

## THE INFLUENCE OF FINANCIAL DISTRESS, DEBT COVENANT AND POLITICAL COST ON ACCOUNTING CONSERVATISM IN BANKING SECTOR FINANCIAL SERVICES COMPANIES LISTED ON THE INDONESIAN STOCK EXCHANGE

Wulandari Cahyani Putri<sup>a</sup>, Lindawati<sup>b</sup>, Syamsul Mu'arif<sup>c</sup>

<sup>a</sup>Program Studi Akuntansi, Fakultas Ekonomi dan Bisnis, [dosen02274@unpam.ac.id](mailto:dosen02274@unpam.ac.id) Universitas Pamulang

<sup>b</sup>Program Studi Akuntansi, Fakultas Ekonomi dan Bisnis, [dosen02151@unpam.ac.id](mailto:dosen02151@unpam.ac.id) Universitas Pamulang

<sup>c</sup>Program Studi Akuntansi, Fakultas Ekonomi dan Bisnis, [dosen02286@unpam.ac.id](mailto:dosen02286@unpam.ac.id) Universitas Pamulang

### ABSTRACT

*This research aims to prove empirically the effect of financial distress, debt covenants, and political costs on accounting conservatism. This research was conducted in a financial services company in the banking sector listed on the Indonesia Stock Exchange (IDX) in 2016–2020. The research method used is descriptive quantitative. The type of data used is secondary data. Samples were collected using purposive sampling method. The number of companies that were used as research samples were 22 companies with a research period of 5 (five) years, so that 110 samples were obtained. Data processing using Microsoft Office Excel Program and Statistics Program Eviews 9 analyzed descriptive statistics, model suitability test, classical assumption test, coefficient of determination (R<sup>2</sup>), panel data regression analysis, F statistical test and t statistical test. The results of the F statistical test for financial distress, debt covenants, and political costs variables simultaneously affect accounting conservatism. The results of the t-statistical test for the financial distress variable have a negative effect on accounting conservatism, debt covenants and political costs partially have a positive effect on accounting conservatism.*

*Keywords: Financial Distress, Debt Covenant, Political Cost, Accounting Conservatism*

### 1. INTRODUCTION

Financial statements prepared by management must adhere to the objectives, regulations, and accounting principles in effect. The information in financial statements is essential for external parties and management in making financial decisions. However, it's important to note that information in financial statements has limitations, such as cost-benefit considerations, materiality principles, industry practices, and conservatism. Management has flexibility in choosing accounting methods in line with Financial Accounting Standards (SAK).

Management has flexibility in preparing financial statements, allowing them to create reports according to their preferences, whether using a conservative or optimistic approach. However, it's important to note that the misuse of this flexibility, especially in adopting an optimistic approach, can lead to fraudulent actions in financial reporting. As an example, Bank Bukopin experienced issues in presenting its financial statements, with a significant revision of net profit from IDR 1.08 trillion to IDR 183.56 billion. This change was primarily related to a significant decrease in income from credit cards from IDR 1.06 trillion to IDR 317.88 billion. In addition to the credit card income issue, the revision also involved Bank Syariah Bukopin (BSB) subsidiaries related to a decrease in reserve balances for specific debtor impairment. Previously, Bank Bukopin also revised its equity, which decreased from IDR 9.53 trillion to IDR 6.91 trillion at the end of 2016, with a reduction in profit balance from IDR 2.62 trillion to IDR 5.52 trillion because the previous profit report was inaccurate.

This represents a highly misleading form of fraud for investors and other stakeholders (Rachman Fauzi, 2018). However, according to Ahmed Raihi Belkaoui, as cited in Indra Iman Sumantri (2018), accounting conservatism is a modification principle regarding the presentation of relevant accounting data because it favors options that benefit shareholders' equity. This less-than-ideal accounting conservatism can be observed when managers with a high equity stake in the company use a lower level of conservatism to avoid a drop in stock prices.

Companies have the freedom to choose accounting methods that they consider appropriate for their specific situations and to anticipate economic uncertainties. This leads to a cautious approach in preparing financial statements, known as the principle of conservatism (Iskandar, 2016). This principle is applied with the assumption that companies will face economic uncertainties in the future, so the measurement and recognition of figures in

financial statements are done carefully. The principle of conservatism, as explained in the Glossary of Financial Accounting Statement Concept No. 2 from the Financial Accounting Standards Board (FASB), involves exercising caution in the face of inherent uncertainties in a company, with the aim of ensuring that uncertainties and risks in the business environment are adequately considered.

It's important to note that the term "conservatism" is no longer used in the International Financial Reporting Standards (IFRS) since 2010 and has been replaced with the term "prudence." Prudence focuses more on a cautious approach in assessing uncertain situations within a company. Nevertheless, companies still apply the principle of conservatism in certain situations, such as when determining loss provisions, recognizing deferred tax assets, capitalizing development costs, and recognizing uncollectible accounts receivable (Apriani, 2015).

As of now, conservatism remains a controversial topic in accounting. In the conceptual framework of IFRS for financial reporting, conservatism is no longer considered a fundamental qualitative characteristic. The new IFRS theoretical framework emphasizes that financial statements should have attributes like relevance, faithful representation, reliability, and neutrality while avoiding bias and lack of conservatism (Hellman, 2008). However, in Indonesia, the adoption of IFRS regulations is not yet fully comprehensive, and some companies still have options in choosing accounting methods that allow the use of conservative principles.

There are various criticisms of the concept of conservatism, including the view that it can lead to bias in financial reporting, thus losing its ability to serve as a tool for assessing a company's risk. Additionally, there are arguments within the FASB accounting conceptual framework that state that the application of conservatism can result in information asymmetry that may reduce investors' understanding of future cash flows (Biddle et al., 2016).

