

CONSERVATISM IN ACCOUNTING: FINANCIAL DISTRESS, TAX AND LITIGATION RISK

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Abstract

In the application of accounting conservatism plays an important role in assessing the earnings quality of a financial report. If financial statements are made using conservative principles, they tend to reflect the company's financial condition which is not true. The concept of conservatism is often used by companies that trade their shares openly. For example, a company listed on the Indonesia Stock Exchange is a forum for companies or issuers to trade their company shares. With the aim of obtaining additional capital needed by the company in carrying out its operational activities. This study consists of three independent variables Financial Distress (X1), Litigation Risk (X2) and Tax (X3). And the dependent variable is accounting conservatism. The object of research is a company listed on the Indonesia Stock Exchange from 2018 to 2020. The data used in this study amounted to 135 data. The data analysis technique uses the Eview10 application by using regression model analysis, classical assumption testing and hypothesis testing

Keywords : *Financial Distress, Litigation Risk, Tax and Conservatism*

INTRODUCTION

Indonesia has guidelines in preparing financial reports that have been prepared in Financial Accounting Standards (SAK). The SAK contains a rule that companies and business actors can choose the accounting method used in preparing their financial statements according to the conditions and needs of the company. A method that allows recognizing costs or losses more quickly without having to wait for tangible evidence and delaying the recognition of revenue is called Conservatism.

In 2012 the principle of conservatism has been replaced with the term prudence, this is because Indonesia has now adopted International Financial Reporting Standards. However, although the principle of conservatism has changed its term to prudence, it does not completely leave SAK which still uses the concept of conservatism in certain circumstances, such as cost capitalization.

Although there are opinions that do not agree with the use of the principle of conservatism, in practice there are still many companies that use the principle of conservatism in the presentation of their financial statements. Many factors are behind the

company in using the principle of conservatism, including the existence of incentives related to politics, contract costs, litigation and taxes.

Usually, companies assume that using the principle of conservatism will minimize excessive spending on the government, courts, shareholders and managers as well as parties related to the company.

In addition, the principle of conservatism is also used to minimize the level of risk. However, the principle of conservatism should not be used excessively because errors can occur in periodic profits or losses that do not show the actual financial condition of the company. If used excessively, it will reduce doubts in the assessment of the quality of financial statements, so that decision making will not consider the financial statements that have been made. Various factors that can influence management to use the principle of conservatism in the preparation of financial statements come from internal factors and external factors. external factors include litigation and tax risk. Meanwhile, internal factors include debt contracts, ownership structure and growth opportunities and so on. Company management tends to manipulate the information presented in the financial statements to make it look good.

Company management has a habit of increasing profits or assets with the aim of hiding poor performance. Actually, in Indonesia.

In this study, we chose a manufacturing company listed on the Indonesia Stock Exchange as the object of research on accounting conservatism. The object was chosen because it has a very close relationship with a company that carries out operational activities requiring funds from outside parties, namely investments, loans and others. The way to get funds from investors and creditors is to present financial statements using the principle of conservatism. So that in this study researchers are interested in raising the topic of accounting conservatism as a research theme. Based on this, this research is entitled **"The Effect of Financial Distress, Litigation Risk and Taxes on the Application of Conservatism in Accounting"**

STATEMENT OF THE PROBLEM

Based on the background stated above, the problem formulation is as follows:

1. Does financial distress affect the implementation of accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange in 2018-2020?
2. Does litigation risk affect the implementation of accounting conservatism in manufacturing companies listed on the IDX in 2018-2020?
3. Does the tax affect the implementation of accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange in 2018-2020?
4. Do financial distress, litigation and tax risk affect the implementation of accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange in 2018-2020?

Furthermore, the objectives to be achieved are:

1. For companies can provide an overview of the factors that can increase the application of accounting conservatism
2. For researchers, this research can be useful to increase knowledge and understanding of matters relating to the factors that affect the application of accounting conservatism.
3. For the general public, this research is expected to be a reference material in increasing knowledge about financial distress, litigation risk and taxes on accounting conservatism

THEORETICAL FOUNDATIONS

The Financial Accounting Standards Board (FASB) in SFAC No. 2 of 1996 states that accounting conservatism is a reaction of prudence in responding to uncertainty by ensuring that uncertainty and business risks have been adequately considered. This explains that the company tries to ensure the uncertainties and risks that will come by carrying out a prudent reaction by doing so the company is able to manage the worst risks.

