International Journal of Economic Research

ISSN : 0972-9380

available at http: www.serialsjournal.com

Volume 14 • Number 3 • 2017

Good Corporate Governance, Corporate Ethical Value and Creative Accounting: The Case of the State-owned enterprise in Indonesia

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Abstract: This study aims to determine the effect of good corporate governance on creative accounting practices, also, whether corporate ethical value moderate the influence of good corporate governance to creative accounting practices. The 58 state-owned enterprises (SOEs) in Indonesia obtained by simple random sampling was analyzed. By moderated linear regression analysis using SPSS, the results obtained: 1). Good corporate governance affect creative accounting practices negatively. This shows that good corporate governance are the effective instruments for reducing creative accounting practice, 2). Corporate ethical value moderates the influence of good corporate governance to creative accounting practice.

Keywords: good corporate governance, corporate ethical value, creative accounting practice.

INTRODUCTION

The quality of financial reporting in Indonesia, both in public and private sectors is not as expected yet. For example, 154 companies has problematic of financial report (Hussein, 2011). In the public sector, quality of financial reports was getting worse, which indicated through much more qualified and disclaimer opinion of financial statements (Nasution, 2011).

The low of quality of financial reporting occur because of the lack of attention in applicating of accounting standards in financial reporting, as known as creative accounting. Creative accounting is the process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of business organizations (Amat, Blake, Dowds (1999), Balaciu, et al (2009)). Accounting with creativity is often used to hide certain information from competitors, shareholders and the financial community (Amor and Warner, 2003: 22). Creative accounting as a means used by companies to adapt, develop and become more competitive in the turbulent environment in which they operate (Vladu, 2010). Creative accounting is a financial number game. Creative accounting include all things that are used in a financial number games, including aggressive choice, fraudulent financial reporting, earnings management and income smoothing (Mulford and Comiskey, 2002: 2).

Supreme Audit Agency (Badan Pemeriksa Keuangan/BPK) revealed often find fraud committed by State-Owned Enterprises (SOEs) in the accounting report. (Badan Pemeriksa Keuangan/BPK) found there were 14 state-owned enterprises (SOEs) are problematic in performance and financial statements since 2009-2014 (Qosasih, 2015). In addition, many government-owned companies have allegedly made statements as if profit received is greater than the actual earnings (Bisri, 2013).

Creative accounting in all its forms is an action that may mislead users of financial statements to present information that is not accurate and relevant. From an ethical standpoint, earnings management as a form of creative accounting is an act that violates the trust (Ficher and Resenzweig, 1995). Although creative accounting is not illegal, but it is indicate that the managers under financial pressure find solutions without consider ethical issues. In other words, a half truth and lying could be likely considered as fraud (Marilena and Corina, 2012).

LITERATURE REVIEW

Corporate Governance

Good corporate governance (GCG) is actually not a new concept. This concept was developed along with the development of social economy and the complexity of the business. GCG as a system in which companies are directed and controlled. The board of directors is responsible for corporate governance. Meanwhile, the role of shareholders in corporate governance is concerned with duties in appointing board (Cadbury Report, 1992). GCG involves a set of relationships between management, board of directors and shareholders (Organisation For Economic Cooperation and Development/OECD, 2004). GCG as structures and processes to direct and control the enterprise (Report on the Observance of Standards and Codes/ ROSC, 2010: 2).

Corporate governance can be implemented by adopting a set of principles and best practices, such as adopting policies that include environmental protection, whistleblowing, ethics training programs, and so forth. Companies with good governance will pursue gains in ethical boundaries (Arjoon, 2005). Corporate governance tend to look to the agency theory and the Council needs to curb excessive executive power to influence the decision of the board of directors, where directors face ethical pressure when making decisions (Nordberg, 2007). Corporate governance practices also affect organizational performance. In connection with managerial implications, although ethical considerations can not directly affect the performance of the organization, a higher level of ethical considerations (such as surveillance) could lead to more effective implementation of corporate governance (Wu, 2006).

