The Effect of Accounting Conservatism, Investment Opportunity Set, Leverage, and Company Size on Earnings Quality

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Abstrak

Penelitian ini bertujuan untuk menganalisis pengaruh konservatisme akuntansi, investment opportunity set, leverage, dan ukuran perusahaan terhadap kualitas laba. Populasi dalam penelitian ini adalah perusahaan yang terdapat dalam industri sektor barang konsumsi pada tahun 2011-2014 yang terdiri dari 38 perusahaan. Pengambilan sampel dilakukan berdasarkan metode purposive sampling dan diperoleh sebanyak 24 perusahaan. Data analisa yang digunakan adalah Regresi Linier Berganda. Hasil analisis menunjukkan bahwa konservatisme akuntansi dan ukuran perusahaan memiliki pengaruh dengan kualitas laba. Sedangkan investment opportunity set dan leverage tidak memiliki pengaruh terhadap kualitas laba. Hasil penelitian secara simultan menunjukkan bahwa seluruh variabel independen berpengaruh terhadap kualitas laba. Saran untuk penelitian selanjutnya adalah menambah variabel maupun indikator yang sesuai dengan situasi dan kondisi obyek penelitian.

Abstract

This study aimed to analyze the effect of accounting conservatism, investment opportunity set, leverage, and the size of the company towards the quality of earnings. The population in this study is companies contained in the consumer goods industry in 2011 until 2014 which consists of 38 companies. The sampling technique was purposive sampling method which results for 24 companies. Data analysis used is Multiple Linear Regression. The analysis showed that accounting conservatism and company size had influence with the quality of earnings. While the investment opportunity set and leverage did not have an influence on the quality of earnings. Simultaneous test showed that variables of accounting conservatism, investment opportunity set, leverage and company size are influence significantly with earning quality. The suggestion for further research is to add another variable and indicator for further research.

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INTRODUCTION

Financial statements are the final process of accounting process that plays an important role for the measurement and assessment of a company's performance. Financial statements are also a form of accountability of the management to the parties concerned that are the owners of companies, managers, creditors, bankers, investors, government and other parties (Munawir, 2012: 2). One part of the financial statements which are often taken as the basis for decision-making is the earnings statement (Risdawaty and Subowo, 2015). Earnings information generated by a company does not guarantee that earnings generated by the company is qualified. Companies that have good earnings quality are companies that have stable and continuing earnings (Risdawaty and Subowo, 2015). Companies with high earnings quality will report their profits transparently without engineering results. Earnings information is expected to be guidance for shareholders and other users of financial statements. The importance of a company's earnings information makes some management manipulate their real company's earnings information. This is done to attract investors to invest their shares in the company and to maintain management positions in the company. Agency theory explains that there is a separation of ownership with the manager of the company (Jensen and Meckling, 1976). In managing the company, the owner tends to appoint the agent (management) to conduct company's operations. Separation of ownership with managers can lead to conflict within the company. There are some management who modify the financial statements prepared by inflating the profits in accordance with that is desired by management. This incident can cause the resulting profit to be less qualified.

There are several cases of financial manipulation involving companies in Indonesia. As in PT Kimia Farma Tbk. At the audit on December 31, 2001, Kimia Farma management reported a net profit of Rp. 132 billion. Ministry of State-Owned Enterprises (SOEs) and Capital Market Supervisory Agency (Bapepam) considered that the net profit was too large and contained elements of engineering. After re-audit, on October 3, 2002, in the new financial statements, the profit presented was only Rp. 99.56 billion, or lower by Rp. 32.6 billion, or 24.7% of reported earnings. Errors that occurred arising from raw material industry unit in the form of overstated sales in the amount of Rp.2,7 billion, central logistics unit in the form of overstated goods inventory in the amount of Rp. 23.9 billion, and pharmaceutical wholesalers unit in the form of overstated inventory in the amount of Rp. 8.1 billion and overstated sales in the amount Rp. 10.7 billion (Kompasiana, 2015). The case of financial manipulation above occurred because the company did not explain about the actual condition of the company. This was caused by the separation of ownership that caused conflict within the company. This relationship can lead to the existence of information asymmetry because the principal or agent wants to gain maximum benefit from the management company. The case shows that financial statements that should be guidance for investors in business decision making are misleading and detrimental to these investors.

