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Related Party Transactions and Accrual Earnings Management: The Role of Organizational Capital as a Moderator

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Abstract: This study aims to test and analyze the effect of related party transactions on accrual earnings management which is moderated by organizational capital. This study uses manufacturing companies listed on the Indonesian Stock Exchange (BEI) in 2018-2021 using a purposive sampling method. A panel data approach was used to test the hypotheses of this study. The results of this study found that related party transactions had a positive and significant effect on accrual earnings management, while organizational capital cannot strengthen the effect of related party transactions on accrual earnings management. This study has important implications for the development of agency theory. This study shows that agency theory has an important role in creating information asymmetry between shareholders and company management. Information asymmetry triggers managers' actions to manage earnings on an accrual basis through the use of related party transactions. The aim is to improve company management performance, so that managers' motivation to obtain bonuses can be achieved.

Keyword: Related Party Transactions, Organizational Capital, Accrual Earnings Management.

INTRODUCTION

The issue of earnings management has remained an important issue in recent years. This condition is caused because earnings as a measure of manager performance encourages managers to carry out earnings management. Schipper (1989) describes earnings management as the involvement of managers in the external financial reporting process deliberately to fulfill personal interests. Khuong et al. (2023) describe that managers can use loopholes in accounting standards to falsely communicate company performance to stakeholders. This condition shows that managers use accrual earnings management to exacerbate the difficulties of stakeholders who rely on company financial reports to evaluate company performance. Scott & O'Brein (1997) and Penman (2013) explain that accrual earnings management is related to certain actions of managers to choose accounting policies that have an impact on company earnings.

The issue of managers using accrual earnings management has been proven by the case of PT. Tiga Pilar Sejahtera Food, Tbk in 2017 which will be tried in 2021. The company case is related to the management of six affiliated distributor companies which are reported to be third parties and the inflated receivables from these six companies with a value of up to IDR 1,4 trillion, as well as the alleged flow of funds from company to management worth IDR 1,78 trillion. The alleged flow of funds was through several schemes such as disbursement of funds from several banks via time deposits, bank transfers, and others. This phenomenon occurs because companies do not make adequate disclosures, thereby potentially violating capital market regulations (Nasionalkontan, 2021).

Case of earnings management carried out by PT. Tiga Pilar Sejahtera Food, Tbk tends to accrual earnings management through related party transaction receivables. Maigoshi et al. (2016) describe that related party transactions are used as a means of earnings management. Habib et al. (2017) explained that related party transactions are one way to increase the earnings of managers and majority shareholders because regulations governing shareholder protection are still weak. Kharista et al. (2020) explain that related party transactions can reduce the level of prosperity of minority shareholders. Kuan et al. (2010) explain that the purpose of carrying out related party transactions to improve earnings management is to fulfill the manager's personal interests.

Several previous studies describe that the impact of related party transactions on earnings management and company performance is still a matter of debate (Tarighi et al., 2022; Gavana et al., 2022; Dou et al., 2022; Bian et al., 2022). Jalan et al. (2020) describe that the existence of related party transactions can reduce accrual earnings management. Alhadab et al. (2020) and Al-Dhamari et al. (2018) describe that the phenomenon of misuse of related party transactions tends to be higher in developing countries due to weak governance systems, high agency costs and inadequate implementation of international financial reporting standards which causes limited disclosure and low transparency in financial reporting. This condition shows that the opportunity for related party transactions to occur is higher in developing countries.

Indonesia as one of the developing countries shows that it is important to research the importance of studying misuse of related party transactions which can improve accrual earnings management. Nguyen & Tan (2020) describe that poor governance systems in developing countries allow high levels of related party transactions. Khuong et al. (2023) describe that to date only a few previous studies have examined the impact of related party transactions on accrual earnings management, namely the study by Marchini et al. (2018), El-Helaly et al. (2018), Alhadab et al. (2020); and Gavana et al. (2022). However, the findings of several studies are still inconsistent. Therefore, the importance of this study is to fill the gaps in previous and inconsistent studies.

