

The Effect of Financial Distress, Growth Opportunities, and Leverage on Accounting Conservatism

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Abstract: A company's financial statements reflect management's performance in managing company resources entrusted to it. Financial reports must be reported in accordance with the actual conditions of the company. Financial Accounting Standards provide the freedom to choose the accounting method that will be used in preparing financial statements. The flexibility given to management in choosing the accounting method to be used is one of which is applying the principle of accounting conservatism. This study aims to determine the effect of financial distress, growth opportunities, and leverage on accounting conservatism. The population in this study are state-owned companies listed on the Indonesia Stock Exchange for the 2016-2019 study period. The number of samples analyzed are 96 observational samples for 24 companies. The samples are selected using a non-probability sampling method with purposive sampling technique. The analysis technique used is multiple linear regression analysis. The results of this study indicate that financial distress has no effect on accounting conservatism, growth opportunities has no effect on accounting conservatism, and leverage has a positive effect on accounting conservatism.

Keywords: Financial distress, Growth Opportunities, Leverage, Accounting Conservatism.

I. INTRODUCTION

The capital market is currently very fast growing in Indonesia. The capital market is a means of bringing together companies that need capital and investors who want to invest. The company will try to increase the value of its company in order to attract investors to invest in the company (Fatoki, 2017). In making investment decisions, investors rely heavily on relevant and accurate information with the aim of receiving dividends and capital gains. This information is in the form of a company's performance in a certain period. Investors certainly do not expect mistakes and mistakes in making investment decisions (Vishnani & Misra, 2016). The quality of information in published company financial reports greatly affects the quality of investors' investment decisions. Financial reports must be reported in accordance with the actual conditions of the company. In addition, financial reports must be prepared in accordance with accounting standards applicable in Indonesia. Generally Accepted Accounting Principles provide flexibility to management to determine the methods and estimates that will be applied in accounting records and reporting of corporate financial transactions. The method in preparing financial statements will produce different financial statements for each entity according to the needs of the entity. One of the flexibility given to management in choosing the accounting method to be used is applying the principle of accounting conservatism (Noviantari & Ratnadi, 2015). Companies that apply this conservatism principle will tend to have low revenues and high costs. The principle of accounting conservatism is important to use in dealing with economic uncertainty and business activities which are then associated with situations that are likely to result in losses and conditions that allow for profit to be postponed until the situation is significant. (Hajawiyah et al., 2020). Accounting conservatism helps investors and gatekeepers (auditors, financial analysts, and the media) acting on their behalf to monitor the actions of managers (Hsieh et al., 2019). The principle of accounting conservatism needs to be considered to avoid errors in recording financial statements. In addition, the principle of

conservatism is needed to anticipate errors that can occur during the recognition and measurement of income and assets and to help reduce the possibility of manipulation of financial statements by company management. (Sari, 2020).

One of the cases is related to the application of accounting conservatism that occurred in the state-owned company PT Garuda Indonesia (Persero) Tbk. Garuda's financial statements posted a net profit of US \$ 809.84 thousand or IDR11.33 billion (exchange rate of 1 \$ = IDR14,000). Two commissioners Chairul Tanjung and Dony Oskaria refused to sign the 2018 book report because they did not agree with the recording of the cooperation transaction with PT Mahata Aero Teknologi which had been recognized as revenue. This recording is considered contrary to the Indonesian Financial Accounting Standards Statement number 23 paragraphs 28 and 29 (CNN Indonesia, 2019). According to the two commissioners of Garuda Indonesia, an accounting error occurred in entering the cooperation transaction with PT Mahata Aero Teknologi in the 2018 book report. This is because the agreement did not contain a clear term of payment, and the method of payment were still negotiated. The agreement was signed on October 31, 2018 even until April 2, 2019 the company did not receive any payment from PT Mahata Aero Teknologi even though one unit of equipment was installed at Citilink. (CNBC Indonesia, 2019). The case that happened to Garuda Indonesia proves the low application of accounting conservatism. There was an overstate of earnings on Garuda Indonesia's financial statements as of December 31, 2018. Management is considered to be not careful in presenting financial reports. In the case of Garuda Indonesia, the company in posting profits was deemed to have overstated profits and had excessive optimism which resulted in the company's printed profit being higher than it should have been.