FASB and IASB once collaborated on a project to develop a better conceptual framework. However, in 2010, both institutions removed the concept of conservatism from their conceptual frameworks (Biddle et al., 2016). This was done because conservatism was seen as conflicting with the principle of neutrality. The fundamental principle of financial reporting is to provide information that is free from bias and useful. One of the factors that can influence accounting conservatism practices in companies is difficult financial conditions, which can trigger financial distress.

Financial distress begins when a company's financial performance declines to its lowest point. At this stage, the company is unable to meet its financial obligations and typically records negative net income, declining operating income, and decreased book value of equity. According to Hery (2016:33), financial distress is a situation in which a company struggles to meet its financial obligations, where the company's income is insufficient to cover total costs, resulting in losses. For creditors, financial distress is an early sign of the debtor's failure.

Financial distress can be explained in two extreme conditions, from short-term liquidity issues to insolvency (debt exceeding assets). Short-term financial difficulties are usually temporary but can worsen over time. According to Fahmi (2013:157), if a company experiences liquidity problems, it can be an early indication of entering a period of financial distress, and if not addressed promptly, it can lead to bankruptcy. To avoid bankruptcy, a company needs to implement various policies and strategies and may need assistance, both internal and external, including entering into debt agreements or debt covenants.

Debt covenants explain that managers of a company that violates debt agreements tend to choose accounting methods that have an impact on increasing profits. According to Latifa Dinar Ayuningsih (2016), debt covenants can be used to predict that managers are motivated to increase profits and the company's assets to reduce costs when renegotiating debt contracts. This motivation arises because managers want to maintain a good reputation in the eyes of external parties, so in some cases, the principle of conservatism in accounting may be overlooked. Debt covenants explain how managers react to debt agreement violations. Managers facing debt agreement violations will make efforts to avoid them by choosing accounting policies that benefit the company (Tri Pujadi Susilo, 2016).

Debt covenants are agreements designed to protect the interests of creditors, such as preventing managers from making excessive dividend payments, taking additional loans, or reducing working capital to the extent that it falls below the specified limits. The greater the likelihood of a company violating debt agreements, the more likely

managers are to choose accounting procedures that allow them to shift profits from future periods to the current period. This is done to reduce the risk of default.

The agency theory explains that when there is a separation between the owner of the company as the principal and the manager who acts as an agent running the company's operations, conflicts of interest may arise. According to Jensen and Meckling (1976), each party will try to maximize their personal gains. Management, for example, will strive to increase the company's profits, mainly because this can impact the bonuses they receive. In this context, the principle of accounting conservatism may not always be strictly applied.

Additionally, there are other factors that affect accounting conservatism, such as political costs. Political costs refer to the costs that arise from the interaction between a company's management and the government, society, and the media, which can influence the company's operations. Companies may tend to report lower profits in the current period with the goal of shifting profits to future periods. This is done to avoid political pressures, such as accusations of monopolistic behavior, protectionism against imports, or labor union demands. This is sometimes necessary to maintain the company's reputation and reduce the potential negative impact of political costs.

Large companies, especially those operating in highly regulated environments, tend to have significant political costs. Governments and regulatory bodies tend to monitor large companies more closely. Therefore, large companies may be more inclined to apply conservative accounting principles so that reported profits are not excessively high. This can help reduce the political costs they have to bear (Ardina & Januarti, 2012; Jayanti & Sapari, 2016).

## **2. LITERATURE REVIEW**

### **2.1 Agency Theory**

The agency theory, as understood from the work of Jensen and Meckling (as explained by Risa Dewi A'isyah, 2019), focuses on the relationship between the owner (principal) and the manager (agent) in a company. This theory arises when there is a separation of roles, with the owner hiring a manager to oversee the company's operations. Information imbalance often occurs in this context, with managers having more access to information than owners. Owners and managers have different goals, where owners seek optimal investment returns while managers are more focused on fair compensation for their work. Thus, owners expect maximum performance from managers to yield the best returns on their investments, while managers also have incentives to pursue personal gains, both through positive and negative actions.

The main goal of agency theory is to measure the "net wealth" of the owners (principals). This means that owners have assets and liabilities, and the balance sheet is used to measure changes in their ownership. Income and expenses are considered changes in ownership that do not come from investments or withdrawals of capital by the owners. Net income, after accounting for the company's debt and income tax, is referred to as the dividend cost.

Conflicts of interest between owners and managers are reflected in various ways. Providing bonuses to managers incentivizes them to achieve the best performance, which may affect the choice of accounting methods by reducing a company's conservatism. Debt covenants, as debt agreements, encourage managers to achieve the best performance, which can also influence the choice of accounting methods that support this goal, resulting in less conservative financial reports. Companies with high political costs tend to report lower profits, which can be achieved through the selection of more conservative accounting methods (Risa Dewi A'isyah, 2019).

### **2.2 Accounting conservatism**

Accounting conservatism, according to the Financial Accounting Standards Board (FASB) in Statement of Financial Accounting Concept (SFAC No. 2), is a cautious approach in the face of business uncertainty. It involves delaying the recognition of future cash inflows by acknowledging potential costs or losses in the future. Although conservatism is a principle in Generally Accepted Accounting Principles (GAAP), there are arguments to reduce its use to make financial statements more neutral. Accounting conservatism can influence managerial decisions, especially regarding stock ownership. Managers are more likely to use accounting conservatism if external stock ownership is smaller compared to managerial ownership. The primary purpose of financial statements is to provide information about a company's financial position, financial performance, and cash flows for economic decision-

making. Accounting conservatism is a pessimistic view and attitude reflected in accounting approaches, involving reducing reported earnings through revenue recognition delays, expense accelerations, asset impairments, and increased liability assessments.

### **2.3 Financial Distress**

Financial distress refers to a company's financial condition that is experiencing a significant decline, which can ultimately lead to bankruptcy if not addressed promptly. The causes of financial distress can be internal, such as management issues, high levels of debt used to cover operational costs, and sustained losses from company operations. External factors, such as government policy changes like tax rate increases and interest rates, can also affect a company's financial condition.

