

# The Implementation of Accounting Conservatism Principle in Indonesia

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**Keywords:** Accounting Conservatism, Cash Flow, Independent Commissioner, Leverage, Liquidity, Profitability

**Abstract:** The aim of this research is to analyze the factors that influence the implementation of accounting conservatism principle in Indonesia. The population of this research were 143 manufacturing companies that listed on the Indonesia Stock Exchange (IDX) in 2015-2017. Technique to collect the sample was purposive sampling, and selected 39 companies with 117 units of analysis. The technique of data collection used documentation by collecting data published by other parties. The technique of data analysis used multiple linear regression analysis. The test results showed that independent commissioners, leverage, profitability, and liquidity have a significant positive effect on the implementation of accounting conservatism, while cash flow has no effect on the implementation of accounting conservatism. Suggestions for further research can use positive accounting theory to better explain the variables that influence the implementation of accounting conservatism.

## 1 INTRODUCTION

Financial statements are information provided by the company to stakeholders to provide an overview of the company's financial condition for decision making (Collins, Hribar, & Shaolee, 2014). The financial statements presented should be in accordance with general accepted accounting principles and applicable accounting standards (SAK) in order to provide relevant information which can be accounted for and can be compared with each other.

One of the accounting principles that prevails in Indonesia is the implementation of conservatism principle. Conservatism is a precautionary principle in which a company will recognize expenses and liabilities as soon as possible even though there is uncertainty about the results, but only recognize income and assets when there is certainty that they will be accepted. This principle is applied to provide guarantee to stakeholders (Ball & Shivakumar, 2005) because it shows that the income and assets listed in the published financial statement are real, they are truly have become the rights of the company. On the other hand, the income statement and other comprehensive incomes will present too

low profit (understatement), because the expense is recognized as soon as possible whereas income is not. This is attempted to avoid any indication of financial statement manipulation for the company's internal interest which can harm the external parties of the company.

One example of financial statement manipulations was carried out by PT Kimia Farma in 2001 which provided overstate profit of Rp 32 billion (Bapepam). In 2015, PT Toshiba was also proven to be inflating profit of Rp 1.2 billion over the past seven years, which resulted in 45 shareholders seeking compensation for inappropriate accounting practices (kompas.com). These cases indicate that the implementation of the conservatism principle to companies in Indonesia is still very low, so that the financial statements produced are not accurate enough to be used as material for decision making for the stakeholders.

Several previous studies had tried to identify the causal factors of the conservatism principle application. One of them is an independent commissioner who has no relationship with any party. Independent commissioners can carry out their duties by monitoring management through the implementation of accounting conservatism. (Foroghi, Amiri, & Fallah, 2013), (R. S. K.

Pratanda, 2014) explained that independent commissioners have a positive and significant effect on accounting conservatism. This research result is not in line with (Padmawati & Fachrurrozie, 2015), (Risdiyani & Kusmuriyanto, 2015) and (Zulfikar, May, Suhardjanto, & Agustiningih, 2017) who showed that independent commissioners have no effect on accounting conservatism.

Leverage is a debt financing activity (Utama & Khafid, 2015). The higher the leverage, the higher the right of the creditors to oversee management performance and demand manager to be conservative. (R. S. Pratanda & Kusmuriyanto, 2014), showed that leverage has a significant positive effect on accounting conservatism. This research result is not in line with (Brilianti, 2013) who explained that leverage does not affect the level of accounting conservatism.

Profitability is the company's ability to make profits. (Saputri, 2013) presented that companies with high profitability will tend to choose conservative accounting to manage profits so that they do not experience any fluctuation. (R. S. Pratanda & Kusmuriyanto, 2014), (Syifa, Kristanti, & Dillak, 2017) explained that profitability has a positive effect on accounting conservatism. This research result is not accordance with (Padmawati & Fachrurrozie, 2015), (Jayanti, 2016) who revealed that profitability has a negative effect on accounting conservatism.

Liquidity is the company's ability to pay off short-term debt. Companies with strong conditions will choose conservative accounting so that the company performance is maintained. (Nasir, Ilham, & Yusniati, 2014) stated that liquidity has a positive and significant effect on accounting conservatism. This research is not in line with (Susanto & Ramadhani, 2016) who explained that liquidity has no effect on accounting conservatism.