Accounting conservatism is one of the principles in accounting that has big implications for the research of company assets. Kazemi et al. (2011), states that accounting conservatism generates higher-quality profits because in practice it is able to prevent companies from inflating profits and helping users of financial statements in presenting profits. Tuwentina and Wirama (2014) examine the effect of accounting conservatism and good corporate governance on earnings quality, which shows the result that Conservatism has a positive effect on earnings quality. Earnings quality is also influenced by investment opportunity set (IOS). IOS is a company's opportunity to grow. IOS is used as the basis for determining growth classification of the company in the future. IOS can also affect the perspective of managers, company's owners, investors and creditors towards the company. Companies with high growth opportunities are considered to generate high returns as well. Research conducted by Wulansari (2009) on the effect of investment opportunity set, liquidity, and leverage

on the quality of earnings obtained the result that investment opportunity set does not have a significant effect on earnings quality. Novianti's research (2012) that measures IOS variable with market to book value of asset ratio shows that IOS has a positive effect on earnings quality.

Leverage is one of the important factors in funding the company. Financial leverage is a debt to increase profit. If the company lends to parties outside the company, the debt will arise as a consequence, means the company has made financial leverage. Companies with high leverage will cause investors less trust to the company, it is caused by the company is more concerned to pay its obligations that is debt to outsiders than the dividend payment. This leverage is also one of management supporting factors in conducting earnings management where management is willing to fulfil every requirement submitted by the lender. Associated with agency theory, lenders are one of the principals that give management authority to manage a certain amount of funds in order to fulfil obligations as a borrower. When the condition of the company is not experiencing profits then management tend to make earnings management resulting in low profit quality produced. Thus the higher the level of leverage, the lower the quality of the resulting profit. Maharani (2015) states that leverage has a negative effect on the earnings quality. Meanwhile Novianti (2012) states that leverage has no significant effect on earnings quality.

Company size is an indicator that can show about the condition or characteristics of the company. Some parameters that can be used to determine the size of companies such as the number of employees, total sales achieved, the amount of assets owned by the company and the number of shares outstanding (Romasari 2013). The size of the company related to the quality of earnings because the greater the size of a company then the company's business continuity will be higher in improving financial performance so that management does not need to practice earnings manipulation. Investors prefer to invest in large companies, this is because large companies have a lot of information and the performance of the management is better and investors assume that large companies have a good earnings quality. Research conducted by Dira and Astika (2014) shows that company size has a positive effect on earnings quality. While research conducted by Irawati (2012) shows the result that conpany size does not have effect on earnings quality. The existence of the gap phenomenon and research gap, the purpose of this study is to know the effect of accounting conservatism, investment opportunity set, leverage, and company size on earnings quality. The research hypothesis to be tested in the research is:

H_1 : Accounting Conservatism, Investment Opportunity Set (IOS), Leverage and Company Size affect on Earnings Quality.

H_2 : Accounting Conservatism has a positive effect on Earnings Quality.

H_3 : Investment Opportunity Set (IOS) has a positive effect on Earnings Quality.

H_4 : Leverage negatively affects on Earnings Quality.

H_5 : Company size has a positive effect on Earnings Quality

METHODS

The population in this study was the whole company which was on LQ 45 index during 2011 until 2014 with total number of 90 companies. The sampling technique used purposive sampling and resulted in final sample of 16 companies.

Table 1. Detail of Research Sample

Criteria	Number
Consumption sector companies listed on Indonesia Stock Exchange (IDX) year 2011, 2012, 2013, and 2014	38
Companies that did not publish audited report respectively during 2011-2014	(5)
Companies that have not profit condition respectively from 2011-2014	(7)
All data required for the research was not complete	(2)
The number of companies which become sample	24
Number of companies sample 24 x 4	96
Outlier Data	(3)
Analysis Unit	93

Source: secondary data processed, 2016

Data analysis used was multiple regression analysis with significance level of 5%. This means the research hypothesis would be accepted when the result of significance value showed less than 0.005. To get good research result hence it must be conducted classical assumption test. Classical assumption tests included tests of data normality, multicollinearity, heteroscedasticity, and autocorrelation tests.

