



Impact of Financial Distress and Accounting Conservatism

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Abstract

This study aims to investigate the effect of financial distress, sustainability reports, and sustainability reports on accounting conservatism. By using quantitative research methods. The data used in this study are secondary data in the form of financial reports and annual reports. The population in this study is 67 companies listed on the Indonesia Stock Exchange for the period 2020 to 2022. The sample for this study was selected using a purposive sampling technique in order to obtain 47 manufacturing companies that met the criteria. This research was conducted at manufacturing companies in the goods and consumption industry sector. In this study, the hypothesis testing method was used using Structural Equation Modeling (SEM) with the help of SmartPLS version 3.0 software.

Keywords: financial distress, sustainability report, sustainability report and accounting conservatism.

1. INTRODUCTION

A negative conservative rate, or less conservatism in financial reporting, was found in data analyzing the level of accounting conservatism in five manufacturing organizations. (2002) (Ibrahimi & Suryaputri). The accounting conservatism rate for the company code IIKP was -0.0446% by 2020 and -0,0179% from 2020 to 2022. The conservative rate of -0,0787% in 2020, -0.0289% in 2020, and roughly -0,0269% in 2022 are the following on the GGRM corporation code. For the company code INDF, the values are roughly -0,0148% in 2020, -0,0024% in 2020, and 0.0088% in 2022. The following values for the KAEP company code are for 2020: -0,0387%, -0.0271%, and -0,0640%. 2020 will see 0.0035%, 2020 -0.0386%, and 2022 -0.0510% for the company code KLBF. Companies are stated to be less conservative in publishing corporate financial reports because they have a negative degree of accounting conservation, according to the assessment of the level of conservative accounting.

Financial issues or financial distress are one that has an impact on accounting conservatism. A business is in financial distress when it cannot satisfy its obligations, both short-term and long-term, leading to a reduction in financial performance, among other things. 2020 (Suprihatin). In order to prevent problems from arising on the financial side, it can help the manager regulate the level of accounting conservatism. Financial difficulties can influence

investors to take over the administration of the organization if the director is unable to handle the organization's problems properly (Haryadi et al., 2020). Financial distress affected the use of accounting conservatism, according to the research findings (Abdurrahman & Ermawati, 2020; Rafida et al., 2023) and (Abdurrahman & Ermawati, 2020). According to studies (Elaisza et al., 2018), (Hanum et al., 2020), and (Elisa et al., 2018), financial distress has no appreciable impact. However, other outcomes have been found.

The sustainability report is another aspect that affects accounting conservatism. A company's capacity to make money over a specific time period is reflected in a sustainability report. (2002) (Goffar and Muhyarsyah). Companies with high sustainability levels can compete with other businesses of a comparable size (Welni et al., 2023). Companies that have higher sustainability reports and more retained earnings also likely to follow conservative principles since they have higher political expenses, such as tax payments. Companies with higher sustainability reports also tend to have higher sustainability reports. [Rafida et al., 2023]. Because of this, the business adopts a conservative stance in order to pay less taxes. Ramdhani and coauthors 2022). Sustainability reports have an impact on accounting conservatism, according to studies by Hanum et al. (2020), Rohadi (2018), Novianty et al. (2022), and Suwasono & Anggraini (2022). However, the findings of the study by Rafida et al. in 2023 have no bearing on accounting conservatism.

Despite much investigation, the conclusions are still inconsistent. However, earlier research that explicitly connected sustainability reports to accounting conservatism is still exceedingly rare, according to preceding studies that dealt with accounting conservatism. Based on the aforementioned information, this study seeks to further understand and learn more about the effects of financial distress, sustainability reports, and sustainability reports on the application of accounting conservatism principles in the preparation of financial reports for manufacturing companies listed on the Indonesian Stock Exchange in 2020–2022.

