

Corporate Governance Mechanism, Political Connection, and Accounting Conservatism: Evidence from Indonesia

Hendy Satria¹, Djoko Suhardjanto², Wahyu Widarjo³, Setianingtyas Honggowati⁴, Kusumaningdiah Retno Setiorini^{5*}

Abstract

This study aims to see the effect of corporate governance mechanisms, political connections, and accounting conservatism in Indonesia, using the moderating variable firm size. The samples used in this study amounted to 137 manufacturing companies for four years from 2019 to 2022, with 548 data. The results of this study indicate that all hypotheses are accepted. The independent commissioner, audit committee, and institutional ownership variables positively affect while political connections and firm size hurt accounting conservatism. Furthermore, the moderating variable's measurement shows that the two equations show that firm size strengthens the relationship between corporate governance mechanisms and strengthens the relationship of political connections to accounting conservatism.

Keywords: *Corporate Governance Mechanism, Political Connection, Accounting Conservatism.*

1. INTRODUCTION

The current rapid business development can trigger competition among business actors. Companies do various ways to defend themselves. Therefore, every company has different policies and regulations as a form of their self-defense. The form of policies, management of company resources, and management performance can be reflected in the company's financial reports (Habbash, M., 2017). Money-related reports can be an apparatus to degree the execution of administration in overseeing the company and appear the company's current and future condition that's getting prevalent or more deplorable. Companies must meet the targets concerning bookkeeping rules and standards agreed with by and large acknowledged guidelines to deliver responsible and useful money related reports for each client. However, to achieve these objectives, an accounting principle is needed to apply to every management in the company. One of the standards in budgetary detailing is the rule of accounting conservatism.

¹ Doctoral Program in Economics Science, Postgraduate School, Universitas Sebelas Maret, Surakarta, Indonesia
Sekolah Tinggi Ilmu Ekonomi (STIE) Pembangunan, Tanjungpinang, Indonesia, Hendysatria91@gmail.com, Orcid ID:
<https://orcid.org/0000-0002-5000-8436>

² Department of Accounting, Faculty of Economics and Business, Sebelas Maret University, Surakarta,
djoko.suhardjanto@yahoo.com, Orcid ID: <https://orcid.org/0000-0002-5027-0311>

³ Department of Accounting, Faculty of Economics and Business, Sebelas Maret University, Surakarta,
widarjo@staff.uns.ac.id, Orcid ID: <https://orcid.org/0000-0001-9872-2797>

⁴ Department of Accounting, Faculty of Economics and Business, Sebelas Maret University, Surakarta,
setianingtyas_27@yahoo.co.id, Orcid ID: <http://orcid.org/0000-0002-9962-6104>

⁵ Doctoral Program in Economics, Faculty of Economics and Business, Sebelas Maret University, Surakarta
Department of Accounting, Faculty of Economics, Universitas Alma Ata, Yogyakarta, k.retno.s@almaata.ac.id, Orcid ID:
<https://orcid.org/0000-0001-8868-0941>

The principle of conservatism is the principle of exclusion or modification in that the principal acts as a limitation on the presentation of relevant and reliable accounting data. The principle of accounting conservatism is still considered a controversial principle among researchers. On the one hand, accounting conservatism is considered a constraint that will affect the quality of financial statements because it is biased because it does not reflect the company's actual conditions. On the other hand, bookkeeping conservatism is valuable for lessening positive thinking within its chief and proprietor. The benefits that are organized reflect the negligible benefit claimed by the company. (R. . Watts, 2003) defines conservatism as the act of management slower to recognize profit or revenue. If this principle is applied, it will cause the profit and income figures to tend to be low while the cost figures tend to be higher. (Basu, 1997) Interpret conservatism as the tendency of accountants to recognize good news as an advantage rather than recognizing bad news as a loss.

