

# The Effect of Creative Accounting Practices with Statutory Auditor as Mediation, and Accountant Ethics Standards on the Reliability of Financial Statements

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## ABSTRACT

Some big companies in the world and Indonesia have scandal because of the lack of reliability of Financial Statement. The purpose of the study was to obtain empirical evidence about the effect of the creative accounting technique, the role of the statutory auditor and accountant ethical standards toward the reliability of financial statements in companies in Jakarta from external auditor view. The study was using the quantitative method and conducted with purposive sampling and data obtain a total sample of 78 respondents of the external auditor who works at an accounting firm in Jakarta. Data tested by using SmartPLS 3.0. The result of this study indicate that creative accounting techniques have no significant influence directly but have significant through a mediating variable toward the reliability of financial statements, meanwhile, the role of the statutory auditor and ethical standards have a positive significant influence on the reliability of financial reporting. According to this study, an institution which is generating accounting standard should consider reducing of creative accounting practices, and for auditors give disclosure of audit report with appropriate with professional skepticism and independent principle.

**Keywords:** *Creative Accounting Techniques, Role of Statutory Auditor, Ethical Standards, Reliability of Financial Statement*

## 1. INTRODUCTION

Financial statements have an important role for stakeholders, both internal stakeholders, and external stakeholders in making decisions. Through financial reports, stakeholders can assess the performance of the company. The information contained in the financial statements should reflect the company's actual financial condition so that it does not mislead stakeholders in making decisions. Good report information if the information on the financial statements can be compared (comparable), verifiable, timely, and understandable [1], in preparing financial statements companies must follow the reporting framework or applicable accounting standards issued by state-recognized institutions or institutions. However, in making financial statements, an accountant must not only follow the standards in force, sometimes must follow the needs and desires of management. This has led to the occurrence of creative accounting practices (creative accounting). Creative Accounting is the root cause of various accounting scandals, many input proposals for accounting reforms that demand the elimination of these practices [2]. In enhancing

competition and the economic environment, some of the reasons companies do various accounting manipulation techniques intending to show the best business. However, the negative impact of manipulation of accounting techniques causes many companies to face major scandals, such as some creative accounting practices that cause cases such as Enron, WorldCom, Bank of Credit, Global Crossing, International Commerce, Cadbury [3]. In Indonesia, a case of manipulation of financial statements occurred in 2001 involving Kimia Farma, at which time the company engaged in the field of drugs carried out manipulations in its sales. This is the cause of misstatement in the financial statements which resulted in net income in the financial statements of PT Kimia Farma becoming more serving [4], PT Great River in 2003 which allegedly presented the recording of sales accounts using a different method from the existing provisions.

Statutory auditors have a role in assessing whether the presentation of financial statements is following applicable principles. The role of the statutory auditor can detect the creative accounting itself whether it is done by referring to the weaknesses of the existing accounting standard regulations through the audit process following audit standards. However, creative accounting techniques that are not following applicable rules and regulations will

have a negative assessment from the auditor because the auditor will examine the financial statements following the applicable principles and conditions.

On the other hand, the preparation of financial statements is still done or ordered by humans, the practice of creative accounting is inseparable from the behavior or ethics or morals of the perpetrators of the report makers who can be influenced by the interests or needs of management. The nature of a professional accountant is very critical of ethics. Accountants hope to be relied upon in maintaining ethical standards, so ethics and professionalism are key factors for an accountant. However, the lack of integrity, an accountant will remove all creditability as a professional accountant.

### **1.1. Contribution**

Based on the background conditions above, this study aims to find out how creative accounting practices and the role of management accountants ethics on the reliability of financial statements produced from the external auditor's point of view, so that this research can see input obtained for management who carry out creative accounting practices and for makers standards as input how applicable accounting standards can produce reliable financial reports remove all creditability as a professional accountant.

