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Accounting Conservatism and Its Determinants: Evidence from Indonesian Industrials

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Abstract

Purpose – *This study aims to obtain empirical evidence on the influence of Cash Flow, Leverage, Firm Size and Managerila Ownership on Accounting Conservatism.*

Design/methodology/approach *– This study uses quantitative research. The sample in this study consist of 16 companies in the industrials sector listed on the Indonesia Stock Exchange from 2019 to 2023. The analysis technique used to test the hypothesis was panel data regression analysis using Eviews 9 software.*

Findings – *The results of this study found that Cash Flow has a positive effect on Accounting Conservatism, as does Leverage. Firm Size has a negative influence on Accounting Conservatism, while Management Ownership has no influence on Accounting Conservatism.*

Research limitations/implications – *This study discusses Accounting Conservatism and other factors such as Cash Flow, Leverage, Firm Size and Managerial Ownership that focus on industrial sector companies. This study uses the Accounting Conservatism (CONACC) model as a measurement of Accounting Conservatism.*

INTRODUCTION

Financial statements are essential for investors and creditors in evaluating company performance. However, some firms manipulate reports by delaying loss recognition or acceleratin revenues, weakening the reliability of financial information. The application of accounting conservatism, which emphasizes prudence, is therefore crucial. The industrials sectors, as a key driver of the national economy, also faces challenges such as fluctuating costs and project delays, making the role of conservatism even more important. Consequently, examining the determinants of accounting conservatism in this sector is necessary to ensure transparency, protect stakeholders and enhance the credibility of financial reporting.

A notable case was the financial reporting manipulation by PT Garuda Indonesia Tbk in 2018, which at that time was classified in the industrials sector. The company reported a net profit of USD 809 thousand, while in reality it suffered a significant loss of over

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USD 114 milion. This wa achieved by prematurely recognizing income highlighted weak implementation of accounting conservatism and raised concerns about the realibity of financial reporting in the industrials sector. Such practices not only mislead investors and creditors but also undermine public trust, demonstrating the importance of stronger adherence to conservative accounting principles in preventing earnings management.

Prior studies on the determinants of accounting conservatism have shown inconsistent results. Some found that *Cash Flow, Leverage, Firm Size* and Managerial Ownership positively affect conservatism (Anton et al., 2022; Chiedu Christian et al., 2022; Efendi & Handayani, 2021; Tumiwa, 2024), while others reported negative or insignificant effects (Arianto, 2021; Rahmania Indayani, 2024; Safitri, 2024; Suhardiyah, 2023). These inconsistencies create a research gap, especially within the industrials sector in Indonesia, which remains underexplored despite its vital role in the national economy and its exposure to gih-profile financial reporting issues. This gap indicates that fuether empirical investigation is required to provide more robust evidence on the determinants of accounting conservatism in this specific sector.

Therefore, this study aims to examine the influence of Cash Flow, Leverage, Firm Size, and Managerial Ownership on Accounting Conservatism in Industrials Sector Companies during 2019-2023. The results are expected to enrich the academic literature and offer practical insight for investors, regulators and company managers in strengthening financial reporting credibility.

LITERATUR REVIEW

Agency Theory

Jensen & Meckling (1976) explain the conflict of interest between principals and agents. In financial reporting, this conflict mcan encourage managers to manipulate reports to show better performance than reality. The application of accounting conservatism serves as a mechanism to reduce agency conflicts by recognizing losses earlier and delaying the recognition of profits (Pramuditya, 2024).

Signaling Theory

Signaling Theory expalind how management sends signals to external parties to reduce information asymmetry (Spence, 1973). In financial reporting, conseravatism can serve as a positive signal to investors and creditors, demonstrating management's prudence. Research by Safitri (2024) shows that companies with storng cash flows or high leverage tend to apply conservatism to signal financial capability and protect the interest of creditors.

Asymmetry Information Theory

Asymmetric Information occurs when managers have more complete information than external parties, creating potential moral hazard and adverse selection problems (Akerlof, 1970; Jensen & Meckling, 1976). In accounting, this imbalance may lead to financial reporting manipulation. Accounting conservatism function as a mitigating mechanism by recognizing losses promptly while recording profits only when realized.

Hypothesis Development

The Effect of Cash Flow on Accounting Conservatism

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https://ejurnal.stietribhakti.ac.id/index.php/JAATB
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Cash flow reflects a company's ability to generate cash from its operating activities. High cash flow indicates financial stability, which encourages management to apply accounting conservatism as a preventive measure. Previous studies by (Djatnicka et al., 2024; Susilawati, 2023; Tumiwa, 2024) found that cash flow has a positive effect on accounting conservatism. Based on the above theoretical and empirical evidence, the researchers proposed the following hypothesis:

H_1 : Cash Flow has a positive effect on accounting conservatism.

