



## THE EFFECT OF CORPORATE GOVERNANCE, FINANCIAL DISTRESS, TAX INCENTIVES, AND FIRM SIZE ON ACCOUNTING CONSERVATISM IN THE INDONESIA BANKING SECTORS

Afra Aulia <sup>1)</sup>; Praptiningsih <sup>2)\*</sup>

<sup>1)</sup> [afraulia28@gmail.com](mailto:afraulia28@gmail.com)\*, Universitas Pembangunan Nasional Veteran Jakarta

<sup>2)</sup> [praptiningsih@upnvj.ac.id](mailto:praptiningsih@upnvj.ac.id), Universitas Pembangunan Nasional Veteran Jakarta

\* *for corresponding author*

### Abstract

The objective of this study is to examine the effect of corporate governance, financial distress, tax incentives, and firm size on accounting conservatism in the banking sector in Indonesia. Corporate governance mechanisms in this study are represented by managerial ownership and institutional ownership, reflecting the role of governance structures in influencing accounting practices. The study analyzes a total of 75 data units derived from 25 banking companies listed on the Indonesia Stock Exchange (BEI) during the 2021-2023 period, selected through purposive sampling. This research employs a quantitative research method and relies on secondary data sources, such as annual reports and company financial statements. The analysis technique used is multiple linear regression technique using Stata version 13. The results of the study prove that there is a negative significant effect of financial distress and tax incentives, but there is no significant effect of managerial ownership, institutional ownership, bank size on accounting conservatism.

**Keywords:** Accounting Conservatism, Corporate Governance, Financial Distress, Firm Size, Tax Incentives

### INTRODUCTION

Financial reports have a role as a medium for conveying information related to company performance to stakeholders, both internal and external. Stakeholders will make a decision on the company based on the basic financial reports presented, so the company's financial reports need to be presented with good quality so that no losses will befall the financial reports users. The quality of good financial report presentation is the presentation of financial data that is truly in accordance with the economic conditions experienced by the company. Good quality financial reports are obtained from good financial data and information. The lower the information contained in the financial reports, the lower the quality of accounting profit, so that it can encourage investors and creditors in assessing the company's actual financial performance (Harymawan & Nurillah, 2017). A good company financial report is a financial report that complies with the established regulations. One form of regulation for presenting financial reports is the Standar Akuntansi Keuangan (SAK) set by the Ikatan Akuntan Indonesia (IAI) as a standard that must be adhered to by companies in Indonesia. Several Prinsip Standar Akuntansi Keuangan (PSAK) regulate the calculation, presentation, and reporting of transactions with several methods. Several choices of methods indicate that company management is free to choose and use several methods professionally in recording financial information as long as it is permitted in SAK (Lasdi, 2009).

The freedom to use several methods permitted by accounting standards can create loopholes for management to carry out earnings management. Moreover, financial statements users tend to focus on information about profits without looking in more detail at how the profits were obtained (Mustikasari et al., 2020). This will have an impact on the delivery of asymmetric information by managers who have the authority to manage transaction and profit recording. This asymmetric information can trigger moral hazard and opportunistic management behavior in manipulating financial statements, such as providing information related to profits. This deviant behavior can be prevented and limited by applying a principle in financial reporting called conservatism (Afriani et al., 2021). Conservatism is a prudent principle that company management can consider to report finances not to accelerate the recognition of income or



profits, but to accelerate the recognition of costs or losses that may occur (Hariyanto, 2021). According to Ruch and Taylor (2015), accounting conservatism is an accounting policy or tendency to bias downward in accounting for net asset value relative to net economic asset value. According to Watts (2003), conservatism is defined as the different verification capabilities required in recognizing gains and losses.

Management moral hazard behavior due to asymmetric information is depicted in several cases of financial report manipulation and poor financial performance related to the principle of conservatism. The phenomenon of financial report modification has occurred in the banking sector, PT Bank Bukopin Tbk, which was revealed in 2018. Reported by CNBC Indonesia (2018), Bank Bukopin has been reported to have submitted financial reports with overstated profits due to errors in recording more than 100,000 credit cards that had occurred more than five years before 2017, where the company recognized credit card business income that did not actually exist. With the discovery of the problem, Bank Bukopin was asked to restate its financial statements for a maximum of 3 years, 2017, 2016, and 2015. In the restatement, it was discovered that Bank Bukopin had a much smaller profit, that reported in 2016 of IDR 1.091 trillion, to IDR 176 billion, and the reported profit in 2015 of IDR 964 billion to IDR 427 billion. The case had an impact until 2020 - 2024. Bank Bukopin's non-performing loan (NPL) ratio reached 30.58% in 2020 and 27.85% in October 2021. This high ratio made Bank Bukopin receive intensive supervision by the Otoritas Jasa Keuangan (OJK). Although Bank Bukopin's NPL continues to improve, Bank Bukopin is still under intensive supervision by the OJK in early 2024.

