

Research Paper

DETERMINANTS OF ACCOUNTING CONSERVATISM

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ABSTRACT

Purpose - The purpose of this research is to investigate and analyse the effects of investment opportunity set, company size, and financial distress on accounting conservatism in mining sector companies.

Research Method - The research used both descriptive and verificative methods. The population of the study consisted of 34 mining sector companies that were listed on the Indonesia Stock Exchange from 2017-2019. The sample for the study included the annual reports of 39 mining sector companies listed on the Indonesia Stock Exchange during the same period. The data analysis technique used in the study was panel data regression.

Findings - This research shows that Investment opportunity set has a positive and significant effect on accounting conservatism. Company size has a positive and significant effect on accounting conservatism. Financial distress has a negative and significant effect on accounting conservatism.

Implication - The implication of this research is that management of mining sector companies can increase the level of accounting conservatism by considering factors such as investment opportunity set, company size, and financial distress. Additionally, the findings of this research can provide valuable information for investors, analysts, and regulators in making investment decisions in mining sector companies.

Keywords: Accounting Conservatism, Investment Opportunity Set, Company Size, Financial Distress

JEL code: B41, C01, G01, G24

Article History Received : 15 November 2022 Revised : 28 March 2023 : 03 May 2023 Accepted : 05 May 2023	DOI : http://dx.doi.org/10.37253/gfa.v7i1.7252 Web : https://journal.uib.ac.id/index.php/gfa/article/view/7252
Citation Wiharno, H., Hamzah, A., & Pangestu, R. H. (2023). Determinants of accounting conservatism. <i>Global Financial Accounting Journal</i> , 7(1), 14-27. http://dx.doi.org/10.37253/gfa.v7i1.7252	

INTRODUCTION

The conceptual framework of accounting aims to translate financial reporting into the fundamental quality of accounting, which should be relevant (able to provide clarity on the company's financial flows so that users of the information can make informed decisions) and meet the characteristics of quality financial information where the information presented reflects the substance of the financial transactions that occur in the company. Financial reporting must also meet additional qualities of accounting information, such as comparability, verifiability, timeliness, and understandability.

In addition to the fundamental qualities of accounting, the principle of conservatism is also applied in financial reporting. This principle recognizes that liabilities and expenses must be recognized, but income and assets will only be recognized when they are certain. According to the principle of conservatism, if there is uncertainty about losses, the accountant should be inclined to record them. On the contrary, if there is uncertainty about profits, the accountant should not record them. Therefore, profit reports tend to result in lower amounts of profits and asset values, just in case.

The concept of conservatism in financial reporting adopts a prudent and pessimistic approach, setting accounting reports lower than their actual value, even when not properly disclosed. This can increase a company's value by limiting payments to managers or other parties who may engage in opportunistic behavior. Understating net assets can also reduce the risk of litigation or lawsuits, as investors tend to be risk-averse and understatements are considered safer than overstatements, which can mislead decision-making.

In the mining sector, many companies listed on the Indonesian stock exchange apply accounting conservatism, according to data analysis. 43% of the studied companies applied accounting conservatism, as measured by a market-to-book ratio greater than 1, while 51% did not apply accounting conservatism, with a market-to-book ratio less than 1. Three companies had incomplete data during the study.

This phenomenon indicates that there are still many publicly listed companies that lack financial statement integrity in meeting the information needs of report users. The principle of conservatism is crucial, and companies must adopt policies that ensure this principle has a positive impact on their development. According to Savitri (2016) several factors influence management's decision to implement conservatism, such as investment opportunity sets, company size, and potential financial difficulties.

The Investment Opportunity Set (IOS) is regarded as a key element in the application of accounting conservatism, in accordance with the positive accounting theory. According to this argument, large businesses are more likely to incur considerable political expenses, which could cause them to understate their earnings in financial reporting. A higher IOS causes the market-to-book ratio to rise, which raises the price of the company's stock. As a result, IOS becomes more valuable, contributing to the accounting conservatism principle. Several studies, including those conducted by Permatasari and Yulianto (2020); Andreas et al. (2017); Saputri (2013); Dwitayanti and Fahlefi (2015); Murwaningsari and Rachmawati (2017) have shown that IOS has a significant positive effect on accounting conservatism. However, there are conflicting results from other studies, including those conducted by Angela and Salim (2020); Budiandru et al. (2019); Hakiki and Solikhah (2019); Sugiarto and Fachrrozie (2018); Saptono and Gurendrawati (2014) which suggest that IOS has no significant influence on accounting conservatism.