The first factor that can affect accounting conservatism is financial distress. Financial distress can be interpreted as an early symptom of bankruptcy due to a decline in financial conditions experienced by a company. Based on signal theory, this financial distress condition can encourage managers to increase the principle of conservatism in presenting their financial statements. This shows that if the company is unable to complete its payment obligations, the manager will give a signal for the company to use the principle of conservatism in presenting its financial statements so that the resulting financial reports are of high quality (Nataliantari et al., 2020). Signal theory explains that managers provide signals to shareholders to reduce information asymmetry. The Indonesian Ministry of Finance has reported that several state-owned enterprises (SOE) are listed as vulnerable to bankruptcy. Financial distress starts from the company's inability to pay its obligations. A bad score in financial distress indicates a company is prone to bankruptcy. The government as the SOE manager can provide additional capital to companies experiencing financial distress. With this assistance, it is hoped that the company's financial condition will improve. This financial distress condition can certainly affect the behavior of managers in reporting company financial statements. Viola & Diana (2016), Syifa et al. (2017), Dilla & Afrizon (2018) and Sugiyarti & Rina (2020) found financial distress has a positive effect on accounting conservatism.

The second factor that can affect accounting conservatism is growth opportunities. Growth opportunities are opportunities to invest in things that benefit the company. In agency theory, companies with high growth opportunities will cause agency conflicts between shareholders and management. For investors or shareholders, company growth opportunities can provide high returns in the future due to high investment return opportunities for the company. For management, when the company experiences growth opportunities, it will choose to carry out investments that can provide benefits in the future compared to distributing company profits in the form of dividends (Holiawati & Julianty, 2017). SOE companies are ready to expand into overseas markets next year. SOE is deemed necessary to improve competitiveness in order to be able to compete globally. There are several SOE companies that plan to expand their business, such as PT Wijaya Karya Tbk., PT Inka, and PT Bank Mandiri Tbk. In 2020, PT Wijaya Karya Tbk. will expand the market to three countries, Madagascar, Mauritius and Ethiopia. PT Inka in 2020 in an effort to enter the global market, PT Inka will hook several other SOEs and offer product packages, starting from research, planning and financing. Several SOEs collaborated with, including PT KAI, PT Len Industri, PT Wijaya Karya, and others. PT Bank Mandiri Tbk. in the long term, it will expand its market in several countries, such as the Philippines, Vietnam and Malaysia (Market Bisnis, 2019). SOE companies are experiencing growth opportunities by seeking to expand their companies into the global market. Before doing business expansion, a company must consider its funding capability. This business expansion to the global market will certainly cost a lot. Therefore, SOE companies must prepare large funds so that business expansion activities can be realized. These growth opportunities can affect the company's financial statements, especially in presenting company profits. This is because the company is trying to save reserve funds which will be used for future expansion activities. Hakim (2017), Tazkiya dan Sulastiningsih (2020), Sugiyarti & Rina (2020), Nuraeni & Tama (2019) found growth opportunities have a positive effect on accounting conservatism

The third factor that affects accounting conservatism is leverage. Leverage indicates how much the company's assets are financed by debt as well as an indication of the level of security of the lenders (Haryadi et al. 2020). Based on the Debt Covenant Hypothesis in positive accounting theory, the company is in a *ceteris paribus* state, the company will decide to use accounting procedures that can replace earnings reporting for future periods to the current period if it has a high leverage ratio (Sumiari & Wirama, 2016). High earnings reporting will show positive company performance. This will provide assurance to creditors that the company can return the debt with the capital it owns, which is supported by the resulting profits (Affianti & Supriyati, 2019). Moody's Investor Service released that several SOEs in Indonesia are showing worrying debt levels. Several Indonesian SOEs that were highlighted in Moody's report were PT Waskita Karya Tbk. (WSKT), PT Garuda Indonesia Tbk. (GIAA), PT Adhi Karya Tbk. (ADHI), PT Kimia Farma Tbk. (KAEF), PT Karkatau Steel Tbk. (KRAS), and PT Indofarma Tbk. (INAF). PT Waskita Karya Tbk. (WSKT) occupied the first position with debts of IDR 9.7 trillion in 2014 to IDR 103.7 trillion at the end of June 2019, which increased by 970% in 6 years. PT Perusahaan Gas Negara Tbk. (PGAS) with a total debt of IDR 4,212.1 trillion, GIAA with a total of IDR 3,568.2 trillion, and KRAS of IDR 2,572.1 trillion (CNBC Indonesia, 2019). This shows that the level of debt held by SOE companies has increased significantly. The level of debt owned by this company is certainly not a problem if the company can pay off the debt. However, this excessive level of debt will result in the company having a high leverage ratio. This of course will create doubts for investors to invest or for creditors to provide loans for the company. This condition results in encouraging the behavior of managers who do not apply the principles of accounting conservatism in corporate financial reporting. This aims to generate high profits that can show the good performance of the company. Hafizhah (2016), Hotimah & Retnani (2018), Gustina, (2018), Utama & Titik (2018), Fitriani & Ruchjana (2020) found the results that leverage has a negative effect on accounting conservatism.

