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by Novi Darmayanti

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THE IMPLICATION OF OPPORTUNISTIC BEHAVIOR TOWARDS A FINANCIAL REPORT CONSERVATISM (A Study of Banking Company Go-Public at IDX)

Novi Darmayanti[1]* Nur Suci Mei[2]
[1]Universitas Islam Darul Ulung Lamongan-Indonesia, and [2]STIE Perbanas Surabaya-Indonesia

Corresponding email: novismile_ub@yahoo.com

ABSTRACT

The aim of this study is (1) to examine the accounting conservatism from its upside parts, especially on its relation with debt contract and dividend payments; (2) to examine the phenomenon of debt contract and dividend payments that potentially generates opportunistic behavior regarding the dividend policy. An analysis unit is a banking company that go-public at IDX during 2011-2012. The Implication for Business Practices/Practical Contribution (1) A manager is able to consider the decision-making, particularly related with opportunistic behavior, towards financial report conservatism, (2) An accountant tends to be more conservative in making and presenting the financial report based on Indonesian Accounting Standard (IAS). Theoretical Contribution this study contributes to Market Based Accounting Research.

Keywords: conservatism, opportunistic behavior, dividend

1. INTRODUCTION

Opportunistic behavior is a conflict of interests between investors and creditors caused by the tendency of investors to do a transfer of wealth from the creditors (Fama, 1978a; 1978b). Creditors urges a rather high interests rates and the implementation of a more conservative financial report (De Jong and Dijk, 1999). The concept of opportunistic behavior is divided into three: (1) in terms of direct transfer of wealth, the dividend payments is too high and fund sources from the debt tends to become a major priority (Smith and Warner, 1979); (2) In the case of asset substitution, in which a company is involved in the high-risk projects (Jensen and Meckling, 1976); (3) in the case of underinvestment, in which investment prospect and growth will not be implemented by investors unless there is a loan from the creditors. The implication of those 3 concepts leads to the effort of transfer of wealth from creditors to investors. In other words, investors prefer funding coming from debts. Therefore, the more debts a company owns, the more potential opportunistic behavior made by investors and creditors (Fama and Miller, 1972). All of those three concepts become a motivation towards the implementation of financial report conservatism. Some trickery cases in Indonesia implicitly reveal the low rate of conservatism implemented by a company in making their financial report (Ahmed et al., 2002).

This study is inspired by the study conducted by Ahmed et al. (2002) stating that trickery cases in Indonesia implictly reveal the low rate of conservatism implemented by a company in making their financial report. This study has not ever been conducted before, especially in Indonesia (Ahmed et al., 2002), and hence the writer pays attention to conduct a further research. This stufy aims to: (1) Examine the accounting conservatism from its upside parts, particularly related with contract of debts and dividend payments; (2) Examine the contract of debts' phenomenon and dividend payments that potentially generate opportunistic behavior associated with dividend policy.

There are 2 limitations in this study:

1. The use of sample is only limited for banking company that go-public at BEI, and therefore, it could not be generalized for all kinds of industries.
2. The range of time of the financial report data is only used during 2011-1012, and hence, the amount of the sample is rather only a few.

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2. LITERATURE REVIEWS

2.1. Theory

Theory implemented in here is agency theory stating that if there is a separation between the owner as the principle and the manager as the agent that runs a company, there will be an agency problem since each party attempts to optimize its functions of utility. In order to minimize the agency problem, it needs contracts in the company either between the shareholders and the manager or contracts between management and employees, suppliers, and creditors (Jensen and Meckling, 1976).

2.2. Related Studies

Basu (1997) defined conservatism as a practice in decreasing profit and lowers net asset in responding bad news, yet it does not increase profit (net asset) in responding good news.

Qiang (2003) stated that investors were able to transfer wealth from creditors through a too high dividend payment, funding for new debts, and transfer, acquisition, or penghapusan aktiva. In order to deal with this conflict, it needs a dividend restriction, capital structure, and assets changes. The restriction is usually included in the loan agreement. So, creditors tended to urge a more conservative financial report.

A hypothesis about relations between conflicts of interests in the contract of debt and conservatism is based on an assumption stating that the opportunity of company investments generates a dividend policy and company funding. Related with several fundings needed to implement a company investment opportunity, it is assumed that a manager also urges to reduce cost of debt. A company is able to reduce its cost of debt by receiving a more strict rules of restrictions regarding dividend payments and applying conservatism accounting.