The size of a company is considered an indicator of the principle of accounting conservatism, which refers to the total assets of the company and is used to observe the political costs borne by the company. The political cost hypothesis predicts that larger corporations are more sensitive to political costs, which are related to the influence of the government on the payment of political costs. To avoid wishful thinking, companies may engage in conservative

reporting, which can help reduce the payment of political costs. Previous research by Watts and Zimmerman (1990), Jensen and Meckling (1976), and Watts and Zimmerman (1978) suggested that political costs increase with the size of the company. Recent studies by Sholikhah et al. (2020); Hakiki and Solikhah (2019); Kusumadewi (2018); Chairunnisya et al. (2017) have found that the size of the company has a positive influence on accounting conservatism. Large companies face high political costs and therefore tend to use conservative reporting to reduce such costs, especially in the income statement. However, other research by Angela and Salim (2020); Susanto and Ramadhani (2016); Tista and Suryanawa (2017); Romadona (2016); Sumiari and Wirama (2016) has found no significant influence of company size on conservatism. This suggests that the size of a company is not a consistent predictor that can affect accounting conservatism in a company.

Financial distress is considered an important factor in assessing a company's financial prospects and risks. While a company's profitability can indicate its prospects, financial difficulties can highlight the risks. Accounting conservatism is a response to the need for prudence in uncertain situations that may arise during a company's operations. The application of conservatism may lead to lower profits as the company prioritizes prudence in its financial reports. Based on studies by Savitri (2016); Pahriyani and Asiah (2020); Tazkiya and Sulastiningsih (2020); Sulastris and Anna (2018); Syifa et al. (2017); Tista and Suryanawa (2017) financial distress has a positive impact on accounting conservatism. Companies facing high financial distress tend to apply higher conservatism to avoid additional expenses, including taxes and political costs. However, this finding is not consistent with research conducted by Putri et al. (2020); Rivandi and Ariska (2019); Abdurrahman and Ermawati (2018); Setiyaning et al. (2018); Santoso (2018) which suggests that financial distress has a negative impact on accounting conservatism.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Signal Theory

The signal theory is a framework that explains how managers use financial statements to reduce information asymmetry by providing positive signals to stakeholders. According to Wolk et al. (2001). This is achieved by applying accounting conservatism policies to produce higher quality profits in line with this principle. The signal theory also sheds light on the relationship between Investment Opportunity Set (IOS), company size, financial distress, and accounting conservatism. Companies with larger IOS typically have more opportunities to invest in high-risk, high-reward projects. However, they may also opt for accounting conservatism to demonstrate financial discipline and minimize the risk of project failure. Financial distress can also affect the use of accounting conservatism, as companies in such situations may use it as a defensive measure or to instil confidence in investors. However, this can also lead to uncertainty among investors. Overall, the signal theory provides valuable insights into the complex relationship between IOS, company size, financial distress, and accounting conservatism. To fully understand the implications of these relationships for financial reporting and investment decisions, further research is necessary.

Agency Theory

Agency theory explains that one or more agency relationships emerge when individuals or organizations hire others to provide a service and delegate decision-making authority to the agent, according to Jensen and Meckling (1976) as cited by Romadona (2016). However, conflicts of interest often arise between managers and stakeholders, as managers prioritize their own interests over those of stakeholders without considering the impact on them (Noviantari & Ratnadi, 2015). To mitigate these conflicts, the agency theory proposes the use of accounting conservatism to reduce agency costs. In the context of investment opportunity set (IOS), larger

companies with more investment opportunities may face higher agency costs due to the separation of ownership and control, and accounting conservatism may be used to reduce information asymmetry and align the interests of management with those of shareholders.

Similarly, financial distress can increase agency costs as the credibility of financial reports may be questioned, and information asymmetry may worsen. Accounting conservatism can be used to reduce agency costs associated with information asymmetry, providing more transparent financial reporting that aligns the interests of management and shareholders. Understanding the implications of these relationships for financial reporting and investment decisions is crucial, as effectively managing agency costs can lead to better alignment of interests between shareholders and management and more effective decision-making. Further research is needed to identify the most effective strategies for reducing agency costs and promoting transparency in financial reporting.