The reason for using this variable is because the three variables are mutually exclusive related and influence the application of accounting conservatism. Financial distress can be interpreted as a condition where the results of the company's operations are unable to meet the company's obligations (insolvency). Companies experiencing financial distress need action from management in order to improve the company's financial condition. Management can choose to use financial assistance in the form of debt or leverage. Creditors will certainly be more careful in giving their funds to companies that are experiencing financial distress because the company may not be able to pay its debts. Therefore, creditors have the right to know and supervise the company's operational activities. When the company's financial condition has improved, the company will always want to grow. This starts from the emergence of growth opportunities at the company. Growth opportunities can be defined as investment opportunities for companies to increase firm value in the future. The company's investment activities will certainly require large funds. These funds can come from internal and external company funds. When companies prefer to use external funds in the form of debt, they must be careful in using these funds. If management is unable to manage these external funds properly, a problem will arise which can lead to financial distress (Akhsani, 2018). Then, the hypothesis that can be developed is

H₁: Financial distress has a positive effect on accounting conservatism

H₂: Growth Opportunities has a positive effect on accounting conservatism

H₃: Leverage has a negative effect on accounting conservatism

II. RESEARCH METHODS

In this study, the research design used was a causal associative research design. This research was conducted by taking data from the Indonesia Stock Exchange. The scope of this research is limited to SOE companies listed on the Indonesia Stock Exchange for the period 2016-2019. SOE is one of the main sectors of the economy which is the source of driving the national economy that the state can rely on. The SOE companies used are companies whose financial statements have been audited because the information provided from these financial statements is reliable and can be used as a basis for decision making for the users of financial statements. The object of research in this study is accounting conservatism (Y) applied to SOE companies which are tested by financial distress (X1), growth opportunities (X2), and leverage (X3).

The measurement of the conservatism variable was carried out using the following accrual-based measures by Tazkiya dan Sulastiningsih (2020). The accrual model is used because this study does not focus on market reactions but focuses on its relation to profit and loss so that the accrual model is appropriate

$$\text{Total Accrual} = \frac{(\text{Net Income} + \text{Depreciation}) - \text{Operating Cash Flow}}{\text{Total Assets}} \times (-1) \dots\dots\dots(1)$$

Fiqtyandi (2016) found that the Grover G-Score model is the most suitable prediction model applied to SOE companies listed on the Indonesia Stock Exchange (IDX) because this model has the highest level of accuracy compared to other prediction models, which is 97%. Financial distress in this study is calculated using the Grover G-Score model with the following formula:

$$G\text{-Score} = 1,650X_1 + 3,430X_3 - 0,016ROA + 0,057 \dots\dots\dots(2)$$

$$X_1 = \text{Working capital/Total assets}$$

$$X_3 = \text{Earnings before interest and taxes/Total assets}$$

$$ROA = \text{net income/total assets}$$

In this study, growth opportunities are measured by proxies based on stock prices, namely using the market to book value equity ratio which is also used in Ursula & Adhivinna (2018). The reason for using Market to book value of equity is because it can illustrate the potential value of the company in the future. The formula for the market to book value of equity is as follows:

$$\text{Market to book value of equity} = \frac{\text{Outstanding shares} \times \text{closing price}}{\text{total equity}} \dots\dots(3)$$