Financial distress conditions are often caused by poor operational performance, leading to the company incurring losses or minimal profits. If this condition persists for several years, and the company fails to improve it, then it is at risk of bankruptcy. This is due to the company's inability to operate effectively and meet its financial obligations to various stakeholders. In other words, financial distress characterizes the company's liquidity difficulties and a decrease in its ability to fulfill obligations to creditors (Angela and Salim, 2020).

### **2.4 Debt Covenant**

Debt covenant is an agreement made by lenders (creditors) to restrict actions that may harm the loan and its recovery. In publicly traded companies, managers often tend to report profits and assets optimistically to reduce the costs of renegotiating debt contracts. Violating debt agreements can result in costs and disrupt management, so management seeks to prevent such violations. The more significant the amount of debt a company desires, the more it strives to demonstrate strong performance so that creditors have confidence in the company's ability to repay its debt. When profits are high, creditors believe the company can reduce the risk of unpaid debt, and conservative accounting standards may protect creditors (Januar Eky Pambudi, 2017).

### **2.5 Political Cost**

Political cost is the tax payment imposed on a company based on the effective tax rates as a result of differing interests between the company and the government. Companies are oriented towards maximizing profits, while the government needs revenue for infrastructure development and social interests. Larger-sized companies tend to have higher political costs due to the complexity of their operations. To reduce political costs, companies apply conservative accounting methods, delaying revenue recognition and accelerating the recognition of losses, thereby reporting lower profits. Lower profits reduce the taxes the company has to pay, in line with the political cost hypothesis in positive accounting theory (Pratiwi, 2015).

### **2.6 Hypothesis Development and Thinking Framework**

The greater the value of liabilities will encourage management to display high asset values and profits to fulfill the agreed contracts. The higher the value of liabilities, the higher the demand for achieving asset value and profit. This aligns with agency theory, where company management with high liability values will be motivated to achieve profit targets that meet debt contracts and avoid contract renegotiations. This will encourage a less conservative presentation of financial statements. In the post-IFRS convergence period, conservatism still applies regarding the influence of the debt covenant variable.

According to Fahmi (2015), financial distress has 4 (four) classification categories, namely: First, financial distress category A or very high or dangerous. Second, financial distress is category B or high and is considered dangerous. Third, financial distress is category C or moderate. Fourth, financial distress is category D or low. Research on financial distress with accounting conservatism has been carried out previously by previous researchers.

#### **H1: It is suspected that financial distress has an effect on accounting conservatism**

Dewi and Suryanawa (2014) and Aryani (2016) found that financial distress significantly negatively influences accounting conservatism. Higher financial distress will encourage managers to reduce the level of accounting conservatism. According to Anggraini (2017) and Pramudita (2012), financial distress harms accounting conservatism, and this follows agency theory because managers tend to cover up poor performance, which will

trigger shareholders to propose a change of manager, thereby reducing the manager's market value in the labor market, as a result, this threat encourages managers to reduce their accounting conservatism.

A debt covenant is an agreement that arises from an obligation contract that aims to maintain the company's long-term financial position so that it remains within a corridor that allows it to pay off its obligations. Thus, this contract usually arises from a long-term loan. The size of this variable can be quantified through the value of long-term liabilities (Risa, 2019)

*Debt covenants* are contracts directed at borrowers by creditors to limit activities that might damage the loan value and loan recovery. Companies that have gone public will certainly not be free from debt that can be used to expand their business. Regarding the renegotiation of debt contracts, debt covenants are guided by accounting numbers. Furthermore, debt covenants indicate that managers overstate profits and assets to reduce the renegotiation costs of debt contracts (Januar, 2017).

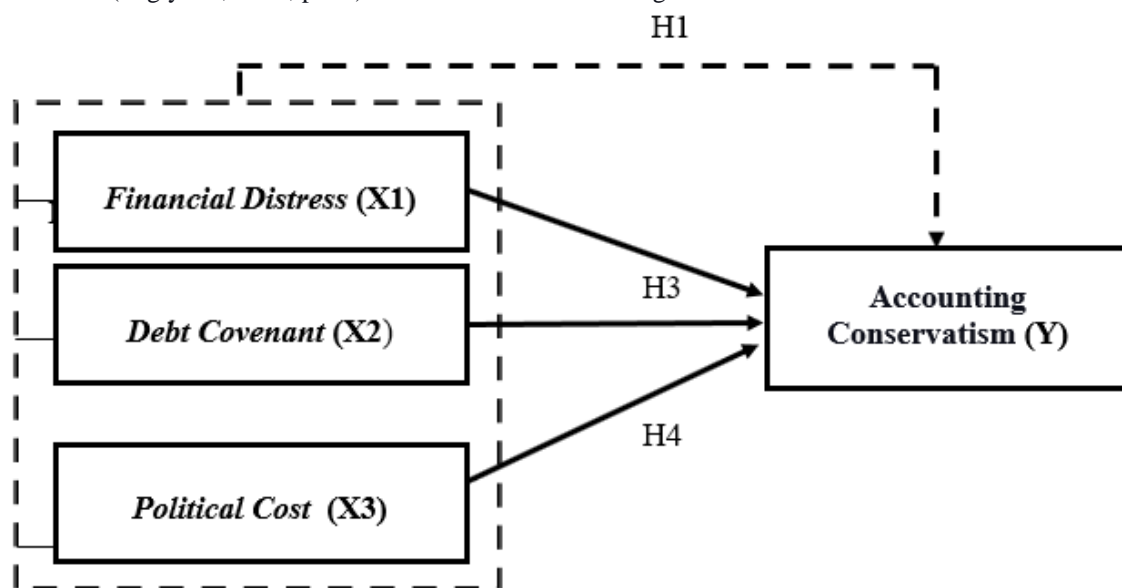
In agency theory and research conducted by Okto Reyhansyah (2018) regarding debt covenants affecting accounting conservatism because debt covenants regulate the percentage of funds provided by creditors, the greater the leverage ratio used to measure the debt covenant ratio, the greater the possibility of the company will use procedures that increase the current period's reported earnings or financial statements presented.

