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ANALYSIS OF THE EFFECT CORPORATE GOVERNANCE AND COMPANY CHARACTERISTICS ON ACCOUNTING CONSERVATISM IN COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE

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ABSTRACT

The study was conducted to examine and analyze the effect of the independent variable, namely corporate governance and company characteristics on the dependent variable, namely accounting conservatism. The independent variables of corporate governance consist of the size of the board of directors, independent board of directors, type of auditor and the independent variables of company characteristics consist of firm size, leverage, profitability, and sales growth. Measurement of accounting conservatism in this research is measured based on accrual-based following Al-Saidi (2020). The object of this research are companies that have annual reports that are registered and published on the Indonesia Stock Exchange. The data used in this research was 5 years for the period from 2016 to 2020. There are 729 companies listed on the Indonesia Stock Exchange, only 436 companies passed the selection to be used in this study. The data that has been collected will be processed using SPSS software and Eviews which will be analyzed using a panel regression model. The results obtained by the researcher indicate that the independent board of directors, leverage, profitability and sales growth have a significant positive effect on accounting conservatism. The variable size of the board of directors, type of auditor and firm size did not show a significant effect on accounting conservatism.

Keywords: *Accounting Conservatism, Corporate Governance, Company Characteristics*

PROPOSED INNOVATION

Financial statements recorded by an accountant can show the company's profit or loss based on facts, where the facts in question are based on evidence of transactions. The results of recording financial statements can see how the activities of the company run from year to year. This is very concerning for an accountant in recording whether it is in accordance with applicable accounting standards and in accordance with the applied company principles and policies. One of the policies implemented by each company is conservatism which can result in the condition of financial statements. Accounting conservatism is defined as the recognition of revenue which is only recognized when it is absolutely certain that it will be received while the recognition of expenses is recognized when there is uncertainty about the outcome involved (Chandra, B., & Junita, N.

2021; Yopie & Erika, 2021; Itan, I., Laudeciska, L., Karjantoro, H., & Chen, R., 2023). Accounting conservatism can be defined simply where it means timeliness in recognizing losses compared to gains (Saeed & Saeed, 2018). Conservatism in accounting activities is considered a major characteristic in the field of accounting where accounting conservatism has been practiced by companies for centuries and can be said to be is an important income attribute. Accounting conservatism is also used as a measurement of earnings quality (Oyedokun & Salisu, 2018). The corporate governance structure is a term that represents the structural and relational status of corporate entities. The direction of the company and the responsibilities of a performance are defined by the structural and relational framework (Saeed & Saeed, 2018). Corporate governance is a system that can be used by companies in

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES)

Taichung, Taiwan 3-6 March, 2022

controlling activities caused by management and ownership problems. The company's directors are very important for companies where the company's directors are elected by the shareholders because everything that is made by the directors will be used by management. These decisions not only affect business operations but also affect business viability (Phapho et al., 2020). Corporate governance has also received great attention because of its significance to the welfare of economic enterprises (Suleiman & Anifowose, 2014; Yopie & Robin, 2023). Accounting conservatism on the average company produces a significant influence from the results of the study. From the results of these research, there is no significant effect of the board of directors on accounting conservatism (Edi, E., & Yopie, S. 2019). The results of the research stated that the small size of the board of directors in the company is considered a weak corporate governance mechanism to compensate for their reporting, so managers will tend to be conservative (Nasr & Ntim, 2018). Other researchers have also found results that there is a lack of guidance against conservatives by the big council. They argue that the lower incidence of conservatism is due to the larger board size (Oyedokun & Salisu, 2018).

Independent board of directors is the number of non-executive directors who can reduce company problems by effectively monitoring the behavior of a manager (El-Habashy, 2019). The presentation of financial statements will not be done fraudulently if the company has a high level of independent directors (Oyedokun & Salisu, 2018). Firm size has a sensitive and positive influence on accounting conservatism because larger companies tend to be more conservative about their reporting than smaller companies, due to public surveillance (Nasr & Ntim, 2018). Large leverage to equity ratio which is owned by the company can maintain a high percentage of profits with the aim of providing funds to pay off the company's debt (Teymouri & Sadeghi, 2020). Companies that have a large leverage value state that the company's ability to pay off obligations is very low. An increased leverage ratio can lead to high conservative reporting (Wati et al., 2020). Sales growth tends to affect

accounting conservatism because sales growth will affect accruals such as inventories and receivables and for companies, if there is a decline in sales it can be possible that there is a bad accounting measure against accounting conservatism (Foroghi et al., 2013). Lower accounting can be used by companies that have high profitability because the choice in making conservative is lower than companies that have low profitability. (Soliman, 2014).

