

Financial leverage and ASEAN corporate governance scorecard on accounting conservatism

Diyah Santi Hariyani^{1*}, Afrida Dwi Agustine², Wenni Wahyuandari³, Eni Minarni⁴

^{1,2}Universitas PGRI Madiun, Indonesia

^{3,4}Universitas Tulungagung, Indonesia

Abstract

This study aims to examine the effect of financial leverage and the ASEAN Corporate Governance Scorecard (ACGS) on accounting conservatism. This study uses a quantitative descriptive research approach to test hypotheses. The population includes companies that are on the Kompas 100 stock index. The sampling method used is purposive sampling, which is a company that is in the top rank 50 of the ASEAN Corporate Governance Scorecard for the period 2017-2020. After the data was selected, there were 40 companies selected according to predetermined criteria. The analysis method uses multiple linear regression with SPSS 23. The results of this study show that Financial Leverage has a significant effect on Accounting Conservatism and the ASEAN Corporate Governance Scorecard has a significant effect on Accounting Conservatism. The results of this study are in line with the phenomenon in Indonesia that 40 companies that have been included in the ASEAN Top 50 were awarded the ACGS, this shows that corporate governance in Indonesia is still weak. The results of this study do not support the agency theory and the theory of the firm. The results of this study can be used by the OJK in improving the standards of good corporate governance.

Keywords: ASEAN Corporate Governance Scorecard, Financial Leverage, Accounting Conservatism

Introduction

Good financial reports are used for users to get the right and quality sources of information. Profit is one of the indicators for creditors and investors that is used in evaluating the company's performance. One of the principles of accounting that deals with profits and financial statements is conservatism. Cultivating proper accounting can produce useful and quality information, although companies are faced with obstacles, one of which is conservatism

(Ahmed & Duellman, 2012; Chen et al., 2014; Ruch & Taylor, 2015)

According to the Financial Accounting Standards Board (FASB), conservatism is a careful reciprocity of doubt in an attempt to ensure that inherent doubts and risks are accepted without denial. According to (Beatty et al., 2008; Hong, 2020; Watts, 2003). Conservatism El-Habashy (2019) is a principle that recognizes costs and losses faster, recognizes income and profits more slowly, and values the lowest-value assets and high

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*Corresponding Author:
 Universitas PGRI Madiun, Jawa Timur, Indonesia
 E-mail: diyah.santi@unipma.ac.id

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-value liabilities. If the principle of conservatism is applied, profits and assets will be lighter, but funds and liabilities will be heavier. Because of this, there is a tendency to use conservatism to complicate the justification of opinions but make it easier to determine funds, this has an impact on profits that tend to be less (understatement). On the other hand, if companies tend to apply conservatism to slow cost recognition, it will have more impact on maximum recorded profit (García Lara et al., 2016; Khalilov & Osma, 2020; Savitri, 2016).

In Indonesia, there were cases of failure in the implementation of the principles of accounting conservatism in 2018 implemented by PT Garuda Indonesia Tbk. The beginning of this case was when Garuda Management and PT Mahata Aero Teknologi entered into an association agreement on connection assistance, intermezzo organizers on board, and content management. However, in the 2018 financial report, PT Garuda Indonesia Tbk recorded an opinion from PT Mahata worth US\$ 239.94 million which made PT Garuda Indonesia Tbk not suffer a loss, even though in 2017 it suffered a fairly high loss. Another case related to accounting conservatism also occurred in a company classified as the Kompas 100 Index was PT Kimia Farma in 2001 which marked-up its net profit which was reduced to Rp. 132 billion.

Seeing this case, researchers argue that in every company it is better to apply the principle of accounting conservatism or prudence in acting for decision-making because it will have an impact on the financial details used by the issuer for certain purposes.

Leverage is a ratio that shows how much debt or capital finances the company's assets. Based on agency theory Jensen and Meckling (1976), here is an agency relationship between managers and creditors. Managers who want to get credit will estimate the leverage ratio. The results

of the study show that the larger leverage ratio will tend to encourage companies to regulate profits and present financial statements that tend not to be conservative (Hariyani et al., 2021; N. Y. Putra & Subowo, 2016; Thomas et al., 2020; Viola & Diana, 2016).