## **1.2. Theory Review**

### **1.2.1. Agency Theory**

An agency relationship is a contract between the manager (agent) and the investor/owner (principal). Agency relationships occur when one or more people (principals) employ another person (agent) to provide one service and then delegate decision making authority [5] which states that agency theory uses three assumptions of human nature namely: 1) selfishness (1) self-interest), 2) have limited thinking power about the perception of the future (bounded rationality), and 3) humans always avoid risk (risk-averse). From the assumption of human nature, it can be seen that agency conflicts that often occur between managers and investors/owners are triggered by these traits. Managers tend to prioritize personal interests rather than the interests of shareholders to increase the value of the company, while the investor/owner expects to increase the wealth (wealth) of the investments made. Meckling and Jensen also suggested that this theory raises agency costs, which occurs when there is a separation between control and management. Agency theory suggests that the appointment of accountants must be based on the needs of management and third parties. The reason could be the fact that the agent's perception of risk is incorrect while the owner may have a different attitude towards risk [6].

### **1.2.2. Institutional Theory**

The institutional theory describes how administrative practices and structures are formed through modifications caused by normative pressures from internal and external sources such as guidelines and law [7]. According to this theory, an institution is designed to meet social expectations because operations are always visible to the public or stakeholders. The implementation of this theory is the existence of governance in managing businesses. Effective governance practices come from the perspective of agency theory, where the directors' main obligation is to oversee management and protect shareholders from conflict of interest arising from the separation of ownership and control [8]. The Corporate Governance principle consisting of transparency, accountability, responsibility, independence, and fairness and equality is needed to achieve business sustainability (sustainability) of the company by taking into account stakeholders (stakeholders) [9]. Good and strong governance can influence manipulative activities and influence the adoption of creative accounting techniques [10].

### **1.2.3. Stakeholders Theory**

Based on Agency theory, Stakeholder or stakeholder theory was proposed by Edward Freeman in 1984. This theory is to explain the tripartite relationship that exists in an organization - agents (implementing or management), owners and stakeholders, or stakeholders (creditors, investors, government, customers, and more). This theory also discusses morals and values in managing organizations. Stakeholders are parties who can influence company operations and who have an interest in company activities and actions [10], and stakeholders are parties who can influence the company's operations and who have an interest in company activities and actions [10]. In the context of this research, how the financial statements produced by accounting techniques produce reliable financial reports for external stakeholders. There are no financial reports produced by professional management accountants that are not used for stakeholders, at least for internal stakeholders such as management, shareholders, and other internal elements of the organization. Thus the theory will be more relevant to this research because it will broaden insights in understanding the concept of "stakeholders" in an organization. This theory is also relevant to other fields such as ethics, law, and organizational management. Stakeholder theory provides a solution to the deviations identified in agency theory [12]. Further explained that managers or stakeholders must act under company objectives based on several ethical principles [13].

#### 1.2.4. Creative Accounting.

Creative accounting is a process carried out by accountants using their knowledge of accounting rules to manipulate numbers reported in the accounts of a business organization [14]. Based on the word creative origin is from the Latin, *Creatus* which means to have grown, the word can be interpreted as a creative process that involves making ideas or concepts, which can be influential (novelty) or original so that creative action is not an act of deception [15]. Creative accounting is reflected in the deceptive accounting synonym [2]. Creative accounting practices generally involve activities to reduce earnings that are fluctuating, management actions on income that do not provide long-term economic benefits that can harm the organization, the process of selecting repeat measurements that have an impact on revenue streams, the process of manipulation and the selection of methods in changing reports and transaction processes structured, and intervention activities in the process of making financial statements [15]. But the act of creative accounting does not violate standards, accountants use weaknesses of accounting rules called loophole, namely flexibility of regulations such as method selection [16], regulatory compliance, ie short and incomplete regulations [15], managerial scope and the area of estimation, for example, management decides to increase or reduce the provision of uncollectible debt [17], transaction time, management determines the year of recording the transaction that benefits the company [15], and artificial transactions, namely manipulating financial statements relating to obligations with third parties, for example, sales and leaseback of company assets or reclassifications and explanations of financial statements [18]. Thus Creative Accounting is not an illegal act but an immoral act that can mislead investors [2] and cause financial reports that do not reflect the fairness of financial statements and the description of the objectives of the business [19]. Creative Accounting as a choice of accounting techniques that may (or may not) adhere to accounting principles or standards, but deviates from what these principles and standards want to achieve, to present the desired business image [20].

