



Impact Factors of Conservatic Accounting



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Abstract

This study aims to obtain empirical evidence regarding the influence of firm size, company risk, capital intensity, debt covenant, and litigation risk on accounting conservatism. The population in this study were manufacturing companies listed on the Indonesia Stock Exchange from 2014 to 2019. The sampling technique in this study used a purposive sampling method to obtain 25 companies as research samples. The data analysis technique used in this study uses multiple linear regression. The test results show that firm size and litigation risk have a positive and significant effect on accounting conservatism. While testing on corporate risk variables and debt covenants does not affect accounting conservatism.

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1 Introduction

Companies are allowed to apply any method in preparing the financial statements, one of which is accounting conservatism. However, in IFRS the term accounting conservatism is known as prudence. The principle between prudence and conservatism has a fundamental difference is the recognition of income. In the concept of income, prudence may be recognized if the standards in revenue recognition are met, even though the realization has not been obtained. In contrast to conservatism where he recognizes the burden first, then the company will recognize revenue. The equation between these two concepts is a concept where they make the company more careful in evaluating each financial statement post in an uncertain situation,

The effect of accounting conservatism can be measured through many factors including firm size, company risk, capital intensity, debt covenant, and litigation risk. In this study, the manufacturing sector was chosen as the object of research because the manufacturing sector is more often found in the application of conservatism, because the conservatism principle arises due to the existence of an accrual component that can be regulated by company management, such as inventory, development and research, depreciation in which the accrual component is contained in manufacturing company. The motivation of this research is to conduct a re-study by bringing together several factors that are considered not consistent with previous studies. Besides, to determine the effect of firm size, company risk, capital intensity, debt covenant and litigation risk on accounting conservatism because until now there are still many companies that do not understand to apply accounting conservatism, accounting conservatism is very important to be used in evaluating financial statement items with caution, so that investors believe and will not occur adverse events that occur in the future to achieve the survival of the company.

Literature review and development of hypotheses

Agency Theory

The relationship between agency theory and accounting conservatism is that the agency theory forces the company to explain all costs and revenues that are in the company. Given that agency, the theory is one place for direct interaction between companies and investors. With coercion, it makes managers make reports that are as clear and understandable as possible.

Positive Accounting Theory

Positive accounting theory holds that managers are rational (like investors) and will choose accounting policies in their own best interests if they can do so. Positive accounting theory emphasizes the need for empirical research to emphasize how the trade-off between capital and contract costs, between managers choosing a set of accounting policies and the company's management structure, varies depending on the environment. Positive accounting theory does not try to patronize people or constituents about what they should do. Theories that do this are called normative theories. Whether or not the ability of the normative theory to predict depends on the extent to which each individual decides as suggested by the theory.

Effect of Firm Size on Accounting Conservatism

Hope to create a good political relationship, so the company will make financial statements very carefully so that the company applies the concept of accounting conservatism. The higher the firm size or in other words, the larger companies, the higher the level of the prudence of the company in reporting their finances, so it is easy to understand and be trusted (Andini & Sukartha, 2020; Moeller *et al.*, 2004). This is supported by researchers Sinarti & Multihatunnisa (2015) and Susanto & Ramadhani (2016) who state that firm size has a positive effect on accounting conservatism. Based on the description of the results of previous studies, the researchers propose the following hypothesis:

H1: Firm size has a positive effect on accounting conservatism

Effect of Company Risk on Accounting Conservatism

Creating financial statements that make the company will be more careful in making the value of each post in the report

so that it can be held responsible by the company if there are problems or risks of the company (Hung, 2000; Cabedo & Tirado, 2004). High company risk will make managers more careful or conservatism in disclosing every financial statement post. This result is supported by researchers, Agustina *et al.* (2016), who state that company risk positively influences accounting conservatism. Based on the description of the results of previous studies, the researchers propose the following hypothesis:

H2: Company risk has a positive effect on accounting conservatism

Effect of Capital Intensity on Accounting Conservatism

Capital agencies are a measure of the use of funds. The use of a company's funds makes the company must issue financial reports. Good financial statements can be seen from the values of financial posts that can be accounted for. In making the value of the post in the financial statements accountable, the company must report every value listed in the financial post must be very careful that will make the company add value to the company and increase capital and also make the use of funds even higher because this capital will add operations and increased operations will also cause high costs. Therefore, the higher the capital intensity, the higher the accounting conservatism. This is in line with research from Agustina *et al.* (2015) and Susanto & Ramadhani (2016), which state that capital intensity has a positive effect on accounting conservatism. Based on the description of the results of previous studies, the researchers propose the following research hypotheses:

H3: Capital intensity has a positive effect on accounting conservatism

Effect of Debt Covenant on Accounting Conservatism

The creditor's curiosity makes the creditor want all the values in the post to have the true value, so the manager is required to be careful in disclosing the value of each item in the financial statements in other words, debt convenient influences accounting conservatism. This disclosure is in line with Noviantari & Ratnadi (2015) which states that debt covenants have a positive effect on accounting conservatism. Based on the description of the results of previous studies, the researchers propose the following research hypotheses:

H4: Debt covenant has a positive effect on accounting conservatism

Effects of Litigation Risk on Accounting Conservatism

Company reporting on the part of the law that will make the company feel more disadvantaged, both financially due to a long legal process, can also be a bad company value in the eyes of the public resulting in unsold products on the market and forcing companies to go bankrupt. Because they do not want to experience such a thing, the company generally issues its financial statements carefully, so that the values in the company's financial statements can be accounted for so that the company will not be involved in legal proceedings. Therefore, the risk of litigation affects accounting conservatism. Litigation risk will affect accounting conservatism in line with research from Aisya & Vestari (2019); Rizkyka *et al.* (2017), which states that litigation risk positively influences accounting conservatism. Based on the description of the previous research results above, the researchers propose the following research hypotheses:

H5: Litigation risk positively influences accounting conservatism

2 Materials and Methods

The population in this study are manufacturing companies listed on the Indonesia Stock Exchange from 2014 to 2019. The sampling technique in this study used a purposive sampling method to obtain 25 companies as research samples. The data analysis technique used in this study uses Multiple Linear Regression.

3 Results and Discussions

Multiple Linear Regression Test Results

Testing the hypothesis in this study using multiple regression analysis. The calculation results are presented in Table 1.

Table 1
SPSS Output Tabulation

Variable	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.180	.101		1,781	.077
Firm size	.006	.004	.155	1,638	.004
Company Risk	-.011	.015	-.066	-.725	.469
Capital Intensity	-.019	.012	-.142	-1.602	.011
Debt Covenant	.086	.032	.317	2,661	.139
Litigation Risk	.014	.009	.173	1,457	.477

Primary Data, 2020

A constant value of the positive value of 0.180 can be interpreted that if the value of firm size, company risk, capital intensity, debt covenant, and litigation risk is equal to zero, then the value of accounting conservatism will decrease by 0.180 which indicates that the company's earnings quality will increase. Coefficient value β_1 of 0.006 indicates that if the value of firm size increases by 1 unit, then the value of accounting conservatism will increase by 0.006 assuming the other independent variables are constant. The coefficient value β_3 of -0.019 indicates that if the value of capital intensity increases by 1 unit, the value of accounting conservatism will decrease by -0.019 assuming the other independent variables are constant. The coefficient value of β_4 is 0, 086 shows that if the value of debt covenant increases by 1 unit, the value of accounting conservatism will increase by 0.086 assuming the other independent variables are constant. The coefficient value β_5 of 0.014 indicates that if the value of litigation risk increases by 1 unit, the value of accounting conservatism will increase by 0.014 assuming the other independent variables are constant.

Coefficient of Determination (Adjusted R Square)

Table 2
Determination Coefficient Test (*adjusted R2*)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.251a	.363	.630	.0648082	1,844

Source: Data processed, 2019

In the determination coefficient test table it can be seen that the results of the determination coefficient test with an adjusted R2 value of 0.630 this means that 63.0% variation of accounting conservatism is influenced by variations in firm size (X1), company risk (X2), capital intensity (X3), debt covenant (X4) and litigation risk (X5) as influencing variables. The remaining 37.0% is influenced by other factors outside the model.

Test Model F

Table 3
F test

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.041	5	.008	1,935	.002b
	Residual	.605	144	.004		
	TOTAL	.645	149			

Source: Data processed, 2019 (Appendix 7)

In the model feasibility test table, the results of the calculated F are listed as 1.935 with a significance level of 0.002 which is smaller than the significance level of 0.05 so that it can be concluded that the regression model made is suitable for use in research.