The principle of accounting conservatism is controversial because there have been many criticisms that have emerged over applying this principle, but there are also those who support it (Mayangsari, 2002). Those who oppose the principle of conservatism argue that applying accounting conservatism in preparing financial statements will produce financial reports that tend to be biased because they do not reflect the company's actual financial condition. (Kiryanto dan Suprianto, 2006). But on the other hand, those who bolster the rule of conservatism contend that by applying the guideline of bookkeeping conservatism in planning financial reports, it'll be valuable to dodge the intelligent behavior of directors who need to control profit (Fala, 2007).

This guideline is still utilized because the inclination to overstate profit in money-related detailing can be decreased by applying a critical demeanor to balance over the top positive thinking of directors. Also, the profit presented too high is more dangerous than the presentation of low profit because the risk of lawsuits obtained will be greater when presenting financial statements that are much higher than the real thing. (Noviantari & Ratnadi, 2015). Cases that occur in several manufacturing companies show a failure to apply the principle of accounting conservatism in several manufacturing companies. Management is considered to be less careful in presenting financial statements, resulting in overstated earnings. In this case, management is considered to have excessive optimism in recognizing earnings, which causes the value of earnings to be greater than it should be. The cases that have occurred support the thoughts that see the need for the application of accounting conservatism. With the application of accounting conservatism, excessive management optimism can be neutralized, resulting in a more pessimistic or conservative financial report. Accounting conservatism in companies is applied to different degrees. One of the components that significantly decides the level of conservatism in a company's money related detailing is the administration's commitment and the companies inside parties in giving straightforward, exact, and not deceiving data for financial specialists. This can be a portion of the execution of great corporate administration. The execution of corporate governance is carried out by all parties within the company, counting the board of executives responsible for overseeing and administering company execution.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

In overseeing and administering the execution of the company, the free commissioner is entrusted with managing the execution of the executives and supervisors in terms of the reasonableness of obligations and obligations carried out by the company administration with the approaches set by the company and guaranteeing that the chiefs and supervisors have truly worked for the interface of the company in agreement with the methodologies that have been decided. Set. One of these arrangements is related to the conservatism guideline utilized by companies in announcing their monetary condition. Therefore, the

characteristics of the company's independent board of commissioners will affect the level of conservatism that will be used in preparing its financial statements (Ratna Wardhani, 2008)

For the supervision carried out by the board of commissioners to be tighter, the board of commissioners can form committees such as the audit committee, the nomination committee, or the compensation or remuneration committee. (Ratna Wardhani, 2008) expressed that the presence of a review committee inside a company, which is also one of the corporate administration components, plays a vital part in deciding the company approach received. (Abdel-Khalik, 2002). This is related to the duties of the audit committee in providing input to the board of commissioners. The audit committee is the final party that monitors the company's financial reporting process. They will influence the policies adopted by the company, including the level of conservatism policy used. The accounting expertise possessed by the audit committee is considered to provide a greater level of monitoring to management in preparing the company's financial statements (Ratna Wardhani, 2008). The presence of a review committee incorporates a positive impact on conservatism within the monetary articulations, and the background of expertise of the audit committee is also positively related to conservatism. (Ratna Wardhani, 2008).

The influence of political connections on conservatism has attracted a lot of attention from several previous studies, such as the study of the effect of political connections on financial access (Claessens et al., 2008), (Mara Faccio Ronald W. Masulis John J. McConnell, 2007) states that a company is said to have political relations if one of the company executives (CEO, president, vice president, chairman, or secretary) or one of the largest shareholders (at least shareholders who control 10% of the total shares with voting rights) have or are currently serving as a member of parliament, minister, or an individual closely related to a politician or political party.

The firm size variable studied by (Pakpahan 2017) shows a positive influence on accounting conservatism. These results follow the research (Noviantari & Ratnadi, 2015), who found that firm size has a positive and significant effect on accounting conservatism. In contrast to the research conducted (Alfian, Angga, 2013), (Wulandini, 2012), there is no influence between firm size on accounting conservatism. Company size describes the size of a company. According to (R. dan Z. Watts, 1986), based on positive bookkeeping hypothesis, in case a company is categorized as an expansive company, at that point the company will apply preservationist bookkeeping since huge companies have tall political costs so that they gotten to be the consideration of the open and the government. To reduce this attention, the company provides a not excessive profit, and the government does not supervise the company in providing social responsibility to the community.