The results of the research of Maulana et al., (2021), who said the large leverage ratio indicates that the company's condition is not very good, so managers tend to increase profits so that financial conditions look good by creditors. This shows that the higher the leverage, the less conservative the financial statements will be.

Previous research conducted by Affianti et al. (2017), Habiba (2017), and Sulastri et al. (2018) explained that leverage has a significant effect on accounting conservatism. The higher the leverage on the enterprise, the higher the implementation of accounting conservatism. The results of various studies conducted by Aryani and Muliati (2020), Solichah and Fachrurrozie (2019), Noviantari and Ratnadi (2015) explained that leverage has no effect on accounting conservatism. Due to the low value of leverage on the company allows the debtor to have a lot of knowledge about the application of accounting conservatism. That is, the debtor does not associate the credibility of the company with the high value of the debt.

The implementation of good corporate governance mechanisms is one of the means to supervise the course of company activities, including in supervising the level of management prudence in the presentation of financial statements. Neutralized Corporate Governance can reduce the asymmetry of information that agents use to principals. The application of Corporate Governance can be used to supervise managers to carry out actions in accordance with what is desired by stakeholders (Balagobei, 2018; Basuki & Siregar, 2019; Mulyono et al., 2020;

Rizkiadi & Herawaty, 2020; Triyuwono, 2018). Corporate governance is a good governance principle and mechanism to regulate company management and maintain corporate sustainability in the long term (Almagtome et al., 2020; Balagobei, 2018; Crifo et al., 2019; Puspa et al., 2021).

Corporate Governance as a proxy of the ASEAN CG Scorecard (ACGS) is one of the assessments used by corporate governance. The ASEAN CG Scorecard is defined as a corporate governance standard, approved by the ASEAN Capital Market Forum (ACMF), which is based on OECD principles and builds investor confidence in companies listed on the ASEAN stock exchange.

Sulastri et al. (2018) put forward the results of the hypothesis that the ASEAN CG Scorecard has a bad impact on accounting conservatism, this can be said that if the ACGS score is getting higher so that the lower the accounting conservatism and the issuer feels good and the public perception of the issuer becomes positive, it is the assumption that the issuer no longer attaches importance to the application of the ASEAN CG Scorecard. Based on research by Hajawiyah et al. (2020) , and Ramli and Setiany (2021) explained that corporate governance proxied by the ASEAN Corporate Governance Scorecard affects accounting conservatism. This explains that if the corporate governance assessment score is low, then stakeholders have the right to demand that managers apply accounting conservatism in the preparation of financial statements.

Meanwhile, Sulastri et al. (2018) stated that the ASEAN Corporate Governance Scorecard does not have a significant effect on accounting conservatism because the increase in the ASEAN Corporate Governance Scorecard assessment score means that companies no longer care about accounting conservatism and feel that the company is good. Basuki and Siregar (2019) explained that corporate governance has no significant effect on accounting

conservatism, and Habiba (2017) stated that the size of directors, the type of auditor, and the size of the company did not have a significant effect on accounting conservatism.

The purpose of this study is to prove that the financial leverage of the ASEAN Corporate Governance Scorecard affects accounting conservatism.

The Effect of Financial Leverage on Accounting Conservatism

When the company chooses to increase financing through loans, the company will show good performance to get a loan. Companies will tend to present less conservational or optimistic financial statements by raising the value of income and assets as high as possible, as well as lowering liabilities and expenses. This is one of the company's efforts to convince lenders that the loans provided will be guaranteed. The company's high leverage ratio encourages management to tend to reduce conservatism in preparing financial statements, so leverage affects accounting conservatism (Utama & Titik, 2019).

Research conducted by Lo (2005) and LaFond and Roychowdhury (2008) states that leverage has a positive effect on accounting conservatism. The higher the level of debt, the recognition of profits will be carried out by the management more carefully by slowing down its recognition (conservative). Because the creditor tends to supervise the implementation of the company's operations and accounting.

