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# The Effects of Capital Intensity, Financial Distress, Leverage, Analyst Coverage and Investment Opportunity Set on Accounting Conservatism in Politically Connected Companies Listed on Indonesia Stock Exchange

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**ABSTRACT:** This study aims to examine the effect of capital intensity, financial distress, leverage, analyst coverage and investment opportunity set on accounting conservatism in politically connected companies listed on the Indonesia Stock Exchange. This research was conducted on 16 state-owned companies (BUMN) listed on the Indonesia Stock Exchange for the 2017-2021 period using a proposive sampling method. This research uses multiple regression method. The results of the study show that partially analyst coverage has a positive effect on accounting conservatism. Financial distress, leverage and investment opportunity sets have a negative effect on accounting conservatism. Capital intensity has no effect on accounting conservatism.

**KEYWORDS:** Capital Intensity, Financial Distress, Leverage, Analyst Coverage and Investment Opportunity Set and Accounting Conservatism.

## I. INTRODUCTION

The principle of conservatism is to recognize expenses and liabilities as soon as possible even though there is uncertainty, but only recognize income and assets when there is absolute certainty that the income and assets will be received (Savitri, 2016). There are two main principles of conservatism, namely: first one must admit that losses may occur, but one must not anticipate gains before they occur. Second, when faced with several choices, accountants are expected to choose the least profitable accounting method for the company (Suharli, 2009 in Dewi & Suryanawa, 2014). In addition, according to Siswanto and Wijaya (2021) implementing conservative decisions can prevent management from being overly optimistic. An overly optimistic attitude can have an impact on the presentation of financial statements and can lead to demands from external parties as a result of poor reporting. There are several points of view criticizing the application of accounting conservatism. The application of accounting conservatism is believed to make financial reports biased and profits are considered too low (Isniawati et al., 2016). This was also stated by Andreas et al. (2017), the application of this principle causes the choice of an accounting method that reports lower profits or assets and reports higher liabilities. This is considered less relevant for assessing the risk of a company. However, due to the emergence of information asymmetry, the application of the conservatism principle can reduce agency costs and managers tend not to manipulate financial reports.

Companies that are politically connected can make it difficult for companies to publicly provide information to outsiders, so companies that are politically connected tend to have opaque financial reports, which allows them to carry out rent-seeking activities (Wati, et,al 2020). Chaney et al. All, (2011) argue that because government bureaucrats protect firms, politically connected firms pay less attention to the quality of accounting information and are less concerned with accurately representing earnings. They also find that managers of politically connected firms have little incentive to respond to market pressures to improve the quality of financial reporting.

Politically connected companies are less conservative and less motivated to report losses in a timely manner, and tend to report large profits because the companies are protected by the government (Joni; Ahmed 2020). Companies with politically connected commissioners and board members are considered to have poorer corporate governance practices and larger agencies, which leads to a lack of implementation of accounting conservatism in their financial reports (Desanti, 2019).

Several phenomena of political relations are scattered in developing and transition countries, and their implications have attracted increased research interest (Sohn and Zhou, 2017). China is one of the largest transition countries, Fan et al. (2008) reported that debt financing of companies connected with corrupt Chinese bureaucrats has significantly decreased than companies that had no relationship with these corrupt bureaucrats after they were arrested. East Asian country Malaysia in particular, it has a welldocumented history of politically connected companies which has been used in many previous studies in the areas of financial reporting, corporate governance, and corporate finance (Muhammad, Ahmed, & Ji, 2017). Taiwan provides an ideal environment for investigating the relationships between family businesses, political relations, and conservative financial reporting. During Taiwan's economic development, many traditional businesses sought government relations through owners and top managers who were involved in public affairs (Claessens et al, 2000; Fan et. al, 2008). In Indonesia, at the beginning of President Joko Wiododo's administration, political connections were also evident, commissioners at state-owned companies were appointed from political parties or volunteers as commissioners of state-owned companies. This shows that political relations are commonplace in the organizational structure of government-owned companies in Indonesia. Quoted from many traditional businesses seek links with government through owners and top managers who are involved in public affairs (Claessens et al, 2000; Fan et. al, 2008). In Indonesia, at the beginning of President Joko Wiododo's administration, political connections were also evident, commissioners at state-owned companies were appointed from political parties or volunteers as commissioners of state-owned companies. This shows that political relations are commonplace in the organizational structure of government-owned companies in Indonesia. Quoted from many traditional businesses seek links with government through owners and top managers who are involved in public affairs (Claessens et al, 2000; Fan et. al, 2008). In Indonesia, at the beginning of President Joko Wiododo's administration, political connections were also evident, commissioners at state-owned companies were appointed from political parties or volunteers as commissioners of state-owned companies. This shows that political relations are commonplace in the organizational structure of government-owned companies in Indonesia. Quoted from This shows that political relations are commonplace in the organizational structure of government-owned companies in Indonesia. Quoted from This shows that political relations are commonplace in the organizational structure of government-owned companies in Indonesia. Quoted from cnnindonesia.com.