The components that impact bookkeeping conservatism have been broadly considered by past analysts, among them by (Alfian, Angga, 2013) ; (Brilianti 2013); (Noviantari & Ratnadi, 2015) and (Pakpahan 2017). The previous research above shows that the results of relatively inconsistent variables are more common in company size. This allows for a research gap. Research conducted by (Ramalingegowda, Santhosh, and Yu, 2012) and (Ahmed, A. S., & Duellman, 2007), firm size hurts accounting conservatism. In contrast to research conducted by (Alfian, Angga, 2013) and (Wulandini 2012), there is no influence between firm size on accounting conservatism. Furthermore, the results of research conducted by (Nasr, M. A., & Ntim, 2018) show that independent commissioners have an influence on accounting conservatism. However, research conducted by (Wulandini 2012) shows that independent commissioners have no effect on accounting conservatism. Another factor that is thought to affect is the audit committee. The presence of a review committee inside the company as an underwriter of the decency of the money related explanations displayed by the administration and commendable of being the premise for choice-making (Brilianti, 2013).

Past considers they have appeared that political associations may exist in both created and creating nations, including Indonesia. Indonesia is a country with an emerging market and a history of strong political connections in business (Harymawan et al., 2019). Companies with political connections in Indonesia rely heavily on the benefits of their connections (Raymond Fisman, 2001). Therefore, companies that have political connections will benefit.

This research focuses on Indonesia because research on the effect of corporate governance mechanisms on accounting conservatism is more carried out in developed countries than in developing countries. Specifically, there's a have to move forward productivity and straightforwardness concerning budgetary and non-financial announcing and revelation, which is basic to the capacity to draw in outside coordinate venture (FDI) in Indonesia. The reactive stance on developments in CG law practices and reforms, including CG guidelines, reflects the generally weak legal system in many developing countries. (Khaled Samaha, Dahawy, Hussainey, 2012).

The hypothesis in this study is formulated as follows:

(Michael C.Jensen William H.Meckling, 1976) Agency theory is a theory that arises because of a conflict of interest between principals and agents. Agency theory concerns the contractual relationship between members of the company. This legally binding relationship happens when one or more shareholders or speculators (central) utilize another individual (operator) to supply a benefit and, after that, assign a decision-making specialist. Agency theory in the company identifies parties with various interests to achieve goals in activities within the company (Ahmed, A. S., & Duellman, 2007). Independent commissioners are members of the board who are not affiliated with the board, management, or shareholders. Independent commissioners can act as a counterweight in supervising managers not to take advantage of their positions and monitoring managers not to sacrifice shareholder wealth (Evana, 2020). Research conducted by (Evana 2020) and (Nasr, M. A., & Ntim, 2018) shows that independent commissioners affect accounting conservatism. The hypothesis in this study is formulated as follows: H1: Independent commissioners affect accounting conservatism.

The audit committee has a role in ensuring the fairness of the presentation of financial reporting. With an audit committee consisting of at least three people following Bapepam regulations, the financial reporting process will be properly monitored. This will encourage management to report conservatively (Putri & H, 2016). Research conducted by (Putra et al., 2019) shows that the review committee has an impact on bookkeeping conservatism; the theory in this consider is defined as takes after. The hypothesis in this study is formulated as follows: H2: The audit committee affects accounting conservatism.

The percentage of shares owned by institutions is an understanding of institutional ownership, mentioned by (Ahmed, A. S., & Duellman, 2007). (Ramalingegowda, Santhosh dan Yu, 2012) stated that the higher the institutional ownership, the shareholders would monitor their shares, especially the quality of financial reporting, meaning that institutional ownership positively relates to accounting conservatism. Positive significant research results were also found in the study (Ahmed, A. S., & Duellman, 2007), (Putra et al., 2019). at the same time, research from (Chi, Wuchun, 2007) gets significant negative results. Research (Salehi, M., & Sehat, 2019) obtained insignificant results between the two. The hypothesis in this study is formulated as follows: H3: Institutional ownership affects accounting conservatism.