Cash flow is the amount of money moving into and out which consists of company operational activities, investment activities and funding activities. Companies will be more conservative by presenting small value assets and profits when cash flow is generated high (Martani & Dini, 2010). (Jayanti, 2016) showed that operating cash flow has a positive effect on accounting conservatism. This research result is not accordance with (Saputri, 2013) and (Rohminatin, 2016) who believed that cash flow does not significantly influence accounting conservatism.

## 2 THEORICAL FRAMEWORK

Institutional ownership is the number of shares by institutional parties. Institutional parties can be an effective monitoring tool for management in increasing company value. The higher the institutional ownership, then the institutional parties have the ability to control management parties through an effective monitoring process (Brilianti, 2013). The greater the share ownership in financial institutions, the greater the power of voice and the drive to oversee management performance (Prahasta, 2016).

Independent commissioners are parties that have no relationship with any party. The existence of independent commissioners make the supervision conducted by the board of commissioners becomes strict (Siahaan, 2013), (Klein, 2002). The more proportion of independent commissioners in a company will show a strong board of commissioners so the level of desired conservatism also will be higher (Savitri, 2016). In addition, based on agency theory, the existence of independent commissioners can oversee management performance (El-Chaarani, 2014) so it can avoid manager's opportunistic attitude and demand managers to apply conservative accounting. (Foroghi et al., 2013), (Salama, 2017), (Ahmed & Henry, 2012) and (R. S. Pratanda & Kusmuriyanto, 2014) explained that the proportion of independent commissioners has a significant positive effect on accounting conservatism.

H1: Independent commissioners have a positive effect on accounting conservatism

Leverage is a ratio that shows a comparison of how much debt a company has with asset or equity. Leverage becomes an indicator to find out whether the company finances asset or its capital is obtained from debt. If the company has been given a loan by creditors, then the creditors automatically have an interest in the security of the loaned funds that are expected to generate profit (Pambudi, 2017). The relationship between company managers and creditors can be seen using agency theory. The higher the company's debts indicate the greater the role of creditors in overseeing managers and it will tend to demand managers to apply accounting conservatism. As a result, information asymmetry between creditors and company will be decreased because managers cannot hide financial information that might be manipulated or overstated assets (Susanto & Ramadhani, 2016). (Dewi & Suryanawa, 2014), (R. S. Pratanda & Kusmuriyanto, 2014) explained that leverage has a significant and positive effect on accounting conservatism.

H2: Leverage has a positive effect on accounting conservatism

Profitability is the company's ability to make profits. The high profitability shows how the value of a company. The higher the value of profitability, then the company will strive to present the profit obtained which is not too fluctuating. The presentation of profits in order to make it look flat and not have high fluctuation, managers can use accounting conservatism as part of earnings management (Padmawati & Fachrurrozie, 2015). It is based on signal theory which reveals that manager will provide a signal of high profitability in the form of company growth in the future. The high profitability makes the company has a lot of retained profits and it indicates that accounting conservatism is implemented (Andreas, Ardeni, & Nugroho, 2017). (Saputri, 2013) and (Syifa et al., 2017) showed that profitability has a positive effect on accounting conservatism.

H3: Profitability has a positive effect on accounting conservatism

Liquidity is the company's ability to fulfill its short-term obligations. The higher the liquidity indicates the better the company. The high liquidity value will show the strength of the company's condition. The higher the liquidity, the more conservative the company will be (Pramudita, 2012). It is done in order to maintain the company's performance. In addition, the greater the liquidity ratio, the company will be more careful because if current assets increase, political costs will also increase, so managers will tend to be conservative to reduce profits so that political costs do not increase.

The relationship between liquidity and conservatism can be explained by signal theory, which can be seen from the financial information presented by management. Companies that have high liquidity value show the strength of the company's conditions (Nasir et al., 2014). It happens because it is better when the liquidity ratio is higher because the current assets used to pay off the current debts are getting bigger. One way that can be done in order to maintain the company's performance is applying accounting conservatism. (Nasir et al., 2014) presented that liquidity has a significant and positive effect on accounting conservatism.

