

## Factors Affecting Accounting Conservatism in Manufacturing Companies Listed on the Indonesian Stock Exchange in 2017-2019

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**Abstract.** Conservatism is a precautionary principle that can be considered in accounting because a company has an uncertain or unexpected event. The purpose of this study was to determine the effect of company size, capital intensity, debt covenant, and litigation risk on accounting conservatism. This study uses secondary data in the form of annual financial statements of manufacturing companies listed on the Indonesia Stock Exchange with the study period in 2017-2019. The population in this study were 168 manufacturing companies using a purposive sampling method, there were 25 company data included in the criteria. The analysis technique used is to use multiple linear regression analysis. The results of the analysis in this study indicate that at the time of the F Test all independent variables simultaneously influence accounting conservatism, and after the T test is performed shows that company size and debt covenant variables partially affect accounting conservatism, while other independent variables do not influence conservatism accounting, manufacturing companies listed on the Indonesia Stock Exchange in 2017-2019.

**Keywords:** company size, capital intensity, debt covenant, litigation risk, accounting conservatism

### 1. Introduction

Global competition has begun to be felt by companies in Indonesia by the end of 2019. This is due to the large number of companies that are allowed to enter free of charge in Indonesia. However, companies in Indonesia are not quite ready to face this global competition. One consequence is the lack of awareness of companies to use international Financial Reporting Standards (IFRS). The purpose of the company is required to implement this IFRS standard is to equal the financial statements of all companies in Indonesia with the world [1]. Financial statements are an operational result of a company in a period [2].

In the creation of known financial statements a concept called conservatism. In general, conservatism is said to be a principle that acknowledge costs or expenses in advance of income at the back. Conservatism often said to be a pessimistic principle due to revenues recognized later than the load. But some say conservatism as a helpful principle company in anticipation of not being too optimistic, as any speculation of the company is not can always run smoothly [1]. The influence of accounting

conservatism can be measured through many factors including the size of the company, the intensity of capital, debt covenant and the risk of litigation [3].

## 2. Literature Review

### 2.1 Agency Theory

Agency theory explains that an agency relationship arises when one or more principals hire another person (agent) to provide a service and then delegate decision-making authority to the agent. The relationship between agency theory and accounting conservatism lies in the theory of agency forcing the company to explain all costs and revenues contained within the company [4]. Given where agency theory is one of the containers of direct interaction between the company and investors.

### 2.2 Accounting Conservatism

Conservatism is usually defined as a prudent reaction to uncertainty, aimed at protecting the rights and interests of shareholders and debtholders who determine a verification of higher standards for acknowledging good news than bad news [5]. Such uncertainties and risks must be reflected in financial statements in order for the predicted value and neutrality to be corrected. Careful reporting will provide the best benefits for all users of financial statements. In measuring accounting conservatism using [1].

$$\text{CONACC} = \frac{(\text{NIO} + \text{DEP} + \text{CFO})}{\text{TA}} \times (-1)$$

Description:

CONACC = Conservatism profit according to the item to be paid

NIO = Operating profit for the year

DEP = Depreciation of the year

CFO = Total net cash flow from operating activities

TA = Total Assets

### 2.3 Company Size

Based on its size the company can be divided into companies large and small. Where large companies must have more complex management systems and high profits. However, large companies have more complex problems and risks than smaller companies. The size of the company can be expressed in the total assets, sales and market capitalization. The larger the total assets, sales and market capitalization, the larger the size of the company. The larger the company's assets, the more capital invested, the more sales the faster the turnover of money and the greater the market capitalization, the larger the company is known to the public. The size of the company can be measured by the following formula [6].

$$\text{Company Size} = \text{Natural Log (Total Assets)}$$

### 2.4 Capital Intensity

A relative measure in the use of capital that will be compared to labour factors in the company's process, especially the production process and measurement that is often used is the ratio of labour capital or capital shares in payment factors. The assets here are such as factory equipment, machinery and other properties owned by the company [5]. What this means is that this ratio will be able to give an idea of how much of the company's assets are already invested in the form of fixed assets. The company's assets can be cash, cash equivalents and capital. It is expected that the fixed asset will generate an income that will later become the company's capital. The measurements used in measuring variable capital intensity are as follows [3].