Judging from the events that occurred in several companies, the low level of application of accounting conservatism principles has caused major problems in the future. The problem that is often faced by companies is fraud. In the face of business competition, many managements manipulate their financial statements for personal gain or gain. The principle of accounting conservatism has a prudent role in preventing management performance errors in managing company resources that manage financial reports, both internal problems and gaps in the interests of related parties. Watts (2003) states that understatement of net assets is accounting conservatism, said so because conservatism produces quality earnings and helps present financial statements so as to provide profits that are not overstated.

**Table I. Case Data of Politically Connected Companies in Indonesia that Do Not Practice Accounting Conservatism**

| No. | Company name | Year | Experienced case |
|---|---|---|---|
| 1. | PT. Tin Company (Persero) TBK | 2015 | Experiencing a loss of Rp. 59 billion but not disclosed in the financial statements (source: Online News). |
| 2. | PT Garuda Indonesia | 2017-2018 | In 2018 it reported a profit of 809 million rupiah while still losing 216.58 million rupiah in 2017. After tracing 2018, it still lost 244.96 million rupiah (Online news source |
| 3. | PT Tiga Pilar Sejahtera Food Tbk | 2019 | Through political connections, namely working with PT Pertani (Persero), several financial accounts were overstated, namely the value of receivables in the 2017 financial statements of IDR 3 trillion.(CNBC Indonesia, 2019). |
| 4. | PT Asuransi Jiwasraya (Persero) | 2018 | The results of the KAP audit of the 2017 JS financial statements included correcting the overstatement of the interim financial statements, which originally recorded a profit of IDR 2.4 trillion to IDR 428 billion ((www.cnbcindonesia.com) |

**Source:** Processed Data (2022)

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Capital intensity is an indication of the amount of capital a company needs to earn revenue. According to (Ardianto & Rivandi, 2018), companies with large amounts of capital face relatively large political costs, so management tends to be careful and will choose accounting procedures that do not exaggerate profits, so that the financial statements prepared are conservative. Therefore, the resulting financial reports are conservative. However, opinions differ from research (Sinarti & Mutihatunnisa (2015) that capital intensity affects accounting conservatism, the greater the proportion of capital intensity of a company, the less careful the company is in preparing its financial reports, resulting in less conservative financial reports, as is the case with research (Daryatno, Andreas Bambang, et. al, (2020) that capital intensity has no effect on accounting conservatism.

Financial distress can be interpreted as a signal or early symptom of bankruptcy in response to a declining company's financial condition or conditions that occurred before bankruptcy or liquidation. When companies face financial difficulties, managers regulate the level of accounting conservatism (Khoirunnisa, 2021). Financial difficulties due to late payment of debts, failure to pay debts at the end of contract extensions, moratorium on lawsuits or litigation (Kao & Sie 2016). However, when faced with sustainability challenges, politically connected companies may seek financial and non-financial assistance from the government, such as government grants or government-driven restructuring. Therefore,

Accounting conservatism can also be affected by leverage or debt levels. The leverage ratio is "a ratio that describes a company's ability to meet its obligations. The results of research by Quljanah, et al, (2017), Wati and Pirzada, (2020), state that leverage has a significant effect on accounting conservatism. However, when it comes to debt, politically connected companies have many advantages over non-politically related companies. (Sohn and Zhou, 2017).