A high NPL ratio indicates a high credit risk where many debtors are unable to pay their credit obligations on time. Although Bank Bukopin's NPL has decreased and improved slightly, the ratio is still at an alarming level. In fact, based on Bank Indonesia regulations no. 23/2/PBI/2021, the required NPL ratio is <5%. The examples of cases that befell Bank Bukopin reflect that there are still banking sectors that are not careful. Being careless in recognizing credit card business income faster and providing excessive credit has a more dangerous risk. In fact, banks have a crucial role in participating in building the national economy. Their duties as managers and distributors of public funds should be carried out carefully so as not to cause losses to the community. Ha's research results (2021) prove that banks that adopt greater conservatism tend to have lower NPLs and higher-quality loan portfolios, as a result of enhanced monitoring of lending decisions.

Conservatism arises due to the uncertainty of economic conditions. This uncertainty is also a result of the application of the accrual basis in the presentation of financial statements (Zulni & Taqwa, 2023). These uncertain conditions sometimes put pressure on management so that there is an opportunity for management to make a deviation in the form of prioritizing profit reporting to look good in investor assessments. Carelessness in the recognition and reporting of a company's finances is feared to cause errors in the information provided by the company (Fadhiilah & Rahayuningsih, 2022). The application of the conservatism principle in accounting remains a subject of controversy. Opponents assume that the quality of financial statements is affected by obstacles in the form of incomplete disclosure of all relevant information due to the application of the principle of conservatism (Haryadi et al., 2020). On the other hand, accounting conservatism has advantages, such as mitigating agency costs, reducing litigation risks, and increasing contract efficiency for parties in the company (García Lara et al., 2009). Moreover, some cases of banks with poor financial performance can reduce the trust of users of financial statements who want to make business decisions, so that the conservative principle can allow interests to be better protected.

Corporate governance is defined as a mechanism used by shareholders to unify corporate management to minimize agency costs (Ruch & Taylor, 2015). One of the monitoring



roles is related to the preparation of financial reports by management. Several aspects of corporate governance, namely managerial ownership and institutional ownership. As a party with more information, management cannot avoid opportunistic attitudes that are self-interested which can create agency problems between agents and principals. Therefore, the existence of share ownership in management can influence them to act conservatively. Several studies have shown that the higher the share ownership by company management, the higher the tendency of management to apply accounting conservatism (Hariyanto, 2021). Conversely, there are also studies that find that high share ownership by company management will lower their conservative actions (Hajawiyah et al., 2020; Lafond & Roychowdhury, 2008; Sari & Agustina, 2021). However, there are also studies that show that managerial ownership does not affect accounting conservatism (El-Haq et al., 2019; Fadhiilah & Rahayuningsih, 2022; Noviyanti & Agustina, 2021).

Institutional investors are also part of corporate governance and have an important role in corporate governance, namely connecting managers through direct actions in terms of voting (Lin, 2016). Institutional investors include investors who have a lot of experience, so that their supervision of operations and management is carried out effectively and tends to be hesitant (Putra et al., 2019). Thus, institutional share ownership can influence government policy. This is supported by research by Ramalingegowda & Yu (2012), Alkurdi et al. (2017), and Hajawiyah et al. (2020) which showed that the more share ownership by institutions, the higher the level of conservatism applied. Conversely, there is also an explanation that the less share ownership by an institution, the lower the level of conservatism applied (Noviyanti & Agustina, 2021). However, other studies have shown that institutional ownership has no effect on accounting conservatism (Fadhiilah & Rahayuningsih, 2022; Hariyanto, 2021).

The existence of costs, such as agency fees and litigation costs, when faced by companies, often results in a lot of money expenditure and brings the company into a state of financial distress. Therefore, the condition of financial distress allows for the influence of conservative behavior so that the condition can be improved and prevented. Several research results reveal that financial distress has a positive influence on the application of accounting conservatism (Pujiono et al., 2023; Stiawan et al., 2022; Widhiastuti & Rahayu, 2022). In addition, the results of other studies prove that financial distress also has a negative influence on the application of accounting conservatism (Sugiyarti & Rina, 2020). In other studies, accounting conservatism is not influenced by financial distress (Haryadi et al., 2020).

Tax incentives are tax facilities provided by the government to domestic and foreign companies to facilitate and reduce the tax costs imposed, thus affecting the company's economic activities as well (Sugiyarti & Rina, 2020). By utilizing tax incentives, companies can increase profits without worrying about high tax burdens. This explanation is in line with several studies, such as research by Mashuri and Praptiningsih (2024), Pangkey et al. (2024), Sugiyarti & Rina (2020), Fadhiilah & Rahayuningsih (2022), and Stiawan et al. (2022) which state that there is an effect of tax incentives on conservative accounting. However, there is a study that results there is no effect of tax incentives on conservative accounting actions (Atika et al., 2021).