2. LITERATURE REVIEW

Theory of agency (Agency Theory)

The theory of agency is a theory that deals with a contractual relationship between two or more parties in which one party is called a principal and the other is called an agent. (Jensen, 2018). The agency theory emphasizes the importance of the delegation of authority from the principal to the agent, where the agent has an obligation to manage the company in accordance

with the interests of the principal. (Christian, 2022). With the existence of the delegation of authority from principle to agent, it means that the agent has the power and control of a company in its survival, therefore the agent is required to be always transparent in its management activities over a company. (Zhang et al., 2022). According to the agency theory, there is a conflict of interest between the financial owners of a company, including the accounting conservatism. (Novianty et al., 2022). The theory of agency with the variable financial distress and sustainability report has a relationship when a company is in financial difficulties, managers may have a tendency to harm owners by taking high-risk actions to improve the sustainability reports of the company so that it will affect conservative financial reports. (Farha et al., 2020). In addition, there is a link between agency theory and the variable sustainability report, where companies have good sustainability reports, then managers can pay more attention to long-term goals, such as corporate reputation and business sustainability. (Ramdhani et al., 2022). It can influence managers to make conservative decisions and financial planning and reporting, including decisions about accounting conservatism (Couwenberg, 2018). In this case, agency theory can be used to understand the influence of financial distress, sustainability reports and sustainability report on accounting conservatism. (Zulni & Taqwa, 2023).

Accounting Conservatism

Conservatism is an attitude that tends to lead to a cautious attitude, which is done to ensure that the risks are adequately considered. (safrizal, 2022). According to the FASB statement of concept no.2 explaining conservatism is a cautious reaction or prudent reaction to face situations of uncertainty in financial statements (Haryadi et al., 2020). On financial statements when the principle of conservationism is applied it can improve the quality of information of financial reports as well as reduce costs (Hanum et al., 2020).

Financial Distress

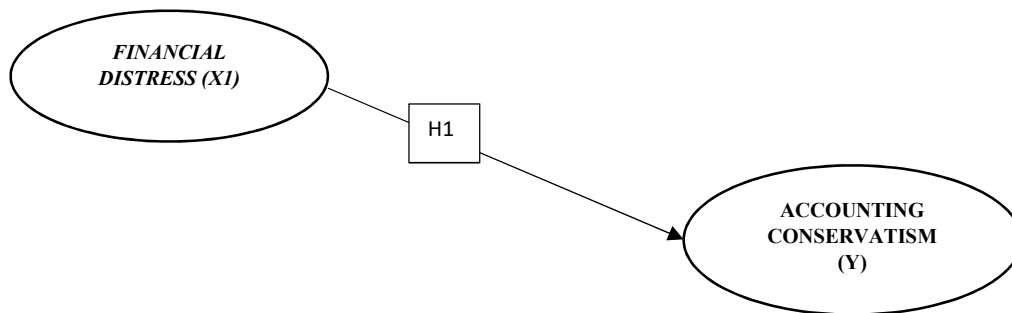
Financial distress refers to a decline in the performance of a company before it goes bankrupt or is unable to pay its financial obligations at maturity. (Rafida et al., 2023). Companies suffer from delayed deliveries, poor product quality, company late payment of bank bills as a sign of financial difficulties and inability to pay short-term debts (Zulni & Taqwa, 2023). Companies that are experiencing financial difficulties in making decisions and regulating conservative levels are the role of managers. (Wijaya et al., n.d.). So accounting conservatism can restrict agents

from reporting excessive profits and dividends can be distributed accordingly, so the availability of cash is increased to pay off debts and the possibility of financial difficulties will be controlled.

Framework of Thought

This research framework describes the relationship between independent and dependent variables. The research establishes Financial Distress, Sustainability report and Sustainability Report as independent variables, whereas for the dependent variable is Conservatism Accounting. Based on the above description, the conceptual framework of research can be defined as follows:

Figure 1. Conceptual framework



3. HYPOTHESIS

Financial Stress' Impact on Accounting Conservatism

According to Yanti et al. (2022) "financial distress" refers to a situation where a company's state is unable to generate sufficient revenues, leading to the company facing financial troubles that ultimately lead to bankruptcy. According to agency theory, a company's good financial standing may put managers under pressure that leads to contract customers (Yanti et al., 2022). In order to encourage more meticulous inspection of financial reporting, shareholders may think about reviewing or changing managers in a financially challenged corporation, according to the agency theory.2020 (Hanum et al.). Because the future is unknown, the corporation can adopt a more conservative accounting policy or be more cautious when recognizing earnings to get out of a financial jam.[Rafida et al., 2023]. The profit made will be higher if a company uses conservative accounting principles in its financial statements (Zulni & Taqwa, 2023). Previous studies by (Abdurrahman & Ermawati, 2020), (Rafida et al., 2023), (Farha et al., 2020), (Zulni & Taqwa,