Companies are said to have political connections when one of the parties to the company is a member and has a relationship with the government (Mara Faccio Ronald W. Masulis John J. McConnell, 2007). He found that politically connected companies did not care about the quality of financial reporting. This means that political connections have a negative relationship with political connections. Research conducted by (Mohammed, N. F., Ahmed, K., & Ji, 2017) gets significant negative results. While research (Sohn, B. and

Zhou, 2017) get the result, there is no relationship between them. Then the hypothesis in this study is formulated as follows: H4: Political connections hurt accounting conservatism.

The size of a company, large or small, by measuring its total assets can be interpreted as an understanding of the company's size. (Ahmed, A. S., & Duellman, 2007) found that the larger the company, the smaller the demand for accounting conservatism because it has small information asymmetry. Research conducted (Ramalingegowda, Santhosh dan Yu, 2012), (Ahmed, A. S., & Duellman, 2007) get significant negative results. Then the hypothesis in this study is formulated as follows: H5: Firm size hurts accounting conservatism.

Research conducted by (Evana 2020), (Nasr, M. A., & Ntim, 2018), (Putra et al., 2019), (Putra et al., 2019) shows that corporate governance mechanisms affect accounting conservatism, and based on the hypothesis and come about of past considers, the speculation in this think about is: H6: Firm Size strengthens the influence of corporate governance mechanisms on accounting conservatism.

Research conducted by (Mohammed, N. F., Ahmed, K., & Ji, 2017) gets a significant negative result. He found that politically connected companies did not care about the quality of financial reporting. And based on the hypothesis and comes about of past investigate, the speculations in this think about are: H7: Firm size strengthens the influence of political connections on accounting conservatism.

3. RESEARCH METHODS

3.1 Sample and Research Model

This ponder took a test of all fabricating companies recorded on the Indonesia Stock Trade (BEI) for the 2019-2022 period; the fabricating companies that got to be the test were:

1. Basic Industry and Chemicals (SIC 3)
2. Miscellaneous Industry Sector (SIC 4)
3. Consumer Goods Sector (SIC 5)

The retrieval sampling technique was purposive sampling. The criteria for companies that will be sampled are :

1. Manufacturing companies recorded on the IDX amid the 2019-2022 period.
2. Companies not removed from the list during the study period.
3. Companies that provide the data required in the annual report.
4. Financial statements were audited and ended on December 31st.

Based on the criteria, the number of sample companies obtained in this study was 137 companies for four years, so that the sample of this study was 548 samples.

3.2 Research Model

This study will use a measure of conservatism, namely by using accrual measures and market value measures.

