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Unregulated financial reporting decissions: Considerations of systems oriented theories

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Abstract

This study aims to know how community perceptions can influence disclosure policies, know how Legitimacy Theory and Stakeholder Theory can be used to explain why an entity conducts voluntary disclosure, know the meaning of organizational legitimacy and how disclosure in annual reports can be used as a strategic tool to maintain organizational legitimacy, know how the power and information demands of certain stakeholder groups can affect disclosure policies, know the view that a successful organization is an organization that can manage or balance the demands of different stakeholders. An alternative theoretical perspective that answers this question is to use legitimacy theory and stakeholder theory. Gray, Owen, and Adams (1996) stated that a systems-oriented organization and society will allow us to see the role of information in the relationship between organizations, countries,individulas, and groups.

Keywords: System-Oriented-Theories, Legitimacy Theory, Stakeholder Theory

1. Introduction

Theoretical arguments such as why company management chooses to voluntarily provide certain information to parties outside the organization are based on Positive Accounting Theory. Alternative theoretical perspectives that overcome this problem include using legitimacy theory and stakeholder theory. Gray, Owen and Adams (1996) [3] stated that a system-oriented organization and society will allow us to see the role of information in the relationships that occur between organizations, countries, individuals, and groups.

Fig 1: Organization shown as part of an extended social system

"Systems-oriented theories" are legitimacy theories and stakeholder theories. In the systems-based perspective, an entity is assumed to be influenced by and also affects society. Gray, Owen and Adams (1996) [3] stated that a system-oriented organization and society will allow us to see the role of information in the relationships that occur between organizations, countries, individuals, and groups. Based on legitimacy theory and stakeholder theory, accounting disclosure policy is seen as a strategy to influence the organization's relationship with other parties. Legitimacy theory and stakeholder theory are applied to explain why companies disclose social responsibility in their annual reports.This theory can also explain why companies choose to adopt certain accounting techniques.

2. Literature Review

2.1 Political Economy Theory

Legitimacy theory and stakeholder theory are theories derived from political economy theory (Gray, Owen and Adams, 1996) [3]. Gray defines political economy as a framework that links social, political and economic problems. Economic problems cannot be separated without paying attention to social problems. By using political economy a researcher can pay attention to the broader (social) issues that impact the company, and what information should be disclosed.

Guthrie and Parker (1990) [4] stated that the political economy perspective views accounting reporting as a social, political, and economic document. Accounting reporting is used as a tool for the development, maintenance, and legitimacy of economic and political institutions.Disclosure has the capacity to convey social, political, and economic meanings for a plurality of report readers. Guthrie and Parker further state that company reports cannot be considered as neutral and impartial (fairly presented) reports as claimed by the accounting profession, but that company reports are only a product of exchange between the company and its surrounding environment to mediate and accommodate various parties. interests.

Owen & Adam (1996) [3] say that political economy theory has been divided into two major parts. The two sections are labeled "classic and bourgeois" in classical economic theory.

1. Classical political economy is concerned with the work of philosophers such as Karl Mark and classes of interest, structural conflict, inequality,and the role of the State (Owen & Adams, 1996) [3].
2. In contrast to the "bourgeois" label, political economy theory according to Kouhy and Lavers (1995) ignores the larger elements and, as a result, is content to see the world as essentially pluralistic.

2.2 Legitimacy Theory

Legitimacy theory states that organizations are continuously looking for ways to operate within the limits of social norms, meaning that the company's operations are seen by others as legitimate. Existing norms are always changing, so companies must adapt. Lindblom (1994) distinguishes legitimacy as a status or condition, and legitimacy as a process that leads to an organization being declared legitimate. Legitimacy theory is based on the idea that there is a social contract between companies and society. Society now expects companies toprevent environmental damage, ensure safety for consumers and employees. Therefore, companies with poor social environment will find it difficult to run their business. The company's way or tool to legitimize according to Dowling and Pfeffer,among others:

1. Companies must adjust their outputs, objectives, and operating methods according to the norms of community legitimacy.
2. Companies must use communication tools to change people's views.
3. The company must communicate its meaning in accordance with the symbols of community legitimacy.