**H2: It is suspected that the Debt Covenant has an effect on accounting conservatism**

For companies, political intensity is often related to company size (Watts and Zimmerman, 1986: 235). Political costs reveal that large companies are likely to face greater political costs than small companies. In agency theory and Nico Wicandy's research, political costs influence accounting conservatism because large companies are usually more supervised by the government and society. If large companies have relatively permanent high profits, then the government may be encouraged to raise taxes and demand higher public services from companies. Finally, managers of large companies may choose accounting methods that delay reporting profits to reduce the political costs borne by the company.

**H3: It is suspected that political costs have an influence on accounting conservatism.**

The thinking framework is a conceptual model of how theory relates to various factors identified as important problems (Sugiyono, 2017). The framework of thinking in research needs to be stated if the research involves two or more variables. If the research only discusses one or more variables independently, what the researcher does in addition to presenting a theoretical description for each variable and arguing for variations in the magnitude of the variables studied (Sugiyono, 2017, p. 60). The framework of thinking in this research is as follows:



**Figure 1. Thinking Framework**



**3. RESEARCH METHODOLOGY**

This research applies quantitative research methods, a traditional research approach. Quantitative methods use data in the form of numbers and involve statistical analysis in the data processing process (Sugiyono, 2019). This approach aims to empirically prove the influence of financial distress, debt covenants, and political costs on accounting conservatism. Quantitative descriptive methods allow research to focus on one or more variables without the need to compare them and also make it possible to identify relationships with other variables (Sugiyono, 2019).

The following is the operationalization of the variables in this research:

**Table 1. Variable Operations**

No	Variable	Parameter	Skala Ukur
1.	<i>Accounting conservatism</i>	$Total\ Accruals = \frac{(Net\ Profit - Depreciation) - Operating\ Cash\ Flow}{Total\ Asset} \times (-1)$	Rasio
2.	<i>Financial Distress</i>	$Zscore = 6.56X1 + 3.26X2 + 6.72X3 + 1.05X4$	Rasio
3.	<i>Debt Covenant</i>	$DAR = \frac{Total\ Debt}{Total\ Asset}$	Rasio
4.	<i>Political Cost</i>	$SIZE = LN (Total\ Asset )$	Rasio

The data used in this research is secondary, originating from the financial reports of companies in the banking sector listed on the Indonesia Stock Exchange (BEI). The research involved 44 companies during the 2016-2020 period, and this data was obtained via the official website [www.idx.co.id](http://www.idx.co.id). The selection of research locations is based on the availability of data that is relevant to the research objectives. A purposive sampling technique was used in the sampling process, which involves certain considerations (Sugiyono, 2019). These considerations include:

1. Banking sector companies listed on the Indonesia Stock Exchange (BEI) from 2016 to 2020.
2. A banking company continuously publishes annual financial reports from 2016 to 2020.
3. Availability of required data for the period 2016 to 2020.
4. Companies that did not experience losses during the research period.

The selected sample consists of companies that provide the required data based on the results of the research on financial distress, debt covenants, and political cost, adjusted according to criteria using purposive sampling method. This resulted in data from 22 companies listed on the Indonesia Stock Exchange (IDX) during the years 2016 to 2020, as follows:

**Table 2. Research Sample**

No	Code	Emiten
1	AGRO	PT Bank Rakyat Indonesia Agroniaga Tbk
2	BACA	PT Bank Capital Indonesia Tbk
3	BBCA	PT Bank Central Asia Tbk
4	BBMD	PT Bank Mestika Dharma Tbk
5	BBNI	PT Bank Negara Indonesia (Persero) Tbk
6	BBRI	PT Bank Rakyat Indonesia (Persero) Tbk
7	BDMN	PT Bank Danamon Indonesia Tbk
8	BINA	PT Bank Ina Perdana Tbk
9	BJBR	PT Bank Pembangunan Daerah Jawa Barat Tbk
10	BJTM	PT Bank Pembangunan Daerah Jawa timur Tbk
11	BMAS	PT Bank Maspion Indonesia Tbk
12	BMRI	PT Bank Mandiri (Persero) Tbk
13	BNBA	PT Bank Bumi Arta Tbk
14	BNII	PT Bank Maybank Indonesia Tbk

15	BSIM	PT Bank Sinarmas Tbk
16	BTPN	PT Bank Tabungan Pensiunan Nasional Tbk
17	MAYA	PT Bank Mayapada Internasional Tbk
18	MCOR	PT Bank China Construction Bank Indonesia Tbk
19	MEGA	PT Bank Mega Tbk
20	NISP	PT Bank OCBC NISP Tbk
21	PNBN	PT Bank Pan Indonesia Tbk
22	SDRA	PT Bank Woori Saudara Indonesia 1906 Tbk

Data was analyzed using statistical software such as Microsoft Office Excel and EViews 9. After data collection, the analysis stage included descriptive analysis tests, model selection, classical assumption tests, calculation of the coefficient of determination, panel data regression analysis, and hypothesis testing.

