
ACCOUNTING INQUIRIES
WITH NEW APPROACHES
IN THE
POST-PANDEMIC ERA

Volume 2

Editors

Prof. Dr. Iskandar MUDA

Dr. Muhammad Ali TARAR

Mr. Luigi Pio Leonardo CAVALIERE



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Volume II

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PREFACE

In the digital era and technological developments like now, the flow of information goes so fast, internet technology has changed one's view of getting information, including in the world of business accounting. Technological developments change business, making the number of human resources needed in business, including accounting staff, not many. This has resulted in the underestimation of the accounting profession regarding the impact of technology on accountants' work. This is a formidable challenge that must be answered.

The rapid development of technology is a signal of the era of automation/digitalization. That is, the role of technology began to shift control of the work that is usually done by humans. The potential of technology to replace the role of the accounting profession is only a matter of time. The role of accountants will be strategic and consultative. Therefore, accountants need to have certifications such as technologically fluent, in order to be able to survive in the competition. An accountant must also have a strategy, including mastery of soft skills, both interpersonal skills and intra-personal skills, business understanding skills and technical skills to be able to answer the challenges of this digital era. An accountant must be aware of the development of the industrial revolution 4.0 by looking at the opportunities that exist.

Changes in the era are unavoidable, and therefore must always be able to control reactions and attitudes towards these changes in order to be able to move forward with the times. In the accounting sector, the various challenges that come with the advent of the digital era cannot be left alone, they must be studied properly in order to determine the attitude to overcome them. Fluency in technology is one of the keys to facing challenges in this era.

In the next 5 years where 5G technology in telecommunication devices has been fully adopted, internet access at Gigabit per second speed and hardware and humans

have been connected to each other either by IoT or IoP, will change the role of accountants which will be replaced by AI technology (Artificial). Intelligence) and robotics in carrying out the basic work of accountants, namely recording transactions, processing transactions, sorting transactions, automating the preparation of financial reports as well as analyzing the financial statements independently without human intervention. This pattern of self-management of the basic functions of accountants certainly increases the efficiency and effectiveness of work and the results are immediately known (real time). Many companies have developed this because it has been supported by standardization of financial management processes and adequate standardization of information system architecture and according to the demands of the fourth generation industry so that the crucial competencies needed for the next accountant are data analysis skills, following developments in information technology and updating leadership styles.

For this reason, students must be ready to face it all and readiness is shown by the mindset outlined in the paper Accounting Inquiries with New Approaches in the Post-Pandemic Era Volume II.

Prof. Dr. Iskandar MUDA
Bursa - July 2022

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CHAPTER 1

The Quality of Internal Audit and Hofstede's Cultural Dimensions (A Study in Indonesian State Universities)

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ABSTRACT

Based on this, this research was conducted to explain things that can improve the quality of internal audit of a State University (PTN) so that it can improve the quality of auditing and internal supervision of a PTN, and its relationship with the cultural dimensions that the PTN has. This study uses a quantitative descriptive method. In obtaining research data, researchers will distribute questionnaires to research samples. Related to this, the population of this study is all members of the internal supervisory unit of state universities in Indonesia, while the sample that the researcher will use is individuals who respond to the research questionnaire. The results showed that the variables Power Distance, Uncertainty Avoidance, and Individualism had an effect on the Quality of Internal Audit. This study proves that it is necessary to increase education for members of the internal supervisory unit of state universities so that they are always objective in conducting supervision. This education improvement is carried out in order to achieve an ideal internal audit environment.

Keywords : Power Distance, Uncertainty Avoidance, Individualism, Quality of Internal Audit

1. INTRODUCTION

In some developing countries, the attitude towards the actions required by the Chief Audit Executive (CAE) in maintaining the independence of the Internal Audit Function (IAF) is different, thereby increasing barriers to the implementation of internal audit tasks. Effective (Al Qadri et al., 2020). These different attitudes stem from different cultural views and traditions (Hell & Wang, 2009). This topic has been a hot topic of discussion among previous researchers, but very few researchers have discussed the impact of culture on the way internal audits as opposed to externals perform their work. These researchers reveal that in countries believed to have low scores on uncertainty avoidance, collectivism, and assertiveness, it is more common to find a professional internal audit community than in countries not characterized by these traits. At the same time, they find that in countries where lower levels of power distance and collectivism prevail, they are more likely to find high levels of uniformity in internal audit practices (Habbe et al., 2019). Indonesia scores highly on uncertainty avoidance, collectivism, and power distance, and as a result can be expected to result in a lack of uniformity in internal audit practice along with a lack of professionalism among members of its internal audit personnel.

This lack of uniformity and professionalism can be seen as a result of certain cultural traits that result from the fact that Indonesian society is based on ideas of family and personal ties, and traditional imperatives. This means that it is very likely that the activities undertaken by the IAF, which operates as a monitoring and control mechanism to remove vested interests from financial transactions, could be compromised, and with it efforts to result in good corporate governance.

The object of this research is Indonesia State Universities. The reasons why this research makes state universities as the object of research is because the largest funding of state universities which comes from the state budget revenues and expenditures APBN. In connection with In this case, mismanagement of APBN funding will have an impact on the emergence of potential acts of corruption that lead to state losses, in which the possibility of these acts of corruption can be reduced by strengthening efforts internal control in a PTN (Nurhasanah, 2016). In addition, college The country is also a forum for community learning and is very important concerns the interests of the wider community, for which these three reasons are regulated and described in Law no. 12 of 2012 concerning Higher Education.

2. LITERATURE REVIEW

Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013) explains that Internal audit is a process carried out by the board of directors, management and other personnel in an organization. This process is designed to provide reasonable assurance regarding the achievement of the organization's objectives related to operations, reporting, and compliance with existing regulations (Sinaga et al, 2020).

The International Standard for Professional Practice of Internal Auditing adds that basically there are three parties that participate in an internal audit process, namely 1) those who are directly involved with the operations, functions, processes, and systems of an organization, 2) the group that carries out the internal audit or assessment., and 3) the group that uses the results of the assessment carried out.

In connection with this explanation, the quality of an audit can also be projected through the level of reliability of the audit report results (Zahmatkesh and Rezazadeh, 2017, Elisabeth et al., 2018 and Muda et al., 2020). In addition, audit quality can also be assessed from detected supervisory weaknesses (Bedard and Graham, 2011, Cavaliere et al., 2021 and Purba et al., 2021), the number and level of accuracy of audit findings, auditor's skeptical individualism, value of recommendations, clarity of reports, audit benefits, and follow-up on audit results (Efendy, 2010 and Warae et al., 2021).

This monitoring process, as explained in the previous section, is very likely to be influenced by the characteristics or values of a culture (Atmanegara et al., 2021). This research will focus on *Hofstede's cultural dimensions*, namely *Power Distance*, *Uncertainty Avoidance*, and *Individualism*. The three dimensions of culture can be interpreted as;

Power Distance

Power distance is a cultural dimension that measures the extent to which individuals in a social environment accept disparities in social status. High power distance will tend to see that power is held by the highest position in a hierarchy. Meanwhile, low power distance has more democratic thinking and respects each individual's opinion (Hofstede, 2014).

There are implications for internal audit effectiveness from these characteristics, and hence, it is imperative to consider them in any exploration of internal audit quality, because, as noted by Gramling and Vandervelde (2006) and Nasution et al (2022), low QIA may represent a material weakness in internal control.

H1: *Power Distance* has a negative effect on Internal Audit Quality.

Uncertainty Avoidance

Uncertainty Avoidance is a cultural dimension that measures the extent to which individuals feel comfortable or not with uncertainty and how much confidence the individual has to avoid uncertainty (Liu and Tang, 2007; Hofstede and Bond, 1984).

In the research of Sarens and Abdolmohammadi (2010), it was revealed that uncertainty avoidance is negatively related to internal audit professionalism. And other researchers, such as Hell and Wang (2009) and Hughes et al. (2009), claim that a high uncertainty avoidance environment encourages less accurate audits. Thus, it can be said that organizations with high uncertainty avoidance have less QIA.

H2: *Uncertainty Avoidance* has a negative effect on Internal Audit Quality

Individualism

Individualism is a cultural dimension that measures how individuals see themselves as independent individuals or as individuals who are part of a group (Liu and Tang, 2007). Collectivism within (professional) groups may be strong, and this may trigger greater professional attitudes towards the use of, and compliance with, standards (Abdolmohammadi & Sarens, 2011), thereby increasing QIA. Of course, it is logical for individuals who consider themselves to be part of a professional community to seek to adhere to the best practices as identified by that community, thereby maintaining quality within the IAF.

H3: Individualism has a negative effect on Internal Audit Quality.

3. METHODS

This research is an *explanatory*. Research *Explanatory* is a study that aims to explain the causal relationship between independent and dependent variables (Sekaran and Bougie, 2017). In this regard, this study uses all members of the internal supervisory unit of state universities in Indonesia, while the sample that the researcher will use is individuals who respond to the research questionnaire.

4. RESULTS AND DISCUSSION

4.1. Results

After testing the responses to the research questionnaire, the researcher can perform a descriptive analysis as below.

Table 1. Descriptive Variable

Variable	N	Min	Max	Average	Std. Deviation
Power Distance	100	23	90	64	15
Uncertainty Avoidance	100	52	250	213	26
Individualism	100	20	40	29	8.5
Internal Audit Quality	100	25	50	45	10.5

After the Descriptive Analysis, the researcher will conduct a Validity Test and Reliability Test. Validity test is a procedure to ensure whether the questionnaire that will be used to measure the research variables is valid or not. In addition, the reliability test is a test used to measure a questionnaire which is an indicator of a variable. A questionnaire is said to be reliable or reliable if a person's answer to the statement is consistent or stable from time to time. The following are the results of the Validity Test and the Reliability Test of this study,

Table 2. Validity Test

Variables	Item	r Calculate	Table r	Information
Power Distance	X1.1	0.664	0.312	Valid
	X1.2	X1.3		Valid
	0.504	0.489		Valid
Uncertainty Avoidance	X2.1	0.549	0.312	Valid
	X2.2	0.742		Valid
Individualism	X3.1	0.771	0.312	Valid
	X3.2	0.549		Valid
	X3.3	0.775		Valid
Internal Audit Quality	X4.1	0.764	0.312	Valid
	X4.2	0.612		Valid

Table 3. Reliability Test

No	Variable	Cronbach's Alpha	Description
1	Power Distance	0.666	Reliable
2	Uncertainty Avoidance	0.688	Reliable
3	Individualism	0.701	Reliable
4	Internal Audit Quality	0.864	Reliable

Hypothesis testing H1, H2, and H3 was carried out with multiple regression analysis to test the effect of Power Distance, Uncertainty Avoidance, Individualism, and Internal Audit Quality. The test results are shown as follows:

Table 4. Coefficient of Determination Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.678	0.460	0.415	4.20762

The results of the coefficient of determination test in the table above show the adjusted r square value of the regression model is used to determine how much ability the independent variable has in explaining the dependent variable or how much influence the independent variable has on the dependent variable. Based on table 16, the adjusted r square value is 0.415, this shows that 41.5% of Internal Audit Quality is influenced by the variables of Power Distance, Uncertainty Avoidance, Individualism, and Religiosity. In addition, 58.5% is influenced by other variables not examined in this study.

Table 5. F Test - Simultaneous Test

Model	of Sum of Square	Df	Mean Square	F	Sig	
1	Regression	542,028	3	180,676	10,205	0.000
	Residual	637,347	36	17,704		
	Total	1179,375	39			

Based on the table below above that in multiple regression testing shows the calculated F result of 10.205 with a significance level of 0.000 which is smaller than 0.05, where the calculated F value is 18.485 greater than the F table value which is 2.87 (df1 = 4-1 = 3 and df2=40-4=36). This means that the variables Power Distance, Uncertainty Avoidance, and Individualism together affect the Quality of Internal Audit.

Table 6. T-Test

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std.Error	Beta		
1	(Constant)	10,516	6,979		1,507	1,141
	Power Distance	0.944	0.326	0.458	2.897	0.006
	Uncertainty Avoidance	1.165	0.331	0.520	3.523	0.001
	Individualism	1.169	0.305	0.600	3.837	0.000

Based on the table above, the estimation model can be analyzed as follows:

$$Y = 10,516 + 0.944 X_1 + 1,165 X_2 + 1,169 X_3 + e$$

Information:

Y	= Internal Audit Quality
X ₁	= Power Distance
X ₂	= Uncertainty Avoidance
X ₃	= Individualism
a	= Constants
1, 2, 3	= Regression Coefficient
e	= Standard <i>error</i>

4.2. Discussion

The results of the interpretation of the research hypotheses (H1, H2, H3) that are proposed can be seen as follows:

Power Distance has a negative and significant effect on Internal Audit Quality (H1).

Based on the table above, it can be seen that the Power Distance variable has a t value count $2.897 >$ t table value of 2.024 (sig. = 0.05 and df = nk, which is $40-4 = 36$) with unstandardized coefficients beta of 0.458 and a significance level of 0.006 which is smaller than 0.05, then Ha1 is accepted. This means that Power Distance has a negative and significant effect on the Quality of Internal Audit.

Uncertainty Avoidance has a negative and significant effect on Internal Audit Quality (H2).

Based on table 18, it can be seen that the Uncertainty Avoidance variable has a t-count value of $3.523 <$ t-table value of 2.024 (sig. =0.05 and df=nk, which is $40- 4 = 36$) with unstandardized coefficients beta of -0.520 and a significance level of 0.001 which is smaller than 0.05, then Ha2 is accepted. This means that Uncertainty Avoidance has a negative and significant effect on the Quality of Internal Audit.

Individualism has a negative and significant effect on Internal Audit Quality (H3).

Based on table 4.20 it can be seen that the Individualism variable has a t-count value of $3.837 >$ the t-table value of 2.024 (sig. =0.05 and df=nk, ie $50-4= 46$) with unstandardized coefficients beta of 0.600 and a significance level of 0.022 which is smaller than 0.05, then Ha3 is accepted. This means that individualism has a negative and significant effect on the quality of the internal audit.

5. CONCLUSION

This research has been conducted on 80 members of the internal supervisory unit in 45 state universities in Indonesia. The purpose of this study is to provide empirical evidence on whether the cultural dimensions of a member of the internal audit unit at a public university in Indonesia can affect the quality of the internal audit it produces. Based on the test results indicate that the dimensions or cultural values affect the quality of internal audit. In this study, the cultural dimension is represented by the dimensions of Power Distance, Uncertainty Avoidance, and Individualism.

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CHAPTER 2

Consolidated Statement Following Traditional Transfer Pricing Model

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ABSTRACT

Multinational companies are currently faced with the fact that most of today's global trading activities are conducting "intragroup" transactions which make transfer prices very important for companies and are considered to have an influence on tax revenues in each country. There are several methods classified in transfer pricing and divided into 2 categories, namely the traditional transaction method and the transactional profit method, where each method has advantages and disadvantages that will have an impact on the economy. From this analysis, it can be concluded that various countries including the 1995 OECD have preferred the traditional transaction method is better than the transactional profit method. However, in choosing the transfer pricing method, companies must consider the facts, types of transactions, functional analysis, and other factors that are considered to be able to make adjustments to the data to improve comparability.

Keywords : Transfer pricing, Traditional transaction methods, OECD

1. Introduction

The fact that within a multinational company group, a considerable portion of global trade today consists of international transfers of commodities and services, capital, and intangibles, which are referred to as "intragroup" transactions, there is evidence that intragroup trade is gradually increasing, accounting for almost 30% of all foreign transactions (United Nations Practical Manual on Transfer Pricing, 2017). Furthermore, transactions involving intangibles and multitiered services are becoming a larger and bigger part of an multinational company commercial transactions, which has raised the complexity of analyzing and understanding them. The structure of transactions within an multinational company group is determined by a combination of market and group-driven pressures, which may differ from open market conditions that operate between independent businesses (Reza, 2021). As a result, a growing proportion of international transactions are no longer dominated only by market forces, but by forces motivated by the group's common interests.

In this context, determining the appropriate price for intragroup, crossborder transfers of products, intangibles, and services, referred to as the "transfer price," becomes critical. The pricing of crossborder, intrafirm transactions between related parties is referred to as transfer pricing. The issue of transfer pricing has a significant impact on individual countries' tax revenues (Brabec & Hasprová, 2016). Transfer pricing is the practice of identifying the price at which a transfer of goods or services should be regarded to have occurred between related corporate entities in different nations. The international trading system has this as a natural and endemic component (Bastin, 2014). Transfer pricing has an impact on payroll taxes, customs fees, tariffs, sales taxes, value-added taxes, environmental taxes, and other government fees. Minimizing a company's income taxes might occasionally clash with the other goals that the company's top executives seek to achieve through transfer pricing.

According to a 2010 Ernst & Young survey of multinational corporations in 25 countries, transfer pricing is "absolutely crucial" or "extremely significant" to 74 percent of parent firms and 76 percent of subsidiary respondents. The reason for this is because depending on the transfer pricing mechanisms used, parent firms can save a lot of money on taxes. Consider Google's advertising sales in the United Kingdom, which totaled £6 billion between 2004 and 2010. Despite the fact that the UK's business income tax rate is 28%, Google UK only paid £8 million in taxes over that time. But how did this happen?

Duhigg & Kocieniewski (2012) explained in their article that Google has licensed Google Ireland Holdings, a Bermuda-based Irish firm that is tax-exempt in Ireland, the offshore rights to its intellectual property. When Google receives money from a consumer in the United Kingdom, it is credited to Google Ireland Limited, a Dublin-based Irish company. This organization accounts for roughly 88 percent of Google's non-U.S. revenue. However, because it pays a royalty charge to the Bermuda/Irish business for the use of Google's intellectual property, it makes essentially no pretax profit. The money is routed through Google Netherlands Holdings BV (Amsterdam) rather than being paid directly, which would impose an Irish withholding tax. These methods are thought to have saved Google \$1 billion per year. Similar transfer-pricing strategies have been adopted by Microsoft, Facebook, and Forest Laboratories, a pharmaceutical company based in New York City. It is predicted that profit shifting arrangements can save firms up to \$60 billion per year.

However, one transfer price may not always be sufficient to meet all of a firm's objectives, such as lowering income taxes, attaining goal congruence, and encouraging managers' efforts. As a result, a business may decide to preserve one set of accounting records for tax purposes and another set for internal management reporting. According to a survey of large companies (with revenues of more than \$2 billion) conducted by the AnswerThink Consulting Group, Separate reporting systems were used by 77%

of organizations judged to follow "best practices" to track internal price information, compared to around 25% of enterprises outside that group.

International taxes, on the other hand, complicates transfer pricing and e-commerce issues in multinational companies. Traditional transfer pricing strategies have been used to solve these issues. However, the OECD (2015) is concerned that established methodologies for evaluating transfer pricing, such as the Comparable Unrelated Price Method, Resale Price Method, or even the Cost Plus Method would no longer be valid due to the increasing disappearance of observable comparable transactions. The digital economy, with its linked global value chains and proclivity to create quasi-monopolies, is the rationale for the latter.

To answer this doubt, the objection of this research is to conduct an intensive in depth study regarding the method of transfer pricing, especially the traditional method. To support this goal, a literature review research method is applied where the authors examines theory, previous research, and related policies. Through the result of this study, a further understanding about what transfer pricing is, the purpose of transfer pricing, how it has evolved, what are the methods of transfer pricing, and lastly, an intense explanation about traditional methods of transfer pricing is expected. Hopefully, this would aid the firm in giving accurate information on transfer pricing and preventing transfer price manipulation, which is an activity that involves increasing expenses or lowering invoicing in order to reduce the amount of tax owed.

2. Literature Review

2.1 Transfer Pricing

Transfer pricing is defined by the Oxford Dictionary of Accounting as the prices at which goods and services are acquired and sold inside a corporation's divisions or subsidiaries (Owen & Law, 2006). According to Kayode (2003), transfer pricing is a price associated to commodities and services that are traded among divisions under the supervision of a central administration. Movement pricing is defined by Dean et al. (2008) as the transfer of goods and services between members of a corporate family, including parent to subsidiary, subsidiary to parent, and subsidiary to subsidiary.

Transfer pricing, according to Smith (2002), governs transactions between divisions of a company, that is, for companies that operate in a single tax jurisdiction. Transfer prices are primarily used to keep track of internal transactions and allocate expenses to various operations, as well as to provide incentives to divisional managers. A transfer price is the cost of a product or service provided by one component (department or division) to another subunit of the same organization (Horngren, et al. 2015). As a result, transfer pricing is a cost to the receiving division and a revenue to the supplying division, affecting each division's profitability.

In general, For tax purposes, transfer pricing involves establishing the prices of items and services sold between members of a group of firms, resulting in a reduction in the group's profits tax. By reducing the pricing of intra-group transactions, the firm is able to fix the majority of the benefit in the most lenient tax jurisdictions (Matei & Pirvu, 2011). Domestic transfer pricing between divisions, branches, affiliates, or subsidiaries is also utilized to control, evaluate, and encourage divisional managers toward company-wide goals, according to Ezejelue (2008). As a result, goal congruence, divisional autonomy, and performance evaluation are the most important factors in determining domestic transfer pricing.

2.2 Objectives of Transfer Pricing

Corporations frequently exploit the transfer pricing mechanism to avoid paying excessive taxes in certain nations (Matei & Pirvu, 2011). According to Barker & Brickman (2017), a company

can utilize transfer pricing to decrease its tax bills by declaring more income in low-tax nations and less income in high-tax countries. However, different countries' tax laws limit the transfer prices that businesses can utilize.

The logic behind transfer prices is that when sub-unit managers (such as the manager of the engine division) make decisions, they only need to consider how their actions will effect their subunit's success rather than the company's overall performance. In this way, transfer prices make it easier for subunit managers to analyze information and make decisions. Managers in a well-designed transfer-pricing system focus on optimizing the performance of their subunits, which in turn optimizes the company's overall performance.

According to Mueller et al., (1997) when products or services are traded between organizational units of the same corporation, a transfer price must be determined. In lieu of a market price, a transfer price can be employed. When one of a corporation's subsidiaries sells to another, this term is commonly used. Intra-company transactions between operating units are given a monetary value by the transfer pricing mechanism. The transfer price affects each subunit's operating income by generating revenues for the selling subunit (in this case, the engine division) and expenditures for the buying subunit (in this case, the assembly division). These operational earnings can be used to assess the performance of subunits and incentivize their managers. An intermediate product is a product or service that is transferred between organizational subdivisions. The receiving unit (in the engine example, the assembly division) may continue to work on the product, or it may be transferred from manufacturing to marketing and sold directly to an external customer.

Furthermore, transfer prices can lower tariffs by minimizing global import charges. Intracompany transfers and sales to unaffiliated customers are usually subject to import tariffs. If the items are brought in at a low cost, the tariffs that arise will be lower. When a country sets a limit on the value of items that can be imported, the same pricing technique might be employed. A subsidiary may be able to import a bigger number of goods and services by valuing at low transfer prices, and vice versa. Low import tariffs are frequently linked to a country with high income tax rates. The multinational company must deal with customs and income tax officials.

2.3 Evolution of Transfer Pricing

Since the 1990s, several new transfer pricing laws have been implemented, and substantial documented examination of official papers and pronouncements, such as the national legislation, OECD Guidelines, OECD data and tax authority guidance statements, has been conducted. The OECD has been a key player in the international development of transfer pricing policies. The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the guidelines), as well as the OECD Model Tax Treaty¹¹ and US rules, are the most important sources of inspiration for the developed world's transfer pricing regulations. The 1995 OECD Guidelines represent a consensus among OECD Member nations, predominantly industrialized ones, and have been widely adopted in domestic transfer pricing rules. The USA Transfer Pricing Regulations (26 USC 482) are another noteworthy transfer pricing structure that has evolved over time.

According to a 2008 KPMG analysis, the number of nations that adopted transfer-pricing restrictions nearly doubled from 1995 to 2007. During the last global recession, more governments throughout the world were compelled to enforce stricter trading laws and collect tax revenues more aggressively. Previously, foreign enterprises in China were given preferential status. However, regulators recently enacted new laws forcing multinationals to present substantial evidence on transfer pricing. India, Canada, Turkey, and Greece, for example, have enhanced their examination of transfer prices, with a particular focus on intellectual property valuations, back-office expenses, and any losses.

Since then, the OECD transfer pricing guidelines, as well as the interpretations and commentaries related to the OECD transfer pricing standards, have changed. Numerous concepts

have been presented in various court cases, but it was only after a specific year that they were fully recognized in the rules. Taxpayers will not be required to use the specific 2017 process to identify the transaction and/or risk in years prior to 2017. In practice, the introduction of the passive association idea has necessitated multinational companies determining, in a nutshell, the borrower's stand-alone rating, determining the gap with the parental rating, and quantifying the extent to which the rating gap should be decreased through changes. The 2020 Transfer Pricing Information on Financial Transactions supplemented the guidance on passive association and implicit support strategies with technical guidelines for evaluating credit ratings of group organizations for the first time. Applying the newly specified ideas to pre-2017 and pre-2020 eras might be problematic if the guideline is regarded to be genuinely new rather than a clarification of existing conceptions.

3. Transfer Pricing Methods

Many transfer pricing mechanisms are utilized in general. The approach they utilize or use will be determined by their policies or the goals they wish to attain. The nations that are members of the OECD believe that it would be beneficial if general instructions for establishing transfer pricing were created (OECD, 2009). These instructions would not be regulations, so OECD members might utilize them but would not be obligated to follow them.

3.1 Classifying Transfer Pricing Methods

OECD guidelines (2009) divide the transfer pricing methods into two groups:

A. Traditional transaction methods:

1. Comparable Uncontrolled Price Method.

The comparable uncontrolled price technique compares the price charged in a controlled transaction to the price charged in a comparable uncontrolled transaction under similar conditions. Royalties for the use of an intangible asset at arm's length can also be calculated using the CUP Method. CUPs can be based on both "internal" and "external" transactions of a similar nature.

2. Resale Price method

The resale price method is used to determine how much a reseller will pay for a product bought from a related firm and resold to a different company. The purchase price is set so that the reseller's margin is sufficient to pay its selling and operational costs while still allowing for a respectable profit. It's a common transaction method for assessing if a transaction adheres to the arm's length principle. In the transfer price study, the Resale Price Method focuses on the linked sales firm as the tested party, which is responsible for marketing and sales.

3. Cost Plus method (C+)

The cost-plus method is used to establish what price a provider of property or services should charge a linked purchaser. The Cost Plus Method focuses on the connected manufacturing business as the tested party in the transfer pricing analysis in a regulated transaction involving physical property. In the event of rendered services, the Cost Plus Method can also be employed. The price is set by adding an adequate gross margin to the provider's costs in order for the supplier to make an appropriate profit in light of market conditions and functions fulfilled.

B. Transactional Profit Methods:

1. Profit Split Method

Profit-split methods take the cumulative earnings obtained by two related parties from one or a series of transactions and divide them on a predetermined basis in order to replicate the profit division that would be expected under an arm's length agreement. Working backwards from profit to price, arm's length pricing is derived from both parties. When

both sides of a controlled transaction contribute considerable intangible property, it is commonly used. The profit will be split in the same way as it would be in a joint venture.

