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The Impact of Annual Report Readability on Agency Costs: Internal Control as Moderating Variable

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Abstract

This examination looks at the impact of yearly report comprehensibility on organization costs with inward control as a directing variable. This examination was directed at assembling organizations recorded on the Indonesia stock exchange in the 2014-2017 period. The populace utilized in this investigation added up to 142 organizations, and after the determination of tests with purposive examining methods got, 44 assembling organizations would be utilized as tests in this examination. The insightful technique in this examination utilizes the different straight relapse test with moderate regression analysis (MRA). The aftereffects of this investigation show the clarity of yearly reports influence office costs, which implies the higher the degree of yearly report coherence, the higher organization costs looked by investors, the inward control reinforces the impact of yearly report lucidness on office costs, which implies that with inner control can diminish the impact of report intelligibility yearly along these lines lessening office costs.

Keywords: yearly report, comprehensibility, organization costs, inward control.

I. INTRODUCTION

Comprehensibility is a fundamental quality in the content of data. Exploration on clarity has been led in different fields. As of late, coherence issues have become a concentration in the capital market (Lo et al., 2017; An & Suh, 2020; Hoffmann & Kleimeier, 2021; and Pajuste et al., 2021). Changes to terms or conditions bring about a critical expansion in the quantity of divulgences of yearly report data.

The current yearly report contains a great deal of text data in account as opposed to quantitative structure. The account text presents a normal of about 80% of required exposure structures from the organization's yearly report (Prasadhita, 2018). This progressions the perspective on the past yearly report with the current report. Past reports present numerous clarifications in the quantitative structure in the fiscal summaries segment as it were (Lo et al., 2017). Simultaneously, the current yearly report has a great deal of data in account text, illustrations, pictures, and figures that can clarify data both monetary and non-monetary (Sahyda et al., 2019). The expanding number of revelations in account structure turns into an administration freedom to uncover a portion of the principal purposes for the organization's exhibition, monetary usefulness, and choices (Jayasree & Shette, 2021). The measure of text story divulgence data should be offset with comprehensibility or intricacy in the yearly report. Yearly reports are supposed to be acceptable if the revelation of text story data has an undeniable degree of coherence, just as data put together by the executives, can be effectively perceived by its clients (Dong et al., 2016; Pajuste et al., 2021).

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Hypothetically, the yearly report is a mechanism of correspondence among investors and the board. The yearly report presents data that can be utilized to survey the organization's presentation, monetary status, and possibilities in regards to the choices they make. (Smith & Taffler, 1992) contends that text stories in yearly reports become a compelling mechanism of correspondence so clients of yearly reports can without much of a stretch comprehend the message that organization the board conveys. This makes the coherence of the yearly report essential and a significant quality in estimating the degree of literary comprehensibility in the yearly report (Tarjo & Anggono, 2020).

The significance of the lucidness of the yearly report has been suggested by the securities and exchange commission (SEC) with the distribution of, "plain English disclosure and a plain English handbook" on the most proficient method to clarify exposures. It means to work with public organizations in decreasing intricacy and improving the coherence of data to help financial backers in getting data. While in Indonesia, the significance of intelligibility has been insinuated by the financial services authority (OJK) with the issuance of roundabout number 30/SEO.04/2016, which clarifies one of them, the yearly report is arranged consistently and instructively to work with financial backers in improving by the data required (Akbar & Daljono, 2014). All the more great exposure of yearly data report then, at that point checks the high effect of data for financial backers in dynamic.

A few specialists, in regards to the disturbing intelligibility of the executives intentionally dark the story text on their yearly report for their motivations (Hassan, 2014; Jones & Smith, 2014; and Lo et al., 2017). Examination directed by Lo et al. (2017) discovered organizations with complex yearly report revelations purposely utilize subtle words to darken their horrible showing. Jayasree and Shette (2021) said that the conveyance of good and terrible organization execution should be possible in a different of ways, one of which is an organization with great execution will furnish yearly report data with great and straightforward sentences so it very well may be seen effectively by its users (Pajuste et al., 2021).