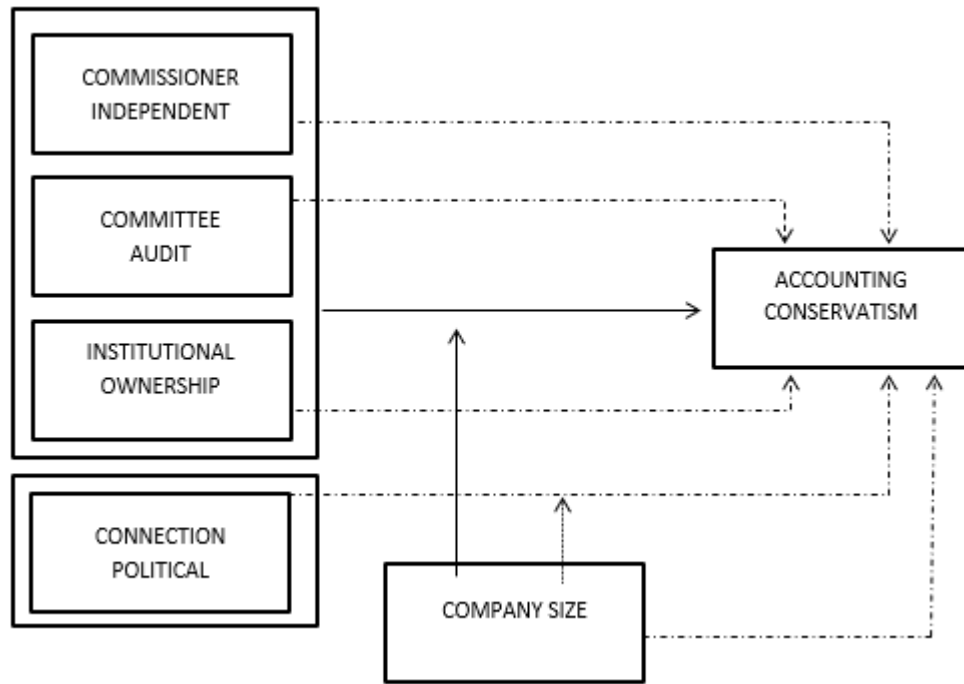


Figure 1. Research Model

A measure of conservatism using accruals, according to (Givoly Dan, 2002). Based on this explanation, the research model formed is conservatism with an accrual measure with the following equation:

Equation I

$$KON_ACC_{i,t} = \beta_0 + \beta_1 INDEP_COM_{i,t} + \beta_2 COMM_AUD_{i,t} + \beta_3 INST_OWN_{i,t} - \beta_4 CONN_POL_{i,t} - \beta_5 SIZE_COM_{i,t} + \epsilon_{i,t}$$

Equation II MRA Mechanisms for Corporate Governance, Conservatism and Company Size

$$KON_ACC_{i,t} = \alpha + \beta_1 INDEP_COM_{i,t} + \beta_2 COMM_AUD_{i,t} + \beta_3 INST_OWN_{i,t} + \beta_4 SIZE_COM_{i,t} + \beta_5 INDEP_COM_{i,t} * COMM_AUD_{i,t} + \beta_6 INDEP_COM_{i,t} * INST_OWN_{i,t} + \beta_7 INDEP_COM_{i,t} * SIZE_COM_{i,t} + \epsilon$$

Equation III MRA Political Connection, Conservatism and Company Size

$$KON_ACC_{i,t} = \alpha + \beta_1 CONN_POL_{i,t} + \beta_2 SIZE_COM_{i,t} + \beta_3 CONN_POL_{i,t} * SIZE_COM_{i,t} + \epsilon$$

$KON_ACC_{i,t}$ = The level of conservatism with the accrual measure of the firm I at time t

$INDEP_COM_{i,t}$ = The proportion of independent commissioners to the total number Commissioners company I at time t

$COMM_AUD_{i,t}$ = \sum number of audit committee

$INST_OWN_{i,t}$ = Percentage of total institutional shareholdings by total shares Outstanding I at time t

$CONN_POL_{i,t}$ = Financial Transaction Reports, and Analysis Center for the year (2019)

$SIZE_COM_{i,t}$ = Natural Log (Total assets)

4. RESULTS AND DISCUSSION

4.1 Normality Test

Table 1 Kolmogorov-Smirnov Test Results for Equation I, II, and III

Constructs	Sig
Equation I	0.200**
Equation II	0.170**
Equation III	0.100**

According to the results of a sample Kolmogorov-Smirnov method shown in Table 1, the apparent significance value is $0.200 > 0.05$. Therefore, both regression models are normally distributed and satisfy the normality assumption

4.2 Multicollinearity Test

Table 2 Multicollinearity Test for Equation I, II, and III

Equation	Constructs	Tolerance	VIP
I	INDEP_COMi,t	.742	1.347
	COMM_AUDi,t	.584	1.712
	INST_OWNI,t	.421	1.347
	CONN_POLi,t	.561	1.513
	SIZE_COMi,t	.482	1.711
II	INDEP_COMi,t	.551	1.816
	COMM_AUDi,t	.571	1.613
	INST_OWNI,t	.419	1.216
	SIZE_COMi,t	.541	1.412
	MOD_Z1	.423	1.811
III	CONN_POLi,t	.441	1.714
	SIZE_COMi,t	.541	1.854
	MOD_Z2	.411	1.706

According to the multicollinearity test results in Tables 2, it can be seen that all the independent variables in Equations 1,2, and 3 have a tolerance > 0.1 and a VIF value < 10 . From these results, it can be concluded that all variables did not have multicollinearity in the study.