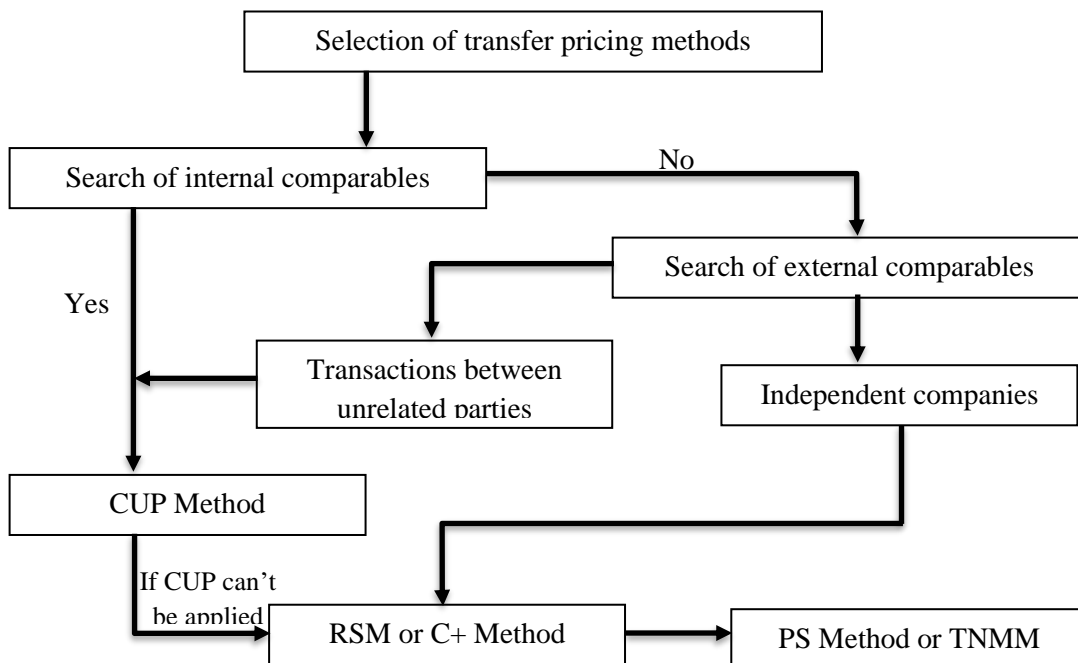
2. Transactional Net Margin Method

The TNMM assesses a taxpayer's net profit margin from a controlled transaction in relation to an applicable basis (e.g. costs, sales, assets) (or transactions that are appropriate to be aggregated). To be considered comparable, transactions must be "broadly similar," according to the TNMM. In this instance, "broadly similar" suggests that the compared transactions do not have to be identical to the controlled transaction. This broadens the range of conditions in which the TNMM can be applied.

3.2 Selection of Methods

Taxpayers must first analyze their transactions and then choose a method for determining transfer pricing, according to the main principles of transfer pricing. First, if practicable, the comparable uncontrolled price technique must be chosen, according to the OECD Transfer Pricing Guidelines (OECD, 1995). If the data required for this method's application is insufficient or unreliable, the resale price or cost-plus approach must be chosen. It's worth noting that the price determined using typical transaction procedures is the most similar to the arm's length pricing (Mackevicius & Novikovas, 2008). Traditional transaction processes are sometimes difficult, if not impossible, to employ due to the complexity of modern company. When finding comparable transactions is impossible or the data on such transactions is insufficient (untrustworthy), transactional profit methods (profit split and transaction net margin methods) must be used. Figure 1 shows the sequence in which transfer pricing strategies are selected.

Figure 1. Selection of Transfer Pricing Methods



Source: United Nations Practical Manual on Transfer Pricing (2017)

Furthermore, Feinschreiber (2004) stated that there are several key components to consider when doing a transfer pricing analysis, including:

- Taxpayers must utilize the most efficient approach. The regulation educates taxpayers on the most appropriate way for specific products in specific scenarios. The method that uses the arm's length principle to determine the price is the best.
- The comparative analysis will be done by the taxpayers. During the comparability study, the following factors are needed to assess the comparability of uncontrolled transactions with controlled transactions: functional analyses, contractual circumstances, risk, economic conditions, and transferred items or services (Levi, et al. 2006).
- When assessing transfer pricing, taxpayers must adhere to the arm's length principle. The essential notion of the arm's length principle, according to OECD instructions from 1995, is that the profit earned by taxpayers from a transaction between two related parties should be similar to the profit earned if they were working with a non-related party.

4. Discussion

4.1 Traditional Transaction Methods

Traditional transaction methods compare the terms and conditions of real-world transactions between independent businesses to those of a simulated transaction. This comparison can be conducted using direct indicators such as a transaction's price, as well as indirect measures such as gross margins realized on a specific transaction.

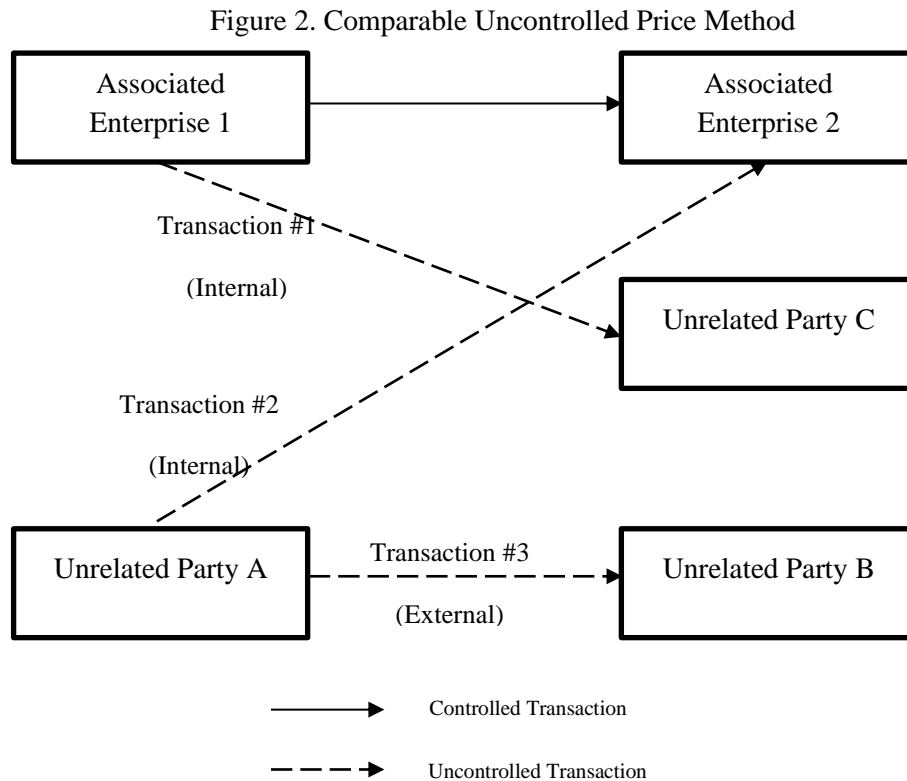
4.1.1 Comparable Uncontrolled Price

The market prices are used in the Comparable Uncontrolled Price Method. This method establishes the transfer price by comparing the method of price computation used by an unregulated company that has used this pricing in similar product or service sales situations. When there are no differences between controlled and uncontrolled transactions, or when these differences have no meaningful consequence, or when these discrepancies may be improved, there is comparability between these transactions. We can say that the Uncontrolled Price Way is the most suitable method of transfer pricing (Method of the Market Prices).

The CUP approach compares the real price of an intangible item charged by a multinational corporation to the prices charged for equivalent services delivered or sold in comparable uncontrolled transactions. This includes any sales of the same goods or services by global firms to unregulated distributors in similar areas. In reality, unless the international corporation produced the same product or provided the same service to uncontrolled clients in the United States or a comparable market, the CUP strategy is unlikely to be applied. Even if a multinational corporation sold its intangible assets to an unconnected entity or market, the fees or prices paid in cross-border commercial transactions would not be accurate indications of arm's-length requirements for sales to its American subsidiary. Unless the third-party transactions were comparable to sales to the American subsidiary in terms of: (a) functions performed; (b) risk allocation; and (c) contractual arrangements to reconcile the disparities (Warner, 2002).

Minor or substantial variances in intellectual property or sale situations may need adaptations to the CUP approach. The CUP technique, on the other hand, determines intangible asset values that are basically alternative prices at which the intangible asset in a

related party sale may have been bought on the open market (Miesel, et al., 2003). In the context of the specific case study on the next part, Figure 2 explains this distinction.



Source: United Nations Practical Manual on Transfer Pricing (2017)

The controlled transaction in the figure above involves the illustration where the items are transferred between Associated Enterprise 1, an item maker in Country 1, and Associated Enterprise 2, an item importer in Country 2, which acquires, imports, and resells the things to unrelated item dealers in Country 2. Associated Enterprise 1 is Associated Enterprise 2's parent firm.

4.1.1.1 When to Use the CUP Method

Depending on the situation, CUP may or may not be appropriate. The CUP Tool is often a very reliable method to utilize in establishing if the terms of commercial and financial transactions between connected firms are at arm's length in circumstances when comparable uncontrolled transactions can be found. This means that an examiner should always assess if the CUP Method can be used. That is, an examiner should analyze whether or not appropriate internal and external comparables may be found. As a result, in any analysis, one question that should be answered is whether one of the related firms is engaging in transactions with independent enterprises.

The CUP Method will be most beneficial when one of the linked enterprises participating in the transaction participates in comparable uncontrolled transactions with an independent enterprise (i.e., an internal comparable is available), according to the UN Practical Manual on Transfer Pricing. In this case, because all relevant information on uncontrolled transactions

is available, all material differences between controlled and uncontrolled transactions are likely to be identified; alternatively, it can be useful when transactions involve commodity type products with minor differences between them.

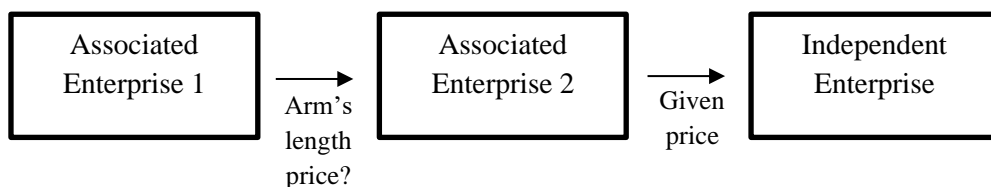
4.1.1.2 Strengths and Weakness of the CUP Method

The method offers various advantages due to its characteristics. First, because the price utilized reflects an agreement between two unconnected parties to the transaction, it is a two-sided study. And due to the reason that it includes a direct transactional comparison of a similar transaction between unrelated parties, it can also avoid the question of who of the related parties engaged in the controlled transaction should be considered as the tested party for transfer pricing reasons. That is, it is a more direct measure of the arm's length price than the other approaches, which all derive arm's length pricing indirectly through the assessment of arm's length profits. The CUP Method is less vulnerable to variances in non-transfer pricing elements since it is a more direct (For example, discrepancies in cost accounting between controlled and uncontrolled parties). In other cases, such as transactions involving commodity items, the strategy may be more easily used.

The CUP Method's drawback, on the other hand, is the difficulty of locating comparable uncontrolled transactions in light of the comparison rules that must be adhered to, particularly in the case of product, intellectual property, or service comparability.

4.1.2 Resale Price Method

The RPM presupposes that competition among independent wholesalers or distributors in the external market results in identical margins on sales by wholesalers or distributors providing similar services or performing similar activities. The RPM determines the price at which a buyer should pay in order to achieve a gross margin comparable to that of enterprises doing similar tasks. The seller gets all of the transaction's surplus profit. Major changes are made, as with the CUP technique, to account for variances in the economic circumstances of the transaction and the terms of sale (Miesel, et al. 2003). Figure 3 illustrates this point.



Source: United Nations Practical Manual on Transfer Pricing (2017)

Figure 3. Resale Price Method

As a result, under the RPM, the sales company serves as the starting point for the study. The following formula can be used to define the transfer price for the sale of products between the sales company (i.e. Associated Enterprise 2) and a connected company (i.e. Associated Enterprise 1):

$$TP = RSP \times (1 - GPM)$$

Note:

TP = a product's transfer price between a sales firm and a linked company;

RSP = the price at which a product is resold (resale price) to unrelated clients by a sales business

GPM = the ratio of gross profit to net sales that a certain sales organization should achieve. It's the difference between Net Sales and Cost of Goods Sold..

The Resale Price Method requires less direct transactional (product) comparability than the CUP Method since it is based on arm's length gross profits rather than directly determining arm's length prices (as the CUP Method does). However, in order to properly use the RPM, comparability of functions and intellectual property design is required. When two criteria are met, comparability is required under this method: (1) the functions performed, risks assumed, and level of intangible assets are similar to those of the related party whose transfer prices are being determined. (2) the intangible assets are generally similar to the related party's assets. Some or all of the disparities in the mix and intensity of functions performed, the economic conditions of the transaction, and the conditions of the sale are adjusted for comparability.

4.1.2.1 Arm's Length Gross Profit Margin

The arm's length principle (ALP) is used to define an arm's length transfer price: the amount that would be paid if the identical transaction were carried out by unrelated third parties in most nations' tax transfer pricing legislation. Net sales minus cost of goods sold equals gross profit. It's simplest to figure out where the reseller doesn't add much to the product's worth. The money made by selling products to unconnected customers is known as net sales, whereas the cost of goods sold is the cost of acquiring the items sold plus certain non-operating expenditures. As a result, the cost of goods sold will include the transfer price paid to the connected manufacturer when calculating the gross margin for products purchased from a related company.

The arm's-length price of an intangible asset is calculated by comparing the gross margins generated by an American subsidiary from reselling intangible products acquired from, or services provided by, a foreign corporation to the gross margins achieved by uncontrolled distributors from identical transactions. The RPM focuses on one side of the transaction, either the manufacturer or the distributor, and estimates the transfer price using a functional method. Unfortunately, comparable uncontrolled distributor gross profit data may not be accessible or precise enough to serve as a baseline for an arm's length standard (Warner, 2002).

4.1.2.2 When to Use the Resale Price Method

If the CUP Method is not applicable, or if the sales companies do not own valuable intangible properties, the Resale Price Method is an appropriate method to use in a typical inter-company transaction involving a "fully fledged" manufacturer owning valuable patents or other intangible properties and affiliated sales companies that purchase and resell the products to unrelated customers.

4.1.2.3 Strengths and Weakness of the Resale Price Method.

RPM's strengths and weaknesses are determined by a number of factors. For starters, the approach is based on the resale price, which is a market price, and so represents a demand-driven strategy in instances when the costs incurred and the

sales price of a product or service have a poor link. It can also be employed without pressuring distributors to "make profits" in an unethical way. However, while the distributor earns an arm's length gross profit margin, high selling expenditures spent as a result of commercial methods such as a market penetration plan may result in operating losses. The Transactional Net Margin Method, on the other hand, will often produce a positive operating profit range within an arm's length range when examining a financial ratio based on operational profits. The tested party in the study would most likely earn a positive operational profit within the range. The Resale Price Method, on the other hand, does not always result in the tested party earning positive operating profits.

However, due to accounting irregularities, it may be difficult to find comparable data on gross margins when using this method; and the method entails a one-sided study because it focuses on the associated sales firm as the tested party in the transfer price analysis. It's likely that the arm's length gross profit margin and, as a result, transfer price, which is based on a benchmarking analysis, will result in an extreme result for the sales company's connected supplier (e.g., the supplier might experience a loss even though its supplier is profitable).

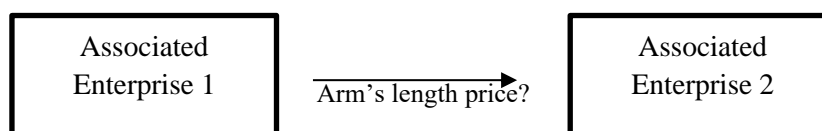
4.1.3 Cost Plus Method

The Cost Plus Method begins with the costs spent by the provider of property (or services) in a regulated transaction for property transferred or services given to a connected purchaser. An acceptable cost + mark-up is then applied to this cost to achieve an appropriate gross profit based on the activities performed, risks accepted, assets used, and market circumstances.

When analyzing transfer pricing issues involving tangible property or services, the Cost Plus Method is applied. Manufacturing and assembling activities, as well as relatively modest service providers, are the most common applications. In the transfer price analysis, the Cost Plus Method focuses on the related party manufacturer or service provider as the tested party. The technique looks at the gross profit margin on costs paid by suppliers of tangible property (or services) for tangible property transferred to assess if an inter-company fee is arm's length (or services provided). It compares the gross profit margins achieved by the tested party for manufacturing products or delivering services to the gross profit margins earned by comparable firms (Santoso, 2020).

The implicit assumption underlying the Cost Plus Method is that price and profit margins will be similar across a large number of manufacturing enterprises due to competition. When the activities performed, risks assumed, and degree of intangibles are the same as or similar to those of the connected party, the Cost Plus Method demands comparability. Differences in sales and purchase terms, freight terms, inventory turnover, and other considerations are all taken into account. Similarly, the production costs of the controlled (or related-party) manufacturer or the uncontrolled comparative may need to be restated to reflect cost levels compatible with different intangible asset life cycle (Miesel, Higinbotham & Chun, 2003).

Figure 4. Cost Plus Method



Source: United Nations Practical Manual on Transfer Pricing (2017)

Figure 4 describes this in greater detail. Country 1's Associated Enterprise 1, an electrical goods firm, manufactures for Associated Enterprise 2. Associated Enterprise 2 gives Associated Enterprise 1 instructions on the amount and quality of goods to be manufactured. Sales to Associated Enterprise 2 will be guaranteed, and there will be little risk for Associated Enterprise 1. Because Associated Enterprise 1 has fewer functions and risks than Associated Enterprise 2, the CUP Method study would concentrate on Associated Enterprise 1 as the tested party. The Cost Plus Way may be the optimum method of analysis in this scenario because Associated Enterprise 1 is a simple manufacturer. The Cost Plus Method compares the gross profit margins made by enterprises making identical goods for (or delivering comparable services to) unrelated parties to identify if Associated Enterprise 1's gross profit mark-up is reasonable. The Cost Plus Method does not explicitly check if the transfer price is at arm's length by comparing prices. As a result, it is a less direct (transactional) technique than the CUP Method..

4.1.3.1 Mechanism of the Cost Plus Method

The cost of producing the tangible property for the controlled party plus a suitable gross profit markup, defined as the ratio of gross profit to cost of goods sold (excluding operational expenditures) for a comparable uncontrolled transaction under the Cost Plus Method, equals an arm's length price (when applied to sales of tangible property). The following is the formula for computing the transfer price in product inter-company transactions:

$$TP = COGS \times (1 + \text{cost plus mark-up})$$

Note:

TP = the Transfer Price of a product sold between a manufacturing company and a related company;

COGS = the Cost of Goods Sold to the manufacturing company

Cost plus mark-up = gross profit mark-up defined as the ratio of gross profit to cost of goods sold. Gross profit is defined as sales minus cost of goods sold.

4.1.3.2 Determination of Costs

The Cost Plus Method has a number of possible drawbacks when it comes to determining expenses in addition to those associated with inconsistent accounting treatments:

- a. Because the link between incurred expenses and market price might be relatively weak, gross profit margins can vary dramatically from year to year
- b. Applying a comparable mark-up to a comparable cost foundation is critical
- c. It is necessary to identify differences between the tested party and comparables. In this regard, it's critical to distinguish between the managed and uncontrolled transactions in terms of the amount and types of expenses incurred in relation to the functions performed and risks assumed. If the differences are purely due to the parties' differing efficiency, no adjustments to the gross profit markup should be made. If the testing party is doing additional functions, it may be essential to decide a suitable additional return for such function and to provide a distinct return for these new activities. Similarly, if the comparables execute tasks that the tested party does not, the return for those functions should be deducted from the gross profit margin applied to the tested party's controlled transactions

- d. Carefully assess which expenditures should be eliminated from the cost base. Costs that are explicitly not subject to a mark-up (that is, costs that are passed through) in both the tested party and similar transactions are an example of costs that should be omitted.
- e. Accounting consistency is critical, just as it is with the Resale Price Method. The affiliated enterprise and the independent enterprises should compute gross profit markups in the same way
- f. Individual units of output should be assigned historical costs in principle. If expenses vary over time, average costs over time may be employed; the Cost Plus Method can be applied using either projected or actual costs
- g. Individual units of output should be assigned historical costs in principle. If expenses vary over time, average costs over time may be employed; the Cost Plus Method can be applied using either projected or actual costs
- h. Because the Cost Plus Method solely considers the costs of the products manufacturer or service provider, an issue with the distribution of some costs between the manufacturer or service provider and the customer of goods or services may develop.

4.1.3.3 When to Use the Cost Plus Method

The Cost Plus Method is widely employed in intra-group service provisioning or inter-company sales of tangible property where the related party manufacturer only undertakes limited manufacturing operations. The approach generally anticipates the occurrence of minimal risks since the level of costs will better represent the value offered and hence the market price.

The strategy is also commonly employed in transactions involving a contract manufacturer, a toll manufacturer, or a low-risk assembler that does not hold product intangibles and is not exposed to significant risk. In terms of services fulfilled, the connected customer engaging in the regulated transaction will typically be far more sophisticated than the contract manufacturer (e.g. marketing and selling functions, production and sales coordination, giving quantity and quality production instructions to the contract manufacturer, and purchasing raw materials in some cases), risks incurred, and assets owned. As a result, the contract maker is the less complex party and should be the one to be examined in the transfer pricing study.

Furthermore, it is rarely a good approach to utilize in transactions involving a fully-fledged manufacturer with valuable product intangibles because finding independent manufacturers with equivalent product intangibles might be challenging. The Cost Plus Method is widely employed in intra-group service provisioning or inter-company sales of tangible property where the related party manufacturer only undertakes limited manufacturing operations. The approach generally anticipates the occurrence of minimal risks since the level of costs will better represent the value offered and hence the market price.

4.1.3.4 Strengths and Weakness of the CPM Method

The Cost Plus Method's strength is that it is based on internal expenses, which are usually easily available to global corporations. The Cost Plus Method, on the other hand, has a number of flaws, including the following:

- a. There could be a shaky relationship between cost levels and market prices;
- b. Data on mark-up gross margins may not be comparable due to accounting errors and other issues.
- c. Accounting consistency between controlled and uncontrolled transactions is necessary.
- d. The investigation is limited to the linked party manufacturer.
- e. Because the method is based on actual costs, the controlled manufacturer may have no incentive to control costs.

5. Conclusion

Traditional transaction procedures are seen to be the most straightforward way of determining if circumstances in related firms' commercial and financial connections are at arm's length. This is because any pricing difference between a managed transaction and a comparable uncontrolled transaction can usually be traced back to the commercial and financial relationships established or enforced between the businesses. The arm's length criteria are then determined by replacing the price of the similar uncontrolled transaction for the price of the regulated transaction. As a result, while both the conventional transaction technique and the transactional profit approach are equally dependable, the traditional transaction method is preferred over the transactional profit method. Furthermore, changes in the exact qualities of property or services frequently account for variances in their open market value, at least in part. As a result, comparing these characteristics might be helpful in defining the transaction and assessing the comparability of regulated and uncontrolled transactions.

Given the nature of the approaches described, there is still a lot of subjectivity when it comes to standard transaction procedures. Traditional transaction techniques were recommended above transactional profit methods in the 1995 OECD Transfer Pricing Guidelines, with the latter being used only as a last option. In certain nations, classic transaction procedures such as the Comparable Uncontrolled Price, Cost Plus, and Resale Price Method are preferred. The UN Manual on Transfer Pricing, on the other hand, states that the most appropriate technique should be chosen based on facts and circumstances, transaction type, functional analysis, comparability factors, and the potential of making data revisions to improve comparability. Even if the traditional transaction technique is favored in some circumstances, a full grasp of these principles is still required to ensure that the organization uses the optimum way.

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CHAPTER 3

Development of Efficient Markets Hypothesis (EMH) by Frama and Others

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ABSTRACT

Investment decision-making process involves a relatively complex behaviour and is influenced by several factors. At least there are two fundamental factors that affect the process are internal resources such as age, education, income, investment portfolio and technical factors such as the financial model that represents the relationship between risk and return. Efficient Market Hypothesis assumes investors are rational beings who produce economically rational decisions (Expected Utility Theory). Investors are assumed to be, because the perspective of Expected Utility Theory, placed human beings merely as utility maximizing individual in a circle and directing the material into homo economicus. This article discusses the conflict between the efficient market hypothesis, or EMH with anomalies described in terms of financial behavioural theory. EMH is a hypothesis which underlies a market situation which is ideal for using the assumption that all investors are rational individuals and rely on information for decision making.

Keywords : Efficient Market, Market Inefficiencies, Efficient Market Anomaly, Behavioral Finance

Introduction

According to Law Number 8 concerning the Capital Market, the capital market has a strategic role in national development as a source of financing for businesses and a vehicle for investment for investors. Anoraga and Pakarti (2011) explain that the capital market is seen as an alternative means of accelerating the development of a country because the capital market is a vehicle that can raise long-term mobilization of funds from the community and channeled to productive sectors. The function of the capital market, namely the economic function and the financial function.

The economic function of the capital market is that the capital market provides facilities that bring together those who have excess funds and those who need funds. While the financial function of the capital market is that the capital market provides the possibility and opportunity to obtain returns for the owners of funds, according to the selected characteristics (Darmadji & Fakhruddin, 2001).

Capital markets are built on the basis of information. Information is a basic need for every investor to reduce the uncertainty that occurs so that they can make decisions according to their beliefs and expectations. The decision making is related to the expected rate of return by investors.

A market is said to be efficient if the price in the market reflects all publicly available information. An efficient market assumes that all market participants pay attention to any such information and react quickly to that information. Efficient markets result in none of the market participants receiving abnormal returns. In an efficient market assumption, market participants act as price takers so that nothing can affect the market price.

In reality, there is no efficient capital market because there are deviations in the capital market that allow investors to receive abnormal returns. The deviation that occurs in the efficient market hypothesis is called the efficient market hypothesis anomaly. The anomaly of the efficient market hypothesis occurs because there are a small number of market participants who can influence prices (price makers), non-uniform access to information among market participants, and different abilities of market participants in interpreting information.

Factors causing deviations in efficient markets are (1) the presence of insider trading, (2) market participants are naive investors and unsophisticated investors. This happens because each market participant has a different ability to take and analyze differently in responding to information. In actual fact, many market participants perceive information without conducting an analysis first, so that sometimes it is not appropriate to interpret the information content which is a signal from a company.

Each market participant has their own way of conducting analysis to determine their decisions. Analysis can be done by looking at the company's fundamentals, technicals, and behavior. These various kinds of analyzes result in market participants trying their best to obtain the possibility of obtaining abnormal returns.

The anomaly that occurs in the capital market results in a capital market reaction, although it does not contain economic information. This happens because of the behavior analysis carried out by market participants by looking for abnormal returns from market behaviors that occur repeatedly even though these have no effect at all on the economy. The technical analysis carried out also results in deviations because market participants try to make forecasts of past prices which are expected to occur again in the future. Capital market anomalies result in abnormal returns experienced by investors so that it is contrary to the efficient market hypothesis theory

From the presentation of this article, it is hoped that the reader can gain knowledge and a clear picture of the existing anomalies and their causes which are explained by behavioral finance and how they contradict the efficient market hypothesis (EMH).

Literature Review

Investation

Tandelilin (2010) defines investment as a commitment to a number of funds or other resources carried out at this time, with the aim of obtaining a number of benefits in the future. According to Jogiyanto (2013), investment is delaying current consumption to be used in efficient production for a certain period. In general, investment is defined as the cost that is sacrificed today in the hope of obtaining a greater return in the future.

Jogiyanto (2013) classifies investment instruments into two groups, namely investments in real assets and investments in financial assets. Investments in financial assets can be divided into direct investments and indirect investments. Direct investment is an investment made by buying directly the securities of the company that issued it in the capital market, capital market, or derivative market.

Direct investments are grouped into two, namely investment instruments that cannot be traded (non-marketable securities) and investments that can be traded (marketable securities). In investing, investors will be faced with returns and risks (Heikal et al., 2018). Return is the rate of return received by investors. In the capital market, investors can get returns in the form of capital gains and capital yields.

Capital gain is the profit received when the selling price of shares is higher than the purchase price. While the capital yield is the profit received from the distribution of dividends made by the company (Khaddafi et al., 2018). Risk is the possible difference between the actual return received and the expected return. Risk is classified into unsystematic risk and systematic risk. Unsystematic risk is the risk associated with a particular stock which can generally be avoided or minimized through diversification. Meanwhile, systematic risk is a risk that applies to all shares in the capital market concerned and cannot be avoided by using diversification.