The trouble of understanding data because of the great clarity of the yearly report impacts helpless correspondence between the head and the specialist. It can mess office up, one of which is data unevenness. Data deviation happens because of contrasts in data dominance among chiefs and specialists because of the partition of interests. The division of interests bringing about the development of office clashes would thus be able to cause pointless expenses if its operational exercises are overseen by the proprietor himself called organization charges.

Corporate administration is one of the systems that can be utilized to tackle office issues. Great corporate administration can guarantee that administration is doing its obligations and capacities by the proprietor's goals (head), as indicated by the corporate administration systems that can be utilized to improve the nature of the organization's detailing and decrease clashes.

Interior control as a component of corporate administration is required to smother the entrepreneurial conduct of the executives as far as oversight. Great inner control can forestall the act of cheating in the introduction of yearly reports with the goal that intricacy or clarity isn't utilized as a medium to shroud their horrible showing. Luo et al. (2018) discoveries propose that inside controls may heighten the effect of yearly report intelligibility in diminishing office costs.

As per organization hypothesis to defeat office clashes among specialists and administrators because of contrasts in interests one of them with straightforwardness in the administration of the organization. The partition of interests brings about an awkwardness of data authority that can prompt a condition called data unevenness. The imbalance of data can be a chance for supervisors in submitting misrepresentation to deceive the proprietor about the organization's condition data so it can be his own profit.

Simple to-peruse yearly reports can decrease data imbalance among investors and the executives and lessen office costs. Inward controls are relied upon to expand oversight, making yearly reports simple to peruse or improving lucidness, subsequently diminishing organization costs.

Yearly reports with an undeniable degree of comprehensibility can profit investors on the data uncovered by the organization. This is the explanation for the organization's efficiency, monetary execution, near benefit, and intensity. Along these lines, high comprehensibility can lessen data imbalance among investors and the executives, accordingly decreasing organization costs. Interior control fills in as a corporate administration system that can keep the board from cheating, for example, controlling incomes. This is on the grounds that it is expected that income can fortify the lucidness impact in bringing down office costs.

In view of the foundation depiction over, the difficult plan in this examination: first and foremost, regardless of whether the meaningfulness of the yearly report on assembling organizations recorded on the Indonesia Stock Exchange for the period 2014-2017 influences office costs and besides, whether inside controls can direct the effect of the intelligibility of the yearly report of assembling organizations recorded on the Indonesia Stock Exchange for the period 2014-2017 on office costs. The reason for this examination is: first, knowing the effect of the lucidity of the yearly report of assembling organizations recorded on the Indonesia stock exchange period 2014-2017 on office costs and also, knowing whether inner controls can direct the effect of intelligibility of the yearly report of assembling organizations recorded on the Indonesia Stock Exchange period 2014-2017 on office costs.

The selection of manufacturing companies and the year of observation from 2014-2017 is based on phenomena globally and Indonesia in particular. This phenomenon is in the form of fraud cases that have hit many companies in the manufacturing sector. For example, the Indonesian fraud survey in 2016 found that the losses caused by fraudulent financial statements reached $1,000,000 (ACFE, 2016b). In addition, in the association of certified fraud examiners survey globally, fraud cases in the manufacturing sector from 2014-2017 reached 520 cases (ACFE, 2014; 2016b; and 2018). This fraud phenomenon will undoubtedly affect the readability of financial statements (Lo et al., 2017; Sahyda et al., 2019; Hasan & Habib, 2020; and Jayasree & Shette, 2021). And in the end, it will affect the agency costs Luo et al. (2018).

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. The Effect of Readability on Agency Costs

Organizations with simple to-peruse yearly reports have a significant degree of data divulgence quality. A yearly report with a serious level of meaningfulness will lessen the imbalance of data among investors and the executives and along these lines increment oversight inside the organization and diminish lopsidedness costs (Luo et al., 2018).

The hypothesis of the office set forward by Jensen and Meckling (1976) clarifies the office relationship because of the partition of interests between the position (head), specifically investors, with the getting party authority (specialist), in particular the supervisor. Such connections can mess organization up because of contrasts in interests between each gathering for its advantage.

