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Board Independent, Firm Size, CEO Ownership, and Accounting Conservatism: Evidence Banking Company in Indonesia

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ABSTRACT

The aim of this study is to provide empirical findings regarding a range of determinants that may impact accounting conservatism. Specifically, the research will examine the effects of company size, CEO ownership, and independent boards. Secondary data, specifically information derived from annual financial reports, is utilized in this study. Information for financial reports is acquired from the IDX data stream and website. From 2013 to 2022, the population of this study comprises all banking institutions listed on the Indonesia Stock Exchange. Significantly positive effects of board independence and company size on accounting conservatism are demonstrated by the findings of this study. Furthermore, CEO ownership has a significant negative impact on accounting conservatism, according to the findings of this study. The findings of this study present a practical illustration for stakeholders regarding the responsibilities of shareholders, which may prove beneficial in overseeing the organization's operations. This research demonstrates that when a company is owned by its CEO, its conservatism decreases. The findings of this research have implications for decision-makers who rely on financial reports. Stakeholders can place trust in managers who provide information about the company through financial reports that reflect its condition.

Keywords: Accounting Conservatism, Banking Companies, CEO, Company Size, Independent Board, Ownership

INTRODUCTION

As of the present moment, conservatism remains a principle that has generated considerable controversy. Although numerous criticisms have surfaced, there are also proponents of the viewpoint. Accounting conservatism is implemented as a risk management strategy to mitigate the influence of excessive optimism exhibited by company owners. Nevertheless, excessive application of conservatism may lead to inaccurate periodic profits or losses that fail to accurately represent the true state of the organization. Information that fails to accurately represent the true state of a company will cast doubt on the reporting's credibility, reducing its ability to facilitate informed decision-making and potentially misleading users of financial statements.

An instance involving inaccurate information that fails to represent the true state of a company is evident in the 2018 financial report of PT Garuda Indonesia Tbk (GIAA), which was prepared in Indonesia. The oddity of the company's net profit was noted. GIAA generated a net profit of 11.33 billion IDR in 2018. This revenue was generated by the soaring revenues of other businesses, which totaled $306.88 million. Two commissioners exhibited hesitancy in affixing their signatures to the financial report. The recognition of income derived from aviation transactions between PT Mahata Aero and PT Citilink Indonesia was met with opposition. It was determined that this acknowledgment did not adhere to the tenets outlined in Statement of Financial Accounting Standards (PSAK) number 23. The administration of Garuda Indonesia acknowledged revenue of $239,940,000 from Mahata, of which $28,000,000 was comprised of profit sharing from PT Sriwijaya Air. Despite the funds remaining in the form of receivables, the organisation acknowledged their inclusion in revenue. Conversely, the government, being the largest shareholder, holds the contrasting perspective.

In general, company stakeholders require organizations to adopt conservatism in their financial reporting so as to limit excessive optimism. When closer review, the degree of conservatism exhibited by a company differs based on the methods utilized and a number of additional factors. The degree to which accounting conservatism is implemented is contingent upon a variety of factors, an board independent being among them. Wistawan et al. (2015) define a board independent as a party that has no affiliations or associations with management, shareholders, or other relationships that could compromise the independence of business management. Ahmed and Henry (2012) posit that the implementation of accounting conservatism can be facilitated by an autonomous board, thereby serving to protect the interests of shareholders. An effective oversight of management conduct by an board independent, in accordance with agency theory, mitigates agency problems. Consequently, the implementation of accounting conservatism may benefit from the utilization of an board independent as a mechanism to reduce the degree of agency conflicts that result from the separation of shareholders and managers (Al-Saidi, 2020).

An additional determinant that may impact the inclination of management to adopt a conservative approach is the scale of the company. As a regulator, the government establishes policies that promote the well-being of its citizens and expedite progress by directing funds from entities that have excess capital through the imposition of taxes. Conversely, the organization's primary objective is to maximize profits and ensure its continued existence. The tax liability is contingent upon the revenue generated, with revenue being thought to be directly correlated with the scale of the organization. It is rational to expect large companies to adopt conservative strategies in order to reduce their tax liability. Research conducted by Noviantari and Ratnadi (2015) provides support for this assertion by demonstrating that a firm size exerts an important impact on accounting conservatism.