Literature Review

Accounting Conservatism

Accounting conservatism is a perception to recognize future cash flows and is usually required by an accountant to report the results of recording the lowest financial statements that allow the lowest value to be an asset from income, and the highest value is a liability from expenses or expenses (Sulastri & Anna, 2018). One researcher argues that applying accounting conservatism when recording financial statements will help in completing relatively ordinary financial statements because this application does not describe the actual condition of a company's financial profitability. The results of his research in terms of other parties stated that applying accounting conservatism can be useful to avoid behavior that manipulates company profits (Noviantari & Ratnadi, 2015). The researchers state that accounting conservatism can provide good benefits for the company, namely if the conservative income recorded by the company by basic accounting principles can reflect the company's minimal profits, so profits designed with conservative methods do not mean increased profits and can be recognized as a quality advantage (Aristiyani & Wirawati, 2013). According to Subramanyam and Wild (2014) in academic research there are 2 types of accounting conservatism, namely as follows (Liyanto & Hairul Anam, 2017):

a. Unconditional conservatism

Unconditional conservatism is an accounting conservatism that is applied constantly to the board of directors. This leads to asset values which tend to be perpetually lower.

b. Conditional conservatism

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES)

Taichung, Taiwan 3-6 March, 2022

Conditional conservatism is conservatism that stipulates the adage that a loss can be recognized quickly but gains can be recognized if it has occurred.

The Effect of The Size of The Board of Directors on Accounting Conservatism

The size of the board of directors is that the board makes decisions with the highest ranking in any company and is the main guardian of the interests of shareholders (Bommaraju et al., 2019). Utilization of individual expertise and knowledge, as well as the ability to reach agreement greatly, affects the size of the board of directors in the company, where it can be said that the size of the board of directors is very important in corporate governance. (Abdul-Manaf et al., 2014). The large size of the board of directors can lead to inaccurate earnings and book values which lead to the use of conservative accounting (Ahmed & Henry, 2012). Firms with weak board sizes are less likely to adopt a higher level of conservativeness than firms with strong board sizes. Agency theory explains that the board of directors is expected to minimize agency conflicts so that companies apply conservative accounting principles (El-Habashy, 2019). A large board of directors size can increase the effectiveness of the monitoring process and can increase the scope of accounting conservatism due to the diversity of expertise, especially the quality of financial reports (Ebrahim & Fattah, 2015). The results of research examined by Abdul-Manaf *et al.* (2014), Phapho *et al.* (2020), Jeong and Kim (2013) and Jaimuk *et al.* (2020), show that there is a significant positive effect on accounting conservatism.

H01: The size of the board of directors will have a significant positive effect on accounting conservatism.

The Effect of Independent Board of Directors on Accounting Conservatism

An independent board of directors is a position that does not have any relationship and affiliation with the board of directors, shareholders, and the board of commissioners. Independent directors are elected independently and transparently, based on competence, free

from internal company influences, work objectively based on the principles of good corporate governance (Wistawan et al., 2015). Non-executive directors limit managers' opportunities to influence earnings and become more conservative in their reports (Nasr & Ntim, 2018). Independent directors outside the company have more experience because they are managers in other companies and state the importance of adopting conservative accounting in improving accounting quality (Mohammed et al., 2017). IFRS and a higher number of independent boards of directors, of course, have a complementary impact on accounting conservatism. The independent board of directors is the center of decision making and controls company managers and provides advice to approve a decision and the independent board of directors can understand the benefits of the principle of conservatism and apply more conservative accounting in the company (Elshandidy & Hassanein, 2014). The results of research examined by Phapho *et al.* (2020), Jaimuk *et al.* (2020), Elshandidy and Hassanein (2014), El-Habashy (2019), Nasr and Ntim (2018) and Oyedokun and Salisu (2018) show that independent boards of directors have a significant positive effect on accounting conservatism.