Large companies that are well-known to the public usually disclose more information so that they can increase investor confidence (Abdiputri & Angraini, 2024). Large companies that are trusted by the public find it easier to obtain funds from investors. However, large companies are not free from high risks and can result in political costs and financial distress, so companies need to be careful in order to maintain investor confidence and the sustainability of the company (Hariyanto, 2021). The effect of company size on the implementation of conservative accounting is supported by several studies conducted by Widhiastuti and Rahayu (2022), Hariyanto (2021), Atika et al. (2021), El-Bannany (2017), Hamdan (2011). On the other hand, research by Sari and Agustina (2021) found no effect of company size on the



implementation of conservative accounting. The inconsistency of the results found in each factor of previous research motivated researchers to re-examine those factors and their impact on accounting conservatism in the banking sector.

## **LITERATURE REVIEW**

### **Agency Theory**

Jensen and Mecklin (1976) explained that an agency relationship arises when there is a cooperation contract between the owner of funds (principal) who appoints another person, namely the manager (agent) to manage interests related to decision-making in the company. The principal as a shareholder or owner of the company has an interest in obtaining high and maximum investment returns, while the agent has an interest in obtaining high salaries, bonuses or incentives in return for their high contributions and performance. The difference in interests that are desired to be achieved can cause agency problems, one of which is asymmetric information (Aurillya et al., 2021). Concerns about asymmetric information arise from the fact that managers and agents have more information about the company than the principal. Proponents of agency theory believe that agents tend to carry out activities for personal interests that are detrimental to the principal, if there is no supervision (Antwi, 2021). The occurrence of interest problems between principals and agents in this agency theory is caused by the agent's behavior which tends to be opportunistic (Noviyanti & Agustina, 2021). To achieve their interests, agents carry out income management as a way to make financial reports in accordance with estimates of good income projections. Through earnings management practices, agents can accelerate or delay expenses and income in accounting practices to generate consistent income growth so that these practices can provide incentives as expected by agents, but do not represent the actual economic conditions of the company at that time (Palliam & Shalhoub, 2013).

Agency problem is overcome by providing incentives from the principal to agents so that they manage the company based on the principal's wishes, which in this case is called agency costs (Jensen & Meckling, 1976). In addition to agency costs, corporate governance supervision is needed so that agents do not manipulate high profits so that they get incentives. The existence of good governance that carries out supervision is an effort to avoid the opportunistic attitude of agents who want incentives, but in a way that tends to reduce the value of the company (Kazemian & Sanusi, 2015; Nugraha et al., 2021). One form of supervision that can be carried out by corporate governance is the application of accounting conservatism. Corporate governance underlies the application of accounting conservatism in the form of share ownership by managers and institutional investors. Managerial ownership of shares helps align the interests of shareholders and managers, which in turn reduces agency costs, while institutional investor share ownership plays a role in the form of greater monitoring of agency problems and the use of their ownership rights to pressure managers to take the best actions in the interests of shareholders (Chung & Zhang, 2011; Cornett et al., 2007).

### **Positive Accounting Theory**

Positive accounting theory was introduced more widely by Watts and Zimmerman (1978) and it was stated that positive accounting theory is a theory that can determine accounting standards. Positive accounting theory aids in comprehending the pressures that impact the selection of accounting standards and the effects of applying different standards across organizations and individuals, providing insight into why an organization invests resources to shape the standard-setting process. According to Setijaningsih (2012), positive accounting theory is intended to explain and estimate accounting standard options by analyzing the costs and benefits arising from the provision of financial information between individuals and the distribution of economic resources. The formation of positive accounting theory comes



from assumptions about the nature of human society, namely the assumption that a choice of human action is based on predetermined goals (Januarti, 2004). Watts and Zimmerman (1978) assume that the selection of accounting standards is based on management interests, such as obtaining imbalances or other wealth.

There are three hypotheses developed from this theory by Watts and Zimmerman (1978), namely the bonus plan hypothesis, the debt contract hypothesis, and the political cost hypothesis. In the bonus plan hypothesis, accounting methods that are able to increase company income tend to be used. The increase in income will be placed by managers in the period in which the company has planned a bonus, so that there is an increase in the bonus that the manager will receive. In the second hypothesis, accounting methods that are able to increase company income tend to be used by managers if the company's debt/equity ratio is high. This high ratio will make it more likely for the company to violate the debt contract and incur costs from the default. In the third hypothesis, the selection of accounting methods is based on the size of the company. Larger companies tend to be more exposed to government/political supervision, so they tend to face more political costs and losses than small companies. Managers in larger companies often prefer accounting methods that minimize reported profits. This aims to prevent the company from being accused of obtaining special facilities or monopolies (Gumanti, 2002). Thus, the size of the company and its political costs can be a consideration for managers in implementing conservative accounting.

### **Accounting Conservatism**

Conservatism is one of the principles that can be implemented in accounting. The application of the principle of conservatism is by recognizing expenses or losses first rather than recognizing income or profits later (Hariyanto, 2021). According to Hellman (2008), accounting conservatism can be interpreted based on the balance sheet assessment, namely the lower the net asset value (assets minus liabilities), the higher the level of accounting conservatism. Basu (1997) interprets conservatism as the principle where accountants exhibit a greater level of verification to recognize good news (profits) compared to bad news (losses) in financial reporting. Basu stated that reported earnings capture bad news more thoroughly and promptly than good news.