H4: Liquidity has a positive effect on accounting conservatism

Cash flow is the amount of money moving into and out from activities carried out by the company. The cash flow report consists of company

operational activity, investment, and funding. Cash flow statement from operational activity is indicator that determines whether the operations of a company are able to pay off debt, pay dividend, maintain company operation, and make new investment (Savitri, 2016). Companies will be more conservative when operating cash flow they produce is high (Madsen, 2011), (Martani & Dini, 2010), (Lightstone, Wilcox, Beaubien, & Lightstone, 2014). The high operating cash flow can indicate the good performance of the company (Wampler, Smolinski, & Vines, 2009).

Cash flow and accounting conservatism can be associated with signal theory, in which managers provide signal in the form of cash flow information. Cash flow information will be used by investors to assess company performance. Managers will try to apply accounting conservatism when the cash flow they generate is high. (Jayanti, 2016) showed that operating cash flow has a positive effect on accounting conservatism.

H5: Cash flow has a positive effect on accounting conservatism.

### 3 RESEARCH METHOD

This research was quantitative research using secondary data, namely annual report data taken from the company's website. The population used in this research was manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2014 to 2016 (along with the Toshiba case revealed in 2015) as many as 149 companies. The sampling technique used purposive sampling and selected 39 companies with 117 data analysis units. The sample determination in this research was based on the following criteria in Table 1.

This research used the implementation of the conservatism principle as the independent variable and independent commissioner, leverage, profitability, liquidity and cash flow as independent variables with the operational definition of the variable presented in table 2.

The technique of data collection was carried out by documenting the data related to the research variables. The research data was in the form of the sample company annual reports from 2014-2016. Hypothesis testing used multiple linear regression analysis.

Table 1: Determination of Research Sample

No	Criteria	Beyond	Number
1	Manufacturing companies listed on the Indonesia Stock Exchange in 2014-2016		149
2	Manufacturing companies listed on the Stock Exchange in 2014, 2015 and 2016 respectively	(14)	135
3	The company published financial statement consistently from 2014, 2015 and 2016	(18)	117
4	The company presents financial statement in rupiah	(22)	95
5	The company has a market to book value of more than 1	(56)	39
6	The total number of companies included in the sample of the research		39

Source: Secondary data processed, 2018

Table 2: Variable Operation Defenition

Variabel	Variabel Definition	Indicator
Accounting conservatism (MTB)	a concept that recognizes expense and liability immediately even though there is uncertainty about the results, but only recognizes income and asset when it is certain to be accepted (Savitri, 2016)	$MTB = \frac{Price}{EPS}$ (Saputri, 2013)
Independent Commissioner (IND)	parties that are not related to any party and carry out the main function of independently monitoring the company's management performance (Prahasta, 2016)	$\frac{\text{Number of Independent Commissioners}}{\text{Number of Commissioners}} \times 10$ (Risdiyani & Kusmuriyanto, 2015)
Leverage (LEV)	debt financing activities (Utama & Khafid, 2015)	$DER = \frac{\text{Total Debt}}{\text{Total Equity}}$ (Murhadi, 2015)
Profitability (PROF)	the company's ability to generate profits (Murhadi, 2015)	$ROE = \frac{\text{Net Profit after Tax}}{\text{Total Equity}}$ (Saputri, 2013)

Variabel	Variabel Definition	Indicator
Likuiditas (LIK)	the company's ability to fulfill its short-term obligations (Susanto & Ramadhani, 2016)	$CR = \frac{\text{Current Asset}}{\text{Current Debt}}$ (Nasir et al., 2014)
Cash Flow (CF)	inflow and outflow cash or cash equivalent (PSAK No. 2)	$CFROA = \frac{\text{Cash from Operating Activity}}{\text{Total Asset}}$ (Jayanti, 2016)

Source: Author's summary, 2018.

## 4 RESULT AND DISCUSSION

The classical assumption test is a prerequisite before hypothesis testing. This research has passed the classical assumption test, with the normality test result of 0.096 which is greater than 0.05. The multicollinearity test has a tolerance value of more than 1 and VIF less than 10. The autocorrelation test gets a result of 0.115 which is greater than 0.05. While the heteroscedasticity test obtains the result of 43,758 which is less than 142,138. Table 3 shows the results of hypothesis testing related to research variables.

