

CHAPTER II. THEORITICAL FRAMEWORKS

2. 1. Theoretical Framework

2. 1. 1 Agency Theory

Definition of agency theory by Jensen and Meckling (1976) is a contact relationship of the principals and the agent, which principals delegate agent performing service on behalf of the decision making. Azzahra, Luthan, and Fontanella (2020) stated that agency theory occur since the principal only invests in the company and does not directly manage it. Principal considered as investor or stakeholders in the other hand, agent such as board of directors or managers is the one who operate the company and have the authority to decide within the company. This theory describes that each party only focus on their sake which cause a conflict of interest between principal and agent.

According to Abrar (2018), both the principal and the agent seek to maximize their own interests, resulting in information asymmetry. When one party (agent) has more power and information about the company, there is an information asymmetry. External stakeholders' lack of knowledge about a company results in a poor valuation. By reducing information asymmetry, the firm's value can be increased. It can be decreased by producing solid financial information, for example, to lessen ambiguity about the company's prospects (Wolk et al, 2000).

One strategy to overcome information asymmetry, according to Healy, Hutton, and Palepu (1999) is for the agent to disclose all information so that the principal can evaluate the portion of their investment that has been appropriately managed. The gap between management and investors can be bridged by sharing firm results to demonstrate the company sustainability in the long-term. Investors are more interested in investing their cash where thorough transparency is reported, they also have the right to know all companies' information.

Biological asset disclosures give investors a confidence since they demonstrate that a company's biological assets are well-managed and transparent.

The amount of compliance with mandatory disclosure, according to Sutyok and Rahmawati (2014) is directly tied to agency theory. Mandatory disclosure and voluntary disclosure are the two types of financial reporting disclosure. In mandatory disclosure, the information is included in the annual report or is required by applicable accounting standards, whereas voluntary disclosure refers to information provided by the company as supplementary information which the scope is determined by each corporate policy. Biological asset disclosure is related to the mandatory disclosure indicated in PSAK No. 69 about agriculture, which has since become the financial disclosure guidance for agricultural companies. According to Prawinandi et. al (2012), financial disclosure serves as a guide for rational decision making, a form of management responsibility, and compliance with applicable regulations or laws for investors, creditors, and other users.

2. 1. 2 Signaling Theory

Signaling theory, according to Djono (2019), recommends how a company should communicate with financial statement users because the company understands more about its internal operation and its prospects than external parties. Reliable financial data reduces investor concern about the company's future and sends a favorable signal (Azzahra, Luthan, & Fontanella, 2020). Signals, according to Brigham and Houston (2011), offered information about the company's actions as a means of realizing public or shareholder desires. This theory explains how businesses behave in order to take advantage of full financial statement disclosure, which sends a good signal to other parties. Agents frequently release thorough and transparent information in the hopes that investors will view it as a good indicator of the company's performance.

According to Djono (2019) using regulation like PSAK No. 69 can increase the quality of reporting information and provide more information about a company's competitive advantage, sending a favorable signal to its users. A favorable signal for the company is adequate and reliable information, which distinguishes it from competitors. Signaling external parties can be accomplished in this study by providing trustworthy biological asset measurements and a description of the relationship between biological asset disclosures and biological asset intensity, company size, and profitability.

2. 1. 3 Biological Asset

2. 1. 3. 1. *Definition*

Living plants and animals which undergo biological transformation refer to biological assets (Dewan Standar Akuntansi Keuangan, 2018). Either current or non-current assets are the classification of biological assets in financial statements. Biological transformation is quantitative or qualitative changes experienced by the biological assets. Agricultural company owned this unique asset which in the financial report classified as an asset. This uniqueness results from the biological transformation of plants and animals to produce either product that can be consumed directly or reprocessed to produce other products (Jesemčika, 2010). Fresh fruit bunches from oil palm, tea, rubber latex, chicken, beef, and fish are examples of biological assets commonly found in Indonesia. The biological assets and agricultural products of an entity are recognized if in the past, the company has control, there is benefits which flow onto company, and the cost of biological assets can be reliably measured using fair value (International Accounting Standard Committee, 2022). Derived from the description, biological asset is plant and animal obtained by

agricultural company from the past events which during their lifetime experience a biological change.