### **Corporate Governance**

Corporate governance is a mechanism that ensures that company assets are used efficiently so that it becomes a guarantee for fund providers to get profit from their investment (García Lara et al., 2009; Shleifer & Vishny, 1997). Corporate governance is defined as a term that describes the processes, policies, and institutions that direct the actions, management, and operational control of organizations and companies. Corporate governance has an essential role in the implementation of accounting conservatism, namely reducing agency problems through efficient monitoring and management contracts to ensure efficient decision making and maximize company value (García Lara et al., 2009).

### **Managerial Ownership**

Managerial ownership is a form of company share ownership structure, some of which are owned by management, so that management is more than just managing the company, namely as a shareholder (Trisnadewi, 2020). Managerial ownership makes the manager's position equal to the position of the shareholder. Managerial ownership can be a bridge that connects and unites the interests of managers and shareholders, so that benefits are obtained to consider a decision that can cause losses carefully, while bearing the loss (Nugraha et al., 2021). Conversely, managerial ownership tends to make managers not carry out their responsibilities and performance optimally, prioritize personal gain, and place themselves at a higher level, thus creating a negative relationship between managerial ownership and performance (Florackis et



al., 2009). Moreover, managers control more information (information asymmetry) than shareholders which can trigger their opportunistic attitudes.

### **Institutional Ownership**

Institutional ownership is part of external corporate governance. Institutional ownership is the fraction of a company's shares held by institutional investors (Chung & Zhang, 2011). Institutional investors are not individuals, but legal entities, ranging from profit-oriented joint stock companies, limited partnerships, to other bodies established under special laws, such as sovereign wealth fund managers. Institutional investors are able to act independently or become part of a larger corporate group. Different forms of institutional investors have different characters and levels of ownership involvement (Çelik & Isaksson, 2013).

### **Financial Distress**

Financial distress is a state of financial difficulty experienced by a company which is characterized by a decrease in net profit over several periods (Pujiono et al., 2023). Financial distress reflects the condition of a company that finds it difficult to pay short-term or long-term debt due to inadequate cash funds (Galant et al., 2023). According to Whitaker (1999), financial distress is cash flow, net profit plus non-cash costs, which are less than the maturity of long-term debt. When cash flow is greater than debt, the company is considered to have funds to pay the debt, and vice versa. If the lack of cash flow continues, it will lead the company to default.

### **Tax Incentives**

Taxes play an important, but underemphasized, role in corporate valuation. Tax incentives are the provision of tax relief facilities by the government to domestic and foreign companies so that they can have an impact on the company's economic activities (Sugiyarti & Rina, 2020). According to Graham & Lemmon (1998), tax incentives are defined as any action that explicitly provides benefits for certain economic activities. Tax incentives are used as a tool for national development and tax competition, which is mostly experienced by developing countries. Tax incentives are also used by developed countries with a focus on foreign investment. Some forms of tax incentives include reductions in corporate income tax rates, dividend withholding taxes, corporate income tax that invests new capital domestically (tax holidays), to tax reductions through tax credits and investment allowances (Klemm, 2010).

### **Firm Size**

Company size is something that can compare the size of a company, one of which is related to the company's assets (Pahriyani et al., 2020). Company size is commonly used to identify important characteristics of a company (Dang et al., 2018). Company size can be a consideration for managers in preparing financial reports because of several interests, such as obtaining funding to avoiding risk costs.

### **The Effect of Managerial Ownership on Accounting Conservatism**

In agency theory, agency problems arise as a result of the separation of managers and shareholders with misaligned interests (Jensen & Meckling, 1976). Agents have an interest in getting incentives from their performance, while principals have an interest in getting profits from the capital they invest to the sustainability of the company. Management has a wider and more complete scope of information on current and future company performance so that they are involved in decision making and create a situation of information inequality. Not infrequently, management acts to exploit this opportunistically to increase their wealth (Watts & Zimmerman, 1978). Agency problems can be mitigated when managers' interests are aligned with those of shareholders. This can occur in the form of ownership of company shares by managers or can be called managerial ownership.

Although the alignment of the role of managerial ownership can play a role in minimizing conflicts of interest and agency costs, managerial ownership can also allow managers to try to gain as much personal gain as possible. Managers with share ownership who



have greater control and power will continue to increase the value of their companies by increasing profits. High profits make managers with stock ownership gain additional wealth in the form of incentive rewards and stock options and higher stock returns. Increased value and increased profits can be obtained because managers recognize all uncertain income and ignore uncertain expenses. It can be said that managers are not being careful or not implementing accounting conservatism. Thus, it can be estimated that managerial ownership can have a negative effect on accounting conservatism (Hajawiyah et al., 2020; Lafond & Roychowdhury, 2008; Sari & Agustina, 2021).