CEO ownership is another factor believed to exert an influence on accounting conservatism. The data regarding CEO ownership pertains to the proportion of outstanding company shares that the CEO ownership. Wardhani (2008) asserts that there are two distinct perspectives on managerial ownership. The initial viewpoint posits that superior performance by directors and managers in carrying out their supervisory duties and responsibilities will result in higher quality financial reports. Consequently, this necessitates the application of the conservatism principle. Conversely, in cases where managerial ownership exists or where the company is utilised to gain advantage, a greater propensity for employing more liberal (i.e., aggressive) accounting principles will be observed. The objective of this study is to identify determinants of accounting conservatism, specifically board independent, firm size, and CEO ownership.

LITERATURE REVIEW

The relationship between the principal and another party known as the agent, through which the principal delegates work to the agent, is described by agency theory as proposed by Jensen and Meckling in Lumapow (2018). In companies whose capital is derived from investor share ownership, investors serve as principals, whereas company management functions as agents. This theory posits that the proprietor or shareholder furnishes the necessary resources for management to operate the organisation, while management is obligated to perform a service for the proprietor in a manner consistent with the proprietor's interests. The owner also grants authority to management to make decisions regarding the operation of the business. Eisenhardt (1989) identifies two challenges that arise in the principal-agent relationship: first, the principal and agent may have divergent desires or objectives; second, the principal may find it difficult or prohibitively expensive to verify the actions taken by management in the management of the company. Due to the challenge faced by shareholders in authenticating management's operational activities, the latter owns a greater degree of knowledge concerning the financial standing and operational activities of the company.

Watts and Zimmerman (1986) argue that accounting numbers in financial reports frequently dictate the relationship between shareholders and management. The performance of management is evaluated, monitored, and assessed by shareholders in order to ascertain the degree to which management has enhanced the welfare of shareholders. Moreover, a number of organizations base their compensation for management on financial reports. Furthermore, financial reports serve as substantive evidence that other stakeholders, including creditors and government. Based on the description of the agency theory above, it can be seen that the relationship between agency theory and this research is whether or not the principle of accounting conservatism will be used in the preparation of the company's financial statements by company management. In the agency relationship between company owners and company managers and company managers and creditors, it is likely that companies will choose accounting procedures that increase profits or procedures that do not apply the principle of accounting conservatism.

Positive accounting theory predicts actions such as the choice of accounting policies by company managers and how these managers respond to proposed new accounting standards (Scott et al., 2003). Positive accounting theory explains observed accounting phenomena based on the reasons that cause an event to occur (Watts and Zimmerman, 1986). Positive accounting theory is intended to explain and predict the consequences that occur if managers make certain choices. Watts and Zimmerman (1986) developed a positive approach that is more oriented towards empirical research and justifying various accounting techniques or methods currently used or looking for new models for the development of accounting theory in the future. Watts and Zimmerman (1986) also linked positive accounting theory to the phenomenon of manager opportunistic behavior by forming three hypotheses behind the manager's opportunistic behavior, namely: (1) Bonus Plan Hypothesis, states that bonus plans or managerial compensation will tend to select and use accounting methods that will make reported profits higher; (2) Debt (Equity) Hypothesis, states that companies that have a larger ratio between debt and equity tend to choose and use accounting methods with higher profit reports and tend to violate debt agreements if there are certain benefits and advantages that they can achieve; and (3) Political Cost Hypothesis, states that companies frequently select and implement accounting practices that have the potential to increase or decrease reported profits. This concept posits that company executives have a propensity to contravene governmental regulations, including tax laws, in pursuit of specific benefits and advantages. Managers may manipulate profits to ensure that payment obligations are not excessively burdensome, thereby aligning profit distribution with the objectives of the company.

