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The Effect of Effective Tax Rates, Leverage, Litigation Costs, Company Size, Institutional Ownership, Public Ownership and the Effectiveness of Audit Committees in Accounting Conservatism at Public Companies LQ45

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Abstract

This study aims to analyze the effect of effective tax rates, leverage, litigation costs, company size, institutional ownership, public ownership and the effectiveness of audit committees in accounting conservatism at public companies LQ45. Data is taken from financial statements presented on the Indonesia Stock Exchange in 2013-2018. The sample was obtained by a sample of 24 companies with certain criteria from 45 LQ45 public companies. Panel data processing uses Eviews10 to obtain the fixed effect regression equation, t test (partial) and the sensitivity of the effect on public companies (individuals). The results revealed that accounting conservatism was significantly affected by litigation costs (-), company size (+), public ownership (+) and audit committee effectiveness. Accounting conservatism is not influenced by variables effective tax rate, leverage and institutional ownership. The highest positive sensitive effect was on BBNI and the lowest sensitive was on ADRO while the highest negative sensitive influence was on UNVR and the lowest sensitive was on PGAS. Therefore, this research can improve the quality of corporate financial reporting.

Keywords: Accounting Conservatism, Corporate Financial Reporting, Public Company LQ45

1. Introduction

Accounting conservatism is motivated by the preparation of accrual-based financial statements. Accrual recording contains the possibility that causes income to be recorded even though cash has not been received and expenses are recorded even though cash has not been issued. Uncertainty in the future that causes the emergence of accounting conservatism which can be interpreted simply as an act of caution or pessimism in the recording of financial statements. This caution causes the numbers in the financial statements to be recorded lower or higher than the actual values. Companies that have a large total assets tend to be careful in presenting their financial statements. The risk is related to political costs that must be incurred. Companies are careful about presenting financial statements to avoid political costs such as taxes. The lower the debt to equity ratio, the better because the higher the company's ability to pay its obligations. Debt / equity hypothesis in positive accounting theory states companies with high debt levels will increase profits so that financial statements look good for stakeholders (Watts & Zimmerman, 1990), but creditors and good corporate governance mechanisms will oversee the actions of managers to be careful careful in presenting figures in financial statements. Penman and Zhang (2002) state that the application of accounting conservatism not only affects the company's balance sheet but also impacts

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the figures reported in the income statement. Companies that apply accounting conservatism report lower profits than companies that implement liberal accounting.

In this case, we can take an example of a case of fraud that occurred in the S Chips company which is a Chinese company listed on the Singapore Stock Exchange, including China Hongxing, a polyester fiber producer, Hongwei Technologies and China Gaoxian Fibrefab Holdings Ltd. which have been suspended due to accounting irregularities. In the case of Noble Group, based on Iceberg's research, it was found that there was a gap of $ 603,000,000 in carrying value and market value recorded on the interest rates of subsidiaries in the 2013 and 2014 annual reports. A similar case occurred in Indonesia with the disclosure of the overstated case of PT Kimia Farma's financial statements, due to inflated annual net profit of Rp 32,700,000,000 which was 2.3% of sales and 24.7% of PT Kimia Farma's net income.

Therefore, this study is very closely related to the research of Ahmed et al. (2002), and focused conflict between shareholders and bondholders on dividend policy and the greater the conflict, the more conservative corporate financial reporting.

2. LITERATURE REVIEW

2.1. Accounting Conservatism

Accounting conservatism is an accounting principle that when applied produces profit and asset figures tend to be low, as well as cost and debt figures tend to be high. Although there are no regulations requiring conservative accounting reporting. The manager took the initiative to present financial statements conservatively. In accounting, conservatism is debated because conservatism qualitatively makes accounting information in doubt and earnings quality questionable. Paek et al (2007) revealed that conservatism causes miss-maching where future costs are machined with current income. Costs for this period should be machined with income for the same period. Miss-maching causes an understatement of current period earnings and can lead to overstatement of next period earnings. Opponents of the principle of accounting conservatism assume that the profits generated are not qualified, irrelevant and not useful. Nevertheless accounting conservatism is useful to avoid opportunistic behavior of managers relating to contracts that use financial statements as a contractual medium (Watts, 2003).