In this study, leverage is measured using the Debt to Equity Ratio (DER). The reason for using the debt to equity ratio is because the DER ratio is able to measure a company's ability to guarantee its debt. The formula for the Debt to Equity Ratio is as follows:

$$DER = \frac{\text{Total Debt}}{\text{Total Equity}} \dots\dots\dots(4)$$

The population of this study are all SOE companies listed on the Indonesia Stock Exchange from 2016-2019. The sample in this study were SOE companies listed on the Indonesia Stock Exchange (IDX) in the 2016-2019 period which were selected using purposive sampling technique. The criteria set by the researcher in determining the research sample as follows: 1) SOE companies listed on Indonesia Stock Exchange (IDX) and consistently publish audited financial reports from 2016-2019; 2) SOE companies listed on Indonesia Stock Exchange (IDX) publish their financial reportd ending on December 31; 3) The company has complete data on financial distress, growth opportunities, leverage, and accounting conservatism; 4) The company has positive equity throughout the observation period. Based on these crieteria, a total sample of 24 SOE companies obtained for a total sample of 96 observations from 2016-2019. The data collection method used in this study is the non-participant observation method. The data analysis technique used in this research is descriptive statistical analysis, classical assumption test, multiple linear regression analysis, and hypothesis testing.

III. RESULTS AND DISCUSSION

Multiple linear regression analysis is used to determine how much influence the independent variables, namely financial distress, growth opportunities, and leverage on the dependent variable, namely accounting conservatism in SOE companies. The results of multiple linear regression testing in this study are presented in Table 1 as follows:

Table 1: Summary of the Results of Multiple Linear Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
1	(Constant)	-0,225	0,027		8,453	0,000
	Financial Distress	0,040	0,033	0,116	1,206	0,213
	Growth Opportunities	0,001	0,002	0,058	0,632	0,529
	Leverage	0,027	0,005	0,534	5,517	0,000

Source: Data processed, 2020

Based on the results presented in Table 1, the multiple linear regression equation is as follows:

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + e$$

$$Y = -0,225 + 0,040X_1 + 0,001X_2 + 0,027X_3 + e$$

The regression model has an F-value of 10.336 with a significance value of less than 0.05, which is equal to 0.000. The number of data (n) in this study was 96 and the number of variables (k) was 4 variables. The F test is done by looking at the degrees of freedom ($v_1 = 4-1$; $v_2 = 96-4$) is 2.70. Then, it can be concluded that the financial distress, growth opportunities, and leverage variables simultaneously have a significant effect on accounting conservatism

The significance value of the t test for financial distress of 0.213 is greater than the real level of 0.05 with a β value of 0.040. These results indicate that financial distress in this study which is proxied by the G-Score Model does not have a significant effect on accounting conservatism. The value of $\beta = 0.040$ indicates that when the level of financial distress of SOE companies on the IDX in the 2016-2019 period increases by one unit, accounting conservatism will increase by 0.040. Thus the first hypothesis (H_1) which states that financial distress has a significant positive effect on accounting conservatism is rejected. Companies experiencing financial distress do not attempt to apply the principles of accounting conservatism in reporting financial statements. The application of accounting conservatism will reduce company profits. It is feared that this will create pessimism among investors and creditors towards the company. Therefore, companies in financial distress will try to maintain a sense of trust in investors and creditors that the company can survive. It is hoped that by maintaining the confidence of investors and creditors, they will stay in touch with the company. Investors will start investing and creditors will provide loans to the company. This can keep the company's operations running and through financial distress.

Companies in facing this financial distress can use other methods besides the application of accounting conservatism that affect company profits. Financial distress in a company can occur due to poor management of finances. Companies with weak corporate governance are prone to economic downturns which result in worsening financial distress (Shrived et al., 2016). Thus, the company can replace the management within the company so that the company's financial management can be better which has an impact on the company's decreased level of financial distress. Changes in management in the company can be welcomed by investors and stakeholders to re-invest in the company. This research is not in accordance with the signal theory which states that when the company is in financial distress, the manager will increase the level of accounting conservatism to reduce information asymmetry and generate quality profits. The use of the principle of accounting conservatism in companies in financial distress will lead to pessimistic attitudes towards investors and other stakeholders in the company. The results of this study are in accordance with the results of research conducted by Rahmadhani & Nur (2018).

The significance of the growth opportunities of 0.529 is greater than 0.05 with a β value of 0.001. These results indicate that the growth opportunities in this study which are proxied by Market to Book Value Equity do not have a significant effect on accounting conservatism. The β value of 0.001 indicates that when the growth opportunities of SOE companies on the IDX in the 2016-2019 period increase by one unit, accounting conservatism will increase by 0.001. Thus the second hypothesis (H_2) which states that growth opportunities has a significant positive effect on accounting conservatism is rejected. Firms in growth opportunities do not influence firms to apply accounting conservatism. This is because meeting the company's funding for growth opportunities does not only come from the company's hidden reserves. Managers can obtain funds that come from external parties, namely in the form of debt. The greater the investment opportunities in the future, the more companies will use external funding as a form of funding (Goenawan & Wasistha, 2019). If the company prefers to use external funds, accounting conservatism does not need to be applied.

