The Effect of Managerial Ownership, Debt Angreements and Litigation Risk on Accounting Conservatism

Asha Qorynilova*

1Master of Accounting Study, University of Muhammadiyah Tangerang
*ashaqorynilova1@gmail.com

Abstract

The purpose of this study was to examine the effect of managerial ownership, debt covenants, financial distress and litigation risk on accounting conservatism. The population in this study consists of manufacturing companies, and consumer goods industry sub-sectors listed on the Indonesia Stock Exchange in 2015–2018. A sample of 12 companies used in this study was determined by the purposive sampling method. The data used is secondary data. Data analysis was carried out with descriptive statistics using panel data regression analysis techniques. The empirical results of this study indicate that independent debt covenants do not have a statistically significant effect on accounting conservatism, while managerial ownership and litigation risk have a negative significant effect on accounting conservatism. The results show that managerial ownership has a significant positive effect on accounting conservatism and litigation risk. Significant positive effect on Accounting Conservatism, debt covenants do not have a significant effect on Accounting Conservatism, and managerial ownership, and litigation risk, together have an effect on Accounting Conservatism.

Key words: managerial ownership, debt covenant, financial difficulty, litigation risk, accounting conservatism

Introduction

This study aims to determine the extent to which managerial ownership, debt covenants and litigation risk affect the level of conservatism in the financial statements reported by management. The important reason for conducting this research is that conservatism is a cautious reaction to the uncertainty in the risks associated with the business situation which can be adequately considered and these uncertainties and risks must be reflected in the financial statements so that predictive value and neutrality can be improved. On that basis, reporting based on prudence will provide the best benefits for all users of financial statements (Almilia, 2004 in Deviyanti, 2012).

One of the cases of accounting conservatism is the case of financial statement scandal. Included in the financial statement scandals include the case of PT. Kimia Farma, Tbk in 2002 which involved financial reporting, which started from the detection of manipulation.

The case of manipulation of financial statements was carried out by the Toshiba Corporation. One of the cases of accounting conservatism is the case of financial statement scandal. Which was included in the internal accounting scandal in May 2015.
Toshiba Corp's chief executive officer, Tanaka and other officials resigned because they were involved in the accounting scandal in Japan. The company's management is known to set unrealistic profits so that when the target is not achieved the company is forced to manipulate the financial statements in accordance with the targeted profit. (https://www.integrity-indonesia.com).

Scope of Problem

In order for the discussion of this research to be directed so that the objectives of this research can be achieved, the focus and limitations of the problem in this study are as follows:

a. The independent variables used in this study are managerial ownership, debt covenants, and litigation risk, in consumer goods industrial manufacturing companies listed on the Indonesia Stock Exchange (IDX) 2015 – 2018.
b. The dependent variable used in this study is the company's performance (accounting conservatism) which is measured using the Market To Book Ratio.

Previous Research

Research on factors that influence the selection of accounting conservatism. This research will not produce a maximum answer from the truth without any supporting theories from previous findings. Among the research results that support these are as follows:

a. Ni Kd Sri Lestari Dewi I Ketut Suryanawa. (2014) The empirical test results show that the managerial ownership structure variable has a significant positive effect on accounting conservatism simultaneously.
b. Aulia Romadona (2014). The effect of managerial ownership, institutional ownership, firm size and leverage on accounting conservatism has a positive effect on accounting conservatism.

Literature Review

Agency Theory

Agency theory or agency theory is an unequal interest between principal and agent (Jensen and Meckling 1976). Agency theory is based on the contractual relationship between shareholders or owners and management or managers. According to this theory, the relationship between owner and management is essentially difficult to create because of conflicting interests.

In agency theory, agency relationships arise when one or more people (principals) employ another person (agent) to provide a service and then delegate decision-making authority to the agent.

Hypothesis Formulation

The hypothesis is a temporary answer to the formulation of the research problem and has not been based on empirical facts obtained through data collection (Sugiyono, 2018:63). Based on the theoretical basis and previous research
regarding Managerial Ownership, Debt Covenants and Litigation Risk on accounting conservatism and business strategies that are suspected to have an influence on accounting conservatism, the formulation of the hypothesis that can be explained is as follows:

**Managerial Ownership with Conservatism**
Managerial ownership is the proportion of common stock owned by management. With managerial ownership, it encourages management to maximize its performance in the form of profit targets. When management has motivation to improve company performance, Therefore, the research hypothesis is formulated as follows:

H1: managerial ownership has a positive effect on accounting conservatism.

**Debt Covenant with Accounting Conservatism**
Debt covenant is a debt contract which is measured by leverage. Leverage itself is a ratio that calculates how much the company's assets can pay off a company's obligations. With the debt covenant, the manager will get a lot of assets that come from loan funds provided by creditors.

Therefore, the research hypothesis is formulated as follows:

H2: Debt covenants have a negative effect on accounting conservatism.

