

# Good Corporate Governance and Bondholder-Shareholder Conflict: The Case of Implementation Accounting Conservatism for Mining Companies

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The application of the Accounting Conservatism Principle in various companies can have a different impact. The application of this principle is considered able to result in Financial Statements not being used as a tool to evaluate the company's risk. However, other parties have stated otherwise, that the application of the Accounting Conservatism Principle could generate reasonable financial reports and provide relevant Financial Information. The Objective of this study is to analyse the effect of Good Corporate Governance and Bondholder-Shareholder Conflict against company accounting conservatism. Analysis of accounting conservatism done using quantitative methods and data testing is done with the classical assumption and hypothesis testing with the multiple linear regression model. The level of accounting conservatism is measured by the value of accruals and the market value. The sample was mining companies listed on the Indonesia Stock Exchange in 2014-2017. The results of the research show that each company is engaged in accounting conservatism at different levels. In accrual, accounting managerial ownership affects conservatism; it is different from the approach in which the market value of managerial ownership did not affect the significance of the accounting conservatism. Institutional ownership does not affect accounting conservatism when measured accrual, but has the effect of market value when measured. The presence of independent directors when measured accrual as well as market value, is able to influence the level of accounting conservatism.

**Key words:** *Good Corporate Governance, Bondholder-Shareholder Conflict, Political Cost, Accounting Conservatism.*

## Introduction

The application of financial statements must generate relevant Financial Information, so Accounting Conservatism is very necessary. With relevant Financial Information, users of financial statements can evaluate company performance and can predict risks in the future. Some corporate scandals such as Enron Corporation, Xerox, WorldCom, show that financial reports that are generated by accounting can become of public concern (Deil, 2014).

The principle of accounting conservatism is not a qualitative characteristic in a conceptual framework. International Financial Reporting Standard(IFRS) doesn't use the conservatism principle in corporate accounting reporting in order to provide reasonable financial reports (Andre & Filip, 2012). The higher the implementation of the Accounting Conservatism Principle by the company, the greater the information asymmetry between financial report makers and users of financial statements (Mance, 2012). This matter has potential to cause losses for other uninformed investors. Thus, the principle of conservatism isn't suitable with the objectives of modern accounting that requires accounting standards to predict the condition of the company in the future. Financial accounting standards also provide space for the application of accounting conservatism in terms of method selection, accounting estimation, and in decision making (Mance, 2012). In the case of earnings management, for companies that generate profits exceeding last year's target, usually accounting practices that are used are less conservative. Conservatism can make the profits reported by a company become understated or overstated and affects the quality of earnings itself (Dunbar et. al, 2004). Conservatism plays an important role in agency theory. In practice, management applies conservative accounting policies by calculating high depreciation which will produce relatively low profits.

The opinion of Lafond dan Rouchowdhury(2007) stated that managerial interests in the company could influence the method of financial recording including the selection of a more conservative recording methods. If managers want to have better performance, companies tend to produce non-conservative financial reports. The development of the business world and interrelated laws exposes managers to lawsuits by disadvantaged parties (Watts, 2003). Managers are more careful in providing financial statements that have a more conservative tendency.

Another thing that encourages managers to apply conservative accounting principles is the existence of Bondholder - Shareholder Conflict. This conflict happens when companies try

to find funding sources from debt. Sources of financing from debt are external financing used by companies to finance company funding needs (Stolt & Högnelid, 2012). The decision to use debt must consider the size of the loan interest as a fixed cost debt that has an impact on increasing financial leverage and the increasingly uncertain return of debt to shareholders. Likewise, dividend payments that are too high can threaten the interests of bondholders because they will reduce assets that should be used for repayment of debt, as a result the amount of dividends paid is limited (Stolt & Högnelid, 2012).

A conflict of interest happens because investors try to take advantage through excessive dividend payments. On the other hand, investors have an interest in the security of their investment funds. For companies in Indonesia, the existence of independent commissioners is part of the implementation of good corporate governance. The independent commissioner serves as an independent controller of the company's management performance (Amran & Manaf, 2014). Therefore, in carrying out their duties, independent commissioners need accurate, relevant and quality information that uses more conservative accounting principles. Based on the phenomenon, the research aims to analyse the effect of Good Corporate Governance and Bondholder - Shareholder Conflict on the implementation of Accounting Conservatism. On the other hand, companies whose board of directors are weak in conducting supervision, tend to use accounting principles that are more aggressive or less conservative.

