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Effect of Managerial Ownership, Leverage, Firm Size and Profitability on Accounting Conservatism

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ABSTRACT

This study aims to obtain empirical evidence about the effect of managerial ownership, leverage, firm size, and profitability on accounting conservatism. The population of this study were 149 manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2014 until 2016. The number of samples used was 82 companies with a unit of analysis of 246. The selection of research samples using purposive sampling method. The analytical tool used to test the hypothesis is multiple regression analysis using IBM SPSS 23. The results of this study prove that managerial ownership, leverage, firm size, and profitability simultaneously influence accounting conservatism. The hypothesis testing partially shows that the size of the company has a significant positive effect on accounting conservatism. Profitability has a significant negative effect on accounting conservatism. Meanwhile, managerial ownership and leverage have no significant effect on accounting conservatism. Conclusions in this study indicate that the greater the size of the company will increase the application of accounting conservatism while the greater the profitability will reduce the application of accounting conservatism in manufacturing companies.

INTRODUCTION

Every company must submit financial information to those who have an interest in the information. Stakeholders need corporate financial information consisting of internal parties and external parties. Information that must be presented by each company is usually disclosed in the annual report in order to be able to inform corporate condition both financially and non-financially. The preparation of these financial statements is carried out by corporate management as a form of responsibility. Based on the financial statements made by management, the owner of the company (shareholders) can assess how much management is capable of managing the company. One of the objectives of the financial statements according to Kasmir (2008) is to present information about management performance in a period that can be indicated by profits earned during a certain period. The purpose of these financial statements is related to the form of corporate responsibility to the owner of the company as well as to investors and creditors.

Financial statements must present information that can help users in determining the decisions to be taken. The quality of financial statements will raise doubts if it does not show information that is in accordance with the circumstances of the company (Dewi & Suryanawa, 2014). Especially the earnings information provided is often used as an indicator of the estimation of the corporate aspects in the future, in which it is very important for economic decision making (Khafid, 2012).

Each management has the right to choose accounting policies in the form of what methods the management will choose to develop strategies in the preparation of financial statements in accordance with generally accepted accounting principles. Freedom in the selection of accounting policies in preparing financial statements can influence the actions to be taken by management (Wardhani, 2008). To prevent management behaviour that is overly optimistic with financial statements made and the presentation of financial statements can produce information that can be accounted for to external parties, the company chooses accounting methods conservatively. According to Zhong & Li (2017) accounting conservatism is very important and cannot be excluded in making financial statements.

The concept of accounting conservatism is claimed as an accounting concept that still has a pro and

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contra view in its implementation to compile a financial report (Padmawati & Fachrurrozie, 2015). Accounting conservatism within a company is considered as an obstacle that can affect financial statements related to its quality. This is because by applying accounting conservatism, the financial statements will be biased and do not explain the actual situation. Therefore, this concept cannot measure the level of risk that will occur in a Company. On the one hand, the implementation of conservatism can also be beneficial for companies to prevent manager's opportunistic behaviour in presenting financial statements related to corporate agreements where financial statements are used for the media to make agreement contracts (Watts, 2003).

Freedom given to managers to compile and report the company's financial situation is often misused. Frequently, financial statements are presented overstated which can be misleading and detrimental to the users of financial statements. One example of the presentation of financial statements which is overstated by management is the bankruptcy cases of PT Kimia Farma Tbk and Toshiba. PT Kimia Farma Tbk is one of the cases of companies that conduct earnings management in Indonesia. PT Kimia Farma Tbk inflated its annual net profit worthed 32.668 billion rupiah in the financial statement in 2001. A similar case occurred with Toshiba which inflate earnings for the past six years. Thosiba presents overstated earnings by inflating earnings to IDR 16 trillion from April 2008 to March 2014.

Research gap also occurs in the results of previous studies, such as research conducted by Dewi & Suryanawa (2014) empirical evidence found managerial ownership and leverage significantly influence the implementation of accounting conservatism. This research is in line with Oktomegah (2012) that leverage and firm size can also provide significant influence in the direction of positive relations on accounting conservatism. However, managerial ownership has proven unable to explain the significant influence on accounting conservatism. Similar research conducted by Padmawati & Fachrurrozie (2015) finds result that managerial ownership is not able to explain its influence on accounting conservatism. While profitability has a significant negative effect on accounting conservatism (Chen, Folsom, Paek, & Sami, 2013; Yuliarti & Yanto, 2017). Pratanda & Kusmuriyanto (2014) in their research found that managerial ownership, profitability, and leverage have a significant influence with the direction of the positive relationship to accounting conservatism.

