

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Along with the growth of the increasingly rapid era, it also affects various sectors of life. This is also in line with the current business development which continues to develop, thus triggering intense competition between businesses. To be able to exist and survive in intense competition, every company must do its best to be carried out and displayed to internal and external users, namely displaying financial statements. Financial statements have an important role in the performance of companies. Financial statements are a form of management responsibility for managing a company's performance through years. Financial statements show the company's good or bad performance and act as a guideline for shareholders, both internal and external to the company (Abdurrahman & Ermawati, 2018).

Users will be assisted in making decision by financial reports, which allow them to assess the company's performance and risks. Financial statement of the company is prepared in along with generally accepted accounting standards, provide management a lot of flexibility in deciding on accounting procedures. Managerial behavior in accounting records and reporting of the company transaction will be affected by this flexibility. With flexibility, managers can perform optimistic and conservative financial reporting. Optimistic financial reporting can lead to manipulate which tends to exaggerate is sometimes misleading

and detrimental to users of financial statements and cause declining in its performance (Andreas et al., 2017).

For example, in 2019 it was found out a case of PT Garuda Indonesia (GIAA) where the financial statement of 2018, GIAA recorded an account receivable with contracts valid for the next 15 years of PT Mahata Aero Terknologi as income which valued US\$ 239.94 million or around Rp 3.48 trillion. As a result, the company that previously made a loss then made a profit. After it was found out by Financial Services Authority (OJK), it finally recorded adjustment and resulting loss of US \$ 175 million or equivalent to Rp. 2.53 trillion, where there was a difference of US \$ 180 million from what was stated in the company's financial statements for the 2018 financial year (Sandria, 2021).

Another manipulating financial statement case also occurred in 2019 where the case of PT AISA (PT Tiga Pilar Sejahtera Food Tbk) which has been caught manipulating financial statement in 2017. The former executives of PT AISA (PT Tiga Pilar Sejahtera Food Tbk) has overstated the subsidiary's receivables to AISA in financial statements of 2017. The Financial Services Authority (OJK) investigated the case and found that there was a flow of funds to affiliated companies or privately owned by the AISA executives, namely the company's cash flow worth Rp 1.78 trillion to management through several schemes such as loan disbursement from several banks, disbursement of time deposits, transfer of funds in bank accounts, and financing of affiliated party expenses by AISA Group (Kompasiana.com, 2022). The Financial Services Authority (OJK) also found overstatements in the current assets which are accounts receivable and inventories,

and the fixed assets of the AISA Group. The former executives had overstated funds worth of Rp 4 trillion and then there were even also findings of an alleged overstatement in income of Rp 662 billion and another overstatement of Rp 329 billion in the EBITDA (Earnings Before Interest, Tax, Depreciation, and Amortization) of the issuer's food industries (Kompasiana.com, 2022).

From the cases above, there are some of companies that still do not apply the accounting conservatism. The company's management is not careful when presenting financial statements, causing overstated profits. In this case, the company is considered making markup profit and tends to be overly optimistic in recognizing profits so that the profit value is greater than the actual value. As a result of the size of the precautionary principle applied by management is detrimental to the company itself and other users involved in the company which resulting will reduce the trust of users of financial statements in the company's financial statements. Therefore, accounting conservatism can be a solution for suppressing manager's opportunistic behavior in reporting financial statement.

Accounting conservatism is a pessimistic perspective of accounting where delaying recognition of revenue, accelerating cost recognition, reducing asset value, and increasing debt valuation in the context of profit or loss uncertainty. Accounting conservatism is based on the philosophy of cautious reporting which has been around for a long time (Yuliarti et al, 2017). The revenue recognition of accounting conservatism requires more reliability compared to losses. By applying conservative methods will limit management's ability to take advantage of

opportunities, giving creditors more certainty and resulting in better-quality performance and reduced litigation costs (Hejranijamil et al., 2020).

According to Concept number 2 of FASB (Financial Accounting Standards Board) in Statement, accounting conservatism is a sensitive reporting based on a healthy skepticism creates confidence in the results and in the long term, better reflects all deserve interest. However, the concept of accounting conservatism is still reaping the pros and cons. Accounting conservatism is considered an obstacle to the quality of financial statements, with the principle of accounting conservatism, the financial statements of companies disclosed is considered bias and do not reflect the current state or condition of the company. However, accounting conservatism is also considered useful to avoid opportunistic behavior of managers associated with contracts that use financial statements (Rivandi & Ariska, 2019).

Manufacturing sector will be object in this research. Manufacturing sector has a big market cap. When manufacturing sector is compared to other sectors, manufacturing sector has the second highest market cap on Indonesia Stock Exchange, as shown in the below chart:



Figure 1. 1 Comparison of Industries in the Indonesia Stock Exchange 2019–2021

Source: Prepared by writer (2022)

The chosen object by the writer for this research is because most companies in Indonesia are companies engaged in manufacturing industry which make the manufacturing industry very sensitive to changes in global economic conditions. Based on the assumption that the higher the number of observed objects, the more accurate the results of the result will be. Moreover, according to Hutomo (2021), the manufacturing sector is the biggest contributor of Indonesia's economic growth. This can be proven from Gross Domestic Product (GDP) of Indonesia manufacturing sector of 2019 was 20,79%, 20,61% in 2020, and 20,55% in 2021 (Badan Pusat Statistik, 2021).