Managers using related party transactions to improve accrual earnings management can be supported through organizational capital. Organizational capital is conceptualized as a collection of knowledge, capabilities, culture, design and business processes that enable a company to achieve efficient production and stable business operation activities aimed at increasing company productivity and performance (Hasan & Cheung, 2018; Li et al., 2018). Therefore, a company has a specific advantage when the company has organizational capital. Boubaker et al. (2022) describe that companies that have organizational capital can increase the company's cash flow. The higher organizational capital indicates that the manager's compensation will be higher (Eisfeldt & Papanikolaou, 2013; Lev et al., 2009). Atkeson & Kehoe (2005) describe that companies that have more than 40% cash flow in intangible assets indicate high organizational capital of the company. Eisfeldt & Papanikolaou (2014) describe that organizational capital is a company's investment in resources.

Organizational capital as company-specific knowledge that is codified and integrated can help companies understand complex accounting standards, so that companies can exploit gaps in accounting standards. Gallemore & Labro (2015) explain that tax planning, compliance, and implementation are expensive endeavors, require a long time, require intensive knowledge, and require considerable economic resources. Thus, companies that have high organizational capital tend to be better able to carry out accrual earnings management. Based on this description, this study aims to test and analyze the effect of related party transactions on accrual earnings management which is moderated by organizational capital.

Agency Theory

Agency theory explains the existence of an agency relationship as a contract between the principal and the agent. The principal or shareholder delegates decision-making authority to the agent or manager and there are differences in interests between the principal and agent which can give rise to conflicts of interest and agency costs (Jensen & Meckling, 1976). Amir et al. (2022) describes that the problem that arises in agency relationships is that managers do not always act to fulfill the interests of shareholders, resulting in the loss of shareholder wealth. Furthermore, Amir et al. (2022) describe that shareholders prefer to maximize their wealth in the long term by carrying out long-term projects that can generate high earnings. Instead, managers focus more on short-term earnings to maximize personal earnings. Huu Nguyen et al. (2020) describes that to reduce the existence of corporate conflicts between shareholders and managers, an effective monitoring and control system is needed.

Biggerstaff et al. (2019) describe that one way to reduce agency conflicts between shareholders and managers is through well-designed compensation. On the other hand, if the compensation scheme is not implemented well it will have a negative impact on decreasing overall economic performance (Sanbet, 2011). Earnings management carried out through related party transactions can increase agency problems, thereby indicating an imbalance in business transaction information. In other words, there has been a biased business transaction that has an impact on business decision making.

Related Party Transaction and Accrual Earnings Management

Jensen & Meckling (1976) describe that there is an agency correlation between the principal and the agent. Principals are often referred to as shareholders, while agents are often referred to as managers. The agent is given authority by the principal to manage the company, so the agent is expected to act to fulfill the principal's interests. However, agents do not always act to fulfill the principal's interests. This condition shows that there is a conflict of interest between the principal and the agent.

Conflicts of interest not only occur between principals and agents, but also between majority and minority shareholders. Nurim et al. (2017) and Panda & Leepsa (2017) describe that agency conflicts between majority and minority shareholders are supported by concentrated ownership in the company, such as majority shareholders are supported by the board of directors, so that they can take advantage of private information and make decisions that benefit their interests. The implication is that minority shareholders experience losses.

Previous studies found that related party transactions are one potential means for managers to take over shareholder funds (Ryngaert & Thomas, 2012). Related party transactions provide a direct opportunity for related parties to take over the prosperity of minority shareholders to fulfill the interests of majority shareholders. This condition shows that related party transactions are used to fulfill the interests of certain parties.

El-Helaly et al. (2018) describe that if related party transactions can be a separate method for managing reported earnings, then it is possible that companies use related party transactions to manage accrual and real earnings or a combination of both earning management. Zang (2012) found that managers use accrual and real earnings management as a substitute to fulfill their interests. To manage earnings both in accrual and real terms, managers use related party transactions.