2023), and (Saputra, 2018) are also worth mentioning. Financial strain has a strong impact on accounting conservatism, according to (Elaisza et al., 2018). According to earlier study, the following formulation of the hypothesis can be made:

H1: Accounting conservatism is significantly impacted by financial difficulties effect of the sustainability report on conservatism in accounting

According to Farha et al. (2020), sustainability reports are documents that include non-financial data and socio-environmental efforts that assist sustainable corporate growth. Based on the sustainability report variable, it has something to do with agency theory, which states that non-financial aspects of business activities should be reported on to increase transparency and accountability of the company to external stakeholders, such as investors, regulators, and the general public. (Octiana et al., 2020). To ensure proper and correct disclosure in this situation, corporate management will be more likely to practice accounting conservatism (Suwasono & Anggraini, 2021). According to earlier studies by Suwasono & Anggraini, Farha et al., and Putra & Subroto as well as Putra & Subroto, the sustainability report has a favorable impact on accounting conservatism. According to earlier study, the following formulation of the hypothesis can be made:

H2: Accounting conservatism is significantly impacted by the sustainability report.

4. RESEARCH MODELS

The data employed in this study, which employs quantitative techniques, is secondary data. Manufacturing firms in the consumer products business sector that are listed on the Indonesia Stock Exchange (IDX) make up the study's target population. The sample employed in this study, which spans the years 2020 to 2022 and includes a total of 67 companies, meets the following requirements: The company is a manufacturer in the consumer goods sector that will be listed on the Indonesia Stock Exchange in the 2020–2022 timeframe. Second, for that time period, the corporation produces entire financial report data. Third, rupiah currency is used to present the financial statements. Finally, the corporation made a series of profits between 2020 and 2022.

47 of the 67 companies listed on the Indonesia Stock Exchange (IDX) met predetermined criteria and were chosen as samples using a purposive sampling technique based on criteria that were pertinent to the research, allowing for the use of software-based data analysis techniques in

this study. SmartPLS. Outer model analysis, inner model analysis, and hypothesis testing are the three steps of data analysis.

5. RESULTS AND DISCUSSION

1) Godness of Fit (GoF) Test Analysis

Goodness of Fit (GoF) analysis, in contrast to covariance-based SEM, in SEM-PLS GoF testing is done manually because it is not included in the SmartPLS output. The GoF value categories are 0.1, 0.25 and 0.38 which are categorized as small, medium and large. The formula used is as follows:

$$GoF = \sqrt{AVE \times R^2}$$

The values needed in this analysis are the average value of average variant extracted (AVE) and R2. Based on the data obtained from the previous test smartPLS output, the average value of AVE is 0.925 and the value of R2 is 0.930. After knowing the average value of AVE and R2, the next step is to calculate the value of Goodness of Fit based on the formula above.

$$\begin{aligned} GoF &= \sqrt{AVE \times R^2} \\ GoF &= \sqrt{0,925 \times 0,930} \\ &= 0.927 \end{aligned}$$

The results of the calculations that have been carried out, the GoF result is 0.927 which is greater than 0.38. Thus it can be concluded that the model built has a very good goodness of fit.

After testing the R-Square, F-Square, Q-Square and Goodness of Fit, it can be said that the model formed is robust. The output of the outer model and inner model in the SEM-PLS model which has gone through the testing phase and is declared robust are as follows:

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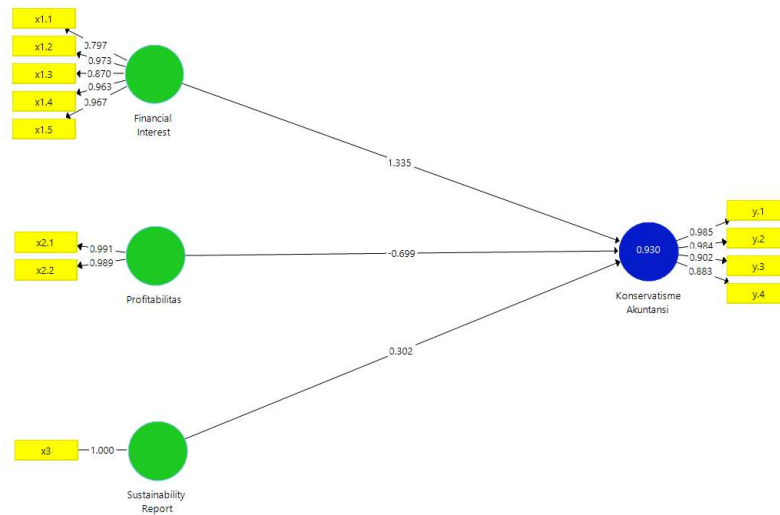


