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ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS | RESEARCH ARTICLE

The effect of good corporate governance mechanisms on accounting conservatism with leverage as a moderating variable

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Abstract: This study aims to analyze the effect of good corporate governance mechanisms (institutional ownership, managerial ownership, and independent commissioners) on accounting conservatism with leverage as a moderating variable. Manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2014–2016 are the population in this study, which consists of 135 companies. The samples are selected with some criteria which result in 33 firms each year (99 units of analysis). The data are analyzed using moderated regression analysis with a test of absolute difference values using SPSS software. This study shows that institutional ownership and independent commissioners have a significant positive effect on accounting conservatism, while managerial ownership has a significant negative effect on accounting conservatism. Leverage moderates the effect of managerial ownership and independent commissioner on accounting conservatism but do not moderate the effect of institutional ownership on accounting conservatism. This study concludes that good corporate governance mechanisms that have been implemented can affect accounting conservatism practice in the company.

Subjects: Business, Management and Accounting; Accounting; Corporate Governance

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PUBLIC INTEREST STATEMENT

There are a lot of uncertainties in conducting the business. Accounting conservatism is important to be used to deal with these uncertainties in economic and business activities. The principle of accounting conservatism is used to avoid opportunistic management behaviours related to contracts that can minimize agency costs. Nowadays, Good Corporate Governance (GCG) become an important thing in companies' rule of conduct, whether this Good Corporate Governance can affect accounting conservatism practice of companies were questioned in this paper. Further, the existence of debtor interventions through a high level of leverage ratio also tested to know whether it has a moderating effect.

Keywords: Accounting conservatism; good corporate governance; independent commissioner; institutional ownership; managerial ownership; leverage

1. Introduction

Financial statements are used by companies to communicate information to stakeholders. Earnings information that contains the financial performance of the company within a certain period is one of the main concerns in financial reporting (Alhayati, 2013). Reported earnings information should be in accordance with accounting principles. One of the principles used in the financial reporting process is the principle of conservatism. Accounting conservatism is a principle of prudence in which costs and losses are more quickly recognized while revenues and profits are more slowly recognized. So that it affects the numbers in the financial statements (Ruch & Taylor, 2015).

Accounting conservatism is important to be used to deal with uncertainties in economic and business activities. The principle of accounting conservatism is associated with the circumstances that are likely to result in losses. Circumstances that are possible to generate profits are postponed until the situation occurs significantly.

According to Zelmiyanti (2014), accounting conservatism is used to avoid opportunistic management behaviors related to contracts that can minimize agency costs. Accounting conservatism is carried out as an effort to balance management opportunistic actions with the obligation to carry out asymmetric information.

Various studies have been conducted to know the factors affecting accounting conservatism. One of them is the good corporate governance mechanism. According to Wahyudin and Solikhah (2017), corporate governance is a system of rules that is closely related to managers, directors, employees, controllers, and other stakeholders. Previous research on the effect of good corporate governance mechanisms consisting of institutional ownership, managerial ownership, and independent commissioners showed inconsistent results.

Institutional ownership was examined by Wardhani (2008), Xia and Zhu (2009), Ramalingegowda and Yu (2012), Foroghi et al. (2013), and Alkurdi et al. (2017) which shows that institutional ownership has a significant positive effect on accounting conservatism, while Risdiyani and Kusmuriyanto (2015) showed a significant negative effect. Studies by Brilianti (2013), Kootanaee et al. (2013), and Pratanda and Kusmuriyanto, (2014) show that institutional ownership has no effect on accounting conservatism. Managerial ownership researched by Septian and Anna (2014), Pratanda and Kusmuriyanto (2014), Dewi and Suryanawa (2014), and Pambudi (2017) showed the results had a significant positive effect on accounting conservatism. While Lafond and Roychowdhury (2008), Limantauw (2012), and Brilianti (2013) showed the results of a significant negative effect and Risdiyani and Kusmuriyanto (2015) showed the results had no effect on accounting conservatism. Independent commissioners are examined by Foroghi et al. (2013), Pratanda and Kusmuriyanto, (2014), Zelmiyanti (2014) as well as Mohammed et al. (2017) showed the results had a significant positive effect on accounting conservatism and Limantauw (2012) and Risdiyani and Kusmuriyanto (2015) showed that independent commissioners were not proven to affect accounting conservatism.