Another aspect that influences conservatism is analyst coverage. Analyst coverage plays an intermediary role in capital market information because their work includes understanding, obtaining information, and conveying it to other market participants (Sun and Liu, 2011). The analyst's work also helps users of financial statements make informed decisions about the true risk to stock value (Isniawati et al., 2016). Sun and Liu (2011) revealed that analysts can directly or indirectly influence the choice of management accounting policies. The level of accounting conservatism is influenced by analyst coverage; the higher the analyst coverage, the higher accounting conservatism is implemented in the company (Sun and Liu, 2011; and Isniawati et al., 2016).

Investment opportunity set (IOS) is a set of investment decisions in the form of assets owned and future investment options or potential investments (Dwitayanti and Fahlevi, 2015). The financial characteristics of a company are influenced by investment opportunity set (IOS) policies, such as: company capital structure, debt contracts, dividend policies, compensation agreements, and accounting rules (Budiandru, et. al, 2019). The greater the investment opportunity set (IOS), the higher the market to book ratio as a proxy for accounting conservatism (Savitri, 2016). On the other hand, the smaller the investment opportunity set (IOS), the smaller the market to book ratio as a proxy for accounting conservatism.

Based on the formulation of the problem above, the purpose of this study is to examine and analyze the effect of capital intensity, financial distress, leverage, analyst coverage and investment opportunity sets on the implementation of accounting conservatism in companies connected to politics on the Indonesia Stock Exchange.

## II. LITERATURE REVIEW

To explain relationshipscapital intensity, financial distress, leverage, analyst coverage and investment opportunity set on the implementation of accounting conservatism. This study uses two theories, namely agency theory and positive accounting theory. Agency theory as the basis for the relationship between the owner and the manager. In an agency relationship, the owner of the company (principal) employs a manager (agent) with the aim that the manager manages the company for the benefit of shareholders (Jensen and Meckling, 1976). However, these goals sometimes conflict with the ambitions of managers, who tend to prioritize their own interests and those of the organization. When there are differences in interests between the two parties it can cause agency conflicts.According toZimmerman (1986). Positive accounting theory adheres to the concept of maximizing personal wealth and self-interest. This theory explains the nature of managers who are motivated to achieve maximum prosperity for themselves. This theory has also been used to predict poor performance by managers, which can be compensated for by increasing profits.

### *A. Effects of Capital Intensity on Accounting Conservatism*

Based on agency theory, the high intensity of capital in a company means that investors will further increase monitoring of manager performance with incentives, this is done to keep their investments safe from risks that occur in the future. So that company managers will be more conservatism in presenting financial reports and tend to suppress earnings engineering. If the incoming and outgoing cash flows in a company are large, it will indicate the condition that the cash flow statement is overstate, causing it to be less attractive to investors and the company will tend to apply accounting conservatism to make it look stable. Several studies have examined the effect of capital intensity on accounting conservatism.Daljono and Purnama, 2013; Susanto and Ramadhan, 2016; Rivandi and Ariska, 2019).This means that the higher the capital intensity value, the company will choose conservatism in financial reporting. H1: Capital intensity partially has a positive effect on accounting conservatism.

### *B. Effects of Financial Distress on Accounting Conservatism*

Based on the agency theory, companies experiencing financial distress tend to use conservative accounting in their financial reports, which aims to reduce conflicts between investors and creditors. Accounting conservatism is a precautionary principle in financial reports, so that the existence of financial distress encourages companies to be more careful in dealing with uncertain environments. Therefore, the higher the company's financial distress will encourage managers to increase the level of accounting conservatism, and vice versa if the financial distress is low, the manager will reduce the level of accounting conservatism (Priyanto and Suryadari, 2012). This is supported by studies that have been conducted by Sugiarto and Fachrurrozie, 2018; Sulastri and Anna, 2018; Ningsih and Heliana, H2 : Financial distress partially has a positive effect on accounting conservatism.

### *C. Effects of Leverage on Accounting Conservatism*

Based on the perspective of positive accounting theory, a high level of debt can make companies more careful, because high debt can threaten the survival of the company, so creditors have greater rights to know and monitor the company's operational and accounting performance (Pramudita, 2012). Greater rights will reduce the information asymmetry between creditors and company managers. This is because creditors must know how much collateral returns to the company. Creditors also have an interest in the distribution of net assets in the financing of assets granted and lower income to managers and shareholders. Therefore, companies will apply conservative accounting because managers have difficulty hiding information from creditors according to research by Geimechi and Khodabakhshi, 2015). H3: Leverage partially has a positive effect on accounting conservatism.

