

Analysis of Factors Affecting the Choice of Corporate Accounting Conservatism

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Abstract

This study aimed to analyze the effect of managerial ownership structure, the cost of litigation and the size of the company, both simultaneously and partially on accounting conservatism on companies listed in Indonesia Stock Exchange in 2011-2013.

The samples used in this study are 22 companies listed in Indonesia Stock Exchange. The total sample is 66 companies. Samples were taken by purposive sampling with certain criteria. Testing methods used in this research is multiple linear regression analysis.

The results of this study show that (1) the structure of managerial ownership, litigation costs and firm size simultaneously affect the accounting conservatism, (2) partially managerial ownership structure has a significant influence on accounting conservatism, (3) the cost of litigation is partially negative influence and significant accounting conservatism. (4) the size of the company partially have a significant impact on accounting conservatism.

Keywords: Managerial Ownership Structure, Cost of Litigation, Company Size, Accounting Conservatism.

1. Introduction

1.1. Background

The financial statements have an important role in the decision making process by the internal and external to the company, this is due to the financial statements to evaluate the company's performance during certain periods. Therefore, the financial statements presented by the company is expected to reflect the actual situation of the company so that it can be helpful for users and not misleading.

Nowadays many of us have encountered cases concerning the presentation of financial statements that do not correspond to the actual state of the company, this happens all over the world. One often the case that the presentation of financial statements that overstatement. In Indonesia, there are several cases concerning the presentation of financial statements that overstatement, as in the case of PT. Kimia Farma ever inflating the annual net profit in 2001 of Rp 32.668 billion in the financial

statements should Rp 99.594 billion but expressed Rp 132 billion, this case came to light in 2002. This can mislead users of financial statements, especially investors and creditors. Cases like this occur because accounting principles provides flexibility for management in determining accounting estimates and methods used so that managers can make financial reporting upbeat. Navid (2012) stated that financial reporting optimists tend to overstate sometimes misleading and detrimental to the users of financial statements.

To avoid such an optimistic attitude, the manager needs to be a bit of pessimism in the financial statements. According Resti (2012), this pessimistic attitude necessary to counteract excessive optimistic attitude that existed at the managers and owners as optimistic attitude will lead to overstatement that are considered more dangerous than understatement. One way that can be done by managers in order to produce financial statements that pessimism is by using the principle of conservatism in financial statement presentation.

Conservatism is one of the basic principles of accounting. The concept of conservatism is born as efforts to improve the financial statements. The use of this principle is based on the assumption that companies are faced with economic uncertainty in the future, so that the measurement and recognition for these figures is done with caution. Sari and Adhariani (2009) states that it acknowledges the costs and losses faster, recognizing revenue and profit more slowly, assessing assets with the lowest value, and assessing liabilities with the highest value.

There are several factors that make accounting conservatism still survive and continue to be used within the company. Watts (2003) stated that conservatism is beneficial for companies to reduce agency costs and reducing excess payments to the parties as a manager, shareholder, court and government.

1.2. Formulation of the Problem

Based on the research background, the formulation of the problem in this study are as follows:

1. Is the managerial ownership structure, the cost of litigation and the size of the companies jointly affect the accounting conservatism on companies listed in Indonesia Stock Exchange.
2. Is managerial ownership structure affect the accounting conservatism on companies listed in Indonesia Stock Exchange.
3. What is the cost of litigation affect the accounting conservatism on companies listed in Indonesia Stock Exchange.
4. Is the company size effect on accounting conservatism on companies listed in Indonesia Stock Exchange

1.3. Research Purposes

Based on the formulation of the problem, the research objectives to be achieved are as follows:

1. To analyze the structure of managerial ownership, litigation costs, and the size of the companies jointly affect the accounting conservatism on companies listed in Indonesia Stock Exchange.
2. To analyze the effect of managerial ownership structure of the accounting conservatism on companies listed in Indonesia Stock Exchange.
3. To analyze the effect of the cost of litigation against accounting conservatism on companies listed in Indonesia Stock Exchange.
4. To analyze the effect of firm size on accounting conservatism on companies listed in Indonesia Stock Exchange.

2. Theoretical

2.1. Accounting Conservatism

FASB Statement of Concept No. 2 in Lasdi (2009) defines conservatism as a reaction to the uncertainty careful to ensure that the uncertainties and risks inherent in business situations is well controlled.