Previous research that show inconsistent result suggest that there are other variables that influence the relationship between institutional ownership, managerial ownership, and independent commissioners on accounting conservatism. The purpose of this study is to analyze and describe leverage as a moderating variable in the effect of institutional ownership, managerial ownership, and independent commissioners on accounting conservatism.

Originality in this study is leverage as a moderating variable. This is based on previous research that shows leverage has a consistent effect on accounting conservatism. The higher the leverage ratio, the higher the financial risk faced by both the company and creditors. High levels of debt will make companies more careful because high levels of debt can be a threat to the survival of the company. This makes the creditor has the right to observe and monitor activities in the company (Pramudita, 2012). This will encourage companies to apply the principles of accounting conservatism.

2. Literature review and hypothesis development

This research is based on agency theory. Agency theory examines the relationship between the owner and manager of a company. Agency theory states that the separation between the owner and manager of the company causes problems because each party will always optimize their interests. This relationship will trigger the emergence of information asymmetry between the management and the owner known as agency conflict. The conflict can be resolved by the company with a system called the mechanism of good corporate governance.

One mechanism of good corporate governance is institutional ownership. Institutional ownership is the proportion of shares owned by the institution (Khafid, 2012). Institutions can be insurance companies, investment companies, foreign institutions, and ownership of other institutions. Based on agency theory, the presence of institutions as shareholders has a great influence on the company. Agency conflicts that occur between managers and shareholders can be minimized by having a majority shareholding as well as institutional ownership.

More effective supervision will be carried out by institutions when their shares are higher in the company. This will minimize management's opportunistic actions. The institution is trying to press the manager to implement conservative accounting so that the capital they invest in the company is maintained and has a high quality of return. In general, the institutions give up their capital management in a special section by appointing skilled experts in the fields of analysts. This was done so that they could monitor the capital they invested. The above description is strengthened by the results of the study of Wardhani (2008), Xia and Zhu (2009), Ramalingegowda and Yu (2012), Foroghi et al. (2013) and Alkurdi et al. (2017) which shows institutional ownership has a significant positive effect on accounting conservatism. Based on the description above it can be understood that increasing institutional ownership in companies will increase the application of accounting conservatism.

H1: Institutional ownership has a significant positive effect on accounting conservatism

Another Good Corporate Governance mechanism is managerial ownership. Managerial ownership is the proportion of shares owned by management and company directors (Khafid, 2012). Agency theory suggests that management with a high shareholding in a company will reduce agency conflict. This is because management with high share ownership will have a stronger motivation in raising the value of the company's shares.

Management with high share ownership will try to use the principle of accounting conservatism. This happens because the company is not merely oriented to have high profits but is more concerned with the sustainability of the company. High managerial ownership makes management more involved in the company's activities so that the company's future is more concerned and not just focused on getting bonuses. The above description is strengthened by the research of Septian and Anna (2014), Pratanda and Kusmuriyanto (2014), Dewi and Suryanawa (2014), and Pambudi (2017) which show managerial ownership has a significant positive effect on accounting conservatism. Based on the description above it can be understood that increasing managerial ownership in companies will increase the application of accounting conservatism.

H2: Managerial ownership has a significant positive effect on accounting conservatism

Another mechanism of Good Corporate Governance is the existence of independent commissioner on its board of commissioners. Independent commissioners are parties who do not have any relationship in the field of business or kinship with the company (Wardhani, 2008). Agency theory states that the agency conflict could appear because of information asymmetry. The conflict can be overcome by increasing the proportion of independent commissioners in the company.