Jian & Wong (2010) explain that related party transactions can be a separate method for managing reported earnings and are not completely accrual based, but can also be cash based. Jiang et al. (2010) and Tambunan et al. (2017) explain that majority shareholders have the potential to take over the wealth of minority shareholders through receivables from related party transactions. This condition is caused because related party receivables can negatively affect the company's productive assets and company value.

Hendratama & Barokah (2020) explain that high receivables from related party transactions are considered to reduce company value. This condition shows that related party transaction receivables are used as an opportunistic action by managers in managing their interests, thereby triggering the emergence of accrual and real earnings management behavior. This description shows that this study has the following hypothesis.

H_1: Related party transactions has a positive effect on accrual earnings management

Related Party Transaction, Organizational Capital, and Accrual Earnings Management

Elkelish (2017) explains that conflicts of interest create agency problems and give rise to agency costs because management takes over company resources to fulfill personal interests using related party transaction facilities. Earnings management carried out through related party transactions can increase agency problems, thereby indicating an imbalance in business transaction information. In other words, there has been a biased business transaction that has an impact on business decision making.

Specifically, one of the managers' strategies for carrying out earnings management through related party transactions can be supported by organizational capital. Organizational capital is conceptualized as a collection of knowledge, capabilities, culture, design and business processes that enable a company to achieve efficient production and stable business operation activities aimed at increasing company productivity and performance (Hasan & Cheung, 2018; Li et al., 2018). This means that organizational capital shows the specific advantages that a company has to remain sustainable. Boubaker et al. (2022) describe that companies that have organizational capital can increase the company's cash flow.

The higher organizational capital indicates that the manager's compensation will be higher (Eisfeldt & Papanikolaou, 2013; Lev et al., 2009). Atkeson & Kehoe (2005) describe that companies that have more than 40% cash flow in intangible assets indicate high organizational capital of the company. Eisfeldt & Papanikolaou (2014) describe that organizational capital is a company's investment in resources. This description shows that the hypothesis of this study is as follows.

H_2: Organizational capital strengthens the effect of related party transactions on accrual earnings management

METHOD

The population of this study is manufacturing companies listed on the Indonesia Stock Exchange during 2018-2021. However, this study uses 2019-2021 to test the hypothesis, while 2018 is used as the base year to measure accrual earnings management and organizational capital. The method for determining the sample for this study uses purposive sampling with the criteria (1) manufacturing companies are registered during 2018-2021, (2) companies have related party transaction data during 2019-2021, (3) the number of companies in one sub-sector is at least 8 to measure earnings management variable. This condition is in accordance with that suggested by Cohen et al. (2010), and (4) reporting uses rupiah currency.

This study defines and measures the variables of related party transactions, organizational capital, and accrual earnings management as follows.

a. Related Party Transaction (TPB)

Related party transactions are conceptualized as the transfer of resources or services between a reporting entity and a related party, regardless of whether a price is charged (Zimon et al., 2021). This study uses related party transaction receivables adopted from the Hendratama & Barokah (2020) study with the following formula.

$$Related\ Party\ Transaction = \frac{Rec.\ from\ related\ party\ transaction}{Asset\ Total}$$

b. Organizational Capital (OCA)

Organizational capital is conceptualized as a collection of knowledge, capabilities, culture, design and business processes that enable a company to achieve efficient production and stable business operation activities aimed at increasing company productivity and performance (Hasan & Cheung, 2018; Li et al., 2018). This study's organizational capital measurement was adapted from the study of Hasan et al. (2021) with the following formula.

$$Organizational\ Capital = \frac{Sales, General, \&\ Administrative\ Cost}{Lag\ Asset\ Total}$$

c. Accrual Earnings Management (MLA)

Schipper (1989) describes earnings management as the deliberate involvement of managers in the external financial reporting process to fulfill personal interests. Accrual earnings management is a specific action taken by managers to choose accounting policies that can affect company earnings (Scott & O'Brein, 1997; Penman, 2013). The measurement of accrual earnings management adopts the study of Dechow et al. (1995) because it is considered capable of explaining accrual earnings management compared to other measurement models. Measurements as follows.