Exploration led by Hassan et al. (2019) found that there is a positive connection between the yearly report that is handily perused with organization costs estimated with resource use. Luo et al. (2018) research say the comprehensibility of the yearly report can help in spew office costs. Accordingly, simple to peruse and comprehend reports can decrease data and can build oversight of individuals in the organization, and lessen office costs.

H_1: readability of yearly reports influences organization costs.

2.2. Moderation of Internal Control on the Impact of Annual Report Readability on Agency Costs

Inward control is another significant instrument that can be utilized to guarantee income quality in yearly reports. Given the coherence of the yearly report is a type of exposure of data on the organization, while the quality benefit of uncovering data relies upon the nature of income (Li, 2008). So there should be a type of inside control that can be utilized to guarantee the nature of pay.

Siallagan and Machfoedz (2006) said the inner control framework is one piece of good corporate administration that, in its system, can improve the nature of monetary revealing, for example, benefit quality. Subsequently, inward controls can ensure top caliber of benefit and accordingly can strongly affect the lucidness of yearly reports in diminishing office costs. In view of the portrayal over, the analysts propose the subsequent theory as follows:

H_2: internal control can reinforce the effect of annual report readability on agency costs.

2.3. Research Framework

Based on the hypothesis above, to describe the effect of the readability of the annual report on agency costs with internal control as a moderating variable, the following frame of mind is created:

Figure 1
Research Framework
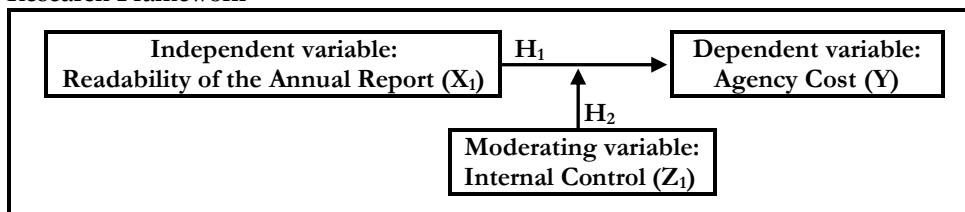
III. RESEARCH METHODOLOGY

3.1. Population and Samples

This research uses quantitative approaches. The population in this study was manufacturing companies listed on the Indonesia Stock Exchange in 2014-2017. This selection was based on cases of fraudulent financial stewardship during the 2014-2017 period that occurred in Indonesia, especially in companies in the manufacturing sector (ACFE, 2016a). Sample selection is made using the purposive sampling method to get a

representative sample by the specified criteria. The sample criteria used in this study are as follows:
1) Manufacturing companies listed on the Indonesia Stock Exchange for the period 2014-2017.
2) Manufacturing companies that consistently published annual reports for the period 2014-2017.
3) Manufacturing companies that issue reports in the rupiah currency.
4) The Company discloses information about management discussion analysis and data related to variable measurements required.

3.2. Variable Operational Definitions

3.2.1. Dependent variables

Variable agency costs are costs arising from agency conflicts. Agency costs are a fundamental indicator of agency conflicts that can incur the cost of monitoring by the principal. In this study, researchers refer to previous studies conducted wherein measuring agency costs is measured by asset turnover (ATO). The asset turnover ratio is used to measure the efficiency of the company's assets. Because a high turnover of assets reflects assets in the utilization of resources and with increasingly productive in using these assets can create value for shareholders.

$$\textbf{Asset Turnover (ATO)} = \frac{\textbf{Total Sales}}{\textbf{Total Assets}} \quad .... \quad (1)$$

Where:
Asset Turn Over : management's ability to efficiently leverage assets to generate sales.
Total Sales   : total sales for the t-period.
Total Assets   : number of fixed assets and current assets

3.2.2. Independent variables

The independent variable in this study is the readability of the annual report in the analysis section of the sample company management discussion. Following previous research conducted by (Rennekamp, 2012; Loughran & Mcdonald, 2014; and Lo et al., 2017) in this study, researchers will measure the readability of company reporting using gunning Fox Index.