Profit quality was one of the information affecting stakeholders in making decisions about the company concerned (Tuwentina and Wirama, 2014). This study used quality of income ratio as profit quality proxy.

$$Quality\ Of\ income\ Ratio = \frac{CFOit}{NIit}$$

Explanation :
CFO : Cash flow of company i operations in the period of t
NI : Net income of company i in the period of t

Independent variables used in this study were accounting conservatism, investment opportunity set, leverage, and company size.

Table 2. Operational Definition of Independent Variables

Variables	Definition	Measurement
Accounting Conservatism	Accounting conservatism measured through the accrual basis of Givoly and Hayn model (2002) states that if accrual is negative, then the earning is classified as conservative, which is caused by lower earnings than cash flows obtained by the company in a given period.	KNSV= $\dfrac{\text{Net Profit-Operating Cash Flow- Depreciation) x-1}}{\text{Total asset}}$
Investment opportunity set	IOS shows investment decision of a company and also company's opportunity to grow and as a basis to determine growth classification in the future.	MVBVA= $\dfrac{\text{Total Asset-Total Equities+(Shares outstanding x Closing price)}}{\text{total asset}}$
Leverage	Leverage is a ration used to measure the extent to which company's assets which financed	$Leverage = \dfrac{Total\ debt}{Total\ asset}$

	by debt	
Company Size	Company size is measured by Sizet = Ln(Tat) using natural log of total asset	

RESULTS AND DISCUSSIONS

Descriptive statistics provided overview or descriptive of a data that seen from the values of mean, standard deviation, variant, maximum, minimum, sum, range, kurtosis, and skewnes (Imam Ghozali, 2013: 19). Variables that were processed in this research were accounting conservatism, investment opportunity set, leverage, company size, and profit quality could be seen in the table below:

Table 3. Result of Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
QIR	93	-1,2574	2,7930	,913185	,7349524
KNSV	93	-,2438	,2251	,022582	,0839531
MVBVA	93	,5644	9,3102	2,797798	2,0171703
LEV	93	,1306	,9770	,380869	,1624003
SIZE	93	25,1940	32,0847	28,316001	1,7129289
Valid N (listwise)	93				

Source: output of SPSS 21, 2016

Data analysis result for hypothesis testing which included F test and t test was as follows:

Table 4. Simultaneous Test

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	24,545	4	6,136	21,472	,000b
1	Residual	25,149	88	,286		
	Total	49,694				

Source: output of SPSS 21, 2016

Based on Table 4.14 above then F_{count} value equal to 21.472 and sig value equal to 0,000 were expressed with a positive sign then the direction of the relationship was positive. In this research showed that 0.000 <0.005, then H_a or H_1 was accepted, it meant that simultaneously or together Conservatism, Investment Opportunity Set, Leverage, and Company Size affected to profit quality.

Table 5. Partial Test

Model	Unstandarized Coefficients		Standarized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	-1,680	,929		-1,808	,074
KNSV	5,968	,696	,682	8,574	,000
MVBVA	,011	,031	,030	,355	,724
LEV	,085	,034	,199	2,526	,013
SIZE	,036	,378	,008	,096	,924

Source: output of SPSS 21, 2016

Variable of accounting conservatism had a positive effect on profit quality. The result of the analysis obtained t_{count} of 8,574 stated with positive sign then the relation was positive with significance level of 0.000 <0,005 then H2 was accepted, so it could be concluded that conservatism had a positive effect on profit quality. Variable of investment opportunity set had t_{count} value equal to 0,355 expressed with positive sign then the relationship was positive with a significance level of 0.724> 0.05, then H3 was rejected, it could be concluded that investment opportunity set individually did not have effect on earnings quality.

Leverage variable had t_{count} value equal to 0,096 stated with positive sign hence its relationship was positive with a significance level of 0,924> 0,05, h4 was rejected, it meant that leverage individually did not have an effect on earnings quality. Variable of Size Company had t_{count} value equal to 2,526 stated with sign positive then the relationship was positive with a significance level of 0.013 <0.05, then H5 was accepted, meaning that the size of the company individually positively affected the quality of earnings.

