



DOES POLITICAL CONNECTION AND CONSERVATISM INFLUENCE EARNINGS MANAGEMENT?

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ABSTRACT: *The purpose of this research is to determine the influence of the political connection and conservatism toward earnings management.*

The sample in this research are manufacturing companies that listed on Indonesia Stock Exchange (IDX) which consist of 126 observation which come from 63 companies for the period of 2016-2017. Multiple linear regression is used to analyze the hypothesis in this research.

The results show that political connection has no significant effect towards earnings management, meanwhile conservatism has significant effect towards earnings management.

Keywords: *Earnings Management, Political Connection, Conservatism*

INTRODUCTION

Earnings management is a common issue in accounting research. The most popular scandal of earnings management are Enron and WorldCom scandals. Politically-connected firm have high probability of doing earnings management in consideration for having lower detection risk and added by several benefit that offered by political connection itself (Braam et al., 2015). However, activity such as earnings management is short-termism managerial activity. This kind of activity bring problem to the neutrality of financial report on the long-term. Thus, accounting conservatism should able to constrain earnings management activity, as the concept accounting conservatism itself is “anticipate no profit but anticipate all losses” which reflect on the caution of manager in preparing financial report. Conservatism will make manager to do earnings management more cautiously to anticipate the possibility of future losses.

Earnings management refers to the use of accounting techniques to produce financial reports that different from the real condition of company. Earnings management will induce the overestimation or underestimation of income in financial report. On Indonesia itself, there is already lot of research about earnings management. One of them are Siregar and Utama (2008), about earnings management in various type of firm such as institutional ownership and family ownership firm.

According to Kim and Zhang (2015), there are several advantages for having political connection such as lower detection risk because of political protection and early access for future regulation so they can have better anticipation than firms that did not have political connection. Usually, a firm indicated to have political connection if one of the board manager or major shareholders are political figure or someone who has close connection to them.

According to Fisman (2001), Indonesian firms with political connection have overreliance on the benefit that they got from political connection. In other study, Leuz and Oberholzer-Gee (2006) show that politically connected firms has to face financing difficulties when their connections loss or fall from power.

Braam et al. (2015) in his research on the relation between political connection and earnings management, suggest that conservatism may have an influence toward earnings management. The most basic concept of conservatism can be summarized as “anticipate no profit, but anticipate all losses” which come from Bliss (1924). In other words, it is about the good news or profits should be higher than bad news or losses (Basu, 1997). The accounting conservatism is mechanism that determine and verify the higher level profit than losses or higher level good news than bad news. This activity would defer the earnings recognition and net asset understatement.

The common application of accounting conservatism is to deal with income, liabilities, and assets. Specifically, some of the reflection about the degree of conservatism can be analyze by analyzing the allocation cost for research and development. To reduce capitalized assets, research and development should be expensed in the reporting periods (Basu, 1997; Givoly et al., 2007).

LITERATURE REVIEW AND HYPOTHESIS

Earnings Management

According to Blom (2009), financial reports are used to inform the stakeholders about the firm’s performance. Ideally, financial report helps to distinguish between the good performing firms with the poor performing one and help stakeholder to facilitate the efficient of resources allocation and stewardship (Healy and Wahlen, 1999). By improving financial report effectiveness, the manager will have a way to communicate with potential creditor and investor. Thus, manager have an opportunity to make decision or judgment in financial reporting (Xiong, 2006). This decision or judgment are required by manager to decide the accounting method for same transaction. Manager also required to have this judgment to forming statement for future obligation such as bad debt losses or asset impairment.

Earnings management is misstatement on financial statement which is intentional by the manager that resulting to lead the number that would be different when there is no manipulation on it (Mohanram, 2003). This definition is the most common interpretation on earnings management in relevant literature. Usually, earnings management researcher use the two most used definition which are :

- Schipper (1989): “Manager intervention of financial reporting with the purpose to obtain some specific gain.” (emphasis added).
- Healy and Wahlen (1999): “The occurrence of earnings management caused by the alteration of financial report with the purpose to mislead some of stakeholder, the mislead is either by the understatement or overstatement the economic performance of company” (emphasis added).

Based on these definitions, the definition of earnings management can be concluded as manager intervention in financial reporting with the purpose to mislead specific parties to obtain some specific gain for themselves by understate or overstate the economic performance of the company.