Results of research on GCG showed varying results. Earnings management in companies with high family ownership that does not have a business group compared with earnings management in companies with different ownership structures (Siregar and Utama, 2008). Others, overall governance quality is negatively related to the level of abnormal accruals and positively influences the return-earnings association (Niu, 2006). The adequacy rather than the strength of corporate governance that is associated with discretionary accruals (Yaghoobnezhad, 2011). Corporate governance structure effectiveness reduces the likelihood of fraudulent financial reporting. These results indicate that effective corporate governance structure is paramount in enhancing the credibility of financial reporting (Asyiqin, et al., 2014). The role of external directors is limited and that Boards which meet more frequently take a more active position in the monitoring of insiders, so it can reduce the manipulative practice (Gonzalez and Garcia-Meca, 2014). Discretionary accrual have been used to manipulate and mislead investors. The audit committee and audit quality is believed to contribute to reduce earnings management drastically (Miko and Kamardin, 2011).

Corporate governance can reduce or even eliminate the level of earnings management. Typically, an institutional environment that provides better legal protection the interests of managers can control to a certain extent. The independence of the board can improve the behavior of specific monitoring on managers, including misappropriation of assets. The audit committee can oversee internal controls for financial reporting and the quality of financial information. Directors with financial expertise can provide additional control effect on earnings management, particularly companies with weak corporate governance (Man and Brossa, 2013).

Corporate Ethical Value

Conduct more or less synonymous with morality (Boatright, 2009: 23). However, there is little difference between ethics and morality, that ethical term often used to restrict the rules and norms of behavior or some kind of code of conduct for particular groups. Morality is generally used to describe a sociological phenomenon, namely, the existence of rules and standards of behavior in society. Every society has a morality, because this is the basis for mutually beneficial interaction.Furthermore, corporate ethical value (CEV) is part of organization culture, which represents the multidimensional interaction between the various systems "formal" and "informal" to control the behavior (Trevino, et al., 1998). Although there is no universally accepted definition, corporate ethical value is considered as a combination of individual ethical values of the organization's manager and both formal and informal ethics policy (Hunt, et al., 1989).

Corporate ethical values are important determinants of the perception of earnings management (Elias, 2004). Corporate ethical values correlated positively with ethical value leadership.Ethical value affect positively on the ethical decision making (Iqbal, et al., 2013). Ethical tendencies of CFO (Chief Financial Officer) on earnings maangement will restrict earnings management behavior. This is proved by decreasing the influence of CFO's personal and company financial incentives with high ethical earnings management (EM-Ethics) (Beaudoin, et al., 2014). Companies with high ethical commitment are not involved in earnings management, reported more conservative profits and predict future earnings more accurately comparing companies with lower ethical commitment (Choi and Pae, 2011). Ethics is a solution used to limit opportunistic behavior in accounting (Vladu and Cusdreorean, 2013).

Creative Accounting

Creative accounting is often used to hide certain information from competitors, shareholders and the financial community (Amor and Warner, 2003: 22). Amat, Blake, Dowds (1999) stated that creative accounting is the process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of a business organization. The concept of creative accounting is usually used to describe the process by which accounting professionals use their knowledge to manipulate the figures included in the report (Balaciu, et.al, 2009). Vladu (2010) defines creative accounting as a tool used by companies to adapt, develop and become more competitive in the turbulent environment in which they operate. Salome, et al (2012) suggest that creative accounting is also known as aggressive accounting is the process of dealing with matters of accounting valuation, conflicts items and events. This flexibility gives area for manipulation, fraud and error. Therefore, accountants use their knowledge of accounting rules to manipulate the figures reported in the business accounts. Kamau, et.al (2012) states that creative accounting practices explain the series of events and activities technically legal accounting conventionally not accepted or practiced. This practice is done with the aim of making the company appear financially strong or weak, depending on the management aspirations. Creative accounting involves financial statements to create the illusion that the entity is healthier and more prosperous than the actual condition. This illusion is sometimes done by creating economic realities through the misuse of accounting principles intentionally.

CONCEPTUAL FRAMEWORK

Based on the discussion presented in the literature review section, the following conceptual framework was constructed and presented in Figure 1.