Table 6. Coefficient of Determination (R^2)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,703a	,494	,471	,5345868

a. Predictors: (Constant), Leverage, KNSV, SIZE, MVBVA

Source: Output of SPSS 21, 2016

Table 6 showed that the value of Adjusted RSquare was 0.472. Adjusted RSquare's positive value indicated that the test performed gave good results. It could be said that 47.1% of independent variables could explain or predict dependent variables. It could be interpreted that the variables of conservatism, investment opportunity set, leverage and company size could explain the quality of earnings equal to 47.1%. While the rest equal to 52.9% predicted and explained by other factors.

Based on Table 4. that was accounting conservatism, investment opportunity set, leverage, and company size simultaneously affected the quality of earnings with a significance value of 0.000 or less than 0.005 9 (H_1) was accepted. Variable of accounting conservatism had a positive effect on earnings quality. The result of analysis obtained t_{count} of 8,574 stated with positive sign hence its relationship was positive with a significance level of 0.000 <0,005 then H2 was accepted, so it could be concluded that conservatism had a positive effect on earnings quality. Accounting conservatism affected the quality of earnings because some companies listed in the study has applied the principles of accounting conservatism. Kazemi et al. stated that the principle of accounting conservatism avoided the optimistic views of management and excessive attitudes toward financial statements. Conservatism was profitable for users of corporate accounting reports such as reducing management's opportunistic behaviour to increase profits, if it could be minimized then the resulting profit is more qualified. This research was in accordance with research conducted by Tuwentina and Wirama (2014) which stated that accounting conservatism had a positive effect on earnings quality.

Variable of investment opportunity set had a t_{count} value of 0.355 stated with a positive sign then the relationship was positive with a significance level of 0.724> 0.03, then H_3 was rejected, it could be concluded that the investment opportunity set individually did not effect on earnings quality. Investment opportunities did not directly affect on the quality of earnings, this could be affected by the total assets of a company or could come from internal factors of a company. Internal factors could be caused by unobservable manager actions that lead the principal could not know whether the actions undertaken by the management was in accordance with the wishes of the principals or not. This unknown actions by the principal could cause management to do something

freely without being noticed by the principal so that management was able to make earnings management that could degrade earnings quality of the company. This research was supported by Wulansari research (2009) which stated that investment opportunity set did not have effect on earnings quality. This research was different from Novianti (2012) which stated that investment opportunity set had a positive effect on earnings quality.

Leverage variable had t_{count} value equal to 0,096 stated with positive sign hence the relationship was positive with a significance level of 0,924> 0,05, then H_4 was rejected, it meant that leverage individually did not affect on earnings quality. Wulansari (2009) stated that leverage did not have significant effect on earnings quality. This was due to the level of debt was not the main focus of investors in making investment decisions, Investors focused more on published earnings. Maharani (2015) stated that leverage had a negative effect on earnings quality. The higher the level of corporate leverage would lower the quality of corporate earnings seen from the company's ability to generate operating cash flow of the company in generating profits and conversely.

Variable of company size had t_{count} value of 2,526 stated with a positive sign then the relationship was positive with a significance level of 0.013 <0.05, then H_5 was accepted, it meant that the size of the company individually positively affected on the quality of earnings. The size of earnings in this study affected the quality of earnings because the size of the company made by investors to make investment decisions. If the size of the company was large then the company had a large capital, more employees, and better sales so relatively stable compared with small companies. The larger the size of the company then automatically the operational activities of the company in obtaining profits was higher and higher. This study was in accordance with research conducted by Dira and Astika (2014) which stated that company size had a positive effect on earnings quality. This research was different with Irawati (2012) which stated that company size did not affect the quality of earnings.

CONCLUSION

The result shows that the variables of accounting conservatism and company size had a positive effect on earnings quality and for variable of investment opportunity set and leverage did not affect on earnings quality. Simultaneous testing shows that variables of accounting conservatism, investment opportunity set, leverage and company size together affected on earnings quality. Suggestion for further research is in order to use other proxies in measuring investment opportunity sets and leverage, in order to obtain an appropriate proxy for further research.

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