The results of the research of Noviantari and Ratnadi (2015), Aristiyani and Wirawati (2013) who said the large leverage ratio indicates that the company's condition is not very good, so managers tend to increase profits so that financial conditions look good by creditors. This shows that the higher the leverage, the less conservative the financial statements will be. Research by Afriani et al. (2021) states that leverage results have a very important impact on conservatism. According to

Putra and Sari (2020) also have the same result that leverage has a good impact on accounting conservatism. Based on the results of the elaboration it is hypothesized as follows:

H₁: Financial Leverage has a significant effect on accounting conservatism.

Influence of ASEAN CG Scorecard on Accounting Conservatism

One of the factors that determine the level of conservatism is the commitment of management and internal parties of the company in providing transparent, accurate, and non-misleading information for its investors. This is part of the implementation of good corporate governance (Sulastris et al., 2018). Corporate governance plays an important role in implementing accounting conservatism. Companies with strong corporate governance will show the high application of accounting conservatism. As well as companies that are in the top 50 of the ACGS assessment automatically show a high corporate governance value so that it can be interpreted that companies that enter the top 50 ACGS assessments have a high level of conservatism application. Companies that have a high ACGS score reflect the high implementation or implementation of corporate governance principles, because ACGS itself is the latest corporate governance assessment framework issued by ACMF to rank public corporate governance in the ASEAN region.

The research conducted Sulastris et al. (2018) ASEAN CG Scorecard has no relevant impact on accounting conservatism, this is because the higher the ASEAN CG Scorecard score so that the lower the level of accounting conservatism in the company. However, in the research of Ramli et al. (2021) explained that corporate governance has a very important impact on accounting conservatism. Then in the research of Novitasari (2022) stated that the mechanism proxied by the proportion of audit committees had a positive impact on accounting conservatism. Based on the

results of this description, the second hypothesis can be drawn in this study, namely:

H₂: ASEAN Corporate Governance Scorecard has a significant effect on accounting conservatism

Method

This study uses a quantitative descriptive research approach to test hypotheses. The sample of companies selected is companies that are included in the Kompas 100 Index for 2017-2020. Data selection is carried out using purposive sampling techniques according to predetermined criteria, namely Kompas 100 Company which is included in the top rank 50 of the ASEAN Corporate Governance Scorecard for the 2017-2020 period. After the data tabulation is selected, there are 40 Kompas 100 Index companies selected according to the criteria that have been determined for 4 years so that a total of 160 data will be processed so that a total of 160 data will be processed. And to analyze the data in this study using the Windows SPSS program version 23.

Conservatism with accrual standards is CONACC model Givoly and Hayn (2002) The reason for the use of accrual measures, this is because the study focuses on conservatism's discussion of gains and losses rather than market reactions due to the corresponding level of supply. The concept of accrual accounting is a method of accounting in which income and expenses are recognized or recognized at the time the transaction is made, not at the time when cash is paid or received for the transaction. Givoly and Hayn (2002) divide accrual into two, namely operating accrual and non-operating accrual. In addition to Givoly and Hayn (2002) and Zhang (2008), other researchers also used formulatable CONACC (Afriani et al., 2021; Sari et al., 2020; Viola & Diana, 2016).

$$\text{CONNAC} = \frac{\text{NI} - \text{CFO}}{\text{Total Assets}} \times (-1)$$

Where:

CONNAC : Accounting Conservatism

CFO : Earnings before extraordinary items plus depreciation

Total Assets: Total assets in the current year.

In order to estimate the financial leverage ratio, researchers use DER (Debt Equity Ratio), because as one of the financial ratios used as a benchmark for financial performance, he uses to measure the level of debt use against the number of stakeholders' equity in the company. This ratio is useful for knowing the amount of funds provided by the borrower (Hariyani, 2021), the higher the debt, the greater the company's financial risk. The formula used refers to the research that has been done (Putri, 2021; Sari et al., 2020).

$$\text{DER} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

Results

Based on the predetermined criteria of the Kompas 100 Company which is included in the top rank 50 of the ASEAN Corporate Governance Scorecard for the period 2017-2020. After the data tabulation was selected, there were 40 Kompas 100 Index companies selected according to predetermined criteria. Descriptive statistics of data processing are shown in table 1. Furthermore, classical assumption tests are

carried out including normality tests, multicollinearity tests, heteroskedasticity tests, and autocorrelation tests in table 3,4,5,6 (attachment).