Capital Market Efficiency

The concept of an efficient market is always associated with the tendency of market participants to always try to find mispriced or price deviations from its fundamental value.

Market participants try to analyze the information obtained from the financial statements to find out whether there are price deviations from their intrinsic value in the hope of obtaining abnormal returns. The market can be said to be efficient when there is no price deviation from its intrinsic value (Beaver, 1989).

Several other definitions of efficient market are stated by several researchers. Fama (1970) defines an efficient market as a market in which the price of securities is in equilibrium, which means that the securities are valued fairly and the price reflects all information available to the public (fully reflects). According to Beaver (1989), an efficient market occurs when changes in security prices act as if everyone is observing every available information (full information price). Jones (1996) in his research includes an element of asymmetrical speed of information dissemination.

According to Jogiyanto (2013), the market is said to be efficient when the market reacts quickly and accurately to reach a new equilibrium point that fully reflects the available information. According to Tandelilin (2010), several conditions that must be met in order to achieve an efficient market are as follows.

1. There are many investors who are rational and try to maximize profits. These investors actively participate in the market by analyzing, assessing, and trading stocks.
2. All market participants can obtain information at the same time in an easy and inexpensive way.
3. Information that occurs is random.
4. Investors react quickly to new information, so that the price of securities will change according to changes in the actual value due to the information.

Efficient Market Hypothesis

The price formation of an asset lies on the EMH, which provides a normal return. In Fama (1970), it is assumed that asset prices reflect all available information. In turn, a market that always fully reflects available information is named as 'efficient.' The author, in his study, determines the division of information into three subsets, and then he tests them.

The subsets were classified into:

- Efficient in the weak form, where the information set consists only in historical prices
- Efficient in the semi-finished form, where prices adjust efficiently after other information becomes publicly available
- Efficient in the strong form, where asset prices adjust even if investors or groups have a monopoly on information access.

These conditions are hardly met in practice. However, such conditions are sufficient, but not necessary. When carrying out the empirical tests, their results showed that the weak form reached statistical significance. In turn, the semi-strong and strong forms showed consistency with the EMH. However, as there is information asymmetry and transaction costs in practice, Fama (1991) argued that the EMH was false, but he stressed its importance to be used as a benchmark. Each person would be free to judge the scenario in a market and how close it might be to the hypothesis. In Fama (1991), there is a change in the classification of subsets and their forms for operationalization. In general, the main characteristics did not change significantly.

Given the hypothesis that the assets provide normal results in terms of information, political instabilities, they presumably make the market more volatile. More than mere negotiations based on hypotheses with economic and accounting rationale, sometimes the capital market ends up escaping rationality. Returns might also capture periods of indecision, i.e. a psychological aspect of the negotiating mass.

It is worth noticing, however, that the study of events for the EMH is not aimed only at political issues, but at various circumstances that can be captured. For instance, Lima et al. (2008), through the positive accounting theory and the EMH, have verified whether the information provided to the capital market about the intention to issue American Depositary Receipts (ADRs) among Brazilian companies generates abnormal returns in the stock prices of these companies.

Efficient Market Anomaly

In actual conditions that occur in the market, efficient markets cannot be separated from deviations based on the tests that have been carried out. According to Jones (1996), market anomaly is a technique or strategy that seems to contradict the efficient market.

Deviations that occur in the market is what causes things that should not happen in an efficient market. With the anomaly, it is possible for investors to obtain abnormal returns from the market. Testing based on the presence or absence of anomalies uses a back tested approach model. Researchers conduct tests to answer the question of how historical data moves or changes as a result of events.

In a market anomaly, the resulting outcome is opposite to the expected return on an efficient capital market position. Anomalies appear in all forms of market efficiency, both in the weak form, in the semi-strong form, and in the strong form. However, most of the evidence links the anomaly to the semi-strong form of efficient market. Facts in the market show that abnormal conditions can occur and are very likely to occur. Abnormalities can occur in the market as a whole, but can also occur in the movement of certain stocks. Anomalies that occur in certain stocks can usually be detected or estimated (Jogiyanto, 2013).

Efficient market anomaly occurs when there are deviations in the assumption of an efficient capital market which is sometimes difficult to explain based on the company's fundamental condition. Anomalies that occur often occur repeatedly so as to form a pattern. Anomalies that occur are influenced by the sophistication of market participants in responding to any information that occurs. The sophistication of market participants is often based on analyzes by predicting patterns or habits that form in the market. (Jogiyanto, 2013).

Causes of Market Anomalies

Market anomalies occur because investors find more effective strategies to get abnormal returns. Several research results were found by Fama & French (1988) which stated that the return from

market securities as a whole is greater when the variables that are very easy to observe such as the dividend/price ratio, dividend yield have a high value.

Several more detailed explanations regarding the cause of the anomaly are also expressed by Bodie, et al. (2008). A comprehensive explanation or interpretation of the occurrence of anomalies is due to the risk premium factor as expressed by Fama & French (1993) and the inefficiency factor as expressed by Lakonishok, et al. (1995). The explanation of these two factors is as follows.

1. Premium Risk

Fama & French (1993) stated that the effect or anomaly can be explained as a manifestation of the risk premium. The risk premium referred to here is the risk premium demanded by investors for securities that have a large risk. The risk measured here is systematic risk or beta which is the volatility of the company's return on market returns. Fama & French (1993) proved through their research that securities with high betas have higher average returns due to the demand for a premium on the risk borne. This is in line with what is stated in the CAPM regarding the relationship between return and risk.

2. Market Inefficiencies

Lakonishok, et al., (1995) stated that this anomaly is evidence of market inefficiency. More specifically, it is caused by systematic errors of forecasting by stock analysts due to their irrationality. This is a behavioral approach where this may occur because investors have cognitive limitations in making decisions. They argue that stock analysts tend to overprice (overprice) companies that have performed well and underprice companies that have previously underperformed. In the end, when the perpetrators realize their mistake, the price will reverse. This is consistent with the winner loser anomaly and is also consistent with the size effect and book-to-market effect as proven by Grinblatt, et al., (1995).

Behavioral Finance

Behavioral Finance or behavioral finance is a field that discusses behavioral biases and their effects on the capital market (Jeffry et al., 2020). Behavioral finance also studies the emotional aspects of investors in making investment decisions that affect the capital market. (Bodie, et al., 2008)

The theory of behavioral finance states that investors often make systematic errors when processing information about the stock market. This can cause the market to experience an overreaction, both positive and negative overreaction. Some of the mistakes made by investors in processing information are as follows. (Bodie, et al., 2008)

1. Predicting errors

Kahneman & Tversky (1973) found that people give greater weight to experiences that will occur in the near future than prior beliefs when making forecasts about future conditions with information that contains inherent uncertainty. This makes investors inclined to produce extreme forecasts. The P/E Effect is one of the anomalies caused by this error.

2. Overconfidence

This error is a mistake that occurs because investors tend to be too confident in their beliefs and predictions, and also too confident in their abilities. The implication is found by Barber & Odean (2001) who found that predictable poor investments yield better returns than good investments.

3. Conservatism

Conservatism is meant here is that investors are too slow (too conservative) to update their beliefs when there is new evidence so that they underreact when there is new information that has implications for slowness.

Method

Efficient Market Hypothesis is a hypothesis which states that the capital market is efficient if the price of securities quickly adjusts to available information. This hypothesis emphasizes the concept of relevance of information where information in the capital market will be able to influence the decision making of investors so that it affects the price of securities in accordance with the law of supply and demand.

In the practice that occurs in the capital market, the concept of an efficient capital market is not fully realized. The market at any given time can be efficient because security prices reflect the content of relevant information quickly. However, at certain times it also moves against the existing information or it can move towards a new level of adjustment slowly.

When there is no information that contains relevant information, the market can adjust prices to a certain level, either to be higher or lower due to the behavior of investors in taking advantage of certain events to obtain abnormal returns due to unsophisticated processing of information. exists or because investors take advantage of an event that occurs to obtain abnormal returns.

This movement is called an anomaly. Anomaly is a form of market inefficiency because anomaly is an event in the capital market where the price of securities can change without any relevant information that can affect the price of the company's securities. This research method includes a comprehensive qualitative description of the relevant literature sources.

Result and Discussion

A. Result

Most economic and monetary hypotheses depend on the recommendation that people act judiciously and consider all suitable data in their dynamic cycles (Jones, 1996). Notwithstanding, in actuality the market is comprised of unreasonable individuals who don't put together their choices with respect to accessible data.

Not with standing data, the way of behaving of the capital market can likewise be made sense of by the brain science of financial backers. The ramifications that we can take from the clarifications in regards to social money above is that the oddity is made by the silly way of behaving of financial backers due the elements referenced above, like outlining, mental bookkeeping, and others. Moreover, financial backers additionally focus on existing examples to get unusual returns. These reasons create conduct money can be the reason for making sense of the event of existing oddities.

For instance, schedule oddities that happen, for example, the January Effect, Holiday Effect, Day of The Week Effect, and others are completely brought about by financial backer way of behaving in exploiting these minutes to get unusual returns on the grounds that these occasions continue to rehash the same thing with similar side effects, albeit not consistently. happens consistently.

January Effect, which happens in high liquidity or additionally in light of the fact that financial backers are adjusting their portfolios subsequent to sinking toward the year's end (Sivano, 2011). The huge return after special times of year is additionally a ramifications of the way of behaving of financial backers who increment their buys on the grounds that they have enormous assets after special times of year, particularly the Idul Fitri and New Year occasions where numerous rewards are purchased at these two minutes.

The Rogalsky Effect that happened in Indonesia, to be specific the April Effect is likewise a ramifications of the way of behaving of financial backers who purchase a great deal of offers in April on the grounds that in April there was a ton of positive data about the organization's fiscal reports that should be submitted in April to the OJK. (Muliadi, 2013).

This multitude of minutes are utilized by financial backers to get unusual returns. As a matter of fact, these minutes have no relationship with the organization and are likewise not pertinent data about the organization, so as per EMH there ought not be a cost change since there ought to be no response from financial backers, however actually there is a cost change.

An illustration of an oddity that has happened in Indonesia as of late is the event of an inconsistency occasion that has gotten an adequate number of media consideration, to be specific the huge expansion in the JCI at the hour of the arrangement of Joko Widodo (Jokowi) as an official applicant from the Indonesian Democratic Party of Struggle (PDIP). At the hour of Jokowi's appointment as president, practically all lists entered the green zone, with the exception of the mining area, and the JCI rose altogether to arrive at 152.4 places (Wibowo, 2014). This critical increment was brought about by hopefulness from financial backers about the monetary possibilities

in Indonesia assuming Jokowi became president so the market, particularly unfamiliar financial backers, made enormous purchasing activities which made costs rise.

This peculiarity is normally alluded to by individuals as the Jokowi Effect. This Jokowi Effect is an inconsistency in light of the fact that the genuine data on Jokowi's application isn't important data about the organization and there is no connection between the organization and Jokowi. As per EMH, Jokowi's bid shouldn't carry huge changes to stock costs. In any case, actually it has an exceptionally critical effect.

This can happen in light of the fact that confidence is a mental side and the way of behaving of financial backers who are hopeful is because of Jokowi's figure. They then, at that point, exploited this Jokowi official political decision to get unusual returns.

Discussion

From a few clarifications with respect to the event of peculiarities and the realities in regards to the abnormalities above, it tends to be seen that the market is to be sure firmly affected by the way of behaving and brain science of financial backers and without a doubt these personal conduct standards truly do happen and have been tried for their reality by scientists as confirmed by oddities. that occurred. Conduct affects the market since stock costs in the capital market are full grown in view of the law of market interest.

Whenever the degree of interest as a longing to purchase is high, the cost will be higher, and when the degree of supply as a craving to sell is high, the cost will fall significantly further.

The development of financial backers in deciding if they have any desire to trade isn't just restricted by the accessible data, yet additionally due to inclinations, wants, and market brain science around then. Here and there financial backers don't give a lot of consideration to the accessible data on the grounds that the financial backer wants to trade shares as of now because of requirements or abundance reserves. Financial backers' good faith and cynicism about the market during this period will likewise make a difference. Like that, without even a trace of significant data, costs can move because of the way of behaving of these financial backers. This is the reason for the clarification of social money.

Since abnormalities are brought about by financial backer way of behaving, the presence of peculiarities won't generally be predictable in light of the fact that it relies upon financial backer way of behaving in answering data at a specific time. Oddities in some cases happen in one period yet not in another. This is on the grounds that the way of behaving of financial backers isn't something very similar starting with one period then onto the next because of the various conditions looked by financial backers consistently. In specific periods, financial backers can have various choices on their ventures so the ramifications or outcomes that happen are likewise unique and the peculiarity doesn't happen in that period.

One model is that the inconsistency doesn't happen in light of the fact that financial backers are hanging tight and see for the current data and just pursue a choice to trade after the important data about the organization is accessible.

Another chance is that financial backers are hesitant to go with speculative choices because of troublesome monetary circumstances. This irregularity has been demonstrated in a few examinations led by a few past scientists, for example, the two investigations on the January Effect which delivered two distinct outcomes between Siagian (2010) and Andreas and Daswan (2011). Aside from being because of conditions, peculiarity irregularities can happen because of the superfluity of the methodology that causes the abnormality. Since the oddity is the ramifications or aftereffect of a methodology to get unusual returns, then, at that point, when the procedure is known, the system will presently not be pertinent to get strange returns. Normally this makes the abnormality vanish without help from anyone else as expressed by Basu (1983) in regards to the size impact in 1980

This irregularity that makes the oddity can't be said as a monetary hypothesis that can negate the effective market theory. Also, the proficient market speculation itself can't be wiped out in light of the fact that the effective market idea really happens in the capital market. EMH as of now has an

exceptionally impressive establishment or establishment since it has clear benchmarks and rules in deciding business sector effectiveness as well as the hidden estimation apparatuses. Likewise, this is additionally in light of the fact that objective and complex financial backers in pursuing speculation choices base their choices on accessible data like those in the effective market idea. The capital market itself has prompted what is expressed in the idea of a productive market since now monetary data about organizations has opened up to showcase members.

A few examinations have additionally observed that the Indonesian capital market has been proficient in a powerless structure in spite of the fact that there are as yet numerous who express that the Indonesian market isn't productive. Market effectiveness actually must be tried in light of the fact that there are as yet conflicting outcomes between studies. Social money has not had the option to cut short EMH on the grounds that conduct finance doesn't yet have clear measures like those in EMH and is likewise simply ready to make sense of the reason for the abnormality, yet can't make sense of why the distinction happens.

Social money itself is just preoccupied from the way of behaving of financial backers saw by analysts and afterward make a speculation about the reasons for this peculiarity.

From the conversation above, it tends to be finished up from the conversation that the ideas of productive market and inconsistency are two totally unrelated against things and both are totally unrelated on the grounds that the peculiarity that happens demonstrates that the market is wasteful because of stock cost developments despite the fact that there is no pertinent data. This development is caused additional by deviations from the sane way of behaving of market members. This deviation can be brought about by mental and mental elements of market members that trigger this way of behaving.

Social money or conduct finance hypothesis is a hypothesis that can make sense of deviations from judicious way of behaving by financial backers so they can make sense of the reasons for oddities that exist with regards to financial backer way of behaving.

Albeit the inconsistency has had the option to be made sense of by conduct finance, the abnormality has not had the option to cut short EMH. EMH must be cut short when social money has had the option to show itself as a preferable and more significant hypothesis over EMH. However long the social money idea has not had the option to cut short the EMH, the inconsistency likewise can't cut short the EMH. This is on the grounds that oddities are just important for market shortcoming. The EMH idea itself as of now has a solid groundwork in regards to the rules that should be met, while the actual inconsistency, in spite of the fact that it has been made sense of by conduct finance, doesn't happen reliably and the outcomes change every period because of erratic financial backer way of behaving so there is no sureness. which can be summed up to social money to turn into a pertinent hypothesis of money.

Conduct finance itself is just extricated from research on financial backer brain science so it can make sense of the reason for the peculiarity according to a social viewpoint, yet can't make sense of why there is irregularity with the goal that it can't cut short EMH. Notwithstanding, to really accomplish an effective market as has been reprimanded by EMH consumes a large chunk of the day and should join all discernments from financial backers that they should be reasonable people who base their choices on an unmistakable premise. through capital market schooling to assist with making an effective capital market (Bodie, et al., 2008).

As to my perspective on which hypothesis among EMH and social money is more illustrative or applicable to the ongoing capital economic situations, particularly in Indonesia, I think for the present conduct finance is even more pertinent to the ongoing circumstance in light of the fact that the Indonesian capital market is as yet not proficient with regards to data and choices. The explanation is that the Indonesian public are as yet not modern with the current data and the current financial backers will generally conjecture and pursue choices in light of nature. This should be visible from financial backers' choices which are as yet in light of data that has no relationship with the organization and furthermore responses to corporate activities that are still off-base or even

don't respond on the grounds that financial backers don't have the foggiest idea about the purpose of the data as referenced in the investigations above.

Another explanation is that there are still gatherings who can move the market as cost creators since they have enormous assets so silly peculiarities normally happen, for instance, a terrible stock abruptly gets more expensive. The realities additionally express that putting resources into the securities exchange such a long ways by Indonesians is as yet thought to be a bet or theory in light of the fact that an objective choice won't really be productive for financial backers. On the off chance that the market is as depicted by EMH, putting resources into stocks ought to presently not be a bet since all choices depend on applicable data and everybody acts soundly on that data so they respond the same way. Proof of putting resources into stocks which are as yet considered betting is likewise a pointer that the capital market isn't effective. This demonstrates that numerous financial backers have not acted normally.

In the interim, from a conduct finance viewpoint, this monetary hypothesis is more applicable to depict the present status of the capital market since all cost changes that happen are just an instrument of financial backer way of behaving in market interest, where such way of behaving doesn't need to be founded on judicious activities in light of accessible data. there is. Numerous financial backers are in Indonesia, yet additionally financial backers from different nations who are not refined about the current data or in light of the fact that they just play stocks to estimate searching for unusual returns. This makes financial backers just follow their senses in regards to the market possibilities around then for sure numerous different financial backers do which in conduct finance is frequently called the grouping impact.

Conclusion

The conclusion that can be drawn from the discussion of EMH versus anomaly with a behavioral finance perspective is that it turns out that market anomaly is a phenomenon formed by investor behavior that is not related to the presence of relevant information in the market. The causes of this anomaly can be explained by the concepts that exist in the behavioral finance. Behavioral finance can also be one of the basic explanations for the phenomena that exist in the capital market because the price of securities in the capital market is composed of the existing forces of demand and supply. The magnitude of the power of demand and supply that exists is in fact not only influenced by relevant information that can affect the company, but also the preferences of investors for their investments which also influence their behavior.

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CHAPTER 4

The Effect of Religion Transcends National Boundaries on Accounting Systems

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ABSTRACT

The relationship between religious norms that affect every aspect of human life and business practices has some value conflicts in practice. Therefore we need an accounting system that can combine these two aspects. The purpose of this study is to present the influence of religion beyond the boundaries of the national accounting system. This research will use a descriptive approach in the process and use the six religions prevailing in Indonesia as the object of research.

Keywords : Accounting System, Religion, Business Practice

1. INTRODUCTION

The role of accounting in the world economy is so great that accounting can also be referred to as the "language of business". This is because accounting can be used as a communication tool among business people, because it functions as a measuring tool for the results of economic activities as well as a provider of information for managers, investors, creditors and other parties in need (Bakar et al., 2021). The process of developing the accounting system in Indonesia itself has gone through several stages (Lubis et al., 2021). Accounting began to be applied in Indonesia since 1642, but clear evidence is found in the bookkeeping of Amphioen Societeit which was established in Jakarta since 1747. Furthermore, accounting in Indonesia developed after the forced Cultivation Law was abolished in 1870. This resulted in the emergence of Dutch private entrepreneurs who invested capital in Indonesia. In 1994, the Indonesian Accounting Association (IAI) has carried out various harmonization steps using international accounting standards in the process of developing accounting standards and made a total revision of the 1984 Indonesian Accounting Principles (PAI) and since then issued a Financial Standard which was named the Financial Accounting Standards (Finance Accounting Standards). SAK) which has been issued since October 1, 1994. Financial Accounting Standards (SAK) are established as the standard accounting standards in Indonesia.

The development of the accounting system is influenced by several factors and one of the factors is spiritual or religious. Where in Indonesia itself, the influence of religion plays a major role in all aspects of Indonesian people's life (Marini et al., 2019). In the business world, religious organizations are included as non-profit organizations that are oriented to community service and not to corporate profits. In business life there are often several aspects that are contrary to religious values, such as in business practices, some business people are willing to do various ways to get the maximum profit even though it is a dirty way. Therefore the question arises "What is the role of the religious aspect in overcoming things that are contrary to societal norms in the accounting system?". In this study, we will discuss the influence of religion that goes beyond the social boundaries of the accounting system, where religion is expected to create an accounting system that is fair and transparent to all parties included in it.

2. LITERATURE REVIEW

The accounting system provides various information needed by economic actors in making decisions (Yulisfan and Nedelea, 2021). The accounting system itself is a procedure used in conveying activity data, especially those related to financial information to interested parties (Hidayat et al., 2013, Yulisfan et al., 2021). According to Mogontha (2017) an accounting system is a collection of resources, such as people and equipment, which are managed to convert data into information. According to Rendi et al., (2014) accounting system is an organization of forms, records, procedures and other tools that are coordinated with one another so that they can collect, organize, and summarize various transactions that occur within the company that can be used by third parties. management in managing the company's operations. In Paulus (2016), there are several functions of the accounting information system, namely:

- Collect and store data about the activities and transactions.
- Processing data into information that can be used in the decision-making process.
- Precise control of the assets of the organization.

In the KBBI, religion is a teaching, a system that regulates the system of faith (belief) and worship of God Almighty as well as a system of rules related to the relationship between humans and humans and their environment. According to Haryanto, the concept of religion as a system in which there are ritual practices, worship and rules that regulate the relationship between humans and God, humans and humans and humans and the environment. There are 6 recognized religions in Indonesia, namely Islam, Catholic Christianity, Protestant Christianity, Buddhism, Hinduism, and Confucianism. And these six religions teach norms that must be followed by society for the purpose of achieving a better life.

3. METHOD

In carrying out this research, the method used by the author is a descriptive approach. According to Moleong (2005), in a qualitative descriptive approach the data collected are in the form of words, pictures and not numbers. These data can be obtained from interviews, field notes, photos, video tapes, personal documentation, notes, or memos and other documentation. This research will produce information about the influence of religion on the development of the accounting system and its benefits for economic actors.

4. RESULTS AND DISCUSSION

4.1. Results

4.1.1. Religious Views in Business Practices

In Islamic teachings it is also known as Hisab where reckoning is one of the processes of calculating charity during human life in the world by Allah. Therefore, every human being in his life must always be in a state of trust, honesty and high commitment to the promises that have been made to Allah. Therefore, charity in Islam is not only limited to formal worship, but must also be applied in everyday life, including developing a business. In other words, work can be worship if done properly.

In Christianity there is a commandment of God: "You shall love your neighbor as yourself." Love in this commandment refers to all individuals, and groups without exception. In love we are taught to forgive our fellow human beings, treat our fellow human beings as ourselves, and help in joy and sorrow. This also applies in running a business, we should love each other by being fair while doing business, so that no one feels disadvantaged. Buddhism teaches the concept of anatta. The point is that all components, objects, or living things consist of components that come from outside themselves. When we see a flower that blooms beautifully, it really does not have an inherent eternal essence in it. The flower consists of clouds, rain, minerals, soil, weather and so on which come from outside but manifest into a beautiful flower when the causes and conditions have been fulfilled. When we make other people happy, then that happiness will eliminate our own suffering and bring happiness to all. No business can be sustainable if it is built on greed and ego gratification by simply taking things from other people and nature (Efferin, 2015).

Tri Hita Karana is a philosophy rooted in Hindu Tradition. This philosophy emphasizes the importance of building harmony between God (parhyangan), humans, and nature/environment (palemahan) (Pertwi and Ludigdo 2013). Hindu Dharma teaches humans to maintain harmony between the two cosmos for the sake of prosperity and happiness both physically and mentally. So the balance of the ecosystem needs to be created and maintained because of the unity of humans with nature. In the context of business, business activities need to prioritize the harmony of the above elements and be manifested in the relationship between these elements.

4.1.2. The Influence of Religion Beyond the National Accounting System

In realizing business practices that are clean from various kinds of things that are contrary to religious norms, a Sharia-Based Accounting System is established which is regulated in PSAK Syariah 59. The contents of this PSAK are:

- PSAK 101: Presentation of Islamic Financial Statements
- PSAK 102: Murabaha Accounting
- PSAK 103: Accounting Greetings
- PSAK 104: Istishna' Accounting
- PSAK 105: Mudharabah Accounting
- PSAK 106: Musyarakah Accounting
- PSAK 107: Accounting for Ijarah
- PSAK 108: Accounting for Sharia Insurance Transactions
- **PSAK 109: Accounting for Zakat and Infaq/Alms**
- PSAK 110: Accounting for Sukuk

The principles of the Islamic financial system include the prohibition of usury, risk sharing, not considering money as a commodity, prohibiting speculative activities, and one party may not

renege on a contract so that it is maintained and remains pure (Heikal et al., 2018). And these things are clearly stated in PSAK Syariah 59. In addition, the practice of religious organizations (churches, mosques, etc.) as organizations that focus on public service is also regulated in PSAK 45 as a non-profit entity. PSAK 45 regulates the Financial Reporting of Non-Profit Entities which are expected to become financial statements that have relevance, comparability, and can be used as a form of accountability. The contents of the financial statements of non-profit entities according to PSAK 45 are statements of financial position, activity reports, cash flow statements, and notes to financial statements. So that in practice religious organizations can run their business according to religious teachings that do not harm others but raise the standard of living of all the people involved in it.

4.2. Discussion

An accounting system is needed in order to simplify the process of implementing and presenting the results of economic activities as well as strengthening the accuracy of financial information that will be presented to the parties in need. We as humans who have a culture must run our business according to the teachings of the religion that we believe in so that in running the business so that all parties can benefit, therefore we need a system that can regulate and monitor the course of economic activity so that it remains in line with religious norms that happens in society. The application of this accounting system is contained in PSAK Syariah 59 which regulates what things can and cannot be done in business according to Islamic law, and PSAK 45 which regulates non-profit entities which include the business practices of religious organizations.

5. CONCLUSION

The main goal in running a business is to get the maximum profit, but as civilized and religious human beings, we should not do things that are contrary to our own beliefs. Therefore, an accounting system was formed that can support this religious-based business practice, namely PSAK Syariah 59 and PSAK 45. So that the wider community can be more confident and have confidence in the financial information. From this we can see that religion affects an accounting system, because with a religious-based accounting system, the information obtained can be more valuable and reliable in the eyes of the community because it is in accordance with the teachings that they have believed.

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CHAPTER 5

How Accounting Can Be Used to Reduce Costs Associated With Various Political Processes

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ABSTRACT

This study investigates how accounting could be used to reduce related costs with various political processes by using three Grand Theories namely Positive Accounting Theory, Theory agency and Signaling Theory. This study uses a qualitative or normative method with using qualitative data in the form of normative formulations regarding the understanding of accounting information and the implementation of information. This research gives a multi-angle analysis look about how managers get power or flexibility in earnings management to reduce related costs with cost process politics. The political cost hypothesis that arises as a result of the phenomenon that large companies with market share and very large profits will get a lot of public attention big too. These companies are usually required to meet performance standards vulnerable operation and high environmental performance against increased taxes and other levies.