**Litigation Risk with Accounting Conservatism**
Litigation risk is a risk inherent in the company that allows the threat of litigation by interested parties with companies that feel aggrieved (Anike, 2017).

From this explanation, it is found that litigation risk has a positive effect on accounting conservatism, meaning that the greater the litigation risk that occurs in the company, the greater the application of accounting conservatism. Therefore, the research hypothesis is formulated as follows:

H3: Litigation risk has a positive effect on accounting conservatism.

**Method**

**Research Approach**

**Place and Time of Research**
This research was conducted on manufacturing companies listed on the Indonesia Stock Exchange for the 2015-2018 period. The choice of the Indonesia Stock Exchange as a place of research is because the data needed by researchers can be easily accessed directly or indirectly by visiting the Indonesia Stock Exchange or through the website www.idx.co.id.

This research is quantitative because it uses data sourced from the company's annual financial statements where the data obtained is data in the form of numbers.

**Variable Definition and Measurement**

**Research Variables**
A variable is an attribute or nature or value of a person, object or activity that has a certain variation determined by the researcher to be studied and then drawn conclusions.

**Operational Definition**
Operational variables are needed to determine the types and indicators of the variables used in the study. The following are operational variables in the study:

Accounting Conservatism \((Y)\) Conservatism is a cautious reaction to uncertainty in trying to ensure that the uncertainties and risks in business situations are taken into account.

**Book to market ratio.**

\[
(CON_{-MKT}) = \frac{Equality\text{tobookvalue}}{Closing\text{price} \times volumneshares}
\]

WHERE:

EQUITY BOOK VALUE: Total Assets – Total Liabilities
CLOSING PRICE: The price of shares at the
CLOSE OF THE YEAR VOLUME SHARES: The volume of shares traded at the end of the year.
Managerial ownership. Managerial ownership is an ownership of company shares by managers and this share ownership can be obtained from bonuses given by the company.

\[
\text{Managerial Ownership} = \frac{\text{thenumberofsharesownedbymanagement}}{\text{thenumberofsharesoutstanding}}
\]

Debt Covenant. Debt covenant is a debt contract that aims to analyze the company’s expenditures to pay off debt and the company’s ability to pay interest and other fixed expenses. Measurement of debt covenants.

\[
AR = \frac{\text{Total Debt}}{\text{Total Assets}}
\]

Litigation Risk. Litigation risk is a risk that is inherent in the company and can allow the occurrence of litigation or legal threats.

\[
\frac{\text{Shorttermassets} - \text{shorttermliabilities}}{\text{totalassets}}
\]

Data Analysis Method
To see the effect of managerial ownership, debt covenants and litigation risk on Accounting Conservatism, it is done by using panel data regression analysis. According to Eksandy and Heriyanto (2017:1) panel data regression is a combination of cross section data and time series data, where the same cross section unit is measured at different times. So in other words, panel data is data from several individuals (sample) who are observed from several certain periods of time.

Descriptive Statistical Analysis
Descriptive statistics are statistics used to analyze data by describing or describing the data that has been collected as it is without intending to make conclusions that apply to the public or generalization (Sugiyono, 2018:147-148).

Panel data regression Estimation
Panel data regression models are grouped into three approaches, namely Common Effect Model (CEM), Fix Effect Model (FEM), and Random Effect Model (REM).

Common Effect Model (CEM). The first assumption introduced in panel data regression with the CEM model is the assumption that the intercept is a fixed slope both over time and between individuals. Each individual (n) who was regressed to find out the relationship between the dependent variable and the independent variables was the same for each time. Likewise with time (t), (Eksandy 2018:21).

Fixed Effect Model (FEM). Fixed effect model is a panel data regression model that can show differences in constants between objects in the same regression coefficient. The fixef effect describes an object of observation having a constant that has a fixed value for several periods of time (time invariant) (Eksandy 2018:23)

Random Effect Model (REM). In the random effects model it is assumed that the difference between the intercept and the constant is caused by residuals or errors as a result of differences between samples and time periods that occur randomly (Eksandy 2018:26)

Panel Data Regression Model Selection Technique
To determine the right panel data regression model to be used in panel data regression analysis, we can perform the following tests (Eksandy, 2018):

Panel Data Regression Model Selection Scheme
Chow test. According to Eksandy (2018: 79) the Chow test is used to choose the model to use whether it is better to use the common effect model (CEM) or the fixed effect model (FEM).

Hausman test. According to Eksandy (2018:81), the Hausman test is used to choose which model is better, whether it is better to use the fixed effect (FEM) model or the random effect (REM) model.
**Langrange Multiplier Test.** According to Eksandy (2018: 82) the Lagrange Multiplier test is used to choose the model to use, whether it is better to use the common effect model (CEM) or the random effect model (REM).

**Classic assumption test.** The classical assumption test is a statistical requirement that must be met in Regression analysis using the Ordinary Least Squared (OLS) approach in its estimation technique. (Eksany, 2018:85).