The Gunning fox index formula is used because the readability index is most commonly cited in business writing (Bogert, 1985). The fog index developed by Robert Gunning in 1952 is a fairly well-known and simple formula for measuring readability (Ajina et al., 2016).

$$\textbf{Fog} = \textbf{0.4 x (Word per sentence + Percent of a complex word)} \quad ... \quad (2)$$

The number of words per word is calculated as the ratio of the total number of words divided by the number of English sentences in the management discussion & analysis of the company's annual report. Complex words are words that have three or more syllables.

Klare's research (1974) showed that the number of two simple variables of word length and sentence length was relatively good enough in predicting readability. This study in calculating readability using gunning fog index tool in http://gunning-fog-index.com/website.

3.2.3. Internal control

Internal control is one of the mechanisms that can be used to ensure the quality of income and independent external auditors. The readability of the company's annual report includes a form of quality disclosure of company information, while the quality value of disclosure depends on the quality of revenue. According to said, "one aspect of

the provision of complete and reliable information and taken seriously by the financial community, one of which is the aspect of internal control".

Therefore, researchers used content analysis to calculate internal control indexes (Leng & Ding, 2011). Then in the analysis based on whether the item/phrase is used (exists) or not used (does not exist) in the annual report, which refers to internal control information (Uyar & Karamahmutoglu, 2012).

$$\text{Internal Control Index} = \frac{\sum \textbf{Actual Disclosures}}{\textbf{Possible Disclosure (8 items)}} \quad .... \quad (3)$$

Table 3.1.
Internal Control Evaluation

Items	Content
Control Environment	Governance structure, human resources policy, corporate culture.
Risk Evaluation	Identification of internal and external risks, risk analysis, risk response
Control Activities	Internal control activities based on risk
Information and Communication	Establishment of information and communication systems
Internal Surveillance	Internal oversight of the internal audit department
Internal Control Damage	Damage to abnormal items in internal controls and repair methods
Internal Assessment	Assessment of the board of directors
External Assessment	Assessment from external auditors

Source: adaptation from Leng and Ding (2011)

3.3. Data Analysis Techniques

The data used by researchers is secondary data in the form of annual reports of manufacturing companies in 2014-2017 listed on the Indonesia Stock Exchange. The data analyst techniques used are descriptive analysis, classic assumption test, and multiple linear regression with moderated regression analysis (MRA).

3.4. Research Model

The data obtained is then analyzed to test hypotheses using multiple regressions with rate analysis regression (MRA) mode, as follows:

$$\textbf{Y} = \boldsymbol{\alpha} + \boldsymbol{\beta_1 X_1} + \boldsymbol{\beta_2 Z_1} + \boldsymbol{\beta_3 X_1 * Z_1} + \boldsymbol{\varepsilon} \quad .... \quad (4)$$

Where:
Y   : Agency cost.
α : Constant.
$\beta_1 X_1$: Readability coefficient.
$\beta_2 Z_1$: Internal control coefficient.
$\beta_3 X_1 * Z_1$: Readability in moderation with internal control.
ε : Error.

IV. RESULTS AND DISCUSSIONS

4.1. Descriptive Analysis

Descriptive statistics analysis is done to get a descriptive picture of all variables used in the research conducted. The descriptive analysis describes the average, minimum, maximum, amount, and standard deviation values in the processed data (Ghozali, 2018).

Table 4.1.
Descriptive Analysis Results

Variable	N	Minimum	Maximum	Average	Std. Deviation
Agency Cost	200	.21	6.33	1.154	.7716
Readability	200	13.21	25.19	17.104	1.8356
Internal Control	200	.25	1.00	.745	.1546
Valid N (listwise)	200				

Based on the results of the descriptive analysis in the table below the readability value shows an average value of 17.10 which explains that the annual report of this research period has a high level of readability. This is consistent with stating gunning fog index scores of 14-18 (hard to read), 10-12 (acceptable), and 10-8 (easy).