H02: Independent board of directors will have a significant positive effect on accounting conservatism.

The Effect of Auditor Type on Accounting Conservatism

The type of auditor is the ability of an auditor to report and detect recording errors or material errors and detect whether fraud occurs, which in the auditing process has high quality (Thijeel et al., 2018). According to agency theory, the separation of shareholders and managers requires a third party to provide assurance and increase investors. The existence of the Big Four auditors demands more conservatism. Auditors are motivated to use conservatism to reduce litigation costs (Saeed et al., 2018). Firms that engage with high-quality auditors are more incentivized to adopt high earnings quality and high accounting conservatism in common law countries, such as

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES)

Taichung, Taiwan 3-6 March, 2022

South Africa because they recognize bad news promptly (Iatridis, 2012). The level of credibility and conservatism given by Big 4 KAPs is higher because they are exposed to public scrutiny and risk of reputational trust in the application of accounting standards and financial reports (Nasr & Ntim, 2018). The results of research researched by El-Habashy (2019), Leventis *et al.* (2013), H. Mohammed *et al.* (2019), and Thijeel *et al.* (2018) show that the type of auditor has a significant positive effect on accounting conservatism.

H03: Auditor type will have a significant positive effect on accounting conservatism.

The Effect of Firm Size on Accounting Conservatism

Firm size is a scale in measuring the size of a company through total assets, company sales, and market capitalization. Large companies tend to have low risk because they have large assets and large sales and can control market value conditions in the face of competition (Siahaan, 2013). Large companies tend to be more monitored by the government because the government will increase taxes and companies will apply conservative principles by reporting low corporate profits on a regular basis (Isnawati *et al.*, 2016). Firm size is sensitive and has a positive effect on accounting conservatism, as larger firms tend to be more conservative about their reporting than smaller firms, due to public scrutiny (Lim, 2011). Competition between companies and competition for consumer conditions greatly impacts the company so that companies apply more conservatism in their financial reporting in order to remain competitive (Chairunnisya *et al.*, 2017). The results of research researched by Muslim (2020), Soliman (2014), Makhlof *et al.* (2018), Leventis *et al.* (2013), Foroghi *et al.* (2013), Boussaid *et al.* (2015), and Koubaa & Jarboui (2017) show that firm size has a significant positive effect on accounting conservatism.

H04: Firm size will have a significant positive effect on accounting conservatism.

The Effect of Leverage on Accounting Conservatism

Leverage is defined as long-term debt and short-term debt derived by the market value of equity (Koubaa & Jarboui, 2017). Companies that have high levels of leverage tend to be able to influence accounting conservatism because companies have greater bondholder and shareholder conflicts (Foroghi *et al.*, 2013). Companies that have a high level of leverage can also be stated that the company has a great ability to pay off their long-term obligations in a low manner, which causes managers in the company to tend to use the principle of accounting conservatism (Kusmuriyanto & Risdiyani, 2015). The results of research researched by Muslim (2020), Soliman (2014), Makhlof *et al.* (2018), Lin (2014), Teymouri and Sadeghi (2020), and Koubaa & Jarboui (2017) show that leverage has a significant positive effect on accounting conservatism.

H05: Leverage will have a significant positive effect on accounting conservatism.

The Effect of Profitability on Accounting Conservatism

The success of management, attractiveness to investors, and the sustainability of the company can be shown from the company's income after deducting costs is the definition of profitability (Alarussi & Alhaderi, 2018). A company that has higher profitability will be more conservative in presenting the company's financial statements because using conservative principles by management can help in managing earnings to be stable (Affianti & Supriyati, 2017). With high profitability, companies will get the opportunity to compete together with companies where the company is engaged in the same field and by applying accounting conservatism, the company's retained earnings will increase (Andreas *et al.*, 2017). The results of research examined by (Soliman, 2014), (Suleiman & Anifowose, 2014), (Pratanda & Kusmuriyanto, 2014), (Saputri, 2013) and (Andreas *et al.*, 2017) show that profitability has a significant positive effect on accounting conservatism.

H06: Profitability will have a significant positive effect on accounting conservatism.