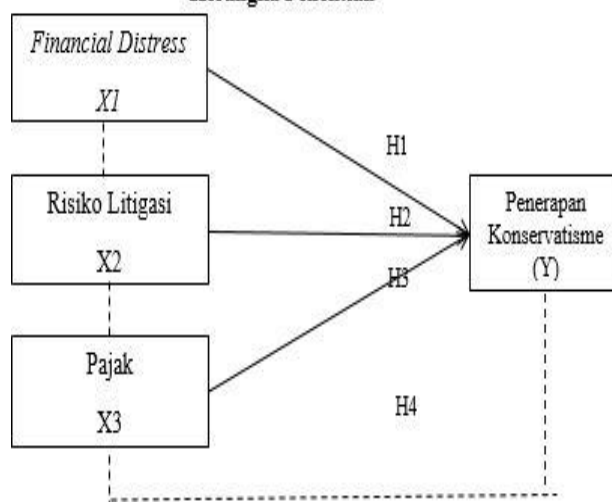
According to (Fahmi, 2013) Financial distress is the emergence of early signs of bankruptcy on the preparation of the company's financial condition. Companies are often faced with a problem,

one of which is bankruptcy, this can be avoided by predicting the causes that can lead to bankruptcy, namely by looking at financial distress.

Litigation risk is the risk of the company related to the possibility of the company being litigated by investors and creditors. Litigation risk is defined as the risk inherent in the company that allows the threat of litigation by parties with an interest in the company who feel aggrieved. (Suryandari and Priyanto, 2012)

Based on (Law No.28, 2007) article 1 concerning Tax Provisions and Procedures. Tax is a taxpayer's contribution that is paid annually which is required by law, the contributions paid cannot be directly enjoyed and used to finance government activities.

Gambar 2.1
Kerangka Penelitian



Based on the theoretical basis and hypothetical framework in this study, it can be written as follows:

H1 : Financial distress has an effect on

Accounting Conservatism

H2 : Litigation Risk Affects Accountig

Conservatism

H3 : Taxes Affect Accounting

Conservatism

H4 : Financial distress, litigation

and tax risk affect accounting

conservatism

RESEARCH METHOD

Type of research

This type of research is descriptive research using quantitative data. The type of data used in this study is secondary data which includes published financial statements of manufacturing companies taken from the Indonesia Stock Exchange data, data for 2018 to 2020, which includes income statements, balance sheets, statement of change in equity and cash flows, and notes on financial statements. Manufacturing companies registered from 2018 to 2020 amounted to 182 companies. Of these, 45 companies were used as samples.

The analytical technique used in this thesis is to use the E-Views application method. The analysis in this study uses panel data which is a combination of time series data and cross-sectional data. There are two kinds of panel data, namely panel balance data and panel data unbalance, panel balance data is a situation where the cross-sectional unit has the same number of time series observations. Meanwhile, panel data unbalance is a situation where the cross-sectional unit has an unequal number of time series observations. In this study, we use balance panel data.

RESULTS AND DISCUSSION

Descriptive Statistics

This study uses panel data which is a combination of cross section data and time series data. The cross section data consists of 45 companies and time series data from 2018 to 2020. To estimate the parameters of the method used in determining the panel data multiple regression model, there are three techniques used, namely the Common Effect Model (CEM) method, Fixed Effect Model (FEM) and Random Effects.

Common Effect Model

In this research, there is one dependent variable, namely Accounting Conservatism (KA) and the independent variables are Financial Distress (FD), Litigation Risk (RL) and taxes. The result of common effect test appears below:

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|--------|
| C | 353.7221 | 170.0283 | 2.080372 | 0.0395 |
| X1 | 3.122290 | 0.602364 | 5.183397 | 0.0000 |
| X2 | 0.053548 | 0.049705 | 1.077316 | 0.2833 |
| X3 | -0.636993 | 0.200411 | -3.178427 | 0.0019 |
| R-squared | 0.328713 | Mean dependent var | 563.0043 | |
| Adjusted R-squared | 0.313221 | S.D. dependent var | 2315.963 | |
| S.E. of regression | 1919.287 | Akaike info criterion | 17.98669 | |
| Sum squared resid | 4.79E+08 | Schwarz criterion | 18.07319 | |
| Log likelihood | -1201.108 | Hannan-Quinn criter. | 18.02184 | |
| F-statistic | 21.21925 | Durbin-Watson stat | 1.504360 | |
| Prob(F-statistic) | 0.000000 | | | |

Sumber: Hasil Pengolahan Data *Eview10* (2022)

From the table of Common Effect Estimation Test results above, it can be seen that the R Square value is 0.328713, because the R Square value is smaller than 0.5. Thus, it can be said that the predictor ability, namely the independent variables X1, X2 and X3 is not strong in explaining the response variable. And the Prob (F-Statistics) value of 0.0000, which is less than 0.05, it can be said that the response variable is statistically significant.