4.2. Hypothesis Test

4.2.1. Multiple linear regression test with moderate regression analysis (MRA)

The data analysis conducted in this study is using multiple linear regression models with moderate regressions analysis to test the impact of annual report readability on agency costs with internal control as moderation variables. Here's a double linear regression table with MRA:

Table 4.2.
Multiple Linear Regression Test Results with Moderate Regression Analysis

Variable	Coefficient	Q	Significance
(Constant)	1.179	3.528	.001
Lag_X_1	-.901	-2.937	.004***
Lag_Z_1	3.684	2.653	.000***
Lag_X_1. Lag_Z_1	3.686	2.915	.004***
Change in adjusted R^2	3.507		

Notes: * p-value < .100; ** p-value < .050 and *** p-value < .010

4.2.2. Hypothesis test (t-test)

Partial t-tests are used to determine how far independent variables are individually describing dependent variables. The t-test was conducted by looking at the significance value with an alpha of 0.05. If the significance value is smaller than alpha 0.05, it can be concluded the hypothesis is accepted (Ghozali, 2018, p. 99).

Based on the results of multiple linear tests with moderate regression analysis in Table 4.2. can be concluded as follows:

a) T-test results between the readability of the annual report on agency costs obtained a significance value of 0.004 < 0.05 to be interpreted as having an influence. Based on this, it can be concluded that accepting hypothesis 1 that states the readability of the annual report affects the agency's costs.

b) The internal control t-test in moderating the readability effect of the annual report on agency costs obtained a significance value of 0.004 < 0.05 to be interpreted to accept hypothesis 2 that states internal control can moderate the impact of readability of the annual report on agency costs.

The coefficient of determination test (R^2) is conducted to know how much dependent variables can be explained by independent variables. A value of R^2 that is small or well below zero indicates that independent variables in describing dependent variables are very limited. Similarly, if the value of R^2 is close to zero, it explains that almost all the information is needed to predict the variation of dependent variables (Ghozali, 2018, p. 97). Table 4.2. above shows the value of the coefficient of determination (Adj. R^2) of 0.050 which can be interpreted that the variable Lag_Y (agency cost) can be explained by variables Lag_X_1, Lag_Z_2, and X_1. Z_2 is 4 %.

4.3. Discussion

4.3.1. Effect of annual report coherence on agency costs

The aftereffects of the principal theory test showed the yearly report coherence variable (X_1) influenced office costs(Y). The aftereffects of the various relapse tests in Table 4.2. show an importance worth of 0.004, which means not exactly the likelihood worth of 0.05. The determined t worth of -0.901 negative demonstrates that meaningfulness has a critical adverse consequence on ATO (asset turnover). Since the ATO is a threatening intermediary in estimating organization costs, it very well may be presumed that comprehensibility emphatically influences office costs. This can be deciphered as an expansion in the yearly report meaningfulness variable by 1 unit, and afterward the resource turnover will diminish by -0.901. As such, the organization charge increments by 0.901, expecting another autonomous variable in the relapse model is fixed. This demonstrates that yearly reports with high fog index (coherence) scores in the difficult to-peruse sense will in general have high office costs, etc. So the primary speculation that expresses the coherence of the yearly report significantly affects organization costs is satisfactory.

The aftereffects of this investigation are in accordance with research directed by said there is a positive connection between the simple to-peruse yearly report on office costs as estimated by resource use. Low resource use shows that administration puts resources into non-useful resources (not creating pay) in dealing with the organization's assets and expanding office costs. So sequestered from everything its failure in resource use, the board will in general make account data perplexing and hard to peruse. The aftereffects of the investigation are upheld by Luo et al. (2018) by demonstrating that yearly reports with an undeniable degree of intelligibility (simple to peruse) can decrease the degree of data imbalance among investors and the board and subsequently can build oversight inside the organization just as lessen office costs. In its exploration said that unmistakable, unambiguous revelations can expand financial backer certainty, lessen data deviation and accordingly decrease organization costs.