4.3 Linearity Test

Table 3 Linearity Test for Equation I, II, III

Constructs	Sig
Equation I	0.011**
Equation II	0.000**
Equation III	0.017**

Based on the linearity test table in table 3, it is known that the sig. $0.000 < 0.05$, so it can be concluded that there is a linearity relationship in the model structure in the equation I, II, and III

4.4 Hypothesis Testing

Table 4 t-test of conservatism

Dependent	Constructs	T	Sig
Conservatism	INDEP_COMi,t	2.253	.031**
	COMM_AUDi,t	3.331	.027**
	INST_OWNI,t	2.319	.012**
	CONN_POLi,t	-1.112	.001**
	SIZE_COMi,t	-1.473	.000**

MOD_Z1	1.977	.000**
MOD_Z2	2.034	.016**

Based on the t-test table in 4, it can be concluded that:

- a. One kind. According to Table 4, the variable commissioner independent value count $2.253 > t\text{-table } 1.960$ and the significant value $0.031 < 0.05$. Therefore, H1 is acknowledged, suggesting that autonomous commissioner y incorporates a positive and coordinated effect on bookkeeping conservatism.
- b. According to Table 4, the committee audit variable's value is t count $3.331 > t\text{-table } 1.960$, and the effective value is $0.027 < 0.05$. This accepts H2, which means that committee audit has a positive and direct impact on accounting conservatism.
- c. According to Table 4, the institutional ownership variable's value is t count $2,319 > t\text{-table } 1.960$, and the effective value is $0.012 < 0.05$. Therefore, H3 is accepted, which means that profitability positively and directly impacts accounting conservatism.
- d. According to Table 4, the connection political variable count $-1.112 > t\text{-table } -1.960$ and the significant value $0.001 < 0.05$. Therefore, H4 is accepted, which means that connection political has a negative and direct impact on accounting conservatism
- e. According to Table 4.4, the company size variable value count $-1.437 > t\text{-table } -1.960$ and the significant value $0.000 < 0.05$. Subsequently, H5 is acknowledged, which implies that company estimate contains a positive and coordinated effect on bookkeeping conservatism
- f. From table 4, it can be seen that the MOD_Z1 number is positive 1,977, it can be concluded that company size strengthens the relationship between corporate governance mechanisms and accounting conservatism.
- g. From table 4, it can be seen that the MOD_Z2 number is positive 2.034, it can be concluded that company size strengthens the relationship between political connections to accounting conservatism.

4.5 Determinant Coefficient Test (R2)

Table 5 R2 Test of Equation I, II, and III

Constructs	R Square	Adjusted R Square
Equation I	0.510	0.487
Equation II	0.661	0.589
Equation III	0.291	0.223

From Table 5 over, the balanced R-squared sum based on the investigation comes about is 0.487. In this manner, the effect of corporate administration instrument on the bookkeeping conservatism is 48,7%. The remaining 51,3% is influenced by other factors not examined, such as use and liquidity. Next, From Table 5 above, the adjusted R-squared amount based on the analysis results is 0.589. Therefore, corporate governance mechanism and company size have a 58,9% impact on bookkeeping conservatism. The remaining 41,1% is influenced by other factors not inspected in this think about, such as company use and obligation approach. And Table 5 over, the R-squared sum based on the investigation comes about is 0.291. Therefore, connection political and company size have a 29,1% impact on accounting conservatism, and the remaining 70,9% is influenced by other factors not inspected in this think about, such as company use, corporate administration, etc

5. CONCLUSION

The results of this study indicate that all hypotheses are accepted, in which the independent commissioner, audit committee, and institutional ownership variables have a

positive effect, while political connections and firm size hurt accounting conservatism. Besides, the directing variable's estimation appears that the two conditions appear that firm estimate fortifies the relationship between corporate administration instruments and fortifies the relationship of political associations to bookkeeping conservatism.

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