The Effect of Leverage on Accounting Conseravtism

Leverage reflects the extent to which a company uses debt to finance its operation. High leverage increases the risk of default, encouraging managers to apply accounting conservatism in order to maintain creditor confidence. Studies by (Anton et al., 2022; Dang & Tran, 2020) support the positive relationship between leverage and accounting conservatism. Therefore, the researchers propose the following hypothesis:

H_2 : Leverage has a positive effect on accounting conservatism.

The Effect of Firm Size on Accounting Conservatism

Firm size affect the complexity of organizational structure and external oversight. Larger companies tend to adopt conservative accounting policies to maintain their reputation and reduce political costs. An empirical sudy by (Efendi & Handayani, 2021) proves that company size positively influences accounting conservatism. Therefore, the researchers propose the following hypothesis:

H_3 : Firm Size has a positive effect on accounting conservatism.

The Effect of Managerial Ownership on Accounting Conservatism

Managerial ownership occurs when managers own shares in the company, so their interests are aligned with those of the owners. High managerial ownership encourages conservatism reporting to protect investors and reduce litigation risk. (Abbas et al., 2022; Chiedu Christian et al., 2022) provide empirical support for this positive effect. Therefore, the researchers propose the following hypothesis:

H_4 : Managerial Ownership has a positive effect on accounting conservatism.

RESEARCH METHOD

This study aims to examine the relationship between independent variabels cash flow, leverage, firm size and managerial ownership and dependent variabels accounting conservatism. The aradigm used is positivism with a deductive quantitative method. This methodology answers question related to how much, how often, how many, when and who (Cooper & Schindler, 2014). The data used is secondary data from the financial statement of industrial sector companies listed on the Indonesia Stock Exchnage (IDX) for the eriod 2019- 2023. The sampling technique used non-probability samling with the purposive sampling method. From a population of 73 industrials sector companies, 16 companies were obtained that met the sample criteria.

Tabel 1. Measuring instruments and sources of variable measurement

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Concept	Variable	Measurement	Sources
Dependent	Accounting Conservatism	$\frac{(Net\ Income + Dep) - CFO}{Total\ Assets} \times (-1)$	(Savitri, 2016)
Independent	Cash Flow	$\frac{Cash\ Flow\ Operations}{Total\ Assets}$	(Safitri, 2024)
	Leverage	$\frac{Total\ Liabilities}{Total\ Assets}$	(Dang & Tran, 2020)
	Firm Size	Log Natural Total Assets	(Edison et al., 2023)
	Managerial Ownership	$\frac{Management\ share\ ownership}{Outstanding\ shares}$	(Pramuditya, 2024)

RESULTS

Table 2. descriptive

	Accounting Conservatism	Cash Flow	Leverage	Firm Size	Managerial Owership
Mean	-0.010230	0.119688	0.363628	13.49913	0.102924
Median	-0.011050	0.107200	0.357450	12.41375	0.024050
Maximum	0.245600	0.322400	0.856500	28.59440	0.600000
Minimun	-0.291300	-0.110900	0.061100	10.91370	0.000000
Std. Dev	0.074020	0.084968	0.169019	4.003756	0.163283
Observations	80	80	80	80	80

Source: Output Eviews 9 (2025)

Selection of the Best Panel Data Model

Chow Test

The citeria for making cow test decisions are ad follows:

1. If the probability (Prob) on Cross Section F < 0.05 then a better model is Fixed Effect.
2. If the probability (Prob) on Cross Section F > 0.05 then a better model is Common Effect.

Table 3. Chow Test

Effect Test	Statistic	d.f	Prob
Cross-section F	8.876.732	(15,60)	0.0000
Cross-Section Ch-Square	93.530210	15	0.0000

Source: Output Eviews 9 (2025)

Based on the results of the Chow Test using Eviews 9, it is stated that the probability value of Cross Section F is 0.00 which is less than the significance level value (α = 0.05). This mean that the best model used is the Fixed Effect Model (FEM). Therefore, the Hausman Test is needed in order to choose the best model between the Fixed Effect Model and the Random Effect Model.