The existence of an independent commissioner can provide better quality assurance for monitoring to shareholders. This is because the independent commissioner demands the existence of accurate and verifiable financial statements. Independent commissioners strive to make stricter observations on the company's operational activities. These observations are carried out so that the information generated in the financial statements can be presented accurately and transparently. Independent commissioners will encourage company management to act conservatively to face economic uncertainty by not putting excessive optimism on profits generated by the company. The above description is strengthened by the study of Foroghi et al. (2013), Pratanda and Kusmuriyanto (2014), Yunos et al. (2014) as well as Mohammed et al. (2017) which states that independent commissioners have a significant positive effect on accounting conservatism. Based on the description above it can be understood that the increase in independent commissioners in companies will increase the application of accounting conservatism.

H3: Independent commissioners have a significant positive effect on accounting conservatism

Previous research on the relationship of good corporate governance mechanisms to accounting conservatism shows inconsistent results. This is allegedly due to other factors that influence the relationship between the two. Agency theory explains that company owners will monitor company managers. If the monitoring costs are high, the company owner will appoint a third party in this case the creditor to help carry out the monitoring.

The existence of additional monitoring activity by a third party (creditor) can be shown by the level of debt compared with the total asset of the company, which is called leverage ratio. The higher the leverage ratio, the higher the financial risk faced by both the company and creditors. High levels of debt will make companies more careful because high levels of debt can be a threat to the company's survival. This makes the creditor has the right to observe and monitor activities in the company (Pramudita, 2012). The existence of supervision conducted by creditors will encourage supervision which is also carried out by institutions in the company's operational activities. The supervision makes the company try to run the principle of accounting conservatism because it has difficulty in hiding information both from shareholders and creditors. Based on the description above, it can be understood that leverage can moderate the effect of institutional ownership on the application of accounting conservatism.

H4: Leverage moderates the effect of institutional ownership on accounting conservatism

Previous research on the relationship of good corporate governance mechanisms to accounting conservatism shows inconsistent results. This is allegedly due to other factors that influence the relationship between the two. Agency theory states that the existence of high debt can make creditors have the right to oversee the company's operational activities.

Greater supervision by creditors will reduce information asymmetry that occurs in creditors and company managers (Risdiyani & Kusmuriyanto, 2015). That is because creditors must know how much the funds returned by the company for the funds they invested. When company risk is high as measured by high debt ratios, management tries to reduce perceived risk for creditors by presenting relatively more stable earnings reports. Based on the description above, it can be understood that leverage can moderate the effect of managerial ownership on the application of accounting conservatism.

H5: Leverage moderates the effect of managerial ownership on accounting conservatism

Agency theory explains that company owners will monitor company managers. If the monitoring costs are high, the company owner will appoint a third party in this case the creditor to help carry out the monitoring. The higher the leverage ratio, the higher the financial risk faced by both the company and creditors. High levels of debt will make companies more careful because high levels of debt can be a threat to the survival of the company. This makes the creditor has the right to observe and monitor activities i the company (Pramudita, 2012). Supervision by the creditor will help the independent commissioner monitor all the company's operational activities. It can be concluded that the supervision will make the company implement conservative accounting. Based on the description above, it can be understood that leverage is able to moderate the effect of independent commissioners on the application of accounting conservatism.

H6: Leverage moderates the effect of independent commissioners on accounting conservatism

Based on the framework of thinking above, the research model can be seen in Figure 1 as follows:

Firstly, this research aims to examine the direct effect of Good Corporate Governance Mechanism (Institutional Ownership (H1); Managerial Ownership (H2): and Independent Commissioner (H3)) towards accounting conservatism. Secondly, due to various result of previous studies, this research aims to examine the moderating role of leverage on the effect of (Institutional Ownership (H4); Managerial Ownership (H5): and Independent Commissioner (H6)) on accounting conservatism.

3. Research methods

This quantitative research uses secondary data in the form of an annual report of manufacturing firms listed on the Indonesia Stock Exchange (IDX) for the period 2014–2016. This population amounted to 135 companies. Samples are chosen using some criteria as shown in Table 1:

Variable definition and operationalization are shown in Table 2.