Positive Accounting Theory

Positive Accounting Theory (PAT) is a theory that aims to explain and predict various phenomena. Watts and Zimmerman (1986); Sumiari and Wirama (2016) identified three hypotheses in PAT: bonus plan hypothesis, debt covenant hypothesis, and political cost hypothesis. PAT provides insights into how economic and market factors influence accounting practices. In the context of Investment Opportunity Set (IOS), company size, financial distress, and accounting conservatism. PAT suggests that companies use accounting conservatism to maximize their economic benefits. Larger companies with more investment opportunities are likely to apply accounting conservatism to reduce earnings volatility and improve market perception. Similarly, firms facing financial difficulties may use accounting conservatism to signal financial stability to external stakeholders and minimize the risk of financial challenges. PAT also suggests that firms use accounting conservatism to manage relationships with lenders, investors, and other stakeholders by providing transparent financial information and reducing information asymmetry. By considering the self-interest of companies and their stakeholders, PAT helps identify the economic factors that motivate firms to apply accounting conservatism and predict accounting practices in different contexts. Understanding these relationships can assist in making effective investment decisions and managing economic risks.

The Effect of Investment Opportunity Set on Accounting Conservatism

The Investment Opportunity Set (IOS) is a combination of investment decisions that involve assets owned and positive investments or Net Present Value (NPV) that can impact a company's value. As part of signal theory, managers communicate with investors about the IOS, which can have a positive effect on accounting conservatism in the enterprise. When a company's IOS increases, it attracts investors who are willing to invest in the company, thereby increasing its value. This increase in value influences the market-to-book value of the company, resulting in a higher level of accounting conservatism applied by the company. Investment opportunities also have a positive impact on stock prices, indicating that a larger IOS leads to a higher market-to-book ratio, which serves as a proxy for accounting conservatism. On the other hand, a smaller IOS results in a smaller market-to-book ratio, which is a proxy for accounting conservatism. According to signal theory, investors expect to receive these signals and evaluate the company more thoroughly. Several studies, including those conducted by Permatasari and Yulianto (2020); Andreas et al. (2017); Murwaningsari and Rachmawati (2017); Dwitayanti and Fahlefi (2015) and Saputri (2013) have demonstrated that IOS has a significant positive impact on the implementation of accounting conservatism. This is since the market responds positively to a company's growth, resulting in an increase in its stock price.

The higher the value of the IOS, which reflects the company's growth rate, the higher the level of accounting conservatism applied by the company.

H1: The Investment Opportunity Set (IOS) has a positive effect on accounting conservatism.

Effect of Company Size on Accounting Conservatism

The political cost hypothesis posits that larger companies are more susceptible to political costs due to the government's greater focus on them. Governments may target larger companies as they have the potential for high profits and development and may impose regulations and policies that require political payments for their own benefit. Consequently, larger companies face higher political costs that can lead to lower profits and asset values. To avoid paying high political costs, management may defer profits from the current period to future periods, resulting in larger companies reducing the application of accounting conservatism. This is a strategic move to mitigate the amount of political costs faced by companies that are being scrutinized by the government. Previous research by Sholikhah et al. (2020); Hakiki and Solikhah (2019); Kusumadewi (2018); Chairunnisya et al. (2017) supports this explanation by showing that company size has a positive correlation with the application of accounting conservatism. This implies that larger companies face higher political costs and tend to adopt accounting principles that decrease the value of their income statements to manage the amount of political costs.

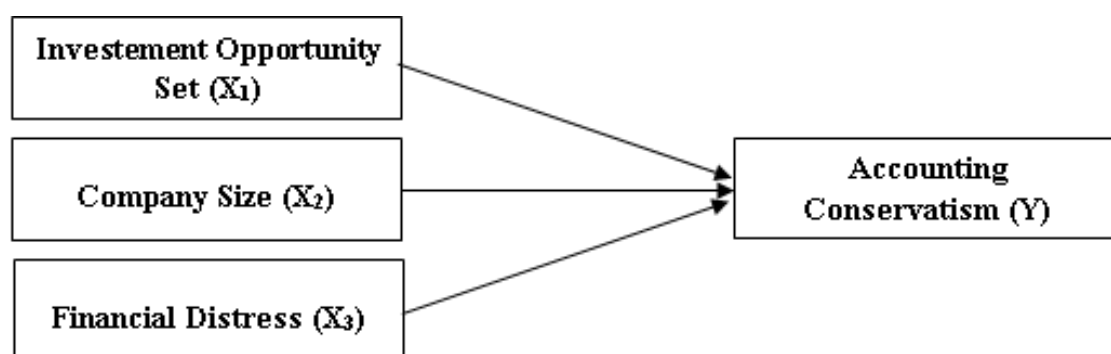
H2: Company size has a significant positive effect on accounting conservatism.