Test Signification t-value

Based on Table 1, a partial analysis of each variable can be explained. The results of testing firm size variables on accounting conservatism are obtained value of 1.638 with a significance of 0.004 which is smaller than the real level (α) used is 0.05. These results indicate that firm size has a positive influence on accounting conservatism so that H₁ received. Variable test results company risk to accounting conservatism shows a t value of -0.725 with a significance of 0.469 which is greater than the real level (α) used is 0.05. These results indicate that corporate risk does not influence accounting conservatism so H₂ rejected. Variable test results capital intensity to accounting conservatism shows a t value of -1.602 with a significance of 0.011 which is smaller than the real level (α) used is 0.05. These results indicate that capital intensity has a positive effect on accounting conservatism so that H₃ received. Variable test results *debt covenant* to accounting conservatism shows the value of t is 2.661 with a significance of 0.139 which is greater than the real level (α) used which is 0.05. These results indicate that the debt covenant does not influence accounting conservatism so H₄ rejected. Variable test results litigation risk to accounting conservatism shows at the value of 0.1457 with a significance of 0.047 which is smaller than the real level (α) used is 0.05. These results indicate that litigation risk does not influence accounting conservatism so H₅ received.

Effect of Firm Size on Accounting Conservatism

Based on positive accounting theory, large companies are considered to be more politically sensitive and have a relatively large wealth transfer burden, so to anticipate the uncertainty of these political costs, managers within a large corporation will adopt conservative accounting policies to minimize these political costs. This means that the larger the firm size, the company will be more careful in the process of preparing financial statements so that the resulting financial statements will be more conservative.

The average increase in firm size indicates that the company's efforts to maintain the company to face competition by increasing the company's total assets each year. The greater the total assets of the company, the condition of the company can be said to be good and can be a positive signal to attract investors. Companies that are classified as large companies have higher profits than small companies, so large companies tend to have higher political costs. So companies that have large total assets will tend to report lower profits by applying the principles of accounting conservatism to avoid high political costs. Political costs are due to government taxation. The results of this study are consistent with the results of Noviantari & Ratnadi (2015); Hardiansyah (2013), which states that there is a significant influence between firm size and accounting conservatism.

Effect of Company Risk on Accounting Conservatism

The average company risk for conservatism values above average has a higher value than the average company risk for conservatism values below average company risk (Curry *et al.*, 2008; Allen & Jagtiani, 2000). The difference between the average company risk for accounting conservatism above and below the average is not large enough which indicates that the company's risk does not have a significant effect on the value of accounting conservatism. The company will create financial reports to avoid investment risk or company risk which will make the company suffer losses which will make investors not willing to invest. Risks arise as a result of careless disclosure or lack of accounting conservatism. Careless disclosure is a reflection of decision making in the wrong way to determine the values in the financial statement items. High company risk will be followed by an increase in accounting conservatism. Company risk does not affect accounting conservatism caused by the sample of companies in this study are companies that experience profits. Companies that experience profits are healthy or do not experience company risk. A large company risk or a company with a small company risk will also apply accounting conservatism because the company will think about its survival. Company risk does not affect accounting conservatism caused by the sample of companies in this study are companies that experience profits. Companies that experience profits are healthy or do not experience company risk. A large company risk or a company with a small company risk will also apply accounting conservatism because the company will think about its survival. Company risk does not affect accounting conservatism caused by the sample of companies in this study are companies that experience profits. Companies that experience profits are

healthy or do not experience company risk. A large company risk or a company with a small company risk will also apply accounting conservatism because the company will think about its survival. The results of this study are consistent with the results of the [Priambodo & Purwanto \(2015\)](#), the study which states that corporate risk does not have a significant effect on accounting conservatism.

Effect of Capital Intensity on Accounting Conservatism

Capital intensive companies certainly require large capital from external parties, in this case, investors who will invest. Capital-intensive companies will strive to present financial statements following investor expectations to provide confidence in the security of funds to be invested so that to achieve these objectives, managers will adopt accounting policies that will generate high profits to get attention and large capital, so the resulting financial statements tend to be optimistic and the level of accounting conservatism in the company will be low ([Khan & Watts, 2009](#); [Lara et al., 2016](#)).