Lindblom (1994) states that a company may apply four legitimacy strategies when facing various legitimacy threats. Therefore, to deal with the failure of the company's performance:

1. Try to educate its stakeholders about the company's goals to improve its performance.
2. Attempt to change stakeholder perceptions of an event (but not change the actual performance of the organization).
3. Divert (manipulate) attention from the problem of concern (concentrate on some positive activity that is not related to failure).
4. Attempts to change external expectations of performance. In accordance with Dowling and Pfeffer, companies can use the company's annual report as a public disclosure.

Hurst (1970) stated that one of the functions of accounting is to legitimize the existence of the company. Companies that operate not in accordance with societal norms or expectations will be penalized. The term "operating license" refers to the notion of "social contract".

2.3 Stakeholder theory

Stakeholder theory has two branches, namely the moral or normative (ethical) branch and the positive (managerial) branch. Both theories explicitly consider the various groups (of stakeholders) that exist in society, how the expectations of certain stakeholder groups can have more (less) influence on corporate strategy. This can have implications for how stakeholder expectations are considered and managed by the company.

2.3.1 Moral or Normative (Ethical) Theory

This theory states that all stakeholders have the right to be treated fairly by the company. Any stakeholder must be treated well. Stakeholders have intrinsic rights that should not be violated (such as a reasonable salary).The definition of a stakeholder (Freeman & Reed) is a group or individual who can influence or be influenced by the achievement of company goals.

Clarkson divides stakeholders into two, namely primary and secondary stakeholders. Primary stakeholders are parties who have a real contribution to the company, without these parties the company will not be able to survive. Meanwhile, secondary stakeholders are parties who will not directly affect the survival of the company. According to Clarkson, primary stakeholders must be considered by management for the company to survive.

2.3.2 Positive (Managerial) Theory

This theory is more centered on the organization (organization-centered). Companies must identify stakeholder concerns. The more important stakeholders are to the company, the more effort must be expended in managing their relationships with these stakeholders. Information is an important element that can be used by companies to manage (manipulate) stakeholders to continue to get support.

3. Methods

3.1 Empirical tests of legitimacy theory

Empirical tests of legitimacy theory are used by many researchers examining social and environmental reporting practices. Empirical tests of legitimacy theory are also used to try to explain disclosure and to explain changes in disclosure patterns. Disclosure is part of a portfolio strategy carried out to bring legitimacy or maintain organizational legitimacy.

In research conducted by Hogner (1982), corporate social reporting in annual reports at the US Steel Corporation for 8 years shows that the extent of social disclosure varies from year to year, and this variation may be due to changing public expectations.How does the company determine people's expectations? You do this by researching through newspapers or the media. The media can usually shape the opinions of people's expectations. Brown and Deegan state that media

coverage of a particular issue is a measure of what people are concerned about. The higher the media coverage, the higher the disclosure in the annual report. Legitimacy theory shows the relationship between corporate disclosures and public expectations.
Legitimacy theory is very similar to the political cost hypothesis in positive accounting theory.Besides the similarities, there are also differences, namely the legitimacy theory is not based on economic assumptions where all actions are driven by self-interest (wealth maximization) and do not use the assumption of market efficiency.

3.2 Empirical tests of stakeholder theory

The benefit of this theory is that it is used to test the ability of stakeholders to influence the disclosure of corporate social responsibility. Roberts (1992) found that a measure of stakeholder power and related information needs can explain the level and type of corporate social responsibility disclosure.
Setyaningrum (2011) expresses the opinion that companies expected to pay attention to the interest of stakeholgers, especially related to social information and information related to the environment for the following reasons:

1. Environmental issues involve the interests of various groups in community that can interfere with their quality of life
2. The area of globalization has encouraged traded products must be friendly to the environment
3. Investors in investing their capital tend to choose companies that own and develop policies and programs environment
4. LSM and environmentalists are increasingly voval in critizing companies who care less about the environment

One way that companies can do to maintain relationships with stakeholders, namely by conducting environmental disclosure. With this disclosure, it is hoped that the company can meet the information needs of stakeholders and increased stakeholder trust in the company.