After testing classical and fulfilled assumptions, multiple linear regression analysis was then carried out to examine the effect of financial leverage and the ACGS on accounting conservatism. The results of multiple linear regression testing are shown by the results of regression calculations in table 2.

The Effect of Financial Leverage on Accounting Conservatism

Based on table 2, there are results that explain if the financial leverage variable has a sig value of $0.007 < 0.05$, the variable financial leverage essentially affects accounting conservatism. In this study, leverage had a significant positive effect on accounting. So the first hypothesis in the study was accepted.

The positive influence of leverage variables is related to the higher the leverage owned by the company, the creditor has a greater right to supervise and know the operation and accounting of the company because the creditor has an interest in the security of his funds which is expected to be profitable for him. Creditors will tend to demand managers to apply conservatism in preparing financial statements. So managers are required to report reports. In general, the more obligations a company uses, the greater its financial impact. Long-term debt has a positive effect on accounting conservatism,

Table 1. Descriptive Statistics

| | N | Minimum | Maximum | Mean | Std Deviation |
|-------------------------|-----|---------|---------|--------|---------------|
| Financial leverage | 160 | .02 | 7.19 | .9067 | 1.13318 |
| ACGS | 160 | 0 | 1 | .91 | .283 |
| Accounting conservatism | 160 | .01 | 11.17 | 1.8118 | 2.02428 |
| Valid N (listwise) | 160 | | | | |

Source : SPSS Processed Data

Table 2. Multiple Liniear Regression Tests

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig |
|--------------------|-----------------------------|------------|---------------------------|-------|------|
| | B | Std. Error | Beta | | |
| (Constant) | .745 | .551 | | 1.351 | .178 |
| Financial Leverage | .258 | .140 | .145 | 2.846 | .007 |
| ACGS | .912 | .560 | .128 | 2.630 | .005 |

a. Dependent Variable: Accounting Conservatism

Source : SPSS Processed Data

which can raise awareness of debt that can pose a large interest expense. The greater the debt, the greater the interest obligations carried by the company which can minimize the company's margins, so that there is an increase in accounting conservatism of a company itself to be more careful in conducting debt transactions so as not to result in a decrease in the profit and performance of a company.

Based on the positive accounting theory of Watts and Zimmerman (1986) on the debt or equity hypothesis states that the higher the company's debt ratio, the more likely it is for managers to choose accounting methods that can increase profits. The use of too high debt will also harm the company, therefore company managers are trying to increase the level of confidence of investors and creditors by increasing the company's profit through accounting methods.

This research is supported by the research of Afriani et al. (2021) and Putra and Sari (2020) as well as Sulastris et al. (2018) which revealed that leverage proxied by financial leverage has a significant effect on accounting conservatism. It can be explained that the greater the financial leverage, the higher the application of accounting conservatism in the enterprise. Because if the DER is greater than 1, the entity must bear a high cost of capital, and if the entity's investment does not provide optimal returns, the entity bears an increased risk Agus and Martono (2001)

Meanwhile, the research of Andani and Nurhayati (2021); Noviantari and

Ratnadi (2015) does not support this research, where leverage does not have a significant effect on conservatism. This can cause companies to choose non-conservative in presenting financial statements with accounting methods if the company experiences high losses.

Influence of ASEAN Corporate Governance Scorecard on Accounting Conservatism

Based on table 6 above, there are results that show the ASEAN Corporate Governance Scorecard variable of $0.005 < 0.05$ and calculate as much as 2.630 with a table value of 0.676. Which means a signification value of 0.005 is less than 0.05. Based on these results, it shows that ACGS has a significant effect on accounting conservatism variables.

The positive influence on the ASEAN CG Scorecard shows that the directors of the sample company are influenced by internal parties or directors who have a superior mindset so as to provide a greater gap for managers to implement activities using more dynamic accounting principles. Not only that, the positive influence is suspected that if the company has a low corporate governance score but is included in the top 50 ACGS, the company has not been able to see it well and the general view is that the company is still bad so the company puts forward conservative principles.