The dependent variable in this research is Accounting Conservatism. Accounting conservatism is accounting policies or tendencies that result in the downward bias of accounting net asset value relative to economic net asset value (Watts, 2003 in Ruch & Taylor, 2015), while FASB (1980) in Ruch & Taylor (2015) states that "Conservatism is a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered". Thus, if two estimates of amounts to be received or paid in the future are about equally likely, conservatism dictates using the less optimistic estimate. Conservatism is define as reporting the

Figure 1. Research model.

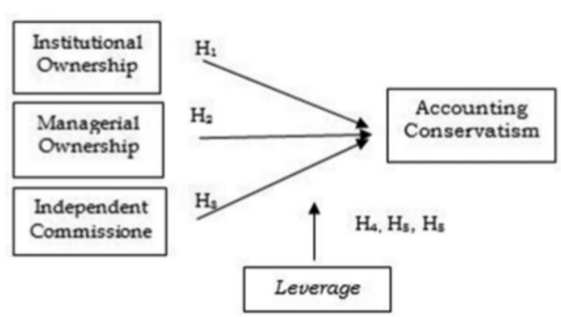

Table 1. Sampling criteria

No.	Criteria	Exclude	Include
	Manufacturing firms consistently listed in Indonesia Stock Exchange (IDX) in 2014–2016		135
	Manufacturing firms issued financial statement in 2014–2016	(18)	117
	Manufacturing firms issued financial statement using IDR currency in 2014–2016	(22)	95
	Manufacturing firms have market to book ratio more than one during 2014–2016	(62)	33
	Number of firms as sample		33
	Number of Year Observation		3
	Number of Unit Analysis		99

Source: secondary data processed, 2018.

Table 2. Variable definitions and operationalization

Variable	Definition	Measurement
Accounting Conservatism (CONACC)	The precautionary principle whereby costs and losses are more quickly recognized and recognition of revenues and profits is slowed so that it affects the numbers on the financial statements. (Ruch & Taylor, 2015)	$\textit{Market to Book Ratio} = \frac{\textit{Market value of shares}}{\textit{Book value of shares}}$ (Murhadi, 2013)
Institutional Ownership (INST)	The proportion of shares owned by the institution. (Khafid, 2012)	$\frac{\text{Number of shares hold by institutional Investor}}{\text{Number of shares outstanding}}$ (Susanti & Mildawati, 2014)
Managerial Ownership (MANJ)	The proportion of shares owned by management and company directors (Khafid, 2012).	$\frac{\text{Number of shares hold by management}}{\text{Number of shares outstanding}}$ (Susanti & Mildawati, 2014)
Independent Commissioner (INDP)	Independent commissioners are parties who do not have any relationship in the field of business or kinship with company (Wardhani, 2008).	$\frac{\textit{Number of Independent Commissioned}}{\textit{Number of Commissioner}}$ (Susanti & Mildawati, 2014)
Leverage (LEV)	The amount of company assets financed by debt (Murhadi, 2013).	$\frac{\text{Total Debt}}{\text{Total Asset}}$ (Murhadi, 2013)

lowest value among possible alternative values for assets and the highest alternative value for liabilities (Ruch & Taylor, 2015).

We choose a market to book value ratio for accounting conservatism because it indicates market value-based measure of accounting conservatism. Greater market to book value indicates greater accounting conservatism of a company. Conservatism results in understating the book value of equity relative to market value equity. Firms with high accounting conservatism will have a higher market to book value equity ratio (Ahmed & Duellman, 2007).

The Independent variable in this research is Good Corporate Governance with three mechanisms selected (institutional ownership, managerial ownership, and independent commissioner). We choose these three mechanisms because according to the previous result, these three mechanisms still have various results in affecting accounting conservatism in Indonesia, so it still needs to be studied further whether there is another factor moderated those relationships.