#### 4. RESULTS AND DISCUSSION

##### 4.1 Descriptive statistics

Based on the data recapitulation results, the research data description is presented as follows:

**Table 3. Descriptive statistics**

	<b>Accounting conservatism</b>	<b>Financial Distress</b>	<b>Debt Covenant</b>	<b>Political Cost</b>
<b>Mean</b>	0.007782	3.680579	0.819936	31.93032
<b>Maximum</b>	0.269652	12.04078	0.918899	34.95208
<b>Minimum</b>	-0.152449	1.201399	0.614457	28.48930
<b>Std. Dev.</b>	0.063380	2.119492	0.049935	1.681597
<b>Observations</b>	<b>110</b>	<b>110</b>	<b>110</b>	<b>110</b>

The results of descriptive statistical analysis show that the variable accounting conservatism in banking companies on the Indonesia Stock Exchange (BEI) in 2016-2020 has significant variations. The minimum value of accounting conservatism is -0.152449, recorded by the company PT Bank Woori Saudara Indonesia 1906 Tbk (SDRA) in 2018, while the maximum value is 0.269652 from the company PT Bank Ina Perdana Tbk (BINA) in 2020. The average value of accounting conservatism (mean ) is 0.007782, with a standard deviation of 0.063380, indicating the heterogeneity of the accounting conservatism variable.

Likewise, the financial distress variable in banking companies on the IDX in 2016-2020 also has significant variations. The minimum value of financial distress is 1.201399, found in the company PT Bank Pembangunan Daerah Jawa Barat Tbk (BJBR) in 2020, while the maximum value is 12.04078 from the company PT Bank Ina Perdana Tbk (BINA) in 2020. The average value of financial distress (mean) amounted to 3.680579, with a standard deviation of 2.119492, indicating the homogeneity of the financial distress variable.

The debt covenant variable in banking companies on the IDX in 2016-2020 also shows significant variations. The minimum debt covenant value is 0.614457, found in the company PT Bank Ina Perdana Tbk (BINA) in 2017, while the maximum value is 0.918899 from the company PT Bank Capital Indonesia Tbk (BACA) in 2019. The average debt covenant value (mean) is 0.819936, with a standard deviation of 0.049935, indicating the heterogeneity of the debt covenant variable.

The political cost variable for banking companies on the IDX in 2016-2020 also shows significant variations. The minimum political cost value is 28.48930, found in the company PT Bank Ina Perdana Tbk (BINA) in 2016, while the maximum value is 34.95208 from the company PT Bank Rakyat Indonesia (Persero) Tbk (BBRI) in 2020. The average political cost value (mean ) is 31.93032, with a standard deviation of 1.681597, indicating the homogeneity of the political cost variable.

##### 4.2 Selection of Panel Data Regression Models

Panel data regression can be carried out with 3 (three) models, namely the Common Effect Model (CEM), Fixed Effect Model (FEM) and Random Effect Model (REM). The choice of model depends on the assumptions used by

the researcher and the fulfillment of the requirements for correct statistical data processing so that it can be statistically justified.

#### 4.2.1 Chow Test

The results of the chow test can be seen as follows:

**Table 4. Chow Test**

<b>Redundant Fixed Effects Tests</b>			
Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
<b>Cross-section Chi-square</b>	<b>35.378140</b>	<b>21</b>	<b>0.0257</b>

Source: Processed Data Eviews 9, 2022

Chow test results show that the chi-square probability value is 0.0257, which is lower than the significance level of 0.05 ( $0.0257 < 0.05$ ). Therefore, we can reject the null hypothesis ( $H_0$ ) and accept the alternative hypothesis ( $H_1$ ). This means that the most appropriate model is the Fixed Effect Model (FEM). Next, we need to carry out the Hausman test to decide whether the Fixed Effect Model (FEM) is more suitable than the Random Effect Model (REM).

#### 4.2.2 Hausmann Test

The results of the Hausmann test can be seen as follows:

**Table 4. Hausmann Test**

<b>Correlated Random Effects - Hausman Test</b>			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
<b>Cross-section random</b>	<b>9.160071</b>	<b>3</b>	<b>0.0272</b>

Source: Processed Data Eviews 9, 2022

The results of the Hausman test indicate that the probability of Cross Section random is 0.0272, which is less than 0.05 ( $0.0272 < 0.05$ ). This means that we accept the null hypothesis ( $H_0$ ) and reject the alternative hypothesis ( $H_1$ ). Therefore, the model that is more suitable is the Fixed Effect Model (FEM). Next, we perform the third test, which is the Lagrange multiplier test to assess whether the Random Effect Model (REM) is better than the Common Effect Model (CEM).

#### 4.2.3 Lagrange Multiplier Test

The third test is the Lagrange multiplier test which is useful for finding out whether the Random Effect Model (REM) is better than the Common Effect Model (CEM).

**Table 5. Lagrange Multiplier Test**

<b>Lagrange Multiplier Tests for Random Effects</b>			
Alternative hypotheses: Two-sided (Breusch-Pagan)			
	Test Hypothesis		
	Cross-section	Time	Both
<b>Breusch-Pagan</b>	<b>(0.8341)</b>	<b>(0.0258)</b>	<b>(0.0251)</b>

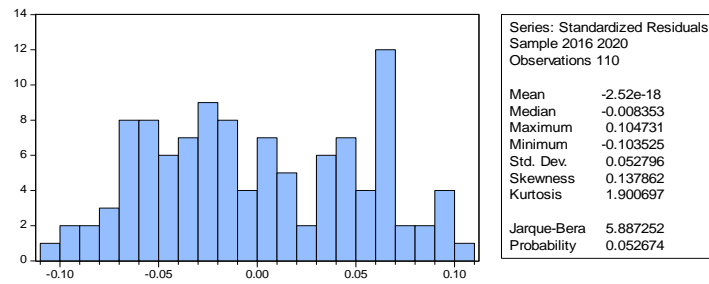
Source: Processed Data Eviews 9, 2022

The results of the Lagrange multiplier test show a Cross Section Breusch-Pagan probability of 0.8341, which exceeds the value of 0.05 ( $0.8341 > 0.05$ ). Therefore, we accept the null hypothesis ( $H_0$ ) and reject the alternative hypothesis ( $H_1$ ), indicating that the more suitable model is the Common Effect Model (CEM). In conclusion, among the three model options, the Fixed Effect Model (FEM) is the best choice.