H1: Managerial ownership has a negative effect on accounting conservatism.

### **The Effect of Institutional Ownership on Accounting Conservatism**

One of the important roles of institutional ownership in corporate governance is to supervise the mechanisms and performance of the company carried out by managers. Unlike individual investors in general who are small investors, institutional investors are more experienced and sophisticated in measuring company performance based on financial reports (Ramalingegowda & Yu, 2012). In addition, just like other investors, institutional investors also incur costs that are included in agency costs as a form of supervision and minimization of agency problems, even greater (Chung & Zhang, 2011)

Institutional investors use their ownership rights to push managers toward making decisions that best serve the interests of shareholders (Cornett et al., 2007). Their ownership rights are supported by the size of their share ownership which tends to be larger so that they have the opportunity to influence decisions made by the company. Institutional investors prefer to avoid incurring high monitoring costs, even if such expenses could yield long-term benefits for them. Instead, they aim to reap the benefits of their investment through stock returns and maintain the liquidity of their ownership to gain short-term profits. Institutional investors, who are generally more concerned with a company's future profitability, seek the implementation of accounting conservatism to secure long-term benefits. This includes the sustainability and stability of the company, which ultimately leads to high returns for investors (Lin, 2016). One alternative to meet their interests, institutional investors have a high demand for conservative accounting reporting. The greater the ownership of shares by institutional investors, the greater the demand for accounting conservatism.

H2: Institutional ownership has a positive effect on accounting conservatism.

### **The Effect of Financial Distress on Accounting Conservatism**

Financial distress is a condition of a company facing a financial crisis that can bring the company to the bankruptcy. Financial distress can be observed through the decline in the company's net profit over several periods (Pujiono et al., 2023). When financial difficulties occur, the performance of the board of directors and management becomes a concern. According to the Office of the Comptroller of the Currency (OCC), financial distress, especially that experienced by banks, when there are asset and capital problems, is referred to as a failure of the board of directors and management. Failure of performance or direction management is caused by a lack of attention and lack of information, overly aggressive actions, to other problems related to insufficient supervision and monitoring of the activities of the management board and staff (Simpson & Gleason, 1999). This will create negative prospects and reputations from stakeholders in the company, including management. Then, unmitigated financial distress can end in the bankruptcy of the company (Galant et al., 2023). When a company goes bankrupt, it is possible that managers can be dismissed and lose their positions.

One policy that managers can take to avoid this is accounting conservatism. The use of accounting conservatism with the principle of prudence is used as a positive signal sent to external stakeholders to show that they are managing risks and reporting their finances carefully



and maintaining the quality of financial information. Thus, accounting conservatism can increase in financial distress conditions (Pujiono et al., 2023; Widhiastuti & Rahayu, 2022).

H3: Financial distress has a positive effect on accounting conservatism.

### **The Effect of Tax Incentives on Accounting Conservatism**

Tax incentives are part of government policy to stimulate economic activity by providing tax reductions on certain activities or sectors (Klemm, 2010). Tax incentives result in a lower tax burden owed by a company. Positive accounting theory, through the political cost hypothesis, suggests that large companies are likely to reduce profits in order to avoid political costs, such as high tax cost. (Watts & Zimmerman, 1978). To reduce the tax cost, managers are inclined to select accounting methods and principles that lower profits, such as accounting conservatism. Through conservatism, companies can delay the recognition of uncertain income and hasten the recognition of uncertain costs.

With tax incentives, managers can enhance the company's value and earn substantial incentives or bonuses from high profits for their performance, all while avoiding high tax costs. Therefore, tax incentives can make company managers remain optimistic and aggressive so that the use of conservative principles is reduced in the presentation and reporting of financial information. Thus, tax incentives can have a negative effect on accounting conservatism (Fadhilah & Rahayuningsih, 2022; Stiawan et al., 2022).

H4: Tax incentives have a negative effect on accounting conservatism.

### **The Effect of Firm Size on Accounting Conservatism**

In positive accounting theory, the political cost hypothesis posits that firm size serves as a proxy for political attention, which in turn acts as a proxy for political costs (Watts & Zimmerman, 1990; Zimmerman, 1983). The political and governmental spheres to society pay greater attention to larger companies. The goal is to find out and monitor whether the profits generated come from monopolistic practices (Watts & Zimmerman, 1990). Additionally, larger companies in certain industries are more likely to face higher political costs, particularly in the form of taxes (Zimmerman, 1983). This makes companies with higher incomes a priority for the government as policy makers to oversee tax collection and payment (Sari & Agustina, 2021)

Managers in larger companies tend to choose policies that can reduce the risk of political costs, one of which is being conservative in recognizing profits and presenting financial information. Conservative actions in recording financial information can reduce profits and reduce assets. Small profits and assets reduce negative public attention, political pressure, political demands, and incentive supervision of large companies. Thus, company size can have a positive effect on accounting conservatism (El-Bannany, 2017; Widhiastuti & Rahayu, 2022)

H5: Company size has a positive effect on accounting conservatism.