2. 1. 3. 2. Characteristics

Agricultural activities make extensive use of biological assets. PSAK No. 69 defines agricultural activity as "a mechanism for managing biological transformation and the harvesting of biological resources for the purpose of sale, conversion into agricultural products, or the creation of more biological resources." Besides their characteristics of biological transformation, the measurement of revenue is correlated with asset growth or when an asset is sold. The term "biological transformation" refers to the natural transformation of biological assets through growth, aging, disease treatment, and the development of new biological assets through reproduction until it can no longer reproduce itself and dies.

Growth refers to an increase in the number or quality of animals and plants. For example, the body weight of beef cattle increases as the cow ages. Both quantity and quality of an animal or plant's life could decline, which is what is meant by the term "decline." Dairy cows, for example, have lower milk quality or produce less milk. Reproduction occurs when a parent produces one or more offspring through mating or vegetative reproduction. Annual or annual crops, agriculture, plantation cultivation, forestry, flower cultivation, and aquaculture are all examples of agricultural activities (fish cultivation) (Dewan Standar Akuntansi Keuangan, 2018). Certain common features exist are:

1. The capability of living plants and animal to change by increasing the quantity or improving the quality of animals or plants (growth), decreasing the quantity or decreasing

the quality of animals or plants (degeneration), or creating additional living animals or plants (procreation);

2. Change of the management according to Sedláček (2010) involves improving or stabilizing (nutrition, humidity, temperature, fertilizing, and light conditions) for a process called biological transformation, which is an efficient way to exploit crops; and
3. Change of the measurement related with quality and quantity during biological transformation or harvest is monitored and measured routinely (International Accounting Standard Committee, 2022).

2.1.3.3. Types

Biological asset can be separated into two types depend on their features and useful life or period of biological transformation.

1. Features

A study of Bohušová, Svoboda, and Nerudova (2012), argued that biological assets can be split into two types based on the production system which are:

- a. Consumable biological asset is animal and plant which solely harvested as agricultural production for sale, such as livestock for meat production or for sale, annual crops such as maize and wheat, and timber from trees as agricultural products.
- b. Bearer biological assets is an asset which is not agricultural product but is owned by the company to produce agricultural products and can be self-generated such as cattle to produce milk, grapevines, and trees which already produce wood but still grow.

2. Useful Life or Period of Biological Transformation

According to Sedláček (2010), animals and plants are separated into long-term and short-term life cycles in the balance sheet.

- a. Short term biological assets with a useful life of less than a year are classified as current assets. Examples of short-term biological assets are plants or animals that can be harvested or sold in the first year or second year after breeding or seedling such as fish, chickens, rice, and corn.
- b. Long term biological assets with a useful life of more than a year are classified as non-current assets. Examples of long-term biological assets include fruit-producing plants (oranges, apples, durians) and plants or animals that can be harvested or sold for more than one year (horses, cows, donkeys).

2. 1. 4 Pernyataan Standar Akuntansi Keuangan No. 69

2. 1. 4. 1. *General*

PSAK No. 69 intends to control the disclosure and accounting treatment of agricultural product and biological assets in relation to agricultural activities. PSAK No. 69 does not apply to a variety of items, including land used for agricultural purposes as described in PSAK No. 16 about fixed assets, PSAK No. 13 about investment properties, and ISAK No. 25 about land rights; and productive crops (bearer plant) used for agricultural purposes as described in PSAK No. 16 about fixed assets, government grants related to bearer plants (PSAK No. 61 Accounting for Government Grants and Disclosure of Government Assistance), and intangible assets related to agricultural activities (PSAK No. 19).

PSAK No. 69 regulates each step of a biological asset in a different way; for example, sheep, dairy cattle, and pigs are biological assets that produce agricultural products such as wool, milk, and pork, and are covered by PSAK No. 69. Tea plants, grapevines, oil palm trees, and rubber trees are examples of crops that fit the description of bearer plants under PSAK No. 16 respecting Fixed Assets. However, the goods grown on these productive plants, such as tea leaves, grapes, oil palm fresh fruit bunches, and rubber latex, are covered by PSAK No. 69, which is about agriculture. Agricultural products are included in the scope of PSAK No. 14 about inventory if they are reprocessed into cheese, yarn, wine, palm oil, and rubber products.

Agricultural company acknowledge biological assets based on PSAK No. 69 in the form of agricultural goods, seasonal crops, and animals. Biological assets are assets that produce agricultural products (such as milk from cows), agricultural products (such as beef from cows), and other biological assets (cows produce calves). Agricultural product, on the other hand, are harvested from biological assets, and PSAK No. 69 measured at the harvest point.

