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THE MODERATING EFFECT OF FINANCIAL DISTRESS IN THE RELATIONSHIP BETWEEN DEBT COVENANT AND POLITICAL COST TOWARDS ACCOUNTING CONSERVATISM IMPLEMENTATION: AN EMPIRICAL ANALYSIS FROM SOEs IN INDONESIA

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Abstract

This study aims to examine the impact of debt covenants and political costs on the implementation of accounting conservatism, with financial distress as a moderation variable. Debt covenants in this study are proxied by the debt-to-assets ratio and political costs are proxied by capital intensity. In this study, financial distress as a moderating variable was measured using the Altman Z-Score Modified and accounting conservatism using an accrual measure. This study used a purposive sampling technique and resulted in a total sample of 51 companies. In this study, research data were obtained from all state-owned enterprises (SOEs) listed on the Indonesian Stock Exchange for the period 2020–2022. The analysis technique used in this research is multiple linear regression analysis with STATA v13. The findings of this study indicate that debt covenants have a significant negative effect on the implementation of accounting conservatism, while political costs do not affect accounting conservatism. Furthermore, this study proves that financial distress can moderate the effect of debt covenants on accounting conservatism. In contrast, financial distress has not shown its ability to moderate the impact of political costs on accounting conservatism.

Keywords: Accounting Conservatism, Debt Covenant, Political Cost, Financial Distress

Abstrak

Penelitian ini bertujuan untuk menguji pengaruh debt covenant dan biaya politik terhadap penerapan konservatisme akuntansi, dengan financial distress sebagai variabel moderasi. Debt covenant dalam penelitian ini diproksikan dengan debt-to-assets rasio dan biaya politik diproksikan dengan intensitas modal. Dalam penelitian ini financial distress sebagai variabel moderasi diukur menggunakan Altman Z-Score Modified dan konservatisme akuntansi menggunakan ukuran akrual. Penelitian ini menggunakan teknik purposive sampling dan menghasilkan total sampel sebanyak 51 perusahaan. Dalam penelitian ini data penelitian diperoleh dari seluruh Badan Usaha Milik Negara (BUMN) yang terdaftar di Bursa Efek Indonesia periode 2020–2022. Teknik analisis yang digunakan dalam penelitian ini adalah analisis regresi linier berganda dengan STATA v13. Temuan penelitian ini menunjukkan bahwa debt covenant berpengaruh negatif signifikan terhadap penerapan konservatisme akuntansi, sedangkan biaya politik tidak berpengaruh terhadap konservatisme akuntansi. Lebih lanjut penelitian ini membuktikan bahwa financial distress dapat memoderasi pengaruh debt covenant terhadap konservatisme akuntansi. Sebaliknya, kesulitan keuangan belum menunjukkan kemampuannya untuk memoderasi dampak biaya politik terhadap konservatisme akuntansi.

Kata Kunci: Konservatisme Akuntansi, Perjanjian Hutang, Biaya Politik, Kesulitan keuangan

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INTRODUCTION

Financial reports are essential for a company's survival (Wiecandy & Khairunnisa, 2020). After carrying out its business activities, each company will prepare financial reports (Lubis et al., 2022). This aims to assess management performance in managing the company's operational activities (Ibrahimi & Suryaputri, 2022). Therefore, financial reports are a form of disclosing information to all stakeholders in assessing the performance of a company (Sholikhah & Suryani, 2020). According to Meilinda et al. (2022) the presentation of financial reports needs to be adjusted to financial accounting rules and guidelines. This action aims to produce credible and high-quality financial reports.

