with the theory proposed by (ANTHONY, ROBERT N, DEARDEN, JOHN, and BEDFORD, 1991), that is, without any participation from the top management, there will arise the likelihood of managers to “play around” with the budgetary system, with some attempting to propose easily achievable budgets or reporting budgets in a way that allows unforeseeable things to happen. This finding is

supported by the research conducted by (BASYIR, 2016) on the factors influencing budgetary slack, which shows that budgetary participation influences budgetary slack.

### The Effect of Budget Emphasis on Budgetary Slack

The second hypothesis (H2) states that budget emphasis has an effect on budgetary slack. The results of the statistical test employed in this research show otherwise, thus H2 was rejected. It can be concluded that budget emphasis was not an essential factor that influenced budgetary slack in the OPD Gresik.

The research results show that an increase in budget emphasis did not cause an increase in budgetary slack in budget target setting. Budget emphasis arose when budget target was used as a standard against which subordinates' performance was measured or when recognition or reward such as bonus was given as the budget target was accomplished. It was found out from the research that budget emphasis was not related to budgetary slack in the OPD Gresik.

This finding differs from the theory by (SUARTANA, 2010), that is, performance appraisal based on whether or not a budgetary target is achieved will provide subordinates with an incentive to create slack in order to increase possible compensation in the future. The absence of relationship between budget emphasis and budgetary slack in this research could be attributed to the fact that the sample used was part of a budget preparation team. The sample wielded greater

influence in determining the budget size and aimed to protect their long-term title to participation. They would made an effort to avoid negative evaluation by the central government and the community on the budget they developed.

This finding agrees with the research by (BUCKLAND, 1999), which revealed that budget emphasis was not related to budgetary slack, but did not with the research by (AFRIYANTI, 2016), which found that budget emphasis significantly affected budgetary slack.

#### The Effect of Information Asymmetry on Budgetary Slack

The third hypothesis (H3) states that information asymmetry has a negative effect on budgetary slack. The results of the statistical test employed in this research show just that, hence H3 was accepted. It can be concluded that information asymmetry was not an essential factor that influenced budgetary slack in the OPD Gresik.

The negative effect exerted by information asymmetry on budgetary slack suggests that when there was a rise in the information asymmetry during the budget preparation process, budgetary slack would not necessarily rise as well. The reason would be that the state civil apparatuses (ASN) were in possession of fairly reliable information on the potential performance of the responsibility center than their superiors did. It could also be caused by the possibility that they were aware of their status as the sample of this research and gave

answers favoring them, causing information asymmetry to lower budgetary slack.

This finding is supported by the theory by (DUNK, 2009), which states that budgetary slack is inversely proportionate with information asymmetry. If the information provided by the subordinates is reliable, the degree of budgetary slack can be reduced. In theory, information asymmetry can also be reduced by improving monitoring and the quality of disclosure. This finding is synonymous with the finding of the research by (ASAK, 2016), which also found that information asymmetry had a negative effect on budgetary slack.

#### **4. CONCLUSION**

The results of analysis and testing in this research unveil the following: 1.) budgetary participation had an effect on budgetary slack, as was found by (BASYIR, 2016); 2.) Budget emphasis did not have any effect on budgetary slack, as was found by (BUCKLAND, 1999); and 3) information asymmetry had a negative effect on budgetary slack, as was found by (ASAK, 2016).

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