Table 2. 1

Example of Biological Asset, Agricultural Produce, and Processed Product

Biological Assets	Agricultural Produce	Processed Product
Sheep	Wool	Yarn
Dairy cattle	Milk	Cheese
Pig	Pork	Sausage
Tea plants	Tea leaves	Tea
Grapevines	Grapes	Wine
Palm trees	Oil palm fresh fruit bunches	Palm oil
Rubber trees	Rubber latex	Rubber product

Source: PSAK No. 69 (2022)

2.1.4.2. Scope

The scope of PSAK No. 69 shall be applied on the following when they relate to agricultural activity:

1. Biological assets, except bearer plants;
2. Agricultural produce at the point of harvest; and
3. Government grants covered in paragraph 34 and 35.

Tea, grapes, oil palm, and rubber are examples of plants that meet the definition of productive crops as defined in PSAK NO. 16 regarding Fixed Assets in Agriculture: Bearer Plants. Bearer plants that are not included in PSAK No. 69 since it is become a provider of agricultural products, expected to produce agricultural product over a period, and can be sold as incidental scrap but has a small chance of being sold as agricultural products (for example cut down and sell tree trunks as firewood).

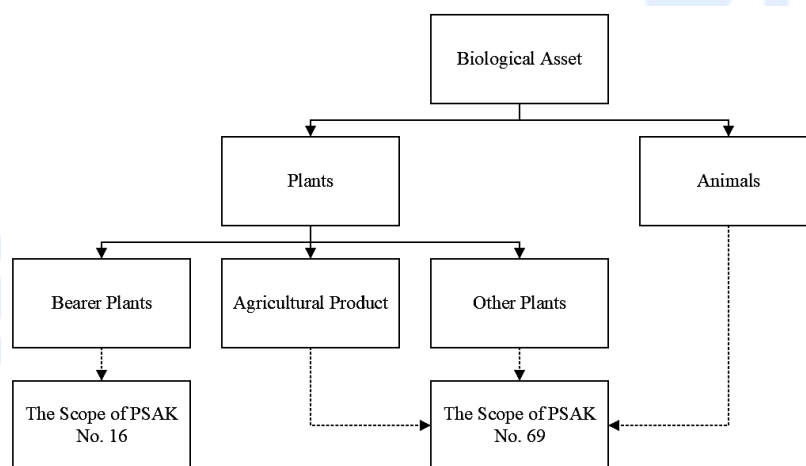


Figure 2. 1

The Scope of PSAK No. 69

Assets that are not identified as bearer plants, on the other hand, have the following characteristics, according to PSAK No. 69:

1. Plants that are grown to produce agricultural products (for instance, trees grown being used as lumber);
2. Plants that are grown to produce agricultural products and more than a remote likelihood of being harvested and sold as agricultural products than accidental scraps;
3. Annual crops; and (for example, corn and wheat).

2. 1. 4. 3. Recognition

If a company has control over past occurrences, future financial benefits are likely to flow to the company, and the cost of biological assets can be accurately determined using fair value, then the company is required to recognize its biological assets and agricultural products. Gains and losses are recorded in the period in which agricultural goods and biological assets are first recognized and added to profit or loss (Dewan Standar Akuntansi Keuangan, 2018). A loss occurs when a biological asset is first recognized because costs to sell are deducted in determining fair value less costs to sell biological assets. Gains may occur during the initial recognition of biological assets, such as when a calf is born. Gains or losses from agricultural products may arise because of crop yields at the time of initial recognition. According to Vijay (2022) biological assets and agricultural products are recognized only if and only if the entity, in this case the government, has control over the assets. A biological asset that is not under control is for example ocean fishing.

2. 1. 4. 4. Measurement

According to PSAK No. 69, the measurement of a biological asset at initial recognition is its fair value less costs to sell at the end of each financial reporting period. Profit and loss for the period includes any gains or losses brought on by changes in

fair value. Biological assets and agricultural products must be categorized according to their characteristics, such as age or quality, for calculating fair value. The selection of these attributes is used as the basis for determining the price and must be in accordance with the attributes in the market. The company also does need to calculate for cash flows in asset financing, taxation, or biological asset regrowth after harvest (for example, costs of replanting timber forests after harvest).