4. Results and discussion

4.1 Result

Shortly after 1900, the external financial reporting of U.S. industrial companies was relatively limited because many companies rarely provided financial reports (Hawkins, 1963;Concise, 1987;Sivakumar and Waymire, 1993). Incorporation laws require companies to discloser annual reports but do not specify their form or content.
Over the next three decades, corporate reporting gradually became more informative as managers responded to the demands of bankers and other users of financial statements for greater disclosure (Hawkins, 1963). The increase in ownership dispersion also leads to broader financial reporting. The NYSE listing agreements began to require exchange-traded companies to discloser further financial information (Shultz, 1936, pp. 16-22). Shortly after 1900, theses agreements required industrial companies to discloser annual financial statements to be listed on the NYSE; after 1910, agreements usually include a commitment to discloser interim earnings data. However, according to the agreement the listing was basically voluntary before 1929 (Hawkins, 1963).
The development of accounting and auditing principles was in its infancy in the 1920s (Ely and Waymire, 1999). Pre-SEC accounting principles were more like norms without disclosing specific in practice, companies sometimes deviate from this norm without disclosing specific accounting policies. Only after the stock market crash of 1929 did the NYSE require listed companies to discloser their accounting policies. In the early 1930s, the NYSE began working with the American Institute of Accountants to develop a statement of basic accounting principles. Researchers believe that in the early 20th century, although auditors had limited power in disputes with management, auditing would increase the accuracy of financial reports and reduce managerial optimism in financial reporting.

4.2 Discussion

This study uses a sample of 540 companies listed on the New York Stock Exchange (NYSE) during the October 1929 stock market crash, we provide evidence that managers have an incentive to report higher quality financial information, and such reporting provides favorable protection for investors. This study measures the quality of financial reporting based on the dimensions of financial statement transparency and credibility and measures protection for investors by decreasing investor losses during October 1929 associated with higher quality of financial reporting.Based on empirical analysis, it shows that the proxy for the quality of financial reporting is significantly related to financial reporting variables capture cross-sectional variation in reported drivers relating to equity market information costs, contracting and control conflicts, potential competitive and regulatory costs, and the availability of alternative information for assessment and monitoring.This evidence suggests that managers respond to the economic push to provide higher quality financial reports even in the absence of regulation. This finding is consistent with the idea that high-quality financial reporting is self-determined by managers in terms of favorable protection for investors.
The findings of this study relate to issues discussed in several previous studies and suggest additional areas of investigation. Previous research has shown that favorable protections for investors from high quality financial reporting are observed under mandatory disclosure regimes (Johnson *et al.*, 2000; Glaeseretal, 2001; Mitton, 2002).Future researchers can also examine the evolution of firms with strong financial reporting to understand, for example, what circumstances led these firms to adopt better reporting and what role regulation played in the process. In contrast, other analyzes could investigate whether the weak reporting of companies was substantially affected by regulation, that is, whether the company's "pull ups" financial statement regulations are the weakest. Such analysis will provide the needed evidence on the role of regulation in increasing corporate disclosure.

5. Conclussion

Legitimacy theory shows the relationship between corporate disclosures and public expectations provides evidence that corporate managers believe that the media will shape public opinion and the disclosure of annual reports is a guarantee of restoring public trust after media rejection reviews. Legitimacy theory is very similar to the political cost hypothesis in positive accounting theory.Besides the similarities, there are also differences, namely the legitimacy theory is not based on economic assumptions where all actions are driven by self-interest (wealth maximization) and do not use the assumption of market efficiency.
And stakeholder Theory, indicates that companies are more responsive to the demands of financial and government stakeholders (regulators) than environmental stakeholders. This shows that the company faces a situation where stakeholders compete with each other for their interests, so the company will choose the most important

stakeholder. Unfortunately, managerial stakeholder theory does not directly prescribe what information should be disclosed. So this will raise the problem of "who is the most important (powerful) stakeholder, and what information is needed by the stakeholders".

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