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES)

Taichung, Taiwan 3-6 March, 2022

The Effect of Sales Growth on Accounting Conservatism

Sales growth is the percentage increase in sales from year to year (H. Mohammed et al., 2019). Sales growth will affect accounting conservatism because accruals such as receivables and company inventories, declining sales levels will affect accounting conservatism while large sales levels can increase market value expectations with cash flows in the future which will likely affect accounting conservatism (H. Mohammed et al., 2019). Companies that are experiencing growth tend to apply the principle of accounting conservatism. High company growth makes managers use accounting conservatism to minimize the risk of future economic uncertainty (Permatasari & Yulianto, 2020).

The results of research examined by Suleiman and Anifowose (2014), Foroghi et al. (2013), Kusmuriyanto and Risdiyani (2015), Padmawati and Fachrurrozie (2015), and Andreas et al. (2017) show that sales growth has a significant positive effect on accounting conservatism.

H07: Sales growth will have a significant positive effect on accounting conservatism.

METHODS

This research uses quantitative data, involved with the measurement of variables was conducted using the purposive sampling method. The object used is a manufacturing company on the Indonesian stock exchange (IDX) for the 2016-2020 period with data from the company's annual report and financial statements that have been audited by KAP in the last year period. Companies listed or listed on the IDX from 2016-2020 have as many as 729 companies. Companies that meet the research segment are 436 companies, the amount of data that can be sampled for 5 consecutive years is 2180 data with 86 data outliers, so the remaining data that can be used for further testing is 2094 data.

Accounting Conservatism

Accounting conservatism is a perception to recognize future cash flows and is usually required by an accountant to report the

results of recording the lowest financial statements that allow the lowest value to be an asset from income, and the highest value is a liability from expenses or expenses (Sulastri & Anna, 2018). Measurements of accounting conservatism variables can be found in the statement of financial position, income statement, cash flow statement, and notes to financial statements. The structure of this dependent variable is formulated with the following equation (Al-Saidi, 2020):

$$\text{Accruals} = (\text{net profit} + \text{depreciation expense} - \text{total operating cash flow}) / \text{Total Asset}$$

$$\text{AC} = \text{Accruals} / 3 \text{ years} * (-1)$$

Independent Variables

The measurement of independent variables and control variables can be seen in Table 1.

Table. 1 Measurement of Independent Variables

Symbol	Variable	Description
BSZB	The Board of Directors	Total number of board of directors (Nisar & Nisar, 2018)
BSNDPN	Independent of The Board of Directors	Number of independent board of directors / total number of board of directors (Nisar & Nisar, 2018)
AUDT	Auditor Type	Dummy variable: 1 if the companies is audited by Big 4 and 0 otherwise (Nisar & Nisar, 2018)
PSIZE	Firm Size	Total assets (Nisar & Nisar, 2018)
LEV	Leverage	Total debt / total assets (Nisar & Nisar, 2018)
PROF	Profitability	Net profit / total assets (Saad & Saad, 2018)
SAL EGRO	Sales Growth	Current sales - sales of previous year sales of previous year (Nisar & Nisar, 2018)

RESULT AND DISCUSSION

Descriptive Statistics

Table. 2 Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Accounting Conservatism	-0,2680109	0,3975717	0,0023289	0,04152224
The Size of The Board of Directors	2	10	4,72	1,761
Independent of The Board of Directors	0	0,5	0,1190571	0,1368097
Firm Size	5.224.504.957	338.205.000.000.000	14.046.162.458.270,88	30.256.336.929.704,375
Leverage	0,0036927	0,0036927	0,6010658	1,1697392
Profitability	-2,0841729	-2,0841729	0,0169139	0,1347639
Sales Growth	-5,0763011	-5,0763011	0,0448777	0,4358305
Dummy Variable				
	Code	Dummy	Frequency	Percent
AUDT	0	Non Big4	1329	63,5
	1	Big4	765	36,5

The results of the descriptive statistical test attached are drawn that each variable has the same information with different numerical results where the information is the number of samples, the number of minimum values, the number of maximum values, the number of average values, and the number of standard deviation values. Based on the attached table, it

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES)

Taichung, Taiwan 3-6 March, 2022

can be seen that the accounting conservatism variable has a minimum value of -0,2680109, which means that the company has a lower level of conservatism. The maximum value of 0,3975717 can be stated that the company has a higher level of accounting conservatism. The average value of accounting conservatism is 0,0023289, which means that companies on average have a high level of conservatism where the value shows a positive number.