Table 3: Hypothesis Test Result

Variable	Partial TestSig	Simultaneous Test Sig	Determination Coefficient Adjustment R2
(Constant)			
IND	0,045		
LEV	0,000		
PROF	0,000	0,000	0,884
LIK	0,028		
CF	0,472		

Source: processed secondary data, 2018

Table 3 shows that the IND, LEV, PROF, LIK variables affect the MTB variable partially with a significance value of less than 0.05. While for the CF variable partially does not affect the MTB variable because the significance value is more than 0.05. The test result of the determination coefficient obtains Adjustment R2 value of 0.884 means that 88.4% of the factors that influence accounting conservatism can be explained by the independent variables in this study. While the remaining 11.6% is explained by other variables outside the research model.

### The Effect of Independent Commissioners on Accounting Conservatism

Independent Commissioners have a significant positive effect on accounting conservatism.

Independent commissioner variable becomes one of the factors for companies in determining decision to implement accounting conservatism. The more the proportion of independent commissioners in a company will show a strong board of commissioners (Yanto, Hasan, Fam, & Raeni, 2017), so that the level of conservatism desired is higher as well (Savitri, 2016).

Agency theory explains that agency conflict can be reduced by the existence of a board of commissioners that demands managers to apply accounting conservatism. (Risdiyani & Kusmuriyanto, 2015) and (Wahyudin & Solikhah, 2017) explained that the existence of a board of commissioners in a company is intended to reduce the existence of an interest conflict between shareholders and managers. Independent commissioners will demand the managers to apply conservative accounting to produce quality financial information. This research result is in line with (Foroghi et al., 2013), (R. S. Pratanda & Kusmuriyanto, 2014) who showed that independent commissioners have a significant positive effect on accounting conservatism.

#### **The Effect of Leverage on Accounting Conservatism**

Leverage has a significant positive effect on accounting conservatism. The higher the value of leverage will increase the company in applying accounting conservatism. Companies that have been given loans by creditors, the creditors automatically have an interest in the security of the loaned funds that are expected to generate profits (Pambudi, 2017). This result causes creditors conduct strict supervision then managers tend to be demanded to apply conservative accounting.

Agency theory explains the agency relationship between managers and creditors. Creditors have an interest in the security of the funds that have been lent so that the funds can provide profits. In this case, creditors have an interest in the distribution of net assets and lower profits to managers and shareholders so creditors tend to demand managers to apply conservative accounting (Pramudita, 2012). This research result is in line with (Dewi & Suryanawa, 2014) and (Prahasita, 2016) who stated that leverage has a significant positive effect on accounting conservatism.

#### **The Effect of Profitability on Accounting Conservatism**

Profitability has a significant positive effect on accounting conservatism. The higher the value of

profitability owned by the company indicates the better the company financial condition (Risdiyani & Subowo, 2015), (Baroroh, 2017). Companies that have a high amount of profitability value will try to make the profits presented do not have high fluctuation. If managers want to present profits to be flat and not too fluctuating, they can use accounting conservatism as part of earnings management (Padmawati & Fachrurrozie, 2015).

Signalling theory explains managers give signals to markets or investors related to the condition of the company. Managers will provide a signal of high profitability value in the form of the growth in the future. The higher the value of profitability makes the company has a lot of retained earnings and it indicates that accounting conservatism is applied (Andreas et al., 2017). This result is in accordance with (R. S. K. Pratanda, 2014) and (Saputri, 2013) who showed that profitability has a positive effect on accounting conservatism.

#### **The Effect of Liquidity on Accounting Conservatism**

Liquidity has a significant positive effect on accounting conservatism. The higher the value of liquidity will increase the company in applying accounting conservatism. The higher the liquidity ratio shows the better the company because the current assets owned are able to pay off the current debts. A large liquidity ratio shows the ability of the company to have good performance and strong financial conditions, so it tends to choose conservative accounting in order to maintain the company performance (Risdiyani & Kusmuriyanto, 2015)

Signalling theory can explain the relationship between liquidity and accounting conservatism, in which managers give a signal in the form of financial information related to the condition of the company. The condition of a company can be seen from the value of liquidity owned by that company. Companies that have high liquidity value show the strength of the company's conditions (Nasir et al., 2014). A company will try to keep maintaining the condition of the company itself, one of the trials is by applying accounting conservatism. This result is in line with (Nasir et al., 2014) who revealed that liquidity has a significant positive effect on accounting conservatism.