When preparing financial reports, accounting standards provide flexibility for companies in deciding which accounting principles they want to apply (Sugiyarti & Rina, 2020). So that management can have more freedom to determine the appropriate accounting method according to the economic situation faced (Sulastri & Anna, 2018). However, in reality, management often abuses this flexible policy when preparing financial reports (Kurniawan et al., 2022). Flexibility in choosing accounting methods also has an impact on changes in the values presented in financial reports (Ibrahimi & Suryaputri, 2022). In addition, the economic situation in the future is full of uncertainty, requiring companies to be careful in facing various possibilities that may occur (Meilinda et al., 2022). Therefore, in the end, when preparing the company's financial reports, it must be based on the principle of prudence (Kristina & Yuniarta, 2021).

Hariadi (2023) interprets accounting conservatism as a principle in accounting so that companies can be more careful when presenting financial reports so that they can be held accountable to all interested parties. Meanwhile, according to Ibrahimi & Suryaputri (2022), accounting conservatism is the principle of caution when presenting financial reports, namely by minimizing profit reporting by delaying revenue recognition, then hastening expense recognition and reducing asset values and increasing liability measurements. Therefore, it can be concluded that the accounting principle of conservatism anticipates expenses or losses more than profits (Rivandi & Ariska, 2019).

The application of accounting conservatism in preparing financial reports cannot be ruled out (Zhong & Li, 2017). Reskino & Vemiliyarni (2014) said that management is often too optimistic in recognizing income which causes financial reports to be overstated so that they can be misleading and cause losses to parties who use financial reports. Therefore, implementing accounting conservatism is considered important because it can reduce opportunistic actions carried out by management and reduce information asymmetry (Hajawiyah et al., 2020). Apart from that, accounting conservatism is also able to reduce risks that occur due to management optimism (Sulastri & Anna, 2018). Then confirmed by Hejranijamil et al. (2020) who say that using accounting conservatism will be able to inhibit opportunistic actions carried out by managers so that management performance will be better and of better quality.

In Indonesia itself, there are many cases related to accounting conservatism. Among them is the case that happened to PT Waskita Karya. This case emerged when there was a change in directors at PT Waskita Raya. This started when an

overstate recording of net profit of IDR 5 billion was discovered in PT Waskita Raya's 2008 financial report. This could happen due to manipulation of financial statements where the director previously recognized income from projects next year into current year's income. This manipulation of financial reports allegedly started from 2004 to 2008. Then, there was the case that happened to PT Garuda Indonesia. This started with the 2018 financial report of PT Garuda Indonesia which recorded net income amounting to USD 809.85 thousand, which if converted into rupiah is equivalent to IDR 11.33 billion. This is a problem because in the 2017 financial year, the Indonesian airline company suffered losses of up to USD 216.5 million. This problem became controversial because the commissioners who served at that time, namely Chairil Tanjung and Dony Oksaria, stated that the financial reports provided were not in line with applicable accounting regulations and guidelines. This problem should be minimized by applying conservative principles because in conservative principles income can only be recognized when it is actually realized.

Accounting conservatism itself, in its implementation, can be influenced by a number of various factors, one of which is the Debt Covenant. Harahap (2012) defines a debt covenant as a debt agreement that protects creditors from all managerial actions that are contrary to the interests of creditors. Aprilia (2023) states that debt covenants can reflect the amount of debt owned by the company. The higher the debt in a company, the creditors have more significant authority in monitoring the company's activities and performance (Arthasari & Dwiati, 2022). Because companies will be more vulnerable to violating contractual agreements due to higher debt (Priyono & Suhartini, 2022). Then, in positive accounting theory, it is explained that a company that is likely to violate a debt contract will tend to use accounting methods that aim to increase profits (Watts & Zimmerman, 1990). This has an impact on company financial reporting which tends to be less conservative (Deslatu & Susanto, 2010). Based on this, it can be concluded that when a company has a debt covenant, the financial statements presented are not conservative. Studies conducted by Nuraeni & Tama (2019) and Manulu & Fiana (2023) state that debt covenants have a negative influence on accounting conservatism. Meanwhile, Aurillya et al. (2021) and Dewi & Rahayuningsih (2023) said that no influence was found on debt covenants on accounting conservatism.