Keywords : Cost Politics , Management Profit , Manager

1. INTRODUCTION

The current financial statements are information that can be said to be basic needs in the business environment. Starting from management, analysis finance to government officials and the public at large to the company's financial statements. On the other hand, financial statements are accounting products that have legitimacy through established standards by a prestigious professional body such as the Association of Indonesian Accounting (IAI) or Financial Accounting Standards Board (FASB). Report Maker finance has the privilege to choose an accounting method as long as legitimized by the standard in most cases the accounting method established is not have a direct effect on the company's cash flows, for example the depreciation. If so then a different accounting method will not affect firm value. However, there is empirical evidence that conclude that the choice of accounting method is relevant to the economic decisions. Example the case with the phenomenon the decline in the share prices of oil companies in reaction to mandatory use of successful-efforts (SE) in recording costs exploration. While the use of the SE and FC (full-cost) methods does not have a direct effect on cash flow but it turns out to be very influential to the value of the company as measured by the stock price.

The choice of accounting method will can be used for two things, namely for purposes of efficiency and opportunistic purposes. Efficiency objectives are intended to minimize contract costs and maximize the value of the company, it is understandable why the above hypotheses are used on the one hand to explain the phenomenon of *disclosure* which has a positive connotation, while on the other hand it is also used to explain the phenomenon of negative connotation, namely income smoothing (earnings management). This means that on the one hand political and contractual hypotheses can encourage decreased conflict with increased disclosure, but on the other hand both This hypothesis is also expected to encourage "negative" practices such as income smoothing or earnings management.

One of the information contained in the financial statements is financial information about profit. Profit or profit is often used as the basis for decision making of various stakeholders, such as used as a basis for giving bonuses to managers, used as a basis to calculate taxable income, and also used as an assessment company work (Bakar et al., 2021). Therefore, managers often take advantage of opportunities to manipulate earnings figures with accrual engineering to influence the results of various decisions such as motivational bonuses, are considered to do more good or to minimize the income tax burden that must be paid by company (Nurdiniah, 2015). Watts and Zimmerman (1978) explain the above phenomenon with introduce the paradigm of Positive Accounting Theory. Positive Accounting Theory views the company as a "nexus of contract" with a contract fee that greater than zero. In the "nexus of contract" view, companies considered a collection of agreements or contracts between companies with various parties with an interest in the company such as creditors, employees, owners of capital, suppliers and other parties. From here then Various conflicts arise due to differences in interests between the parties. This conflict arises because each party is assumed to maximize their respective interests.

Positive accounting theory reveals that managers have the power or flexibility to choose accounting procedures that suit the procedures his choice. This allows managers to choose procedures that can increase profit or decrease profit to modify the report financial, or to achieve a certain goal. Manager actions in Manipulating financial statements is usually referred to as earnings management. Agency conflicts can result in management having the opportunity to report earnings improperly, will cause the value of the company to decrease in the future front (Nurdiniah, 2015). Conflict of interest occurs between shareholders or principal with the manager as agent where the agent has information more to the company than the principal, and the agent must convey the information contained in the company to the principal. Thing This becomes a problem because in conveying the information the agent can manipulate reports about the company against the principal so that performance looks good and in the end get compensation from principal.

Another factor that influences earnings management is firm size. Gunawan (2015) found that firm size had a positive effect to earnings management. Veronica and Bachtiar (2003) found that

firm size is positively correlated with earnings management. Companies have a large enough incentive to carry out earnings management, the reduction of political costs is one of the reasons big companies carry out earnings management that reduces the amount of reported earnings. Another reason is that the company must be able to meet certain profit targets that are must be achieved can be the reason why companies manipulate profits that reported for a higher value.

There are also many political motives behind the practice of income smoothing. Practice income smoothing is often used to minimize attention or costs unfavorable politics for the company. Companies who have a high political risk will try to reduce this risk one of the ways is by conducting income smoothing practices (Watts and Zimmerman, 1978; Godfrey and Jones, 1999). Cahan (1997) stated that with the existence of anti-trust laws, companies tend to reduce the level of income/sales that have direct implication with decreasing profit. Too tall company earnings or large companies that tend to be monopolistic or Oligopolistic is often a public concern, especially with regard to wealth transfer. In other words, taxes or other levies by the government or the public for such a company would have the potential to be raised.

The basic question that will arise is how political costs explain two different phenomena and tend to be contradictory background, and what are the implications for financial statement analysis (Warae et al., 2021). In this context the foresight and prudence of various parties who has an interest in financial statements is an absolute must. In On the other hand, standard setters must take into account the phenomena in setting standards so that conflicts of interest can be reduced. Standard plays an important role in this case, considering that standards are a corridor that enable managers to communicate fully and effectively with outside investors and other stakeholders. However, standards alone are not sufficient for the operation of this communication mechanism to be effective. A number of Ways that can be done to achieve the effectiveness of this communication are audits and audits voluntary disclosure. It is this difference of interest that causes the company manages political costs in the form of tax burdens that must be borne by company so as not to burden the company.

2. LITERATURE REVIEW

There are several theories that support the formulation of this research hypothesis, namely: agency theory and positive accounting theory .

Agency Theory

Agency theory describes the company as the locus (meeting point) of the agency relationship between the owner of the company (principal) and company management (agent). The parties involved in agency relationships within the company seek to maximize their utility (Wolk and Tearney, 1996: 89). This utility maximization effort encourages conflicts of interest between the owner (principal) and management (agent), because each party tries to maximize its interests: the owner wants to achieve an ever-increasing level of profitability, while management tries to maximize the fulfillment of his economic and psychological needs through compensation contracts. To resolve the conflict, the owner puts a monitoring function in place. The forms of monitoring commonly used include the preparation of periodic financial reports for the benefit of the owners (stewardships and accountability) and an independent auditing function in expressing their opinion on the fairness of the company's financial statements (Francis and Wilson (1988) in Zuhror (1996)). The financial statements prepared by managers are expected to present a reasonable level of income which usually shows a relatively insignificant level of income variability in several financial reporting periods. In other words, managers will always try to achieve the income level desired by the owner, present a reasonable level of income, and maintain income variability. In agency relationships, managers have information asymmetry and can use the information they know more flexibly in an effort to maximize their interests. One example is income smoothing. Research related to income smoothing will be discussed in more detail in the literature examples chapter discussing economic consequences.

According to Watts and Zimmerman (1986) agency theory is the theoretical basis that underlies the company's business practices used so far. The theory is rooted in the synergy of

economic theory, decision theory, sociology, and organizational theory. The main principle of this theory states that there are working relationship between the party giving the authority (principal), namely the investor with the party receiving the authority (agency), namely the manager, in the form of cooperation contract called "*nexus of contract*". The agency relationship is a contract between the principal and the agent, which separate ownership (investors) and management (managers/agents). There is a separation of ownership by the principal and control by the agent in an organization tends to cause agency conflicts between principals with agents. Watts and Zimmerman (1986) stated that financial statements made with accounting numbers is expected to minimize conflict between interested parties. Financial reports that reported by agents as accountability for their performance, used by principals to assess, measure, and monitor the extent to which agents work to improve their welfare and as a basis for giving compensation to agents. Agency costs arising from the conflict This interest is the monitoring costs, bonding costs, and residual loss. To reduce costs several mechanisms can be used for agency agency, namely through share ownership companies for managers, combining sources of funding from loans and equity, and dividend distribution.

Positive Accounting Theory

The 'why' question is the hallmark of economic consequences. To explain this phenomenon, a theory called positive accounting theory (PAT) was introduced. The term positive indicates that a theory can be used to predict an event in the future in the real world. For example, to predict which oil and gas companies will use for their exploration costs (using successful effort accounting (SE) or using full-cost accounting (FC)). A company can be seen as a nexus of contracts so the company can be broadly described with a number of contracts. For example, contracts with employees, managers, suppliers, and providers of capital. These contracts include accounting variables. For example: income to measure performance, financial ratios such as debt to equity or time interest earned or minimum level of working capital or equity. The company wants to minimize contracting costs, such as negotiation costs, monitoring costs of contract performance, the possibility of renegotiation, and failure/bankruptcy costs. PAT also states that the company's accounting policies will be chosen in light of the problem of minimizing contract costs (Nasution et al., 2028). For example, Mian and Smith (1990) conducted a study on the selection of accounting policies to consolidate subsidiaries. The argument is that if consolidated financial statements are prepared for internal monitoring (to see the manager's performance) and consolidated financial statements for reports to external parties, the costs will be lower. Management flexibility in choosing accounting policies provides opportunities for opportunistic behavior, assuming rational managers (investors). The case of oil and gas is the most interesting example in choosing full-effort over successful-effort.

Positive accounting theory according to Scott (2000) seeks to make predictions about good according to real events. Further Godfrey et.al (1997) in Anis and Imam (2003) stated that positive accounting theory seeks to answer, among others: the following question from an economic point of view. :

- a. Are the costs incurred commensurate with the benefits obtained in the the selection of alternative accounting methods?
- b. Are the costs obtained commensurate with the benefits obtained in regulation and accounting standard setting process?
- c. What is the impact of published financial statements on stock prices?

To answer the above questions, a positive accounting theory has been developed can be grouped into two stages, namely (Godfrey et al., 1997 in Anis and lmam, 2003):

- a. Accounting research and capital market behavior. At this stage it is not explained about accounting practice, but research is conducted on the relationship between earnings announcements and stock price reaction. To conduct research at this stage, the hypothesis is used Efficient Market (*Efficiency Market Hypothesis*) (Scott, 2000). An efficient capital

market is capital market where the prices of securities traded at any time are reasonable and reflects all publicly known information relating to the letter valuable and *the Capital Asset Pricing Model* (CA PM).

- b. Research in the second phase is carried out to explain and predict practice intercompany accounting focused on opportunistic reasons in terms of the company chooses a certain accounting method, or for reasons of efficiency, namely the accounting is chosen to reduce the cost of contracts between the company and its *stakeholders*. The first reason is that the opportunistic perspective is called *ex-post*, namely the selection of methods Accounting is carried out after the facts are known. The second reason is the efficiency perspective called *ex ante* because the selection of accounting methods is done before the facts are known. Research in this field uses *agency theory* which discusses paradigms control.

Positive flow assumes that between power and politics as something that fixed and social systems in organizations consist of concrete and value-free empirical phenomena (not dependent) on managers and employees who work in it (Machintosh, 1994 in Nur Indriantoro, 1999). Then the *positivist* considers himself an observer neutral, objective and value-free from the observed accounting phenomena (Nur Indriantoro, 1999). Positive accounting theory is also built on assumptions about the *nature of human society*. It is assumed that humans always set goals first before choosing to take an action. In this case humans have "*a single superordinate goal*" i.e. "*utility maximization*" this assumption appears in agency theory accountancy. According to this theory, an agent (manager) will always like to work a little more than a lot, while the owner (*principal*) hopes to maximize return on investment.

According to Weston and Brigham (1998), the agency relationship occurs between shareholders (owners) and managers as well as shareholders (through managers) and creditors. In the agency relationship between company owners with company managers and company managers with creditors, the company is more likely to choose accounting procedures that increase profits or procedures that do not apply the principles of accounting conservatism. Not applying the principle accounting conservatism due to the calculation of bonuses that will be obtained by managers and other insiders are calculated from the value of profits earned by the company. Then another reason is to show good performance, that way the company will easily borrow funds to creditors. Because in a high profit situation, creditors will believe that the company able to cover its debts and assume the company can reduce the level of risk debt is not paid.

Watts and Zimmerman (1986) argue that there are three hypotheses in the theory positive accounting theory that can motivate managers to do profit management. The hypotheses are:

- a. The *Plan Bonus Hypothesis*, in the *ceteris paribus* of managers companies with bonus plans are more likely to choose procedures accounting that can replace the *earnings report* for the next current period or known as *income smoothing*. With this hypothesis, if the manager in the payroll system is very depending on the bonus will tend to choose an accounting method that can maximize his salary, for example with the accrual method (Yyulisfan et al., 2021).
- b. *Debt Convenat Hypothesis*, in *ceteris paribus* managers of companies that have a large leverage ratio (*debt/equity*) will prefer to choose accounting procedures that can replace *earnings reports* for the future period to the current period. By choosing an accounting method that transfers profit recognition to future period to the current period, the company will have *leverage a small ratio*, thereby lowering the probability of a *technic default*. As It is known that many debt covenants require the borrower to comply or maintain a debt to equity ratio, working capital, shareholder equity etc. during the agreement period, if the agreement is violated the debt agreement may be impose penalties, such as constraints on dividends or additional loans.
- c. The *political process hypothesis*, in *ceteris paribus* the greater the political costs of the firm, the more likely firm managers are to choose accounting procedures that defer current period *earnings statements* to future periods. This hypothesis is based on the assumption that firms with large political costs more sensitive in relation to transfer prosperity possible larger than

companies whose political costs are small in words. On the other hand, large companies tend to prefer to reduce or reduce profits that reported than small firms.

The three hypotheses indicate that positive theory accounting recognizes the existence of 3 agency relationships between management and owners, between management and creditors, between management and the government (Anis and Imam, 2003). *Agency* problem arises because of the information asymmetry between the *agent* and the *principal*, where *The agent* has more information than the *principal*. resulting in there is a moral *hazard* (Ahmed RB, 2000). Economic theory of the political process adopts a *self-interest view* that assumes politicians will maximize their utility. The political process in the economy is a competition to transfer wealth, taxes, and other regulations for the sake of individual interests. Interested parties will try to lobby a policy which would be detrimental to their interests. There are several factors that influence the success of the political process carried out, namely a) information costs, b) heterogeneity interests, and c) organizational costs. If accounting numbers (eg profit/ *earnings* are used as the basis for regulations, government (with regard to income tax), Watts and Zimmerman (1986) stated There are several things that encourage managers to choose accounting procedures because: by the political process, as follows:

- a. *Asymmetric Loss Function*. Economists argue that the impetus for producing information in the political process and the *cost* of that information affect regulatory bias issued by bureaucrats. *Asymmetric loss function* is the result of various *costs of* information and government actions that cause an accounting loss to be charged to the individual.
- b. *Effects of a Potential Crisis* . Accounting figures can be used by politicians to resolve the "crisis." Therefore, the income statement receives great attention from politicians and therefore managers are encouraged to adopt procedures accounting that can reduce reported earnings.
- c. *tax* . Because the inventory method affects income taxes, managers will consider these tax effects when selecting the inventory method. This matter explains why during inflation some companies do not use the LIFO method. This method can increase the variability (and covariability) of the company's cash flow.
- d. *Variance Effect of Procedures*. This process is a political process that creates incentives to reduce discrepancies in reported corporate earnings. Difference This is important because of the political and regulatory sanctions, which put pressure on companies that have high profits in a period and recognize them in other periods with lower profits. This asymmetry is consistent with the *cost* of information. The media sometimes calculate the percentage increase in profit over the same period of year previously so that company managers will reduce the difference in profits that reported.

It was suggested by Watts and Zimmerman (1986), that the influence of the political process to the selection of accounting procedures. Large companies are more politically sensitive and relative transfer of greater wealth charged to the firm (political cost) than small companies. Big companies do it in an effort to reduce agency costs. Big companies also face greater political costs because it is an entity that is widely highlighted by the general public. The results of the empirical study of Watts and Zimmerman (1986) also stated that large companies will be charged a higher tax by the government based on the profits earned company. Another effect of the income statement is the possibility of a salary increase request from employees if it is known that company profits have increased. So the choice made by the company, namely by going through the accounting process so that profits can be displayed more low (income minimization). However, if examined further, the company is most likely pay higher taxes, but large corporations also receive significant political advantages for example, lucrative government contracts, import restrictions, and others. Costs borne by the company that chooses the accounting method more conservative to avoid surveillance or reduce surveillance known as political costs (Mills, *et al.*, 2010). According to Mills, *et al* . (2012) political costs are tax payments to the government by providers goods/services based on effective

tax rates apply. Research results Mills, *et al* . (2012) showed that the high political sensitivity influences a company providing goods/services to pay more taxes than other goods/service providers.

Signaling Theory

The encouragement of economic factors to report something (even something bad) is the core of the signaling theory argument. (Wolk and Tearney, 1996). In the case of income smoothing behavior, companies that issue financial statements containing income smoothing are actually driven by economic factors. Besides that, logically, from the point of view of users of financial statements, income smoothing behavior itself is a dishonest and unhealthy accounting practice and income smoothing behavior that is revealed will be seen as "bad" income information because it can mislead stock investment decisions. by stock market practitioners. This is in line with the opinion of Gordon (1964) which explains that income smoothing can provide a bias signal to shareholders in making decisions to estimate possible future income based on past income. Signaling theory shows that there is information asymmetry between company management and parties with an interest in this information because managers know more information about the company and its prospects in the future than external parties. Companies that have neutral income information (as is or in accordance with existing real conditions) will be motivated to report this information in order to avoid suspicion from external parties that the company has bad information. Managers of companies that have relatively low income information have a tendency to issue financial statements (income smoothing behavior) with the aim of maintaining the credibility of the company in the stock market (Wolk and Tearney, 1996: 91). Has the manager's efforts to perform income smoothing succeeded in influencing the investment decisions of stock market practitioners? The results of research by Lev and Kunitzky (1974) show that shareholders are not The naive group of users of financial statements means that shareholders are not easily fooled by the management's actions.

3. METHOD

This research is a type of basic research and literature study because it aims to improve scientific theory and increase knowledge and understanding of the phenomena that occur. In general, it leads to efforts to develop theoretical studies so that they are closer to facts and reality, as a basis for developing knowledge (Wahyudi, 2009). This research is also qualitative in nature using qualitative data in the form of normative formulations regarding the understanding of accounting information and the implementation of information. Sources of data obtained through several articles, both national and international. Data collection techniques are adapted to the methods used in this study, namely data obtained from theoretical studies and several statements from related experts.

4. RESULTS AND DISCUSSION

4.1. RESULTS

From the description above, we can see that the opportunistic attitude and at the same time the desire to achieve efficiency are the driving factors for companies to disclose financial statements and at the same time it turns out to allow earnings management to be carried out. The extent of mandatory disclosure of financial statements cannot be used as a reference for assessing the quality of financial reports, other things such as the possibility of manipulations in the form of earnings management must receive good attention by investors, financial analysts and moreover standard setters. Due to the weakness of existing standards, the management can take active action in reducing miscommunication of financial statements. Things that can be done by management include expanding voluntary disclosures such as disclosures about the choice of financing policies taken by the company and hedging policies taken by the company (Healy and Palepu, 1993).

The political cost hypothesis can help management, standard setters financial analysts and researchers to further enhance the ability of standards and financial analysis techniques, for example

by answering why management makes voluntary disclosures and what matters are preferred to be disclosed by management, standard setters can make regulations or standards related to the above . On the other hand, by knowing the motive for income smoothing, standard setters can also consider what things must be considered to reduce the possibility of income smoothing. For investors and analysts, these two hypotheses can be used as a warning that disclosure alone is not sufficient so that new analytical techniques to detect opportunistic management practices can be identified. However, other motives must also continue to be investigated to find out why or for what reasons management practices even distribution profit .

Cost hypothesis politics states that large-scale companies and strategic industries tend to lower profits in order to reduce the level of visibility especially during periods of high prosperity. This effort was made with the hope of obtaining facilities and facilities from the government. Cost Politics arises because high company profitability can attract media and consumer attention. Several other studies also explain motivation in carrying out earnings management including market motivation capital due to incentives for managers to manipulate earnings by the purpose of influencing the performance of stock prices in the short term.

4.2. DISCUSSION

Zmijewski and Hagerman (1981) who stated that Capital-intensive firms are hypothesized to have greater and more political costs possible to reduce earnings or financial statements tend to be conservative. This hypothesis supported by the results of research by Sari and Adhariani (2009) which states that companies capital-intensive ones will have greater political costs, so it will be possible for management to reduce earnings or financial statements tend to be conservative . The political cost hypothesis introduces a political dimension to policy choices accountancy. For example , political costs can be determined by high corporate profits. This matter will attract the attention of the media and consumers, that attention will quickly be '*political heat*' in companies and politicians will respond by issuing new taxes or other regulations. In Scott (1997) an example is given of the company oil and gas. When the price of oil increases due to the limited supply of crude oil, public anger arose, so the government issued a special tax on oil companies to extract excess profits. This has an impact on company, so managers will switch to LIFO method to reduce the possibility of this happening again.

Incur political costs so that the company does not lose revenue from contracts with the government (Mills *et al .*, 2012). The existence of a large contract value obtained by the company and the importance of revenue from government contracts for the company encourage the company's sensitivity in spending political costs that must be borne by the company, namely the tax burden. Therefore, the company is willing to bear the political costs which are its obligations in the form of paying larger taxes in accordance with the amount of income obtained compared to other companies. This is in accordance with the political cost hypothesis, where large companies with very large market shares and profits will receive great public attention and companies will tend to use various more conservative accounting methods by reporting tax payments in accordance with tax provisions so that companies do not attract the attention of the government or the media who will monitor companies that have high profits in the industry. Research results Mills *et al .* (2012) show that political sensitivity has a positive and significant effect on political costs .

5. CONCLUSION

The financial report made by the company is one of the most important information describes the activities or performance of management who have been entrusted with managing resources company power. The main focus in financial statements is earnings information, because it provides information about the financial performance of a company for a period . Positive Accounting Theory views the company as a "*nexus of contract* " with a contract fee that greater than zero. In the "*nexus of contract*" view, companies considered a collection of agreements or contracts between companies with various parties with an interest in the company such as creditors,

employees, owners of capital, suppliers and other parties . There are three hypotheses in the theory positive accounting theory that can motivate managers to do earnings management is one of them a. The political cost hypothesis that arises as a result of the phenomenon that large companies with market share and very large profits will get a lot of public attention big too. Companies like this are usually required to meet performance standards high operating and environmental performance. Companies like this are vulnerable against increases in taxes and other levies. Company management that facing high political costs will tend to be conservative, i.e choose an accounting method that will reduce the company's profit. Besides that management will also be able to reduce its political costs by certain lobbies that are usually aimed at obtaining protection from government. Protection is intended to face competition with foreign companies. In order to obtain this protection, the company will trying to reduce profits so that it seems as if the decline is the result of there is competition .

In this study there are several weaknesses and limitations, namely this research no have research variables as description object research. This research does not interpret a complex research and only serve addition outlook and knowledge for reader . Then, after reviewing the results of this study, the suggestions that the author can propose are: for further research is to increase the period and research variables so that they can be seen trends in the long term and can increase the number of observations. *Secondly*, it is hoped that further research will expand the research so that could becomes instruction for maker company policy. And the last one is to expand the sample selection research by researching.

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CHAPTER 6

Measuring to Understand Intangible Performance Drivers

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ABSTRACT

The present qualitative study explores what 11 Swedish organizations have systematically worked at to increase the understanding of the importance of intangibles as performance drivers. The present analysis is accomplished using a combination of evolutionary theory, knowledge-based theory and organizational learning. The results indicate that assets in an accounting sense seem to be of less interest than perceptions of activities that enable future performance. These 'enablers' are often customer and employee perceptions of individual, organizational, and relational competence. The way for the firms to ascertain a continuous organizational learning process with respect to the value creation chain is to measure intangibles as well as to maintain organizational routines that ensure the transformation of measurement results into action.

Keywords : Performance Drivers, Knowledge-Based Theory, Accounting Sense

1. Introduction

Powerful forces are reshaping the economic and business world and many of these powers have led to a fundamental shift in organizational processes. The prime forces of change include globalization, higher degrees of complexity, new technology, increased competition, changing-client demands, and changing economic and political structures. Such a development has resulted in steep learning curves, in that companies struggle to adapt quickly, respond faster, and to proactively shape their industries. Organizations are beginning to recognize that technology-based competitive advantages are transient and that the only truly sustainable competitive advantages they have are their intangible resources. The interest in intangibles has grown rapidly in numerous fields, including economics, accounting, and strategic management. The literature on intangibles exploded throughout the 1990s (Johanson et al., 1999) and many firms, as well as influential organizations (e.g., the OECD, European Commission, Brookings Institute, and the Conference Board), embraced intangibles wholeheartedly onto their agenda. One of the main problems in understanding the importance of intangibles appears to be that, while there is still a heavy reliance on financial information, there is a general lack of information on intangibles. In response to this information gap or lack of understanding many concepts and measurement models have been proposed over the years. A couple of the "older" concepts are human resources (HR), human resource accounting (HRA) and utility analysis (UA) those were proposed already in the 1960s. About 30 studies have been performed during the past 20 years concerning the effects of HR measurements on decision-making and learning (Johanson, 1999a). The studies reveal that measurements make a meaningful difference on decision-making and individual managerial learning, whereas integration in the organizational routines is seriously hampered or blocked entirely. HRA and UA, as for many other concepts, continue to exist within a traditional financial accounting framework. However, in the 1990s new and different models were proposed. Some of these models include the balanced scorecard (BSC) (Kaplan & Norton, 1992), intellectual capital (IC) (Edvinsson and Malone, 1997), and the intangible assets monitor (Sveiby, 1997). A common feature linking these models is that although they still rely on measurements, financial information is only looked upon as one element of the information that is needed. Up to now there is a lack of rigorous scientific investigations on the consequences of the implementation of these non-financial models (Johanson et al., 1999). Nevertheless, there is some evidence to suggest that there is considerable enthusiasm to employ these models (e.g., the BSC for managerial control) (Olve et al., 1997; Kaplan & Norton, 1999, Ax and Björnemark, 2000). HRA, BSC, IC statements, the intangible assets monitor, and other models have sometimes (though not often) been utilized in annual reports (Ehrvervsutvecklingsrådet, 1997; Johanson et al., 1999; Guthrie et al., 1999, Putra et al., 2020). Even if investors and analysts frequently state their strong interest in taking information on intangibles into account (Epstein & Freedman, 1994; Mavrinac & Boyle, 1996), it appears that what ultimately counts is conventional financial information (Eccles & Mavrinac, 1995; Carlsson & Eliasson, 1991). Why is it that investors and analysts stubbornly decline to rely on intangible information? Is it because of a fear that the external reporting is not based on internal measurement routines (MR) utilized for managing the firm? The concept MR refers in this paper to the evolutionary (Nelson & Winter, 1973 and 1982) and knowledge-based theories (Grant, 1996; Roberts, 1999) indicating that the firm is regarded as an institution for knowledge creation and exploitation through a set of rules and routines. The paper aims at investigating how MRs enhance the understanding of how intangibles contribute to economic competence, i.e. the ability of the firm to create and exploit business opportunities (Carlsson & Eliasson, 1991). This is to say that the unit of activity to be analyzed is not primarily individuals but MRs. Measurement pertains to the process of assigning numerals to resources. Resources could be assets, activities, or relations. The concept of intangible resources will be discussed in greater detail later but it could be stated already that the unit of analysis is the social construction of intangibles. Boudreau (1998) proposes that human resource metrics are not linked to organizational outcomes but many practitioners, policy making organizations, and individual firms have argued in favor of utilizing some kind of measurement model for the purpose of not only external reporting of intangibles but even management control. Most organizations are transforming their management

control systems continuously, and nowadays they are often based on including more intangible aspects into their management control routines (Almqvist and Skoog, 1999). Why do firms want to expand MRs into the intangible resource area? What kinds of intangibles are measured? How are they measured? How are the measurements utilized? Regarding the management of intangibles, many MRs, such as the BSC, have been suggested with the explicit objective of enhancing learning, i.e., to improve the understanding of intangibles. After a review of the literature on experiences of putting intangibles into financial and non-financial frameworks (Johanson et al., 1999), it is evident that no published study, at least to our knowledge, has been reported on how non-financial models work in relation to understanding the importance of intangibles and mobilizing action regarding intangibles. Understanding and mobilizing can be seen as two aspects of managing. Ideally, understanding is a precondition for mobilizing action. It is not self-evident to separate the two because, as Schön (1986) suggests, action and learning might be a simultaneous process. Nevertheless, it appears worthwhile to sever the two aspects since it increases our understanding of what is actually going on in firms that have experience with measurement and management of intangibles. The present paper focuses on what firms do to expand MRs into the field of intangibles in order to increase the understanding of the importance of intangibles. However, mobilizing action with respect to intangibles might also be a part of the learning process regarding the importance of intangibles. This means that even the mobilizing routines will be subject to interest although it is not action per se that is of interest but action as a part of feedback in the learning process. The idea of the paper is to take advantage of the comparably long experience with measuring intangibles in Sweden. The purpose is to determine what actions have been taken by a number of “experienced” firms with respect to understanding the importance of intangibles as performance drivers and in mobilizing these intangibles. The paper starts with an outline of the theoretical framework that has served as a background in the interpretation of empirical data. Before presenting the methodology that has been applied we reflect upon definitions of intangibles as well as different models for measuring intangibles.