## Literature Review

Accounting Conservatism plays an important role in presenting conservative profits and assets, but conservatism plays an important role in the agency theory. This theory is the basis of the theory that underlies the company's business practices because of a conflict of interest between shareholders and managers. Managers are obliged to manage resources, while principals have an obligation to provide rewards for tasks that have been charged to company agents that separate management functions and ownership functions that can lead to agency conflicts (Jensen & Meckling, 1976).

This agency relationship motivates individuals to be harmonious and keep their respective interests between the Manager and the Shareholders (Muda, Maulana, Siregar, & Indra, 2018) Information asymmetry allows conflict between Managers and shareholders to try to use others parties for their own interests (Erben, 1993).

The choice of a conservatism method is inseparable from the interests of managers to optimize their interests at the expense of the interests of shareholders (Nakano, Otsubo, & Takasu, 2014). Due to the higher managerial ownership, management is not only an agent, but also the owner of company and this can reduce agency conflicts, so companies tend to use

conservative accounting (Yuliarti & Yanto, 2017). If management has fewer shares than other investors, managers will tend to report higher profits (less conservative). Conversely, if there is more managerial ownership, management tends to report earnings more conservative (Latif, Latif, & Abdullah, 2017).

Conditional conservatism arises because lenders demand that firms recognize losses faster than gains. Thus, lenders demand more conservatism to reduce their downside risk (Hille, J.C., 2011). Risk uncertainty is reflected in the financial statements (Sana'a, 2016). Financial statements based on prudence will benefit financial statement users (Mance, 2012).

The risk management role of accounting conservatism also is of relevance to the ongoing debates regarding the benefits, costs and continuing role of accounting conservatism as a central tenet of financial accounting (Biddle, Gary C., Ma, Mary L Z., Song, Frank M., 2012) Thus, conservatism is a pessimistic view in accounting, because accountants are pessimistic in facing uncertainty of profit or loss by using the principle to slowing down revenue recognition, accelerating recognition of costs, lowering valuation of assets and raising debt valuations (Sana'a, 2016).

Managerial ownership structure reflects the percentage of shares held by management from all the shares in the company (Hamdan, 2018). The choice of accounting methods is also influenced by managers. Ownership of managers determines policies and management choices regarding accounting methods including conservatives (Murwaningsari & Rachmawati, 2017).

Management with large ownership controls has a lower incentive to conduct self-serving behaviours that do not increase company value, so they tend to apply more conservative accounting to improve earnings quality. The greater the management ownership, the management applies conservative accounting to increase firm value (Murwaningsari & Rachmawati, 2017).

The institutional ownership structure reflects the shares held by institutional parties of the total number of shares of the company (Hamdan, 2018). Institutional ownership has the ability to control management through effective supervision to reduce earnings management actions (Latif et al., 2017). In general, the mechanism of Good Corporate Governance can control management behavior (Santhanam, Navethitha; TJ Kamalanabhan; Dyaram, 2013). The ownership structure of institutional investors has a fairly large equity investment, can encourage supervisory actions on the performance of managers more stringent and can increase the value of the company (Latif et al., 2017).

The board of Commissioners plays a very important role in the company, especially in the implementation of good corporate governance (Sekar, Prabowo, Titisari, & Wijayanti, 2018). The Indonesia Stock Exchange issued a regulation requiring companies listed on the Indonesia Stock Exchange to appoint independent commissioners, with a minimum of 30% of all members of the board of commissioners (Otoritas Jasa Keuangan, 2014).