Political Connection

Ang et al. (2013) defines politically connected firm as a firm that have political figure in the decision maker position on the firm. The theoretical literature of political connection show that the firm gain a benefit by having political connection. the benefit that they got from the connections is better understanding on public policy process, obtaining access or direct channel to political figure such as bureaucrats or politician that have authority to make decision that may influence the economic performance (Hillman, 2005). The physical or documented advantages of having political connection include preferential access to financing through government bank, higher likelihood of government bailout, and preferential treatment to contract with government (Agrawal and Knoeber, 2001; Khwaja and Mian, 2005; Karpoff et al., 1999; Blau et al., 2013; Goldman et al., 2011; Backman, 2001; Johnson and Mitton, 2003; Cull and Xu, 2005; ; Claessens et al., 2008; Faccio et al., 2006; Yeh et al., 2013).

Goldman et al. (2009) conduct a research in United States that show 31 percent from 500 firms with politically connected board of director that there is positive effect when they announce that they have politically connected director nominated on the board of director. Cooper et al. (2010) find that in the United States that firm with political connection have greater future prosperity as they contribute in political contribution. In another research, Kim et al. (2012) show that in the United States, there is higher stock return for the firm that located geographically closer to high political power region. Meanwhile, Amore and Bennedsen (2013) show that firm that have connection to local politician have higher value in Denmark. Niessen and Ruenzi (2009) finds that firm with political connection have low valuation ratio but have higher accounting performance and stock return.

The measurement of political connection is taken from Faccio (2006) which is creating a dummy variable CONNECT. The firms that have political connection in that particular year will be valued by 1, while firm that have no political connection in the particular year will be valued by 0. Firms defined to be politically connected if at least one of its major shareholders (anyone controlling at least 10% of voting share) or top management is:

- (1) Member of Legislative
- (2) Minister or high-ranking official of ministry
- (3) Governor
- (4) General of Army or Police
- (5) High ranking official of political party
- (6) Close relative of point (1) until (5)

Conservatism

Accounting conservatism is the asymmetric verification threshold for gains versus losses: the verification threshold for gains is higher (Basu, 1997). It is also referred to as prudence because it tends toward prudent reactions to the future. Accounting conservative have long history, it can be traced that the application already running at least from 500 years ago. The most basic concept of conservatism can be summarized as “anticipate no profit, but anticipate all losses” which come from Bliss (1924). In other words, it is about the good news or profits should be higher than bad news or losses (Basu, 1997). The asymmetric treatment in good news and bad news can result in the undervaluation of net asset in current year, but it will result in overvaluation of net asset in the next year or vice versa. Organizational problem such as moral hazard and agency problem can lead the manager to do manipulation behavior as they will see it as opportunities to introduce noise and bias to financial report. If these opportunistic behavior not constrained, it will be hard to disclose accounting information neutrally as accounting information is required to follow regulation and standard. Because of this, accounting conservative needed to constrain the negative effect that resulted by managerial short-termism¹. The existence of over investment in assets used for operations in relation to the volume of sales obtained with these assets.

The accounting conservatism is mechanism that determine and verify the higher level profit than losses or higher level good news than bad news. This activity would defer the earnings recognition and net asset understatement. These kind of activities result in the constrain of management opportunistic behavior which will increase the value of the company in the eyes of shareholder and stakeholder. Specifically, these activities will benefit the shareholder as it will decrease the litigation cost. In the litigation period, management tend to do opportunistic behavior such as overstate the net asset (Watts, 2003). The common application of accounting conservatism is to deal with income, liabilities, and assets. Specifically, some of the reflection about the degree of conservatism can be analyze by analyzing the allocation cost for research and development. To reduce capitalized assets, research and development should be expensed in the reporting periods. By accelerating the depreciation of non-current assets, the allocation time for research and development will become shorter and also recognize the specific cost earlier. With these activities, the net assets and net income will become undervalued (Givoly et al., 2007; Basu, 1997).

Research Framework

Our research aims to investigate the relationship of political connection and conservatism toward earnings management that represent at the following figure.