2.2. Effective Tax Rates

Indonesian taxation law adopts a self-assessment system, which is regulated in article 12 of the General Taxation Provisions Act. The application of self-assessment in Indonesian taxation law seems to provide an opportunity for taxpayers to reduce the amount of tax to be paid (Brian and Martani, 2014). In addition, Hite and McGill (1992) say "aggressive tax planning is a situation where companies have the authority to carry out tax policies and there is a possibility that these policies will not be audited or disputed from a legal standpoint". Furthermore, the ETR aims to see the tax burden paid in the current year. The ETR approach can illustrate tax avoidance as well as provide a comprehensive picture of changes in tax expense because it represents the current tax burden and deferred tax expense which is referred to as income tax expenses. The formula to calculate the Effective Tax Rate (ETR) from Lanis and Richardson (2014) is Income tax Expenses / Pre-tax Income. Tax avoidance is done by taxpayers to minimize the tax burden owed legally not violating the applicable taxation regulations because it utilizes gaps (grey area) contained in the Tax Law.

2.3. Leverage or Debt Contract

In general, there are two ways to define the meaning of leverage or debt contract related conservatism. First, bondholders can explicitly use conservative accounting. Second, managers can implicitly use conservative accounting consistently to build a reputation for conservative financial reporting. Regarding debt contract renegotiation, debt covenants tend to be guided by accounting

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figures. The debt covenant hypothesis predicts that managers tend to over-declare profits and assets to reduce renegotiation of the costs of debt contracts when companies try to violate their debt contracts. Empirical evidence shows that corporate offenders have more aggressive abnormal accruals and change to more conservative accounting (DeFond and Liambalvo, 1994). Unlike investors, creditors do not have mechanisms to deal with corporate earnings inflation. Instead, creditors are protected by conservative accounting standards. Thus, corporate managers with ex ante risks from debt covenant violations tend to be less conservative.

2.4. Litigation Costs

Watts (2003) state that litigation according to the Capital Market Law encourages conservatism. The reason is because litigation tends to be generated more by excessive statements than statements lower than earnings and net assets. An empirical study of disclosure found the expected costs of litigation to be asymmetric create incentives for managers to reveal bad news as soon as possible (Lev: 1995). This study predicts that company managers with high ex ante expected litigation costs have stronger incentives to implement conservative accounting in reducing expected litigation costs. The risk of lawsuits by creditors and shareholders to managers can encourage the administration of conservative accounting. According to Watts (2003) that what is stated as bad news is in the form of excessive asymmetric statements of net assets which tend to result in higher litigation costs than lower net asset statements. Accounting conservatism by stating lower net assets can reduce litigation risk.

2.5. Company Size

Company size shows the company's capacity based on assets owned. Large companies have a more complex management system and obtain high profits than small companies. The size of the company affects the level of political costs faced so that it will affect the application of conservative accounting (Watts: 2003). Political costs include the costs of transfer of wealth that must be borne by the company related to antitrust actions, regulations, government subsidies, taxes, tariffs, labor demands and so on (Watts and Zimmerman, 1990). Large companies that obtain high operating profits will pay high taxes as well. The government also asked companies to improve public services and social responsibility to the community. Therefore, large companies tend to report lower profits by doing conservative accounting.

2.6. Institutional Ownership

Institutional ownership is shares owned by an institution such as insurance companies, banks, investment companies and other institutional ownership. Institutional ownership structure is the percentage of the number of shares owned by the institutional party of the total number of company shares outstanding. With a high share of ownership, shareholders can strengthen the monitoring function of the board in the company. Institutional ownership is one element of the external mechanism of Good Corporate Governance in controlling management behavior. Institutional ownership has a very important role in minimizing agency conflict between shareholders and management (Cornett,*et.al*, 2006). Institutional ownership has the ability to control management through an effective monitoring process that reduces management's actions in managing earnings. With high institutional ownership, the institutional shareholders can replace or strengthen the monitoring function of the board in the company (Ahmed & Duellman, 2007).

2.7. Public Ownership

Public ownership structure is a percentage of the number of shares owned by the public compared to shares outstanding. Control tends to be low if public ownership spreads with each owner having only a small number of shares. Qiang (2003) explains that companies with public

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ownership are more concentrated, so free riders will be less than small investors, and costs are issued lower to detect fraud. Just like institutional parties, the public tends to want large profits from companies to get dividends or large capital gains. Plus they only concentrate on short-term interests to get a return soon. Thus companies will tend to report earnings that are not conservative if the structure of public ownership is high. In addition, widespread public ownership results in less control of management. With the lack of control over management, causing companies to report profits not carefully.