Another factor that influences the implementation of accounting conservatism is political costs. Oktomegah (2012) stated that conflicts of interest that occur between companies and the government as an extension of society will cause political costs. When companies earn relatively constant large profits, the government has the authority to increase taxes and demand better public services from companies (Iskandar & Sparta, 2019). Therefore, companies try to minimize taxes by showing low profits through implementing accounting conservatism (Rahayu et al., 2018). In line with this, the political cost hypothesis predicts that companies will minimize the political costs they bear by using accounting methods that can defer the profits generated by the company (Watts & Zimmerman, 1990). Because the high profits generated by companies have an impact on increasing the political costs they bear (Watts, 2003). This is relevant to Wicandy & Khairunnisa (2020) and Novari et al. (2021) whose research states that political costs have a positive influence on the implementation of accounting conservatism. However,

Rahayu et al. (2018) and Sulastiningsih & Husna (2017) state the opposite, where in their research they state that the implementation of accounting conservatism in a company is not influenced by political costs.

The originality of this research is financial distress as a moderating variable. This is because researchers see that financial distress has the ability to moderate the relationship between debt covenants and political costs on accounting conservatism.

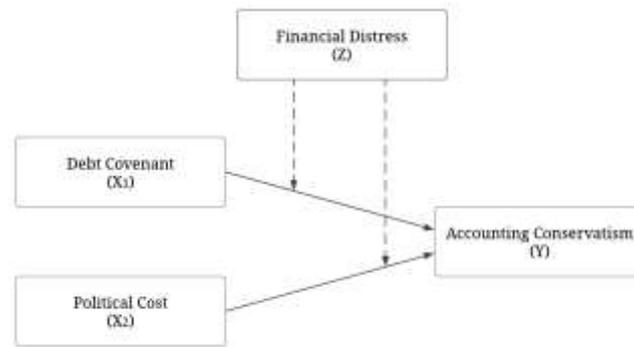


Figure 1. Research Framework

LITERATURE REVIEW

Agency Theory

Jensen & Meckling (1976) said that the contract that occurs between the owner (principal) and management (agent) in a company is called agency theory. The company owner is tasked with providing funds for the company, while management is tasked with managing and making decisions on behalf of the company owner (Lambert, 2006). Bendickson et al. (2016) stated that conflicts of interest are the focus of agency theory. Conflicts of interest that arise between managers and shareholders of a company will trigger opportunistic actions (Kusuma & Mertha, 2021). Dewi & Rahayuningsih (2023) stated that this conflict of interest will motivate managers to carry out earnings management. Managers will increase profits in the company, so managers can increase the compensation they receive through higher bonuses (Jones, 1991). This is, of course done for the manager's own interests at the expense of the interests of investors (Sun & Liu, 2016). Hajawiyah et al. (2020) said that the application of accounting conservatism is considered to be able to overcome the actions taken by management. Because the implementation of accounting conservatism is a form of monitoring and limiting management's opportunistic actions to reduce managers' opportunities to carry out earnings management (Zhong & Li, 2017).

Positive Accounting Theory

Positive accounting theory is a theory that was first coined by Watts & Zimmerman (1986). Demski (1988) stated that the focus of positive accounting theory itself lies in the selection of accounting methods used in a company. This statement is relevant to Priyono & Suhartini (2022) who stated that the center of positive accounting theory lies in the freedom of managers in determining the

accounting principles applied by the company when presenting financial reports by considering future uncertainty. Watts & Zimmerman (1990) stated that there are three hypotheses in positive accounting theory that encourage management to select the accounting method they want to apply, namely :

1. Bonus plan hypothesis which explains that management will strive to increase reported profits so that it will have an impact on increased management performance and managers will receive very high bonuses as a form of appreciation from shareholders.
2. Debt Covenant Hypothesis which explains that when a company has a high probability of violating a debt covenant, the company will use an accounting method that is able to recognize income in the future period into the current period. This aims to make profits large so that they will have an impact on increasing the company's assets and equity.
3. Political cost hypothesis which explains that managers will be encouraged to use accounting methods that are able to defer revenue recognition. This action was taken by management with the aim of reducing the net income obtained so that political costs can be reduced.