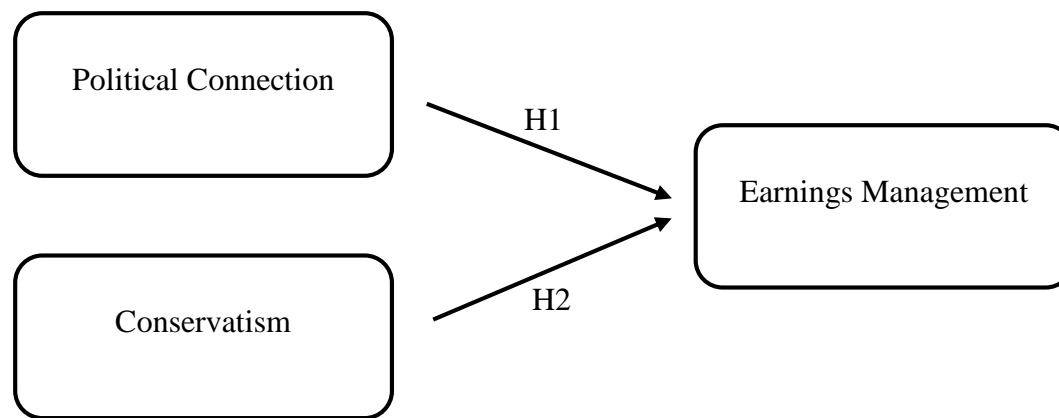


Figure 1. Research Framework

Hypothesis Development

Politically connected firms are likely to use the benefits that they got from the political connection to use on earnings management strategy (Chaney *et al.*, 2011; Watts & Zimmerman, 1990; Faccio, Masulis, & McConnell, 2006; Faccio, 2006). The benefits that they got from the connection itself are privilege access to several information and low risk of detection. However, when the activities are detected, it will not only damage the reputation of the firms and its manager but also damage the social image and reputation of political party or politician that connected to the firms (Hay & Shleifer, 1998 ; Burton, Wilks, & Zimbelman, 2011).

Previous research on political connections indicates that politically-connected firms are under less pressure to be transparent. For example, Houston *et al.* (2014) stated that when politically-connected firms want to request for loan from financial institution. The financial institution lent them more easily as they less concerned about the earning quality of politically-connected firms itself. In another literatures, it shows that politically-connected firms have several benefit and preferential treatment to various form of resources, like preferential treatment by government-owned raw material producers or banks, more lighter tax and more relaxed regulatory oversight (i.e. Chen *et al.* 2011; Faccio 2006; Fisman 2001). In the condition with less pressure of transparency, it is expected that politically-connected firm engage in more earnings manipulation activity as they are not to be specifically concerned about maintaining their earnings quality.

H1: Political connection has impact toward earnings management

Donovan *et al.* (2015) state that the creditor of firm with high degree of conservatism have higher recovery rates, it is because firm with higher degree of conservatism have higher assets productivity. Lee, Li and Sami (2015) find that the high degree of conservatism resulted in reducing the audit fees. While Kim *et al.* (2013) and Goh and Li (2011) found that conservatism improve the quality of internal control and mitigate negative reaction to the fluctuation of seasoned equity offering announcement.

Conservatism likely be able constrain earnings management, as the conservatism concept itself which is “anticipate no profits but anticipate all losses”. Which mean that firm will try to anticipate the losses that will occurred when doing earnings management. Previous research on conservatism shown that conservatism has negative relationship toward earnings management. Lara *et al.* (2009) and Lin *et al.* (2014) found a negative relationship between conservatism and earnings management, the more conservatism firm have less chance of being involved in earnings manipulation, even when the method of estimating earnings management used different approach. They stated that when firm adopting a high degree of conservatism on financial statements, the manager will consider certain type of risk such as operating risk that occurred if they engage in earnings manipulation which resulted increase in the reliability of financial statement and lowering likelihood of earnings management activity.

H2: Conservatism has impact toward earnings management

RESEARCH METHODOLOGY

Sample Selection

This research use data from manufacturing companies that listed in Indonesia Stock Exchange (BEI) in 2016-2017. The data used from year 2016 because researcher assume that year should be the time where the political situation should be stable after the presidential election in 2014. The stability of political situation is required because of one of the variables in this research which is political connection. Data that can be acquired only up to 2017 as it is the latest data available. The sample in this research is decided by using purposive sampling approach based on the criteria that have been set, as follows:

1. Manufacturing company that listed in Indonesian Stock Exchange (IDX) from 2016-2017.
2. Manufacturing companies that use IDR as the currency in their financial statements to avoid bias.
3. Manufacturing companies that have all data that needed by the researcher such as director's profile and financial highlight in their annual report.