Effect of Financial Distress on Accounting Conservatism

The debt covenant hypothesis states that accounting conservatism is affected by financial distress. Companies that are highly vulnerable to financial constraints tend to attribute their situation to poor management quality. This perception could lead to the replacement of managers by shareholders, causing management to reduce the application of accounting conservatism. Financial distress can also lead to a decline in investor interest, resulting in reduced company value and market-to-book value. According to agency theory, management may reduce accounting conservatism levels to maintain a positive image and avoid scaring off potential investors. Previous research conducted by Putri et al. (2020); Rivandi and Ariska (2019); Abdurrahman and Ermawati (2018); Setiyaning et al. (2018); and Santoso (2018) supports this explanation by showing that financial distress has a negative impact on accounting conservatism. As financial distress increases, the level of accounting conservatism tends to decrease. Poor financial conditions can result in shareholder pressure on management to influence decision-making, leading to a reduction in the application of accounting conservatism.

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

Figure 1. Research model



RESEARCH METHODOLOGY

This study utilizes both descriptive and verification methods. The population consists of financial reports from 51 companies listed on the Indonesia Stock Exchange from 2017 to 2019, resulting in 153 observation data. The sampling technique employed is purposive sampling.

Table 1. Sample selection using purposive sampling technique

Criteria	Number of Companies
Mining sector companies listed on the Indonesia Stock Exchange during the period of 2017-2019	51
Companies that consistently reported and published annual reports during the research period of 2017-2019.	43
Companies that have complete data throughout the research period of 2017-2019.	39
Companies included in the sample	39
Total data used in the study (39 companies x 3 years)	117

Source: Secondary data processed (2021)

The study utilized purposive sampling technique and obtained 117 financial statement data from 39 mining sector companies listed on the Indonesia Stock Exchange for the period of 2017-2019. The mining sector was chosen due to its significance in the Indonesian economy, high investment and financial risks, unique accounting regulations and reporting requirements, and exposure to volatile commodity prices and economic factors. The research aims to provide insights into the role of accounting conservatism in a complex and dynamic business environment. The dependent variable in the study was accounting conservatism, which was measured using the market to book ratio conservatism model. A company is considered conservative if the market to book ratio is > 1, and not conservative if the market to book ratio is < 1, according to Beaver and Ryan (2000).

$$MTB = \frac{\text{Closing Price}}{\text{Earning Per Share}}$$

Where:

MTB: Market to Book Ratio,

Closing Price: Stock price per share in year t,

Earnings Per Share: Equity book value divided by the number of shares. Reflects the company's book value.

This research uses independent variables such as Investment Opportunity Set, company size, and financial distress.

Investment Opportunity Set

$$IOS = \frac{\text{Book Value of Total Assets}_t - \text{Book Value of Total Assets}_{t-1}}{\text{Total Assets}}$$

Where:

(Book Value of Total Assets) t is the book value of total assets for the current year (t)

(Book Value of Total Assets) (t-1) is the book value of total assets for the previous year (t-1)

Total Assets is the total assets for the current year (t)

Company size

$$\text{Company Size} = L_n \text{ Total Assets}$$

Financial distress

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

Where:

X: Overall Index

X1: Net profit to total assets

X2: Total liabilities to total assets

X3: Current assets to current liabilities

The assessment criteria are that if the value of X is negative, the company is considered healthy, while if the value of X is positive, the company is considered bankrupt.

RESULTS AND DISCUSSION

Descriptive data analysis

Table 2. Descriptive statistics for accounting conservatism

Accounting Conservatism	
Mean	1.550
Standard Deviation	2.764
Minimum	-21.819
Maximum	35.144
Count	117

Source: Processed secondary data (2021)

The descriptive analysis of accounting conservatism in the mining sector can be summarized as follows: The mining sector exhibited a wide range of accounting conservatism levels during the research period of 2017-2019. The lowest application of conservatism was observed in Capitalinc Investment Tbk in 2018 with a value of -21.819, while the highest application of conservatism was observed in Alfa Energi Investama Tbk in 2018 with a value of 35.144. On average, the mining sector applied accounting conservatism with a mean value of 1.550, indicating a moderate level of conservatism. However, the standard deviation of accounting conservatism for the 39 mining companies during the research period of 2017-2019 was 2.764, indicating a high level of variation in accounting conservatism levels among the companies.