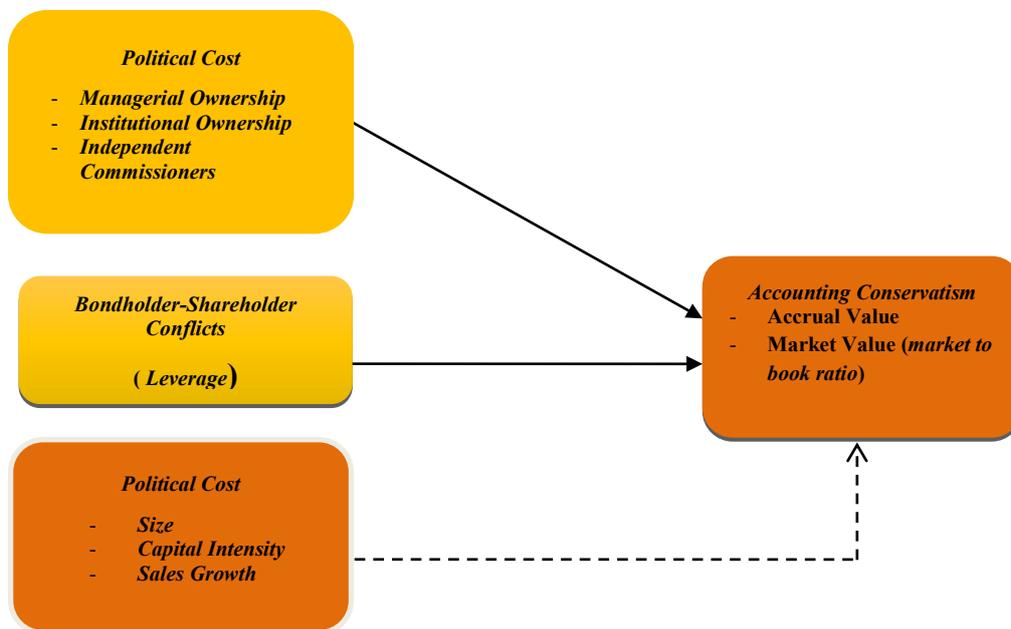
The bondholders-shareholders conflict arises when companies seek funding from debt. Payment of dividends that are too high will cause a threat to the debt holder because it will reduce the assets available for repayment of debt. To overcome these problems, generally the debt holder requires restrictions on dividend payments (Stolt & Högnelid, 2012). Conversely, the increase in corporate debt will reduce bondholders' claims on company assets (Nash, Netter, & Poulsen, 2003). Thus, debt holders want a guarantee that the minimum amount of net assets is greater than the nominal value of the debt. Conservatism plays an important role in presenting conservative profits and assets (Harakeh, Lee, & Walker, 2017). Conservatism will limit the opportunistic behaviour of managers or create profit distortions in presenting financial statements (Mance, 2012).

Large companies tend to use accounting methods that can reduce periodic profits compared to small companies (Waluyo, 2017). Company size is a proxy for political aspects. Political Costs arises from conflicts of interest between the company and the government (Milne, 2002). You might expect the volatility of returns to be greater in countries with governments who intervene in the market. To present a stable earnings pattern or to prevent government intervention, companies make more use of conservative accounting methods (Hille, J.C., 2011). Firm size can also increase Political Cost. Companies with high performance standards and profitability will also increase Political Cost. In the context of Political Cost, accounting conservatism is encouraged to reduce or delay payment of taxes (Milne, 2002).

### **Theoretical Framework and Research Development**

Based on the theory as stated above, the following is presented the Theoretical Framework and Research Development.

**Figure 2.** Theoretical Framework



H<sub>1</sub>: Managerial Ownership affects the Accounting Conservatism

H<sub>2</sub>: Institutional Ownership affects the Accounting Conservatism

H<sub>3</sub>: Independent Commissioners affects the Accounting Conservatism

H<sub>4</sub>: Bondholder-Shareholder Conflict affects the Accounting Conservatism

## Research Methodology

This study uses the hypothesis analysis method; the object that became the focus of observation is Good Corporate Governance (GCG), Bondholder-Shareholder Conflict and Accounting conservatism, in mining sector companies in Indonesia. This study will observe the direct effect between the independent variables (GCG and Bondholder-Shareholder Conflict) on the dependent variable (Accounting Conservatism) using the control variable (Political Cost). The sample used in this study is mining sector companies listed on the Indonesia Stock Exchange (IDX) which published complete annual financial reports from 2014-2017. The Sampling Method that is used in this study is purposive sampling of the mining sector which has a complete data set of 25 companies that consistently published financial reports.

## Analysis and Result

The following Table 1 shows the result of the descriptive statistical output from data processing.

