THE EFFECT OF FAMILY CONTROL ON THE ACCOUNTING QUALITY: EVIDENCE FROM INDONESIAN COMPANIES

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ABSTRACT

This study examines the effect of family control on the accounting quality. Indonesia provides unique evidence due to concentrate of ownership, dominance family firms, and low accounting quality. This study finds that family control has a non-linier relation to the accounting quality. When the family control is low, the entrenchment effect is more dominant than the alignment effect to the accounting quality. However, when the family control is high, the alignment effect is more dominant than the entrenchment effect.

INTRODUCTION

The quality of financial accounting information[1]has been an issue of considerable interest of standard setters, practicing professionals, and academic researchers, especially in accounting scandal era (Enron, Lehman Brother, WorldCom etc.). Based on some previous studies (Graham and King, 2000; Fan and Wong, 2002; Leuz et al., 2003; Haw et al., 2004; *PricewaterhouseCoopers*, 1999, 2002), the quality of accounting information in Indonesian companies are relatively low compare to the other countries, even to other East Asian countries. This incurs despite Indonesian accounting standards were derived from the common law countries accounting standards, that are reported have higher quality than code law countries on some studies (Ball et al, 2000; Guenther and Young, 2000; Ernstberger and Vogler, 2008). The first (1973) and the second (1984) version of Indonesian accounting standards were developed based on US GAAP, and the third version, that is still prevailing now, (since 1994) are referred to the International Accounting Standards (at that time), or since 2001 known as International Financial Reporting Standards (IFRS). Even, Indonesian accounting standard boards has a plan to finish the convergence process of Indonesian accounting standards to the IFRS by 2012, in order to improve the quality of accounting information in Indonesia (Sinaga, 2009).

The potential reason for that phenomenon is the quality of accounting information is not only determined by accounting standards, as reported in some studies. These studies provide mixed result whether post adoption of IFRS will increase the quality of accounting (as reported by Ashbaugh and Pincus, 2001; Barth et al. , 2006, 2007, 2009; Yu, 2005; and Chai et al., 2008), or decrease the quality of accounting information (Duangploy and Gray, 2007; Jeanjean and Stolowy, 2008), and even mixed result in one research, i.e. some measurements show increase, but other measurements show decrease (Devalle et al., 2009; Chen et al., 2009). This have acknowledged in the Statement of Financial Accounting Concepts (SFAC) No. 2 (FASB, revised 2008) that the quality of accounting is also determined by institutional environment. Many empirical studies have supported that proposition (Li, 2010; Ball, et al., 2003; Huang, 2001; Prather-Kinsey and Shelton, 2005; Ding, 2006; Daske et al., 2008; La Porta et al. ,1998; Hung, 2001; Wang, 2007; Bushman and Piotroski, 2006; Lang et al., 2006; Spence, 1973; Francis et al., 2005; Huddart et al., 1999; Burgstahler et al., 2007; Sun, 2006; Jacobson and Aaker, 1993; Ali and Hwang, 2000; Ball and Shuvakumar, 2005; Fan and Wong, 2002; Hwa et al. ,2004; Kinnunen et al., 2000; and Guenther and Young, 2000). Specifically, the most recent studies on the effect of IFRS adaption (Li, 2010) reports that mandatory adaption of IFRS in European Union countries, same as Indonesian case, significantly reduce cost of equity only in countries with strong legal enforcement mechanisms, which Indonesia does not have. This result is consistent to the result of Daske et al. (2008). Have reviewed all research on adoption of different Generally Accepted Accounting Principle (GAAP), Soderstrom and Sun (2007) identified some institutional factors that majorly determine the accounting

[1] The focus of this research is on the quality of financial accounting information, which is differentiated to the other accounting information based on the characteristics of the user and the type of information. Financial accounting is characterized as accounting information prepared for users who have limited access to the company's operation, and the type of information is broad (cover an entity as whole) and for general purposes, in the form known as financial statements, according to the SFAC No. 1 (parg. 27). In this study, term of financial accounting quality is sometimes shortened to the accounting quality, but has same meaning as financial accounting quality.