Hausman Test

The criteria for making decisions on the Hausman test are as follows:

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Vol. 4. No.1-September 2025
https://ejurnal.stietribhakti.ac.id/index.php/JAATB
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1. If the Probability (Prob) < 0.05 then a better model is Fixed Effect.
2. If the robability (Prob) > 0.05 then a better model is Random Effect

Table 4. Hausman Test

Test Summary	Chi-Sq. Statistic	Chi.Sq.d.f	Prob
Cross-Section Random	49.853569	4	0.0000

Based on the Hausman test results, the probability value is 0.00, which is smaller than the significance level (α = 0.05). in this case, this means that the best model to use is the Fixed Effect Model (FEM). Therefore, the Langrange Multiplier test is not necessary.

Multiple Regression Analysis

Table 5. Panel Data Regression Analysis

Variable	Coefficient	Std. Error	T-Statistic	Prob
C	2.208418	0.771542	2.862341	0.0058
CF	0.927656	0.073421	12.63476	0.0000
LV	0.096452	0.049653	1.942506	0.0568
FS	-0.175557	0.056991	-3.080435	0.0031
KM	0.049685	0.098032	0.506826	0.6141

The results of panel data regression estimation using the Fixed Effect Model (FEM) show the results of testing with panel data regression, so that from these results, the following model equation id obtained.

$$KA = 22184.20 + 0.917*CF + 0.098*LV - 0.176*FS + 0.054*KM + \varepsilon$$

Coefficient of Determination Test

Table 6. Coefficient of Determination Test

Cross-Section Fixed (Dummy Variable)			
R-squared	0.815046	Mean dependent var	-0.010230
Adjusted R-square	0.756477	S.D. dependent var	0.074020
S.E. of regression	0.036528	Akaike info criterion	-3.569180
Sum square resid	0.080056	Schwarz criterion	-2.973673
Log likelihood	162.7672	Hannan-Quinn criter	-3.330424
F-statistic	13.91606	Durbin-Watson stat	1.804205
Prob (F-statistic)	0.000000		

R-Squared shows a value of 0.815046, which means that 0.815% of the variables cash flow, Leverage, Firm Size, and Managerial Ownerhip can explain the variable of Accounting Conservatism.

Partial Test (T-Test)

Table 7. Partial Test (T-Test)

Variable	Prediksi	Coefficient	T-Statistic	Prob

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C		2.208418	2.862341	0.0058*
CF	+	0.927656	12.63476	0.0000**
LV	+	0.096452	1.942506	0.0568**
FS	+	-0.175557	-3.080435	0.0031**
KM	+	0.049685	0.506826	0.6141**
		R-Squared		0.816245
		Adjusted R-Squared		0..758056
		F-Statistic		14.02749
		Prob (F-Statistic)		0.000000

CF = Cash Flow, LV = Leverage, FS = Firm Size, KM = Managerial Ownership
Source: Output Eviews 9 (2025)

The results of the test using the Fixed Effect Model (FEM) can be summarized as follows:

1. Cash flow with a probability value of 0.000/2 = 0 < 0.05, can be interpreted as meaning that the cash flow variable has a positive and statistically significant effect on accounting conservatism.
2. Leverage with a probability value of 0.0449/2 = 0.022 < 0.05, can be interpreted as meaning that the Leverage variable has a positive and statistically significant effect on accounting conservatism.
3. Firm Size with a probability value of 0.0029/2 = 0.00145 < 0.05, it can be interpreted that the Firm Size variable has a negative and statistically significant effect on accounting conservatism.
4. Managerial Ownership with a probability value of 0.4232/2 = 0.21 > 0.05, it can be interpreted that the Managerial Ownership variable does not have a significant effect on accounting conservatism.

DISCUSSIONS

The Influence of Cash Flow on Accounting Conservatism

Based on partial testing (t test) using the Fixed Effect Model (FEM), the results show a coefficient of 0.9172 with a probability of 0.000. this is because this study uses a one-tailed hypothesis, so the probability value is divided by two (0.000/2 = 0) which is smaller that the significance level at α = 5% (0.05). from the statistical results, it can be concluded that the first hypothesis (H1) is accepted and it can be concluded that the cash flow variable has a positive and statistically significant effect on accounting conservatism. This explains that the higher the cash flow a company has, the higher the likelihood that the company will practice accounting conservatism.

In this case, the application of the principle of Accounting Conseravtism by companies with high cash flow is a form of a signal of caution and integrity of management in presenting financial reorts. Investors will assess that companies with high cash flow that remain conservative in their reporting are transparent, reliable and minimize manipulation, there by reducing information asymmetry and increasing investor confidence in management.