In facing growth opportunities, companies not only pay attention to funding issues, but also problems with corporate governance practices. Companies with high growth opportunities will always try to expand their business. When conditions have high growth opportunities, companies must pay attention to corporate governance practices, especially business expansion using external funds. Therefore, the company will improve the quality of its corporate governance practices to make it easier to obtain external funds and reduce the cost of capital. The high use of external financing makes companies have to improve their corporate governance structure (Al-Najjar & Al-Najjar, 2017). Creditors will certainly provide loans to companies that have good corporate governance. This results in the company being less likely to minimize profits through the application of the principle of accounting conservatism to meet the investment funds needed in company growth. This study does not support agency theory in which company managers will take advantage of the company's growth opportunities to use funds for investment in things that benefit the company in the future compared to distributing company profits in the form of dividends for the welfare of investors. The results of this study are in accordance with Savitri (2016) who found growth opportunities had no effect on accounting conservatism.

The significance value of the leverage is 0.000, smaller than 0.05 with a β value of 5.517. These results indicate that the leverage in this study which is proxied by Debt to Equity has a significant positive effect on accounting conservatism. The β value of 5,517 indicates that when the leverage of SOE companies on the IDX in the 2016-2019 period increases by one unit, then accounting conservatism will increase by 5,517. Thus the third hypothesis (H_3) which states that leverage has a significant negative effect on accounting conservatism is rejected. Company funding from external parties in the form of debt will create an agency relationship between company managers and creditors. In funding activities, the lender (creditor) has the right to understand and oversee the course of the company's operational activities, especially in companies that have high debt. Tighter supervision by creditors at this company aims to reduce information asymmetry. Thus, information asymmetry can decrease because company managers cannot hide financial information that may be manipulated or over-presented assets. Therefore, creditors will ask managers not to be too optimistic in recording the company's financial statements, one of which is through the use of high accounting conservatism

The high value of leverage will be followed by a growing conflict between bondholders and shareholders, which in turn raises the demand to apply conservative accounting principles. A bondholders-shareholder conflict occurs when a company seeks debt from external parties (Novita, 2017). Shareholders on their investment want high dividends from the company, while bondholders want the company to always have sufficient collateral / assets available for debt payments without paying excessive dividends. Bondholders in facing conflicts with shareholders want the company to use conservative accounting (Thomas & Indriaty, 2020). The application of the principle of accounting conservatism will result in a decrease in company profits. This decrease in profit will have an impact on the distribution of less dividends to shareholders. With the limitation on dividend payments, there is sufficient collateral / assets for debt payments. This study is not in line with the positive accounting theory in the Debt Covenant Hypothesis. This theory states that in a ceteris paribus situation, the company will decide to use accounting procedures that can replace earnings reporting for the future period to the present period if it has a high leverage ratio. However, the results of this study support agency theory regarding the agency relationship between managers and creditors. With debt, the creditor will have more interest in the company. This has an impact on the creditor's right to greater oversight of the company's operations. The manager's creditors will sue the manager to apply the principle of accounting conservatism. The results of this study are in accordance with Yanti et al., (2017), Yusnaini (2019) who found leverage has a positive effect on accounting conservatism.

IV. CONCLUSION

Financial distress has no effect on accounting conservatism. This is because the application of accounting conservatism will lead to a pessimistic attitude towards investors and creditors in the company. In addition, financial distress can be caused by poor financial management so that companies prefer to replace company management rather than applying the principles of accounting conservatism which can change company profits. Growth Opportunities has no effect on accounting conservatism, because the company prefers to take funding from external parties rather than the company's hidden reserves. Companies in growth opportunities will also pay attention to other factors, namely good corporate governance practices that make it easier for companies to get funds so that the application of the principle of accounting conservatism is deemed unnecessary. Leverage has a significant positive effect on accounting conservatism, creditors have a greater right to oversee the company's operations. It requires managers to apply the principles of accounting conservatism in recording financial statements. In addition, bondholders in facing conflicts with shareholders require managers to apply the principles of accounting conservatism so that there are still guarantees / company assets to pay off debts.

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