### *D. Effects of Analyst Coverage on Accounting Conservatism*

Sun and Liu (2011) state that analysts who act as external monitors are careful in separating accurate and inaccurate information because the amount of information produced by accounting such as profits and net assets is timely and informative but not easily verified. Yu (2008) provides evidence that companies with high analyst coverage have a smaller level of earnings management than companies with low analyst coverage. Based on agency theory, high analyst coverage can limit management's opportunistic behavior. Sun and Liu (2011) found that analyst coverage affects the level of accounting conservatism. That is, companies will choose more conservatively when they are followed by many analysts than when they are followed by fewer analysts. The greater the analyst coverage, the higher the conservatism practice applied in a company, meaning that more and more analysts are interested and perform analysis of the company's financial statements, the higher the monitoring of company management so that they will also apply high conservatism so that their performance will be maintained. H4: Analyst coverage has a partial positive effect on accounting conservatism.

### *E. Effects of Investment Opportunity Set on Accounting Conservatism*

Agency theory states that managers and shareholders have different interests, leading to agency conflicts. Conservatism is one of the efforts to reduce agency conflicts that are influenced by investment decisions. Manager variations in defining IOS will influence the role of managers in efforts to overcome agency problems between managers and holders (Savitri, 2016). Not all investment opportunities in the future can be implemented by every company, as a result the expenses experienced by the company will be higher than the value of the lost opportunity. Therefore, companies need the right decisions about something that is uncertain and the risks that will be faced, so that managers will tend to apply conservatism to avoid this uncertainty (Andreas et al., 2017). Based on the results of research conducted by Murwaningsari and Rachmawati (2017), Andreas, Ardeni, and Nugroho (2017) state that IOS has an effect on accounting conservatism. H5: Investment opportunity set partially has a positive effect on accounting conservatism.

## III. RESEARCH METHOD

### *A. Population and Sample*

The population in this study isgovernment-owned companies or State-Owned Enterprises (BUMN) listed on the Indonesia Stock Exchange (go public) in 2017-2021. The sample in this study usespurposive sampling methodmeaning that the population used as the

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research sample is a population that meets certain sample criteria in accordance with the research objectives. The criteria used in selecting the sample are:

1. Companies owned by the government or state-owned companies that are consistently listed on the Indonesia Stock Exchange from 2017 to 2021.
2. Non-financial companies.
3. Companies that publish financial reports during the research year

**Table II. Research Sample Selection Criteria**

| Sample Criteria | Amount |
|---|---|
| 1. Number of companies owned by the government or state-owned companies listed on the Indonesia Stock Exchange in 2017-2021 | 22 |
| 2. Financial companies | (5) |
| 3. Companies that do not issue financial reports during the 2017-2021 period PT. Garuda Indonesia | (1) |
| **Total Sample** | **16** |
| **Year** | **5** |
| **Observation** | **80** |

**Source:** Processed fromwww.idx.co.id

B. ***Measurement of Research Variables***

The variable used in this research is accounting conservatism. According to Watts, (2003), accounting conservatism is a reaction or caution in dealing with uncertainties inherent in companies when compiling financial statements. This measurement uses conv_accrual by dividing net operating income minus cash flow operations by total assets and multiplied by -1.

**Table III. Measurement of Dependent and Independent Variables**

| Variable | Variable Measurement | Scale | Reference |
|---|---|---|---|
| Accounting Conservatism (Y) | $conv_{accrual} = \frac{(NIO - CFO)X(-1)}{Total\ Asset}$ <br>Information : <br>CONACC (Conservatism accrued): Accounting Conservatism <br>NIO (Net Income Operational): net profit in year t <br>CFO (Cash Flow Operational): Cash flow of the company's operational activities in year t <br>TA (Total Assets): The book value of the company's assets in | Ratio | Watts (2003) |
| Capital Intensity (X1) | $IM = \frac{Total\ Aset}{\text{Penjualan}}$ | Ratio | Purnama and Daljono (2013) |
| Financial Distress (X2) | Z' = 0.717X1 + 0.847X2 + 3.107X3 + 0.42X4 + 0.998X5 <br><br>Information: <br>X1 : Current Assets - Current Liabilities / Total Assets <br>X2 : Retained Earnings / Total Assets <br>X3 : Profit Before Interest and Tax / Total Assets | Ratio | Fahmi, (201:158) |