Fixed Effect Model

Fixed effects assumes that differences between individuals (cross section) can be accommodated from differences in intercepts. Results of the Fixed Effect Model are as follows

The R Square value obtained is 0.661764, which means that the predictor variables, namely Financial Distress (X1), X2, and X3 are very strong in describing the response variable because the R Square value is greater than 0.5. And the Prob (F-statistic) value of 0.0000 is smaller than 0.05, this means that the responses variable is statistically significant.

Random Effect Model

Autocorrelation Test

Autocorrelation test can be detected by using the Durbin-Watson test. The value of the Durbin-Watson test is compared with the value of the Durbin-Watson table to determine the presence of a positive or negative correlation. Decisions regarding the presence of autocorrelation. The results of the autocorrelation test as follows:

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|----------|-------------|------------|-------------|--------|
| C | 268.2502 | 183.5448 | 1.461497 | 0.1475 |
| X1 | 4.592141 | 1.121375 | 4.095100 | 0.0001 |
| X2 | 0.032744 | 0.082429 | 0.397235 | 0.6922 |
| X3 | -0.606614 | 0.255979 | -2.369775 | 0.0200 |

| Effects Specification | | | | |
|---------------------------------------|-------------|-----------------------|-------------|--------|
| Cross-section fixed (dummy variables) | | | | |
| R-squared | 0.661764 | Mean dependent var | 563.0043 | |
| Adjusted R-squared | 0.476913 | S.D. dependent var | 2315.963 | |
| S.E. of regression | 1675.014 | Akaike info criterion | 17.95796 | |
| Sum squared resid | 2.41E+08 | Schwarz criterion | 18.99599 | |
| Log likelihood | -1155.183 | Hannan-Quinn criter. | 18.37978 | |
| F-statistic | 3.580000 | Durbin-Watson stat | 2.783439 | |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| C | 268.2502 | 183.5448 | 1.461497 | 0.1475 |
| X1 | 4.592141 | 1.121375 | 4.095100 | 0.0001 |
| X2 | 0.032744 | 0.082429 | 0.397235 | 0.6922 |
| X3 | -0.606614 | 0.255979 | -2.369775 | 0.0200 |

Sumber: Hasil Pengolahan Data dengan Eview10 (2022)

Multicollinearity Test

| Hasil Uji Multikolinieritas | | | | |
|-----------------------------|-----------|----------|----------|-----------|
| | Y | X1 | X2 | X3 |
| Y | 1.000000 | 0.525860 | 0.367782 | -0.059765 |
| X1 | 0.525860 | 1.000000 | 0.693659 | 0.278841 |
| X2 | 0.367782 | 0.693659 | 1.000000 | 0.415878 |
| X3 | -0.059765 | 0.278841 | 0.415878 | 1.000000 |

Sumber: Hasil Pengolahan Data dengan Eview10 (2022)

From the results above, it can be seen that the correlation value of the Financial Distress variable (X1) is 0.525860, Litigation Risk (X2) is 0.367782 and Tax (X3) is -0.059765. The correlation value of the independent variable is less than 0.9, so it can be concluded that there is no multicollinearity in the data.

Heteroscedasticity Test

The heteroscedasticity test was carried out using the glacier test with the following hypothesis:

H0 = There is no heteroscedasticity symptom in the regression model H1 = There is heteroscedasticity symptom in the regression model.

The decision taken is if the significant value is greater than 0.005 then H0 is accepted and vice versa if the significant value is less than 0.05 then H0 is rejected.

The results of heteroscedasticity testing as follows:

Cross-section fixed (dummy variables)

| | | | |
|--------------------|-----------|-----------------------|----------|
| R-squared | 0.598035 | Mean dependent var | 836.6868 |
| Adjusted R-squared | 0.378356 | S.D. dependent var | 1701.548 |
| S.E. of regression | 1341.575 | Akaike info criterion | 17.51400 |
| Sum squared resid | 1.55E+08 | Schwarz criterion | 18.55203 |
| Log likelihood | -1125.438 | Hannan-Quinn criter. | 17.93582 |
| F-statistic | 2.722318 | Durbin-Watson stat | 3.074128 |
| Prob(F-statistic) | 0.000028 | | |

Sumber: hasil Pengolahan Data dengan Eview10 (2020)

From the results above, it can be seen that the probability value of the independent variable, namely Financial Distress (X1) is 0.0941, Litigation Risk (X2) is 0.4672 and Tax (X3) is 0.3501. Because the probability value of each independent variable is greater than 0.05, it can be said that the heteroscedasticity is not detected in this regression model.