#### 1.2.5. Audit Statutory

The statutory auditor's role is to explain whether the financial statements prepared by the company present reasonable financial information. Statutory audits can limit the creative accounting practices carried out by management [21]. Auditors' opinions about the reasonableness of financial statements also have a positive impact on the financial statements themselves besides other important aspects that need to be considered in preparing a financial report are ethical standards. In carrying out his profession, accountants have ethical standards that must be applied. Ethical standards for practitioners of management accounting and financial management (Standards of Ethical Conduct for Practitioners of Management Accounting and Financial

Management) established by The Association of Accountants and Financial Professionals in Business or 22 [22], consisting of integrity, credibility, confidentiality, and competency [23] defines the statutory auditor as "a legally required external audit conducted annually to meet a specific set of requirements by the government. It relies on internal audit reports, verification of financial information, documents, and related stock validations" ([www.crowehorwath.com](http://www.crowehorwath.com)). While the purpose of statutory audit according to [24], statutory is "to provide an independent opinion to the shareholders on the truth and fairness of the financial statements, whether they have been properly prepared by the Companies Act and to report by exception to the shareholders on the other requirements of company law such as where, in the auditors' opinion, proper accounting records have not been kept." ([www.icaew.com](http://www.icaew.com)). So statutory has an important role in examining financial statements. The statutory auditor's role is to state whether the financial statements prepared by the company present reasonable financial information. According to [21], "The auditors are employed by the economic entities to certify the fact that their financial statements are by the economic reality, yet the interest they protect is not that of the employing." So, in doing their job auditors check the financial statements of companies that pay for their services, not merely to protect the company but they must state whether the financial statements made by the company are following the actual reality and the interests that the auditor must protect over the financial information is public interest. 2016)

#### 1.2.6. Standard Ethics for Accountant

Accountant Ethics are governed by some ethical standards issued by accounting professional bodies and institutions both globally and locally. Globally accountant ethics is regulated in a code of ethics by the International Federation of Accountants (IFAC), and locally by the Indonesian Institute of Accountants (IAI). Professional accountant's code of ethics which includes integrity, objectivity, professional competence, and reasonable attention, confidentiality, and professional behavior. This code of ethics can be applied to professional accountants who practice as public accountants and accountants in business or management accountants [23]. The code of ethics in principle governs human beings, not accounting records, and reporting standards, therefore the implementation of the code of ethics is highly dependent on the behavior of the accountant itself. In terms of accounting creative practices, what matters is the ethical issue of accountants in behavior. Although there are already established accounting standards or rules, choosing a method and interpreting the unclear standards in accounting standards becomes the behavioral and moral decision of the accountant who makes. Even in accounting processes that already use computers or automatically determine the standards and methods that are still human. The behavior of accountants in preparing financial

statements is inseparable from the accountant's morale itself, according to [26], ethical behavior of an accountant depends on Moral Sensitivity, Moral Judgment, Moral Motivation, and Moral virtues or permanent attitudes in the interior strengthen formal behavior. While the motivation of the accountant itself there are several objectives for the motivation of the accountant in preparing financial statements, namely to reduce taxes, increase the confidence of shareholders and investors by reporting stable income and psychological expectations related to the anticipated increase in income, income smoothing, providing increased transactions As the capital market is anticipated, there are differences in the analysis of expectations with the actual performance [15].

### 1.2.7. Reliability of Financial Statements

Accounting theory is based on a logical mentality in the form of ideology and provides a universal reference frame of measurable accounting practices, guiding new practices and procedures in development. Accountant integrity and accountant independence are important in influencing the quality of financial statements [3]. The quality of financial statements describes the quality of financial statements as an appropriate way of showing information about company activities related to financial transactions [27], fair and authentic information [28] addressed to shareholders and interested parties. The financial report must fulfill the principle of objectivity which imposes an obligation on all professional accountants not to compromise professional or business judgment that is biased, conflicting interests or influence from others to override professionalism as an accountant. Thus a quality financial report is a financial report that can be relied on by users to conclude, take action, and make plans from the financial statements. Reliable financial reports are reports. Quality financial reports according to the conceptual framework of the FASB and IASB are reports that contain qualitative characteristics including relevant, faithful representation, understandable, comparable, verifiable, and timely [29]. Another factor in the quality of financial statements is reliability. Financial statement information must have information whose reliability quality can make the report useful. This quality is achieved when the information, which is the guide or user base, financial reports must be free from bias and material errors. The reliability or reliability of financial statements is analyzed based on maintained quality, can be verified, and provides neutral or impartial information [30]. Thus a quality financial report is a reliable financial report that will not be misleading for users in evaluating business performance, making plans, and another decision making.