| | | | |
|---|---|---|---|
| | X4 : Market Value of Equity / Total Debt<br>X5 : Sales/ Total Assets | | |
| leverage (X3) | $Laverage = \frac{\text{Total Utang}}{\text{Total Aset}}$ | Ratio | Susanto & Ramadhani, (2016) |
| Coverage Analyst (X4) | 0 = non-LQ45 company<br>1 = Company LQ45 | Nominal | Isnawati, et.al (2108) |
| *Investment opportunity sets* (X5) | $IOS = \frac{NBA\ tetap_t - NBA\ tetap_{t-1}}{Total\ Aset}$<br>Information:<br>NBA: Book Value of Assets | Ratio | Andreas, Ardeni, & Nugroho, (2017) |

**Source:** Processed Data (2022)

## IV. DATA ANALYSIS METHOD

Multiple linear regression analysis is used to determine the effect of two independent variables on the dependent variable shown in the regression equation.

## V. RESULTS

This section describes descriptive statistics, classic assumption tests and hypothesis testing.

### *A. Statistical Descriptive Analysis*

Descriptive statistics of all variables are explained in Table IV below.

**Table IV. Descriptive statistics of all variables**

| Descriptive Statistics | | | | | |
|---|---|---|---|---|---|
| | N | Minimum | Maximum | Means | std. Deviation |
| Accounting Conservatism (Y) | 80 | -,100 | ,348 | .034 | ,0618 |
| Capital Intensity (X1) | 80 | ,693 | 8,876 | 2,342 | 1.605 |
| Financial Distress (X2) | 80 | ,246 | 3,839 | 1,610 | ,849 |
| Leverage (X3) | 80 | ,294 | ,891 | ,607 | , 166 |
| Analyst Coverage (X4) | 80 | 0 | 1 | ,56 | ,499 |
| Investment Opportunity Sets (X5) | 80 | -,129 | ,602 | .031 | .096 |
| Valid N (listwise) | 80 | | | | |

### *B. Classic Assumption Test*

This research uses Kolmogorov-Smirnov to identify whether the assumption of normality is met. Total Sig. is 0.200(2-tailed) which is greater than 0.05, so it can be concluded that the residuals are normally distributed.

The results of the multicollinearity test show that there is no independent variable that has a tolerance value of less than 0.10, which means there is no correlation between the independent variables.

This research uses graphical method seen from the scatterplot graphic to test heteroscedasticity. Based on the scatterplot graph, it shows that the dots spread randomly, do not form a clear pattern, and are spread both above and below the number 0 on the Y axis. This means that there is no heteroscedasticity.

The criteria used to detect the presence or absence of autocorrelation symptoms are based on the Durbin Watson DL (below) and DU (top) tables. Based on the results of processing the regression data, the Durbin Watson value was 2.086. Meanwhile, from the

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DW table with a significance of 0.05 and the number of data (n) = 5, while k = 5 (k is the number of independent variables) the dL value is 1.5070 and the dU is 1.7716 (see Appendix DW). Because the DW value (2.086) is in the region between above the dU value, there is no autocorrelation.

### *C. Regression Testing Results*

The hypothesis in this study was tested using the multiple linear regression method which is generally used to test the effect of two or more independent variables (explanatory) on one dependent variable. The results of the t test, F test, and the coefficient of determination can be seen in Table 5.

**Table V. Multiple Linear Regression Results**

| Variable name | B | Standard Error | tcount | ttable | Sig. |
|---|---|---|---|---|---|
| Constant | 4,504 | 0.180 | 25,089 | 1,993 | 0.000 |
| Capital intensity | -0.255 | 0.649 | -0.393 | 1,993 | 0.696 |
| Financial distress | -1,894 | 0.372 | -5,086 | 1,993 | 0.000 |
| leverage | -4,961 | 1,967 | -2,522 | 1,993 | 0.014 |
| Analyst coverage | 0.964 | 0.421 | 2,289 | 1,993 | 0.031 |
| Investment opportunity sets | -1.107 | 0.406 | -2,728 | 1,993 | 0.008 |
| Correlation Coefficient (R) = 0.908<br>The coefficient of determination (R2) = 0.824<br>Adjusted (R2) = 0.812<br>Fcount = 69.127<br>Ftable = 2.340<br>Sig. F = 0.000 | | | | | |

Based on the regression results shown in table 5,R Square value with a value of 0.812. This value indicates that the contribution of capital intensity, financial distress, leverage, analyst coverage and investment opportunity set is able to explain with a value of 81.2% (0.812 x 100%) accounting conservatism in politically connected companies listed on the Indonesia Stock Exchange. While the rest, namely with a value of 18.8% (100% -81.2%) can be influenced by other variables besides the variables examined in this study. The regression results show an F significance of 0.000 which is significantly strong to conclude that the proposed model is of good quality.