Research Model

This study used descriptive statistical analysis, model selection test, classical assumption test, and multiple regression analysis. Multiple linear regression analysis technique is used in order to analyze the effect of political connection and conservatism toward earnings management. Multiple linear regression analysis was used for research with more than one variable X. This Multiple Linear Regression Test is used to specify the influence of political connection (PC) and conservatism (CONSERV) toward the earnings management (EM) in manufacturing companies that being listed in Indonesia Stock Exchange. The data analysis tool used is Eviews version 10.0, Eviews is a computer software that used to analyze a data with statistical analysis. The formula of multiple regression:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where:

Y	= Earnings camgement
β_0	= intercept/constant (value of Y when X_1 - $X_5 = 0$)
$\beta_1 - \beta_2$	= partial regression coefficients
X_1	= Political connection
X_2	= conservatism
ε	= random error

Variables Measurement

Earnings Management

This research used earnings management as dependent variable. Schipper (1989) defines that earnings management is as manager intervention of financial reporting with the purpose to obtain some specific gain. This research measures the earnings management by discretionary accrual. The step of calculating discretionary accrual follow Jones (1990) and Dechow *et al.* (1995):

- (1) Determining the total accruals

$$TA = NI - CFO$$

- (2) Determining the value of the parameter α_1 , α_2 , α_3 using the formula

$$\frac{TA_{it}}{A_{it-1}} = \alpha_1 \left(\frac{1}{A_{it-1}} \right) + \alpha_2 \left(\frac{\Delta REV_{it}}{A_{it-1}} \right) + \alpha_3 \left(\frac{PPE}{A_{it-1}} \right) + \varepsilon$$

- (3) Calculate the value of non-discretionary accrual (NDA) with the formula:

$$NDA_{it} = \alpha_1 \left(\frac{1}{A_{it-1}} \right) + \alpha_2 \left(\frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} \right) + \alpha_3 \left(\frac{PPE}{A_{it-1}} \right) + \varepsilon$$

Parameter values α_1 , α_2 , α_3 is taken from regression result in step (2)

- (4) Determining indicator value of earnings management which is discretionary accrual (DA) using the formula:

$$DA_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it}$$

Where:

TA = Total Accruals

NDA_{it} = Non-discretionary Accruals

DA = Discretionary Accruals

NI = Net Income

CFO = Cash Flow from Operation

A_{t-1} = Assets of Previous Year

REV_t = Revenue

Δ REV_{it} = REV_t – REV_{t-1}

Δ REC_{it} = REC_t – REC_{t-1}

PPE_{it} = Property Plant Equipment (fixed asset) in year t

Political Connection

Political connection used in this research as independent variable. Ang *et al.* (2013) defines politically connected firm as a firm that have political figure in the decision maker position on the firm. The measurement of political connection is taken from Faccio (2006) which is creating a dummy variable CONNECT. The firms that have political connection in that particular year will be valued by 1, while firm that have no political connection in the particular year will be valued by 0. Firms defined to be politically connected if at least one of its major shareholders (anyone controlling at least 10% of voting share) or top management is:

- (1) Member of Legislative
- (2) Minister or high-ranking official of ministry
- (3) Governor
- (4) General of Army or Police
- (5) High ranking official of political party
- (6) Close relative of point (1) until (5)

Conservatism

This research used conservatism as independent variable. Basu (1997) defines accounting conservatism as the asymmetric verification threshold for gains versus losses: the verification threshold for gains is higher. The conservatism that will be used is conditional conservatism. Beaver and Ryan (2005) indicate that conditional conservatism is related to asymmetric timeliness of earnings. In measuring conservatism, this research use Khan and Watts (2009) model. This measure is also referred as C-Score measure which the measurement has roots into Basu (1997) model.

$$Earn_{it} = \beta_1 + \beta_2 D_{it} + \beta_3 R_{it} + \beta_4 D_{it} R_{it} + \varepsilon_{it}$$

Where:

i = Represent firm

t = Represent year

R = Represent returns

D = Dummy variable (R<0 = 1 or R>0 = 0)

In this model β_3 is used as indicator value for good news while β_4 is used to measure the conservatism (bad news over good news), and the indicator of bad news is given by $\beta_3 + \beta_4$.