Accounting Conservatism

Accounting conservatism is one of the characteristics of financial reports that has been applied for a long time and is an important characteristic of the quality of financial information (Arthasari & Dwiati, 2022). Syahputri & Nawirah (2023) define accounting conservatism as a principle that carefully recognizes and measures company assets and profits due to economic conditions that are always surrounded by uncertainty. By using this principle, the company will recognize losses or costs first because they are likely to occur and postpone income until it can actually be realized (Nazilah & Syaiful, 2023). This principle will prevent overstatement from occurring in company revenues and profits (Efendi & Handayani, 2021). The application of accounting conservatism cannot be ruled out in making financial reports (Zhong & Li, 2017). This is because accounting conservatism is able to avoid excessive optimism on the part of managers and stakeholders (Darmayanti et al., 2022). Gao (2013) also revealed that the financial reports presented will tend to be neutral and avoid management opportunism when companies use accounting conservatism when preparing financial reports. Apart from that, implementing accounting conservatism in financial reporting can mitigate the risk of managers carrying out manipulation (Wardhani & Isnalita, 2019).

Debt Covenant

Positive accounting theory explains that when a company is likely to violate debt agreements, the company is more inclined to use accounting principles that can increase profits (Watts & Zimmerman, 1990). This statement is relevant to Jao & Ho (2019) who stated that if a company is in a state of default, the company will reduce the costs of renegotiating debt contracts by choosing accounting principles that are considered capable of increasing profits. This action is aimed at maintaining the company's reputation in the eyes of creditors so that they continue to believe that the funds they lend to the company remain safe (Manulu & Fiana, 2023). As a result, the financial reports presented will be increasingly far from conservative principles (Deslatu & Susanto, 2010).

Political Cost

Permatasari & Darmayanti (2021) define political costs as costs incurred by companies in response to demands originating from external parties such as the government and labor ties to the company. Boland & Godsell (2020) reveal that political costs will describe the accounting method chosen by a company. This is because the company does not want to accept the costs borne by the government to the company. Because the political costs incurred by the company will increase if the company produces large profits (Scott, 2003). Thus, companies are increasingly encouraged to reduce profits in order to reduce political costs (Attia et al., 2016). This action of reducing profits is one of the practices of accounting conservatism (Wiecandy & Khairunnisa, 2020).

Financial Distress

When a business entity experiences a financial decline before finally being declared bankrupt and liquidated, it can be said that the business entity is experiencing financial distress (Andriani et al., 2023). Financial distress can threaten all companies, both small and large (Meilinda et al., 2022). Financial distress has an impact on the condition of the company which makes the company need additional funds to carry out its operational activities and pay its obligations, so that this makes the company's debt even higher. The financial difficulties experienced by the company will result in a decline in share prices and a reduction in investors (Kristina & Yuniarta, 2021). Thus, companies will be more careful when taking action because financial distress will have a direct effect on the continued existence of a company (Rahayu et al., 2018).

RESEARCH METHODOLOGY

Material and Methods

The population used is all companies classified as non-financial BUMN listed on the Indonesian Stock Exchange (IDX) for the research year 2020 to 2022. The sampling technique used is purposive sampling technique. The total sample obtained in this research was 51 from a total of 3 years of observations. The following are the sampling criteria in this research.