## **METHODS**

In this study, accounting conservatism is the dependent variable, while managerial ownership, institutional ownership, financial distress, tax incentives, and company size are the independent variables. The description and measurement of these variables can be explained as follows.

### **Definition and Measurement**

#### **Accounting Conservatism**

The application of the conservatism principle is by recognizing expenses or losses first and recognizing income or profits later (Hariyanto, 2021). Accounting conservatism is measured by the total accrual model developed by Givoly and Hayn (2000). The greater the value of accounting conservatism, the greater the level of accounting conservatism.

$$ConAcc = \frac{NI + DA - CFO}{TA} \times (-1)$$



ConAcc = Accounting conservatism  
NI = Net income  
DA = Depreciation and amortization expense  
CFO = Cash flow from operating activities  
TA = Total asset

### Managerial Ownership

Trisnadewi (2020) defines managerial ownership as a company's share ownership structure where some of the shares are owned by management so that management has two roles, as company manager and shareholder.

$$\text{Managerial Ownership} = \frac{\text{Number of shares owned by the manager}}{\text{Total shares outstanding}}$$

### Institutional Ownership

Chung & Zhang (2011) define institutional ownership as the fraction of a company's shares held by institutional investors.

$$\text{Institutional Ownership} = \frac{\text{Number of shares owned by the institutional}}{\text{Total shares outstanding}}$$

### Financial Distress

Galant et al. (2023) explain financial distress as a condition in which a company struggles to meet its short-term or long-term debt obligations due to insufficient cash flow. The measurement of this variable uses the Zmijewski model (x-score). In this model, a positive x-score indicates financial distress, and vice versa (Zmijewski, 1984).

$$X = -4,3 - 4,5X_1 + 5,7X_2 - 0,004X_3$$

X<sub>1</sub> = Return on assets

X<sub>2</sub> = Financial leverage

X<sub>3</sub> = Liquidity

### Tax Incentives

Tax incentives are the provision of tax burden reduction facilities by the government to domestic and foreign companies, with the aim of positively impacting the company's economic activities (Sugiyarti & Rina, 2020). Tax incentives can be realized by using proxy tax planning. Increasingly high tax planning is followed by the company's efforts to maximize tax incentives. The measurement of this variable uses the tax incentive measurement carried out by Yin & Cheng (2004) with the formula:

$$\text{Tax planning} = \frac{(\text{Tax rate} \times \text{PTI}) - \text{CTE}}{\text{TA}}$$

PTI = Pre-tax income

CTE = Current tax expense

TA = Total asset

### Firm Size

Company size is an indicator used to compare how big or small a company is, which can be measured through assets, sales, stock market value, and others (Pahriyani et al., 2020; Sari & Agustina, 2021). This study uses the measurement of the natural logarithm of total assets (Hariyanto, 2021).

$$\text{Size} = \ln(\text{Total Asset})$$

### Population and Sample

This study determines banking sector companies listed on the Indonesia Stock Exchange from 2021-2023 as the research population. The banking sector is essential as a financial institution that contributes to the economic development of the country. The implementation of conservative accounting can serve as a controller of the banking sector in carrying out its role and avoiding risks so as to minimize losses suffered by the community and other stakeholders.



The research sample comes from a population selected through a purposive sampling method with several criteria. Details of population selection to obtain samples according to the criteria are presented in the table below:

**Table 1. Selection of Research Samples**

No.	Sample Criteria	Beyond Criteria	Included Criteria
	Banking industry business entities listed on the Indonesia Stock Exchange		47
1.	Banking industry business entities that are fully listed on the Indonesia Stock Exchange (IDX) during 2021-2023.	(2)	45
2.	Banking industry business entities that have complete data and information as a source for measuring the variables studied, including annual reports.	(20)	25
	Number of company samples		25
	Number of years of research		3
	Total samples		75

Source: processed data

This study uses secondary data from the annual reports and financial reports of each company. This study tests data using multiple linear regression analysis techniques for panel data. The multiple linear regression analysis model is shown in the following equation.

$$ConAcc: \beta_0 + \beta_1 MO + \beta_2 IO + \beta_3 FD + \beta_4 TI + \beta_5 FS + e$$

Description:

- ConAcc : Accounting conservatism
- MO : Managerial ownership
- IO : Institutional ownership
- FD : Financial distress
- TI : Tax incentives
- FS : Firm size
- $\beta_0$  : Constanta
- $\beta_1, 2, 3, 4, 5$  : Independent coefficient
- e : Error

## RESULTS AND DISCUSSION

**Table 2. Descriptive Statistics**

	N	Min	Max	Mean	Std. Dev.
CONACC	75	-0,4417007	0,2434882	-0,0120172	0,1121009
MO	75	0,0000000	0,2056142	0,0068886	0,0330323
IO	75	0,6370149	0,9999382	0,9343265	0,0650098
FD	75	-4,0483250	6,8244910	-3,1921970	1,4371340
TI	75	-0,0071423	0,0053005	-0,0002301	0,0014271
FS	75	28,538290	35,315440	32,206430	1,7700920

Description:

CONACC: Accounting conservatism, MO: Managerial ownership, IO: Institutional ownership, FD: Financial distress, TI: Tax Incentives, FS: Firm Size

Source: processed data

The results of descriptive statistics show that the variables of accounting conservatism, managerial ownership, financial distress, and tax incentives have a mean value that is smaller than the standard deviation value. This can be interpreted that the data of these variables tend to be far from the mean value, and have a wide distribution and high variation. Meanwhile, the



variables of institutional ownership and company size have a mean value that is greater than the standard deviation value. This can be interpreted that the data of these variables tend to be close to the mean value, and have a fairly even distribution of data and low variation.