Belkaoui (2006: 288) defines that conservatism is a principle of exclusion or modification in the event that the principle of acting as a limit on the presentation of accounting data that is relevant and reliable. Harahap (2011: 90) states according to this principle when the company faced to choose between two or more accounting techniques are equally acceptable, then the company should put option that gives the smallest gain influence on the equity owners. More specifically, the principle of conservatism implies that the lowest value of the assets and income as well as the highest value of liabilities and expenses should be chosen to be reported. Accounting conservatism principle illustrates that it adheres to the attitude of "pessimistic" when selecting accounting principles for the preparation of financial statements.

Ardina (2012) stated that conservatism is identical to the financial statements that understate the risk is smaller than overstate the financial statements so that the financial statements produced more reliable, meet the criteria for qualitative characteristics of accounting information in accordance with SFAC No. 2.

The purpose of the use of the concept of conservatism is to neutralize optimism excessive managers in reporting its performance. Sari and Adhariani (2009) states that the application of conservatism will generate profits fluctuated, where earnings will fluctuate reduce profit forecast to predict future cash flows.

Principles of accounting conservatism has long been used in the preparation of financial statements. Although it has long been used, the application of this principle is still quite controversial and generated a lot of pros and cons among the researchers. Lafond and Watts (2007) argues that the application of the principle of conservatism in the financial statements can reduce the likelihood of managers to manipulate the financial statements and reducing agency costs. In addition to pro-conservatism, there are also opinions that criticism on this principle. According Haniatidan Fitriany (2010), the application of conservatism resulting financial statements to be biased and therefore can not be used as a tool to evaluate the risk of the company, other than that conservatism will generate profits fluctuate and are not persistent.

2.2. Ownership Structure of Management Accounting Conservatism

Managerial ownership structure of a company related to the information to be provided by the manager in a company. If the managerial ownership in a company is low, then the manager will be more concerned with the bonus that will be obtained from the investors by reporting higher profits than its profit target.

Deviyanti (2012) argues that the financial statements would be more conservative because there is a sense of ownership of the management of the company, so that earnings reported to be smaller, so there is a hidden reserve fund that can be used to expand the company. According Wijayanti (2008), with a conservative method there will be a hidden reserves that can be used to increase the number of investment companies.

2.3. Cost of Litigation against Conservatism in Accounting

Resti (2012) states that the litigation risk is the risk that potentially cost you a bit because dealing with legal issues. Rationally managers will avoid losses due to litigation by way of a financial report conservatively, because profits are too high has the potential litigation risk is too high.

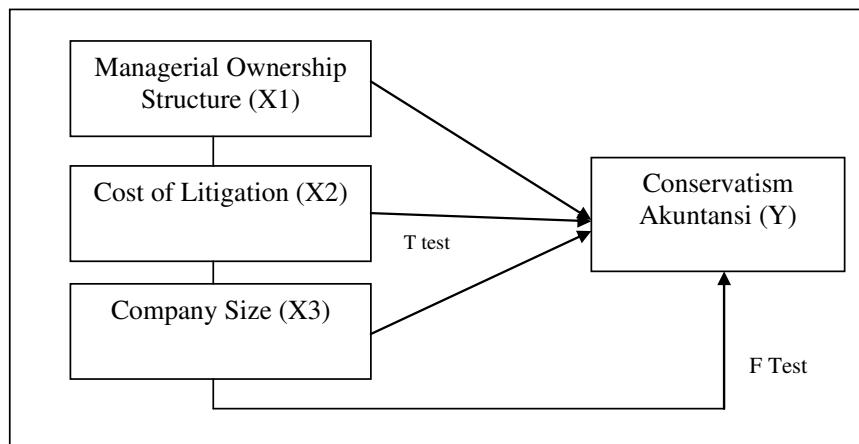
Seetharaman et.al (2002) states that for a company, an attempt to avoid prosecution and litigation threats encourage managers to disclose information that is likely to lead to: (i) the disclosure

of bad news immediately in the financial statements, (ii) delay the good news, (iii) selecting accounting policies which tend to be conservative.

2.4. Company size on Accounting Conservatism

The size of the company may affect the political costs to the company, the company classified into large companies will face the political costs higher than in small companies, this is because a large enterprise established with standard high performance and profitability that will increase the political costs .