The results of this study support the research of [Agustina et al. \(2015\)](#); [Bouquet et al. \(2004\)](#); [Reitenga \(2000\)](#); [Hasan et al. \(2013\)](#), which found evidence that capital intensity had a significant negative effect on the application of the principles of accounting conservatism. The results of this study are consistent with the results of [Noviantari & Ratnadi \(2015\)](#); [Hardiansyah \(2013\)](#), which states that there is a significant influence between capital intensity and accounting conservatism.

Effect of Debt Covenant on Accounting Conservatism

These results support the positive accounting theory put forward by [Watss & Zimmerman \(1986\)](#), which states that when companies begin to approach the occurrence of violations of debt agreements, the company managers will try to avoid the occurrence of these debt agreements by choosing accounting methods that can increase profits. Violations of debt agreements can result in costs and can hamper management's work, thus trying to prevent or at least delay it. Long-term debt contracts are agreements to protect lenders from the actions of managers against the interests of creditors. This contract is based on a positive accounting theory, the Debt Covenant hypothesis. The Debt convenient hypothesis predicts that managerial wants to increase profits and assets to reduce the cost of renegotiating debt contracts when companies break their debt agreements. It can also be said that the closer a company is to a breach of the debt agreement, managers tend to choose accounting procedures that can move future earnings to the current period so that accounting conservatism decreases. Debt covenant which does not influence accounting conservatism which is the result of this research is in line with research conducted by [Susanto & Ramadhani \(2016\)](#); [Tosi & Paidar \(2015\)](#).

Effects of Litigation Risk on Accounting Conservatism

Litigation risk is the risk inherent in a company that allows the threat of litigation by disadvantaged corporate stakeholders. The presentation of incomplete financial statements will lead to lawsuits because investors need accurate financial information about the company. If the financial statements are not presented in full, not following the contractual agreement with the investor, then the investor has the right to make lawsuits. If the presentation of financial statements is incomplete, there will be a high risk of litigation, this triggers managers to tend to increase conservatism because managers will pay more attention to accounting practices to avoid the threat of legal provisions. Whereas if the financial statement presentation is presented in full. The results of this study are consistent with the results of [Noviantari & Ratnadi \(2015\)](#); [Hardiansyah \(2013\)](#), which states that there is a significant influence between firm size and accounting conservatism.

4 Conclusion

Firm size-positive and significant effect on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange in 2014-2019. The greater the firm size, the company will be more careful in the process of preparing financial statements so that the resulting financial statements will be more conservative. Company risk does not affect accounting conservatism on manufacturing companies listed on the Indonesia Stock Exchange in 2014-2019. Company risk does not affect accounting conservatism due to the sample of companies in this study are companies that experience profits. Companies that experience profits are healthy or do not experience company risk

Capital intensity has a significant negative effect on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange in 2014-2019. Capital-intensive companies will strive to present financial statements following investor expectations to provide confidence in the security of funds to be invested so that to achieve these objectives, managers will adopt accounting policies that will generate high profits to get attention and large capital, so the resulting financial statements tend to be optimistic and the level of accounting conservatism in the company will be low. Debt covenant does not affect accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange in 2014-2019. When the company starts to approach the violation of the debt agreement.

Litigation risk significant positive effect on accounting conservatism on manufacturing companies listed on the Indonesia Stock Exchange in 2014-2019. If the presentation of financial statements is incomplete, there will be a high risk of litigation, this triggers managers to tend to increase conservatism because managers will pay more attention to accounting practices to avoid the threat of legal provisions. Meanwhile, if the presentation of financial statements is presented in full, then the risk of litigation will decrease so that managers tend to apply conservatism.

Suggestions which are relevant to be formulated based on the results of the discussion and conclusions above are manufacturing companies listed on the IDX should consider more total assets owned which in turn will generate an income which will later become the company's capital, where the results of the study conclude that capital intensity has a negative influence concerning accounting conservatism, the measurement used to measure the capital intensity variable, which is to compare between total assets and sales value, which means total assets is a measure of how much assets are used in a company's operations in a certain period. It is expected that in the future the company can choose investments in the form of assets, especially fixed assets, which in turn are expected to produce an income that will later become the company's capital.

Conflict of interest statement

The authors declared that they have no competing interests.

Statement of authorship

The authors have a responsibility for the conception and design of the study. The authors have approved the final article.

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