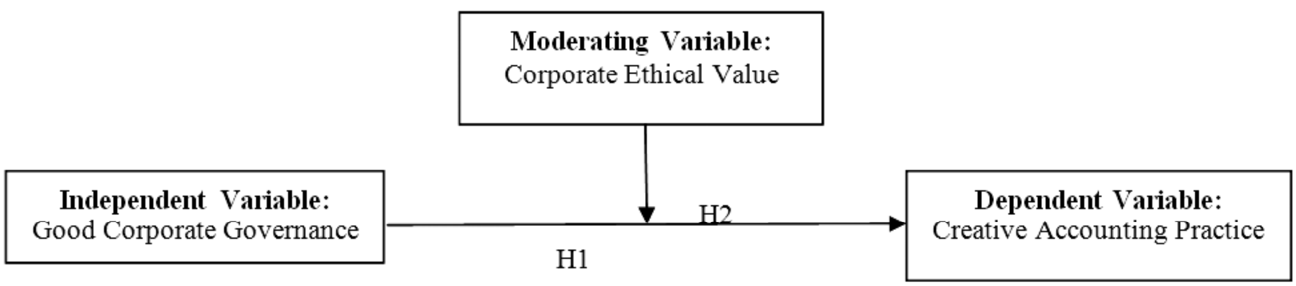

Figure 1: Conceptual framework

Based on the analytical interpretations in the previous section, the following hypotheses were proposed:

H_1: Good Corporate Governance influence the practice of creative accounting.

H_2: Corporate ethical values will moderates the influence of good corporate governance on creative accounting practices.

DATA AND METHODOLOGY

Data

This research was conducted on 58 state-owned companies in Indonesia. Primary data was collected by questionnaire, and secondary data collected from the annual report of each company.

Measurement

X1 = Good Corporate Governance (GCG), measured by GCG score is based on the SOE Ministry Secretary SK No: SK-16 / S. MBU / 2012.

X2 = CEV = corporate ethical values, using its dimension; code of ethics, leadership, structure of authority (the authority structure), reward systems, training programs, peer behavior and ethical norms, (Trevino, et.al, 1998; Hunt, et.al, 1989).

Y = Creative Accounting, using earnings management measured by discretionary accruals (DA) models Kothari (2005). The use of DA as a proxy for discretionary accruals refers to research conducted by Healy (1985) and Dechow et al. (1995).

Equation calculation of earnings management are as follows:

$$TAit = NIIT - CFOit \tag{1}$$

$$TAit = NDAit + DAit \tag{2}$$

$$TA_{it} / Ai_{t-1} = \alpha_1 (1 / Ai_{t-1}) + \beta_1(\Delta REVit / Ai_{t-1}) + \beta_2 (PPEit / Ai_{t-1}) + \beta_3 ROA + \varepsilon_{it} \tag{3}$$

$$DAit = TAit - NDAit \tag{4}$$

$$DA_{it} = (TA_{it} / Ai_{t-1}) - [\alpha_1 (1 / Ai_{t-1}) + \beta_1(\Delta REV_{it} / Ai_{t-1}) + \beta_2 (PPE_{it} / Ai_{t-1}]) + \beta_3 ROA \tag{5}$$

Which is:

TA_{it} = Total accruals for firm i in year t

NI_{it} = Net profit (net income) of firm i in year t

CFO_{it} = Cash flow from operations of firm i in year t

NDA_{it} = Non-discretionary accruals for firm i in year t

DA_{it} = Discretionary accrual firm i in year t

ΔREV_{it} = Revenue firm i in year t minus revenue year t-1

PPE_{it} = fixed assets of the company i in year t

$\alpha 1$ = Constant

$\beta 1, \beta 2$ = coefficient

Ai_{t-1} = Total assets of company i in year t-1

E_{it} = Error term

Methods

The analytical tool used Moderated Regression Analysis (MRA), by the following equation:

PCA = b1GCG + b2GCG * CEV + e

Where is :

PCA = Creative Accounting Practices

GCG = Good Corporate Governance

CEV = Corporate Ethical Value

RESULTS AND DISCUSSION

Description

GCG variables obtained from the annual report state-owned companies in Indonesia. The statistical description of the variables GCG state-owned enterprises in Indonesia, the lowest index of 67.50 and a highest index of 97.04, and a standard deviation of 7.2.

Table 1
Statistic Descriptive of Good Corporate Governance

Item	*Min*	*Max*	*Mean*	*Deviation Standard*
GCG Index	67.50	97.04	83.9	7.2

Corporate Ethical Value variable consists of seven dimensions, each of which have an indicator. Seventh dimensions are: code of ethics, leadership, authority structure, reward systems, program training, peer behavior and ethical norms. Corporate ethical values have a score of 4.06 that is included in the high category. CEV was collected using questionnaires which distributed to the respondents, amount 195 copies (65 units @ 3copies). Of these, questionnaires were completed and returned as many as 95 copies, one copy is not complete, so the number of questionnaires were analyzed as many as 94 copies from 58 entities. Thus, the questionnaire response rate of 48.2051% (94/195) of the number of questionnaires or 89,23% of the units of analysis (58/65).