**Table 1:** The Result of t-Test (Partial Test)

Variable Independent	Dependent : ACCON (1) & MKTCON (2)				Conclusion
	Coefficient		Sig.		
	( 1 )	( 2 )	( 1 )	( 2 )	
(Constant)	0,158	-2,195	0,034	0,000	-
MANOWN	0,001	0,002	0,029	0,520	$H_p$ not accepted (1) $H_p$ accepted(2)
INSOWN	0,000	0,008	0,778	0,005	$H_p$ accepted (1) $H_p$ not accepted(2)
COMID	-0,078	-0,125	0,031	0,076*	$H_p$ not accepted(1) $H_p$ not accepted(2)
LEV	-0,143	0,230	0,000	0,290	$H_p$ not accepted (1) $H_p$ accepted(2)
SIZE	-0,005	0,069	0,174	0,005	$H_p$ accepted (1) $H_p$ not accepted(2)
IM	0,000	0,002	0,512	0,056*	$H_p$ accepted (1) $H_p$ not accepted(2)
SGROW	-0,001	0,002	0,021	0,465	$H_p$ accepted(1) $H_p$ accepted (2)

\*remark for level 10%

### **Hypothesis 1**

The test results in table 1 explain that the coefficient value obtained is 0.001 in the first model and 0.002 in the second model. The resulting probability values are 0.029 in the first model and 0.520 in the second model. The positive coefficient value obtained in both models indicates that managerial ownership of the company has a positive effect on accounting conservatism in a mining company. While the probability value of 0.029 in the first model where accounting conservatism is measured through accrual values is smaller than the 5% error rate, or  $\alpha < 0.05$  states that the influence of the company's managerial ownership structure on accounting conservatism through accrual value in mining companies is significant. Thus, **Hypothesis 1 is accepted** in the first model. Whereas in the second model the alpha value is greater than the error rate of 5% and 10%, or  $0.520 > 0.005$  stating that the

influence of managerial ownership structures on corporate accounting conservatism practices through market value is not significant.

### *Hypothesis 2*

From the results of the t-test (partial) the coefficient value obtained is 0,000 in the first model and 0,008 in the second model with a probability value of 0,778 in the first model and 0,005 in the second model. Positive coefficient values indicate that the structure of institutional ownership in a mining company has a positive effect on accounting conservatism. In the first model the resulting probability value is greater than the 10% error rate, or  $0.778 > 0.10$  states that the influence of institutional share ownership on accounting conservatism through accrual value is not significant. While the probability value on the second model of  $0.005 < \alpha 0.05$  states that the influence of institutional share ownership on mining companies listed on the Stock Exchange in 2014-2017 against accounting conservatism in the company is significant, so **Hypothesis 2 is accepted.**

### *Hypothesis 3*

From the results of the t-test (partial) the coefficient value obtained in the third hypothesis is -0.078 in the first model and -0.125 in the second model. The probability values for the two models are 0.031 and 0.076. The negative coefficient value states that the composition of independent commissioners in a company negatively affects accounting conservatism. In both models, the probability values produced are both smaller than the error rate of 5% and 10%, or  $0.031 < 0.05$  and  $0.076 < 0.10$ , which states that the influence of independent commissioners on accounting conservatism through accrual value or through market value is significant, so **Hypothesis 3 is accepted.**

### *Hypothesis 4*

The coefficient obtained -0.143 in the first model and 0.230 in the second model with a probability value of 0.000 in the first model and 0.290 in the second model. The negative coefficient value in the first model indicates that the bondholder-shareholder conflict in mining companies has a negative impact on accounting conservatism, namely accrual value. Conversely, in the second model where the resulting coefficient value is 0.230, it states that the resulting impact on bondholder-shareholder conflicts is positive. In the first model the resulting probability value is smaller than the error rate of 1%, or  $0.000 < 0.01$  stating that the effect of conflict bondholder-shareholders on accounting conservatism through accrual values is significant, so **Hypothesis 4 is accepted.** While the probability value in the second model

of  $0.290 > \alpha 0.10$  states that the effect of bonholder-shareholder conflict on mining companies on accounting conservatism is not significant.

## Conclusion

Based on the results of research and analysis of mining companies listed on the Indonesia stock exchange, managerial ownership accruals has an effect on the implementation of the Accounting Conservatism Principle, so management tends to increase the value of the company by implementing the Accounting Conservatism Principle. Likewise, institutional ownership affects the implementation of Accounting Conservatism based on market value. This shows that the Financial Report is fairer in its evaluation. However, from the other side the Commissioner does not play a role in his function as a controller in the company.

Generally Bondholder - shareholder conflict will arise because of higher proportions of debt and more risk. In the results of this study, it shows that the implementation of the accrual-based method of the Accounting Conservatism Principle is getting reduced, so companies have a tendency to engage in earnings management.

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