Table 1. Sampling Criteria

Criteria	Total
State owned enterprises companies listed on the Indonesian Stock Exchange (IDX)	21
State owned enterprises companies that are included in the financial sector	(4)
Companies that do not publish annual reports consecutively for 2018 - 2022	0
Companies that do not have complete data	0
Number of samples	17
Research period	3
Total of Sample	51

Table 2. Definition of Variable and Measurement

Variable	Definition	Measurement
Accounting Conservatism (CONNAC)	Accounting conservatism is a precautionary principle implemented by companies when presenting financial reports so as not to hasten recognition of profits and hasten recognition of costs or losses that have a greater chance of occurring. (Watts, 2003)	$CONACC = \frac{(NI + DEP - CFO)}{TA} \times -1$ (Givoly & Hayn, 2000)
Debt Covenant (DC)	An agreement or contract that occurs between creditors and managers as company managers whose role is to protect creditors from all management actions that are contrary to the interests of creditors is called a debt covenant. (Saputra et al., 2016)	$Leverage = \frac{Total\ Debt}{Total\ Assets}$ (Brilianti, 2013)
Political Cost (PC)	Political costs are defined as costs incurred by the company in response to demands originating from external parties such as the government and labor unions. (Permatasari & Darmayanti, 2021)	$Intensitas\ Modal = \frac{Total\ Aset}{Total\ Penjualan}$ (Rivandi & Ariska, 2019)
Financial Distress (FD)	Financial distress is defined as an early indication of bankruptcy in a company due to worsening financial conditions of a company. (Kristina & Yuniarta, 2021)	$Z = 6,56 X_1 + 3,26 X_2 + 6,72 X_3 + 1,05 X_4$ (Syifa et al., 2017)

RESULT AND DISCUSSIONS

Table 3. Descriptive Statistics

Variable	Obs	Mean	Standard Deviation	Minimum	Maximum
CONNAC	51	0.053233	0.070011	-0.04494	0.236659
DC	51	0.661862	0.272667	0.29507	1.849475
PC	51	2.800274	1.981748	0.69328	8.475174
FD	51	1.645504	3.380889	-13.06142	8.122202

CONNAC = Accounting Conservatism, DC = Debt Covenant, PC = Political Cost,
FD = Financial Distress,

The results of the descriptive analysis show that the accounting conservatism variable has a maximum and minimum value of 0.236659 and -0.04494. Then the mean value is 0.053233 with a standard deviation of 0.070011. Then, debt covenant has a mean value of 0.661862 with a maximum and minimum value of 1.849475 and 0.29507 and a standard deviation of 0.272667. Furthermore, the mean value of political cost is 2.800274 with a maximum value of 8.475174 and a minimum value of 0.69328 and 1.981748 for the standard deviation value. Finally, the mean financial distress value is 1.645504 with a standard deviation-ton value of 3.380889 and also the maximum and minimum values, namely 8.122202 and -13.06142

Table 4. Chow Test

Description	Value
Prob > F	0.0000
α	0.05

H_0 : Common Effect Model, H_a : Fixed Effect Model

Based on chow test, it is known that the appropriate model is the Fixed Effect Model (FEM).

Table 5. Lagrange Multiplier Test

Description	Value
Prob > Chibar2	0.0000
α	0.05

H_0 : Common Effect Model, H_a : Random Effect Model

Based on the lagrangian multiplier test, it can be concluded that the appropriate model is the Ran-dom Effect Model (REM).

Table 6. Hausman Test

Description	Value
Prob > Chi2	0.0207
α	0.05

H_0 : Random Effect Model, H_a : Fixed Effect Model

The Hausman test shows that the most appropriate model is the Fixed Effect Model (FEM)

Table 7. Normality Test

Variable	Skewness	Kurtosis
CONNAC	1.22032	4.084099

DC	1.763536	8.459809
PC	1.237998	3.734819
FD	-1.624941	8.79232

Data is normal. This is because the skewness value is < 3 and the kurtosis value is < 10.