The following assumptions relate to the positive influence, namely the annex to the standards used for the assessment of the ASEAN CG Scorecard in Indonesia in

terms of its operations which refers to the principles of corporate governance, namely the shareholder model. The ASEAN Corporate Governance Scorecard is able to overcome agency problems where one way to overcome agency problems is to monitor. The ASEAN Corporate Governance Scorecard functions as a monitoring of management so that supervision of the application of corporate governance scorecard principles in the company is able to reduce information asymmetry. The results of this study are in line with the theory that corporate governance has a role for supervision so that it will give investors confidence that the funds invested are safe (Siringo et al., 2021).

In the study Haloman and Alfionita (2021); Ramli and Setiany (2021) supported this research, where corporate governance as proxied by the ASEAN Corporate Governance Scorecard affects accounting conservatism. This explains that if the corporate governance assessment score is low, then stakeholders have the right to demand that managers apply accounting conservatism in the preparation of financial statements. While Sulastris et al. (2018) does not support this research, due to the increasing assessment score of the ASEAN Corporate Governance Scorecard, companies no longer care about accounting conservatism and feel that the company is good.

Conclusion

Based on the results of data analysis and discussion in this study, it can be concluded that financial leverage has a significant effect on accounting conservatism. It can be said that the higher the level of debt that the company has, the greater the tendency of the company to implement accounting conservatism. This is in line with the research conducted by Guay and Verrecchia (2018); LaFond and Roychowdhury (2008); Utama and Titik (2019) that with the magnitude of the

leverage ratio indicates that the condition of the company is not so good, so managers tend to increase profits so that the financial condition looks good to creditors. Then the higher the leverage, the financial statements generated will be the lower the application of prudence.

The ASEAN Corporate Governance Scorecard affects accounting conservatism. This shows that Kompas 100 companies that are included in the top rank of 50 ASEAN Corporate Governance Scorecard for the 2017-2020 period are 40 companies. This makes evidence that corporate governance in Indonesia is still weak.

The results of this study have not been able to confirm the agency theory and theory of the firm that the role of GCG that is still weak can have an impact on company value which can cause the level of accounting conservatism to be high.

This study has limitations, namely using sample data in 2017-2020 and only in companies that are included in Kompas 100. So the advice for subsequent researchers is to consider the timing of the research and conduct research again based on the company's sector and use other models to measure accounting conservatism, such as measuring the means of the Earning/Stock relationship.

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Attachment

Table 3. Normality Test

One-Sample Kolmogorov-Smirnov Test

| | | Unstandardized Residual |
|----------------------------------|----------------|-------------------------|
| N | | 160 |
| Normal Parameters ^{a,b} | Mean | .0000000 |
| | Std. Deviation | 1.98691059 |
| Most Extreme Differences | Absolute | .136 |
| | Positive | .124 |
| | Negative | -.136 |
| Test Statistic | | .136 |
| Asymp. Sig. (2-tailed) | | .500 ^c |

Table 4. Multicholinerity Tests

| Model | Unstandardized Coefficients | | Standardized Coefficients | | Collinearity Statistics | | |
|--------------|-----------------------------|------|---------------------------|-------|-------------------------|-----------|-------|
| | B | Std. | Beta | t | Sig. | Tolerance | VIF |
| 1 (Constant) | .745 | .551 | | 1.351 | .178 | | |
| Financial | .258 | .140 | .145 | 2.846 | .007 | 1.000 | 1.000 |
| ACGS | .912 | .560 | .128 | 2.630 | .005 | 1.000 | 1.000 |

a. Dependent Variable: Accounting conservatism

Table 5. Heterochedasitivity Tests

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|--------------------|-----------------------------|------------|---------------------------|-------|------|
| | B | Std. Error | Beta | | |
| 1 (Constant) | .676 | .331 | | 2.042 | .043 |
| Financial Leverage | .244 | .084 | .223 | .907 | .104 |
| ACGS | .712 | .336 | .163 | .121 | .136 |

Table 6. Autocorrelation Test

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin- Watson |
|-------|-------------------|----------|-------------------|----------------------------|----------------|
| 1 | .711 ^a | .637 | .624 | 7.99953 | 2.435 |

Predictors (contant), ACGS, Financial Leverage
 Dependent Variable : Accounting Conservatism