2. Literature Review

To help understand the present research interest numerous theoretical frameworks can be applied. A combination of knowledge-based theory, knowledge management, organizational learning and evolutionary theory has served as a filter for analyzing empirical data in the present exploratory investigation. In an evolutionary theory approach the firm is characterized by relatively constant patterns of behaviors or rules (Nelson & Winter, 1973 and 1982). These rules are subject to an evolutionary process in the sense that they are evaluated, reproduced, eliminated, varied, and selected. The rules may be grouped into three levels: at level 0, relatively fixed rules (operating characteristics) govern short-term behavior; at level 1, there are investment rules, recording rules, and influencing rules. Level 2 incorporates search rules that modify all lower-ranking rules (including the search rules themselves). The rules affect physical states (the physical capital stock), knowledge (the ‘contents of file drawers and human memories’) and external states (the attitudes that are directed toward the firm from the external environment, including customers, competitors, and the public). Nelson & Winter define knowledge as being comprised of codified, public, and easily communicated knowledge (termed information), including tacit knowledge (Polanyi, 1983). Further, the knowledge-state is split into technological and economic competence. Economic competence is defined as the ability of a firm to create and exploit business opportunities (Carlsson & Eliasson, 1991). Further, Winter (1986, p. 165) states that an organizational routine is a “relatively complex pattern of behavior triggered by a relatively small number of initiating signals or choices and functioning as a recognizable unit in a relatively automatic fashion.” The provocative feature with routines is their ability to support complex patterns of interactions between individuals in the absence of directives or rules (Grant, 1996). Grant defines rules as standards that regulate the interactions between individuals. The evolutionary theory approach might suggest that measurements gradually extend into new areas because there is an

overall search rule stating that measurements are important and contribute to the success of an organization. Evolutionary theory is intimately related to knowledge-based theory. A firm's distinctive competence is based on the specialized resources, assets, and skills it possesses, and focuses attention on their optimal utilization to build competitive advantage and economic wealth (Penrose, in Rutihinda, 1996). In an evolutionary approach the firm is regarded as an institution for knowledge application. Knowledge creation is, according to Grant (1996), an individual activity and the fundamental task for the organization is to coordinate specialized individual knowledge. In the process of coordination four important mechanisms may be identified: rules and directives, sequencing, routines, and group-related solving and decision-making. The knowledge-based theory of the firm "postulates that knowledge is the only resource that provides sustainable competitive advantage, and, therefore, the firm's attention and decision-making should focus primarily on knowledge and the competitive capabilities derived from it" (Roberts, 1999). The firm is considered a knowledge integrating institution. Its role is neither the acquisition nor the creation of organizational knowledge; this is the role and prerequisite of the individual. Knowledge resides in and with individual people; the firm merely integrates the individually owned knowledge by providing structural arrangements of coordination and co-operation of specialized knowledge workers. In other words, the firm focuses on the organizational processes flowing through these structural arrangements, through which individuals engage in knowledge creation, storage, and deployment (Roberts, 1999; see also Grant, 1996). Demarest (1997) introduces the concept 'commercial knowledge,' a concept related to effective performance. He is defining the concept as "an explicitly developed and managed network of imperatives, patterns, rules, and scripts embodied in some aspect of the firm, and distributed throughout the firm, that creates marketplace performances" (Ibid., p. 377). The term 'imperatives' refers to behavioral directives that are unchallenged; 'patterns' refer to predictive models that have a certain longevity (e.g., "if a customer has never called with a product complaint before, you can expect the following kinds of behavior..."). The difference between rules and scripts is that rules might exist as general postulates while scripts are coordinated sets of rules targeted at a particular context. Commercial knowledge is tacit, shared by a group or embodied in raw materials, products and services, machinery and mechanisms, business practices and processes, or in the environment and culture. Coordinating knowledge means learning, and experiential learning theories of firms assert that actions and beliefs change as a result of monitoring and interpreting consequences of past actions (Docherty, 1996). This could also be a definition of organizational learning (OL). The latter concept has been defined by numerous authors (e.g., Argyris & Schön, 1978; Hedberg, 1981; Schön, 1986; Levitt & March 1988; Senge, 1990). A mutual aspect of these proposals is that OL not only refers to understanding but also to taking some sort of coordinated action based on the new knowledge acquired. Johanson & Nilson (1995) hold that OL is present when domination beliefs are changed and coordinated action has taken place. A proactive approach to organizational learning is knowledge management that is often described either as a strategically focused management tool or as an information handling tool (Mårtensson, 2000). To create a knowledge management strategy, an organization needs to build systems for capturing and transferring internal knowledge and best practices (Allerton, 1998). Knowledge management has to consider (1) the construction of knowledge; (2) the transformation of tacit knowledge into processes, practices, and machinery (embodiment); (3) the dissemination of embodied knowledge throughout the value chain; and (4) the application of disseminated knowledge to particular problems (Demarest, 1997). In the strategic management literature, a distinction is sometimes drawn between the formulation and the implementation of a strategy. The purpose of formulating and implementing strategy is to link the firm to the environment in a way that generates competitive advantage to enhance the firm's long-term goals. A common point of departure for strategy formulation concerns analyses of external factors and in-house conditions. Next, a strategy is sought that aims at utilizing the organization's skills and other resources in the best way possible. The implementation phase involves executing the strategy that has been formulated (Grønhaug & Nordhaug, 1992), i.e. it refers to mobilizing attention and action by, for example, employees and customers.

2.1 Definitions, Classifications, And Measurements Of intangibles

As is so often the case for many concepts, “intangibles” has no generally accepted definition. Canibano & Sanchez (1998) state that the adjective “intangible” normally accompanies different concepts, such as assets, investments, resources, or other phenomena. The transformation of the adjective into a noun is suggestive of the absence of a broadly accepted definition. Numerous definitions and classifications of intangibles have been proposed, particularly during the last decade (Johanson et al., 1999). Not surprisingly, there is a lack of consensus because constituents of what could be regarded as intangibles are dependent on the purpose of addressing the concept, for example, accounting, statistics related to national accounts, and management control. Furthermore, different theories about firms also affect the way in which characteristics and hence definitions of intangibles are formulated. The various definitions that have been suggested will not be discussed in the present paper (for a more detailed report, see Johanson et al., 1999). Johanson (1999b) suggests that classifications found in the literature or specified by different firms could be arranged according to the following four categories.

- A. A dichotomized proposal of classification is perhaps the most common one in the literature. The characteristics of these dichotomies are, for example, legal ownership or not; purchased externally or internally produced; and people dependent or people independent (compare Hall, 1992).
- B. When classifying intangible investments, the most common categorization appears to be R&D, software, marketing, and organization. Examples of this classification are the proposals made by the OECD (1992) and Statistics Netherlands (1998)
- C. Many practitioners propose a simple three-way classification of human, market, and structure capital. These suggestions are now widely dispersed (e.g., Petrash, 1996 and Sveiby, 1997).
- D. In recent literature, it has been suggested that integral components of intangibles include not only static states and input factors but also processes and future opportunities. Therefore, considering assets and activities, “facts” and perceptions are proposed to be a more revealing classification. Haanes & Lowendahl (1997) categorize intangible resources into competence and relational resources. Relational resources refer to reputation, client loyalty, etc., which are conceived of as being fundamental to the performance of the firm. Competence is defined as the ability to perform a given task and exists at both the individual and organizational level. On the individual level, competence includes knowledge, skills, and aptitudes; on the organizational level, it includes client-specific databases, technology, routines, methods, procedures, and organizational culture.

Individual organizations and authors (Canibano et al., 1998; Johanson et al., 1999) have suggested numerous procedures to measure intangibles. In the present paper only models with a Swedish origin are selected. This is due to the assumption that the “Swedish” models may have had a more significant impact on Swedish companies than those originating outside the country. Based on the external reporting on intangibles in 10 Danish (PLS Consult, Ramboll, Sparekassen Nord Jylland) and Swedish (Skandia, Telia, ABB, Luftfartsverket, Sparbanken Sverige, WM Data, Consultus) organizations, Erhvervsudviklingsrådet (1997) classifies a number of measurements of intangibles based on three questions; How it is? What is done?, and What is the output? The intention with these measurements is to highlight value drivers linked to knowledge embedded in people, customer relations, technology, and internal processes. The indices suggest that much, if not all, is possible. “There is an open invitation to all kinds of measurements, and there is certainly the possibility to assemble indicators from at least four themes that can justify measurements (Mouritsen, 1998 p. 10).” Olve et al. (1998) present BSC applications found in 12 British and Swedish firms. They hold that financial measures are normally outcome oriented, whereas renewal and development measures

contain performance drivers. The customer and the process focus comprise a mixture of outcomes and performance drivers. Roos & Roos (1997) interviewed executives in five small Northern-European countries in order to develop an intellectual capital (IC) process model. The authors reported extremely positive reactions toward IC and a number of strategically important process factors could be identified. The authors concluded that to develop an IC routine the company must be mature enough to go beyond solely financial indicators, have a clearly defined business orientation, and a distinct operational commitment to moving ahead. The IC routine should also measure only the IC change affecting the long-term earning capability and it must be rooted in the language of the company. From the interview data, a classification scheme of IC and measurements of different intangibles was also developed, containing measures linked to human, organizational, customer and relational capital. Sveiby (1997) proposes an intangible asset monitor in which financial capital, customer capital, the organization, and the people are measured by means of growth/renewal, efficiency, and stability. The monitor is often used as a complement to traditional annual reports. In association with 11 major Swedish companies, the Swedish Public Relations Association (1996) offers measurements of intangibles into five segments that separate individually owned from company owned resources, such as leadership, market, finance, employees and community. Since 1987, the business aspect of the SIFO group has been to serve as market leaders of management control methods for intangibles in Sweden. They identify their model in terms of Management of Intangible Assets (MIA) (Ennerfeldt et al., 1996), suggesting that the model is a third generation offspring, where the first generation comprised organizational surveys concerning 'the invisible contract' between employers and employees. The MIA mainly comprises measurements of attitudes. To conclude, although there is certainly no shortage of propositions on measurements of intangibles, the extent to which these models are actually practiced remains obscure. Hansson (1998) warns that BSC indicators suggested by different authors are too restricted because they do not capture the unique drivers and processes fundamental to the firm's output. Examples of such drivers might be feelings, values, beliefs, relationships, fear, and dreams. Lank (1997) appears to agree in part with the opinion of Hansson. Lank enumerates a certain number of management measures that have gained acceptance in different organizations. These management measures include training days per employee, total time spent in training, number of personal development plans completed, number of performance appraisals completed, and assessment against competency frameworks. Lank (1997) argues that, even if flawed, these measures demonstrate management's belief in the importance of individual learning, but points out that the development of intellectual capital (or the process of knowledge management) requires a different perspective. To learn about that development a new set of questions must be asked: How well do employees share their knowledge and expertise with colleagues? What processes could be found which make it easy for them to do so? What rewards and incentives contribute to the knowledge base? How is the value of intellectual capital measured?

Lukka (1998) suggests two different kinds of development of non-financial measures in organizations. The first, described in several Scandinavian studies, corresponds to the idea of a narrative understanding of organizations in which non-financial measures are developed in local units, a development undertaken through experimental learning processes. These processes are directly related to the activities performed within the units and the development is independent of the strategic goals of the whole firm. Lukka observes that the other kind of development can be found in recent American studies. Here, non-financial measures are developed from the strategies of the firms in a top-down approach. The measures are similar in different local units of the organization and are directly linked to the critical success factors of the organization. Lukka (1998, p. 340) notes that "the top-down approach to developing a system of non-financial measurement corresponds to the idea of trying to spread paradigmatic understanding within an organization, which may cause problems at the local level." With reference to these two measurement systems, Lukka further comments that a conflict does not necessarily exist between the integration process in firms; both systems can be used in practice inasmuch as "there is a potential division of labor

between the two.” The measures derived from top-down approaches can be used in standard corporate reporting and they can co-exist with measures developed locally to fulfil the needs of information in those local units without any attempt to consolidate them at higher levels in the organization.

3. Method

The present research questions are investigated using qualitative exploratory case studies (Yin, 1994). A number of Swedish companies were selected that are known for being “advanced” and “experienced” in measuring intangibles and utilizing these measurements in their management control process. The selection has largely been based on three sources of information: the present authors’ own experience, literature studies (Ehrvervsudviklingsrådet, 1997; Olve et al., 1997), and asking a panel of eight persons to rank the intent of organizations on being recognized as “best practice firms” in measuring and controlling intangibles. The panel comprised people with different professions but with a good insight into Swedish businesses.

In all, 11 organizations were approached. The sample comprises the following companies: banks (2), software (2), construction (1), telecommunication (1), office equipment (1), education consultant (1), public relations consultant (1), transportation (1), and engineering (1). The majority of the companies are large or medium-sized (more than 500 employees), except for the two consulting firms that have a maximum of 100 employees. In the large firms only one of the divisions has been subject to investigation. One of the two Software companies and the Office Equipment Company have their headquarters in the USA while the remaining firms are Swedish-based. The methodology has similarities with grounded theory (Glaser & Strauss, 1967; Strauss & Corbin, 1990; Parker & Roffey, 1997; Slagmulder, 1997). Documents and respondents have been selected taking “saturation” into account, and previously acquired data have been coded, classified, and reclassified simultaneously with the collection of newly acquired data. Data have been collected using focused interviews (Gilbert, 1993) in addition to studying documents describing the measurement and control routines.

Within each organization, from one to six persons were interviewed and a large number of documents were studied. The organization selected the respondents. Because the present interest was to find “best practice” cases, the bias in selecting respondents in favor of the MR and the measurements actually used do not cause any difficulties. In total, 43 interviews were performed and about 70 documents were analyzed. Note that general conclusions about all employees and about all aspects of the organization cannot be drawn. This is not the point, however. Three researchers normally took part in the interviews and in the assessment of the documents. Each researcher wrote a note for each source. In these notes, data were categorized in a way that appears to be fruitful to understanding what it is that is coming about in the different organizations. The researchers have subsequently discussed and compared their respective notes. From these discussions, several new categorizations have emerged. When gathering data an effort was made to obtain triangulation in two ways. First, data triangulation, where documents, interviews, and literature were triangulated and, secondly, investigator triangulation, where the notes from the interviews were compared among the three participating researchers (Patton, 1987; Yin, 1994). The selection of the theoretical framework was not done before the collection of data started. Rather the selection was accomplished at the end of the data collecting process. At that time some of the empirical findings led to associations with the selected theories. It became obvious that the case firms were interested in learning about the value creation process (hence organizational learning) as well as managing knowledge (knowledge based theories, knowledge management). It was equally striking that the firms had for a number of years gradually built up and established routines related to the measurement of intangibles (evolutionary theories). In the present paper the selected theoretical framework is used to enhance the understanding of the empirical findings.

4. Results and Discussion

4.1 The development of the measurement routine

For most of the organizations, the development of the MR dates back some years but it is impossible to determine when the process actually began. In all of the cases, a story is told describing how the MR emerged. When listening to, or reading these stories, we note that the start of the development of the MR is often dated back to the beginning of the 1990s. In the Office Equipment Company, for instance, the development started already in the 1970s, according to organizational documents and managers within the organization. There are only two or three reinforcing factors that have been mentioned by each source of information. These forces consist of (1) changes in the market place, (2) individual actors, (3) organizational changes, and (4) an encouraging experience with quality assurance work. The predominant initial mobilization force originates from market considerations. Except for the two consultant companies and the software (A) firm, a severe economic crisis or increased competition is alluded to as the main source for the mobilization of change. In the consultant firms market reasons and the prospect of selling also determine the development of the MR. The second most important category of initial driving forces involves the individual actors who have proposed ideas for change. This has been mentioned in most of the cases. Actors refer to either internal individuals or external consultants, but most often to a combination of the two. The background of the internal actor differs considerably and may include human resource departments, controllers, and line management. These internal actors played a significant role as driving forces during the early stages in MR development. With reference to the external actor the same consulting firm played (and still plays) a significant role in at least three of the cases. Remarkably, in some of the firms the people connected to financial matters are left far behind in the developmental process. According to some of the persons interviewed, one of the reasons for their lack of interest is related to their feeling of being threatened by the "new" control routine. This type of behavior can be related to the concept of 'defensive routines' developed by Argyris (1990). These routines are developed by people in order to cope, or actually avoid coping, with the "new" MR. Although it might be expected that such labels as BSC and IC or labels of the model supplied by the consultant firm should appear in interviews or in documents, this is not the case. The firms practice their own labeling. Concepts proposed in the literature or by the consultant firm are not even mentioned by the respondents (even if they sometimes are addressed in documents), except in the education consultant company where the original concept name is mentioned frequently. It is also evident that the organizations tend to mix different "original" concept thoughts in the process of making them their own.

All the different elements of the MR have been there for a long time but now they are brought together. However, the fact that the different subroutines have been practiced for a lengthy period does not exclude the possibility that the step to bring them together has been influenced by, for example, BSC or IC at a meta level within the organization. The general strive appears to be towards connectivity of different intangibles and in the next step towards the financial result. In order to accomplish these connectivity's, measurement parts are bound to be brought together, i.e. the trend is based on a strive towards holism in the MR in relation to the more traditional fragmental way of using different kind of measures within different organizational units/functions.

4.2 What is Measured?

Most of the 11 firms use some kind of diagram in their presentation of the most important intangibles. These diagrams, which are repeatedly practiced, are also used as tools to illustrate how intangibles interact with tangibles and with one another. Bank (A) provides the following schematic diagram. All 11 firms suggest simple classifications in which employees and customers are considered critical success factors. Some firms retain this basic dichotomy while others prefer to also address internal processes and developmental issues. But, what lies underneath

the surface? Normally, firms are not concerned to make a further division of the basic categories of intangibles. Rather, they define and classify measurements of intangibles. That is, the division of the basic classes of intangibles that are addressed in the present text has been deduced from how companies measure them. Except for the two consultant companies and the one software (B) company, all others carry out attitude surveys among their customers and employees. In other words, when intangibles are measured, it is normally accomplished by asking customers and employees about their subjective impressions of certain phenomena. The implication is that the importance of a given intangible resource is determined based on the perception of it. The human and market capital definitions of intangibles are typically vague. For example, What is 'ability to sale' or what defines the borders of the 'meeting with the customer'? When trying to reveal critical intangibles, it is also apparent from the measurements that numerous items are measured. Bank (A) claims that they measure all intangibles presumed important for success. For human capital there are 28 such intangibles (measured by 72 questions). Bank (A) categorizes the human capital into six main classes: customer utility, businessman-ship, collective competence, learning, development of work routines, and leadership. When looking more closely at the items, it is apparent that most could be classified as individual human capital but that some refer to the working group. Some items could have easily been classified under customer or process issues. This is to say that internal process and development activities are recognized as important intangibles even if they are not recognized as a separate class in the basic classification schema. Additionally, it is obvious that the classes deduced from the measurements are not exclusive; i.e., some of the items could have been classified into a category other than the one they were assigned. On the surface, a firm's classifications of intangibles appear simple and easily communicated, but once the surface is penetrated a readily noticeable complex pattern emerges. This is because there are numerous items and the classification schemata are not easily comprehensible since classes are not fixed. An exception to the latter is the human capital in the Construction firm. In this firm the MR has been developed from a theoretical model. Consequently, the classification scheme of different elements of the human capital comprises exclusive classes. As can be recognized in the next illustration (Table 3), assets in the accounting sense are only a small minority of the intangibles. The vast majority of intangibles involve other resources. Further, the classes contain an elaborate mixture of individual and organizational human capital (human, structure, and market capital) and competence and relational issues.

The customer/market oriented intangibles specified in Table 3 relate to each other such that the first three categories are thought to affect customer loyalty. Whereas image is thought to generate attraction, such products as goods or services also significantly affect the relation. Additional to organizational routines, individuals perform the meeting or interaction with the customer. Finally, the output is customer loyalty. Customer loyalty is looked upon as a main asset for the future success of the company. Table 3 should also be viewed as an example of the more complex structure that often is hidden underneath the simple surface division of intangibles.

Haanes & Lowendahl (1997) criticize resource-based theory for its excessive focus on resources. The "real challenge is to energize people in the organization to better utilize and build on available resources" (Ibid. p. 203). The authors maintain that to gain a fuller understanding of key organizational processes it is more effective to study activities instead of resources. The PR Consultant, the Telecommunication Company and, particularly, the Office Equipment Company address this issue. The latter firm states that "key enablers of our business are leadership (setting, deploying, and managing direction), human resource management (supporting employee motivation and satisfaction), business process management (the Office equipment company business process architecture is a framework for management, operational, and enabling processes), customer and market focus (satisfying customers), and information utilization and quality tools (access to

information that improves the output of the work).” The enablers affect results and are process or routine oriented. The results comprise employee and customer satisfaction as well as market share.

For the firms of the present study, intangibles consist of a mixture of individual competence (knowledge and capabilities), organizational competence (databases, technology, routines, and culture) and relational resources (relations, reputation, and loyalty). They measure those intangibles that they believe are of crucial importance for obtaining results. The latter also means that intangibles that are subject to measurement will change because of learning. Measurements result in new discoveries which make earlier indicators inadequate.

4.3 How are measurements performed?

Data collection is typically achieved either by written questionnaires or by telephone interviews. In some cases, the firm itself accomplishes the aggregation of data, whereas in other cases it is achieved from the external consultant. To give an example, the Telecommunication Company has conducted attitude surveys from 1996 to 1998 in about 100 different organizational units. Some aspects of the surveys have been practiced for several years before 1996. The human capital questionnaire is standardized throughout the Telecommunication Company, whereas the market capital measurement differs between organizational units. Questions specific to the business area are appended at a later time. About 80 questions are included in the human capital measurement. The response rate is very high (about 94%). Human capital measurements are done once a year. Market capital measurements are performed via telephone interviews conducted by external consultants. In each of the sales areas, 400 customers are randomly allocated and when responses are obtained from the first 100, all further interviews are cancelled.

4.4 How is learning from the measurement routine achieved?

Because the main objective of the companies is performance enhancement, comparisons are made with the latest measurement figures. The figures are also used for the purpose of benchmarking with other units within the organizations; for instance, in the Telecommunication Company a top 10 unit list is presented annually. In the Telecommunication Company, combining market capital data for a certain business unit with human capital data for employees working within that business is suggested to be very revealing. A high leadership score also implies an augmented human capital score and, when employees have a good understanding of customer needs, the human and market capital scores are high. A manifold of calculations has been performed, resulting in 14 human capital indicators that contribute to a high market capital within sales (although the correlation is very low concerning indicators with a low ranking). The top five indicators concern leadership: the leaders are good at listening; they are just one of the persons in the gang; they are easy to cooperate with; they are good at dealing with new and unusual situations; and they are supportive of responsibility. “Teams holding that they have a good leader receive high scores by customers.” Leadership appears to be a central issue as to employee performance, market performance, and financial performance. The representatives from the Telecommunication Company have thus far been unable to statistically discover which key variables are affecting financial performance. However, it is suggested that the connection is obvious at the “floor” level. In Bank (A), as well as the Construction Company, correlations have been noted on financial performance. In Bank (A) a strong correlation between leadership and an empowerment index has been found. The latter is correlated to financial outcome. (The empowerment index is based on the following questions: Are you dedicated to work? Are you satisfied with your tasks? Have you co-workers who are not afraid of being responsible? In the case that you acquire a certain degree of responsibility do you get the support you need? Do you presently have the competence that is needed? Are you authorized to make your own decisions?).

In the Construction Company with 9,000 responses in 1998 there are substantial differences between different units for workers but not for salaried employees. A value creation

chain regarding the impact of human resources on profitability has been subject to a rigorous test in the database of 1998 and 1999 respectively. Hypothesis regarding value creation items related to the human resources have been subject to a statistical test. The following significant correlations were found ($p < 0.01$).

The correlation with profitability (0.4 above) was calculated for the first time in 1998; the other correlations were found even earlier. General conclusions regarding the correlations between different intangibles and financial outcomes cannot be drawn because intangibles (e.g., leadership) are not measured uniformly among the sample organizations. For instance, whereas the Telecommunication Company and the Construction Company involve personality characteristics, Bank A includes even organizational-related issues in the measurement tool.

4.5 Communication of the measurement results

The MR comprises not only visions of how performance driving intangibles interact and influence the outcomes and measurements of these intangibles, but it also consists of subroutines of communicating visions and figures. Many of the firms have explicitly pointed out that parts of the MR are under the business protection policy but, despite the management control focus, the 11 firms specify parts of the routine in different external reports. It should be noted that the Office Equipment Company and the two consulting firms market their MR. The Construction Company provides the most revealing information, which might be conditional on the explicit objective to inform investors about intangibles.

Every firm uses its personal label of the MR. However, these labels do not reveal the vision to communicate and are not utilized very often throughout the company. Top management may use the label but middle management is likely to use it infrequently and supervisors may not use it at all. However, what is repeatedly practiced in most of the cases is one or a couple of pictures describing the vision to communicate. The figure practiced by the Construction Company has been shown earlier in the text (see figure 2.). This figure briefly describes how different intangibles interact and what variables are being measured though it does not reveal how understanding is encouraged or action is mobilized. The figures practiced by firms normally concentrate on the content of the MR. An exception to this practice is the picture utilized by the Telecommunication Company in which parts of the routine of increasing the understanding (i.e., the statistical analysis) are noted.

Every firm uses its own central figure to communicate important intangibles and their connection to company success. However, the operation involved as to how the communication of visions and figures is performed varies considerably. The communication process takes place between managers and subordinates and between managerial teams and subordinate groups. For the Office Equipment Company the communication process is highly formalized into documented routines; in Bank B a dynamic group process is the primary component of the MR. The Telecommunication Company may again serve as an example. The measurements are presented every year in January at a kick-off meeting in which all the managers in the company are present. At the meeting, each manager is provided with a thick package of ratios (graphs), including comparisons with other units in relation to their specific placing within the overall human and market capital indexes. After the meeting, further discussions about adequate activities to improve the scores are held at a local level. Together with his or her personnel, every departmental manager performs a work plan to improve the index.

4.6 Action in Relation to The Measurement Routine

As a part of the MR, the ownership of every indicator is addressed in a clear manner in the majority of the cases (i.e., the Office Equipment Company, the Telecommunication Company, Bank A and B, the Transportation Company, and the Construction Company). For the two banks, attention is

given to ownership using group meetings; i.e., representatives of top management visit each of the local offices to discuss how improvement could be attained. In this way contracts on improvement are settled between both the employee and his or her superior or the group and top management. Contracts that are agreed upon comprise quantitative goals for the coming period. These goals are related to single or many issues in the market capital or the human capital index. In three cases (the Office Equipment, the Construction, and the Telecommunication Company), employees and managers are rewarded through a salary bonus routine when improvements have been actualized. The most "advanced" example of the salary connection routine is found in the Telecommunication Company. Managers' salaries are partly subject to changes in scores. The maximum salary bonus a manager can receive is a bonus that is equivalent to three monthly wages, in which 60-75% of this bonus is due to financial performance.