$$\text{Capital Intensity} = (\text{Sale Value}) / (\text{Total Assets})$$

### 2.5 Debt Covenant

A debt covenant is a debt contract measured by leverage. Leverage itself is a ratio that calculates how much a company's assets can pay off a company's liabilities. With the debt covenant, managers will get a lot of assets that come from the loans provided by the creditors. measurements used in this study to

measure debt covenant using leverage ratio. Leverage ratio has the purpose of analysing the spending made by the company in a way to pay off the composition of debt, capital as well as the ability of the company to pay interest and other fixed expenses [6]. The measurements used as debt covenant measurements are as follows:

$$\text{Debt Covenant} = (\text{Total Debt}) / (\text{Total Assets})$$

### 2.6 Litigation Risk

Litigation risk is a risk already attached to the company and may allow for the threat of litigation or law posed by the affected parties with the company feeling harmed. Risk comes from investors and creditors who feel losses due to companies that cannot pay debts or dividends to third parties that they eventually report to the authorities and the company feels the risk of such litigation [7]. To find out the risk of corporate litigation measured from the following formula:

$$\text{Debt to Equity Ratio (DER)} = (\text{Total Debt}) / (\text{Total Capital})$$

## 3. Methodology

This study uses a type of quantitative and qualitative data. this data uses secondary data which is the annual report of manufacturing companies listed on IDX. data retrieval procedure by taking several samples using purposive sampling method i.e. sample selection using criteria total of 168 manufacturing companies registered with IDX and after the selection of samples that entered into the criteria as many as 25 companies that will be used as observation data for 3 years. The analytical techniques used are quantitative and qualitative which are calculated using the SPSS program. Will be conducted classic assumption test (normality test, multicollinearity test, heteroskedasticity test, autocorrelation test), regression test and hypothesis test.

## 4. Result and Discussion

Before conducting the hypothesis, test using multiple linear regression analysis, the classic assumption test is carried out with the following results:

1. Normality Test, the results of the normality test in this study state that with a significance of  $0.109 > 0.05$ , this means normal distributed residual data.
2. Multicollinearity Test, the results from the multicollinearity test showed that the Tolerance coefficient for independent variables X1, X2, X3, and X4  $> 0.10$  (10%) and the VIF (Variance Inflating Factor) value of all these independent variables  $< 10$ . So, it can be stated that there is no multicollinearity between independent variables in the regression model, so no independent variables are excluded from the model.
3. Heteroskedasticity Test, the results of this test show that none of the statistically significant independent variables affect dependent variables. This is seen from the probability of its significance  $> 0.05$ , so the regression model does not contain the absence of Heteroskedasticities.
4. Auto correlation Test, results from an auto correlation test showed a Durbin Watson (DW) value of 1,653. The D<sub>l</sub> and d<sub>u</sub> values in the table at  $k = 5$  and the sample number 25, are 0.9530 and 1.8863, then DW of 1,653 is greater than the upper limit (d<sub>u</sub> = 1,877) and less than 4-d<sub>u</sub> (4-1.8863) then there is no positive or negative auto curation, this means there is no auto correlation so that it qualifies the classic assumption.

After passing the classic assumption test, it is followed by regression analysis regression equations obtained from the test results as follows:

$$\text{CONACC} = -0.233 + 0.006 X1 + 0.042 X2 + 0.110 X3 + 0.026 X4$$

Explanations that can be given related to the regression model that is formed are:

1. The constant resulting from the hypothetical test result of -0.233 means that if all independent variables are worth 0, then the company's accounting conservatism will be -0.233.

2. The regression coefficient of X1 (Company Size) was obtained by 0.006, the result shows if the size of the company rises by 1 unit it will be followed by an increase in accounting conservatism of 0.006.
3. The regression coefficient of X2 (Capital Intensity) obtained by 0.042 the result indicates that if the capital intensity increases by 1 unit it will be followed by an increase in accounting conservatism of 0.042.
4. The regression coefficient of X3 (Debt Covenant) was obtained by 0.110, the result shows if the debt covenant rises by 1 unit it will be followed by an increase in accounting conservatism of 0.110.
5. The regression coefficient of X4 (Litigation Risk) was obtained by 0.026, the result indicates if the risk of litigation increases by 1 unit it will be followed by an increase in accounting conservatism of 0.026.

