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The Effect of Conflict Agency, Leverage, and Political Cost on Creative Accounting

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ABSTRACT

Creative accounting occurs because managers expect a benefit from the actions they take. This creative accounting practice does not violate generally accepted accounting principles, but the existence of this practice can erode public confidence in financial statements. This research type is quantitative, using secondary data on financial statements and company annual reports. The population is infrastructure companies whose shares were listed on the Indonesia Stock Exchange during the 2020-2021. The samples taken amounted to 70 firm-years observation that successively disclosed their financial statements and had complete data related to the variables used in the research. MO and audit committee testing results do not affect creative accounting. Leverage and FS have a positive effect on creative accounting. Larger companies choose revenue-deferred accounting methods to avoid political costs.

KEYWORDS: *audit committee, earnings management, firm size, leverage, managerial ownership*

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INTRODUCTION

Firm performance is reflected in net income (NI) information, and it is one of the parameters in the financial statements that are often used to measure the performance of a company's management [1], [2]. This NI information is often the target of management's opportunistic engineering actions to maximize its satisfaction. This opportunistic action is carried out by choosing specific accounting policies so that company NI can be regulated [2]–[5]. This management behavior is known as creative accounting.

Creative accounting is an effort or action taken by management to play with all the components contained in the financial statements by exploiting or looking for permissible loopholes in accounting standards following the wishes of company managers. Creative accounting occurs because managers or preparers of financial statements in the process of financial reporting of an organization expect a benefit from their actions [6], [7]. Creative accounting actions can reduce the credibility of financial statements.

Overcoming the problem of misalignment of interests between agents and principals can be done through good corporate management by implementing good corporate governance. These efforts can be carried out by building a better monitoring and control system because this will encourage the creation of fairness, transparency, accountability, and responsibility in a company's management. The mechanism of good corporate governance used is by increasing managerial ownership (MO) and supervision from the audit committee in the company [8]–[10].MO is considered an effective monitoring tool for companies by aligning the interests of managers to be involved in share ownership.

The audit committee (AC) is a committee formed by the board of commissioners to carry out supervisory duties in the company. An AC is considered a liaison between management and the board of commissioners with management [11], [12].

Leverage is helpful in controlling the company's business risks. The higher the funding value of company assets from third parties, the higher the opportunity for managers to manage earnings. It improves the company's image in the eyes of the public so that investors still want to invest in the company. Another indicator that can be used to detect creative accounting is firm size (FS). FS has a significant positive effect on creative accounting [13], [14]. Large companies have more assets and allow many assets that are not managed properly, so there is a possibility of errors in disclosing the company's total assets.

This study reveals several factors that are thought to influence creative accounting, namely managerial ownership (MO), AC, leverage, and FS. The selection of these variables was carried out because of the inconsistency of the results in previous studies, thus motivating one to do another study to prove the inconsistencies that have arisen.

The samples is infrastructure companies listed on the Indonesia Stock Exchange because many investors were interested in investing in these companies. Companies in this field are considered to have an essential role in contributing to national economic growth. This sector is believed to be able to become a benchmark for economic growth one day. Infrastructure investments are generally long-term and will grow in line with economic growth and are believed to be one of the most promising investments.

LITERATURE REVIEW

Creative accounting practices can be explained by agency theory. Creative accounting arises due to a conflict of interest between the principal and the agent, causing conflict and causing agency problems [6], [15], [16]. Agency theory assumes that each individual is motivated by their curiosity, causing a conflict of interest between the agent and the principal, resulting in an imbalance of information or information asymmetry held by the principal and agent. The assumption that individuals act to maximize their own interests results in agents taking advantage of the information asymmetry they have to hide some information that the principal does not know. Information asymmetry and conflicts of interest between principals and agents encourage agents to present information that is not true to the principal, especially if the information relates to measuring agent performance. It spurs agents to think about how these accounting numbers can be used to maximize their interests.