To estimate the good news timeliness and bad news timeliness, this research used Khan and Watts (2009) model that indicate that good news and bad news by the linear function of firm year characteristic. They refer the good news as G-score and bad news as C-score.

$$G - Score = \beta_3 = \mu_{1t} + \mu_{2t}Size_{it} + \mu_{3t}MTB_{it} + \mu_{4t}Lev_{it}$$

$$C - Score = \beta_4 = \lambda_{1t} + \lambda_{2t}Size_{it} + \lambda_{3t}MTB_{it} + \lambda_{4t}Lev_{it}$$

Where:

SIZE = Total Assets

MTB = Market value of equity / book value

Lev = Total Debt / Total Assets

For the estimation of C-Score and G-Score the annual cross-sectional regression model is:

$$Earn_{it} = \beta_1 + \beta_2 D_{it} + R_{it}(\mu_{1t} + \mu_{2t}Size_{it} + \mu_{3t}MTB_{it} + \mu_{4t}Lev_{it}) + D_{it}R_{it}(\lambda_{1t} + \lambda_{2t}Size_{it} + \lambda_{3t}MTB_{it} + \lambda_{4t}Lev_{it}) + (\gamma_{1t}Size_{it} + \gamma_{2t}MTB_{it} + \gamma_{3t}Lev_{it} + \gamma_{4t}Size_{it} + \gamma_{5t}MTB_{it} + \gamma_{6t}Lev_{it}) + \varepsilon_{it}$$

RESULT AND DISCUSSION

Descriptive statistic is measured on research variables consisting of earnings management, political connection and conservatism. It shows the minimum values, mean values, median values, and standard deviations of each variable. Table below shows the summary of descriptive statistic of each variables for this research, by using Eviews

Table 1.
Descriptive Statistic

	Earnings Management	Political Connection	Conservatism
Mean	-0.052460	0.531746	-0.000819
Median	-0.045483	1.000000	-0.000277
Maximum	0.193346	1.000000	0.002903
Minimum	-0.342654	0.000000	-0.037161
Std. Dev.	0.085341	0.500983	0.003869
Observations	126	126	126

According to the Table 1, the information of both variables are elaborated as follows:

1. Earnings management is a dependent variable, from 126 observational data produces a minimum value of earnings management is -0.342 and a maximum value of earnings management is 0.193. Thus, the earnings management of this sample of research ranged from -0.342 to 0.193. The mean (average) and median on earnings management is -0.052 and -0.045 at the standard deviation of 0.085. The mean value is smaller than the standard deviation of $-0.052 < 0.085$.
2. Political connection is an independent variable, from 126 observational data produces a minimum value of political connection is 0 and a maximum value of political connection is 1. Thus, the political

connection of this sample of research ranged from 0 to 1. The mean (average) and median on political connection is 0.531 and 1 at the standard deviation of 0.50. The mean value is higher than the standard deviation of $0.531 > 0.50$.

3. Conservatism is an independent variable, from 126 observational data produces a minimum value of conservatism is -0.0371 and a maximum value of conservatism is 0.0029. Thus, the conservatism of this sample of research ranged from -0.0371 to 0.0029. The mean (average) and median on conservatism is -0.0008 and -0.0002 at the standard deviation of 0.003. The mean value is smaller than the standard deviation of $-0.0008 < 0.003$.

Model Selection Test

Chow Test

The purpose of Chow test is to find the correct model of regression, the model consisted of fixed effect, common effect, and random effect. Chow test is a test to determine the right cross section model between common effect and fixed effect. If the result of cross-section chi square equal to <0.05 then the correct model to choose are fixed effect.

Table 2.
Chow Test

Redundant Fixed Effects Tests			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	3.208389	(62,61)	0.0000
Cross-section Chi-square	182.637060	62	0.0000

The result of Chow test show that the probability cross-section chi-square are 0.0000 which lower than 0.05. Based on this test, the cross-section model that should be used is fixed effect.

Hausman Test

The purpose of Hausman test is to find the correct model of regression, the model consisted of fixed effect, common effect, and random effect. Hausman test is a test to determine the right cross section model between common effect and fixed effect. If the probability of cross-section random equal to <0.05 then the correct model to choose are random effect.

Table 3.
Hausman Test

Correlated Random Effects - Hausman Test			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	2.198836	2	0.3331

The result of Housman test shows that the probability cross-section random are 0.3331 which higher than 0.05. Based on this test, the cross-section model that should be used is fixed effect.