Research conducted by Mohammed et al. (2017) found that management ownership has a negative relationship with accounting conservatism. Alfian & Sabeni (2013) in their research found a significant influence with a positive direction between leverage ratios and accounting conservatism. Meanwhile, firm size and managerial ownership have no effect on accounting conservatism. Different from Lafond & Roychowdhury (2008), they show the result that managerial ownership has a significant negative effect on accounting conservatism. Similar research is also conducted by Brilianti (2013) which provides empirical evidence of managerial ownership capable of significantly and negatively influencing accounting conservatism and leverage does not have a significant influence on accounting conservatism.

This study aims to analyze the effect of managerial ownership, leverage, firm size, and profitability variables on accounting conservatism. The originality can be seen from the observation period carried out, namely in 2014 until 2016. Hypothesis testing simultaneously conducted to prove independent variables which include managerial ownership, leverage, firm size, and profitability to accounting conservatism. The use of these variables is based on results that show inconsistency in previous studies.

The implementation of accounting conservatism to the company will produce pessimistic financial statements as evidence that conservatism can neutralize the excessive optimistic attitude associated with the benefits that will be obtained between managers and company owners which is not always the same. The problem that occurs between managers and owners cannot be separated from agency problems that arise as a result of the separation between agents and principals. Agency theory in the company arises as a result of the relationship between agents and principals. The agency relationship in this theoretical concept explains where companies that have accumulated cooperation agreements of principals and agents have the duty and responsibility to manage and control the economic resources owned by the principal (Jensen & Meckling, 1976).

In addition, the selection of accounting methods applied in the company cannot be separated from Positive Accounting Theory. Where in positive accounting theory there are three hypotheses that can influence the motive for choosing an accounting method. The three hypotheses consist of bonus plan hypotheses, debt covenant hypothesis and political cost hypothesis. This motive is what makes the factor in the application of conservative accounting. According to Watts & Zimmerman (1990), positive accounting theory is defined as a concept that expresses on the accounting policies used by companies relating to financial statements that will be presented if facing an uncertain situation that befalls the company.

If share ownership by a manager in a high company, it will encourage managers to direct the selection of conservative accounting. Managers feel they have the company so that managers will think that not only compensation or bonuses will be obtained but rather prioritize the sustainability of the company in the future so the managers want to be able to develop the company. In contrast to low managerial ownership, where managers will attach importance to the bonus they will get. This is in accordance with the positive accounting theory in the bonus plan hypothesis which suggests that the bonus or compensation given by the company to the manager is a reciprocal relationship with the contribution given by the managers, so the managers will act along with the bonus they will receive. Several studies on managerial ownership have been carried out by Dewi & Suryanawa (2014), Pratanda & Kusmuriyanto (2014) as well as Shuto & Takada (2010) who found empirical evidence of managerial ownership significantly with a positive direction relationship affects on accounting conservatism.

H_1 : Managerial ownership has a positive effect on accounting conservatism.

Agency theory which becomes the basis of this research put forward a conflict of interest between managers, shareholders, and creditors. As a fund owner, creditors have the right to information regarding the security of the funds that have been lent in the hope that they will get more benefits in the future. Meanwhile, managers have an interest in maximizing the value of corporate earnings so that creditors can extend their debt contracts and to make it easier to do debt contract. In addition, in one of the hypothesis that is built in positive accounting theory, a debt covenant hypothesis predicts managers will direct the presentation of financial statements by overestimating the value of earnings and assets to reduce the renegotiation of the costs of debt transactions. Therefore, the greater the level of leverage that the company has, the lower the presentation of financial statements conservatively. If the leverage ratio is high, then the probability of a dispute arising between the shareholders and the bond owner will also be high. Finally, it will affect the demand technically to implement conservative accounting (Ahmed & Duellman, 2007). Research conducted by Oktomegah (2012), Noviantari & Ratnadi (2015), Gigler, Kanodia, Sapra, & Venugopalan (2009) as well as Geimechi & Khodabakhshi (2015) found a significant negative effect between leverage on accounting conservatism.

H_2 : Leverage has a negative effect on accounting conservatism.