Effect of managerial ownership on creative accounting

MO is the share ownership of a company that is owned by the management of the company. The view based on the alignment effect, which refers to the unification of interests between managers and owners, can be achieved by giving share ownership to managers in the company. If managers own shares in the company, they will have interests that tend to be the same as other shareholders.

Expecting about that, management can feel the direct benefits that will obtaining by the company they manages and all the lines in management will also bear the risks for every policy taken so that it is hoping that the company's performance improvement will continue to develop for the company's survival. In improving the performance of the company's portfolio, both investors and management are fulfilling their responsibilities, they all have strong incentives to obtain pre-disclosure information.

Therefore, with the unification of the interests of managers and other shareholders, the agency conflicts between managers and other shareholders will be reduced to motivate managers to improve firm performance and shareholder prosperity. Managers with access to company information will have the initiative to take creative accounting actions by manipulating the information that managers have if they feel the information is detrimental to their interests.

However, suppose the interests of managers and owners can be aligned. In that case, managers will not be motivated to take creative accounting actions so that the quality of accounting information and the in formativeness of earnings can increase. Enlarging MO is expected to reduce creative accounting actions, as reflected in the reduced value of discretionary accruals. The amount of MO is expected to improve the quality of financial reporting and the resulting NI [17]–[20]. Thus, it can be concluded that the first hypothesis is:

H1: MO has a negative effect on creative accounting

Effect of the audit committee on creative accounting

The AC was formed as a special committee in the company to optimize the oversight function, which was previously the full responsibility of the board of commissioners. The role of the AC is indispensable in terms of company supervision. The AC is expected to be able to assist the board of commissioners in carrying out their duties, namely overseeing the financial reporting process by management.

Apart from oversight which was previously the task of the board of commissioners, the task of reviewing financial information that will be reported by the company to stakeholders is also the responsibility of the audit committee so that the audit committee expected to be able to understand financial reports, company business processes, audit processes, risk management, laws and regulations in the field of capital markets and other regulations required by the company. it can be work according to management's expectations if the audit committee has accounting and finance capabilities and must also will led by an independent commissioner from outside the company.

The AC is needed to improve company performance. With the supervision of the AC, the information presented in the financial statements is more informative and of better quality so as to minimize creative accounting actions [12], [21], [22]. From the results of this study, the second hypothesis of this study is:

H2: The AC has a negative effect on creative accounting

Effect of leverage on creative accounting

Leverage is the ratio between total liabilities and total assets of the company. This ratio shows the size of the company's assets that are financed with debt owned by the company. Debt covenant is one of the hypotheses in positive accounting theory. Debt covenant predicts that managers overstate earnings and assets to reduce the cost of renegotiating debt contracts. Managers also do not want their performance to be judged unfavorable if the reported NI is too small, so the more significant the leverage ratio, the higher the company's debt value. Thus, a company with a high leverage ratio tends to manipulate in the form of creative accounting, and the company will likely use accounting procedures that increase reported earnings for the current period [23]–[26]. It aims to avoid violations of debt agreements.

Creative accounting can also be reflect when there is an opportunity given to management in the difference in information known between investors and management. This is also can be happen if the company has a high debt ratio, the supervision by creditors will be tighter so that management is not flexible in carry out creative accounting practices. Companies with high debt ratios will also have high risk and pressures when the company's bargaining power occurs in debt negotiations and reduces creditor concerns.

It is in accordance with the debt agreement (debt covenant hypothesis) hypothesis, which states that managers are motivated to carry out creative accounting to avoid violating the debt agreement. Managers try to show better financial performance. Thus, it can be concluded the second hypothesis, namely:

H3: The leverage ratio has a positive effect on creative accounting

Effect of firm size on creative accounting

FS is an attempt to evaluate the size of a company and is an indicator to observe the political costs that must be borne. FS shows the size of the assets (assets) owned by a company with total assets, log size, stock market value, and others.

If the company has a large market of outstanding shares and is distributing widely, management will have the power to add new investors by issuing new shares. Thus this things can be in order to meet the company's needs in financing all they needs that can make the company continue to grow and develop properly. It is all about in terms of sales and in other matters which is cannot be usefull by other small companies.