Watt and Zimmerman (1986) stated about debt hypothesis in positive accounting. The hypothesis is that a company owning debts tends to report its profit higher in order to avoid the debt restrictions. Besides, a manager can choose the more aggressive method in order to optimize income and influence the debt creditors.

Ahmed et al. (2002) stated that there would be a possibility for a company not to apply a conservative accounting because it will sacrifice the other aspects. The aspect sacrified is the lower profit performance that leads to the bad marking from the outsiders.

Therefore, studies that only see the relations between opportunistic behaviors caused by contract of debts and conservatism are not sufficient, unless they consider some other factors such as the dividend payment and the uncertainty rates of operation.

This study completes the gap research conducted by Ahmed et al. (2002) by adding the variable of opportunistic behaviors, that is the operation uncertainty yang diproksikan with dividend pay out (DPO), measured by a long period debt ratio towards the assets.

2.3. The Development of Hypothesis

Ahmed et al. (2002) stated that financial report conservatism may decrease opportunistic behavior regarding the dividend policy between shareholders and creditors, particularly those who stated that a company having dividend policy conflict would implement a more conservative financial report policy, and the company implementing a conservative financial report policy will generate a lower cost of debts. This statement is based on theory that conservative financial report will decrease the amount of profit and held profit that is used in the contract of debts in order to restrict the paid dividend. So, the more conservative financial report method's option is one among several ways that can reduce risks to the creditors, that is avoiding the excess of dividend payments. Reducing risks is important. The conflict between the shareholders' interests and creditors are getting wider and leading to other conflicts such as a policy of new debt funding and investment policy. When a company chooses a more conservative financial report method, then a creditor will receive higher return related wih the prevention of high dividend payments. In the basis of this reason, the hypothesis is as follows:

H_1: There is an implication of opportunistic behavior towards financial report conservatism

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3. METHOD

3.1. Dependent Variable

Dependent variable used in this study is dummy variable, those are (1) conservatism and (0) optimistic. The measurement of conservatism in this study is conducted by having several assumptions that is based on Indonesian Accounting Standard (IAS) (2012). The measurement of conservatism proxy based on Earnings/accrual measures (Givoly and Hayn, 2000; Dewi, 2004; Widya, 2004) is:

$$C_{it} = NI_{it} - CF_{it}$$

C_{it} = The rate of conservatism
NI_{it} = Net profit before extraordinary item minus depreciation and amortization
CF_{it} = cash flow from operational activity

If the difference between net profit and cash flow is in negative, then profit is included into conservative (1), yet if the difference between net profit and cash flow is in positive, then the profit is optimistic (0). It is because of profit, which is lower than cash flow obtained by companies during certain period of time.

3.2. Independent Variable

1. The Uncertainty of operation substituted with the standard of return on asset (ROA)
2. The Rate of Dividend Payments substituted with dividend pay out (DPO), that is measured from the percentages of total assets
3. The Debt Rate substituted with leverage, and measured from a long period debt ratio towards assets.

Examined was banking company which goes public at IDX under some considerations:

(1) Banking company which goes public at IDX is regarded, by the writer, as a company with stable net profit report that could support Indonesian economy leading to a small financial report conservatism since the Banking financial report making at IDX is based on SAK in Indonesia.

(2) There are lots of sudies regarding financial report conservatism using manufacturing companies and services industry, and hence the writer considered other companies that were never been involved in financial report conservatism by taking sample of banking company which goes public at IDX.

4. RESULTS AND DISCUSSION

The model used to analyse the data in this study is logistic regression. Logistic regression is part of regression analysis used to analyze dependent variable in which the category and independent variable is categorized, continued, or the combination of both of them. In the testing of logistic regression, assumption of data normality is not necessary since it is included in non-linear regression and therefore it does not meet the requirements of ordinary least square (OLS) method (Ghozali, 2005). Dummy variable conducted in this study, plus the other 3 independent variables, aims to examine whether the probability of conservatism is influenced by the uncertainty of operation, the rate of dividend payments, and the debt rate.