**Table 3. Hypothesis Test Result**

Regression Model						
Variable	Coefficient	Std. Err.	t	P >  t  *	Hypothesis	Results
MO	-0,2668141	27,598660	-0,01	0,992	H1 -	Rejected
IO	0,2711807	0,2257832	1,20	0,230	H2 +	Rejected
FD	-0,1055544	0,0213582	-4,94	0,000	H3 +	Rejected
TI	-22,301160	10,348290	-2,16	0,031	H4 -	Accepted
FS	-0,0051748	0,0089989	-0,58	0,565	H5 +	Rejected
_cons	-0,4575523	0,2430507	-1,88	0,060		
Prob > F	0,0000					
R2	0,3559					
Adj R2	0,3092					

Description:

CONACC: Accounting conservatism, MO: Managerial ownership, IO: Institutional ownership, FD: Financial distress, TI: Tax Incentives, FS: Firm Size

\* Significance level: 5%

Source: processed data

### **The Effect of Managerial Ownership on Accounting Conservatism**

Based on the hypothesis test that has been carried out, the result is that the significant value of the managerial ownership variable is greater than 0.05 so that it cannot prove the influence of managerial ownership on accounting conservatism. Thus, hypothesis 1 is rejected.

The presence or absence of share ownership by managers does not affect managers who have high loyalty in working in making policies that only benefit them (Noviyanti & Agustina, 2021). Then, banking as a sector that functions to maintain the country's financial stability has strict and transparent regulations and supervision from the OJK and BI institutions to ensure banking compliance so that financial conditions are maintained so as not to pose a risk of loss to related parties. These strict regulations can more dominantly influence banking companies in making policies than the ownership structure.

In fact, the ownership structure in the banking sector is also regulated to promote good governance, aiming to enhance and stabilize the growth of banks. One of these regulations is the Otoritas Jasa Keuangan (POJK) No. 17 of 2023 concerning the Implementation of Governance for Commercial Banks. In Article 16 paragraphs 1 and 2, members of the board of directors individually or jointly are not allowed to own shares in other companies or receive bonuses in the form of shares that make share ownership more than or equal to 25%. The mean value of managerial ownership of sample companies is 0.68% and none is more than 25% indicating banking compliance in ownership structure. That mean is low so that it is not sufficient to provide a significant influence on conservative policy making (El-Haq et al., 2019). This study provides different results from the studies of Sari & Agustina (2021), Hajawiyah et al. (2020), and Lafond & Roychowdhury (2008), but remains in line with other studies, namely the studies of Noviyanti and Agustina (2021), and El-Haq et al. (2019).

### **The Effect of Institutional Ownership on Accounting Conservatism**

The result is the significant value of the institutional ownership variable is greater than 0.05 so that it cannot prove the influence of institutional ownership on accounting conservatism. Thus, hypothesis 2 is rejected.

Results also refute the agency theory that supports the development of the second hypothesis. Agency theory explains that principals, including institutional investors, need to



spend money to be able to supervise and minimize agency conflicts. The larger the institutional investor, the higher the agency costs borne by investors and management, which can help resolve agency conflicts. However, the existence of regulators that regulate and strictly supervise the banking sector, such as the Otoritas Jasa Keuangan and Bank Indonesia, can reduce the supervisory function of institutional owners. In addition, the proportion of share ownership by institutional parties does not always guarantee that the supervisory function has been running well in reducing conflicts of interest (Fadhiilah & Rahayuningsih, 2022). There are several other corporate governance mechanisms that are also considered because they have the same function in carrying out supervision, such as an independent board of directors and board of commissioners, to the audit committee (Nofianti, 2009). This study has different results from the research of Hajawiyah et al. (2020), El-Haq et al. (2019), but brings the same results as the research of Fadhiilah and Rahayuningsih (2022) and Hariyanto (2021).

### **The Effect of Financial Distress on Accounting Conservatism**

The result is that the financial distress variable measured by the Zmijewski model (X-Score) has a significance value of less than 0.05, thus proving that there is an influence of financial distress on accounting conservatism. However, the variable has a negative direction coefficient that is different from the direction of the hypothesis so that hypothesis 3 is also rejected. The result contains an indication that the more the company faces financial difficulties, the lower the implementation of conservative accounting by the company.