### *D. Coefficient of Determination*

From the output of SPSS 25, it can be seen the degree of relationship between the independent variable and the dependent variable, including:

**Table VI. Results of Determination Test and Simultaneous Test**

| Model | R | R Square | Adjusted R Square | Fcount | Ftable |
|---|---|---|---|---|---|
| 1 | ,908a | ,824 | ,812 | .072 | 2,086 |

### *E. F-Test*

Based on the results of table 5, the value of Fcount is 69.127 with a significance of 0.000, while Ftable at a confidence interval of 95% or $\alpha = 0.05$ is 2.340. By comparing the results of the study between the values of Fcount and Ftable, then Fcount (69.127) > Ftable (2.340). Then this value is included in the criteria for accepting or rejecting the hypothesis. Then Ha1 is accepted, meaning that the influence of capital intensity, financial distress, leverage, analyst coverage and investment opportunity set has a positive effect simultaneously on accounting conservatism.

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### *F. T-Test*

In this study, testing the hypothesis partially using the t-test with a significance level of 5%. The t-test is used to prove hypothesis one (H1) to hypothesis four (H5). The results of the probability comparison (sig.t) with a significant level of 0.05 are used as a basis for decision making. Table 7 shows the t value of each variable processed by SPSS 25.

**Table VII. T test results**

| Variable | tcount | Sig. | Hypothesis |
|---|---|---|---|
| Capital intensity | -0.393 | 0.696 | Not supported |
| Financial distress | -5,086 | 0.000 | supported |
| leverage | -2,522 | 0.014 | supported |
| Analyst coverage | 2,289 | 0.031 | supported |
| Investment opportunity sets | -2,728 | 0.008 | supported |

## VI. RESULT AND DISCUSSION

### *A. Effects of Capital Intensity on Accounting Conservatism*

Based on the results of statistical calculations, it was obtained that the t value of capital intensity on accounting conservatism was -0.393 and a probability value of 0.696 so that the hypothesis was not supported. This means that the size of capital intensity does not affect managers to apply accounting conservatism in presenting their financial statements to politically connected companies because politically connected companies will definitely bear political costs. Thus, the manager's decision to be conservative is not influenced by capital intensity.

Based on Positive Accounting Theory, there are 3 hypotheses, one of which is the political cost hypothesis. Capital intensity is an indicator of the political cost hypothesis because the more companies use assets to generate income in their company's operations, the more capital-intensive the company will represent. If the company is included in the category of capital-intensive companies, high political costs will arise. Therefore, companies will apply conservative financial reports to reduce political costs (Khoirunnisa et al., 2021)

The findings of this study are in line with previous research, namely research from Murwaningsari and Rachmawati (2017), they emphasized that accounting conservatism is not affected by capital intensity. According to Daryatno, et. all, (2020) Capital intensity as a proxy for political costs can occur due to changes in government regulations on companies and is not directly related to the company's funding side, so capital intensity does not affect accounting conservatism applied by companies. This is also in line with the research of Suharni et al. (2019), no relationship was found between capital intensity and accounting conservatism. This means that the increase or increase in income does not always depend on the amount of capital. The capital intensity of a company can be used as an indicator of a company's opportunity to compete in the market. Both high and low capital intensity affect accounting conservatism if high capital intensity does not always drive sales effectively and efficiently.

The level of efficiency in using company assets to generate sales is represented by the company's capital intensity. A company can be determined to be very large by the number of assets used in its operations to generate product sales. The degree of investor responsibility to contribute capital also increases with company size, or is called a high capital company. As a result, capital-intensive companies tend to reduce revenue due to relatively high political costs (Daljono and Purnama, 2013).