2.8. The Effectiveness of Audit Committees

The size of the audit committee is explained in the JSE Directors' decision number: KEP-399 / BEJ / 07-2001 (Now OJK). Securities Listing Regulation Number IA Letter C, namely the membership of the audit committee consists of at least three members, one of whom is an independent commissioner of a listed company who is also concurrently the chair of the audit committee, while the other members are independent external parties where at least one of them has the ability in accounting or finance. As a committee formed by the board committee, the audit committee can in essence reduce agency problems by reducing information asymmetry between internal and external parties of the company as well as other parties with an interest in making corporate financial decisions. Thus the audit committee can play a role in equalizing the interests of the principal and agent by encouraging the application of conservatism in the financial statements. With an audit committee in a company, the company's financial reporting process will be monitored properly. Therefore, the existence of this audit committee will encourage the application of higher conservatism in the company's financial reporting process.

3. Methodology

This research uses explationary survey, which is a study that aims to analyze the determinants of accounting conservatism. The data used are secondary data in the form of financial statements and disclosures from LQ45 public companies during the period 2013-2018. Sample selection is determined by using purposive sampling technique, which is a sampling technique based on the principle of reducing the portion of the population that does not meet the criteria.

4. Results and Discussion

Based on the results of the chow test the cross-section probability value is obtained where F <alpha (0.0000 <0.05) so that it is concluded that H0 is rejected and Ha is accepted, the more appropriate model used is Fixed Effect (FEM) for the estimation model of the regression equation. Haussman test results obtained $\chi 2$ count = 15.688691 with p-value (Prob value) = 0.0078 <0.05, significant at α = 5%, meaning that the Ha hypothesis is accepted, so the best model approach is the Fixed Effect Model (FEM). The FEM model regression equation is Y = 0.84 - 0.7ETR + 0.019LV - 0.95LC + 0.105SIZE + 0.036IO + 0.58PO + 1.234EAC

4.1. Sensitivity Analysis of Influences to Accounting Conservatism on LQ45 Public Companies

Companies that are very sensitive positively to changes in accounting conservatism treatment are Bank BNI.Tbk (BBNI), meaning changes in the variable value of Effective Taxes Rate (ETR), Debt Contracts (LV), Litigation Costs (LC), Company Size (SIZE), Ownership Institutional (IO), Public Ownership (PO) and Effectiveness of the Audit Committee (EAC) on Accounting Conservatism in Indonesia are responded very quickly positively compared to other companies as seen from the coefficient of fixed effect of 0.225337. While companies that are not positively sensitive to changes in accounting conservatism treatment are Adaro Tbk (ADRO) companies, meaning changes in the value of the Effective Taxes Rate (ETR) variable, debt contract (LV), Litigation Costs (LC), Company Size (SIZE), Institutional Ownership (IO), Public Ownership (PO)

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and the Effectiveness of the Audit Committee (EAC) on Accounting Conservatism in Indonesia are responded very slowly positively as seen from the fixed effect coefficient of 0.004008.
Companies that are very sensitive negatively to changes in accounting conservatism treatment are Unilever Tbk (UNVR) which means changes in the variable value of Effective Taxes Rate (ETR), Debt Contracts (LV), Litigation Costs (LC), Company Size (SIZE), Institutional Ownership (IO)), Public Ownership (PO) and the Effectiveness of the Audit Committee (EAC) on Accounting Conservatism in Indonesia are responded very rapidly negatively compared to other companies as seen from the fixed effect (cross) coefficient of -0.819595. Whereas companies are not negatively sensitive to changes in accounting. Conservatism is Gas Negara Tbk (PGAS), which means that changes in the value of the Effective Taxes Rate (ETR) variable, Debt Contracts (LV), Litigation Costs (LC), Company Size (SIZE), Institutional Ownership (IO), Public Ownership (PO) and Effectiveness of the Audit Committee (EAC) on Accounting Conservatism in Indonesia.

4.2. Analysis of Factors affecting Accounting Conservatism in Indonesia

Effective Taxes Rate (ETR) has no effect on Accounting Conservatism, this is proven from the Effective Taxes Rate (ETR) regression coefficient of -0.070582, with a t-statistic value of -1.020825 and a probability of 0.3095> 0.05, this proves that the Effective Taxes Rate (ETR) does not significantly influence the treatment of Accounting Conservatism in Indonesia. The ineffectiveness of the Effective Taxes Rate (ETR) on Accounting Conservatism can be seen in several government policies, namely, first, it is not permissible to establish reserves for doubtful accounts except for banks and leasing with option rights and insurance companies. Second, reserve reclamation costs for mining businesses and only use the FIFO method or the weighted average method. Third, it is not permissible to use LIFO to assess inventory, in accordance with the Income Tax Law No. 36 of 2008. The results of this study are supported by Jaya et al. (2013) which shows conservatism has no effect on tax avoidance, but rather the government uses the principle of conservatism to maximize tax revenues and narrowing the space for taxpayers to avoid tax.