The following table shows accounting conservatism of companies by using the accrual model measurement which developed by Givoly and Hayn (2000). Some companies are selected as research samples from the years of 2019 to 2021 represent three sectors of manufacturing companies listed on the Indonesia Stock Exchange in the following table, namely, miscellaneous sector, customer goods sector, and basic industry and chemical sector. The higher value means the more conservatism of the company is applied.

Table 1. 1 Data of Accounting Conservatism by Several Manufacturing Companies 2019 – 2021

Code	Accounting Conservatism Applied		
	2019	2020	2021
PRAS	0,0087	-0,0174	-0,0016
CEKA	0,1538	-0,0223	-0,1788
IGAR	0,0492	-0,0086	-0,0826

Source: Prepared by writer (2022)

The differences in accounting conservatism's data by companies are shown in Table 1.1. Data of the companies are presented above are PT Prima Alloy Steel Universal Tbk (PRAS) which represents miscellaneous industry sector, PT Wilmar

Cahaya Indonesia Tbk (CEKA) which represents the customer goods industry sector, and PT Champion Pacific Indonesia Tbk Tbk (IGAR), which represents the basic and chemical industry sector. It's not only the level to which accounting conservatism is used change between companies, but it also changes between periods in the same company.

The writer uses growth opportunities, financial distress, and debt covenant as the independent variables of this research to determine the factors impacting accounting conservatism. Growth opportunities are opportunities for company to increase the amount of investment. Company with high growth opportunities will have a potential to apply accounting conservatism (Tazkiya & Sulastiningsih, 2020). Financial distress is defined as when a company is unable to earn enough income to satisfy or pay the company's obligation. Financial distress can encourage shareholders to replace company managers because managers are considered unable to manage the company properly (Rahmadani & Sulistyowati, 2019). Lastly, debt covenant is a debt agreement that is based on leverage. Managers will get a large number of assets as a result of the debt covenant which will come from loan funds provided by creditors (Oktavia et al., 2018).

The previous research shows inconsistent result of the impact between three variable and accounting conservatism. Sari (2020) reported a significant impact of growth opportunities toward accounting conservatism, and a significant impact of financial distress toward accounting conservatism. Tazkiya and Sulastiningsih (2020) indicated a significant impact of growth opportunities toward accounting conservatism, and a significant impact of financial distress toward accounting

conservatism. Oktavia et al. (2018) indicate an insignificant impact of debt covenant toward accounting conservatism. Noviani et al (2021) establishes an insignificant impact of growth opportunities toward accounting conservatism, and a significant impact of debt covenant toward accounting conservatism. Putri (2017) indicated an insignificant impact of financial distress toward accounting conservatism. Abdurrahman and Ermawati (2018) stated an insignificant impact of financial distress toward accounting conservatism. Aurillya et al. (2021) stated an insignificant impact of growth opportunities toward accounting conservatism, and an insignificant impact between debt covenant toward accounting conservatism.

Due to the inconsistent results of previous research on this topic, the writer decided to do research of the impact between the three aforementioned variables toward accounting conservatism, using secondary data of manufacturing sector companies' financial statement, title: "The Impact of Growth Opportunities, Financial Distress and Debt Covenant Toward Accounting Conservatism on Manufacturing Company Listed on the Indonesia Stock Exchange)"

1.2 Problem Limitation

Due to the limitation of time and resources, the problem limitations of this research are as follow:

1. This research will focus on three factors affecting accounting conservatism, namely growth opportunities, financial distress, and debt covenant.
2. This research is limited to Indonesian publicly listed manufacturing sector companies.

3. The research period under study is restricted to 2019 to 2021.

1.3 Problem Formulation

In accordance with the study's background, the writer has identified the following problems:

1. Does growth opportunities partially have a significant impact toward accounting conservatism?
2. Does financial distress partially have a significant impact toward accounting conservatism?
3. Does debt covenant partially have a significant impact toward accounting conservatism?
4. Do growth opportunities, financial distress and debt covenant simultaneously have a significant impact toward accounting conservatism?

1.4 Objective of the Research

The objectives of this research are:

1. To determine whether growth opportunities partially have a significant impact toward accounting conservatism
2. To determine whether financial distress partially have a significant impact toward accounting conservatism
3. To determine whether debt covenant partially have a significant impact toward accounting conservatism

4. To determine whether growth opportunities, financial distress and debt covenant simultaneously have a significant impact toward accounting conservatism.

1.5 Benefit of the Research

Through the conducted research, benefit that the writer learn from this research are:

1.5.1 Theoretical Benefit

The writer expected this study can give useful information and expand knowledge in the field of finance, particularly with respect to The Impact of Growth Opportunities, Financial Distress, and Debt Covenant Toward Accounting Conservatism on Manufacturing Companies Listed on the Indonesia Stock Exchange. Furthermore, it is expected that future researchers who are interested in carrying out similar research would review this research as an information source.

1.5.2 Practical Benefit

a. For Writer

The writer can learn how to analyses and organize important information by conducting this research. Aside from that, the writer hopes to be more critical when examining a topic from several perspectives.

b. For Company

This research is expected to assist and inform companies on the value of adopting accounting conservatism to their financial statements.

c. For Investor

This research is expected to be useful and can be used as a consideration for investors and potential investors when making a decision whether to continue investing in companies through financial statements that apply the principles of accounting conservatism.