This research use documentation as a data collection technique. Hypothesis is tested using moderation regression analysis with a test of absolute difference. The level of significance used is 5%. Equation (1) is the research model used in this study:

$$\begin{aligned} \text{CONACC} = \alpha + \beta_1 \text{INST} + \beta_2 \text{MANJ} + \beta_3 \text{INDP} + \beta_4 \text{LEV} + \\ \beta_5 |\text{INST} - \text{LEV}| + \beta_6 |\text{MANJ} - \text{LEV}| + \beta_7 \\ |\text{INDP} - \text{LEV}| + e \end{aligned} \tag{1}$$

4. Results and discussion

Table 3 shows the descriptive statistic result of the data:

The result of the classic assumption test shows that the data is normal where the significance value is 0.312, more than 0.05. Multicollinearity test shows VIF value <10 and tolerance value >0.01 so that all independent variables are free from multicollinearity problem. Heteroscedasticity test performed with the White test shows that the data are free from heteroscedasticity problems. Autocorrelation testing proof that the data are free from the autocorrelation problem.

Adjusted R square of 0.647 means that the variation of institutional ownership, managerial ownership, and independent commissioners,, as well as leverage as a moderating variable, can explain the variation of accounting conservatism as much as 64.7%, while remains (35.3%) are caused by other variables. In summary, the results of the hypothesis test can be seen in Table 4 as follows:

4.1. Effect of institutional ownership on accounting conservatism

Institutional ownership has a significant positive effect on accounting conservatism. It means that a high level of institutional ownership will increase the level of accounting conservatism. This result is in line with agency theory which states that agency conflicts between managers and shareholders can be minimized by the presence of majority share ownership as well as institutional ownership. The presence of institutional shareholders has a great influence on the company. The institution has the expertise to control the opportunistic attitude of management by effective monitoring. Management then works more transparently and applies accounting conservatism in the company. This result is in line with research by Wardhani (2008), Xia and Zhu (2009), Ramalingegowda and Yu (2012), Foroghi et al. (2013), and Alkurdi et al. (2017).

Table 3. Descriptive statistic analysis result

	Minimum	Maximum	Mean	Std. deviation
CONACC	1,05	58,48	6,57	10,66
INST	0,33	0,98	0,70	0,16
MANJ	0,00	0,25	0,01	0,04
INDP	0,20	1,00	0,42	0,13
LEV	0,13	0,75	0,40	0,15

Source: SPSS 21 Output, 2018.

Table 4. Hypothesis testing result

	Hypothesis	β	Sig	Result
H_1	Institutional ownership has significant positive effect on accounting conservatism.	2,505	0,000	Accepted
H_2	Managerial ownership has significant positive effect on accounting conservatism.	−5,467	0,000	Rejected
H_3	Independent commissioner has significant positive effect on accounting conservatism.	6,179	0,000	Accepted
H_4	Leverage moderate the effect of Institutional ownership on accounting conservatism.	−0,807	0,357	Rejected
H_5	Leverage moderate the effect of managerial ownership on accounting conservatism.	9,451	0,000	Accepted
H_6	Leverage moderate the effect of independent commissioner on accounting conservatism.	−4,517	0,000	Accepted

Source: Secondary data processed, 2018.

4.2. Effect of managerial ownership on accounting conservatism

Managerial ownership has a significant negative effect on accounting conservatism. It means that high level of managerial ownership will reduce the application of accounting conservatism. This result is not in line with agency theory. Agency theory reveals that if management has a high ownership in the company, it will reduce agency conflict.

The result that shows managerial ownership has a significant negative effect on accounting conservatism may be because high shareholding by management in fact encourages expropriation of the company. So, management is more likely to use more aggressive accounting principles (Limantauw, 2012). In addition, this result also can be caused by the tendency of managers with high equity ownership to use a lower level of conservatism to avoid a decline in share prices (Fatmariani, 2013). This research in line with the research of Lafond and Roychowdhury (2008), Limantauw (2012), and Brilianti (2013).