### 4.3 Classic assumption test

#### 4.3.1 Normality Test





Source: Processed Data Eviews 9, 2022

**Figure 2. Normality Test**

Based on Figure 2, the results of the normality test using Jarque-Bera (JB), it can be seen that the Jarque-Bera probability value is 0.052674 which is greater than 0.05 or  $0.052674 > 0.05$  so it can be concluded that this research has a normal distribution.

**4.3.2 Multicollinearity Test**

**Table 6. Multicollinearity Test**

<b>Accounting conservatism</b>	<b>Financial Distress</b>	<b>Debt Covenant</b>	<b>Political Cost</b>
1.000000	0.082191	0.008244	-0.056740
0.082191	1.000000	-0.594429	-0.141818
0.008244	-0.594429	1.000000	0.172280
-0.056740	-0.141818	0.172280	1.000000

Source: Processed Data Eviews 9, 2022

Based on testing the correlation coefficient values above, each independent variable, namely financial distress (X1), debt covenant (X2), and political costs (X3) produces a coefficient value of less than 0.90, which means it can be concluded that this research does not have multicollinearity problems.

**4.3.3 Heteroscedasticity Test**

**Table 7. Heteroscedasticity Test**

<b>Dependent Variable: ABSRES</b>				
Method: Panel Least Squares				
Sample: 2016 2020				
Total panel (balanced) observations: 110				
<b>Variable</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
Financial Distress	-0.004578	0.003447	-1.328218	<b>0.1877</b>
Debt Covenant	-0.248372	0.138558	-1.792555	<b>0.0766</b>
Political Cost	0.025929	0.015731	1.648331	<b>0.1030</b>

Source: Processed Data Eviews 9, 2022

Based on the Glejser test results above, it shows that the probability value of each independent variable, namely financial distress (X1), debt covenant (X2), and political costs (X3) is greater than 0.05, so it can be concluded that this research does not have heteroscedasticity problems.

**4.3.4 Autocorrelation Test**

**Table 8. Autocorrelation Test**

R-squared	0.524297	Mean dependent var	0.005238
Adjusted R-squared	0.389981	S.D. dependent var	0.007690
S.E. of regression	0.006205	Sum squared resid	0.003273
F-statistic	3.903454	<b>Durbin-Watson stat</b>	<b>2.116848</b>
Prob(F-statistic)	0.000002		

Source: Processed Data Eviews 9, 2022

Based on the autocorrelation results above, the Durbin Watson Stat value is 2.116848. For a sample of 110, it can be seen that the value of  $dL = 1.6336$ ,  $dU = 1.7455$ , and  $4-dU = 2.2545$ . It can be concluded that this research does not have an autocorrelation problem because the Durbin Watson Stat value is greater. of the  $dU$  value and is smaller than  $4-dU$  or  $1.7455 < 2.116848 < 2.2545$ .

**4.4 Panel Data Regression Analysis**

**Table 9. Results of Panel Data Regression Analysis**

<b>Dependent Variable: Accounting conservatism</b>				
Method: Panel EGLS (Cross-section weights)				
Sample: 2016 2020				
Total panel (balanced) observations: 110				
<b>Variable</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
C	-0.823102	0.113030	-7.282151	0.0000
Financial Distress	-0.002284	0.000889	-2.568382	0.0120
Debt Covenant	0.013042	0.003696	3.528763	0.0007
Political Cost	0.240440	0.032592	7.377173	0.0000

Source: Processed Data Eviews 9, 2022

1. The negative constant value is 0.823102, meaning that if the financial distress, debt covenant and political cost variables are considered constant, then the amount of accounting conservatism in the company is -0.823102.
2. The coefficient for the financial distress variable is 0.002284 and is negative. This shows that for every additional financial distress in the company by one unit and other variables are considered constant, the company's accounting conservatism will decrease by 0.002284. Based on the results of the t statistical test, the probability of the financial distress variable is  $0.0120 < 0.05$ . Apart from that, from the results of the comparison of  $t_{count}$  and  $t_{table}$ , the  $t_{count}$  result is 2.568382 and has a negative value, while  $t_{table}$  is 1.98260. From these results it means  $t_{count} > t_{table}$ , namely  $2.568382 > 1.98260$ . So it can be concluded that  $H_1$  is accepted and  $H_0$  is rejected, meaning that partially financial distress has a negative effect on accounting conservatism.
3. The debt covenant variable coefficient is 0.013042 and is positive. This shows that for every additional debt covenant in the company by one unit, and other variables are considered constant, the company's accounting conservatism will increase by 0.013042. Based on the results of the t statistical test, the significance of the debt covenant variable is  $0.0007 < 0.05$ . Apart from that, from the results of comparing  $t_{count}$  and  $t_{table}$ , the result of  $t_{count}$  is 3.528763 and has a positive value, while  $t_{table}$  is 1.98260. From these results it means  $t_{count} > t_{table}$ , namely  $3.528763 > 1.98260$ . So it can be concluded that  $H_1$  is accepted and  $H_0$  is rejected, meaning that debt covenants partially have a positive effect on accounting conservatism.
4. The political cost variable coefficient is 0.240440 and is positive. This shows that for every additional political cost to the company by one unit, and other variables are considered constant, the company's accounting conservatism will increase by 0.240440. Based on the results of the t statistical test, the significance of the political cost variable is  $0.0000 < 0.05$ . Apart from that, from the results of comparing  $t_{count}$  and  $t_{table}$ , the result of  $t_{count}$  is 7.377173 and has a positive value, while  $t_{table}$  is 1.98260. From these results it means  $t_{count} > t_{table}$ , namely  $7.377173 > 1.98260$ . So it can be concluded that  $H_1$  is accepted and  $H_0$  is rejected, meaning that partially political costs have a positive effect on accounting conservatism.