The consequences of this investigation had the option to help the hypothesis of the organization, which clarifies the connection among specialists and directors when a chief recruits a specialist to accomplish something or offer his types of assistance to support the head, one of which is designation of expert in dynamic (Jensen & Meckling, 1976). The coherence of difficult to-peruse yearly reports brings about the beginning of data imbalance among chiefs and specialists. The lopsidedness of data authority coming about because of hard-to-peruse yearly reports turns into an administration freedom to perform shrewd or deceitful activities on their choices. Contrasts in interests among specialists and administrators, conversely can cause office costs that ought not really happen. The office's high resource use costs show that administration in settling on choices can improve the organization's general exhibition, and make an incentive for investors, to adjust the interests among specialists and administrators in lessening office costs.

4.3.2. Effect of annual report readability on agency costs with internal control as moderating variables

In the principal test, there was no collaboration between the meaningfulness of the yearly report and the organization's expenses showed an importance worth of 0.004 with aimless than the likelihood worth of 0.05. In view of this, it very well may be said that the comprehensibility of the yearly report influences the office's expenses.

Interior control is another significant instrument as far as oversight that can be utilized to guarantee income quality. The intelligibility of the yearly report is a type of

organization revelation, while the quality worth of the divulgence relies upon the nature of income (Li, 2008). So fully expecting income quality can fortify the effect of the meaningfulness of yearly reports with office costs, there should be a type of inside control that can be utilized to guarantee the nature of income. As per said, the interior framework is one piece of good corporate administration, which in its instrument can improve the nature of monetary announcing, for example, benefit quality. As per Luo et al. (2018) said, presently, a few world controllers have made a bunch of guidelines as far as inner control pointed toward improving the organization's inside successful control in aggregating fiscal summaries to improve the nature of data revealed.

The hypothesis of the office clarifies that office connections can happen when at least one administrators enlist a supervisor (specialist) to accomplish something or offer their types of assistance to assist the head, one of which is assignment of expert in dynamic. There is a distinction of interest between each gathering with the potential for office clashes that can bring about costs that ought not happen if the organization is independent, called office expenses. Corporate administration is one of the administrative instruments that is relied upon to diminish tricking rehearses and guarantee that administration activities in settling on choices are in accordance with the interests of the head. As far as announcing, interior controls can improve the nature of monetary revealing and diminish administration issues.

In light of the aftereffects of the third speculation test, the impact of the meaningfulness of the yearly report on office costs with inside control as a balance variable shows an importance worth of $0.004 < 0.05$ implies that inner control factors moderate altogether between the clarity of the yearly report to the organization's expenses. A determined t worth of 2,915 that is positive shows meaningfulness directed with inner control having a critical constructive outcome on the ATO (turn over asset). Since the ATO is a negative intermediary for estimating office costs, it tends to be presumed that the meaningfulness of yearly reports directed by inside controls contrarily influences organization costs. This can imply that any expansion in 1 unit of clarity directed by inward control will expand resource turnover as such lessening organization costs. Accordingly the subsequent speculation is acknowledged. The aftereffects of this examination are in accordance with research led by which said the nature of interior control could direct the effect of coherence of yearly reports in diminishing organization costs. Accordingly, inward quality control can improve the nature of income and increment the intelligibility impact of the yearly report in leading oversight of sharp administration conduct, subsequently lessening office costs.

V. CONCLUSION AND SUGGESTIONS

The results of this study prove that readability affects agency costs. The increase in readability value causes a decrease in the value of asset turnover as a proxy for costs, thereby increasing agency costs. The study results explain that companies that have high readability of annual reports can reduce information asymmetry between shareholders and management to reduce agency costs. In addition, internal control can moderate the readability of annual reports against agency costs. This reflects that internal quality control can increase management supervision on the effect of readability of annual reports to reduce agency costs.

Impediments in this examination incorporate estimating the intelligibility of yearly reports with gunning haze file equation just compelling in English content. Furthermore, there are as yet numerous organizations that report yearly reports as

sweep information. In light of the aftereffects of this examination, it is suggested that scientists would then be able to utilize the right estimating instrument or coherence equation to gauge Indonesian content and can utilize unique applications in computing meaningfulness text with information as output information.

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