Model:

$$\mathbf{C_{it} = \beta_0 + \beta_1 ROA + \beta_2 DPO + \beta_3 DC + \epsilon_{it}}$$

Where:

a. C_{it} is dummy variable: 1 is for conservativeaccounting, and 0 is for optimistic.
b. X_1 (ROA) is the uncertainty of operation substituted with standard deviation return on asset (ROA).
c. X_2 (DPO) is the rate of dividend payments substituted with dividen pay out (DPO)
d. X_3 (DC) debt covenant that is substituted by applying leverage (long term-debt/assets) company to period t.
e. ϵ_{it} = error term.

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According to the data taken from 29 banks, it can be put into table about the selection result of the conservatism financial report method and (net profit < cash flow: negative conservatism) and optimism (net profit > cash flow: positive conservatisme). The result of tabulation can be seen in table 1.

Table 1: The Selection Result of Financial Report Method

The Selection of Financial Report Method	Name of the Banks
Conservatism (net profit < Cash Flow) 2011-2012	Bank Pundi Indonesia Tbk.; Bank PermataTbk; Bank of India Indonesia; Bank Mayapada InternasionalTbk; Bank OCBC NISP Tbk; Bank Himpunan Saudara 1906 Tbk
Optimism (net profit > Cash Flow) 2011-2012	Bank Capital Indonesia Tbk.; Bank MutiaraTbk.; Bank Danamon Indonesia Tbk.; Bank BumiArtaTbk.; Bank Pan Indonesia
Conservatism (net profit < Cash Flow) 2011 or only in 2012	Bank Agroniaga Tbk (2011); Bank ICB Bumiputera (2012); Bank Central Asia Tbk (2012); Bank BukopinTbk. (2012); Bank Negara Indonesia (Persero) Tbk (2011); Bank Nusantara ParahyanganTbk. (2012); Bank Rakyat Indonesia (Persero) Tbk (2011); Bank Tabungan Negara (Persero) Tbk.; Bank QNB KesawanTbk. (2012); Bank Mandiri (Persero) Tbk. (2011); Bank CIMB NiagaTbk. (2012); Bank Internasional Indonesia Tbk (2012); Bank Sinarmas Tbk (2011); Bank Tabungan Pensiunan NasionalTbk (2012); Bank Victoria International (2012); Bank Artha Graha Internasional Tbk (2011); Bank Windu Kentjana International Tbk (2011) ;
Optmism (net profit > Cash Flow) 2011 or only in 2012	Bank Agroniaga Tbk (2012); Bank ICB Bumiputera (2011); Bank Central Asia Tbk (2011); Bank Bukopin Tbk. (2011); Bank Negara Indonesia (Persero) Tbk (2012); Bank Nusantara ParahyanganTbk. (2011); Bank Rakyat Indonesia (Persero) Tbk (2012); Bank QNB KesawanTbk. (2011); Bank Mandiri (Persero) Tbk. (2012); Bank CIMB NiagaTbk. (2011); Bank Internasional Indonesia Tbk (2011); Bank Sinarmas Tbk (2012); Bank Tabungan Pensiunan NasionalTbk (2011); Bank Victoria International (2011); Bank Artha Graha Internasional Tbk (2012); Bank Windu Kentjana International Tbk (2012)

From table 1:

1. The companies selected a conservative financial report method (net profit< cash flow) for 2 consecutive years 2011 and 2012 are 6 banks
2. The companies selected an optimistic financial report method (net profit> cash flow) for 2 consecutive years 2011 and 2012 are 5 banks
3. The companies selected a conservative financial report method (net profit< cash flow) for 2 consecutive years in 2011 7 banks and 2012 9 banks.
4. The companies selected an optimistic financial report method (net profit> cash flow) for 2 consecutive years in 2011 9 banks and 2012 7 banks

Bank choosing a conservative financial report either in 2011-2012 or one between 2 years reveals that the banks decrease the amount of profit and it is used in the contract of debt in order to restrict the paid dividend. It is done in order to reduce risks of opportunistic behavior between shareholders and creditors since there is a new policy regarding the new debt funding and investment policy.