#### **The Effect of Cash Flow on Accounting Conservatism**

Cash flow has no effect on accounting conservatism. The higher the company's cash flow does not affect

the choice of companies to apply accounting conservatism. It indicates that cash flow cannot be a determining factor for the company to make decision to apply accounting conservatism.

Signalling theory cannot explain the relationship between cash flow and accounting conservatism. It happens because the cash value which is obtained by the company cannot always finance the company operational activity. It is proven by the research which argues that there was a continuous decline in cash flow during 2014-2016; therefore, applying accounting in that condition is not the best way. Managers will try to apply accounting procedures that increase profits they report to hide the negative impacts of company activities that have a decrease in the amount of cash flow (Rohminatin, 2016). This result is in accordance with (Saputri, 2013) and (Rohminatin, 2016) who declare that cash flow has no effect on accounting conservatism.

Table 4: Results of the small group trial assessment the Learning Materials for Problem Based Learning Strategies

No	Rated aspect	Average	Category
1	Accurate content	3.8	Very good
2	Accuracy of coverage	3.75	Very good
3	Readability of teaching materials	3.5	Very good
4	Logical exposure	3.5	Very good
5	Reasonable resenatation	3.55	Very good
6	Examples related to material	3.35	Good
7	Tools that make it easy	3.3	Good
8	An orderly and consistent format	3.5	Very good
9	Changes / packaging	3.45	Good
10	Ilustration	3.3	Good

#### 4.1 Third Revision

The third revision was carried out to accommodate suggestions from 10 students in small group trials. Improvements include giving examples that are appropriate to the material, the use of symbols that are used more consistently and the use of images that can clarify the information to be conveyed.

#### 4.2 Results of Field Tests with 30 Students

Field trials were carried out on students in the third semester of the Office Administration education program totaling 30 people. In this trial students were asked to work on problem-based student worksheets and study the learning strategies of the Teaching Materials for Problem Based Learning Strategy and continued to follow the evaluation of

learning outcomes. From the results of data analysis using SPSS for the non-Free Samples t-test are known in table 5 below:

Table 5: Paired Samples Test

Paired Samples Test				
			Pair 1	
			Pretest - Posttest	
Paired Differences	Mean	-13.80000		
	Std. Deviation	5.18885		
	Std. Error Mean	.94735		
	95% Confidence Interval of the Difference	Lower	-15.73755	
		Upper	-11.86245	
t	-14.567			
df	29			
Sig. (2-tailed)	.000			

The table above shows t count of -14.567 while the hypothesis in this research is:

H0 = there is no difference in learning outcomes before and after using the Teaching Material for Problem Based Learning Strategy.

H1 = there are differences in learning outcomes before and after using Teaching Materials for Problem-Based Learning Strategy.

The results of t -count are -14.567 and t table -2.04 with significance  $0.000 < .05$ , then H-0 is rejected and H1 is accepted meaning that there are differences in learning outcomes before and after using Teaching Materials for Problem Based Learning Strategies. From the table above, it is also known that MD -13.80 shows the average after higher than the average before, or in other words the negative MD value indicates that the average learning outcomes after using Teaching Materials for Problem Based Learning Strategies are higher than before, it can be concluded that there is an increase in learning outcomes after using the Teaching Materials for Problem Based Learning Strategies.

#### 4.3 Fourth Revision

Questionnaire Results of Students show that the developed textbooks are very good but it is still recommended to improve the appearance of capers and the contents of teaching materials with colors that attract students' attention. This fourth revision is carried out based on input from students by improving the color in the caper and the appearance of the more colorful Learning Materials for Problem Based Learning Strategy.

#### 4.4 Prototype / Teaching Material Model

The final result of this research is a prototype of Teaching Material for Problem Based Learning Strategy that will be implemented by students of the Office Administration Education Study Program.

## 5 CONCLUSION

Based on the results of research and discussion, it can be concluded that independent commissioners, leverage, profitability, liquidity, and cash flow have a significant effect on accounting conservatism.

Suggestions for further research can use positive accounting theory to build hypotheses and can use other measurement proxies for cash flow variable, based on the result of rejected cash flow variable testing.

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