Results are more relevant to positive accounting theory, not agency theory. One of the characteristics of financial distress is difficulty in paying debts due to limited cash funds (Galant et al., 2023). In positive accounting theory, particularly the debt contract hypothesis, companies with a high debt/equity ratio are more likely to adopt accounting policies that boost their profits, thereby reducing the debt ratio and helping the company avoid breaching debt contracts (Watts & Zimmerman, 1978). One effort to increase profits is to transfer and recognize future period profits to the current period (Januarti, 2004). This effort contradicts the concept of accounting conservatism. The findings of this study contradict those of several previous studies such as research by Pujiono et al. (2023), Widhiastuti & Rahayu, (2022), Stiawan et al. (2022). However, the results of this study remain consistent with other previous studies, namely research by Sugiyarti and Rina (2020).

### **The Effect of Tax Incentives on Accounting Conservatism**

The result is that the tax incentives variable measured by tax planning has a significance value of less than 0.05, which proves the influence of tax incentives on accounting conservatism. In addition, the tax incentives coefficient in the regression test produces a negative direction. These findings indicate that the greater the tax incentive, the lower the level of accounting conservatism applied by the company in presenting and reporting its finances. Thus, hypothesis 4 is accepted.

In positive accounting theory, particularly the political cost hypothesis, managers are inclined to select accounting methods or principles that lower profits in order to avoid political costs, such as high tax costs (Watts & Zimmerman, 1978). One way is to apply the principle of conservatism or caution. However, the existence of tax incentives that can reduce the company's tax burden means that managers no longer need to worry about showing high profits without being subject to high taxes. Companies may adopt a more aggressive approach in financial reporting, such as delaying the recognition of costs or accelerating the recognition of revenues that risk reducing the application of the principle of conservatism. Thus, the higher the value of tax incentives indicates the higher utilization of tax incentives followed by a low level of conservatism. The results of this study are in line with the results of previous studies conducted by Pangkey et al. (2024), Fadhiilah & Rahayuningsih (2022), and Stiawan et al. (2022).



### **The Effect of Firm Size on Accounting Conservatism**

Based on the hypothesis test that has been conducted, the result is that the company size variable measured by the logarithm of total assets has a significance value greater than 0.05 so that it cannot prove the influence of company size on accounting conservatism. The findings indicate that the size of the company is not a consideration for the company to implement a conservative financial presentation and reporting policy. Thus, hypothesis 5 is rejected.

These results refute the political cost hypothesis in positive accounting theory which states that large companies tend to face greater scrutiny from the public, government, and other stakeholders (Watts & Zimmerman, 1978). Some large companies already have greater strategies and resources to deal with political pressure. For example, companies can use a lobbying strategy, a strategy of cooperation with regulators, and spend lobbying costs to secure contracts with the government or avoid regulations (Watts & Zimmerman, 1990).

Additionally, there is a strategy of disclosing corporate social responsibility as a means of demonstrating high transparency and accountability. Moreover, there are already several regulations that require many companies to carry out social responsibility, such as Undang-Undang Number 40 of 2007 concerning Limited Liability Companies which requires companies whose operational activities are related to resources to carry out social and environmental responsibility. Then, financial service institutions, including banks, are also given regulations to disclose sustainability which includes social, environmental, and corporate governance aspects in accordance with the Peraturan Otoritas Jasa Keuangan (POJK) Number 51/POJK.03/2017. By implementing social and environmental responsibility, companies can obtain a good image and view from the public and government. Through these strategies, large companies may feel no longer need to implement accounting conservatism as an effort to reduce political costs. This study produces differences with the studies conducted by Widhiastuti and Rahayu (2022), El-Bannay (2017), and Hamdan (2011). However, the results of this study are in line with other previous studies, such as the study by Sari and Agustina (2021).

### **CONCLUSIONS**

This study obtained results that prove the negative influence of financial distress and tax incentives on the level of accounting conservatism in banking sectors. Companies experiencing high levels of financial distress tend to adopt less conservative approaches because as firms avoid breaching debt contracts due to high debt/equity ratios due to financial distress. Companies that take greater advantage of tax incentives also tend to adopt less conservative approaches as reduced tax costs mean they no longer need to worry about reporting large profits. On the other hand, the level of accounting conservatism in banking sectors is not affected by managerial ownership, institutional ownership, and company size. Strict banking regulations, as a vital sector for the national economy, reduce the role of corporate governance supervision in shaping conservative policies. Banks are also subject to social responsibility disclosure rules, easing concerns about negative public perception and substantial political costs from the government.

#### **Suggestion**

Further research is suggested to use banking sector samples or other sectors both domestically and abroad to compare the differences in results with the banking sector. For further research that still uses the banking sector as an object, it is suggested to consider a measurement model whose data and information are presented completely. Further research can consider other factors that can increase the influence on accounting conservatism. Then, practical advice for companies, investors, and other stakeholders is to consider the application of a company's accounting conservatism in decision making as a preventive measure to anticipate potential losses for each party.



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