T-test

The results of the statistical t-test obtained that the t-count value of Financial Distress (X1) is 4.095100 with a probability level of 0.0001 because the t-count value is greater than t table ($4.095100 > 1.65657$) and the probability value is less than 0.05 ($0.0001 < 0.05$), the Financial Distress variable (X1) has a partial effect on the use of accounting conservatism in the preparation and financial reporting of manufacturing companies listed on the Indonesia Stock Exchange from 2018 to 2020.

In this study, the regression coefficient of Litigation Risk (X2) is 0.032744 units, which means that if Litigation Risk increases it will increase the use of accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange by 0.032744 units. While the results of testing the t test hypothesis obtained the t value of the Litigation Risk variable (X2) of 0.397235 with a probability value of 0.6922. because the t arithmetic value is smaller than t table ($0.397235 < 1.65657$) and the probability value is greater than 0.05 ($0.6922 > 0.05$), these results illustrate that the Litigation Risk variable has no effect on accounting conservatism in manufacturing companies that listed on the Indonesia Stock Exchange from 2018 to 2020.

Financial Distress (X1), Litigation Risk (X2) and Tax (X3) variables simultaneously have an effect on Accounting Conservatism. The calculated f value is greater than the f table value with a small probability level of 0.05 which is the basis for the conclusion that Financial Distress (X1), Litigation Risk (X2) and Taxes (X3) affect Accounting Conservatism.

F-Statistic Test

If in the test we accept H_0 , we can conclude that there is no linear relationship between the dependent variable and the independent variable. The results of the statistical F test are as follows:

Redundant Fixed Effects Tests

Equation: Untitled

Test cross-section fixed effects

| Effects Test | Statistic | d.f. | Prob. |
|--------------------------|-----------|---------|--------|
| Cross-section F | 1.924580 | (44,86) | 0.0049 |
| Cross-section Chi-square | 91.850580 | 44 | 0.0000 |

Sumber: Hasil Pengolahan Data Eview10 (2022)

From the table above, it can be seen that the F-statistic value is 3.5800 with a probability level of 0.0000. Based on these results, it can be concluded that the variables Financial Distress (X1), Litigation Risk (X2) and Taxes (X3) simultaneously affect the value of accounting conservatism, this is because the t value is greater than t table ($3.580 > 2.67$) and the probability value less than 0.05 ($0.000 < 0.05$).

Panel Data Regression Model**F Test (Chow Test)**

The Chow test is used to determine which test between the two methods, namely the common effect method and the fixed effect method, should be used in panel data modeling. Chow test was conducted to determine the most appropriate model to use between common effects and fixed effects. The results of the Chow test are as follows:

Redundant Fixed Effects Tests

Equation: Untitled

Test cross-section fixed effects

| Effects Test | Statistic | d.f. | Prob. |
|--------------------------|-----------|---------|--------|
| Cross-section F | 1.924580 | (44,86) | 0.0049 |
| Cross-section Chi-square | 91.850580 | 44 | 0.0000 |

Sumber: Hasil Pengolahan Data Eview10 (2022)

From the results of the Chow Test above, it can be seen that the Chi-square cross-section value is 0.0000. To note that if the probability value of F and Chi-square $\geq 5\%$, then the panel data regression test uses the Common Effects model and otherwise the probability value of F and Chi-square $\leq 5\%$, then the panel data regression test uses the Fixed Effect model. . So from these results it can be concluded that the panel data regression test uses Fixed Effects because the Chi-square value is smaller than 0.05, i.e. 0.0000.

Hausman Test

If the probability value in the Hausman test is less than 5%, then H_0 is rejected, which means that the suitable model used in the regression analysis equation is the fixed effect model. And vice versa if the probability value in the Hausman test is greater than 5% then

Ho is accepted which means that the suitable model used in the regression analysis equation is a random effect model. The results of the Hausman Test are as follows:

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

| Test Summary | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob. |
|----------------------|-------------------|--------------|--------|
| Cross-section random | 9.998565 | 3 | 0.0186 |

Sumber: Hasil Pengolahan Data Eview10 (2022)

From table 4.10 above, it is known that the probability value is 0.0186, the value is smaller than 0.05, so it can be said that the suitable model used in the regression analysis equation is the fixed effect model.

CONCLUSION

1. Financial distress has an effect on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange from 2018 to 2020.
2. The Litigation Risk Variable has no effect on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange from 2018 to 2020.
3. Tax variables affect accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange from 2018 to 2020.

SUGGESTION

1. For companies, it is better to present quality financial reports to interested parties such as owners, creditors or investors, not applying the principle of accounting conservatism too much but using the principle of conservatism when necessary.
2. For investors to be more careful in viewing the information presented in the financial statements as a basis for making decisions.
3. Further research is recommended to add other variables to strengthen this research, for example by including the variable level of financial difficulty of the company and adding the sample used as well as increasing the year of observation period in order to obtain an efficient predictive model.

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