Because biological assets, particularly plants, are physically attached to the soil, there is no separate market for this attachment. Therefore, using data about these integrated assets, companies can determine the fair value of biological assets in a market that is active. For instances, to calculate the fair value of biological assets, subtract the fair value of undeveloped land and land development from the fair value of the combined assets (Dewan Standar Akuntansi Keuangan, 2018). Fair value based on IAS 41 assessed biological assets and agricultural product, according to Cavalheiro, Gimenes, Binotto, and Fietz (2019), except that it is hard to evaluate them properly. Alternative measurements of biological assets are unreliable if quoted market prices are not available at the time of initial recognition. If it is not possible to evaluate properly, the measurement can be conducted by deducting its cost from the total amount of accumulated depreciation or impairment loss.

2.1.4.5. Disclosure

Upon initial recognition of biological assets and agricultural products, the company declares the combined gain or loss for the period in the form of a narrative or quantitative description, which is determined as changes in fair value minus expenses to sell. Quantitative description is the process of

identifying biological assets that may generate mature and immature harvests, bearer biological assets and consumable biological assets, or any combination of these which have met harvesting requirements. This distinction provides data that can be used to forecast the timing of future cash flows.

Separate disclosure by group is essential to evaluate the company's present performance and prospects, especially when the cycle is more than a year old since there will be physical changes and market price changes of biological assets. This type of information, however, is less useful for shorter cycles, such as raising chickens. Companies must disclose the nature and amount of material revenues and expenses in accordance with PSAK NO. 1: Presentation of Financial Statements because agricultural activities are frequently affected by disease, climate, or other natural risks (Dewan Standar Akuntansi Keuangan, 2018).

2. 1. 5 Definition of Disclosure

Financial statement disclosure is the submission of information in financial statements to optimize the needs of efficient capital market operations to parties who require management discussion and analysis, notes to financial statements and other complementary reports. According to Ghozali and Chariri (2007), the term disclosure means not covering or not hiding. Disclosure means providing a sufficient explanation and can represent the actual situation in the company. Thus, information must be complete, clear, accurate, and reliable by portraying the conditions being experienced by the company, both financial and non-financial information, so that no party will be harmed. According to Nuswandari (2009), disclosure is aim of providing information that is deemed necessary to be submitted to provide services to parties in need and to achieve the objectives of financial reporting.

Good quality of disclosure which information must be accurate and relevant is needed to effectively conduct decision-making. The quality of information is the ability of data information provided to meet the expectations of the company in financial activities, thus can be useful in making the right and reliable investor decisions. As suggested by Xiao, Yang, and Chow (2004), content information stated in company website's content is more relevant than its presentation. Diamond and Verrecchia (1991) found, if a company publishes a high-quality financial report in standard format, investors are likely to see the company as less risky.

2.1.5.1. Biological Asset Disclosure

According to Ownusu (1998) financial and non-financial information are used to disclose biological assets' situation and performance. If the company does not disclose and publish information about each group of biological assets, the company must describe each kind of activities for biological assets' one by one, as stipulated in both IAS 41 and PSAK No. 69. The company must report the assumptions or methods used to establish the fair value of each group of agricultural produce and biological assets at the time of harvest. The profit and loss totals of the biological asset that occur over time.

Table 2. 2

Items of Biological Asset Disclosure based on PSAK No. 69 and IAS 41

Paragraph	Item No.	Disclosure Index
Mandatory Item:		
40		An aggregate gain or loss arising during the period:
40	1	On initial recognition of biological assets
40	2	On initial recognition of agriculture produce
40	3	Change in fair value less costs to sell of biological assets
41	4	A description of each group of biological assets
42	5	The description of paragraph 41 is narrative

42	6	The description of paragraph 41 is quantified
46		If not disclosed elsewhere in the information published along with the financial statements, the entity describes:
46	7	A description of the nature of an entity's activities with each group of biological assets
46		A description of non-financial measures or estimates of physical quantities:
46	8	Assets on hand at the end of the period
46	9	Agricultural produce output during the period
47	10	The methods and assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets
48	11	The fair value less costs to sell of agricultural produce at the point of harvest
49	12	The information about biological assets whose title is restricted or that are pledged as security
49	13	The number of commitments for development or acquisition of biological assets
49	14	The financial risk management strategies related to biological assets
50	15	A reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the period
50	16	This reconciliation includes desegregation
54		Additional disclosures when fair value cannot be measured reliably: The entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses
54	17	A description of the biological assets
54	18	An explanation of the reason which fair value cannot be measured reliably
54	19	The range of estimates within which fair value is highly unreliable
54	20	The depreciation method used
54	21	The useful lives or the depreciation rates used
54	22	The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period
55	23	Gain or loss recognized on disposal of such biological assets
55	24	Impairment losses, in case of disposal
55	25	Reversals of impairment losses, in case of disposal
55	26	The depreciation, in case of disposal