The Financial Accounting Standards Board (FASB), namely in Statement of Concept No. 2, defines conservatism as management prudence in anticipating uncertainty. The application of conservatism is still a preference for management in choosing its accounting method. A principle of conservatism is the exercise of prudence in the face of ambiguity, with the aim of accurately assessing risks and ambiguity within the business sector (Watts, 2003). Financial accounting is significantly impacted by conservatism, a notable attribute that has persisted for centuries and is regarded as a critical gauge of financial quality (Basu, 1997). According to Watts (2003), the principle of conservatism necessitates evidence of asymmetry in order to identify advantages and disadvantages. Variable degrees of accounting conservatism exist when establishing profits and losses. Article 1(4) of Financial Services Authority Regulation Number 33/POJK.04/2014 (Indonesia. The Audit Board, 2014) on Directors and Board of Commissioners of Issuers or Public Changes states, "Independent Commissioners" are Board of Commissioners members "from outside the Issuer or Public Company who meet the requirements as intended in this Financial Services Authority Regulation for the position of Independent Commissioner". To ensure that the supervisory function runs smoothly, companies require independent commissioners with a background in accounting or finance and specialized knowledge in their respective fields. The implementation of an board independent will result in more stringent oversight by the board of commissioners, potentially necessitating the adoption of conservative accounting practices to deter management opportunistic behaviour (Manik, 2017).

The main function of an board independent is to independently oversee the performance of the organization's leadership. By virtue of its supervisory function, an board independent can counterbalance the authority of management (particularly the CEO) in managing the company (Wardhani, 2008). Wardhani's (2008) research on the connection between the independence of the board of commissioners and conservative accounting says that a strong board of directors (with a lot of independent commissioners) will demand more reliable information, which will make companies more likely to use conservative accounting principles. Independent board members are those on the board of commissioners who are not associated with other commissioner members or controlling shareholders. They possess no business relationships and are therefore capable of operating autonomously and in the company's best interest. The responsibility of ensuring that the organisation has executed sound corporate governance practices and has treated minority shareholders with integrity and fairness falls upon the board independent of commissioners. According to a prior study by Nasr and Ntim (2018), the independence of the board of commissioners has a beneficial impact on accounting prudence. The implementation of an board independent will result in more stringent oversight by the board of commissioners, which will likely necessitate

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more conservative accounting practices. In addition to this, the inclusion of an autonomous board within an organisation can contribute to a more equitable approach to decision-making, particularly with regard to safeguarding the interests of minority shareholders and other affiliated parties. By augmenting or expanding the percentage of independent commissioners within the organisation, the company can enhance its oversight of directors and managers, thereby exerting an impact on the degree of conservatism in company accounting. This information may serve as the foundation for the subsequent hypothesis: H1: Board Independent has a significant positive effect on accounting conservatism.

Firm size is a metric used to categorize the dimensions of businesses through various criteria, such as total assets, overall revenue, and stock market valuation. It represents the scale of an organization, which can be articulated in terms of total assets or total revenue (Nugroho & Budiman, 2022). Firm size can affect the completeness of the quality of its financial reports. The assets owned by the company are an indicator that can be used to classify between large, medium and small companies. The greater the assets or net sales of the company, the larger the company. The more bear the size of the company will pay greater political costs, so managers prefer to reduce profits to be more conservative (Sari & Adhariani, 2009). Based on Jensen & Meckling (2000) and Watts & Zimmerman (1986) hypothesize that political costs will increase along with company size. Large companies furnish a greater quantity of information with respect to their financial reports in contrast to small companies. The magnitude of a company is determined by its total assets. Large companies incur higher agency costs in comparison to small ones due to the tendency of managers to exercise caution or conservatism when disclosing earnings, seeking to evade heightened scrutiny from regulatory agencies, securities analysts, and the general public. These entities will conduct more stringent oversight of large companies in comparison to small ones. Large companies must be able to provide better public services and social responsibility to the community as demanded by the government and also pay higher taxes in accordance with high corporate profits. According to Hardinsyah and Daljono (2013), firm size can generally be interpreted as a comparison of the size or size of an object. According to Susanto and Ramadhani (2016), firm size has no effect on conservatism. Meanwhile, according to Hardinsyah and Daljono (2013), firm size has a positive effect on conservatism and according to Ramadhani and Sulistyowati (2019), firm size has a negative effect. This information may serve as the foundation for the subsequent hypothesis, H2: Firm size has a significant positive effect on accounting conservatism.