Figure 2. Output of the PLS-SEM Research Model Bootstrapping results

The study hypothesis, which is evident from the t-statistic and probability values, will be put to the test in this part. To test the hypothesis in this study with a 5% significance threshold, resulting in a 1.96 t-statistic value. T-statistics are used as the criterion for accepting the hypothesis; if the t-statistic is greater than 1.96, the hypothesis is accepted and should be accepted. Furthermore, if the P-Values are less than 0.05, the hypothesis is accepted or rejected using probability that is Ha.

The bootstrapping report in the following Path Coefficient table shows whether the hypothesis was accepted or rejected:

Table 1 Path Coefficient

	Original Sample (O)	Sample Means (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Financial Distress -> Accounting Conservatism	1,335	1,447	0.651	2047	0.041
Sustainability report -> Accounting Conservatism	-0.699	-0.796	0.647	1,081	0.280

The analysis of acceptance or rejection of the hypothesis will be explained using the output path coefficient from the Path Coefficient Table as a basis:

H1: The impact of financial distress on conservatism in accounting.

The parameter coefficient for the variable X1 on Y is 1.335 in magnitude, indicating that X1 has a positive influence on Y. According to calculations using bootstrap or resampling, H1 is accepted, meaning that the impact of financial distress has a significant impact on accounting conservatism. The bootstrap result is 1.447 with a t-count value of 2.047 and a standard deviation of 0.651. The p-value value is 0.041 0.05.

H2: The impact of the sustainability report on conservatism in accounting.

There is no positive effect of variable X3 on Y, as indicated by the parameter coefficient's magnitude of 0.302 for the variable X3 on Y. According to calculations using bootstrap or resampling, the hypothesis H3 is rejected, meaning that the sustainability report has no appreciable impact on accounting conservatism. The bootstrap result for the coefficient X3 on Y is 0.286 with a t count value of 0.646 and a standard deviation of 0.468.

6. DISCUSSION

Financial Stress' Impact on Accounting Conservatism

According to the findings of this study's testing of the first hypothesis, for the years 2020 to 2022, financial crisis has a favorable impact on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange. The t-statistic value of 2.047, which is higher than 1.96 and significant at alpha 5% (P-values 0.05), serves as proof of this conclusion. Therefore, it is relevant to agency theory, which explains the importance of oversight as a principal against accounting conservatism, and it is crucial to make sure that the interests of principals are maximized. This means that there is uncertainty in the future and the company may implement accounting conservatism policies in its financial statements. The findings of this study corroborate those of earlier research by Abdurrahman and Ermawati (2020), which found that accounting conservatism is highly influenced by financial crisis.

The impact of sustainability reporting on conservatism in accounting

The third hypothesis of this study was tested, and the findings showed that, for the 2020–2022 research period, there was no substantial sustainability report on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange. The t-statistic value of 0.646, not

exceeding 1.96, and significance at 5% alpha (P-values > 0.05), both support these findings. This demonstrates attempts to put the accounting conservatism theory into practice by treating sustainability reports as corporate property. This may result in a decline in profitability because it is regarded as spending. The agency hypothesis, which explains the existence of a conflict of interest between corporate owners and company management, is thus important to this finding. The findings of this study corroborate those of other studies (Octiana et al., 2020), with the sustainability report's findings having little bearing on accounting conservatism.

7. CONCLUSION

This research was conducted with the aim of investigating the effect of financial distress, sustainability reports, sustainability reports on accounting conservatism in manufacturing companies listed on the Indonesia Stock Exchange (IDX). The sample used consisted of 47 companies, with a research period covering 3 years from 2020 to 2022. Based on the results of the t-statistical analysis conducted in this study, it was concluded that there is a significant influence between financial distress and accounting conservatism in manufacturing companies. However, there is no significant effect on sustainability reports and sustainability reports on accounting conservatism.

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