56		The entity disclose-The fair value of biological assets previously measured at cost less any accumulated depreciation and impairment losses become reliably measurable during the current period
56	27	A description of the biological assets
56	28	An explanation of why fair value has become reliably measured
56	29	The effect of the change
57		The entity disclose-Government grants
57	30	The government grants
57	31	The nature and level of government grants recognized in the financial statements
57	32	Fulfilled conditions and other contingencies attaching to government grants
57	33	Significant decreases expected in the level of government grants
Non-Mandatory but Recommended Items:		
43		A quantified description of each group of biological assets, distinguishing between:
43	34	Consumable and bearer assets
43	35	Mature and immature assets
51	36	The amount of change in fair value less costs to sell included in profit or loss due to physical changes and due to price changes

Source: PSAK No. 69 and IAS 41-customized (2022)

2. 1. 6 Biological Asset Intensity

In 2017, Amelia revealed the proportion of biological assets owned by the company performed by looking at the intensity of biological assets. Intensity is a quantitative metric that also describes the amount of money obtained when a corporation sells its assets. According to Zufriya, Putri, and Nur (2020), generally, intensity is defined as a company's effort to give information to the user of an annual report. Biological asset intensity depicts the amount of biological assets owned in order to provide a description and disclosure on the annual report that adheres to accounting rules.

2. 1. 7 Company Size

The size of a company is a scale used to categorize businesses as small or large. According to Putri and Siregar (2019), large organizations

typically have larger total assets, and small companies typically have fewer total assets. As a result, huge companies are being forced to reveal more biological assets. In terms of overall assets, sales, and stock value, the expectations on disclosure are higher for larger companies than for smaller companies. According to Amelia (2017), thorough and transparent disclosure imply that the company has followed effective corporate governance practices.

2. 1. 8 Profitability

Harahap (2007) said that through sales activities, cash, capital, human resources, and so on the company earns a profit called profitability. Meanwhile, according to Irawati (2018), the profitability ratio measured the operational efficiency of a company in managing its assets to generate profits during a certain period (example semiannual, annual, and others). According to Kasmir (2011), profitability is the ratio of the level of effectiveness and company performance in generating profits from company activities with the support of company resources and management. In line with the signal theory, the company's profit information gives a positive sign to investors on the effectiveness and good performance of the company. Detailed information about biological asset add value in the form of firm performance not only give confidence to investors that biological assets are well managed as a form of accountability but also as a source of profit. Profitability in agricultural companies indicated their ability in managing their biological assets to obtain a certain level of profit.

2. 2. Previous Research

Even though PSAK No. 69 on agriculture offered a guideline for the accounting treatment and disclosure of agricultural activities, companies' compliance with this regulation is rarely examined. Previous research tried to investigate the elements which can affect the disclosure of biological assets and

obtained inconsistent results. Previous research has found that the biological asset intensity of an agricultural company is the most investigated factor, followed by company size and profitability. Duwu, Daat, and Andriati (2018), argued that the more intense the company's biological assets are, the more urge to reveal more thorough and detailed information about biological asset. The disclosure acts as a form of management's accountability to stakeholders as well as a signal to investors that the company may handle its biological assets, which are a source of revenue for agricultural companies.

Jensen and Meckling (1976) suggest that because large companies have a higher share of capital and agency costs, thorough and detailed disclosure of information to stakeholders is required. Furthermore, because large companies are frequently observed by stakeholder groups, positive disclosure practices are likely to be used if the company tries to reduce political costs (Duwu, Daat, & Andriati, 2018). In line with Amelia's research in 2017, the larger a company's biological assets are, the more likely it is to reveal them. It also shows that the company has applied good corporate management practices by disclosing a lot of information. Agricultural company with high total assets has the same interests as agricultural companies with small total assets, which is to raise additional capital from external parties. Therefore, even if an agricultural company has little total assets, it will nonetheless disclose its biological assets to compete with bigger companies (Riski, Probowulan, & Murwanti, 2019).