### *B. Effects of Financial Distress on Accounting Conservatism*

Based on the results of statistical calculations, it is obtained that the t value of financial distress to accounting conservatism is -5.086 and a probability value of 0.000 so that the second hypothesis is supported. This means that a high level of financial distress will have an impact on reducing the application of accounting conservatism. In other words, financial distress can increase accounting conservatism when financial distress decreases and vice versa if financial distress increases, accounting conservatism can decrease.

Based on Positive Accounting Theory explaining the behavior of managers when a company experiences high financial distress, managers will reduce the use of accounting conservatism principles in the company's financial reports (Noviantari & Ratnadi, 2015). Companies that are indicated to be experiencing financial distress will generate negative assumptions from shareholders towards managers that company managers cannot manage the company properly so that this makes shareholders want to change managers. Because of this pressure, management has encouraged management to change earnings by adjusting the level of accounting conservatism. So that the higher financial distress will make the company's management not apply conservative financial reports

Financial distress is when a company's financial situation worsens and it becomes increasingly difficult to fulfill its obligations. Managers with good management skills can avoid financial problems and bankruptcy when faced with competitive economic conditions and challenges from the uncertain wheels of the economy. If the company faces financial difficulties or financial distress, the company's managers are considered to be underperforming. This will lead to conflicts between managers and shareholders and creditors, so companies that are facing a high level of financial distress will force managers to take action to present financial reports that are less conservative. This action will prevent shareholders from changing managers because the manager's performance will be considered to decrease if the company experiences a significant level of financial distress. Meanwhile, accounting conservatism adheres to the concept of accelerating loss recognition but slowing down revenue recognition so that it will produce low profit figures.

The results of this study are supported by previous research from Aryani and Muliati (2020), Suprihatin (2019) Noviantari and Ratnadi (2015), the results of their research also show that financial distress has a negative effect on accounting conservatism.

### *C. Effects of Leverage on Accounting Conservatism*

Based on the results of statistical calculations, it is obtained that the t value of financial distress on accounting conservatism is equal to-2,522and the probability value of0.014so the third hypothesis is supported. This means that high debt will make the company not conservative. This is because high levels of debt can be a threat to the survival of the company, so that creditors have greater rights to know and monitor the operational implementation and current accounting of the company.

According to agency theory, there is an agency relationship between managers and creditors. In order to secure long-term financing and convince investors that their funds will be guaranteed to return, companies try to show good performance in the eyes of creditors and sources of funding. Therefore, companies report their finances in an optimistic or less conservative way by maximizing the value of assets and income and minimizing liabilities and expenses. This is done to give confidence to lenders and provide loan funds to companies. Excessive use of debt can also harm the company, because the company will be classified as extreme debt or extreme leverage, namely being trapped in high debt and difficult to let go. Therefore, if the firm is extremely leveraged, company managers will try to increase company profits through accounting methods to increase the level of investor and creditor confidence. Therefore, if a company has high leverage, but still applies accounting conservatism, it will reduce creditors' confidence in the results of the financial statements presented because the principle of conservatism will result in low profit figures.

The results of this study are supported by previous research, namely research from Aryani and Muliati (2020) and Putri and Anggraini (2017), they also say that individually leverage has a negative effect on accounting conservatism.

### *D. Effects of Analyst Coverage on Accounting Conservatism*

Based on the results of statistical calculations, it is obtained that the t analyst coverage value for accounting conservatism is2,289and the probability value of0.031so the fourth hypothesis is supported. This means that the more analysts who are interested in and perform an analysis of a company's financial statements, the higher the supervision of the company's management so as to encourage them to apply high conservatism in order to maintain their performance and that of the company.

Based on agency theory, the causes of agency conflicts between managers and shareholders can be reduced by the presence of external parties or often called analyst coverage, which assist investors in supervising decisions made by management. Analyst coverage function is to assist investors in assessing the risk of shares issued by the company through the financial statements published by the company. Management makes decisions that are not detrimental to its interests as shareholders, so there must be outside supervision to monitor management actions, and decisions made by company management. Analysts' comments on a company's performance can inform external parties and can also be taken into consideration in evaluating a company's internal performance. The information released by the company will be analyzed by analysts so that the analysts can provide recommendations to investors based on the results of the assessment. The information provided by this analyst will greatly assist investors in deciding which investment opportunity to pursue by understanding the prospects and risks of the company to be selected. Management's opportunistic behavior (such as inflating profits) will be limited by the presence of analysts in the company. Companies choose to report conservatively when they know they have a large number of analysts following them. The information provided by this analyst will greatly assist investors in deciding which investment opportunity to pursue by understanding the prospects and risks of the company to be selected. Management's opportunistic behavior (such as inflating profits) will be limited by the presence of analysts in the

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The results of this study are supported by previous research, namely research from Young (2017), saying that analyst coverage has an effect on accounting conservatism. Furthermore, the same results from Isnawati et al. (2018), stated that analyst coverage has an effect on accounting conservatism.