According to a theory developed by Jensen and Meckling (2000), agency problems can be mitigated through management share ownership. The theory posits that an increase in the number of shares owned by management corresponds to a heightened incentive to strive for the appreciation of the company's shares. A greater proportion of inside directors (affiliated commissioners/commissioners other than the independent commissioner/CEO) will result in a convergence of objectives between management and shareholders, according to traditional agency theory. However, on the other hand, as owners of inside directors, they can use their voting power to expropriate the company. Based on the partial research results, it can be seen that the CEO ownership variable is negative and has an effect on accounting conservatism in property and real estate companies listed on the Indonesia Stock Exchange during 2016-2018. The results of this study support Wardhani's (2008) and Maimiati's (2017) research which states that managerial ownership of a company significantly affects accounting conservatism. This is because management is the party trusted by the company owner and chooses policies in preparing financial statements. Wu in Wardhani (2008) explains that the negative relationship between managerial ownership and accounting conservatism can be caused because managers with high share ownership will choose to use less conservative (aggressive) accounting principles to avoid a decrease in stock prices. In Maimiati's research (2017) it is also explained that this relationship is due to the motivation of managers no longer to get high bonuses due to increased profits but to increase company value. This information may serve as the foundation for the subsequent hypothesis, H3: CEO ownership has a significant negative effect on accounting conservatism.

RESEARCH METHOD

The study used secondary data. The annual financial statements of 355 companies, which were made publicly available on the website of the Indonesia Stock Exchange from 2013 to 2022, provided the data for this study. Econometric Views (Eiviews 11) was utilized for the collected data analysis. The data regression equation model utilized in this study is depicted in the model (1):

CONSERV = β0 + βI1i t+ β2FSit + β3COit+ e (1)

Note:
CONSERV = Accounting conservatism;
BI = Board independence;
FS = Firm size;
CO = CEO ownership.

Conservatism is measured by the model formula (2):

$$NOACC_{it} = \frac{\text{Net Profit} - \text{AKO} - \text{Dep}}{\text{Total Assets}} \quad (2)$$

Note:
NOACC_it = Accounting Conservatism Index;
AKO = Cash Flow from Operating Activities;
Dep = Accumulated Depreciation of Fixed Assets;
TA = Total Assets.
(Givoly & Hayn, 2000)

Board Independence measured using the model formula (3):

$$BI = \frac{\sum DI}{\sum DK} \times 100\% \quad (3)$$

Note:
BI : Board independence
DI : Independent board of commissioners
∑DK : Number of board of commissioners
(Chatterjee, 2020)

Company Size is measured by Total Company Assets

CEO Ownership is measured like a model (4)

$$CO = \frac{\sum \text{saham yang dimiliki}}{(\sum \text{saham yang beredar})} \text{CEO} \times 100\% \quad (4)$$

(Di Meo et al., 2017).

RESULTS

This research aims to determine factors that can influence accounting conservatism, namely through independent boards, company size, and CEO ownership. Table 1 is the results of Descriptive Statistics.

Table 1. Descriptive Statistics Example (N=355)

Construct	Min.	Max.	M	SD
Conservatism	-.568	.263	-.004	.093
Board Independence	.330	66.66	.776	3.50
Company Size	664673.0	1.99E+09	1.68E+08	3.35E+08
CEO Ownership	.000	.015	.000	.000

Note: M = Mean, SD = Standard Deviation.