Table2: The Result of logistic regression analysis

Variable	B	Wald	Sig.	Exp (B)
ROA	0.327	5.467	0.019	1.387
DPO	0.015	4.553	0.033	1.015
DC	15.077	7.192	0.013	3530676.311
Constant	-13.489	3.21	0.073	$1.386\ 10^{-6}$
Nagelkerke R Square = 0.498 Hosmer and Lemeshow Test = 32.907 Prob = 0.000				

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According to table 2, the equation of logistic regression is as follows:

$$\ln\left(\frac{p}{1-p}\right) = -13.489 + 0.327\ X_1 + 0.015\ X_2 + 15.077\ X_3$$

According to the equation above, the explanations are as follows:

1. The coefficient of the conflict of interest towards the uncertainty of operation (X_1) is 0.327, whereas if the other independent variables regarded constant, then in every change of opportunistic behavior towards the uncertainty rate of operation (X_1) will contribute to the probability prediction of accounting conservatism (net profit < cash flow) of 1.387 ($e^{0,327}$) higher compared to optimism (net profit < cash flow)
2. The coefficient of the conflict of interest towards the rate of dividend payments (X_2) is 0.015, whereas if the other independent variables is regarded constant, then in every change of opportunistic behavior towards the rate of dividend payments (X_2) will contribute to the probability prediction of accounting conservatism (net profit < cash flow) of 1.015 ($e^{0,327}$) higher compared to optimism (net profit < cash flow)
3. The coefficient of the conflict of interest towards the debt rate (X_3) is 15.077, whereas if the other independent variables is regarded constant, then in every change of opportunistic behavior towards the the debt rate (X_3) will contribute to the probability prediction of accounting conservatism (net profit < cash flow) of 3530676.311 ($e^{15,077}$) higher compared to optimism (net profit < cash flow)

Based on the table above, the explanation of the result towards hypothetical examination is as follows:

1. The significant value in opportunistic behavior variable towards the uncertainty rate of operation (X_1) is 0.019 < 0.05 reveals that the variable is significantly applied in order to predict the accounting method in the bank.
2. The significant value in opportunistic behavior variable towards the rate of dividend payment (X_2) is 0.0033 < 0.05 reveals that the variable is significantly applied in order to predict the accounting method in the bank.
3. The significant value in opportunistic behavior variable towards the debt rate (X_3) is 0.013 < 0.05 reveals that the variable is significantly applied in order to predict the accounting method in the bank.

The percentage of banks' prediction in applying conservatism and optimism can be seen in table 3 as follows:

Table 3 : The percentage of banks' prediction in applying conservatism and optimism

The number of Banks	Numbers of customers predicted in the upcoming time		Total
	Optimism	Conservatism	
Optimism (net profit>cash flow)	14	13	27
Conservatism (net profit<cash flow)	5	26	31

Based on table 3, the explanation is as follows:

1. There are 27 data of company applying optimism accounting. 14data (51.85%) is predicted keeping up applying optimism accounting, while 13 data of company (48.15%) is predicted applying conservatism accounting method.
2. There are 31 data of company applying conservatism accounting method. 26 data (83.87%) is predicted applying conservatism accounting method, while 5 data of company (16.13%) is predicted applying optimism accounting method.

5. CONCLUSION

Based on the analysis above, the accurate prediction of the three independent variables towards accounting conservatism is 68.97 %. Among 28 banks during 2011 and 2012, it is found that 83.87 %

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data is predicted applying conservatism accounting method. It reveals that banking world applying conservatism in financial report that is more transparent, accountable, and qualified, so it could protect related parties.

This finding supports the previous study conducted by Qiang (2003) that in order to decrease opportunistic behavior, it needs dividend, capital structure, and the asset changes included in the debt agreement, so creditors tends to urge a more conservative financial report.

This finding also supports the previous studies conducted stating that a company can reduce the cost of debt by receiving the more restricted constraint in terms of dividend payments and must implement conservative accounting that is the conservative financial report.

In fact, there are still many trickery cases in Indonesia regarding the financial report. It also supports the study conducted by Ahmed et al. (2002) stating that los of trickery cases in Indonesia indirectly indicates the low rate of conservatism applied by the company in making their financial report. It is because of the possibility of a company not to apply the conservative accounting. If it is applied, then it will sacrifice other aspects. Those aspects are the profit performance reported is lower that leads to the unfair assessment from outsiders.

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