***E. Effects of Investment Opportunity Set on Accounting Conservatism***

Based on the results of statistical calculations, it is obtained that the value of t investment opportunity set against accounting conservatism is equal to-2,728and the probability value of0.008so the fourth hypothesis is supported. This means that the higher the value of the investment opportunity set, the lower the accounting conservatism applied by the company.

Investment Opportunity Set (IOS) has a negative correlation with conservatism, because impairment of assets often cannot be recorded in accounting, so that the greater the IOS, the less impairment cannot be absorbed by accounting (Dwitayanti & Fahlevi, 2015). Accounting has traditionally not responded to changes in the value added and intangible assets of a company. Acquisitions and changes in asset values are generally not recorded unless obtained externally and can be verified. Therefore, if an impairment loss occurs for an unrecorded asset, the amount is not recognized. This causes companies to adopt low conservatism, especially when the value of the company is affected by the value of growth and the value of the company's intangible assets.

Based on agency theory, agency conflicts between managers and shareholders can be reduced by managing investment opportunities through investment decisions taken by management. The role of accounting conservatism as an effort to overcome agency problems between managers and shareholders will be influenced by variations in managers' tendency to set investment opportunity sets (IOS) constantly. The existence of an investment opportunity set (IOS) policy will have an impact on the company's financial aspects such as the company's capital structure, debt contracts, dividend policies, compensation contracts and company accounting policies. In free cash flow agency problems, managers want investments to be funded by their own capital rather than debt, which carries the risk of debt default. However, shareholders want to distribute free cash flow in the form of dividends to increase prosperity. Investments made by management are better financed by debt. In addition to supervision from third parties, namely investment financing creditors with debt, it is hoped that managers will work better because there is an obligation to pay off these debts. Debt investment financing is expected to prevent management from being too opportunistic and investing for personal gain, such as image status and bonuses.

The results of this study are supported by previous research, namely research from Lafond and Rouchowdhury (2008), Oktavianti, et. al (2021) which states that the investment opportunity set (IOS) has a negative effect on accounting conservatism.

## VII. CONCLUSION

This study aims to examine the effectcapital intensity, financial distress, leverage, analyst coverage and investment opportunity set on accounting conservatism in politically connected companies listed on the Indonesia Stock Exchange based on agency theory and positive accounting theory. The results of the study show that capital intensity has no effect on accounting conservatism. This means that this study failed to prove that agency theory does not have empirical support. Meanwhile*Financial distress*partially negative effect on accounting conservatism. This proves that positive accounting theory supports the empiricists. Furthermore, the results of Leverage research partially have a negative effect on accounting conservatism. This implies that agency theory is only partially empirically supported. Analyst coverage partially has a positive effect on accounting conservatism and Investment opportunity set partially has a negative effect on conservatism.

The results of this study only partially support the hypothesis that it may be caused by accounting conservatism measurements. This study develops a measurement of accounting conservatism by combining references containing the opinions of academic experts related to disclosing accounting conservatism. It is possible that several factors used to measure accounting conservatism were not carried out by politically connected companies on the Indonesia Stock Exchange. Therefore, future research is needed to examine the measurement of accounting conservatism in accordance with the provisions of politically connected companies on the Indonesia

Stock Exchange. The limitation in this study is that it does not make comparisons between politically connected companies (BUMN) to private companies or the like.

Adjusted R Square is 0.812 which means the ability of the independent variables to explain the dependent variable is 81.2%, while the remaining 18.8% is influenced by other variables outside the model. It can be concluded that there are still many variables outside the model that influence conservatism in the annual reports of politically connected companies on the Indonesia Stock Exchange which are not included in this, so further studies are still needed regarding the influencecapital intensity, financial distress, leverage, analyst coverage and investment opportunity set against accounting conservatismby adding different variables.

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