4.3. The effect of independent commissioners on accounting conservatism

Independent commissioners have a significant positive effect on accounting conservatism. This condition means that the higher the proportion of independent commissioners, the more conservative accounting practices will be. This result is in line with agency theory which reveals that management tends to have a negative attitude and is concerned with personal desires without regard to the interests of shareholders.

This condition makes the company required an independent commissioner to oversee and monitor all activities carried out by management. The existence of an independent commissioner on the board of commissioners can provide better quality assurance for monitoring to shareholders. This is because the independent commissioner wants an accurate financial report. In addition, more stringent supervision is carried out by independent commissioners so that information generated in financial statements can be presented transparently and reliably.

Independent commissioners will encourage management to act conservatively to face the economic uncertainty by not putting excessive optimism on profits generated by the company. This study supports the research of Pratanda and Kusmuriyanto (2014), Yunos et al. (2014), and Mohammed et al. (2017).

4.4. Leverage moderates the effect of institutional ownership on accounting conservatism

Leverage cannot moderate the effect of institutional ownership on accounting conservatism. This result is not in line with agency theory which reveals that high debt makes creditors have the right to oversee the company's operational activities so that the company will apply accounting conservatism. This is possible for creditors to assume that companies with high profits can pay their debts on time. The creditors do not try to conduct intensive supervision but let the company carry out accounting procedures as desired.

This condition shows that leverage is not the basis for consideration the application of accounting conservatism in a company. This can be seen from the strength of institutional ownership which directly has an effective role in overseeing companies to implement conservative accounting. The description above explains that the increase in the application of accounting conservatism does not depend on increasing institutional ownership by moderating leverage.

4.5. Leverage moderates the effect of managerial ownership on accounting conservatism

Leverage can moderate the significant effect of managerial ownership on accounting conservatism. The agency theory explains that company owners will monitor the management of the company. If the monitoring costs are high, the company owner will appoint a third party in this case the creditor to help carry out the monitoring. The presence of leverage is proven to moderate and can strengthen the effect of managerial ownership on accounting conservatism. The application of accounting conservatism will be higher along with the high level of corporate debt. That is because the creditor expects their lent funds remain secure.

In addition, creditors ask for more accurate financial statements, so they seek to conduct more selective monitoring and press management so that management has no chance of manipulating profits. In companies with high debt ratios, management is less prone to do profit engineering because of intensive supervision from creditors. When the high corporate risk is measured by a high debt ratio, management tries to reduce perceived risk for creditors by presenting relatively more stable earnings, meaning that managers do not do earnings engineering.

4.6. Leverage moderates the effect of independent commissioners on accounting conservatism

Leverage can significantly moderate the effect of independent commissioners on accounting conservatism. The presence of leverage weakens the effect of independent commissioners on accounting conservatism. The presence of independent commissioners in overseeing the operational activities of the company has proven to be effective. This is indicated by the influence of independent directors who can increase the application of accounting conservatism. However, the role of creditors as lenders who should have helped oversight was less effective in pressing management to implement conservatism in the company. This is possible because creditors assume that the company will be supervised by independent commissioners intensively so that creditors do not try to pressure the company's management through the debt agreement that it provides. The explanation above explains that the application of accounting conservatism depends on increasing the independent commissioner by being moderated by the moderating leverage variable.

5. Conclusions

The study concludes that institutional ownership and independent commissioners have a significant positive effect on accounting conservatism. Leverage can moderate the effect of managerial ownership and independent commissioners on accounting conservatism. On the other hand, managerial ownership has a significant negative effect on accounting conservatism. This happens because high shareholding by management in fact encourages expropriation of the company. So, the management is more likely to use more aggressive accounting principles. Additionally, leverage cannot moderate the effect of institutional ownership on accounting conservatism. This happens because creditors may assume that companies with high profits can pay their debts on time. The creditors do not try to conduct intensive supervision but let the company carry out accounting procedures as desired. So, leverage cannot moderate the effect of institutional ownership on accounting conservatism.

This study limited to observation periods of 3 years. Further research can use different measurement tools in accounting conservatism such as accrual measures of earning or stock return to obtain more comprehensive results.

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