#### 4.1 Statistic Test T

Table 1 Statistical Test Results T

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.233	.148		-1.571	.121
	Company size	.006	.005	.147	1.277	.006
	Capital intensity	.042	.018	.278	2.349	.222
	Debt Covenant	.110	.040	.425	2.741	.008
	Litigation risk	.026	.017	.244	1.581	.118

a. Dependent Variable: CON ACC

Variable X1 (Company Size) shows a coefficient yield of T of 1,277 at a significance of  $0.006 < 0.05$  this means X1 (Company Size) has a significant positive effect on variable Y (Accounting Conservatism). Variable X2 (Capital Intensity) shows a coefficient yield of T of 2,349 at a significance of  $0.222 > 0.05$  this means X2 (Capital Intensity) has no significant effect on variable Y (Accounting Conservatism), variable X3 (Debt Covenant) shows a coefficient yield of T of 2,741 at a significance of  $0.008 < 0.05$  this means that X3 (Debt Covenant) has a significant positive effect on variable Y (Accounting Conservatism) while variable X4 (Litigation Risk) shows a coefficient yield of T of 1,581 at a significance of  $0.118 > 0.05$  this means X4 (Litigation Risk) has no significant effect on variable Y (Accounting Conservatism). So, the results showed that only independent variables X1 (Company Size) and X3 (Debt Covenant) individually had a significant effect on variable Y (Accounting Conservatism), while other independent variables had no individual effect on profit management.

#### 4.2 Statistic Test F

The test results the F coefficient of 2,843 at a significance of 0.030 means  $> 0.05$ , which means the company size variable (X1), capital intensity (X2), Debt Covenant (X3) and Litigation Risk (X4) simultaneously or together have a significant effect on accounting conservatism variables (Y).

**Table 2** Statistic Test Result F

ANOVA <sup>a</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.059	4	.015	2.843	.030 <sup>b</sup>
	Residual	.363	70	.005		
	Total	.422	74			
a. Dependent Variable: CON ACC						
b. Predictors: (Constant), Litigation risk, Company size, Capital intensity, Debt Covenant						

#### 4.3 Correlation and Determination Coefficients

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.374 <sup>a</sup>	.540	.491	.0720398	1.653
a. Predictors: (Constant), Litigation risk, Company size, Capital intensity, Debt Covenant					
b. Dependent Variable: CON ACC					

Based on the results of this statistical test the size of Adjusted R is 0.491, which means only 49.1% of Variable Conservatism Accounting (Y) is affected by corporate size variables (X1), capital intensity (X2), Debt Covenant (X3) and Litigation Risk (X4) as well as 50.9% influenced by other variables.

## 5. Conclusion

Based on the results of the analysis and discussion in the previous chapter, it can be concluded as follows:

1. The variable size of the company has a significant effect on the conservatism of accounting with a positive coefficient direction, it means the larger the size of the company, the greater the action of accounting conservatism carried out by the company the larger the. The higher the size of the company or in other words the larger the company will be the higher the level of prudence of the company in reporting their finances, so that it is easy to understand and trust.
2. Variable capital intensity has no significant effect on accounting conservatism because managers will take accounting policies that generate high returns in order to gain trust and great capital from investors.
3. Variable debt covenant has a significant effect on accounting conservatism with a positive coefficient direction, it means the higher the debt covenant, the higher the act of accounting conservatism carried out by

4. The company is getting bigger. A debt covenant is a debt contract measured by leverage. Leverage itself is a ratio that calculates how much a company's assets can pay off a company's obligations. With a debt covenant, managers will get a lot of assets that come from loans and those provided by creditors. This fund loan demonstrates the ability of managers who manage all of the company's assets
5. Variable risk litigation has no significant effect on accounting conservatism. The risk of litigation has no effect on accounting conservatism due to the weak legal force that exists in Indonesia. Weak legal powers will keep companies from considering the threat of lawsuits. Companies that do not consider the threat of lawsuits will continue to report financial statements carefully or accounting conservatism because the company must continue to take responsibility for the company's financial statements so as to keep attracting investors.
6. Variable company size, capital intensity, debt covenant, and litigation risk simultaneously have a significant effect on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2017-2019.

## 6. Acknowledgment

Investors may consider factors that influence accounting conservatism in decision-making to invest. To be more careful and wiser in dealing with all the problems that occur. Especially related to accounting practices, one of which is accounting conservatism by not committing irregularities with respect to the threat of applicable legal provisions.

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