Total Accrual Calculation:

$$TAit = NIit - CFOit$$

Calculation of Non-Discretionary Accruals:

$$\frac{TAit}{At-1} = \alpha + \beta 1 \frac{1}{At-1} + \beta 2 \frac{\Delta Sit}{At-1} + \beta 3 \frac{PPEit}{At-1} + e$$

The estimation results of β1, β2, and β3 are used to calculate non-discretionary accruals as follows.

$$NDAit = \alpha + \beta 1 \frac{1}{At-1} + \beta 2 \frac{\Delta Sit - \Delta RECit}{At-1} + \beta 3 \frac{PPEit}{At-1}$$

Discretionary Accrual Calculation:

$$DAit = \frac{TAit}{At-1} - NDAit$$

Notes:

TAit: Total accruals of company i in year t
NIit: Company i's net earnings in year t
CFOit: Operating cash flow of company i in year t
At-1: Total assets of company i in year t
ΔSit: Change in sales of company i in year t
PPEit: Total fixed assets of company i in year t
ΔRECit: Changes in company i's trade receivables in year t
NDAit: Non-discretionary of company i in year t

DAit: Company i's discretionary in year t

The panel data regression approach was used by researchers in this study to test the hypothesis. The panel data approach requires carrying out the Chow test, Lagrange multiplier test, and Hausman test to determine the best model for testing the hypothesis. The analytical tool used by researchers in this study is eviews version 12. Before testing the hypothesis, first carry out a descriptive statistical test. After descriptive analysis, this study does not test the classic assumption to obtain the smallest residual, because it uses a panel data approach.

RESULTS AND DISCUSSION

This study uses descriptive statistics to describe several variables, namely, related party transaction variables, organizational capital, and accrual earnings management.

Table 1. Descriptive Statistic

Variables	Mean	Std.deviation	Obs.
TPB	0,082	0,093	145
OCA	0,129	0,141	145
MLA	-0,003	0,052	145

Source: secondary data processed by researchers

Table 1 shows that this study has a sample size of 145 observations. The results of this study found that the related party transaction (TPB) variable has a mean value of 0.082 with a standard deviation of 0.093. Furthermore, the organizational capital (OCA) variable has a mean value of 0.129 with a standard deviation value of 0.141. Finally, the accrual earnings management variable has a mean value of -0.003 with a standard deviation value of 0.052.

Table 2. Correlation

Variables	TPB	TPB*OCA	MLA
TPB	1,000	0,824	0,174
TPB*OCA	0,824	1,000	0,066
MLA	0,174	0,066	1,000

Source: secondary data processed by researchers

Table 2 shows that the highest correlation value occurs between the related party transaction variable and the interaction between related party transactions and organizational capital with a value of 0.824. This value has a positive coefficient, thus indicating a strong relationship.

Table 3. Paired Testing

Chow Test		
Description	Model I	Model II
Cross-section F (sig)	0,8339	0,9192
	Common	*Common*
Lagrange Multiplier Test		
Breusch-Pagan Both (sig)	0,1093	0,1519
	Common	*Common*
Hausman Test		
Cross-section random (sig)	0,5489	0,9192
	Random	*Random*
Conclusion	*Common*	*Common*

Source: secondary data processed by researchers

Table 3 shows that the model I test results for the main effect are common effects. Apart from that, the pairwise test for model II of the moderation effect also found that the best model was the common effect. Thus, testing the hypothesis of this study, both the main effect and the moderation effect, uses the common effect model.