The results of the descriptive statistics show that conservatism has a minimum value of -0.568 and a maximum of 0.263, a mean of -0.004 and a standard deviation of 0.093. Board independent has a minimum value of 0.330 and a maximum of 66.66, mean 0.776 and a standard deviation of 3.50. Firm Size has a minimum value of 664673.0 and a maximum of 1.99E+09, a mean of 1.68E+08 and a standard deviation of 3.35E+08. Finally, the results of descriptive statistics show CEO ownership has a minimum value of 0.000 and a maximum of 0.015, a mean of 0.000 and a standard deviation of 0.000.

Table 2. The Regression Results from the Research Model (1)

Variable	Coefficient	t-Statistic	Probability
Board Independence	0.016472	3.439381	0.0113**
Firm Size	2.57E-11	1.771771	0.0003***
CEO Ownership	-80.33589	-4.103930	0.0386**
Adj R-squared	0.051618		
F-statistic	7.422405		
Prob (F-statistic)	0.000078		
Significance at level *10%, **5%, ***1%			

The regression results in table 2 show that the independent board variable has a significant positive effect on accounting conservatism with a significance level of 5% (P value = 0.0113). Furthermore, the results show that the firm size variable has a significant positive effect on accounting conservatism with a significance level of 1% (P value = 0.0003). Finally, the results show that the CEO ownership variable has a significant negative effect on accounting conservatism with a significance level of 1% (P value = 0.0386). The Adj R-squared value is 0,051 or 5.1% with an F-statistic of 0.0000. The regression model results in table 2, prove the entire research hypothesis. There are 3 hypotheses in this study, namely: H1: Independent Board has a significant positive effect on accounting conservatism; H2: Company size has a significant positive effect on accounting conservatism; H3: CEO ownership has a significant negative effect on accounting conservatism. All three research hypotheses are empirically proven.

DISCUSSION

Accounting conservatism is an accounting attitude and view based on a pessimistic attitude in the face of uncertainty of profit or loss which is carried out with the principle of minimizing the cumulative profit reported by slowing down revenue recognition, accelerating cost recognition, lowering the value of assets and raising the valuation of debt 1. The implication of accounting conservatism is that in practice, conservative accounting will recognize all costs or losses that are likely to occur, but not immediately recognize future revenue or profit even though the possibility of occurrence is large. The regression results presented in Table 2 show that the independent board variable has a significant positive effect on accounting conservatism, which means that when the level of board independence is high, conservatism in the company also increases. The results of this study are in line with the research of Yunos et al (2014) and Hajawiyah et al. (2020) which show that independent board has a positive effect on accounting conservatism. Furthermore, the results showed that the firm size variable has a significant positive effect on accounting conservatism, which means that the larger the size of a company, the higher the level of accounting conservatism in the company. The results related to firm size are consistent with the results of research conducted by Noviantari and Ratnadi (2015). Finally, the results showed that the CEO ownership variable has a significant negative effect on accounting conservatism, which means that the higher the share ownership by the CEO in a company, the lower the level of accounting conservatism in the company. The results of this study support the research of Wardhani (2008) and Maimiati (2017).

CONCLUSION

This study uses empirical methods to examine the determinants of accounting conservatism in the context of all Indonesia Stock Exchange-listed banking company from 2013 to 2022. The research findings demonstrate that each of the purported hypotheses in this study has been empirically confirmed. The result that the board independent significantly increases accounting conservatism provides confirmation for hypothesis 1. There is a notable positive correlation between firm size and accounting conservatism. The research findings indicate that conservatism in practice aligns with the predictions of the political cost hypothesis, which posits that conservatism increases with firm size. This finding provides support for hypothesis 2. The fact that CEO ownership has a substantial adverse impact on accounting conservatism provides empirical support for the acceptance of hypothesis 3.

LIMITATION

The limitations of this study are the results of the Adjusted R-square which has a relatively small value of 0.051 or 5.1%, based on this figure it can be concluded that there are still variables from outside the study that can affect accounting conservatism. Other variables that are not examined can affect the results of the study. This research was only conducted on banking companies, so the results cannot be generalized to all industry sectors.

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DECLARATION OF CONFLICTING INTERESTS

All authors declare that they have no conflicts of interest.

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