Table 3. Descriptive statistics for investment opportunity set

Investment Opportunity Set	
Mean	-0.116
Standard Deviation	1.892
Minimum	-2.109
Maximum	0.576
Count	117

Source: Processed Secondary Data (2021)

The investment opportunity set in the mining sector companies during the study period of 2017-2019 can be described through the following analysis: the lowest value observed for

investment opportunity set is -2.109, indicating the least investment opportunities among the mining sector companies during the study period. This was observed in Delta Dunia Makmur Tbk in 2018. The highest value observed for investment opportunity set is 0.576, indicating the highest investment opportunities among the mining sector companies during the study period. This was observed in Capitalinc Energy Tbk in 2017. The average value of investment opportunity set among the 39 mining sector companies during the study period of 2017-2019 is negative at -0.1, suggesting that, on average, the mining sector companies had limited investment opportunities during the study period. The standard deviation value of investment opportunity set is 1.892, which is greater than the mean value, indicating that there is a high level of variability in the investment opportunity set among the mining sector companies.

Table 4. Descriptive statistics for company size

Company Size	
Mean	29.528
Standard Deviation	1.462
Minimum	24.769
Maximum	32.258
Count	117

Source: Processed secondary data (2021)

The descriptive analysis of firm size is presented as follows: the smallest firm size observed in the mining sector during the research period of 2017-2019 was 24,769, which was recorded by Mitra Investindo Tbk in 2019. On the other hand, the largest firm size observed during the same period was 32,258, recorded by Adaro Energy Tbk in 2018. The average firm size of the 39 mining companies during the research period was 29.5. Moreover, the standard deviation value of firm size was 1,462, indicating that the firm size had a lower level of variability.

Table 5. Descriptive statistics for financial distress

Financial Distress	
Mean	-1.221
Standard Deviation	1.765
Minimum	-4.556
Maximum	9.431
Count	117

Source: Processed secondary data (2021)

The descriptive analysis of financial distress potential can be summarized as follows: the mining sector companies' financial distress potential during the research period of 2017-2019 ranged from -4.556 to 9.431. The lowest financial distress potential of -4.556 was observed in Mitrabara Adiperdana Tbk in 2017, while the highest potential of 9.431 was observed in Mitra Investindo Tbk in 2019. The average financial distress potential for 39 mining sector companies during the research period was -1.221, indicating an overall negative potential for financial distress. The standard deviation value of 1.765 for the financial distress potential suggests a higher level of variation among the mining sector companies.

Table 6. Simultaneous test results (Uji F)

ANOVA ^a					
Model	Sum of Square	Df	Mean Square	F	Sig.
Regression	244.780	3	81.593	14.371	.000 ^b
Residual	641.594	113	5.678		
Total	886.374	116			

Source: IBM Statistic SPSS 20 output (2021)

Referring to Table 6, the computed F-value is 14.371, while the tabular F-value is significant at 0.05 level of significance with $df_2 (n-k-1) df_2 = 117-3-1 = 113$. Since the obtained F-value is greater than the tabular F-value ($14.371 > 2.68$), the null hypothesis (H_0) is rejected, and the alternative hypothesis (H_a) is accepted. Therefore, it can be concluded that the hypothesis stating that investment opportunity set, firm size, and financial distress have a simultaneous and significant influence on accounting conservatism is supported.

Table 7. Partial test results (Test t)

Coefficients ^a			
Model	B	T	Sig.
Constant	12.988	2.875	.005
Investment Opportunity Set	.472	3.931	.000
Company Size	.477	3.135	.002
Financial Distress	-.411	-3.200	.002

Source: IBM Statistic SPSS 20 output

Effect of Investment Opportunity Set on Accounting Conservatism

The results presented in Table 7 indicate that there is a significant positive partial effect of the investment opportunity set on accounting conservatism. This is supported by the calculated t-value of 3.931, which is greater than the tabular t-value of 1.658 at a significance level of $\epsilon = 0.05$ and with $df (n-k) = 114$. The significant value of 0.000, which is less than 0.005, further confirms that the null hypothesis (H_0) is rejected, and the alternative hypothesis (H_a) is accepted. Therefore, it can be concluded that the investment opportunity set has a significant positive effect on accounting conservatism, supporting hypothesis 2.