**Table 10. F Test**

R-squared	0.524297	Mean dependent var	0.005238
Adjusted R-squared	0.389981	S.D. dependent var	0.007690
S.E. of regression	0.006205	Sum squared resid	0.003273
<b>F-statistic</b>	<b>3.903454</b>	Durbin-Watson stat	2.116848
<b>Prob(F-statistic)</b>	<b>0.000002</b>		

Based on the F test results in table above, it can be seen that the F count is 3.903454 and the probability value is 0.000002. Meanwhile, to look for  $F_{table}$  with sample size  $(n) = 110$  and number of variables  $(k) = 3$ .  $F_{table}$  can be seen in the F distribution table with a significance level of 0.05 with  $df_2 = (n-k-1) = 110-3-1 = 106$ , where  $n$  is the number of samples and  $k$  is the number of independent variables so that the F table is 2.69. Based on the  $F_{table}$

values obtained, it can be concluded that financial distress, debt covenants, and political costs simultaneously influence accounting conservatism with the test results of  $F_{count} > F_{table}$  ( $3.903454 > 2.69$ ) and a significance value  $< 0.05$  ( $0.000002 < 0.05$ ).

#### 4.5 Discussion

The results of the t statistical test show that financial distress has a negative effect on accounting conservatism. This is in line with agency theory and research findings by Rivandi and Ariska (2019) which state that financial distress has a negative impact on accounting conservatism. This situation is caused by managers facing contractual pressures and possibly facing replacement in poor financial conditions. This threat encourages managers to reduce the level of accounting conservatism to avoid conflicts with creditors and shareholders. Thus, the higher the level of financial distress, the lower the conservatism in the company's financial statements. This research also shows that supervision by principals increases when companies experience financial distress, and managers may have to change earnings reports as a benchmark for their performance in the face of levels of accounting conservatism. These results are useful for companies experiencing financial difficulties to obtain additional funds and overcome bankruptcy problems. This research is not in line with the findings of Mohamad Sidik, Wahyu Nurul Hidayati, and Putri Nurmala (2020), who stated that financial distress has no effect on accounting conservatism.

The results of the t statistical test show that partially, debt covenants have a positive effect on accounting conservatism. This finding supports agency theory and is also consistent with research conducted by Noviani and Homan (2021), which states that debt covenants have a positive effect on accounting conservatism. This can be explained by the leverage ratio which indicates the level of security of loan funds. The higher the leverage ratio in the company, the greater management's motivation to avoid violating debt covenants. Debt contracts often impose restrictions on company policies, including in the choice of accounting methods. This can cause financial reporting that does not reflect actual financial conditions, and the quality of the information becomes questionable. Debt contracts can open up opportunities for violations that result in penalties, encouraging companies to maintain required ratios by applying less conservative accounting. Agency theory also supports restrictions in debt agreements that influence management behavior in financial reporting. Companies have an incentive to demonstrate good performance to lenders in order to obtain larger debt loans, which can encourage management to apply less conservative accounting principles. The results of this research contradict the findings of Titiek Wartini, et al (2020) which stated that debt covenants have no effect on accounting conservatism.

The results of the t statistical test show that partially, political costs have a positive effect on accounting conservatism. The results of this research support agency theory which emphasizes the existence of information asymmetry and conflict between managers and shareholders. In agency theory, large companies with high political costs have an incentive to produce more conservative reports because large companies often have complex management systems and high profits. This encourages companies to apply the principle of accounting conservatism to minimize business risks. This finding is in line with research by Shinta Ardilasari (2018) which states that political costs increase along with the growth of company size. However, the results of this study contradict the findings of Haloman, et al (2021) which stated that political costs have no effect on accounting conservatism.

## 5. CONCLUSIONS

Based on the results of data analysis, the following conclusions can be drawn:

1. Financial Distress conditions have a negative impact on accounting conservatism. These results are in line with agency theory, where managers, in an effort to avoid conflicts with creditors and shareholders, tend to reduce the level of conservatism when faced with contractual pressures and threats of replacement in poor financial conditions. As shareholder scrutiny increases in these situations, managers may have to change earnings reports as a measure of their performance. These results can help companies experiencing financial difficulties to access additional funds and overcome bankruptcy problems.
2. Debt covenants have a positive effect on accounting conservatism. This supports agency theory, where companies with high leverage ratios have greater management motivation to comply with debt covenants. Debt contracts often impose restrictions on corporate policies, including the choice of accounting methods. However, this can also cause financial reporting that does not reflect actual conditions. This result contradicts previous findings which stated that debt agreements have no effect on accounting conservatism.

3. Political costs have a positive effect on accounting conservatism. Large companies with high political costs tend to produce more conservative reports. This is in line with agency theory, where complex companies with high profits tend to apply the principle of accounting conservatism to minimize business risk. These results also support previous research which states that political costs increase with the growth of company size.

### **Suggestion**

Suggestions that can be given from the conclusions are:

1. Researchers suggest that in future research to add or replace other variables besides the variables included in this research, such as good corporate governance, litigation risk, capital intensity and growth opportunities.
2. The researcher suggests that in further research the scope of research can be expanded, so that it is not limited to just one industry.
3. Researchers suggest increasing the time span of the research period so that the results obtained are more consistent.