The "target" dialogue also provides a basis for agreement on salaries with the employees. The manager and the employees come to terms on the employees' performance on a scale ranging from 0 to 800. The performance score is then used as a platform for one part of the monthly salary (Yulisfan and Nedelea, 2021). This salary routine has been practiced for the past 3 years. In some of the cases the MR in itself is subject to a follow up. Response rates on attitude surveys are followed and analyzed. The response rates are in most cases between 80-95% (e.g. in the Office Equipment Company the response rates with respect to the employee survey is normally between 93 and 95%). In the Construction firm the MR is also followed-up by means of a specific question with three response alternatives: I read the figures; I have informed my subordinates; and I have taken action. The answers suggest that there is a strong correlation between taking action and performance as well as response rates respectively. A similar approach is used by Bank (A). Statistical analysis reveal that work satisfaction and performance is significantly higher by those who have got feed-back on performance with respect to what is regarded to be the central issues in the value creation chain. The feedback routine is a significant subroutine to the measurement routine in order to ensure learning, action and change. Another approach to the follow up routine is demonstrated by the Office Equipment Company. A self-assessment is accomplished annually taking three criteria into consideration; (1) The units approach to following documented processes; (2) The pervasiveness of the work; and (3) The results achieved. The assessment is subject to an audit by senior executives from other sister companies in the world. The aim of the business assessment is to secure the survival of the MR and its subroutines.

5. Conclusion

The firms in the present sample can be grouped into three categories:

- A. The most advanced cases. These companies are regarded as most advanced due to the impression that they have developed a deep and well-spread understanding of the importance of intangibles as performance drivers, but also in mobilizing these intangibles into a developed MR. Among these are the Office Equipment, the Telecommunication, the Construction Company, and Bank
- B. The two small enterprises--the consultant companies--which are not comparable with the others because, firstly, the MRs do not have the same high proportions as in the other cases and, secondly, the MRs are not documented.
- C. The rest of the cases, the two software companies, the transportation company, the engineering company, and bank B. In these cases the understanding of the importance of intangibles as performance drivers are quite well recognized, but the mobilizing phase does not seem to be that deep and well-spread within the company.

Concerning the MR, most of the sources (i.e., respondents and documents) hold that the MR has become a part of the management control process in most of the units of the firms. "This is currently a big issue. Many things have happened. It is the way in which management control is obtained in this firm." From another case, the following statement was reported. "We do not reflect upon this

any longer. It has become natural to us.” The case organizations have by developing the MR provided structural arrangements of coordination and cooperation that characterizes a knowledge based view of the firm (Roberts, 1999; and Grant, 1996). Individuals can easily refer to communication situations in which data from the MR or data from the routine itself have made significant differences. The MR “... provides people with arguments for doing something,” and from another firm: “Before I always got excuses when I made presentations. With this new way, I do not get any excuses. Rather, the discussion is very rapidly turning into supplying suggestions with respect to improvements.” The MR is thereby not only about learning but also about coordinated action based on the knowledge acquired which was the definition of organizational learning provided in the beginning of the paper.

A glimpse of the role of MRs as support in persuasion situations is eloquently unveiled in the following quotation. “There is actually nothing new that we did not previously know; this is an affirmation on something that we already knew. It is an established fact from which to increase credibility.” By developing the MR tacit and individually owned knowledge has been transferred into explicit and organizational knowledge (Allerton, 1998; and Demarest, 1997). Further, it seems like the MR has enhanced the process of knowledge management within the case organizations (Mårtensson, 2000). The MR is utilized as a strategic or an operative instrument compared to knowledge management it deals with both the strategy and the information handling side of the concept. To encourage action ... “we have learnt that there is not much point in measuring at the company level; rather, measuring must occur at the unit level of business. A mean value of different business units is not as interesting as the different values. There is no need to measure everything. The aim of measuring is to understand and encourage change. The MR provides excellent feedback. “Thanks to measurement I have a very good picture of how people feel as well as how departments and managers are functioning.” Another case reported that “It’s good to have it on paper and to be able to follow up targets. It is also helpful that there is a time limit. Efforts become more focused. It mobilizes action on the operational level. Although the answers are often far from congruent, the MR provides new knowledge and has the potential to focus on important issues for future learning, action, and competitiveness. We have learned something we did not previously know. We believed something was wrong about our customers but the measurement and analysis of the result showed that we were incorrect. Widely spread and well-documented MRs of intangibles appear to exist in at least four of the firms (one of the banks, the Construction Company, the Telecommunication Company, and the Office Equipment Company). Could these cases be regarded as the best or the most advanced practice for utilizing these measurements in management control process? Best or most advanced can be defined and measured in numerous ways and there is at present no point in trying to answer the question. The present paper is an attempt to understand what is happening in Swedish firms that are thought to be more sophisticated in their measuring methods of intangibles. What do these firms do to increase the understanding of intangible performance drivers and what kinds of understanding has been penetrated thus far?

At a basic level, classifications of intangibles are simple because they are utilized to aid in visualization and thereby communicate how both intangibles and tangibles interact to realize the visions of firms. These simple classifications, however, do not contain exhaustive or exclusive classes since this is of no interest to firms. However, intangibles are subject to division in the endeavor to find the performance drivers. Statistics or investments based on historical “facts” seem to be of less interest than perceptions of activities that enable future performance. These ‘enablers’ are not assets in an accounting sense but are customer and employee perceptions of individual competence (knowledge and capabilities), organizational competence (databases, technology, routines and culture) and relational competence (relations, reputation, and loyalty). This division of intangibles is very near to what has been proposed in the knowledge-based literature. Some of the firms distinguish between intangible enablers and intangible outcomes. This distinction, however, is

not observed in proposals appearing in the literature. Intangibles that are subject to measurement are changed because of organizational learning (e.g., Argyris & Schön, 1978; Hedberg, 1981; Schön, 1986; Levitt & March 1988; Senge, 1990), i.e. dominating beliefs has changed and coordinated action has taken place.

Measurements result in new discoveries with respect to what Demarest (1997) calls the commercial knowledge. However, these new discoveries make earlier indicators inadequate. Firms struggle between changing indicators due to increased understanding and sticking to old indicators to be able to make longitudinal comparisons.

Core measurements performed to increase the understanding of the intangible performance drivers are measurements that are not proposed in the HRA or UA literature (Johanson et al., 1999). It is fully understandable that outside stakeholders (e.g., investors and analysts) reject that sort of information, as long as the value creation chain remains tacit with single operative managers. The case firms are primarily interested in understanding the importance of the kinds of intangible that Haanes & Lowendahl (1997) identify. These are the kinds of intangibles that the case firms hold are leveraging the stock of intangibles and tangibles. They refer to what Coyne (1986) calls functional and cultural differentials. Even positional differentials are measured though as an outcome indicator. The way for the firms in the present cases to ascertain a continuous organizational learning process with respect to the value creation chain is to measure intangibles as well as create and maintain organizational routines that ensure the transformation of measurement results into action. These routines have been subject to an evolutionary development that demonstrates the linkage between the belief from the firms that a precondition for organizational learning is not only the figures themselves but equally important the transformation of the measurements into action

6. References

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CHAPTER 7

Investigated Stock Market Reaction to Accounting Earnings Announcement

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ABSTRACT

This study is conducted to provide empirical evidence of market response due to earnings information. Research was focused at the Indonesian Stock Exchange. The number of samples used is 206 companies listed in Indonesia Stock Exchange period 2018-2020 by simple random sampling method. Data collected by nonparticipant observation method. T test is used as analysis technique. Based on the result, the market responded to surprise earnings information, and the responses are in line with the announced earnings information. It can be concluded that the market, especially investors, would tend to make transactions based on earning information. When a company's earning is below expectations, transactions tend to decrease share price. When earning is above expectations, transactions tend to increase share price.

Keywords : Earnings, Stock Market Reaction, Positive and Negative Earnings Announcements.

1. INTRODUCTION

The capital market is one part of the financial market that carries out economic functions and financial functions (Haykal et al., 2018). The capital market in carrying out economic functions runs by allocating funds efficiently from parties who have funds to those who need funds, while their financial function can be indicated by the acquisition of rewards for parties who provide funds in accordance with the characteristics of their chosen investments. Capital markets are one of the options for investors in channeling the funds they have. In this case, information is something that is very important, because an investor in investing funds does by buying stocks traded in the capital market. He must understand and trust that all available and mechanical information in the capital market is trustworthy, as well as the absence of certain parties that can poorly manipulate information against such trading methods.

The success of a company is reflected in the value of the company. For companies that go public, the value of the company can be observed from the stock price. The stock price always reflects the value of the company when the capital market is in an efficient state. An efficient market can always show a stock price that fully reflect the information available. The information can be in the form of the company's annual report, dividend distribution, stock split, and capital market analysts' reports.

According to SFAC No. 1 (FASB1978), financial statements are the main description of financial reporting that serves as a means of communicating financial accounting information to external parties. With regard to profit and loss, SFAC No. 2 (FASB 1980) states that the income statement is very important for its users because it has predictive value. SFAC No. 1 (FASB 1978) which explains that investors, creditors, and other parties often use earnings information and information on other components of earnings to assess the prospects for cash flow from investments or loans they provide. Shares are securities that are traded in the capital market (Warae et al., 2021). When investors decide to buy or sell shares, investors need information, one of which is company profit information. Stock prices change when investors respond to information. This happens because of the surprise profit, which is the difference between the company's actual profit and the profit expected by investors. Investor reaction can be measured by abnormal returns. If the market is efficient, then abnormal returns will appear around the announcement date of earnings information.

Research that can be said to be a pioneer in capital market research is the previous research by Ball and Brown in 1968. The variables used in this research are information on the value of net income which is proxied by forecast error (in this study it is called surprise profit) and market response is assessed with the stock market price which is related to the investment return. This study shows that the market is in a semi-strong condition, so when there is a negative surprise profit (actual profit is less than expected profit), bad news will be formed which is expected to cause the stock return (price) to decrease. Conversely, when there is a positive surprise profit (actual profit is more than expected profit), good news will be formed which causes the stock return (price) to increase.

In 1968, Beaver published his seminal paper on the information content of earnings announcements, establishing that both trading volume and return volatility increase at the time of earnings announcements. Beaver (1998) in Lubis et al (2018) state that the characterizes earnings as having information content about a security's value if its release alters investors' beliefs regarding the attributes they value, such as claims to future dividends. Hence, for earnings to possess information content, the information contained in the release must be incremental to that already contained in alternative or competing information sources. Beaver finds that earnings possess information content as both trading volume and stock price volatility increase in the week surrounding earnings announcements.

Santoso (2020) state that about Miller and Modigliani empirical study provide empirical evidence which states that reported earnings are adjusted to measure error through the use of instrumental variables, adjusted earnings are very useful for predicting that futures earnings are an important explanatory variable in the valuation formula. This relationship is a good condition for earnings to have information content, but the evidence does not rule out that the opposite is true.

Stocks are a means to multiply profits with a multiplier level that is appropriate to the level of risk. An income statement that has been adjusted for measurement errors is very useful in predicting the market value of a stock. Two reasons the income statement does not provide information are: the measurement error is so large that it is better to use other measurement variables and there are other sources of information that are more timely than the income statement which when announced, the information has been confiscated in market prices.

This issue is important to the accounting profession because the results directly reflect the usefulness of accounting activities. One approach was taken to examine this problem to specify an expectation model of how investors relate reported earnings to market prices.

Fama (1970) presents three types of forms of market efficiency levels based on various forms of reflected information, including: (1) weak form, (2) semi-strong form, and (3) strong form. The weak form is a market whose security prices project fully information on the price and volume of the security in the past. The semi-strong form is a market whose security prices fully project all publicly available information, including financial statement data. The strong form is the capital market where the price of securities projects all private information, even inside information that is not published (off-the records).

Unexpected profit (in this study called surprise profit) is the difference between the amount of profit announced by the company and the profit expected by investors. The existence of an surprise profit will affect the company's stock price and ultimately also affect the return of the company's stocks (Prasetyadan Gunawan, 2007).

Efficient Market Theory indicates that the market will react immediately to new information (Ambarwati, 2008). The reaction or market response is generally observed from the increase or decrease in stock prices that occur around the earnings announcement date. If there is a difference between the expected return and the actual return, an abnormal return is formed due to the announcement of the profit.

This study focuses on the relationship between accounting profit information and stock returns. In this study, new information conveyed by earnings information is measured by forecast error, namely the amount of actual profit reduced by the amount of profit expected by investors. To assess market response With these variables, this study finds that when the forecast error is negative, bad news will form and it is predicted to cause the company's stock return to be less than expected or decrease. Vice versa, when the forecast error is positive, good news will be formed and it is predicted that the announcement of earnings information will cause stock returns to increase or be more than predicted.

2. LITERATURE REVIEW

Research conducted by Ball and Brown (1968) is an empirical study using methods related to accounting earnings on stock prices based on theory and evidence, and the focus of this research is on information that is unique to a particular company. Specifically, the researcher builds two alternative models from several market forecasts of earnings and then investigates the market's reaction when the expectations turn out to be wrong. The result of this research is that all

information about an individual company that becomes available during a year, one or more is in the amount of revenue that year, and is sufficient to be taken into account. However, the annual income report is not very appropriate to be used as a medium, because most of its contents (about 85 to 90 percent) are covered by media that are faster to publish, including interim reports. Since the efficiency of the capital market is largely determined by the adequacy of the data sources, researchers are not surprised if the market turns to other sources that can be obtained faster than annual net income. In addition, the results of the study show that the information contained in the annual profit figures is useful in relation to stock prices. However, annual accounting reports are only one of many sources of information available to investors.

Telaumbanua and Sumiyana (2008) prove that investors react to corporate earnings announcements and is in line with previous empirical studies (Ball and Brown, 1968; Beaver, 1968; Beza 1997; Hanafi; 1997; Sadikin, 2000). However, the empirical results are contradictory to the results of other studies (Ball and Brown, 1968; Foster, 1977; Hayn, 1995). This study actually found that the emergence of positive earnings information led to a more positive response than when there was negative earnings information. This is different from the results of the research by Sugiri and Sumiyana (2009) which found that negative surprise earnings responded more strongly than positive surprise earnings. It is estimated that this is due to investors who are too optimistic and the stock price does not fully reflect the value of the company.

Research by Sugiri and Sumiyana (2009) supports the results of Skinner and Sloan (2002) which shows that there are differences in stock price responses between companies that announce negative surprise earnings and positive surprise earnings. It is concluded that the market responds more to negative surprise earnings than positive surprise earnings. This is in line with Ulfyana's research (2011) which shows that the market responds to negative surprise earnings significantly, but positive surprise earnings do not respond significantly. In Ball and Brown's (1968) research, it was found that a negative forecast error (which in this study is referred to as surprise profit) will generate bad news and reap a unidirectional market response. So, if there is negative surprise earnings information, the market will respond negatively in the form of a negative price or stock return rate. On the other hand, a positive surprise profit will form good news and reap a positive market response. So, when positive surprise earnings information appears, the market will respond positively in the form of a positive stock price or rate of return.

3. METHODS

This research was conducted on companies listed on the Indonesia Stock Exchange (IDX) for the period 2018 to 2020. The source of data used in this study is secondary data (from [ww.idx.co.id](http://www.idx.co.id)). The type of data used is in the form of numbers or quantitative data, namely profit (loss) figures and the number of outstanding shares in the financial statements and the company's stock market price. The non-participant observation method was used to collect data and then the data were analyzed using the t-statistical test. The population as well as the research sample are companies listed on the Indonesia Stock Exchange for the period 2018 to 2020.

There are two main variables used in this study, namely surprise earnings information as an independent variable and market response as the dependent variable. Based on the definition written by Hamdan (2013) about trailing twelve months, surprise earnings can be calculated by the following formula:

$$\Delta EPS_i = EPS_{i,t} - \overline{EPS_{i,t-12}}$$

The average EPS with the trailing twelve months method above is calculated using a formula developed from the definition of trailing twelve months written by Hamdan (2013) as follows:

$$\overline{EPS_{i,t-12}} = EPS_{i,t-3} + (EPS_{i,t-12} - EPS_{i,t-15})$$

Explanation:

$\overline{EPS_{i,t-12}}$ = The average EPS of each company using the method trailing twelve months

$EPS_{i,t-3}$ = EPS of each company in the third quarter of 2019

$EPS_{i,t-12}$ = EPS of each company in 2018

$EPS_{i,t-15}$ = EPS of each company in the third quarter of 2018

Then, EPS (Earning Per Share) is measured using the following formula (Solechan, 2008 in Ulfyana, 2011):

$$EPS = \frac{\text{Earnings After Tax}}{\text{Total Stocks}}$$

To assess market response, this study uses stock prices that are in line with stock returns as measured using CAR (Cumulative Abnormal Return). The steps taken to measure market response with CAR include (Zain, 2007):

1. Calculating daily stock return ($R_{i,t}$) with the formula:

$$R_{i,t} = \frac{P_{i,t} - P_{i,t-1}}{P_{i,t-1}}$$

2. Calculating daily market return/expected return ($R_{m,t}$) with the formula:

$$R_{m,t} = \frac{IHSG_t - IHSG_{t-1}}{IHSG_{t-1}}$$

3. Calculating the abnormal return of each stock using the formula:

$$AR_{i,t} = R_{i,t} - R_{m,t}$$

4. Calculating CAR (Cumulative Abnormal Return) with the formula:

$$CAR = \sum AR_{i,t}$$

4. RESULTS DAN DISCUSSION

4.1. Result

Based on the criteria for selecting the research sample, observational data was obtained as many as 206 companies divided into 95 companies (46.1%) announcing negative surprise earnings and 111 companies (53.9%) announcing positive surprise earnings. The hypothesis analysis of this research was processed using the Statistical Package for Social Science (SPSS) version 22. Before testing hypothesis 1, the sample data was tested for Z Score to determine whether there were outliers with a limit of ± 4.00 (Hair, 1998). From the calculation of the Z Score, it was found that one of the 95 samples had a Z Score that exceeded the limit. Therefore,

the remaining 94 samples are for the category of companies with negative surprise earnings. Then, a one sample t test is carried out on cumulative abnormal stock returns and the following results are obtained:

Table 1
One-Sample T Test Cumulative Abnormal Return of Companies with Negative Surprise Earnings on Stocks in the Observation Period

	t	Sig. (2-tailed)	Description
Negative CAR	-2,506	.034	Significant 5%

Cumulative Abnormal Return (CAR) during the observation period obtained a value of $t_{\text{count}} = -2,506$ with a probability of 0.034. The t_{table} value for = 5% left-hand test is $t_{(0.05;93)} = -1.66$. Based on the table above, the resulting t_{count} is smaller than t_{table} , so it is in the H_0 rejection region. The significance value for the one-sided test of hypothesis one is half of the probability generated by SPSS, which is 0.027. Values below 0.05 indicate that negative surprise earnings announcements elicited a significant response by the market during the observation period at the 5% significance level. This reflects a negative market response, which means that Hypothesis 1 is accepted.

Similarly, testing of hypothesis 2. Before testing the hypothesis, the sample data was tested for its Z Score to determine whether there were data outliers with a limit of ± 4.00 . From the calculation of the Z Score, it was found that one of the 111 samples had a Z Score that exceeded the limit. Therefore, the remaining 110 samples are for the category of companies with negative surprise earnings. Then, a one sample t test is carried out on the cumulative abnormal return of stocks and the following results are obtained:

Table 2
One-Sample T Test Cumulative Abnormal Return of Companies with Positive Surprise Earnings on Stocks in the Observation Period

	t	Sig. (2-tailed)	Description
Positive CAR	2,651	.046	Significant 5%

Cumulative Abnormal Return (CAR) of stocks during the observation period obtained a value of $t_{\text{count}} = 2.651$ with a probability of 0.046. The t_{table} value for = 5% right-hand side test is $t_{(0.05;109)} = 1.66$. Based on the table above, the resulting t_{count} is greater than t_{table} , so it is in the H_0 rejection region. The significance value for the one-sided test of hypothesis one is half of the probability generated by SPSS, which is 0.021. The significance value of less than 0.05 reflects that the announcement of positive surprise earnings caused a significant response by the market during the observation period at a significance level of 5%. This reflects a positive market response, which means that Hypothesis 2 is accepted.

4.2. Discussion

By observing the cumulative abnormal returns of stocks in the period around the announcement of financial statements with negative surprise earnings information, it shows that there is a significant negative response from the market. Likewise for companies that announce positive surprise earnings, cumulative abnormal stock returns show a significant response in the form of a positive response. The results of hypothesis testing indicate that the

market responds to earnings information, both negative surprise earnings announcements and positive surprise earnings announcements. This reflects that the market considers positive and negative surprise earnings information contained in the announcement of the financial statements of companies listed on the Indonesia Stock Exchange (IDX). Investors tend to respond negatively to negative surprise earnings and respond positively to positive surprise earnings. The results of this study support previous research by Ball and Brown, where Ball and Brown found that the market gave a negative response to negative forecast errors and showed a positive response to positive forecast errors.

5. CONCLUSION

Based on the description of the results of the analysis of the research hypothesis and the discussion above, this study concludes that for 11 days of stock trading around the announcement of surprise earnings (both negative and positive), the market showed a significant response in the form of a unidirectional response. This is indicated by the cumulative abnormal return of stocks during the 11-day observation period which is significant at the 5% level.

With a significant market response to positive or negative surprise earnings announcements, it reflects that the company's performance is one of the benchmarks for investors in transacting in the stock market. When negative surprise earnings information appears, investors are advised to sell their shares. Conversely, when positive surprise earnings information appears, investors are advised to buy shares of the company concerned.

Limitations in this study are as follows. First, this study only focuses on the market reaction to earnings announcements for companies whose profits are rising and companies whose profits are falling for the period 2018 to 2020. This study does not map the basic causes of the fluctuations in earnings. Therefore, further research should consider using a sample of all companies listed on the Indonesia Stock Exchange and a longer observation period by considering the causes of fluctuations in earnings. Second, the reaction of stock prices to earnings announcements can still be controlled by the size of the bargaining range. This means that this research can still be developed with a controlling variable for the magnitude of the bargaining range which classifies the magnitude of the reaction shown in the abnormal return. Likewise, the controlling variable is trading volume, as well as up and down markets (up- and down-market). Third, the leakage of earnings information needs to be investigated further for the Indonesian capital market. The reason can be shown that events that are always viewed as events in accounting research are not what are referred to as events in real time. Further research can look for the window period in which there is information leakage which should be negatively correlated with the earnings announcement window period. Fourth, this research which constructs with units of day is no longer efficient to measure the incidence of abnormal returns. Furthermore, this study recommends using intraday return data to measure the amount of abnormal returns when there are earnings announcements.

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CHAPTER 8

The New Scorecard System In Retail Company : Early Success

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ABSTRACT

Given the increasingly complex conditions of an organization, comprehensive performance measures are needed so that all sides of the organization can be described in detail. This provides clarity of goals and objectives for companies in general, especially those engaged in the retail sector to move forward in a balanced manner both from financial and non- financial aspects. The Balanced Scorecard emerged as a tool used to measure overall performance. Furthermore, the Balanced Scorecard also offers retail companies the achievement of competitive advantage because by measuring all aspects of the organization in a comprehensive and balanced manner it will be able to spur various fields such as: product, process, customer, and market development.

Keywords : Balance Scorecard, Financial Performance, Customer Satisfaction, Internal Business Process, Innovation And Learning, Retail Company.

1. Introduction

Facing today's business world, managers are constantly required to keep abreast of global developments. The growth of technology and dynamic business lines are the main factors in the growth of the world economy. Managers will constantly experience difficult business problems, there are many opportunities that can be used to achieve business improvement, but this is in line with the risks that will be faced. A manager is able to make efficient business decisions, increase harmonious relations between employees and fulfill social obligations in an appropriate way.

To test the performance of a business entity, especially a company engaged in retail, it can be seen from the internal and external industries. Several external aspects that influence industrial growth include political growth, macro economics, social aspects, culture, and government policies. Internal aspects that have an influence on industrial growth are financial aspects or aspects of managerial expertise. Developments in the business world today are increasingly competitive, causing a very high level of competition. The influence of these business developments makes changes in terms or other aspects such as production, marketing, management of Human Resources (HR) and how to handle a transaction in a company with customers or between companies and other companies (Wardhani et al., 2021). As a result of these problems, management must be able to review the foundation that has been used so far in order to survive and be able to continue to develop its business in an increasingly fierce competition. As a result, the measurement or assessment of a performance becomes one of the important factors in a company. From the very beginning, an understanding of Performance measurement in an organization is very important and vital. With the results of a good performance measurement it will create an information about the existence of the business and how it is done and where it is happening. In short, performance measurement is a report card for a company. To measure this performance, one of the good performance measurement tools is the balanced scorecard.

Basically the Balanced Scorecard is a tool used to help managers evaluate and determine the scores obtained by certain companies on the following four factors (Muda et al., 2018). These factors are: Financial Performance, Customer Satisfaction, Internal Business Process, and Employee Development & Growth. While Financial performance and Customer Satisfaction are based on historical actions and are thus called historical factors. Internal Business Process and Employee Development are the Key Factors, which are the key to determining the results on the other two factors mentioned earlier (Gusnardi et al., 2019). This paper will describe all aspects related to the Balanced Scorecard as a whole. The Balanced Scorecard or often abbreviated as BSC is a strategic management system that explains the mission and strategy of a company into operational goals and benchmarks for the company's performance.

2. LITERATURE REVIEW

2.1. Performance Measurement

According to Siegel, et al. (1989) performance appraisal is the periodic determination of the operational effectiveness of an organization, its part of the organization and its employees based on predetermined goals, standards, and criteria. From this definition, it can be seen that performance appraisal is more emphasized on how employees as part of the organization can do something based on predetermined criteria. According to the author, this assessment is still suitable when applied in traditional management accounting systems, but not for contemporary management accounting. The assumption underlying performance measurement in traditional management is how workers can work on something that has been expected to achieve company goals, workers are not required to innovate because performance measures are only intended to control personnel actions.

In traditional management accounting, management performance measurement is only based on financial aspects, this is because financial measures can be easily done because these measures are

quantitative values. Therefore, the performance of personnel in the organization is only measured on matters related to finance. Non-financial performances have been neglected because they are considered as something that is difficult to measure (Keswani et al., 2022). Several methods used in traditional management to measure organizational performance are by using return on investment, residual income and economic value added, methods used to measure organizational performance that only pay attention to the financial perspective. In the short term, managers may be able to produce good performance even though they ignore non-financial measures, but not in the long turn.

2.1.1. Job Benefits and Appraisal

Performance appraisal is beneficial for the company as well as for company employees. (Mulyadi 1997), assessing management performance for:

1. Manage the organization's operations effectively and efficiently through maximum employee motivation.
2. Assist in making decisions related to employees, such as promotions, transfers and terminations.
3. Identify employee training and development needs and to provide criteria for selection and evaluation of employee training programs.
4. Provide feedback to employees on how their superiors rate their performance.
5. Provide a basis for award distribution.

2.1.2. Vision Goals and Strategic Goals

To determine performance measures, the organization's vision needs to be translated into goals and objectives. In the strategy formulation process, the organization's vision is translated into goals. The organizational vision is translated into the following organizational goals (Mulyadi and Setyawan, 1999):

1. Financial perspective
The realization of economic responsibility through the application of management knowledge in business management and increasing the productivity of knowledge controlled by personnel.
2. Customer Perspective
The realization of social responsibility so that the company is widely known as a company that is familiar with the environment.
3. Internal business process perspective
The realization of the performance of all company personnel through the implementation of open-book management.
4. Learning and growth perspective
The realization of the company's long-term advantages in the global business environment through developing and focusing on the potential of human resources.

2.2. Retail

Quoting the opinion of Kotler and Keller (2006) retail or retail marketing mix is a set of marketing tools used by companies to pursue their marketing goals. The retail mix includes all the actions a company can take to influence the demand for its products and all the possible actions the company can take can be summed up as a group of variables which include product, location, price, and promotion (Patel et al., 2022). Retail is the sale of a small number of commodities to consumers. According to Levy and Weitz (2001), retailing is a series of business activities to add value to goods and services sold to consumers for personal or household consumption. So consumers who are the target of retailing are final consumers who buy products for their own consumption (Bakar et al., 2021). Meanwhile, according to Berman and Evans (2001), retailing is a business venture that seeks to market goods and services to final consumers who use them for personal and household purposes. Products sold in the retail business are goods, services or a combination of both. According to Kotler (2005) retailing is retail sales including all activities that involve selling goods or services to final consumers for personal, not business use. From the several definitions above, it can be

concluded that retail is all business ventures that directly direct their marketing capabilities to satisfy final consumers. The retail business itself can be classified by examining small and large retailers as separate groupings.