The variable size of the board of directors shows an average value of 4,72, which indicates that companies have an average number of directors of 5 members. The independent board of director's variable shows an average value of 0,1190571 with a percentage of 11% which indicates that for every 10 members of the board of directors there is 1 member who is an independent board of directors, the minimum value is 0 and the maximum value is 0.5.

The auditor type variable uses a dummy measurement where companies that use Non-Big4 KAPs for auditing are worth 0 while companies that use Big 4 Auditor for auditing are 1. Companies that use Non-Big 4 Auditor are 1329 data with a percentage value of 63,5% and companies using Big 4 KAPs are 765 data from 153 companies with a percentage value of 36,5%. This shows that some companies in Indonesia are still using KAP Non-Big4.

The average value of the firm size is 14.046.162.458.270,98, which means that companies in Indonesia on average have high assets which have reached over IDR 50.000.000.000. The average value of leverage variable is 0,6010658 which can be stated that each asset can be used as collateral for debt with a value of 0,6010658. The average value owned by the profitability variable of 0,0169139 can be stated that every Rp.100 asset owned by the company can generate a profit of 1.69% from year to year. The sales growth variable shows an average value of 0,448777 with a percentage of 44,88%, which can be stated that every year the company has an increase in sales of 44,88%.

PATH ANALYSIS Chow Test

The Chow test was conducted with the aim of assessing the fit between the common effect model (CEM) and the fixed effect model (FEM). The results of the Chow test as in table 3 can be seen that the probability value shows the number 0.0000 where the value is > 0.05, meaning that the best model for further testing is the fixed effect model (FEM).

Table. 3 Chow Test

Effects Test	Statistic	Prob.	Conclusions
Cross-Section F	2,306448	0,0000	<i>Fixed Effect Model</i>
Cross-Section Chi-Square	982,742829	0,0000	

Hausman Test

The Hausman test was carried out to know the best model between the fixed effect model (FEM) or the random effect model (REM). The results of the Hausman test in table 4 show that the probability value is 0.0000. The probability value states that the fixed effect model (FEM) is the best model for further testing because the value of 0.0000 is greater than 0.05.

Table. 4 Hausman Test

Test Summary	Chi-q Statistic	Prob.	Conclusions
Cross-Section Random	95,775028	0,0000	<i>Fixed Effect Model</i>

HYPHOTESIS ANALYSIS

F Test

The purpose of testing the F test is to find out how big the significance is between all independent variables and the dependent variable. The results of the F test can be seen in table 5.

Table. 5 F Test

Dependent Variable	F Test	Sig.
Accounting Conservatism	Prob (F-statistic)	0,0000

T Test

The t-test was conducted to find out whether all independent variables influence the dependent variables. How to assess the test results can be seen from the probability numbers of all variables. The results of the t-test can be seen in Table 6.

Table. 6 T Test

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES) Taichung, Taiwan 3-6 March, 2022

Variable	Coefficient	t-Statistic	Prob.	Conclusions
Constant	0,007844	1,466773	0,1426	
BFSIZE	0,000153	0,153017	0,8784	Not significant
BINDPN	-0,019157	-2,692413	0,0072	Significant posi
AUDT	-0,002890	-0,171989	0,4717	Not significant
FSIZE	-0,000000	-1,047799	0,2949	Not significant
LEV	0,005293	3,001575	0,0027	Significant posi
PROF	-0,252681	-35,22887	0,0000	Significant posi
SALESGR	-0,004006	-2,484112	0,0131	Significant posi