Scott (2000) states that the greater the political costs faced by the company, the more likely to managers select accounting procedures reported lower profits. Deviyanti (2012) in his research proves that company size were significant positive effect in the application of accounting conservatism.



2.5. Conceptual Framework and Hypotheses

H1: managerial ownership structure, the risk of litigation and the size of the companies jointly affect the accounting conservatism.

H2: managerial ownership structure affect the accounting conservatism.

H3: The cost of litigation affect the accounting conservatism.

H4: Firm size effect on accounting conservatism

3. Methodology

3.1. Population and Sample

The population in this study are all companies listed on the Indonesia Stock Exchange (IDX) 2011-2013 totaling 136 companies.

This method is a sampling method based on several criteria set by the researchers. The criteria set by the researcher population is as follows:

Population Criteria	Total Company
Total companies listed on the stock exchange for the 2011-2013	136
Companies that do not present a financial report per december 2011-2013 and unaudited.	13
Did not present its financial statements denominated in rupiah	(13)
Negative earnings	(23)
Does not own shares held by the managerial	(56)
Actual positive	(9)
Total	22

3.2. Variables Research

a. Accounting Conservatism

Accounting conservatism is an important principle in financial reporting meant that the recognition and measurement of assets and profits made with great caution because of the economic and business activities covered by uncertainty.

In the event of a negative accrual (profit generated lower than operating cash flow) then shows the application of the principle of conservatism. This means that more and more companies suspend any unrealized income and faster charge. According Givoly and Hayn in Widya (2005) conservatism can be measured by using the formula:

$$C_{it} = NI_{it} - CF_{it}$$

Specification:

C_{it} = level of accounting conservatism

NI_{it} = Profit before extraordinary items minus depreciation and amortization

CF_{it} = Cash flow from operating activities

b. Managerial Ownership Structure

Oktadella (2011) in Ardina (2012) states that managerial ownership is defined as the percentage of shares held by management and actively participate in the decision-making company which includes commissioners, directors, and employees.

Thus the structure of managerial ownership is measured by the formula:.

$$\text{Managerial Ownership Structure} = \frac{\text{The number of shares owned by management}}{\text{Number of shares outstanding}} \times 100\%$$

c. Cost of Litigation

Litigation costs are costs arising from litigation risks inherent in the company which allows the prosecution of the parties with an interest in the company who feel aggrieved. Litigation costs incurred as a result of reporting income and net assets in excess.

As in the study Lasdi (2009) in this study litigation costs of asset growth seen by the formula:

d. Company Size

Watts and Zimmerman (1978) in Deviyanti (2012) states that the size of the company is considered to affect the political costs to be incurred thereby affecting the application of conservatism company. Scott (2000) in Lasdi (2009) states that the greater the political costs faced by the company, the more likely to managers select accounting procedures reported lower profits.

As in the study Deviyanti (2012), in this study the size of the company will be measured from Ln total assets of the company.

3.3. Analysis Method

This analysis aims to look at the effect of managerial ownership structure, the risk of litigation and the size of the company to accounting conservatism on companies listed in Indonesia Stock Exchange 2012-2013 period were analyzed using SPSS (Statistical Package for Social Science).

The regression equation used in this study are as follows:

$$KA = \alpha + \beta_1 SKM + \beta_2 BL + \beta_3 UP + e$$

Specification:

KA = Accounting Conservatism

α = constant

$\beta_1, \beta_2, \beta_3$ = regression coefficient

SKM = managerial ownership structure

BL = Cost of litigation

UP = Size of company

e = error term

4. Results and Discussion

4.1. Description Statistics

Descriptive variable data contained in this research can be seen in table 4.1 below.

Tabel 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
SKM	66	.01	23.08	4.7058	6.66273
BL	66	.02	.63	.1953	.14046
UP	66	25.49	33.00	28.1964	1.94815
KA	66	-2.70E+13	-1.32E+10	-1.9686E+12	4.36821E+12
Valid N (listwise)	66				

Source: Research, Data processed in 2014

Based on Table 4.1 above can be seen at the lower, and the highest average of the variables studied by the number of observations 66 companies listed in Indonesia Stock Exchange in 2011-2013. Accounting Conservatism (KA) as measured by earnings before extraordinary items minus depreciation and amortization decreased by cash flows from operating activities. The lowest value of Accounting Conservatism (KA) is $-2.70E + 13$ or USD (27.036.000.000.000) owned by Astra International Tbk in 2013. The highest value of accounting conservatism is $-1.32E + 10$ or USD (13,215,247,889) owned by Beton Jaya Manunggal Tbk in 2013. the average value of accounting conservatism owned by the companies listed in Indonesia Stock Exchange in 2011-2013 was $-1.9686E + 12$ or USD (-1.968.556.948.490, 4236) with a standard deviation of $4.36821E + 12$ or Rp 4.368.212.552.771,49560.