The political cost hypothesis in positive accounting theory predicts large companies will be more vulnerable to political costs that will arise. This is one of the triggers of manager behaviour in decreasing earnings values with the aim of minimizing political risk in the form of political costs. Differences in interests between managers and policy makers (government) will result in the emergence of political costs in the company. The government and the public will be inclined to highlight the business activities of large companies. Large companies are more likely to report financial conditions conservatively to minimize the political costs that might arise. Research conducted by Kootanaee, Seyyedi, Nedaei, & Kootanaee (2013), firm size is used as a control variable, it is proven that there is a significant influence with a positive relationship on accounting conservatism. Likewise research conducted by Oktomegah (2012) as well as Noviantari & Ratnadi(2015) which has a result in line that firm size positively correlated with accounting conservatism.

H_3 : Firm size has a positive effect on accounting conservatism.

Financial performance in a company can be reflected in the financial statements in the form of earnings that can be used to assess how well the company is running its business. If the earnings value generated by a company is high, it can be predicted that the company has good financial performance. According to Wardhani (2008), with a high profitability ratio in a company, managers will direct to choose a conservative accounting method. Managers will arrange earnings not too high as part of earnings management by choosing a conservative accounting. Based on the political cost hypothesis, companies that have high earnings values will cause greater political costs. This will cause companies that have high profitability to be more inclined to apply conservative accounting methods. This is confirmed in the research conducted by Ahmed & Duellman (2011) as well as Pratanda & Kusmuriyanto (2014) found that the accounting principles of profitability has a significant effect on the positive directional relationship to accounting conservatism.

H_4 : Profitability has a positive effect on accounting conservatism.

Conservatism is the principle to immediately respond to debt and costs, while profits and assets are not immediately considered even though the opportunity occurs high. Thus, the profit contained in the financial statements implies a precautionary concept to reduce the risk that will occur. However, this principle causes fluctuating earnings because earnings become understatement if reported now and can become overstatement of future reporting. This study analyzes the factors that have the possibility of influencing accounting conservatism, namely managerial ownership, leverage, firm size and profitability. Managerial ownership, leverage, firm size, and profitability give an overview of the implementation of accounting conservatism in the presentation of financial statements. Thus, managerial ownership, leverage, firm size, and profitability simultaneously can influence the implementation of accounting conservatism.

H_5 : Managerial ownership, leverage, firm size, and profitability have a simultaneous effect on accounting conservatism.

RESEARCH METHOD

This research was classified as quantitative research with the type of data was secondary data. The population in this study were 149 manufacturing / industrial companies listed on the Indonesia Stock Exchange (IDX) from 2014 to 2016. The sampling technique in this study was purposive sampling which resulted in 82 sample companies. Details of sampling are presented in Table 1.

Accounting conservatism is used to explain the dependent variable. While the independent variables used are managerial ownership, leverage, firm size, and profitability. The operational definitions of the dependent and independent variables are presented in Table 2.

Data collection was done by documentation techniques on financial statements in the manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2014-2016. The analysis technique used descriptive statistical analysis, classical assumption test and

Table 1. Sampling Detail

No	Criteria	Beyond Criteria	Included Criteria
1	Industrial companies listed on the Indonesia Stock Exchange for the period 2014-2016.		149
2	Industrial companies that consistently publish financial statements in a row during the 2014-2016 period	(32)	117
3	Companies that present financial statements in the form of rupiah.	(23)	94
4	Data outlier	(12)	82
	Amount of research data during 2014-2016		246

Source: Secondary data processed, 2018

Table 2. Operational Definitions

Variables	Operational Definitions	Measurement
Accounting Conservatism (CONACC)	Reaction or caution to deal with uncertainties inherent in the company in making financial statements (Watts, 2003).	$CONACC = \frac{NI-CFO}{Total\ Aset} x\ (-1)$
Managerial Ownership (MANJ)	The number of shares owned by management in the company (Guna & Herawaty, 2010).	MANJ = Number of management shares / circulating shares
Leverage (LEV)	Utilization of funding sources by companies that have a fixed burden (Kasmir, 2014).	$DAR = \frac{Total\ Debt}{Total\ Asset}$
Firm Size (SIZE)	Corporate classification according to the size of the company (Samuel & Juliarto, 2015).	$SIZE = Ln\ (Total\ Asset)$
Profitability (ROA)	Corporate capacity to earn earnings to increase shareholder value (Kasmir, 2014)	$ROA = \frac{Net\ Profit}{Total\ Asset}$

Source: Writer's summary, 2018

multiple regression analysis. This study used a significance level of 5% ($\alpha = 0.05$). The mathematical model used in this study is as follows:

CONACC = β0 + β2 MANJ – β1 LEV + β3 SIZE + β4 ROA + e ....(1)

RESULTS AND DISCUSSIONS

Descriptive statistical analysis describes the minimum, maximum, mean and standard deviation values for each variable. This study shows that leverage and firm size have mean values greater than the standard deviation (LEV = 0.44830> 0.201798, SIZE = 28.26259> 1.470941) which means that the distribution of data for each variable is good. Meanwhile for accounting conservatism, managerial ownership, and profitability have mean values lower than the standard deviation (CONACC = 0.03841 <0.089972, MANJ = 0.02280 <0.055052, ROA = 0.04794 <0 , 075907) means the data distribution is less good.

The classical assumption test includes the normality test with the Kolmogorov-Smirnov test showing the value of Monte Carlo Sig. (2-tailed) is 0.051> 0.05, multicollinearity test with Tolerance> 0.1 (MANJ = 0.928, LEV = 0.691, SIZE = 0.886, ROA = 0.701) and VIF <10 (MANJ = 1.078, LEV = 1.447, SIZE = 1.128, ROA = 1.426), heteroscedasticity test with White test shows that the value of c^2 count 21.402 <c^2 table 282,511 means that there is no heteroscedasticity, and the autocorrelation test with the Runs Test shows the value of Asymp.Sig. (2-tailed) 0.609> 0.05 and it can be interpreted that all data that are processed are free from deviation in other words the classical assumption test has been fulfilled.

The value of coefficient of determination or adjusted R^2 shows the result of 0.080 which indicates that the research model is able to explain 8% of the variation of accounting conservatism, while 92% is explained by other variables. The results of hypothesis testing with a significance level ($\alpha = 5\%$) are presented in Table 3. The mathematical model from statistical test is as follows:

CONACC= -0.256 + 0.060 MANJ + 0.020 LEV + 0.011 SIZE – 0.296 ROA ....(2)

Table 3. Summary of Hypothesis Testing

	Hypothesis	Coefficient β	Sig.	Results
H_1	Managerial ownership has a positive effect on accounting conservatism.	0.060	0.565	Rejected
H_2	Leverage has a negative effect on accounting conservatism.	0.020	0.539	Rejected
H_3	Firm size has a positive effect on accounting conservatism.	0.011	0.009	Accepted
H_4	Profitability has a positive effect on accounting conservatism.	-0.296	0.001	Rejected
H_5	Managerial ownership, leverage, firm size, and profitability simultaneously influence on accounting conservatism.	-	0.000	Accepted

Source: Data processed, 2018

The Effect of Managerial Ownership on Accounting Conservatism

Managerial ownership is not able to explain the existence of a significant effect on accounting conservatism. Managerial ownership is not able to explain the implementation of conservative accounting for manufacturing companies in Indonesia. This study shows insignificant results caused by descriptive statistics. The average manager only has a value of 0.0228 of the total shares in the company. This means that the average amount of shareholdings by managerial is very low. The low shareholdings owned by the management results in a small sense of belonging of the manager for the company, which is caused by managers who are less conservative in preparing financial statements. This is influenced by managers who tend to have actions to satisfy themselves and less to consider important their long-term. In addition, the possibility of managers who tend to want be recognized by outside parties on their success. High compensation will encourage managers to manipulate earnings by presenting overstately to get recognition. In accordance with positive accounting theory which stated that the managers will do the work in line with the compensation they will receive (Watts & Zimmerman, 1990). Obtaining recognition from outside management indirectly also receives bonuses from the company. Similar research conducted by Hertina & Zulaikha (2017), Padmawati & Fachrurrozie (2015), and Alfian & Sabeni (2013) found evidence of testing that managerial ownership partially is not able to explain the significant influence on accounting conservatism in the company.

The Effect of Leverage on Accounting Conservatism

Leverage is not able to explain the significant effect on accounting conservatism. The test results in this study are not able to explain agency theory which states that if companies with high level of leverage, the companies will tend to increase earnings to maintain trust in external parties. This is because the level of leverage in the sample companies is included in the low category of 40% of the total sample analysis unit of 246 so that the level of leverage in testing this hypothesis does not affect on accounting conservatism. The low value of leverage in this company allows that debtors have had a lot of knowledge regarding the implementation of accounting conservatism. In other words, the debtors do not connect the credibility of the company based on high debt value. This result is in line with the research conducted by Brilianti (2013), Susanto & Ramadhani (2016), as well as Priambodo & Purwanto (2015) which prove that leverage does not have a significant influence on accounting conservatism.