Creative accounting practice (Y) was measured using discreationary accrual (DA). Decompotition of total accruals into normal and abnormal accruals or discretrionary accrual used Kothari model, which developed from modified Jones model. Abnormal accrual / discretionary accrual component which not explained by variations in sales changes, variation changes in accounts receivable and fixed assets variation. In theory, the amount of the accrual is affected by changes in sales, accounts receivable, and fixed assets.

Table 2
Statistic Descriptive of Discretionary Accrual

Item	*Min*	*Max*	*Mean*	*DeviationStandar*
Discretionary Accrual	-0.12	8.06	0.6009	1.07

Of the 58 companies have an average of DA 0.6009, the lowest of -0,12 and the highest of 8,06. Negative sign indicate income increasing type of earnings management, while positive sign indicate income increasing type of earnings management. The average value of earnings management was 0,6009, indicating that on a net basis, abnormal return is positive, which means there is of rising accrual trend. Of the 58 companies surveyed, 54 companies (91.52%) had positive of DA, and 5 companies (8.48%) had negative of DA.

Test result

The result of test to examine the influence ofgood corporate governance to creative accounting practice and corporate ethical value as the moderating variable, conducted using moderated lenear regression, are presented in Table 3 as follows:

Table 3
Regression Output

Variables	*Coeficient (Standardized)*	*p-value*
Good Corporate Governance (GCG)	-0,770	0,151*)
Corporate Ethical value	0,429	0,707
Interaction: GCG*CEV	1,640	0,161*)
R	0,877	
R^2	0,769	
Adjusted R^2	0,725	
F-test	17,737	0,000

*)sig at α 0,1, *one- tailed test*

Goodness of fit this model, that is R^2 was 0,769 and adjusted R^2 0,725.These results shows that the regression model appropriate to predict discreationary accrual based on existing data. The result shows that GCG has negative effect the creative accounting practices significantly, by regression coefficient of -0.770. The p-value (0.0755/) is smaller than α (0,1), at one-tailed test. Other result showed that the CEV moderating the influence of good corporate governance practices to creative accounting practice. The coefficient of 1,640 and p-value of 0.161/2 resulting p-value (0.0805) is smaller than α (0,1), one-tailed test.

Discussion

This study result that corporate governance has negative influence on creative accounting practice significantly. This means that the increase in GCG will be followed by a decrease in creative accounting practices. Corporate governance is the structure and processes to direct and control the enterprise. Corporate governance concerns the relationship between management, board of directors, controlling shareholders, minority shareholders and other stakeholders (ROSC, 2010: 2).In this study, GCG measured using scores on state-owned companies in Indonesia. GCG score is calculated based on decree of Secretary of the Ministry of State Enterprises No: SK-16/S.MBU/2012, that is about indicators / parameters of assessment and evaluation of the implementation of GCG in SOEs. Assessment indicators of GCG implementation in SOEs consist of six aspects are detailed further to 153 indicators, six aspects are: 1). Good sustaineble commitment to the implementation of GCG, 2). Aspect shareholders and General Meeting of Shareholder, 3). Aspects of the Board of Commissioners / Board of Trustees, 4). Directors, 5). Aspects of the disclosure of information and transparency, 6). Other aspects.

Scores of this assessment are then categorized into five categories, that is very good, if a score> 85, well, if the score> 75-85, good enough for a score of> 60-75, not good for a score of> 50-60, and not good <50. The results showed that 33.9% state-owned company is in excellent condition in implementing GCG, 44.07% included in the good category, 5.08% is not good, and 16.95% do not have a score of GCG.

The results explain the phenomena associated with the implementation of GCG in SOEs in Indonesia. Chairman of the State Finance Accountability Committee House of Representatives, Sumarjati Arjoso stated that most of the SOE (State Owned Enterprises) do not have good governance yet. In 1st semester of Examination Results Summary 2013 there were 21 objects of State Owned Enterprises (SOEs) examinated. They review the results of Audit Board Agencies (BPK) 1st semester of 2013 of examination related to SOE, which found that 510 cases of financial irregularities the State of which 234 cases related to the weakness of internal controll and 276 cases related to non-compliance legislation.