Managerial Ownership Structure (SKM) which is measured by comparing the number of shares held by the management of the number of shares outstanding. Of the 66 samples of the lowest value of managerial ownership structure is 0.01% owned by the company Indo Acidatama Tbk in 2011. The highest value of managerial ownership structure is 23.08% owned by Pyridam Farma Tbk in 2011-2013. The average value of managerial ownership structure owned by the companies listed on the stock exchanges of Indonesia in 2011-2013 was 4.7058 with a standard deviation of 6.66273.

Furthermore Litigation Costs (BL) as measured by total assets minus total assets of the previous year and divided by the total assets of the previous year. Of the 66 samples at the lower of the cost of litigation is 0.02 which is owned by Indo Acidatama Tbk in 2011, Pelangi Indah Canindo Tbk in 2012, and Martina Berto in 2013. The highest value of the cost of litigation is 0.63 which is owned by Martina Berto in 2011 and Alkindo Naratama 2013. Nilai Tbk in the average of the cost of litigation which is owned by the companies listed in Indonesia Stock Exchange in 2011-2013 was 0.1953 with a standard deviation of 0.14046.

Furthermore, Company Size (UP) who measured the natural logarithm (LN) in total assets. Of the 66 samples of the lowest value of firm size is 25.49 owned by Pyridam Farma Tbk in 2011. The highest value of the size of the company is 33.00 owned by PT Astra International Tbk in 2013. The average value of the size of the company owned by companies listed on the Indonesia Stock Exchange in 2011-2013 is 28.1964 with a standard deviation of 1.94815.

4.2. Classical Assumption Test

In this study, all the classical assumption required in the multiple linear regression analysis is fulfilled in that the data meet the test of normality, multicollinearity data is not the case, the absence of autocorrelation, and not the hetrokedasitas.

4.3. Multiple Linear Regression Analysis

4.3.1 Results of Multiple Linear Regression Analysis

Variable name	B	t _{count}	Sig (t)
Constants	-68.313	-15.057	.000
Ln. Managerial Ownership Structure	.123	3.270	.002
Ln. Cost of Litigation	-.318	-3.190	.002
Ln. Company Size	28.292	21.013	.000
Correlation Coefficient (R) = .946 Coefficient of Determination (R ²) = .896 Adjusted (R ²) = .891 F _{count} = 177.436 F _{table} = 2.75 Sig (F) = .000 t _{table} = 1.99897			

Source: Research, Data processed in 2014

Based on the regression results in Table 4.6, the multiple linear regression equation as follows:

$$KA = \alpha + \beta_1 SKM + \beta_2 BL + \beta_3 UP + e$$

Regression model has been converted into the form of a double log regression models Thus the regression equation becomes as follows:

$$LNKA = \alpha + \beta_1 LNSKM + \beta_2 LNBL + \beta_3 LNUP + e$$

$$LNKA = -68.313 + 0.123LNSKM + (-0.318)LNBL + 28.292LNUP + e$$

From the multiple linear regression equation above can be explained that the constant (α) of -68 313 means that if a variable LNSKM, LNBL and LNUP considered constant (value 0), then the value fixed at -68 313 LNKA. LNSKM regression coefficient of 0.123 indicates a positive relationship (unidirectional) which gives meaning that each increase of 100% LNSKM then lead to an increase of 0.123 LNKA assuming other variables are constant Then the regression coefficient value of -0318 LNBL showed a negative correlation (inverse) which gives meaning that each increase of 100% LNBL cause decreased -0318 LNKA assuming other variables are constant. And the value of the regression coefficient of 28 292 LNUP showed a positive correlation which gives meaning that each increase of 100% LNUP cause an increase of 28 292 LNKA assuming other variables are constant.