Thus, large companies have large enough funding, large companies tend to use funds from external parties. The political cost is one of the hypotheses in positive accounting theory. Political costs predict that large companies have higher political costs than small or medium companies; managers in large companies usually prefer accounting methods that defer reported income or NI from the current year to the following year so that managers of large companies can reduce reported NI.

Political costs include all costs (transfer of wealth) that companies must bear related to political actions, such as taxes, regulations, government subsidies, tariffs, antitrust, labor demands, and so on. Larger companies are more encouraged to take creative accounting actions than small companies because they have greater political costs. Political costs arise because high corporate net incompatibility can attract the media's and consumers' attention [27]–[30]. Managers try to avoid political costs by taking creative accounting actions. Thus, it can be concluded the third hypothesis, namely:

H4: FS has a positive effect on creative accounting

RESEARCH METHODS

Population and sample

This type of research is quantitative research. Quantitative research tests theories by measuring research variables with numbers and analyzing data using statistical procedures. Quantitative research is a research method based on the philosophy of positivism; this research is used to examine a particular sample or population.

A population is a group of people, events, or anything with specific characteristics. The population is infrastructure companies whose shares are listed on the Indonesia Stock Exchange during 2020-2021. The sample is a study conducted by examining some of the population elements. The sample selection used a purposive sampling method. Some of the criteria used to select the sample, namely:

a) Infrastructure companies that consistently present their financial statements in 2020-2021.
b) They have complete data related to the variables used.

Secondary data is financial statement data for infrastructure companies listed on the IDX. These financial statements can be downloaded via the IDX website, namely www.idx.co.id, as well as each company's website.

Operational Definitions and Measurement

Managerial Ownership. MO can be measured by the percentage comparison between the number of shares owned by management and the company's total outstanding share capital. MO = (number of shares owned by management × 100%)/total outstanding shares.

Audit Committee. The indicator used is the number of meetings held by the AC in the sample companies.

Leverage. Leverage is the ratio between total liabilities and total assets of the company. This ratio shows the size of the company's assets that are financed with debt.

Firm Size. FS is measured using the natural logarithm of the company's total assets. FS = Ln Total Assets

Creative accounting is proxied by discretionary accruals and calculated using the modified Jones model. Discretionary accruals (DA) are calculated by subtracting non-discretionary accruals (NDA) from total accruals (TAC)

RESULTS AND DISCUSSION

The population is infrastructure companies listed on the IDX for the 2014-2018 period, while the sample selection used purposive sampling, and the data obtained is in Table 1.

Table 1 Research Sample

Item	Amount
Population of infrastructure companies 2021	68
Infrastructure companies that do not provide the variables data	(33)
Number of sample companies	35
Number of samples during the research year (2020-2021)	70

Source: data processed, 2023

Descriptive Statistics

Descriptive statistics are statistical tools to provide an overview or describe an object being researched through population or sample data without analyzing by making generally accepted conclusions based on that data. Descriptive statistics are useful for giving an overview of data seen from the average, maximum, minimum, sum, standard deviation, variance, range, skewness (distribution skewed) values, and kurtosis. The results of processing the descriptive statistical data of the research variables are shown in Table 2.

Table 2 Descriptive Statistics

Variables	Min	Max	Mean	Dev. Std.
MO (X1)	0.01	1.01	0.07	0.17
AC (X2)	2.00	24.00	6.14	4.70
Leverage (X3)	0.03	0.64	0.37	0.17
FS (X4)	21.90	31.17	26.65	2.88
Creative accounting (Y)	0.00	0.07	0.00	0.01

Source: data processed, 2023

Results

Multiple linear regression analysis was carried out using the SPSS application program. Multiple linear regression analysis is used to determine the effect of the independent variable on the dependent variable so that it can show the direction of the relationship between these variables. This study examines the effect of the independent variable (free), which consists of MO, AC, leverage, and FS, with the dependent variable (tied), namely creative accounting. The results of the multiple linear regression analysis of the research hypothesis can be seen in Table 3.