High or low profitability, as measured by the ratio of net profit before tax to total equity owned by agricultural company according to Zufriya, Putri, and Nur (2020). Riski, Probowulan, Murwanti (2019) stated that the breadth of disclosure of biological assets is influenced by the success of agricultural company. Agricultural company with a high degree of profitability are more likely to disclose a wide range of biological assets than those with a low level of profitability. As a result, the impact of agricultural company on the company's disclosure of biological assets becomes a center of attention for investors when making investment decisions. Profitability can be considered as a metric of manager success, according

to Duwu, Daat, and Andriati (2020). Profitability is a measure of a company's capacity to generate profits. Meanwhile, low profitability shows ineffectiveness of the company's actions, thus the corporation is hesitant to release excessive financial statistics for fear of losing investors.

2. 3. Hypotheses Development

2. 8. 1. Biological Asset Intensity Effect on The Biological Asset Disclosures

According to Amelia in 2017, the proportion of biological assets owned by a firm is calculated by looking at the intensity of biological assets, the portion of intensity indicating the company's investment in biological assets. Intensity is a quantitative metric that also describes the amount of money obtained when a corporation sells its assets. It is suggested that a rise in biological asset intensity corresponds to an increase in biological asset disclosure levels. According to Silva et al. (2012)'s research, the reporting of biological assets ensures the standard's conformity to financial statement users. Routes and Patricia (2014), Yurniwati, Djunid, and Amelia (2018) found that there is an influence of intensity on the disclosure of biological assets in previous study. The rise of the level on biological asset intensity followed by the increase of the disclosure (Selahudin et al. 2018).

The increase in biological asset disclosure is accompanied by an increase in biological asset intensity, as seen in the illustration. Wider and more transparent disclosure of the intensity of biological assets in financial statements published by management sends signals to investors, confirming the company's compliance with regulations and facilitating stakeholders' understanding of the portion of the company's investment in biological assets. If the biological asset intensity is high, the agricultural company is advised to declare biological assets as well as follow the rules. Stakeholders are more likely to invest in a company that complies with regulations.

H₁: Biological asset intensity positively effect on the compliance of agriculture company using items of biological asset disclosure based on PSAK No. 69.

2. 8. 2. Company Size Effect on The Biological Asset Disclosures

Large companies demonstrate a strong commitment to increasing business performance, which attracts investors (Kusumadewi, 2018). According to Route and Patricia's (2014) research, the scale of the company has an impact on biological asset disclosure since this scale is proportional to the level of biological asset disclosure. According to Yurniwati, Djunid, and Amelia (2018), as well as Riski, Probowulan, and Murwanti (2019), company size has a beneficial impact on biological asset disclosure. Company size has an impact on the disclosure of biological assets, according to Amelia (2017) and Routes and Patricia (2014).

The larger the company, the higher the demands on the disclosure than the smaller companies in terms of total assets, sales, and stock value. Small companies do not have resources as large as big companies to provide transparent, reliable, and relevant information which reduces asymmetric information and enhance investor interest (Azzahra, Luthan, & Fontanella, 2020). Referred to the illustration, company size has an impact on information disclosure because large organizations tend to have more resources, allowing them to disclose more extensive information to external parties. According to Dewi and Wirakusuma (2014), large companies have more workers, which makes financial report preparation faster and encourages timely disclosure.

H₂: Company size positively effect on the compliance of agriculture company using items of biological asset disclosure based on PSAK No. 69.

2. 8. 3. Profitability Effect on The Biological Asset Disclosures

Khodijah and Utami (2021) stated that wide information about company biological assets increased considerations level of investors to invest, so company can further increase their capacity or value. With these profits, companies can process information more comprehensively and widely (Abrar, 2018). One of the profitability ratios is Return on Assets (ROA). According to Sugiono (2009) ROA measures the rate of return of all existing assets, where the assets of agricultural companies are plants or animals (biological assets). ROA also shows the amount of net profit generated from each rupiah invested in total assets. A high ROA value shows that the management of assets into profits by the company is good (Khodijah & Utami, 2019).

It can be concluded that with high profits, high funds can be used to provide comprehensive, broad, and useful information for investors. A high profitability ratio shows the company's high ability to earn profits which encourages an increase in the disclosure of its financial statements. High financial support encourage company to increased disclosure of information to the public, including the disclosure of biological assets. According to Hackston and Milne (1996) companies with low profits only make disclosures to comply with applicable regulations. Riski, Probowulan, and Murwanti (2019) show positive effect of profitability on biological assets disclosure.

H₃: Profitability positively effect on the compliance of agriculture company using items of biological asset disclosure based on PSAK No. 69.