Classical Assumption Test

Classical assumption test will help to verify whether the model has fulfilled BLUE parameter or not. The model has to pass the normality, heteroscedasticity, and multicollinearity tests in order to qualify in using multiple regression analysis and obtain valid result.

Normality Test

The aim of normality test is to find out whether the residual distribution on the data is normal or not. we used Jarque-Bera test to test the normality of distribution on this research.

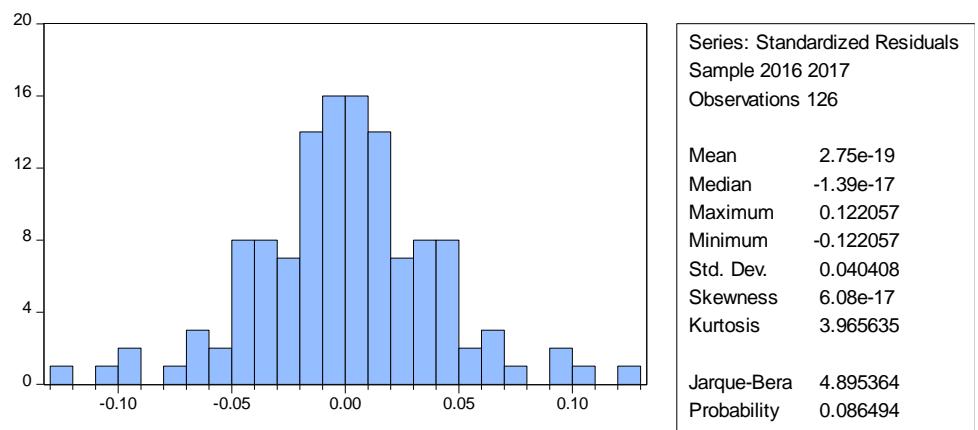


Figure 2.

Jarque-Bera Normality Test Graphic

Figure 4.1 show that the value of Jarque-Bera is 4.89 and the probability of 0.086 which is higher than 0.05. This mean that this research pass on Jarque-Bera test and the residual distribution on this research can be considered as normal.

Heteroscedasticity Test

The aim of Heteroscedasticity is to know that in the regression there is residual variance that is not constant that occur in one observation to another observation. The test on heteroscedasticity on this research uses Glejser test. Glejser test regress the variables on the research to residual absolute. This test only can be executed on Fixed Effect Model

Table 4.
Table of Result on Glejser Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Political Connection	0.023258	0.018611	1.249696	0.2162
Conservatism	-0.509798	1.418408	-0.359416	0.7205
C	0.047166	0.010737	4.392724	0.0000

The dependent variable of the table Glejser Test Model is RESABS which is the residual absolute on regression model of this research. The prob. column shows the probability value of each independent variables. If the probability value <0.05, then there is heteroscedasticity problem. If the probability value >0.05, then there is no heteroscedasticity problem on the independent variables. Based on Table 4. it is shown that the variable political connection has probability value of 0.2162 and variable conservatism has probability value of 0.7265. The independent variables have probability value >0.05 which mean that there is no heteroscedasticity problem on every independent variable.

Multicollinearity Test

The aim of multicollinearity test is to test whether there is correlation between variables in regression model (Ghozali, 2013). In this research the test on multicollinearity is used by analyzing the correlation matrix between

independent variables. The correlation between independent variables should be less than 0.80. if it is more than 0.80, there is indication of multicollinearity.

Table 5.

Correlation Matrix between Each of Independent Variables

	Political Connection	Conservatism
Political Connection	1.000000	-0.080343
Conservatism	-0.080343	1.000000

The Tables 5. shows the correlation between each of independent variables of this research. The coefficient correlation between variable political connection and conservatism show value of -0.080343. It can be concluded that there is no multicollinearity problem between each of independent variables on this research as the coefficient correlation value of each independent variable <0.80.

Multiple Regression Analysis

This research uses multiple linear regression to analyze the effect of independent variables to dependent variable. The significant degree used is 0.05, which mean that if the probability amounted <0.05, it is indicated that the independent variable partially affected the dependent variable. If the probability is >0.05, it is indicated that the independent variables did not have significant effect on dependent variables.

Table 6.