The Effect of Firm Size on Accounting Conservatism

The test results in this study find that firm size has a significant effect with a positive direction relationship on accounting conservatism. This means that firm size is able to guarantee a company to implement conservative accounting principles. The results of this study in accordance with the political cost hypothesis state that large companies will be more sensitive to their political costs compared to small companies. So as to prevent the political costs incurred getting bigger, companies will further apply the conservative accounting principle. Firm size is used as a tool to consider the implementation of accounting conservatism. How large a company can be known from the amount of assets in the company. Companies with large sizes tend to have large total assets, so that it will be followed by increased operational activities. To avoid this, corporate management will be more careful in choosing accounting principles that can minimize earnings. Based on the discussion that has been done, it can be concluded that the company can consider the size of the company used in decision making to implement conservative accounting. This research is consistent with Susanto & Ramadhani (2016), Noviantari & Ratnadi (2015), as well as Oktomegah (2012) which found that firm size has a significant positive effect on accounting conservatism.

The Effect of Profitability on Accounting Conservatism

The fourth hypothesis testing shows that profitability has a significant negative effect on accounting conservatism. The negative relationship resulted from the hypothesis testing between profitability and accounting conservatism is not in accordance with positive accounting theory. In the political cost hypothesis in positive accounting theory, it is assumed that the higher the political costs imposed on the company, then the company will apply conservative accounting. (Watts & Zimmerman, 1990). However, the results of this study show the opposite result. The existence of a negative relationship between profitability and accounting conservatism is because to maintain the existence of the company in the eyes of investors, the companies do not apply conservative accounting principles when high profitability. The companies use economic motives that will make the company looks more exist and avoid major losses. This causes the financial statements reported by management not to be conservative (Padmawati & Fachrurrozie, 2015). The test results in this study are in line with Padmawati & Fachrurrozie (2015), Yuliarti & Yanto(2017) as well as Chen, Folsom, Paek, & Sami (2013) which concluded that profitability has a significant negative effect on accounting conservatism.

The Influence of Managerial Ownership, Leverage, Firm Size, and Profitability Simultaneously on Accounting Conservatism

Accounting conservatism is a precautionary principle to deal with uncertainty in conducting financial reporting by not recognizing earnings as soon as possible and accelerating recognition of expenses. Table 3 finds results that are simultaneously independent variables capable of significantly influencing the dependent variable, so that H5 in this study is accepted. The conclusions taken are Managerial Ownership, Leverage, Firm Size, and Profitability simultaneously have a significant influence on accounting conservatism. Conservative financial statements are able to reduce agency problems between agents (management) and principal (investors) such as differences in objectives and information asymmetry between the two (Goh, Lim, Lobo, & Tong, 2017;Francis, Hasan, & Wu, 2013). That is because by using a conservative accounting method, the management does not overstate financial statements. In addition financial statements made are communication tools that describe information that occurs to the company to other parties in need. Positive accounting theory also mentions in the bonus plan hypothesis that the political costs borne by the company will be as large as the company develops. To overcome the large political costs, management tends to defer earnings now and immediately recognize future obligations in other words applying conservative accounting methods. From the results of the analysis, it can be interpreted that all independent variables are able to provide an accurate picture of the dependent variable and are relevant to used to prove factors that can influence the implementation of accounting conservatism in the manufacturing companies that listed on the Indonesia Stock Exchange (IDX) during the observation period.

CONCLUSIONS

Based on the analysis and discussion that has been done, it can be concluded that simultaneous testing shows the influence between independent and dependent variables. Firm size has a significant positive effect on accounting conservatism, while profitability is able to influence the implementation of accounting conservatism to the direction of negative relations. Managerial ownership and leverage variables have no influence on accounting conservatism. Suggestions in this study for the continuation of further research based on the results and discussion are (1) External parties must pay attention to the factors that can influence accounting conservatism so that they are not making a wrong decision, (2) Further research is expected to add a period of observation to manufacturing companies. The addition of a minimum observation period of 5 years is expected to produce better results because in this study many hypotheses are not proven, (3) Further research is suggested to use another measure of leverage because in this study the variable does not affect on accounting conservatism. Debt to Equity Ratio (DER) can be used to explain leverage seen from corporate debt and equity. The use of DER to proximate leverage is expected to affect accounting conservatism, because the measurement uses a debt to asset ratio is not able to influence accounting conservatism.

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