Table 8. Multikolinearity Test

Variable	VIF	1/VIF
DC	4.21	0.237640
PC	4.99	0.200203
FD	7.01	0.142696

Based on the table above, it can be seen that this research data is free from multicollinearity problems because the VIF value is < 10. Then the data in this research is affected by heteroscedasticity problems. Therefore, this problem is solved using robustness so that the data is free from heteroscedasticity and autocorrelation problems

Table 9. Multiple Linear Regression

Hipotesis	Regression Model : Fixed Effect Model Robust		
	β	Sig	Result
H1 Debt covenant has significant negative effect on accounting conservatism	-0.1582673	0.011	Accepted
H2 Political cost has significant positive effect on accounting conservatism	0.0059612	0.202	Rejected
H3 Financial distress moderate the effect of debt covenant on accounting conservatism	-0.0218582	0.000	Accepted
H4 Financial distress moderate the effect of political cost on accounting conservatism	-0.0009599	0.398	Rejected

R – Square : 0.8315

Based on the results of the multiple linear regression test in the table above, it can be seen that H1 is accepted because the significance value is <0.05. Then H2 was rejected because the significant value was > 0.05. Furthermore, based on this table it can also be seen that H3 is accepted and H4 is rejected. The table above also informs that the R - Square value is 0.8315, which means that variations in debt covenants, political costs and moderation of financial distress are able to explain accounting conservatism as much as 83.15% while the remaining 16.85% is influenced by other variables.

Debt covenants have significant negative effect on accounting conservatism. This indicates that the higher the debt covenant, which is proxied by the debt to

assets ratio, the lower the implementation of accounting conservatism in a company. When a company has high debt, management will be encouraged to violate the debt contract. Then in positive accounting theory it is explained that a company that is likely to violate a debt contract will tend to use accounting methods that aim to increase profits (Watts & Zimmerman, 1990). This certainly makes the financial reports presented further away from the principle of accounting conservatism. This research is in line with studies conducted by Nuraeni & Tama (2019) and Manulu & Fiana (2023).

Political costs have no significant effect on accounting conservatism. This means that large or small political costs, which are proxied by capital intensity in a company, will not have an impact on accounting conservatism. This is not in line with positive accounting theory which explains that companies will try to reduce the profits generated to minimize the political costs borne by implementing accounting conservatism. This research shows that in implementing a level of accounting conservatism, companies do not really consider capital intensity. This research is in line with the study conducted by Rahayu et al. (2018) and Nuraeni & Tama (2019) who explain that political costs have no effect on accounting conservatism.

Financial distress moderates the effect of debt covenants on accounting conservatism. Positive accounting theory explains that companies that have quite high debt and are likely to violate debt contracts will choose accounting methods that are able to increase profits, which will make the company less conservative in presenting financial reports. The presence of financial distress is proven to moderate and strengthen the influence of debt covenants on accounting conservatism. The application of accounting conservatism in a company will be higher if the company experiences financial distress. This is because financial distress conditions in a company make the company need loan funds so that it will increase the debt borne by the company.

Financial distress cannot moderate the effect of political costs on accounting conservatism. This shows that companies experiencing financial distress will not have an impact on the relationship between political costs and accounting conservatism. The condition of financial distress experienced by the company means that the company will be in a condition where it does not consistently generate profits so that the taxes it bears will decrease. Therefore, the political costs borne by the company also decrease. In conditions of financial distress, companies tend to use accounting principles that are able to increase profits with the aim of protecting their reputation and covering up poor manager performance. This means that financial distress has not been able to moderate the influence of the political cost relationship on accounting conservatism.

CONCLUSION

This research concludes that debt covenants have a significant negative effect on accounting conservatism. Meanwhile, political costs have no influence on accounting conservatism. This is because companies tend not to pay attention to capital intensity when implementing accounting conservatism. Then, financial distress is able to moderate the influence of debt covenants on accounting conservatism. On the other hand, financial distress is unable to moderate the influ-

ence of political costs on accounting conservatism. So, the financial distress conditions experienced by the company enable the company to minimize its tax burden because the company continues to experience losses. This financial distress condition actually makes managers even more motivated to increase profits to cover their poor performance and also maintain their reputation in the eyes of investors.

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