1. Small Retailer

Small retail businesses are described as retailers earning under \$500,000 per year, who are characterized by specialization in small jobs. The shop owner is generally fully responsible for sales and management duties. Store owners also have responsibilities, buying, selling, managing work schedules, making sales promotion plans and providing job security for their employees. Most of the store ownership in this small retail business is owned by an individual.

2. Big Retailer

Large retailers are retailers that have large organizations such as department stores, chain organizations, supermarkets, catalog stores, warehouse outlets, superstores and e-mail orders that provide the majority of retail sales.

2.3. Balanced Scorecard

Effective measurement should be an integral part of the management process. The balanced scorecard, first introduced by Robert S. Kaplan and David P. Norton, provides a comprehensive framework that translates the company's strategic objectives into a comprehensive set of performance measures. The balanced scorecard is an accounting report that includes four perspectives for measuring company performance, namely:

1. Financial Performance

Financial performance measure the company's performance in obtaining profits and market value. Financial measures are usually embodied in profitability, growth and shareholder value. The measuring tools commonly used are return on investment, residual income and economic value added. The following is an example of setting strategic objectives and outcome measures from a financial perspective:

Table 1. The setting strategic objectives and outcome measures from a financial perspective

	Strategy Goal	Yield Size
1	Increase financial return	Market share increase
2	Increased sales revenue	Revenue growth sale
3	Lower costs	Full cost reduction

2. Customer Satisfaction

In this perspective, performance is measured by how the company can satisfy customer. The measuring instrument commonly used is market share, customer retention, customer acquisition, customer satisfaction and customer probability. Example of setting strategic objectives and outcome measures from perspective customer is:

Table 2. The Customer Satisfaction outcome

	Strategy Goal	Yield Size
1	Increased trust customer	Increase new and loyal customer
2	The addition of new products and services	Proportion of new products and services to the

		total number of products and services
3	Increase value which obtained customer	Response speed to Request of customer

3. Internal Business Processes

In this perspective, the company's performance is measured by how the company can produce products or services effectively and efficiently. Commonly used measures are quality, response time, cost and the introduction of new products. Examples of goal setting and outcome measures from perspective internal business processes is:

Table 3. The goal setting and outcome measures from perspective internal business processes is

	Strategy Goal	Yield Size
1	Increase improvement towards service to customer	Satisfaction customer
2	Decrease in non-value added activities	Ascension cycle effectiveness

4. Learning and Growth

This perspective emphasizes how companies can innovate and continue to grow and develop in order to compete in the present and in the future. Therefore, resources are required to be productive and continue to learn in order to have the ability to innovate and develop new products that have value for customer. The measuring instrument commonly used is employee satisfaction and information systems available. Examples of goal setting and outcome measures from perspective learning and growth is:

Table 4. Learning and Growth

	Strategy Goal	Yield Size
1	Increased productivity and personnel commitment	Number of personnel educated and trained
2	Increasing the quality of management information systems	Number of new apps installed and implemented

Blocher, et al. (1999) said that the four perspectives in balanced scorecard is financial performance, customer satisfaction, internal business processes and innovation and learning. From the four perspectives above, it can be seen that the elements in balanced scorecard consists of financial elements (financial performance) and non-financial elements (customer satisfaction, internal business processes and learning and growth). Thus then balanced scorecard means that in performance measurement there is a balance between financial and non-financial measures. In order to consider and choose strategic objectives in a comprehensive and coherent way, the organization's vision needs to be translated into strategies and strategic plans. Example of translating vision and strategy with four perspectives balanced scorecard which is the description strategic objectives into outcome measures, targets and strategic initiatives can be seen in the following Table 5:

Table 5. Translation of Strategic Objectives into Result Measures, Targets and Strategic Initiatives

Strategic Objectives	Outcomes	Target	Strategic Initiative
Financial Perspectives			
Increase returns	ROI	10% per year	
Increase sales revenue	Revenue growth	15% per year	
Increase cost effectiveness	Cost reduction	5% per year	
Customer Satisfaction			
Increased trust customer	Customers acquisition	25 customer new per year	Development partnership with customer
Increased satisfaction customer	Customers satisfaction	80% satisfied after 3 years which will come	Service improvement customer
Internal Business Processes			
Improved quality process	Quick to respond	3 cooperation effort per year	Development organizational network
service customer	Cycle effectiveness (CE)	CE above 0.70 in 3 years coming	Business process reengineering
Integrated service process customer			
Learning and Growth			
Increase productivity and	Percentage	100% educated/trained	HR Development

personnel commitment	employee educated	in 3 years coming	Development information Systems management
	SIM that planned can be done	100% installed in 3 years coming	

One form of personal balanced scorecard can be seen in Table 6.

Table 6

The Personal Balanced Scorecard Strategic Performance Measurement

THE PERSONAL SCORECARD

Corporate Objective

- Double our corporate value in seven years
- Increase your earnings by an average of 20% per year
- Achieve an internal rate or return 2% above the cost of capital
- Increase both production and reserves by 20% in the next decade

										Team/Individual Objective and	
1995	1996	1997	1998	1999						1.	
FINANCIAL											
100	120	160	180	250	Earnings (in million of dollars)						
100	450	200	210	225	Net cash flow						
100	85	80	75	70	Overhead & operating expenses						2.
OPERATING											
100	75	73	70	64	Earnings (in million of dollars)						
100	97	93	90	82	Net cash flow						
100	105	108	108	110	Overhead & operating expenses						3.
Team/Individual Measures					TARGETS						
1.											
2.										4.	
3.											
4.											
5.										5.	
Name :											

Source: Kaplan and Norton (1997)

To win the competition in the global market, there are stages in the identification process that can support the strategic objectives that are used to measure the essential aspects and performance of the company, namely Critical Success Factors (CSFs). Cost, revenue and profit Strategic Business Unit (SBU) is a method that has been used to assess strategic performance. SBU profits are evaluated by several non-

financial measures including customer and employee satisfaction, delivery performance and process improvement. Types of information relevant to critical success factor often presented in the format balanced scorecard. Blocher, et al. (1999) provide an example of critical success factor potential and how they might be measured in terms of balanced scorecard SBU.

Table 7. Critical Success Factor and How to Measure Them

	Critical Success Factor	How It Is Measured
1.	Quality	Number of defects or returns, customer satisfaction
2.	Efficiency	Throughput time
3.	Flexibility	Setup time, cycle time
4.	Effectiveness	Value added versus non value added
5.	Skill Development	Training hours, skill performance
6.	Customer Satisfaction	Number of complaints, survey results
7.	Timeliness delivery	Time from order to customer receipt
8.	Timeliness of new product release	- Number of days over/undertargeted introduction - Number of accidents related occurrences date
9.	Safety	Aging of receivables, number of delinquencies
10.	Collections	Cycle time, set up time, number of design changes
11.	Manufacturability	Complaints, turn over

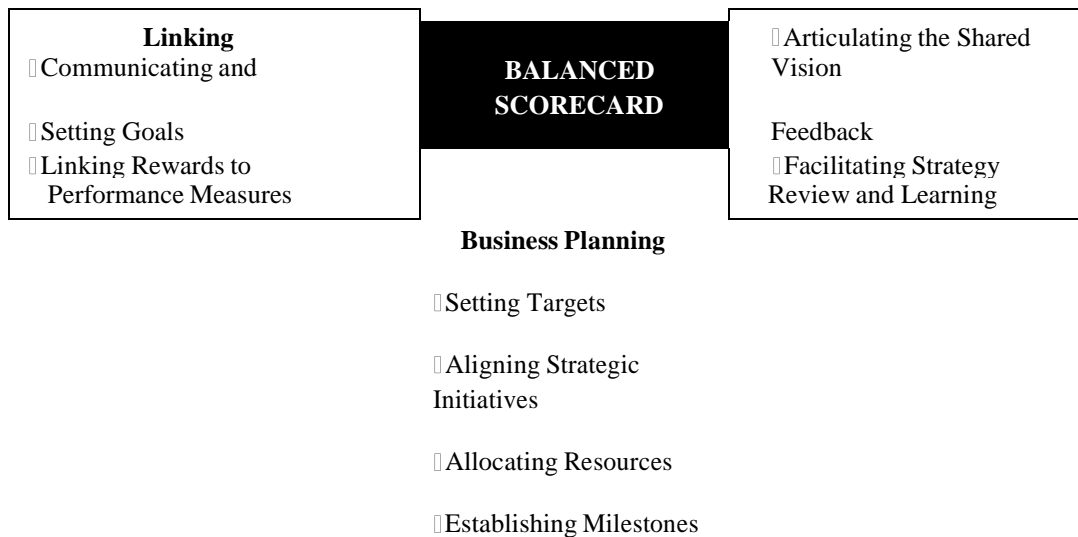
3. USE OF BALANCED SCORECARD AS A STRATEGIC MANAGEMENT SYSTEM

In further developments, balanced scorecard not only used to measure organizational performance, but developed into the core of the strategic management system. More than just measurement, balanced scorecard is a motivating management system break through improvement in all critical areas, such as products, processes, customer and market development. There are four processes managing strategy that combines long-term and short-term goals optimally include:

1. Process translate the vision
This process helps managers build consensus on the organization's vision and strategy.
2. Process communication and linking
This process invites management to communicate individual and departmental goals, settings goal, connect reword with performance measurement.
3. Process business planning
Enables companies to integrate business and financial planning which includes: setting targets, resource allocation, alignment strategic initiative, determination of important events.
4. Process feed back and learning
Articulate part of the vision, prepare strategic feedback, facilitate review and learning strategy.

The relationship of the four processes managing strategy above can be seen in the following Figure 1:

Figure 1.. Managing Strategy: Four Processes



Source: Kaplan dan Norton (1997)

4. RELATIONSHIP BETWEEN BALANCE SCORECARD MEASUREMENTS AND COMPANY STRATEGY

There is a view that the balanced scorecard is a concept used to measure the existing performance in a company, be it service or production or manufacturing by looking at the four perspectives and the performance shown by the company. As has been stated that this approach aligns

the balance scorecard with corporate strategy, so Kaplan and Norton (2000) provide three principles that allow this approach to be linked to corporate strategy as follows:

1. **Causality.** A strategy is a set of hypotheses about cause-and-effect relationships. A cause-and-effect relationship can be expressed by a sequence of if-then statements. The measurement system should identify and make explicit a sequence of hypotheses about a causal relationship between the outcome measure and its performance drivers, eg the link between increased sales training activities for salespeople and increased sales effectiveness profits as a result of the training.
2. **Results and performance drivers.** Performance driving factors, lead indicators are factors that are specific to certain business units. This factor reflects the uniqueness of the business unit's strategy, for example the financial driving factor of profitability, the selected market segment of the business unit and others. A good balanced scorecard should have the right mix of lagging indicators and leading indicators that have been adapted to the business unit strategy. Outcome measures without performance drivers will not communicate how those results were achieved.
3. **Links to financial problems.** Based on the testimonies of the winners, successful entrepreneurs stated that from the various financial problems faced, operational linkages with the company's economic success were needed, which means that the goal of improving the performance of the business unit will be achieved if finance is set as the final goal itself.

5. CONSTRAINTING FACTORS IN THE PROCESS OF APPLICATION OF THE BALANCE SCORECARD

According to Kaplan and Norton (2000:167) that company managers have found that the scorecard allows them to bridge the gaps that exist within the company, but there is a fundamental disconnect between the development and formulation of strategies and their implementation caused by the obstacles of the traditional management systems used by companies to determine and communicate the strategy and direction to be taken by the company, allocate resources, determine goals and directions for departments, teams and individuals, and provide feedback. Those obstacles are:

1. **Vision and Strategy are not Actionable.** This obstacle occurs because at the time of implementing the company's strategy, the company is not able to translate its vision and strategy into terms that can be understood and acted upon or there is no consensus created from a lack of understanding of the meaning of their vision and mission.
2. **Strategy Unrelated to Departmental, Team and Individual Goals.** This second barrier arises when the long-term strategic needs of the business unit are not translated into departmental, team and individual objectives. These barriers may arise from the failure of human resource managers to facilitate the alignment of individual and team goals with overall goals.
3. **Strategy Not Related to Long-Term Resource Allocation,** failure to link action programs and resource allocation with the company's long-term strategic priorities occurs because many companies have a separate center between long-term strategic planning and short-term (annual) budgets which result in funding and capital allocations are often not aligned with strategic priorities.
4. **Non-Strategic Static Feedback,** this last obstacle Due to the lack of feedback on strategy implementation and success. Most management systems only provide feedback on short-term operational performance and feedback on financial measures which are usually a comparison of actual results with monthly or quarterly budgets. Important benefits of the balanced scorecard as a strategic management system arise when companies conduct regular strategic reviews, not just operational reviews.

6. IMPLEMENTATION OF BALLANCE SCORECARD

With four perspectives; financial performance, customer satisfaction, internal business processes and learning and growth, the balanced scorecard can be applied to various companies, both private and state-owned companies, profit-oriented companies and non-profit-oriented companies, because the four perspectives have been includes the perspectives needed to assess organizational performance. The four perspectives in the Kaplan and Norton standard balanced scorecard model, according to the author, are very relevant to be applied to assess the performance of organizations including State-Owned Enterprises (BUMN) (Sudibyo 1997) saying that as long as a BUMN has formulated its mission and strategy and is familiar with, appreciative, and has a positive attitude to the paradigms and approaches of information age management, it can be a conducive environment for the implementation of the balanced scorecard, and the balanced scorecard can be used as a central framework that focuses on the mission and strategies for managing the changes brought about by the adoption of these new approaches.

For companies that are not profit-oriented (non-profit), the customer perspective, internal business processes perspective and learning and growth perspective are new paradigms in assessing organizational performance which have recently been in the spotlight of the wider community and are increasingly being demanded for professionalism. The balanced scorecard will only be effective and provide benefits to companies that have a far-sighted vision, because the application of the customer perspective, internal business processes perspective and learning and growth perspective must be supported by investments that are not cheap and cannot be fulfilled immediately in one accounting period. Soetjipto (1997) said that the BSC is a method of measuring business performance that needs serious attention from executives and company managers because the method measures business performance comprehensively. However, in implementing the balanced scorecard, executives and company managers should not ignore the problem of accuracy of information obtained by providing a clear formulation of performance benchmarks.

7. CONCLUSION

With the increasingly complex conditions of the organizational environment, comprehensive performance measures are needed so that the conditions of various sides of the organization will be seen. This provides clarity of direction and goals for companies in general, especially those in the retail sector, to move forward both from a financial and non-financial perspective in a balanced manner. The balanced scorecard is here to facilitate comprehensive performance measurement, both from a financial perspective and from a customer perspective, internal business processes, and learning and growth which cannot be facilitated by managerial performance measurement. If all sides of the organization can be measured, the organization will be managed properly. Moreover, the balanced scorecard also offers retail companies the achievement of competitive advantage because by measuring all aspects of the organization in a comprehensive and balanced manner it will be able to motivate in various fields such as: product, process, customer and market development.

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CHAPTER 9

Perception of the Role of Accounting in Minimizing Transaction Costs

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ABSTRACT

This paper aims to examine the perception of the role of accounting in minimizing transaction costs based on the analysis of methodological considerations of the corresponding articles. The author aims to develop information and recommendations regarding accounting policies in minimizing transaction costs. This analysis is based on an article on google Scholar with a qualitative analysis. The subject of the analysis is the publication of researchers related to the perception of the role of accounting in minimizing transaction costs with observations in the 2014-2021 period. The author makes observations on related articles perceptions of the role of accounting and combine these empirical insights with recent developments in minimizing transaction costs. That the articles that discuss the perception of the role of accounting in minimizing transaction costs are mostly about the knowledge needed in governance to minimize costs, with efficiency and effectiveness, accountability as the reference.

Keywords : Perception, Role of Accounting, Minimizing, Production Costs

1. INTRODUCTION

In the current era of globalization, the growth and competition of business entities is increasing, so companies must look for control methods so that the business they run can develop. Control of costs to be incurred and reduce costs that are not effective in their activities. Companies need to apply responsibility accounting to support cost control. The application of responsibility accounting and cost control in the company is useful for achieving company goals. The company implements a responsibility accounting system to control the responsibilities of each work unit or department called the responsibility center. With the establishment of responsibility centers, managers are expected to be able to assess the responsibilities and measure the achievements of their members objectively on the tasks delegated to them.

This will assist management in making decisions on controlling existing costs so that in the end the company's goals can be achieved (Yulisfan et al., 2021). Use and perceived success of a costing system (Pierce & Richard, 2006). In its implementation, management often ignores efficiency. According to (Taylor & Robert, 2016) the new accounting system was not well received by accountants "outside" the accounting department use and perceived success of the costing system. That is, if management is right in understanding it will produce efficient policies, such as minimizing transaction costs for sustainable development. So the author believes that research on this is worth doing. Furthermore, to gain deeper insight into the perception of the role of accounting in minimizing transaction costs, which is expected to be understood by the management as an understanding in decision making.

This control of production costs serves to compare the actual production costs with the established standard production costs. With this comparison, it can be evaluated whether there have been deviations, both detrimental deviations and profitable deviations. The production process is a way, method, or technique to increase the usefulness of goods and services by using existing production factors. The production process carried out by companies in the manufacturing sector is an important factor because it affects the company's production costs, both large-scale companies and small-scale companies and middle (Jogjafilm, 2014)

2. LITERATURE REVIEW

2.1. Basic Accounting Concepts

The basic concepts of accounting are the basic things to build accounting information. The basic concepts of accounting are needed to learn how to manage financial data in an organization or company. With this basic concept, financial data processing can be guaranteed to run well (Yulisfan and Nedelea, 2021) which is understood by management as understanding in decision making.

2.2. Management Accounting

Specifically, the roles of management accounting are: (Azmi et al., 2018)

1. Provide information for managers in carrying out planning, controlling, and decision-making functions.
2. Assist managers in directing and controlling company operations.
3. Motivate managers and employees to work together to achieve company goals.

2.3. Understanding Cost Accounting

Cost Accounting is a field of accounting devoted to the process of tracking, recording, and analyzing costs associated with the activities of an organization to produce goods or services. In connection with this, the experts define the meaning and function of Cost

Accounting as a procedure for recording and reporting the measurement results of the cost of making goods and services.

2.3.1. Cost object

A cost object or cost objective is a place where costs or activities are accumulated or measured.

Elements of activities that can be used as cost objects are:

1. Product.
2. Production.
3. Department.
4. Division.
5. Product line.

2.4. Production Cost Control

Daljono (2009:13) states that cost is a sacrifice of economic resources measured in units of money, to obtain goods or services that are expected to provide current or future benefits. Hansen and Mowen (2009: 554) explain that production costs are costs associated with the production of goods or the provision of services. Mardiasmo argued (2002:3) cost control is basically a series of continuous monitoring and evaluation activities and comparing the budgeted costs and their realization. Matz, et al (2001:116) states that cost control is an action taken to direct activities so as not to deviate from the goals that have been previously set in a production process. Supriyanto (2001:295) states that the purpose of controlling production costs is to obtain the maximum amount of production or results with the desired quality, from the use of a certain number of materials, labor, business, or facilities by obtaining the best possible results at the lowest cost. As small as possible under the existing conditions.

3. METHODS

The research method is qualitative research with a general research approach to address the purpose of understanding and adding to the latest insights from the perception of the role of accounting in minimizing transaction costs of future accounting research. Therefore, we focus on articles where we can observe the application of accounting understanding in minimizing transaction costs from related articles on Google Scholar as follows.

No	Writer	Year	Title
1	Adharawati	2010	Application Accountancy Accountability with Budget As Tool Control Cost (Study Case at PT. Pelni Branch Office Makassar)
2	Andriana	2015	Role Accountancy Accountability In Performance Manager Center Accountability.
3	Anik	2013	Evaluation Application Accountancy Accountability As Tool Control Cost Production
4	Cikiana	2018	Analysis Application Accountancy Accountability As Control Cost On (UD. Basmalah Jarit Candipuro Lumajang)
5	Fadhli	2020	Analysis Of The Role Of Responsibility Accounting As A Cost Control Tool At Pt Mitra Beton Mandiri Pekanbaru
6	Faisal	2017	The Role Of Responsibility Accounting For Production Cost Control In Pt. Sugizindo Citeureup 2013-2014.
7	Hamta	2014	Application Planning Cost And Control Cost As Tool Accountancy Corporate Responsibility : Study Case At PT. Cesco Offshore And

			Engineering Batam
8	Hasbiah	2016	Implementation Of Cost Liability Accounting Towards Cost Efficiency In Pt. Palopo Plywood Business Panca.
9	Herniawan	2012	Role Accountancy Accountability As Tool Control Efficiency Cost Production Of PT Indorama Synthetics
10	Jarkoni	2010	Role Accountancy Accountability As Tool Control Cost At PT. Beautiful Harisanda
11	Mandak	2013	Application Accountancy Accountability With Budget As Control Cost Service Manado Transportation
12	Massie	2018	Analysis Control Cost Production For Evaluate Efficiency And Effectiveness Cost Production
13	Prang	2013	Application Accountancy Accountability With Budget As Tool Control For Evaluation Performance At PT. Cruise Indonesian National Branch Bitung
14	Rini	2019	Unravel Map Street Industry 4.0 Accounting.
15	Samryn	2013	Accountancy Management : Information Cost For Control Activity Operation And Investment
16	SARI	2018	Responsibility Accounting Analysis In Supporting Production Cost Control Efficiency In Pt. Nusantara X Ajong Gayasan Jember Plantations
17	Sinaga	2017	Role Accountancy Management Sector Public Towards Good Governance In Indonesia
18	Sundari	0	The Role Of Responsibility Accounting As A Production Cost Efficiency Control Tool
19	Wibowo	2021	The Effect Of Internal Control And Accounting Information Systems On Cost Efficiency And Effectiveness Of Patient Services In Workers' General Hospital.
20	Wibowo	2019	Wibowo, Rivan. "Influence Internal Control, System Information Accountancy To Efficiency Cost, Effectiveness Service Medical And Non - Medical At PT Rumah Sick Peln." Journal World Accounting 4.2 (2019): 1-17.

To obtain relevant data, the authors use the following data:

1. Related articles found on google cholar
2. Journal for 2014 – 2021
3. Trusted journal

From the criteria above, there are 8 articles that were sampled in this study:

No	Writer	Year	Title
1	Andriana	2015	Role Accountancy Accountability In Performance Manager Center Accountability.
2	Fadhli	2020	Analysis Of The Role Of Responsibility Accounting As A Cost Control Tool At Pt Mitra Beton Mandiri Pekanbaru
3	Faisal	2017	The Role Of Responsibility Accounting For Production Cost Control In Pt. Sugizindo Citeureup 2013-2014.
4	Hasbiah	2016	Implementation Of Cost Liability Accounting Towards Cost Efficiency In Pt. Palopo Plywood Business Panca.
5	Massie	2018	Analysis Control Cost Production For Evaluate Efficiency And

			Effectiveness Cost Production
6	Sinaga	2017	Role accountancy management sector public towards good governance in Indonesia
7	Wibowo	2021	The Effect Of Internal Control And Accounting Information Systems On Cost Efficiency And Effectiveness Of Patient Services In Workers' General Hospital.
8	Wibowo	2019	Wibowo, Rivan. "Influence Internal Control, System Information Accountancy To Efficiency Cost, Effectiveness Service Medical and Non - Medical At PT Rumah Sick Pelni." <i>Journal World Accounting</i> 4.2 (2019): 1-17.

The next step is to make observations to find out how the perception of the role of accounting in minimizing production costs is.

4. RESULT AND DISCUSSION

4.1 Result

Evaluation and reporting of production costs are interrelated and very important because with these two things the company can find out about the use of funds in production process activities. And through this evaluation and reporting can be known about the existing cost control in the company. Cost control can be said to be efficient, if the budget is greater than the actual costs used during the production process. If the realization of costs is greater than the budget, the use of costs cannot be said to be efficient. The budget made is also adjusted to the targets to be achieved every year. The following is a budget, realization, and the difference obtained from the calculation of raw material costs, direct labor costs, and factory overhead costs processed by the company.

All costs or all activities that give rise to costs must be authorized by the people responsible for these activities. Therefore, all costs can be controlled at a certain level of management. If a cost cannot be controlled at a certain level of management, then the cost must be controlled by a higher level of management. The responsibility accounting system requires the separation of costs that can be controlled and those that cannot be controlled in the preparation of the budget. This is intended so that it is known who is responsible for these costs.

Of the 8 articles that discuss the perception of the role of accounting in minimizing transaction costs. Our findings show that most of them discuss the knowledge needed in governance to minimize costs, with efficiency and effectiveness, accountability as a reference. From the article it was also found that management in minimizing production costs has an adequate understanding.

Organizational and business decision making (Hansen, Mowen, & Heitger, 2021). Management accounting practices have a policy-setting role (Abrahamsson & Jonas, 2011). Research (Oppi & Vagnoni, 2020) shows that the role of accountants can be considered as two-dimensional: 1) involvement in the company's internal operations, focusing on performance and compliance, and 2) in the external dimension relating to the disclosure of economic information to users of external reports. Increasing awareness of accounting understanding by management will be followed by all parties in an agency (Bassani, Pfister, & Cattaneo, 2021). Accountants as part of management who understand Accounting (Wolf, Kuttner, & eldbauer-Durstmüller, 2020). The perception that management accountants have

on their role in accounting for sustainable development (Friedl, Hamme, & Küpper,, 2009) was also stated by (Mistry, Sharma, & Low, 2014). Where in the determination of the decision is expected to produce efficient policies, such as minimizing transaction costs.

To find out the understanding of accounting principles to minimize production costs, the author reviews several articles related to research in various locations such as PT. Matra Beton Mandiri (MBM) Pekanbaru, PT. PINDAD (Persero), PT. Sugizindo Citereup, CV. Manado Tile Award and others.

4. 2 Discussion

Based on the results of the research that has been obtained, it is hoped that it will be useful for the development of the company.

1. Standards as a cost control tool should be reviewed every time price fluctuations occur, this needs to be done so that standards set by the company have been reviewed in advance according to the considerations of previous reports. So, the company should further improve the control system during the production process so that there are no deviations that can harm the company so that the production process can run effectively and efficiently.
2. The company has carried out standard costing well, but in the future it is hoped that the company can pay more attention to the prices of raw materials and factory overhead costs so that there is no unfavorable cost difference, this can make it easier for the company to conduct analysis and evaluation in the period to come.

From the article there is information that controlling organizational activities is the focus of management in minimizing production costs. Management also emphasizes the relationship between information and the manager who is responsible for the budget and its realization. Appropriate regulation also affects cost efficiency.

The author considers that in general management has an adequate understanding of minimizing production costs. From the results of observations for management knowledge of regulations as well as the selection of methods in determining costs and paying attention to the right control system, the right control. However, the article still lacks information because it only reviews one company.

The author recommends to further researchers to examine the perception of the role of accounting in minimizing production costs by reviewing directly in the field at several companies. In order to produce more accurate and comparable observations.

5. CONCLUSION

From the observations made in the article related to the Perception of the Role of Accounting in Minimizing Production Costs in the article, it was found that in general management understands the Perception of the Role of Accounting in Minimizing Production Costs correctly. From the research results in the article, management has the knowledge needed in governance to minimize costs, with efficiency and effectiveness, accountability as a reference.

The implementation of cost control on the objects of research that became the sample, especially production costs has been efficiently carried out. This can be seen from the responsibility report made by the production manager showing that all realized production costs are smaller than what has been budgeted. In assessing the level of production cost efficiency, the assessment criteria include, among others, the percentage of assessment ranging from 90% to > 100% is said to be Efficient – Very Efficient, while the percentage ranging from 80% to < 60% is said to be Less Efficient – Not Efficient.