### **REFERENCES**

- [1] A'isya, R. D., & Vestari, M. (2019). Pengaruh Bonus Plan, Debt Covenant, Political Cost, dan Litigation Risk terhadap Konservatisme Akuntansi pasca Konvergensi International Financial Reporting Standards. Seminar Nasional dan The 6th Call For Syariah Paper (SANCALL).
- [2] Angela, O., & Salim, S. (2020). Faktor Yang Mempengaruhi Konservatisme Akuntansi pada Perusahaan Manufaktur yang Terdaftar Di BEI. *Jurnal Multiparadigma Akuntansi Tarumanagara*, 1510-1519.
- [3] Ardilasari, S. (2018). Pengaruh Debt Covenant, Political Cost, Bonus Plan dan Growth Terhadap Konservatisme Akuntansi (Studi Empiris pada Perusahaan Manufaktur yang Terdaftar di BEI 2014-2016). SKRIPSI: Fakultas Ekonomi Universitas Islam Indonesia Yogyakarta.
- [4] Astarina, I., & Hapsila, A. (2015). *Manajemen Perbankan*. Yogyakarta: Deepublish.
- [5] Ayuningsih, L. D. (2016). Pengaruh Debt Covenant, Kepemilikan Manajerial, dan Growth Opportunities terhadap Konservatisme Akuntansi. *Kajian Akuntansi*, 17 (2), 19-30.
- [6] Ghazali, I., & Ratmono, D. (2017). *Analisis Multivariat dan Ekonometrika Teori, Konsep, dan Aplikasi dengan EViews 10*. Semarang: Badan Penerbit Universitas Diponegoro.
- [7] Haloman, J. F., Alfionita, V., Prianka, & Katharina, N. (2021). Pengaruh Dari Corporate Governance, Debt Covenant, Bonus Plan Dan Political Cost Terhadap Konservatisme Akuntansi Pada Perusahaan Manufaktur. *Jurnal Ilmiah Manajemen, Ekonomi dan Akuntansi*, 5 (1) 1-14.
- [8] Iskandar, O. R. (2017). Pengaruh Debt Covenant, Bonus Plan, dan Political Cost terhadap Konservatisme Akuntansi (Studi Empiris pada Perusahaan Manufaktur Subsektor Industri Barang Konsumsi yang Terdaftar di BEI Tahun 2012-2015). *DISERTASI: STIE Indonesia Banking School*.
- [9] Jao, R., & Ho, D. (2019). Pengaruh Struktur Kepemilikan dan Debt Covenant Terhadap Konservatime Akuntansi. *Jurnal Riset Akuntansi Jambi*, Vol 2 (1).
- [10] Noviani, I., & Homan, H. S. (2021). Pengaruh Debt Covenant Dan Growth Opportunities Terhadap Konservatisme Akuntansi. *Jurnal Riset Akuntansi dan Perbankan*, 15 (2) 577-596.
- [11] Novitasari, Amin, M., & Hariri. (2020). Pengaruh Adopsi Ifrs, Political Cost, dan Litigation Risk Terhadap Konservatisme Akuntansi. *Jurnal Imiah dan Riset Akuntansi*, 9 (3) 116-125.
- [12] Nuraini, I. (2017). Pengaruh Growth Opportunities, Leverage, dan Financial Distress Terhadap Konservatisme Akuntansi pada Perusahaan Farmasi (Studi Empiris Di Bursa Efek Indonesia Periode 2010–2015). *Disertasi: Sekolah Tinggi Ilmu EKonomi Perbanas Surabaya*.
- [13] Pambudi, J. E. (2017). Pengaruh Kepemilikan Manajerial dan Debt Covenant Terhadap Konservatisme Akuntansi. *Competitive*, 1 (1), 87-110.
- [14] Reskino, & Vemiliyarni, R. (2014). Pengaruh Konvergensi Ifrs, Bonus Plan, Debt Covenant, Dan Political Cost Terhadap Konservatisme Akuntansi. *Akuntabilitas*, 7 (3), 185-195.
- [15] Rizkillah, N. (2019). Pengaruh Debt Covenant, Financial Distress, Struktur Kepemilikan Manajerial Dan Political Cost Terhadap Konservatisme Akuntansi (Studi Empiris pada Perusahaan Farmasi yang Terdaftar di Bursa Efek Indonesia Periode 2013-2017). *SKRIPSI: Fakultas Ekonomi Dan Bisnis UIN Syarif Hidayatullah Jakarta*.
- [16] Sidik, M., Hidayati, W. N., & Nurmala, P. (2020). The Influence of Financial Distress, Growth Opportunities, and Debt Covenant to Conservatism of Accounting Company. *Proceedings International Seminar on Accounting Society Pamulang University*, Vol 2 (1).

- [17] Sinambela, M. O., & Almilia, L. S. (2018). Faktor - faktor yang mempengaruhi Konservatisme Akuntansi. *Jurnal Ekonomi dan Bisnis STIE Perbanas Surabaya*, 21 (2).
- [18] Sitoesmi, M. W., & Herawaty, V. (2020). Pengaruh Financial Distress dan Financial Statement Fraud Terhadap Return Saham yang Dimoderasi oleh Earning Management Pada Perusahaan Perbankan yang Terdaftar Di BEI Tahun 2013-2015. *Prosiding Seminar Nasional*, 2.
- [19] Sugiyono. (2019). *Metode Penelitian kuantitatif dan kualitatif*. Bandung: Alfabeta.
- [20] Sulastiningsih, & Husna, J. A. (2017). Pengaruh Debt Covenant, Bonus Plan, Political Cost Dan Risiko Litigasi Terhadap Penerapan Konservatisme Akuntansi Pada Perusahaan Manufaktur. *Kajian Bisnis Sekolah Tinggi Ilmu Ekonomi Widya Wiwaha*, 25 (1), 110-125.
- [21] Sumantri, I. I. (2018). Pengaruh Insentif Pajak, Growth Opportunity, dan Leverage Terhadap Konservatisme Akuntansi. *Jurnal Ilmiah Akuntansi Universitas Pamulang*, Vol 6 (1).
- [22] Suwartini, T., Widari, L. W., Nurhayati, I., & Ainunnisa, S. Z. (2020). Pengaruh Debt Covenant, Profitabilitas dan Growth Opportunities Terhadap Konservatisme Akuntansi (Studi pada Perusahaan Manufaktur yang Terdaftar Di BEI Tahun 2016-2018). *Proceeding SENDIU*, 627-632.
- [23] Wicandy, N., & Khairunnisa. (2020). Pengaruh Kesulitan Keuangan, Risiko Litigasi, dan Political Cost Terhadap Konservatisme Akuntansi. *Jurnal Akuntansi dan Ekonomi Telkom University*, 64-73.