**Multicollinearity Test**

**Multicollinearity tests.** need to be carried out on regressions that use more than one independent variable, this is to find out whether there is a mutually influencing relationship between the independent variables studied (Eksandy, 2018:85)

**Heteroscedasticity Test.** is a test carried out to see if there is an inequality of variance from the residuals for all observations in the panel data regression model (Eksandy, 2018:87-88).

**Hypothesis Test.** Hypothesis can be defined as a provisional statement, but can be tested. A hypothesis is a logically estimated relationship between two or more variables which is expressed in the form of a statement that can be tested.

After testing the assumptions of the panel data regression model, the next step is to test the hypothesis which consists of:

**Model Feasibility Test (F Test)**

The model feasibility test or commonly known as the F Test is used to explain whether all the independent variables that are included in the model together have an influence on the dependent variable, or in other words the model is fit or not (Exandy, 2018: 88–89).

**R-Squared Test (Coefficient of Determination)**

According to Eksandy (2018: 91) the results of the coefficient of determination explain how far the ability of the regression model in explaining the variation of the independent variables affects the dependent variable. The larger the R-squared result, the better because it identifies the independent variable better in explaining the dependent variable.

**T test**

According to Eksandy (2018: 93–94), the results of the t test explain the significance of the effect of the independent variable partially on the dependent variable.

**Panel Data Regression Analysis**

According to Eksandy (2018: 51) panel data regression analysis is a combination of cross section data and time series data, where the same cross section unit is measured at different times. So in other words, panel data is data from several individuals (samples) that are observed over a certain period of time.

**Results and Discussion**

Simultaneous Test (F Test) is used to determine whether all independent or independent variables included in the model have a joint effect on the dependent/bound variable.

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>t-statistic</th>
<th>Prob.(F-statistic)</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAN (H1)</td>
<td>2.6823020.0103</td>
<td></td>
<td>Rejected</td>
</tr>
<tr>
<td>DAR (H2)</td>
<td>-1.5882440.1194</td>
<td></td>
<td>Received</td>
</tr>
<tr>
<td>RL (H3)</td>
<td>-2.4659840.0176</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Observations</td>
<td>48</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R-Square</td>
<td>0.292463</td>
<td></td>
<td></td>
</tr>
<tr>
<td>F-Statistics</td>
<td>7.475878</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prob. (F-Statistic)</td>
<td>0.000378</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Output Eviews 9.0 (Data processed)
Effect of Managerial Ownership on Accounting Conservatism

The test results regarding Managerial Ownership are declared to have an effect on Accounting Conservatism which shows the MAN t- statistic 2.682302 is greater than the t-table 1.680 and the Prob value of 0.0103 is greater than the significant level of 0.05 and causes H1 to be rejected. These results are in accordance with the research of Ni Kd Sri Lestari (2014) which states that the managerial ownership variable has an effect on accounting conservatism.

The Effect of the Debt Covenant on Accounting Conservatism

The test results regarding the Debt Covenant stated that it had no effect on Accounting Conservatism which showed the t-statistic DAR -1.588244 smaller than t-table 1.680 and the value of Prob. 0.1194 is greater than the significant level of 0.05 and causes H2 to be rejected.

The Effect of Litigation Risk on Accounting Conservatism

The test results regarding Litigation Risk are declared to have an effect on Accounting Conservatism which shows the t-statistic RL -2.465984 is smaller than t-table 1.680 and the value of Prob. of 0.0176 is smaller than the significant level of 0.05 and causes H3 to be accepted.

Conclusion

Based on the results of data analysis that has been carried out in the previous chapter regarding the Effect of Managerial Ownership, Debt Covenant and Litigation Risk on Accounting Conservatism, it can be stated as follows:

a. Managerial Ownership Variables have an influence on Accounting Conservatism. This is evidenced by the t-statistic value of Managerial Ownership of 2.682302 ≥ t-table of 1.68023 and the value of Prob. of 0.013 ≤ 0.05. The results of this study indicate that companies with managerial ownership means that share ownership by managers can determine policies and selection of accounting principles, including applying accounting conservatism.

b. The Debt Covenant variable has no effect on Accounting Conservatism. This is evidenced by the Debt Covenant t-statistic value of -1.588244 < t-table1.68023 and the value of Prob. of 0.1194 > 0.05. This is because the company does not mean that the violation of the debt agreement that has matured can influence a manager to avoid by applying accounting conservatism.

c. The Independent Litigation Risk Variable has an influence on Accounting Conservatism. This is evidenced by the t-statistic value of Litigation Risk of -2.465984 ≤ t-table of 1.68023 and the value of Prob. of 0.0176 ≤ 0.05. This is due to the supervision carried out by litigation, the higher the litigation risk of a company, the weaker the relationship between conflict of interest and accounting conservatism.

References