6. REFERENCE

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CHAPTER 10

Role of External Auditors and Political Costs Resulting from Political Attention from Government and Lobby Groups

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ABSTRACT

This study aims to determine the role of external auditors and political cost resulting from political attention by Government and Lobby Groups. External auditors have an important task for the company and stakeholders to account for the opinions they have given. This paper tries to answer how external auditors and political costs resulting gain political attention from Government and Lobby Groups. This study uses an interpretive paradigm because it aims to understand one's thinking about multiparadigm accounting research and the process of spreading it. The method used in this research is literature review, by collecting literature related to radical humanism from journals, books, and previous studies. Political costs arise from conflicts of interest between managers and the government, where the company is considered to have a share in being responsible for the social interests of the community. One of the government's policies for this is the obligation to pay taxes. The greater the level of income or sales of the company, the higher the tax to be paid. Therefore, to avoid high taxes, management will tend to report lower earnings. Political costs include all costs or transfers of wealth that must be borne by the company related to antitrust actions, regulations, government subsidies, tax rates, labor demands, and so on. Relationship between political cost and political attention from Government and Lobby Group is that the existence of political costs due to the company's high profitability in a large company or entity can attract the attention of the media, consumers, Government and also Lobby Group.

Keywords : Lobby Groups, Political Costs, Radical Humanism

1. Introduction

Accounting plays an important role in running the economy and social system. The decisions taken by individuals, governments, other business entities are determined in their use of the resources owned by a nation. External Auditing is a periodic inspection of the books or records of an entity by an independent third party. External Auditors functions are to examine the management and responsibilities of state finances carried out by the Central Government, Regional Governments, Other State Institutions and other institutions or agencies that manage state finances. The purpose of an external auditor is to provide an opinion in auditing an entity independently so the entity concerned can find out whether its annual financial statements have been presented in real conditions that reflect the condition of the entity. Political cost is the company's political cost arising from the existence of conflicts of interest between managers and government, society, political attention of the company (Fachrizzu et al., 2020). Firms tend to lower profits now by shifting to tomorrow's period earnings. Company motivation to do this is to avoid political pressure such as accusations of monopoly by shows that the company's profits are not excessive as suspected, lobbied for congress to protect industry from imported goods that cause industrial profits slump, avoiding union demands by shows that the company's profits are declining and so on (Jayanti & Sapari, 2016). Role of External Auditors and Political Costs Resulting from Political Attention is very important to examine the entity's financial report to decision making and to make a good impression and trusted financial reporting (Warae et al., 2021). Trust can be obtained if the resulting financial statements are clearly and reliably explained.

2. Literature Review

2.1. Agency Theory

Agency theory assumes that all individuals act in their own interests. First agency theory first introduced by Jensen and Meckling in 1976. Relationship agency arises because of a contract between shareholders (principal) and company management (agent) which are company managers, in the contract the owner authorizes management to carry out company operations that are included in decision making (Destriana, 2015). Agency theory in its development is divided into two streams, namely positivist theory and principal-agent research. Positivists focus on identifying situations when principals and agents experience conflict and governance mechanisms that limit the agent's self-serving. Principal-agent research focuses on the optimal contact between behavior and outcomes. In general, emphasis is placed on the relationship between principal and agent. Principal agent research is an extension of agency theory because it has added to the conflict between coworkers, subordinates, and superiors (top management). This conflict of interest underlies the existence of agency costs. Agency theory says that it is difficult to believe that management (agents) will always act in the interests of shareholders (principals), so monitoring from shareholders is required.

The company's performance that has been achieved by the management is informed to the owner (principal) in the form of financial statements. In a decentralized system, management has superior information compared to owners, because management has received delegation for decision making / company policies. When the owner is not able to perfectly monitor the activities of management, then potentially management can determine policies that lead to an increase in the level of compensation. The principal-agent relationship model is expected to maximize the utility of the principal, and can satisfy and guarantee the agent to receive rewards from the results of company management activities. When the owner is not able to perfectly monitor the activities of management, then management can potentially determine policies that lead to an increase in the level of compensation (Sunarto, 2009).

2.2. External Auditors

An external audit is an independent examination of an organization's financial statements. As mentioned above, while an external audit is usually conducted for statutory or regulatory purposes, there can also be good business reasons to have an audit. The external auditor forms an opinion on whether the financial statements prepared by management are "true and fair" in all material respects and comply with relevant financial reporting requirements. The external auditor responsible for investigating financial statements for errors and fraud, performing audits on operations, and reporting on findings, and providing recommendations.

External Auditor Responsibilities :

- Evaluating financial statements and assessing accounts for accuracy and compliance.
- Investigating internal systems and operations.
- Assessing risk management approaches.
- Reporting on errors and fraud.
- Providing feedback reports on findings.

According to the Professional Standards of Public Accountants (PSA 29 SA Section 508) there are five opinions that may be given by public accountants on the financial statements they audit (Salampessy & Yolanda, 2016)

1. Unqualified Opinion

An unqualified opinion is given by the auditor if there are no restrictions on the scope of the audit and there are no significant exceptions regarding the fairness and application of generally accepted accounting principles in the preparation of financial statements, the consistency of the application of these generally accepted accounting principles, and adequate disclosures in the financial statements. An audit containing an unqualified opinion is a financial report that is most needed by all parties, both by clients, users of financial information, and by auditors. The word reasonable in the opinion paragraph has the following meanings:

- a. Free from doubt and dishonesty.
- b. Complete information.

2. Reports Containing Unqualified Opinion Reports with Explanatory Language.

If there are matters that require explanatory language, but the financial statements still fairly present the financial position and results of operations of the client company, the auditor can issue an audit report in book form.

3. Fair Opinion with Explanation (Qualified Opinion)

The auditor provides a qualified opinion in the audit report, if the auditor encounters the following conditions:

- a. The scope of the audit is limited by the client.
- b. The auditor is unable to perform important audit procedures or is unable to obtain important information due to conditions that are beyond the control of the client or the auditor.
- c. The financial statements are not prepared in accordance with generally accepted accounting principles.
- d. Generally accepted accounting principles used in financial statements are not consistently applied.

4. Unfair opinion (adverse opinion)

The auditor gives an adverse opinion if the client's financial statements are not prepared in accordance with generally accepted accounting principles so that they do not fairly present the financial position, results of operations, changes in equity, and cash flows of the client company. The auditor will also give an adverse opinion if he is limited in the scope of his audit, so that he can gather sufficient competent evidence to

support his opinion. If the financial statements are given an unfair opinion by the auditor, the information contained in the financial statements cannot be trusted at all and cannot be used by users of financial information for decision making.

5. Disclaimer of Opinion.

- a. If the auditor does not express an opinion on the audited financial statements, then this audit report is called a no opinion report. Conditions that cause the auditor to disclaim an opinion are:
 - a. There are extraordinary limitations to the audit environment.
 - b. Auditors are not independent in their dealings with clients.

2.3. Political Cost Result

Political costs show the development of a company's business. The broad market share makes them more pressured to be responsible to the environment. The level of political costs is associated with firm size, therefore firm size will influence management's decision to voluntarily disclose information to avoid political costs. Larger companies will have a greater need to reduce political costs than smaller companies (Darus & Taylor, 2009). Managers will try to make profits seem small with certain accounting methods in order to cover high political costs (Milne, 2017). Market share as a proxy for political costs shows the distribution of the company's market share. Companies with high market share show that they earn high profits as well. This must be proportional to the fulfillment of the company's obligations to the environment, to avoid social protests that may be carried out by the community. This environmental responsibility is a manifestation of the company's efforts to account for the effects of its business activities on the environment and the surrounding community.

Political costs arise from conflicts of interest between managers and the government, where the company is considered to have a share in being responsible for the social interests of the community (Sutrisno et al., 2020). One of the government's policies for this is the obligation to pay taxes. The greater the level of income or sales of the company, the higher the tax to be paid. Therefore, to avoid high taxes, management will tend to report lower earnings. Large companies are also faced with high political costs, so large companies tend to use conservative accounting principles to reduce the magnitude of political costs. Political costs include all costs or transfers of wealth that must be borne by the company related to antitrust actions, regulations, government subsidies, tax rates, labor demands, and so on. The government as a regulator and policy maker of a country where the company operates will supervise large companies more. This shows that the larger the size of the company, the greater the political costs that must be paid, so to reduce these costs the company tries to report its profits conservatively so that profits do not look too high (Ardina & Januarti, 2012).

Relationship between political cost and political attention from Government and Lobby Group is that the existence of political costs due to the company's high profitability in a large company or entity can attract the attention of the media, consumers, Government and also Lobby Group.

3. Method

This study uses an interpretive paradigm because it aims to understand one's thinking about multiparadigm accounting research and the process of spreading it. This research uses narrative and qualitative methods. This research also uses case studies in relation to their thinking and development. This research uses literature review data and the required articles.

4. Result and Discussion

4.1. Result

The existence of an external auditor serves to monitor the performance of management in choosing the accounting method to be applied by the company. With an external auditor, managers will be more careful or more conservative in choosing the method used. The choice of this method affects the political costs paid by the company such as taxes. Management with a conservative method will report costs incurred but will report profits when they are actually incurred. The size of the profit reported by the company affects the political costs incurred by the company.

Companies that are getting bigger and growing will affect the political costs. Companies that are growing and large will receive more attention from the government in paying corporate taxes called political attention. If large companies have relatively permanent high profits, the government can be compelled to raise taxes and demand higher public services from companies. Finally, managers of large companies may tend to choose accounting methods that delay earnings reporting to reduce the political cost borne by the company.

Meanwhile, in making a decision, investors can see from the results of a company's financial statements that have been audited by external auditors. Political cost also states that a conflict of interest between the company (manager) and the government which has the authority to transfer wealth from the company to the public in accordance with applicable regulations (tax regulations and other regulations) will cause political costs.

Purwoto (2011) states that politically connected companies are companies that in some way have political ties or seek closeness with politicians or the government. Gomez (2014) adds that companies that have political connections have exclusive business relationships and have privileged access to every government policy. Resource dependence theory states that the company is an open system that is influenced by an external environment full of uncertainty. One way to minimize this uncertainty is to establish political connections (Pfeffer & Salancik, 2003). Political connections will result in rent seeking activity (Feng, Johansson, & Zhang 2014).

4.2 Discussion

Financial statements are records of financial information of a company in an accounting period. The existence of financial statements can be used to describe the company's performance and can be used by management to make decisions. Financial statements must be presented in accordance with PSAK, namely:

1. Understandability, The financial statements must be clear and easily understood by all parties. Therefore, the preparation must be in accordance with a clear accounting cycle so that parties who need financial information from the report can understand its contents clearly.
2. Relevance, Financial statements must be able to describe some important information that is in accordance with the facts of the company's activities. Information must also be accurate about the condition of the company as a whole for all activities related to profit-making activities.
3. Reliable, The financial statements that are prepared must have reliability, namely in accordance with the components of the financial statements with the size and power of truth testing. In order to have reliability, it is necessary to base certain rules to measure the truth of financial statements. Furthermore, the constraint is only possible if the financial statements are prepared to be neutral or impartial. Reliability can also be

measured by the timeliness in presenting it, because it will be used as the basis for making decisions for the company.

External auditors are needed to examine the company's financial statements. The external auditor's duties are :

1. Give an opinion on the report that has been done by the entity.
2. Assess whether it is in accordance with the applicable principles, namely PSAK/SAK.
3. External auditors must be responsible to shareholders and are obliged to the company to carry out professional work in conducting audits of the opinions that have been given.

Political costs are all costs that must be borne by companies related to government political actions such as taxes and regulations (Watts & Zimmerman, 1978). Government political actions, such as regulations, subsidies and taxes, are an external environment full of uncertainty. The political cost hypothesis explains that large companies tend to perform earnings engineering to minimize political costs to reduce their tax expenses, etc.

5. Conclusion

This study aims how external auditors and political costs resulting gain political attention from Government and Lobby Groups. External audit has the function of supervising the implementation of operational and business activities of a company. The existence of an external auditor makes managers more conservative in choosing the method used in the company. The choice of this method affects the political costs paid by the company such as taxes. Political costs also state that a conflict of interest between the company (the manager) and the government authorized to transfer wealth from the company to the public in accordance with applicable regulations (tax regulations and other regulations) will result in political costs. The size of the company's reported profit affects the political costs incurred by the company. Companies that are growing and large will receive more attention from the government in paying corporate taxes, which is called political attention. The political cost hypothesis explains that large companies tend to perform earnings engineering to minimize political costs to reduce their tax expenses.

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CHAPTER 11

The Origins of Positive Accounting Theory (PAT): The Agency Theory

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ABSTRACT

Accounting problems builds accounting to be more developed. This article attempts to answer accounting problems in the agency theory sector. In this study, we use pure literature survey and conclusions are drawn from theoretical analysis and discussion results. This research will add deeper insight into agency theory. Our research survey presents some of the thoughts of previous researchers regarding positive accounting theory and agency theory. The results of our study show that positive accounting theory has a relationship with agency theory in three spheres of relations. Agency theory discusses agency problems caused by information asymmetry between several parties and requires ways to control agency problems. Through this research, there are two ways to control agency problems, such as by monitoring and binding.

Keywords : Positive Accounting Theory, Agency Theory, Controlling Agency Problems

1. INTRODUCTION

Accounting theory develops over time. Starting from the development of normative accounting theory and refined by the positive accounting theory. Positive accounting theory is closely related to agency theory. Agency theory discusses agency problems and provides solutions to agency problems (Jensen & Meckling, 1976; Ross, 1973). The agency problem begins when human civilization does business and always tries to maximize their desires. This agency problems causes benefit to one party and disserves the other party due to information asymmetry between the principal or owner, creditor, government, and agent or manager. Agency problems need to be controlled. The study of the definition of agency theory, problems in agency, and agency costs is needed to understand how to control agency problems.

In overcoming agency problems, there will spend costs. The cost of controlling the agency problem will affect the effectiveness of the company's performance. Therefore, it is necessary to pay attention to cost efficiency in controlling agency problems. The aim of this article is to review the theoretical and empirical literature on agency theory to try to answer the questions: How is positive accounting theory related to agency theory?, What is agency theory?, What are the problems in agency? How to control agency problems that occur to company owners, creditors, and the government? In this control, it is necessary to pay attention of cost efficiency to overcome agency problems.

2. LITERATURE REVIEW

2.1 The Origin of Positive Accounting Theory

Positive accounting theory emerged because of the examination of assumptions in normative accounting during the years 1956-1970 which was not sufficient to fulfill the needs of accounting advances in the world economy. Normative accounting theory determines how accounting should be carried out to achieve the stated goals. Normative accounting theory is based on a subjective opinion, of what accounts should be reported and the best way to practice accounting. In the early 1970s Henderson, Peirson, and Brown expressed two main criticisms of normative theory:

- a. Normative theory does not pay attention to hypothesis testing.
- b. Normative theory is based on the assessment of a value.

Opinions regarding accounting objectives and methods vary between individuals. Dissatisfaction with the normative approach in large part is that it does not provide a means to resolve differences of opinion. Normative theory cannot be tested empirically because to prove empirically what ought to be is impossible. Positive accounting theory developed supported by dissatisfaction with normative accounting theory by Watts and Zimmerman (Watts and Zimmerman, 1986).

Watts and Zimmerman said that normative accounting theory analyzes a simple accounting and provides unsteady theoretical foundations. Thus, to reduce the gap in the accounting normative theory, Watts and Zimmerman develop a positive accounting theory that is more oriented to empirical research and agree on various accounting techniques or methods that are currently used or look for new structures to adapt to future accounting needs.

2.2 Positive Accounting Theory Hypothesi

There are three positive accounting theory hypotheses that are widely said by Watts and Zimmerman (Watts and Zimmerman, 1986), such as:

1. **Bonus Plan Hypothesis**
The bonus plan hypothesis indicates that company managers who have the goal of getting bonuses will tend to use accounting methods to increase current period income. Thus, the achievement of the manager's bonus will be more optimal.
2. **Debt Contract Hypothesis**
The debt contract hypothesis indicates that company with high debt to equity ratios will try to shift the company's future earnings to the present through the use of accounting procedures. In this case, the company has an obligation to maintain a stable presentation of financial statements that tend to grow. If the company experiences a decrease income which indicates a reduced ability of the company to fulfil its debt obligations, it is likely that creditors will not provide loans. Therefore, an effort to prevent or delay the violation of these obligations, company will tend to use certain accounting policies that can increase current period profits.
3. **Political Cost Hypothesis**
The political cost hypothesis indicates that large company will tend to use accounting methods to transfer income from the present to the future. This is due to the concern of large company over the threat of foreign companies being allowed by the government to enter the domestic market. By presenting company profits that are not high or seem to have decreased, it will encourage the government to protect domestic companies by limiting import transactions in the country.

2.3 Agency Theory

The topic of the application of agency theory was first raised by Michael C. Jensen and William H. Meckling. Agency theory is a theory states that the company is the point of intersection or the basis for the various types of contractual relationships that exist, such as between management, owners, creditors, and the government. Wilson (1968) states that there are individual or group within the company who have various risk considerations and actions, such as the principal or company owner invests his capital and takes risks to obtain economic benefits, while the agent in this case is the manager, who manages the company but tends to avoid risk. which triggers the failure of receiving bonuses and always trying to maximize their personal profits. Both the principal and the agent have opposite risk preferences.

Eisenhardt (1989) states that there are two reasons of agency problems between principals and management, such as :

1. Employers or owners are limited to obtaining information from management. This causes the emergence of asymmetry (imbalance) of information between the agent and the principal. The agent has more information about the work environment, the potential of the company, and all private information contained in the company than the principal. This case causes a moral hazard.
2. Principals and agents have different behaviors in accepting and dealing with risks. In this case the principal or owner of the company is a profit seeker and is neutral or willing to accept risk, while the agent or manager is a profit seeker and tends to avoid risk.

In practice, the agent may not always do what the owner wants, so this will cause agency costs. Agency costs are costs incurred by owners to supervise managers. An example of agency costs is auditing, as a tool to ensure that the company's financial statements have been subject to independent external supervision to assess the fairness of the information presented (Nasution et al., 2022).

In addition to the principal or owner, the fairness assessment of the manager's financial statements by the external auditor provides assurance to outside parties such as creditors regarding corporate governance by the manager. In this case, it is related to the contractual relationship between the company manager and the creditor regarding the funds provided by the creditor to the manager, such as the loan (Wardhani et al., 2022). Managers will try to present financial reports that show the company's growth and liquidity or company ability to fulfill the obligation to pay principal and interest on loans.

Agency theory also explains the contractual relationship between huge company and the government, which can lead to alternative choices by company managers to reduce revenue by utilizing the choice of accounting methods by companies with the aim of convincing the government to protect company from the threat of foreign competitors.

2.4 Agency Fee

Jensen and Meckling (1976) show that agency costs between managers and company owners will be very expensive if the interests of the two parties are not in line. The consequence of the agency problem is that it creates agency costs. The examples of agency costs are as follows:

1. **Residual Loss**

Residual loss are costs that arise as a result of the principal's decision to provide incentives to managers based on asymmetric information. In this case, the manager provides information through the financial statements when the principal as the appraiser expects that the financial statements must reflect the conditions of improving the company's performance, while the manager or agent uses these financial statements to show the good performance of the company which leads to the interests of the manager himself regarding the receipt of incentives. In line with this idea, Lubis et al (2021) reveal that not all information is reported by managers to principals. This causes the company to suffer losses.

2. **Monitoring Fee**

The cost of monitoring the company undertakes to address the residual loss of the agency problem. The Company holds board of directors meetings and uses external audit services to ensure reasonable of the submission of financial reports.

3. **Bonding Fee**

Bonding fee are costs incurred to build and run company activities in accordance with the system established by the company owner (Jensen & Meckling, 1976). Bonding fee cause a limit to the manager's activity. Monitoring costs and bonding fee are opposites. In this case monitoring costs will decrease as bonding fee increase.

This will affect the owner's profits and ultimately have an impact on the company's image.

2. METHODS

A descriptive approach is applied in this study through a collection of previous literature on the origins of positive accounting theory, agency theory, and agency costs. This study will provide a theoretical description of the relationship between positive accounting theory and agency theory, how to control agency problems that occur in company owners, creditors, and the government. This study aims to review various concepts of agency theory and agency costs. These concepts are combined to draw conclusions as considerations in controlling agency problems with the need to pay attention of cost efficiency. Therefore, the methodology used is a pure literature survey and conclusions are drawn from theoretical analysis and discussion results. This research will add deeper insight into agency theory.

3. RESULT AND DISCUSSION

4.1 Result

Based on the research of Watts and Zimmerman related to positive accounting theory with Michael C. Jensen and William H. Meckling related to agency theory, positive accounting theory has a relationship with agency theory. Based on this research, there are three relationships between positive accounting theory and agency theory, such as:

1. Relationship between Manager and Owner

Manager tries to present financial reports that show high company performance so that owners make decisions to provide high incentives to manager. Thus, there is an agency problem that causes owners to suffer losses due to policies based on information asymmetry. In this case, the presentation of financial statements by manager is not the same as the actual financial statements.

2. Relationship between Manager and Creditor

Manager tries to present financial reports that show the company's liquidity and the company's performance that continues to increase to give a good image in the sight of creditors (Warae et al., 2021). This is done as an effort to convince creditors in providing loans. However, this creates agency problems for creditors. Creditors suffer losses due to lending decisions based on information asymmetry. In this case, the presentation of financial statements by managers is not the same as the actual financial statements.

3. Relationship between Manager and Government

Manager tries to present financial reports showing declining company performance to limit government policies in opening up opportunities for foreign companies to enter the domestic market. This creates agency problems for the government. Government tax revenues from companies have decreased and the government is missing out on opportunities to collect taxes from foreign companies (Bakar et al., 2021). This is due to the asymmetry of information obtained by the government from company manager. In this case, the presentation of financial statements by manager is not the same as the actual financial statements.

As a result of information asymmetry between manager, owner, creditor, and the government, it creates agency problems. The agency problem that has been described previously can be controlled with several alternatives, such as:

1. For Owner

Owner can make monitoring efforts by utilizing the services of an external auditor to assess the fairness of the presentation of financial statements by manager. The costs of this monitoring tend to be substantial. Therefore, the owner can make

efforts to control the manager by building and carrying out company activities in accordance with the system set by the company owner. So the manager's activities are limited by the system. Monitoring costs will decrease as bonding costs are spent.

2. For Creditor

Creditor must use the company's financial statements that have been audited by external parties to become the basis for decision making in terms of providing loans to companies.

3. For Government

The government assign the imposition of corporate income tax must be based on the company's financial statements audited by an independent party. So that the problem of information asymmetry from manager can be controlled.

4.2 Discussion

In the literature review, we present a discussion of the agency problem as follows:

Regarding the agency problem, information asymmetry between manager and the government show a more complex motivation than simply preventing foreign companies from entering the domestic market. The motivation for the emergence of agency asymmetry problems between manager and the government could be due to efforts to minimize corporate tax payments.

In reducing monitoring costs to control agency problems of information asymmetry between owner and manager, bonding fee are spent by building a computerized company accounting information system that is connected to company owner. The accounting information system requires the existence of a step procedure in each accounting transaction activity and the policies set by the manager as an effort to bind the manager's activities to carry out earnings management.

If the owner plays a role in company management, it allows the loss of information asymmetry. This is because the owner has full access to the company's operations, both in every accounting transaction and accounting policies set by the company, known by the owner.

4. CONCLUSION

Positive accounting theory seeks to solve the problem of accounting practice, one of which is the problem of agency theory. This agency theory problem is solved by making the decision of the owner of the company to carry out monitoring and binding. In terms of monitoring efforts, the company uses the services of an external auditor to assess the fairness of the presentation of financial statements by manager and holds a board of director meeting to evaluate the manager's performance on a regular basis. In addition, an alternative to bonding fee can be used by the owner to reduce the relatively high monitoring costs. The owner establishes a computerized corporate operational governance system that makes the company's privacy information accessible to company owner and limits the activities of managers to prevent earning management practices.

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The list is based on the accumulation of various scientific papers assessed from the H Index, I Index and citations indexed by Google Scholar. The H Index is an index that attempts to measure both the productivity and impact of a scientist's published work. This index is based on the number of scientific papers produced by a scientist and the number of citations received from other publications.

While the I Index is the score of a researcher in a publication that has articles cited by at least 10 other articles. Citation is the number of scientific works that are cited or cited by other people around the world and become a source of reference for scientific works. This list is a form of recognition by world institutions for the achievements of the work given by scientists.

The AD (Alper-Doger) Scientific Index is a study that shows the total and productivity coefficients of publication performance over the last five years of scientists, based on H-Index scores and citations according to Google Scholar. The index provides a ranking and assessment of scientists in a field of study and academic branch from 14,120 universities and 215 countries.

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Dr. Muhammad Ali Tarar joined University of Agriculture, Faisalabad- Pakistan as Teaching Assistant in 2005, later as, Lecturer Rural Sociology in November 2007 and presently serving the Department of Sociology, Ghazi University, Dera Ghazi Khan-Pakistan as Associate Professor / Chairman Sociology. Additionally, he is also serving as Director office of Research, Innovation & Commercialization (ORIC) from 2015. As Chief Editor, Kisht-e-Nau (student Magazine, University of Agriculture, Faisalabad) published Centennial Number in 2006 and was awarded UNIVERSITY GOLD MEDAL from Chancellor of University/ Governor of Punjab-Pakistan as well-as UNIVERSITY ROLE OF HONOR, UNIVERSITY COLOUR & UNIVERSITY CERTIFICATE OF EXCELLENCE was awarded from Worthy Vice Chancellor for publishing the Centennial Number of “ Kisht-e-Nau “ as Chief Editor on the eve of centenary celebrations of University of Agriculture, Faisalabad (14th to 16th March 2006). He has vast experience in teaching & research. Being Researcher published more than 40 research articles on different social & behavioral issues in National & International quality indexes/ impact factor journals that are recognized by Higher Education of Pakistan and at postgraduate level supervised more than one hundred research students and completed their research. He is also coauthor of book “Introduction to Sociology”. He is also external examiner of research / paper setter of many universities for postgraduate level as well as examination supervisor of Punjab Public Service Commission, Pakistan. Being Director ORIC made collaboration with sister universities and industries to develop academia to academia & Academia-Industry linkages for better knowledge and research sharing and signed more than 20 MOUs and strengthen the external linkages, developed a Business Incubation Center (Regional Plan9) & Women Development Center at Ghazi University with collaboration of Govt. of Punjab, Pakistan. He is Member selection/ recommendation Committee of Ghazi University to recommend BS-1 to BS-16 candidates to the Vice Chancellor for Approval of Appointment, Terms, and conditions of Services); Member Board of Faculty for a period of three years for faculty of Arts; Member Consultative Committee; Member Convocation Organizing Committee for 1st & 2nd Convocation of the Ghazi University; Convener University Disciplinary Committee ; Convener University Disciplinary Advisory Committee; Member Compliance Implementation Plan Committee (CIPC) to prepare Compliance Implementation Plan (CIP) in coordination with respective offices; Nominated as Focal Person to collaborate with QEC regarding IPE Review visit at Ghazi University; Member Affiliation Committee (to affiliate & Disaffiliate Govt. & Private Educational Institutes / colleges with Ghazi University); Member University Grievance Redress Committee; Member University Monitoring, Evaluation and Learning Committee; Member University Scrutiny Committee for Administration Posts; Member Standing Committee for vetting of non-schedule items with the term of Reference (TORs); Member Surveillance committee of Ghazi University; Member Online Quality Assurance (OQA) Task Force of Ghazi University; Members University General Purchase Committee; Member University Semester Rules Committee; Member Inquire committee about matter/ issue regarding allegations on social & print media against employees, Member University Prospectus Committee to prepare prospectus and Member University Admission Committee year 2019, 2020 & 2021; Focal Person Kamyab Jawan Innovation League; Member Plagiarism Standing Committee (PSC) Ghazi University; Member Self Institutional Performance Evaluation (IPE) Committee and Focal person to conduct quantitative research on Beggary in Punjab with collaboration of Department of Social Welfare, UCDP, D. G. Khan (December 2016 to To-date).

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