The size of the board of directors shows insignificant results on the dependent variable of accounting conservatism where the probability value is 0,8784. The results of the research that the size of the board of directors has no significant effect can be stated because the company in determining the size of the board of directors has not been adjusted to the actual needs of the company so that the directors fail to manage resources effectively and fail to implement accounting conservatism in financial reporting (El-Habashy, 2019). The independent board of directors from the attached t-test results can be concluded from the results that the independent board of directors has a significant positive effect on accounting conservatism, where the probability value is 0,0072. Companies that have members as independent boards of directors tend to apply accounting conservatism with the aim of reducing agency conflicts and facilitating or facilitating the monitoring process of managers. The independent board of directors is the center of decision making and controls company managers and provides advice to approve a decision and the independent board of directors can understand the benefits of the principle of conservatism and apply more conservative accounting in the company (Elshandidy & Hassanein, 2014). The type of auditor has no significant effect on the dependent variable of accounting conservatism where the probability value after testing is 0,4717. It can be concluded that there is a lack of companies conducting audits by choosing Big4 audit companies. The results of this study are in line with the research of Saeed et al. (2018) and Veres et al. (2013) which states that Big4 public accounting firms (KAP) with Non-Big4 public accounting firms or auditors with names or not, there is no difference in conservative financial reporting.

Firm size shows that there is no significant effect on accounting conservatism where the

probability value is 0,2949. Yuliarti et al. (2017) argue that company size does not guarantee companies to apply accounting conservatism, or a larger company size will not affect the increase and decrease in the principle of conservatism because other factors can affect companies in implementing accounting conservatism. Leverage has a significant positive effect on accounting conservatism where the probability value is 0,0027. High leverage owned by a company will tend to influence accounting conservatism because the company has greater bondholder and shareholder conflict (Foroghi et al., 2013). High leverage can also be stated that the company has a great ability to pay off its long-term obligations at a low level, which causes managers in the company to tend to use the principle of accounting conservatism (Kusmuriyanto & Risdiyani, 2015). Profitability shows a significant positive result on the dependent variable of accounting conservatism where the probability result is 0,0000. The results of this research are similar to Pratanda and Kusmuriyanto (2014) which state that companies that have high profitability tend to apply conservatism to keep company profits from fluctuating. Sales growth shows a significant positive result on the dependent variable of accounting conservatism where the probability result is 0,0131. Companies that are experiencing growth tend to apply the principle of accounting conservatism. High company growth makes managers use accounting conservatism to minimize the risk of future economic uncertainty (Permatasari & Yulianto, 2020).

GOODNESS TO FIT MODEL

The coefficient of determination test is carried out to determine the ability of the independent variable to explain the dependent variable which can be seen from the R-Squared value. The results of the coefficient of determination test can be seen in table 7.

Table. 7 Goodness to Fit Model

Dependent Variable	R-squared	Adjusted R-squared
Accounting Conservatism	0,656934	0,566403

The 2nd Conference on Management, Business, Innovation, Education, and Social Science (CoMBInES)

Taichung, Taiwan 3-6 March, 2022

The test results show the R-squared value of 0,656934 while the Adjusted R-squared value of 0,566403 which means that the independent variables, namely the size of the board of directors, the independent board of directors, type of auditor, company size, leverage, profitability, and sales growth can explain the accounting conservatism variable by 56,64%, while the remaining 43,36% is explained by other variables not examined in this study. Another variable that is estimated to have an influence on accounting conservatism is financial distress, managerial ownership, audit firm size, auditor specialization, audit tenure, board leadership, audit committee and so on.

CONCLUSIONS

This research was conducted to find out whether there is an effect of the corporate governance and company characteristics on accounting conservatism. Based on the test results, it can be analyzed and concluded based on the research results, namely independent board of directors, leverage, profitability, and sales growth have a significant positive effect on accounting conservatism. There are three variables, namely the size of the board of directors, the type of auditor, and the size of the company that has no significant effect on accounting conservatism.

LIMITATIONS

1. Some companies do not publish financial statement information data or annual report information data which has passed where the average is from 2016-2017.
2. Research conducted in measuring conservatism only focuses on the variables of the size of the board of directors, independent board of directors, auditor type, firm size, leverage, profitability and sales growth.
3. The sample used as research data are companies listed on the Indonesia Stock Exchange (IDX).

FUTURE WORK

Suggestions that can be shown when conducting research in the future or at a later time are as follows:

1. The research sample time for further research is recommended to be able to use the above 2017.
2. Further research can add other variables such as financial distress, managerial ownership, audit firm size, auditor specialization, audit tenure, board leadership, audit committee and so on.
3. Future research may use samples from companies outside Indonesia to maximize the results of data testing.

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**The 2nd Conference on Management, Business,
Innovation, Education, and Social Science (CoMBInES)
Taichung, Taiwan 3-6 March, 2022**

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