Based on information obtained, the problems regarding the implementation of GCG in SOEs as follows:

1. There are some SOEs that have not implemented GCG mechanisms yet, or initiate new GCG implementation in cooperation with the Supreme Audit Agency (Badan Pengawasan Keuangan dan Pembangunan/BPK).
2. SOEs need to increase the role of board of directors, especially independent directors. According to the Regulation of the Minister of State Enterprises No. Per-01 / MBU / 2011 about implementation of GCG in SOEs Article 13, 20% of commissioners/supervisory board are independent directors. Commissioner/independent supervisory board is a member of the Board of Commissioners/ Board of Trustees who do not have the financial, management, share ownership and/or related to other members of the Board of Commissioners/Board of Directors and/or the controlling shareholders or relationship with SOE, which may affect her/his ability to act independently. The role of independent directors are to supervise the management of the policy, both the SOE and the SOE business and give advises to the Board of Directors.
3. The role of the audit committee still needs to be improved. The audit committee is responsible for assisting the board of directors to supervise them to ensure the effectiveness of the internal control system and ensure the external and internal auditors tasks. In addition, the audit committee performing other assignments requested by the Board of Commissioners. In performing its duties, the audit committee is independent and directly responsible to the board of commissioners. The results showed there are some companies that do not have an audit committee, yet. This affects the supervision of state-owned enterprises.

The results support the findings of Niu (2006) which find that the quality of overall governance negatively correlated with abnormal accruals and positively influence earnings return. Yaghoobnezhad (2011) find that the adequacy rather than the strength of corporate governance that is associated with discretionary accruals. Companies with good governance will pursue gains in ethical boundaries (Arjoon (2005). Meanwhile, Miko and Kamardin (2011) states that discreationary accrual accounts have been used to manipulate and mislead investors. The audit committee and audit quality is believed having role in reducing earnings management drastically.

(Asyiqin, et al., 2014) found that the effectiveness of the corporate governance structure reduces the possibility of fraudulent financial reporting. These results indicate that effective corporate governance structure is the paramount of improving the credibility of financial reporting. Gonzalez and Garcia-Meca (2014) states that external directors have a limited role rather than Board which more often plays an active role from inside monitoring, so that it can reduce manipulative practices. Huang, et al., (2008) proved that management is not involved in the misuse of earnings management seeks to provide market signals about the quality of corporate financial information through a selection of board membership. Results research shows that corporate ethical values moderating the influence of good corporate governance on creative accounting practices significantly. This is consistent with the statement of Elias (2004) which states that corporate ethical values are important determinants of perception earnings management.

This study is also consistent with previous testing indicating that GCG influence the practice of creative accounting. With the application of ethical values in conducting surveillance, the ethical values will further strengthen supervision to avoid unethical practices, including the practice of earnings management. This is consistent with the statement of Nordberg (2007) states that the theory of corporate governance tend to look to the agency theory and the board needs to curb excessive executive power to influence the decision of the board of directors, where directors face ethical pressure when making decisions. Wu (2006) found that corporate governance practices also affect organizational performance. In connection with managerial implications, this shows that even though the ethical considerations can not directly affect the performance of the organization, a higher level of ethical considerations (such as supervision) could lead to more effective implementation of the corporatae governance.

Based on respondents' statements, the company always strives to implement ethical value, but still need more attention to implement the company's ethical values as follows:

1. Need to increase socialize of code of conduct to all leaders and employees as part of raising awareness of ethical the organization members .
2. Need to increase the commitment to enforce ethical standards by management as an role models.
3. Enforcement of reward and punishment related to ethics violations.

This results supports the results of previous studies. Arjoon (2005) states that good corporate governance will encourage companies with good governance will pursue gains in ethical boundaries. Valdu and Cusdreorean (2013) states that ethics as a solution used to restrict opportunistic behavior in accounting can have unlimited potential as a long-term solution. Sabir, et.al (2012) shows that corporate ethical values correlated positively with ethical leadership. Furthermore, Iqbal, et al., (2013) shows that the ethical value has positive influence on ethical decision making.Greenfield, et al., (2008) demonstrate a significant relationship between individual ethical orientation and decision making. People with levels higher professional commitment seems less likely to engage in earnings management behavior and less likely to behave opportunistically. Choi and Pae (2011) found that firms with high ethical commitment not to engage in earnings management, reported profits of more conservative, and predict future earnings more accurately rather than companies with lower ethical commitment.

CONCLUSION

1. Good corporate governance affect creative accounting practices negatively. This prove that good corporate governance are the effective instruments for reducing creative accounting practice.
2. Corporate ethical value moderates the influence of good corporate governance to creative accounting practice. Its means that corporate ethical values are important determinants of the perception of creative accounting.

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