Multiple Regression Analysis Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Political Connection	0.036664	0.024684	1.485336	0.1426
Conservatism	-5.806208	1.881257	-3.086345	0.0030
C	-0.076712	0.014241	-5.386656	0.0000

Table 6. shows that the probability of independent variable political connection (PC) to dependent variable earnings management is 0.1426, which is higher than 0.05. This result show that the variable political connection have no significant effect to variable earnings management, it means that *H1: Political connection has significant impact toward earnings management* is not supported.

Another independent variable which is conservatism has the probability value of 0.0030 to dependent variable earnings management. This result show that the variable conservatism did have significant effect to variable earnings management, it means that *H2: Conservatism has significant impact toward earnings management* is supported.

H₁ Analysis

The result shows that there is no significant impact of political connection toward earnings management. It is shown by the probability of 0.1426 which is higher than 0.05. This result is not consistent with the previous research that conduct by Braam et al. (2015). Related to previous research, many researchers assume that the reason why political connection related to earnings management caused by several benefit that provided by political connection itself. The benefit such as pressure to be less transparent, better access to various form of resources such as preferential treatment from government owned bank or raw material producers, lighter taxation and regulatory oversight.

This result did not go as the researcher expected. With several benefit that offered by political connection it is expected that it will affect earnings management activity. However, political connection is not stable factor to

consider in earnings management decision. By the slightest mistake, politician can easily lose the power that they hold. Politician also have sensitive identity as they are public figure in society. Once they involved in scandal, they will lose trust that placed on them and even lose the power that they wield. One of most popular case in Indonesia is the scandal of ex-governor of DKI Jakarta, Basuki Tjahya Purnama which got stripped from his position and jailed because religion related issue. Manager cannot expect to be always backed by politician when they do earnings management activity. Thus, political connection did not have significant impact on earnings management activity.

H₂ Analysis

The result also shows that there is significant impact of conservatism toward earnings management. It is shown that the probability 0.030 which is less than 0.05. This result support the previous research which is Lara et al. (2009) and Lin et al. (2014). Previous research shows that there is negative relationship of conservatism toward earnings management, that mean the higher degree of conservatism in firm the lower chance manager to do earnings management activity.

This result did go as researcher expected. With the basic concept of conservatism which is “anticipate no profit but expect all the losses”, it is expected that the conservatism has effect toward earnings management activity. As earnings management is management short-termism activity, it will affect the firm value in the long-term period. Short-termism activity will boost the firm performance for the short time. However, it will have a bad effect for the firm value in the long term. As the concept of conservatism to anticipate all losses, it will be obvious that the conservatism has significant impact toward earnings management activity.

CONCLUSIONS

The objective of this research is to extend the previous research by Braam et al. about the influence of political connection toward earnings management. The previous research suggests to include conservatism on the research. Thus, this research examines the influence of political connection toward earnings management and add the conservatism as another independent variable on this research. According to the sample that used in this research which is gotten from non-financial company that listed in Indonesia Stock Exchange (IDX) for period 2016-2017, this research can be concluded as follows:

1. Political connection has no effect or influence on earnings management activity. It is proven in this research with significant value amounted 0.1426 which reflect more than 0.05. Political connection is not stable factor on firm, as the politician have sensitive identity that easily got into a scandal. When they involved in scandal, they will easily lose the trust or lose their political power. The manager cannot expect to always be backed by the politician. Thus, political connection did not have significant impact on earnings management.
2. Conservatism has significant effect or influence on earnings management activity. It is proven in this research with significant value of 0.030 toward earnings management. The significant value is less than 0.05. Conservatism anticipate the lose that occurred on the firm. Meanwhile, earnings management is short-termism activity that will have bad effect on the long-term value. Thus, conservatism have significant effect on earnings management activity.

Limitation

The limitations in this research that can be taken as future research for future researcher and those who are involved, as follows:

1. The sample on this research is manufacturing company in Indonesia which mean that the result of this research only represents one type of company and only applied in Indonesia.
2. This research only takes political connection and conservatism as independent variable.

This research can give recommendation or suggestion to future researcher for expanding this research by:

1. Doing international scale of research and choose non-financial company as a sample so that the future result can represent the general type of companies (cannot be generalized with financial company to avoid bias) and applicable not only to one country.
2. Adding other variables that can be used to influence earnings management such as audit committee, institutional investor, and others

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