The Effect of Company Size on Accounting Conservatism

According to Table 7, the test conducted on the variable of company size against accounting conservatism resulted in a calculated t-value of 3.135. The t-table value at a significance level of $\epsilon = 0.05$ with $df (n-k) = 117-3 = 114$ is 1.658. As the calculated t-value is greater than the t-table value ($3.135 > 1.658$) with a significance value of $0.002 < 0.005$, it can be concluded that H_0 is rejected, and H_a is accepted. This means that the company size has a positive and significant effect on accounting conservatism. Therefore, hypothesis 3 is accepted.

Effect of Financial Distress on Accounting Conservatism

According to Table 7, the test of the financial distress variable against accounting conservatism resulted in a calculated t-value of -3.200. The t-table value at a significance level of $\epsilon = 0.05$ with $df (n-k) = 117-3 = 114$ was -1.658. Comparison of the calculated t-value with the t-table value revealed that the t-table value is smaller than the calculated value ($-3.200 < -$

1.658) with a significance value of $0.002 < 0.005$, indicating that H_0 is rejected, and H_a is accepted. Therefore, it can be concluded that financial distress has a negative and partially significant effect on accounting conservatism. Thus, hypothesis 4 is accepted.

Coefficient of Determination (R²)

Table 8. Coefficient of Determination Test Results (R²)

Model Summary ^b	
R	.726 ^b
R Square	.776
Adjusted R Square	.665
Std. Error of the Estimate	2.382

Source: IBM Statistic SPSS 20 output

Based on the results in table 8, an adjusted R-square value of 0.665 indicates that 66.5% of the variations in the dependent variable (accounting conservatism) can be explained by the independent variables (investment opportunity set, company size, and financial distress) included in the model, while the remaining 33.5% are influenced by other variables outside the model, such as the number of board members, public ownership, share ownership by the commissioners and directors, non-CEO family ownership, litigation risk, profit management, political costs, taxes, debt covenants, company growth, application of PSAK 55, profitability, capital intensity, and other factors.

Effect of Investment Opportunity Set, Company Size and Financial Distress on Accounting Conservatism

The results of the F-test indicate that investment opportunity set, company size, and financial distress have a significant and simultaneous effect on accounting conservatism. This significant influence implies that the findings of this study can be generalized to the entire population. Internal and external factors, such as investment opportunity set, company size, and financial distress, affect accounting conservatism.

Investment opportunity sets can encourage companies to increase the application of accounting conservatism. A higher investment opportunity set can attract investors, increase the company's value, and lead to a higher market-to-book value, prompting companies to apply a higher level of accounting conservatism. This is consistent with signal theory, which explains that companies are motivated to provide high-quality financial information to external parties.

Company size can affect the level of political costs that companies face, and thus, companies may increase their application of conservatism to reduce pressure from the government. This aligns with the political cost hypothesis in positive accounting theory, which suggests that companies aim to reduce significant political costs by deferring profits from the current period to future periods.

In contrast, in situations of high financial distress, the manager may be perceived as the most responsible party due to their poor quality. In response, shareholders may seek to replace the manager, leading management to reduce the application of accounting conservatism to maintain a positive image. This aligns with agency theory, which suggests that shareholders, as principals, are only interested in high-quality financial results. As a result, this may lead to an imbalance of information and agency problems, allowing management to manipulate financial statement information without stakeholders' knowledge.

The determination test results in this study indicate that investment opportunity set, company size, and financial distress contribute or influence 66.5% of accounting conservatism, while the remaining 33.5% is influenced by other variables not studied, such as the number of

commissioners, public ownership, litigation risk, political costs, debt covenants, and other factors.

Effect of Investment Opportunity Set on Accounting Conservatism

The results of the t-test show that the investment opportunity set has a positive and significant effect on accounting conservatism. The significant influence implies that the findings of this study can be generalized to the entire population. The investment opportunity set is a management burden that can reflect the company's value in line with the management's policies. It can also be utilized as a current investment option that is expected to generate higher profits. The positive impact of the investment opportunity set indicates that better capital expenditure decisions, such as a combination of assets owned and net present value, will influence the company's value, which will increase. This will encourage management to continually improve the application of accounting conservatism in the company.