These findings are in line with the findings of Tumiwa., (2024) and Djatnicka et al., (2024), which found a positive association between cash flow and accounting conservatism in manufacturing sectors. Overall, the findings emphasize that higher cash flow not only

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strengthens a firm's financial position but also fosters a reporting culture characterized by prudencde, accuracy anf transparency, thereby minimizing misleading information and reinforcing market confidence.

The Influences of Leverage on Accounting Conservatism

Based on the partial test (t-test) using the Fixed Effects Model (FEM), the results show a coefficient of 0.098 with a probability of 0.0449 this is because this study uses a one-tailed hyphotesis, so the probability value is divided by two (0.0449/ 2 = 0.022), which is smaller than the significance level at α = 5% (0.05). from the statistical results, it can be concluded that the first hypothesis (H_2) is acceted and it can be concluded that the leverage variabel has a ositive and statistically significant effect on accounting conservatism. This explains that thehigher the leverage or debt ratio of a company, the greater the tendency for that company to be conservative in its financial reporting.

The application of accounting conservatism in highly indebted companies aims to reduce conflicts between management and creditors. Based on signaling theory, conservatism reduces information asymmetry and prevents opportunistic behaviour that is detrimental to creditors.

These findings are consistent with those of Anton et al., (2022) in the consumer goods industry and Dang & Tran., (2020) in Vienamese public companies, which found a positive relationship between leverage and accounting conservatism. Overall, these findings emphasize that higher leverage indicates that financial leverage encourages the application of accounting conservatism.

The Influence of Firm Size on Accounting Conservatism

Based on a ppartial test (t-test) using the Fixed Effect Model (FEM), the results show a coefficient of -0.1762 with a probability of 0.0029. this is because thos study uses a one-tailed hypothesis, so the probability values is divided by two (0.0029/2 = 0.00145), which is smaller than the significance level at α = 5% (0.05). from the statistical results, it can be concluded that the first hypothesis (H_3) is rejected, and it can be concluded that the firm size variable has a negative and statistically significant effect on accounting conservatism. This explains that the larger the size of a company, the lower the level of accounting conservatism applied.

In the context of Asymmetry Information Theory, this results can be explained by the fact that large companies face more complex organizational structures with more complicated agency relationship between managers and caital owners. This complexity has the potential to increase management discretion, especially if the internal control system in not optimal.

These findings are consistent with the research conducted by Edison et al., (2023) in healthcare companies and Triyono., (2023) in basic chemical industry companies, which found a negative relationship between firm size and accounting conservatism. Overall, these findings emphasize that larger firms rely solely on reputation and external oversight to maintain trist, resulting in a lower tendency to apply conservatism.

The Influence of Managerial Ownership on Accounting Conservatism

Based on the partial t-test using the Fixed Effect Model (FEM), the results show a

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TRI BHAKTI

coefficient of 0.054186 with a probability value is divided by two (0.4232/2 = 0.21), which is greater than the significance level at α = 5% (0.05). from the statistical results, it can be concluded that the first hypothesis (H_4) is rejected and it can be concluded that the managerial ownership variable is not significantly proven. In other words, in the context of the companies studies, the share ownership held by management is not strong enough to influence conservative policies in financial reporting.

Therefore, although in theory share ownership by management is exected to align the interests ofa gents and principals, in practice this role is ineffective if share ownership is not large enough to foster a sense of responsibility for the company's financial sustainability and stability.

This finding is consistent with research conducted by Damayanty & Masrin, (2022), which found that managerial ownership does not affect accounting conservatism. The propotion of managerial share ownership in the non-financial companies studied in this research is still relatively small. In fact, some companies shares are not independently managed or are majority-owned by external institutions.

CONCLUSIONS

1. Cash flow has a positive and statistically significant effect on accounting conservatism.
2. Leverage has a positive and statistically significant effect on accounting coneravtism.
3. Firm Size has a negative and statistically significant effect on accounting conservatism.
4. Managerial Ownership has no effect and is not statistically significant on accounting conservatism.

SUGGESTION

1. Researchers may consider other variables that could potentially influence accounting conservatism, such as profitability, audit quality, institutional ownership and board
structure.
2. Compare the industrial sector with other sectors such as finance, mining or property to see the consistency of the variables influence on accounting conservatism.
3. Researchers can create moderating variabels such as institutional ownership structure, Cororate Governance (GCG) or profitability to see whether these variables strengthen or weaken the relationship between independent variables and accounting conservatism.
4. It is recommended to use more diverse proxies for conservatism, such as Asymmetric Timeline, The Givolyn-Hayn Conservatism Index.

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