Tabel 4. Hypothesis Test

Independent Variable	Model I Main Effect *Common Effect Model* Dependent Variable: MLA			Model II Moderating Effect *Common Effect Model* Dependent Variable: MLA		
	Coef.	t-stat.	Sig.	Coef.	t-stat.	Sig.
TPB	0,094	2,067	0,040	0,208	2,562	0,011
TPB*OCA				-0,599	-1,653	0,100
Const.	-0,012	-2,090	0,038	-0,014	-2,410	0,017
Adjusted R^2	2,2%			3,5%		
F-Stat.	4,273			3,612		
Sig.	0,040			0,029		
Obs.	145			145		

Notes:
Related Party Transactions (TPB), Organizational Capital (OCA), Related Party Transactions*Organizational Capital (TPB*OCA), Accrued Earnings Management (MLA)

Source: secondary data processed by researchers

The table shows that the results of testing H1 regarding the influence of related party transactions on accrual earnings management have a coefficient of 0,094, a t-statistic of 2,067 with a significance of 0,040 < 0,05. This condition shows that related party transactions have a positive and significant effect on accrual earnings management, so that H1 is supported. This study found that related party transactions through related party receivables were used by company management to carry out accrual earnings management. El-Helaly et al. (2018) describe that company managers can use related party transactions to manage earnings both in accrual and real terms. Zang (2012) describes that to fulfill managers' interests, managers use accrual earnings management.

Managers use related party transactions to carry out accrual earnings management. The practice of related party transactions leads to misuse of related party transactions. This means that managers use loopholes from related party transactions to fulfill their interests, without paying attention to the impact that could be detrimental to minority shareholders. The findings of this study support the study of Rahmat et al. (2020) that related party transactions are used opportunistically by controlling shareholders to manipulate earnings on an accrual basis.

The table shows that the results of testing H2 regarding the influence of organizational capital on the relationship between related party transactions and accrual earnings management have a coefficient of -0,599, t-statistic of -1,653 with a significance of 0,100 > 0,05. This condition shows that organizational capital cannot moderate the influence of related party transactions on accrual earnings management, so that H2 is not supported. This condition can be caused by company managers using efficiency which is a representation of organizational capital to manage the company better with the aim of achieving optimal earnings when compared to using accrual earnings management which has a negative impact on the company's long-term performance.

CONCLUSION

The aim of this study is to examine and analyze the effect of related party transactions on accrual earnings management which is moderated by organizational capital. This study uses a sample of manufacturing companies listed on the Indonesia Stock Exchange (BEI) for the 2018-2021 period, while the analysis year uses 2019-2021. A panel data regression approach is used in this study to test the hypothesis. The results of this study found that related party transactions have a positive and significant effect on accrual earnings management. However, the organization cannot moderate the influence of related party transactions on accrual earnings management.

An important implication of this study for the development of agency theory is that agency theory can create information asymmetry between shareholders and company management. Information asymmetry triggers managers' actions to manage earnings on an accrual basis through the use of related party transactions to fulfill managers' personal interests. The high level of receivables from related party transactions allows company management to carry out accrual earnings management, so that the company's earnings target will be achieved. An important motivation for managers to take these actions is to obtain bonuses or compensation.

Although this study can prove that related party transactions have a positive and significant effect on accrual earnings management. However, this study still has several important limitations, namely the measurement of related party transactions, accrual earnings management and organizational capital is only limited to one proxy which refers to previous studies, so the results may not be robust. Apart from that, this study only produced a coefficient of determination level in the range of 2,2%-3,5%. The low coefficient of determination indicates that there are still other variables that influence accrual earnings management that are not involved in this study.

The limitations explained above indicate that this study suggests that future studies can use other measurements to measure related party transaction variables, accrual earnings management and organizational capital with the aim of obtaining more robust results. Apart from that, future studies can also consider other variables that influence accrual earnings management, such as managerial skills, corporate governance, and other variables by considering the phenomena that occur.

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