4.4. Simultaneous Significance Test (Test Statistic F)

From the table it can be seen that the calculated F value of 177 436 with a significant value of 0.000 at the level of 95%. While the F table obtained a value of 2.75 at $\alpha = 0:05$. thus $F_{count} > F_{table}$, namely $177\ 436 > 2.75$ and significant value of $0.000 < 0.05$. From the results of the F test this means accepting H1. Thus managerial ownership structure, the cost of litigation, and the size of the company simultaneously significantly influence accounting conservatism on companies listed in Indonesia Stock Exchange in 2011-2013.

4.5. Partial Significance Test (Test Statistic t)

a. Ownership Structure of Accounting Conservatism

From table 4.7 above it can be seen that t count of managerial ownership structure for 3270 with a significance value is 0.002, while the value t table at $\alpha = 0:05$ obtained a value of 1.99897 means $t > t_{table}$. Then the decision receiving H2, which means partially managerial ownership structure significantly influence accounting conservatism on manufacturing companies listed in Indonesia Stock Exchange in 2011-2013.

The results are consistent with research and Suryawana Goddess (2014), Fatmariyani (2013), Deviyanti (2012), Oktadella (2011) and Christiawan and Tarin (2007) which states that managerial ownership structure affect the accounting conservatism.

Companies with managerial ownership, which at the same manager will certainly align shareholder interests as managers and shareholders so that the manager is more likely to produce quality financial statements. With the managerial ownership managers also have a sense of ownership and responsibility towards the company.

b. Cost of Litigation against Accounting Conservatism

From table 4.7 above it can be seen that the t value of the cost of litigation at -3190 with significance value is 0.002, while the value t table at $\alpha = 0.05$ obtained a value of 1.99897 means $t > t$ table. So that means the decision accepts partial H3 litigation costs significantly influence accounting conservatism on the companies listed on the stock exchanges of Indonesia in 2011-2013 but have a negative relationship.

The results are consistent with research Juanda (2007) which states that the cost of litigation has a significantly negative effect on accounting conservatism. In contrast to research conducted Lasdin (2009) litigation costs have a significant positive effect on accounting conservatism. Watts (2003) which states that the cost of litigation is one of the factors that affect the company reported its financial statements conservatively.

In this study where the higher litigation costs incurred by the company that it will be inversely related to accounting conservatism. The high cost of litigation make the company will not be doing that could cause the company associated with the court. Operational companies on the run with in accordance with the agreed contract with other parties as well as no information hidden by the company.

c. Company Size of Accounting Conservatism

From table 4.7 above it can be seen that the t value of the size of the company amounted to 21 013 with a significance value is 0.000, while the value t table at $\alpha = 0.05$ obtained a value of 1.99897 means $t > t$ table. So that means the decision accepts partial H4 company size significantly influence accounting conservatism on manufacturing companies listed in Indonesia Stock Exchange in 2011-2013.

This is consistent with research Deviyanti (2012) in his research that proves that a positive significant effect of firm size in the application of accounting conservatism. Companies that have large total assets indicates that the company has reached a stage of maturity where at this stage the company has a positive cash flow and is considered to have good prospects in a relatively long period of time, but it also reflects that the company is relatively more stable and better able to make a profit than companies with total assets of small.

5. Conclusions and Recommendations

5.1. Conclusion

1. Simultaneously variable managerial ownership structure, the cost of litigation, and the size of the company simultaneously significantly influence accounting conservatism on manufacturing companies listed in Indonesia Stock Exchange in 2011-2013.
2. managerial ownership structure affect the accounting conservatism
3. The cost of litigation affect the accounting conservatism
4. The size of the company influence on accounting conservatism

5.2. Suggestion

To examine further research references, there are some suggestions that could be addressed, among others:

1. The study was only conducted on a manufacturing company only, for further research is expected to broaden the subject of research, not only in manufacturing, but also in companies such as industrial services, industrial property and the financial industry, in order to take a

more representative population and research results can be assumed for all types of industries.

It is expected that in future research to develop more other factors that may affect the accounting conservatism, since the variables in this study can only explain 89.5% of the variation accounting conservatism, while the remaining 10.5% is explained by other variables not included in the model this research, such as: public ownership structure, institutional ownership structure, growth opportunities, debt covenants, and the level of financial difficulties.

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