Table 3 Results of Multiple Linear Regression Analysis

Variables	Coeff.	Sig.	Condition
Constanta	0.04		
MO (X1)	0.39	0.17	not significant
AC (X2)	-0.39	0.16	not significant
Leverage (X3)	0.49	0.00	significant
FS (X4)	0.32	0.00	significant

Source: data processed, 2023

Discussion

The results of multiple linear regression analysis in the t-test for the first hypothesis (H1) can be seen in Table 4.10 that MO does not have a significant negative effect on creative accounting by looking at the significance level of 0.170, meaning that the higher the MO, the creative accounting will not change (H1 is rejected). MO has no significant negative effect on creative accounting.

Judging from the descriptive statistics that the average MO is very small, in view of the percentage of managers who own relatively very small shares when compared to the total capital owned by general investors, managers who also own company shares tend to take policies to manage earnings from a NI angle. From the viewpoint of investors' wishes, many investors are interested in investing capital to increase the company's stock price by increasing reported NI. It illustrates that the higher the MO, the company's creative accounting does not decrease.

The results of multiple linear regression analysis in the t-test for the second hypothesis (H2) can be seen in Table 4.10 that the AC has no significant negative effect on creative accounting by looking at the significance level of 0.165, meaning that the higher the AC, the creative accounting will not change (H2 is rejected). The AC has no significant negative effect on creative accounting.

The company's goal in forming an AC is only limited to fulfilling regulations, where the rule requires that public companies have an AC. Ineffective role of the AC in monitoring management performance. It illustrates that the existence of an AC cannot reduce creative accounting practices in the company.

The results of multiple linear regression analysis in the t-test for the third hypothesis (H3) can be seen in Table 4.10 that leverage affects creative accounting by looking at the significance level of 0.000. The effect shown by the regression coefficient is positive and significant, which means that the higher the leverage, the higher the creative accounting, so the third hypothesis is accepted (H3 is accepted).

Companies with a high leverage ratio will tend to manipulate in the form of creative accounting so that companies with high leverage tend to manage reported earnings by increasing or decreasing future NI to the current period. In agency theory, the agent is usually regarded as a party who wants to maximize his interests, but he always tries to fulfill the contract. In the case of debt contracts, the company is the agent, and the creditor is the principal. That way, the company, as an agent, wants to maximize itself but always tries to fulfill the contract. The closer a company is to accounting-based breaches of debt agreements, the more likely company managers will choose accounting procedures that transfer reported earnings from future periods to the current period. It happens because managers tend to overstate NI and assets to reduce the renegotiation costs of debt contracts, and managers also do not want their performance to be judged unfavorable if reported NI are too small.

The results of multiple linear regression analysis in the t-test for the fourth hypothesis (H4) can be seen in Table 4.10 that FS affects creative accounting by looking at the significance level of 0.000. The effect shown by the regression coefficient is positively significant, meaning that the higher the size of the company, the higher the creative accounting (H4 is accepted). FS has a positive effect on creative accounting.

It happens because large companies have high political costs than small or medium companies, and usually, managers in large companies will prefer accounting methods that defer reported income or NI from the current year to the following year so that company managers can minimize reported NI to avoid political costs. Political costs arise because high corporate NI can attract the media's and consumers' attention.

CONCLUSION AND LIMITATIONS

Based on the test results and discussion, the following conclusions can be drawn. MO has no significant negative effect on creative accounting. It proves that the greater the MO, the more creative accounting will not have an AC, not having a significant negative effect on creative accounting. It proves that the bigger the AC, the more creative accounting will not change. Leverage has a positive effect on creative accounting. It proves that the higher the leverage, the more creative accounting will be. FS has a positive effect on creative accounting. It proves that a larger FS will improve creative accounting.

This study has limitations that affect the results. These limitations are

1. The criteria are still limited to the infrastructure sector companies listed on the Indonesia Stock Exchange.
2. There is a pandemic condition that might affect the pattern of relationships between variables.

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