According to signal theory, management will signal investors through good financial statements, which will attract investors to invest in the company. This positive influence of the investment opportunity set on accounting conservatism is supported by research by Murwaningsari and Rachmawati (2017) which states that investment opportunities can elicit a positive reaction from stock prices. This means that the market to book value, as a proxy for conservatism, will also be higher, and this will have an impact on increasing the company's value. Thus, the greater the value of the investment opportunity set, the higher the market to book ratio, and the value of accounting conservatism applied by the company will also increase. This explains why investors expect to receive this signal positively and assess the company more representatively. Other studies have also shown that the investment opportunity set has a significant positive effect on the implementation of accounting conservatism, including the research by Permatasari and Yulianto (2020); Andreas et al. (2017); Murwaningsari and Rachmawati (2017); Dwitayanti and Fahlefi (2015) and Saputri (2013). They found that the market reacts positively to the company's growth, leading to an increase in stock price. The higher the value of the investment opportunity set, which indicates the growth rate of the company, the higher the accounting conservatism applied by the company.

Effect of Company Size on Accounting Conservatism

The results of the t-test indicate that company size has a positive and significant effect on accounting conservatism. A significant influence means that the findings of this study can be applied to all members of the population. The positive influence of company size, measured by total assets, suggests that as the size of a company increases, so does its total assets. This, in turn, attracts government attention to promote public services and increase political payments for the benefit of development and other purposes. According to the political cost hypothesis, companies tend to adopt conservative accounting practices to reduce government pressure.

As the size of a company grows, the amount of profit and asset value decreases due to postponing the profit of the current period to the future period. This enables the company to avoid paying high political costs, which in turn increases the application of accounting conservatism in the company. This explanation is supported by previous studies conducted by Sholikhah et al. (2020); Hakiki and Solikhah (2019); Kusumadewi (2018); Chairunnisya et al. (2017) which revealed that company size has a positive effect on accounting conservatism. These findings suggest that large companies face high political costs and tend to use accounting principles that can reduce the value of income statements to minimize the amount of political costs.

The Effect of Financial Distress on Accounting Conservatism

The t-test results indicate that financial distress has a significant negative effect on accounting conservatism. The significant influence implies that the findings of this study can be applied to the entire population. Financial distress can be determined based on the level of profitability and the probability of a company experiencing financial difficulties. A financial analyst should have a good understanding of the fundamental concepts and principles underlying financial statements. When a company faces a high probability of financial difficulties, the managers are responsible for poor quality, which leads to shareholders' desire to replace them. In response to this threat, the management tends to reduce the accounting conservatism of the company.

Companies experiencing financial distress have lower investor interest, which can lead to a decline in the company's value, resulting in a decrease in the market-to-book value ratio. This finding is consistent with previous studies by Putri et al. (2020); Rivandi and Ariska (2019); Abdurrahman and Ermawati (2018); Setiyaning et al. (2018); and Santoso (2018) which have shown that financial distress has a negative impact on accounting conservatism. As the level of financial distress increases, accounting conservatism tends to decrease because poor financial conditions can create significant pressure on the management from the shareholders, thereby influencing every management decision.

CONCLUSIONS AND SUGGESTION

Based on the previous explanation of the research results and discussion, the following conclusions can be drawn: (1) The investment opportunity set, company size, and potential financial difficulties have a simultaneous and significant effect on accounting conservatism. This indicates that the use of investment opportunity set, company size, and potential financial difficulties as predictors together can explain the application of accounting conservatism. (2) The investment opportunity set has a positive and significant effect on accounting conservatism. (3) Company size has a positive and significant effect on accounting conservatism. (4) Financial distress has a negative and significant effect on accounting conservatism.

With an R-square value of 0.665, it can be concluded that 66.5% of the variation in the independent variables can be explained by the determinative variables in the model, while the remaining 33.5% is influenced by other variables outside the model. Therefore, future researchers may consider adding research variables such as the number of boards, public ownership, shareholding by commissioners and directors, non-CEO family ownership, litigation risk, profit management, political costs, taxes, debt agreements, company growth, application of PSAK 55, profitability, capital intensity, and other relevant factors.

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