## **2. HYPOTHESIS DEVELOPMENT**

Management practices creative accounting to attract investors and increase confidence in stakeholders [31]. However, creative accounting techniques that are used

without following the applicable rules and regulations will mislead the financial statement information generated [32]. When management tries to do creative accounting practices in financial statements, they are playing an element of accounting records that can cause financial statements to become misguided [11] state that creative accounting practices harm report quality finance, especially on the income statement. Research of [33], [2], states the practice of creative accounting has a significant effect on the financial statements. Based on the above research, the hypotheses built are:

H1: Creative Accounting Techniques influence the Reliability of Financial Statements

Audit involvement within the limits of creative accounting must be characterized by responsibility, permanence, and at the same time, the auditor must demonstrate independence, impartiality, equality, competence, and reliability [21], so that the auditor has a role in limiting the creative accounting carried out by company management and provide an objective opinion on the truth and reasonableness of the financial statements made by the company. According to [3], independent accountants have a positive and significant influence on the quality of financial statements. This statement is supported by the results of research by [33] which states that "The auditor's comment plays a positive and significant role in financial reporting." Based on the above research, the hypotheses built are:

H2: Creative accounting practices have a significant and positive influence on the role of the statutory auditor

H3: The role of the statutory auditor has a significant and positive influence on the Reliability of Financial Statements

The behavior of professional accountants will have a significant and positive influence on financial statements. This was also supported by [25] in their research in Ghana showing that accounting ethics had an impact on the quality of financial statements. The same thing was conveyed [33]; [32] in his research stating the relationship of accountant ethics with the reliability of financial statements had a positive and significant relationship, and this opinion was supported by [34] who researched Nigeria where ethics have a positive effect on the balance sheet but negative on profit and loss. Based on the above research, the hypotheses built are:

H4: Standard Ethics for an accountant has a significant and positive influence on the Reliability of Financial Statements

## **3. METHODOLOGY**

This research methodology is quantitative research with primary data obtained by distributing questionnaires to auditors working in public accounting firms. Valid data to process is 78 from 96 data respondents.

### 4. RESULT AND DISCUSSION

The results by validity and reliability process fro 78 data respondents shown below :

Table 1. Result of Validity and Reliability Tests

Variables	AVE	Cronbach's $\alpha$
Creative Accounting (CA)	0.543	0.777
Reliability of Financial Statements (RFS)	0.644	0.878
Statutory Auditor (SA)	0.644	0.878
Standard Ethics for Accountant (SEA)	0.570	0.868

The validity and reliability test results show AVE data > 0.5 and Cronbach's  $\alpha$  > 0.7 which means that the data obtained are valid and reliable.

While the path analysis from this data is as follows:

Table 2. Path Coefficient

Influences	t-stat	Results
CA to RFS	1.864 *	No Significant
CA to SA	8.862*	Significant
SA to RFS	3.036*	Significant
SEA to RFS	2.82*	Significant
CA to SA to RSF	2.270*	Significant

\*Coefficient of Significant at the 5% confidence level is t-test > 1.96

Source: Processed by PLS.

Therefore, the results of those data above on model on this on this study can be shown below:

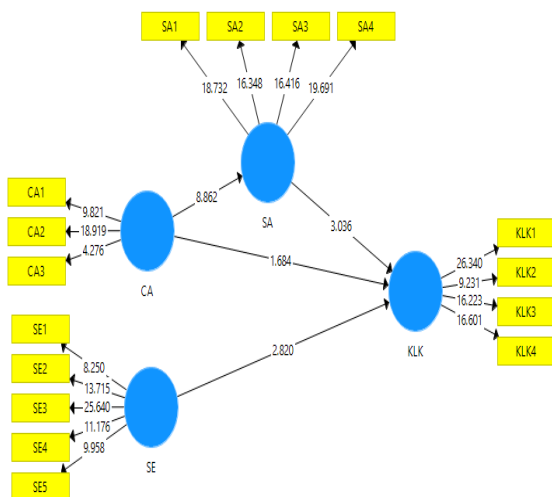


Figure 1. Path Analysis

From the data above, it shows that creative accounting techniques have a potential but not significant effect on the reliability of financial statements, meaning that the practice of creative accounting does not play an important role in ensuring the reliability of financial reports. This result is under the research of [34] which states that creative accounting techniques have a negative influence on the quality of financial statements, especially on the income statement, but are not in line with research by [33] and [2] which states the technique creative accounting has a significant effect on. Creative accounting practices on the role of statutory auditors who have a positive and significant influence on the role of statutory auditors, meaning the role of auditors to maintain their work results so that creative accounting practices become concentrated in the audit process to maintain the reliability of the audit process. Thus, in path analysis, Creative Accounting practices become significant and positive about the reliability of financial statements after being mediated by the role of Statutory Auditors in line with [3], and [33]. Accountant Ethics Standards have a significant and positive influence on the Reliability of Financial Statements This is also supported by research by [25], [33], [32],[34]

### 5. CONCLUSIONS AND IMPLEMENTATION

#### 5.1. Conclusion

Creative accounting techniques in companies in Jakarta, based on data collected have not affected the reliability of financial statements. While it is concluded that the creative accounting practice does not significantly influence but when viewed from its value, the practice of creative accounting has occurred in companies in Jakarta (values 1, 86 are close to values 1, 96 at a 95% confidence level). This is evident when creative accounting practices mediated by the role of statutory auditors make creative accounting practices have a significant effect. While the accountant's ethical standard factors have a positive and significant influence, under previous studies in other countries. This is because the accounting standards are not yet detailed at this time, and are still growing, and the needs or interests of management are more dominant to the needs of financial statement information for business purposes than to comply with existing provisions. From the results of this study, it appears that there is still a lack of understanding of the code of ethics as a management accountant or accountant in the company.

#### 5.2. Discussion

The implications of this study illustrate that Pratik creative accounting has occurred in companies in Jakarta, but based on the data in this study, it has not shown a number that has a significant effect on the reliability of financial statements, seen in coefficients that are close to the limit of

numbers that indicate an influence significantly. But creative accounting practices have taken a positive direction, which means that creative accounting practices occur and are in line with the reliability of financial reports. This result might be different if the respondents who filled out the questionnaire were mostly at managerial or senior level and who had more than three years experience because they understood the possibility of creative accounting practices and had conducted an overall audit of the financial statements or evaluated the financial statements before conducting the engagement with clients. This can also be different if the respondents who fill the cookies are more male because generally, men fill without involving emotions.

In this study, the role of the auditor is quite influential on the reliability of financial statements, even as a mediating variable making creative accounting practices have a significant effect on the reliability of financial statements. This shows that the role of auditor compliance in the process of detecting the existence of creative accounting practices that will affect the reliability of financial statements.

From this research, it can be input for institutions that make accounting standard rules. Standards must be made carefully, reducing or minimizing the possibility of creative accounting practices that can affect the reliability of financial statements that can ultimately harm the company and users in the long run.

While accountant ethics, this study showed a significant and positive influence. This happens because management accountants' understanding of the ethics of professional accountants is still lacking. After all, generally, accountants understand that those who have a code of ethics are public accountants. Therefore, professional institutions that oversee all accountants, especially management accountants must make or provide an understanding of the code of ethics as a professional management accountant, and the role of education in accounting must emphasize the professional accountant's code of ethics in the education process. Also, a public accountant from the results of his audit can educate management accountants to minimize the possibility of creative accounting practices that can affect the reliability of financial statements

This creative accounting practice can benefit the company in the short term, but in the short term, it will harm the company, because report users no longer trust the published financial statements. Also, the role of public accountants in auditing the company's financial statements can reduce the deviation of creative accounting practices so that the reliability of published financial statements can reduce the level of bias against the reliability of financial statements. For further research, we can consider this creative accounting practice against the possibility of fraud.

### 5.3. Limitation

Limitations in this study are the difficulty of getting respondents who are willing to fill out the questionnaire, especially those at the level of senior auditor or managers who have overall financial statement audit experience, analyze the audit is carried out, and review staff work before opinions are issued, so that it is expected to better experience and understanding of standards can provide a way for creative accounting practices to occur in business.

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