Debt Contracts (LV) have no effect on Accounting Conservatism as evidenced from the regression coefficient value of 0.019750, with a t-Statistic value of 1.221740, and a probability of 0.2239 > 0.05 meaning that the Debt Contract (LV) variable does not significantly influence Accounting Conservatism in Indonesia, this can be proven by renegotiating debt contracts, debt covenants tend to be guided by accounting figures. The debt covenant hypothesis predicts that managers tend to over-declare profits and assets to reduce renegotiation of the costs of debt contracts when companies try to violate their debt contracts. The research differs from Ahmed and Duellman (2007), stating that companies that have a lot of debt will choose the application of conservative accounting. Leverage gives insignificant influence on accounting conservatism..

Litigation costs (LC) affect Accounting Conservatism proven regression coefficient of -0.950093, with t-Statistics of -3.034852, and probability of 0.0029 <0.05, meaning that there is a risk of lawsuits by creditors and shareholders to managers to encourage the implementation of conservatism accounting well. The results of this study are supported by the results of the research of Basu (1997), and Holthausen and Watts (2001). which states that there is a significant influence between the risk of litigation on accounting conservatism. Disclosure research has modeled the costs of litigation as an incentive to reveal bad news. Watts (2003) refers to bad news as asymmetric bad news: Excessive statements from net assets tend to result in higher litigation costs than lower statements of net assets.

The size of the company (SIZE) influences Accounting Conservatism, this is evident from the regression coefficient of 0.105412, with a t-statistic value of 5.358292, and the probability of 0.0000 <0.05 means that the variable firm size (SIZE) has a positive and significant effect on Accounting Conservatism, meaning that the company big will be faced with high political costs, so to reduce the political costs, companies use more conservative accounting principles or profit statements that are

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presented not excessive by applying accounting conservatism. Research on the political cost hypothesis has been widely carried out. Among others, Moeinaddin et al (2012), and Hamdan (2011) are some researchers who support the political cost hypothesis. They stated that the larger the size of the company, the manager will apply the principle of accounting conservatism.

Institutional ownership (IO) does not significantly influence Accounting Conservatism in Indonesia, this is evident from the regression coefficient of 0.143199, with a t-statistic value of 0.900002, and a probability of 0.3697> 0.05, because companies that have inactive institutional ownership have a percentage of shares that are small, so that institutional ownership includes minority shareholders whose context tends to not participate in controlling the company and cannot monitor the board of directors in the company (Ahmed & Duellman, 2007). In contrast to Fala's (2008) research, institutional investors have substantial equity investments so that institutional investors are encouraged to monitor the actions and performance of managers more tightly. If institutional investors have large shareholdings, then they have the right to supervise management behavior and performance.

Public Ownership (PO) significantly influence Accounting Conservatism, this is evident from the regression coefficient of 0.580167 <with a t-statistic value of 2.852808, and a probability of 0.0050 <0.05 means that public ownership is high. control over management is more controlled causing companies to report their profits carefully. This was stated by Qiang (2003) stating that companies with more concentrated public ownership, the free rider will be reduced from small investors, and the cost issued more low to detect cheating. This is in accordance with the research of Lafond and Watts (2006) which explains the higher public ownership causes more information to be known by the public so that accounting conservatism is applied in financial reporting.

The effectiveness of the Audit Committee (EAC) significantly influences the Accountancy Conservatism in Indonesia, this is evident from the regression coefficient of 1.234397, with a t-statistic value of 4.224940, and a probability of 0.0000 < 0.05 means that the existence of the audit committee is very effective as evidenced from the dominant regression coefficient of other variables seen from the largest regression coefficient of 1.234397, this is relevant to the field of duties and responsibilities both regarding the application of corporate governance, business ethics, company information reports compliance with laws and other issues, will affect the level of accounting conservatism and the achievement of good corporate governance. The existence of this audit committee will encourage the application of higher conservatism in the company's financial reporting process.

Conclusion

This study concludes that firstly the Company Size, Public Ownership and Effectiveness of the Audit Committee significantly and positively influences Accounting Conservatism in Indonesia. Secondly, the Litigation costs have a significant and negative effect on Accounting Conservatism in Indonesia. And thirdly, Effective Tax Rates, Leverage and Institutional Ownership do not significantly influence Accounting Conservatism in Indonesia

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