THE EFFECT OF CASH FLOW AND FINANCIAL DISTRESS ON ACCOUNTING CONSERVATISM (Empirical Study Of The Manufacturing Sector Listed On The Indonesian Stock Exchange)

Asifah Herdiari[1]*, Sri Wibawani WA [2], Novitasari Agus Saputri [3], Dhaniel Syam [4], Firda Ayu Amalia Saputri [5]

Muhammadiyah Malang University
asifahherdiari1@gmail.com, sriwibawani@umm.ac.id, novitasariagus@umm.ac.id, daniel@umm.ac.id, firdaayuamalia@umm.ac.id

ABSTRACT

Purpose: *This research is to test and analyze empirically related to the effect of cash flow and financial distress on accounting conservatism.,* ***Methods:*** *This study uses quantitative research. The population in this study are manufacturing companies listed on the IDX in 2021. This study used a purposive sampling technique. The type of data used as a secondary data source comes from the Indonesian Stock Exchange website.,* ***Analysis data:*** *Data analysis techniques used descriptive statistics, classical assumption tests (normality test, multicollinearity test, heteroscedasticity test and autocorrelation test), multiple linear regression tests and hypothesis testing (Partial Test, Coefficient of Determination, Simultaneous Test).,* ***Result and discussions:*** *The results showed that if the company's cash flow is high, then the company will pay more attention to the company's conservative level. Because if the cash flow is high but does not apply accounting conservatism, then the cash inflow and cash outflow owned by the company will show good results and will show that the cash flow statement is overstate and less attractive to investors. Meanwhile, if the company applies cash flow accounting conservatism, it will look more stable. Meanwhile, financial distress has a significant effect on accepted accounting conservatism. This is because if a company experiences financial distress it can encourage managers to raise the level of accounting conservatism in the company so that the prospects are good and the quality of the company's managers is getting better.,* ***Conclusion:*** *Based on the results of the research conducted, it was found that cash flow and financial distress had an effect on accounting conservatism.*

Keywords*: Cash Flow; Financial Distress; Accounting Conservatism.*

INTRODUCTION

Today's business people must be more competitive in order to thrive in the business world because of the development of the business world which is also driven by technical advances in the global era. Due to intense business competition, there will also be a greater threat to the ability of business people to plan ahead. According to El-haq (2019), financial reports designed to provide information to those who need it regarding company earnings and other useful information have their own criteria. Companies can set their own guidelines for preparing financial statements, such as utilizing techniques based on company internal policies. Because the approach chosen by the company will also produce unique financial reports for each organization according to the needs of the organization. Therefore, the notion of accounting conservatism emerged as a judgment of companies and in financial reporting based on uncertainty in the actions of companies.

According to Rhemananda et al. (2022), accounting conservatism is an uncertainty perspective that can be applied to make decisions or take actions based on the worst-case scenario of uncertainty. Although the possibility that it will materialize will produce very good results, this idea has implications for accounting principles that require the recognition of costs and losses from existing possibilities but not the recognition of future income or gains. To be able to achieve this with great care, conservatism will be required in the measurement, recognition, and valuation of assets and earnings. Since conservatism can avoid over-reporting of earnings or overstatement, it will also assist the business in preventing any possible financial manipulation by managers.

By using this approach, uncertainty and negative outcomes that may occur in the future can be avoided. This idea can be very important in financial reporting because it can stop business management from being overly optimistic and inflating earnings. However, if the principle of conservatism is applied, many opposing points of view emerge, which can result in biased information in the financial statements because they do not accurately reflect reality. Although in the end this sector remains the main driver of the Indonesian economy during the pandemic, recent economic conditions in the country have resulted in financial volatility in the industrial sector. This industrial sector began to rise along with the PMI (Purchase Manager Index) numbers which began to improve compared to when Covid-19 first entered Indonesia. If measured from the previous quarter, the manufacturing sector experienced a contraction of 4.02%, better than the previous period which experienced a contraction of 5.74%, this industry was able to increase positively by 5.69%. (Rizaldi et al., 2020).

Priyono & Suhartini (2022) conducted a study on the relationship between cash flow and accounting conservatism and found that there is a substantial positive relationship between the two. In contrast, Andani & Nurhayati (2021) examined the relationship between the financial crisis and accounting conservatism and found no evidence of a relationship. In this study, the product of a manufacturing company was used with a potential pandemic effect, which could lead to an uncertain situation. This study was conducted to find out further the effect of cash flow and financial difficulties on accounting conservatism in manufacturing businesses listed on the Indonesia Stock Exchange in 2021, as well as differences in the factors that influence the results of previous studies.

THEORETICAL BASIS

1. Agency Theory

Agency theory underlies the application of the conservatism principle contained in the financial statements of each company. This principle will be applied by the manager to achieve a good relationship between the company and the investor. Thus the manager is required to disclose all costs according to reality, so that investors can believe what the company has said and there will be no more understanding between the manager and the company as well as between the manager and the investor later (Sinambela and Almilia, 2018)

Agency theory can also be the basis used to understand financial distress. Agency theory concerns contractual relations between company members, so that the principle of this theory will state that there is a relationship between the investor as the principal who gives authority and the manager who acts as an agency receiving authority in the form of cooperation. Through the goals of cooperation that occur, different goals usually appear so that they can lead to conflict because company managers tend to pursue goals for cash availability and prevent actions not to increase profits, while usually investors will show their behavior in maximizing interests to pursue large profits or profits.

2. *Signalling Theory*

According to Halim (2021) cash flow in a company that applies conservatism will show high cash flow so that the company will provide a good signal in the form of information regarding good cash flow reports and can be profitable for investors. In addition, the signaling theory put forward by Spence (1973) will also underlie the financial condition and the possibility of bad to the manager, then a manager will give a signal by applying conservative accounting. Thus, signal theory will be used to provide signals from managers regarding good or bad information for companies so that problems of financial difficulties such as financial distress can be controlled in these companies.

3. *Cash Flow*

According to the Indonesian Association of Accountants in Dewi & Heliawan (2021), cash flow is cash inflows and cash outflows or cash equivalents. Cash flows are categorized based on three categories, namely cash flows from operating activities, then cash flows from investing activities and cash flows from financing activities. Cash flow is one of the factors that influence a manager's decision to use the concept of conservatism and is a report that shows all aspects related to company activities from those that have a direct or indirect influence on cash (Halim, 2021).

Information about the company's growth can also be seen through the cash flow statement. As well as being able to see the company's ability to provide internal and external funds, the greater the company's investment opportunities, the greater the investment that will be made. Statements of cash flows obtained through operating activities can be a parameter in knowing whether the activities in the company's operations are able to create sufficient cash flow to pay off debts, maintain the company's operating capacity, pay dividends and meet new investments, so it can be said that the company is showing good performance. If in a conservative company, assets and profits show small value and high cash flows can attract more investors to invest (Priyono and Suhartini, 2022).

4. *Financial Distress*

Financial distress is a broad concept that consists of several condition of a company in the face of financial difficulties. It can be interpreted as the emergence of signals or early symptoms of bankruptcy regarding the decline in the financial condition experienced by a company (Andani and Nurhayati, 2021). According to Sudarmanto & Lestari (2021) financial distress is a condition of a company that is facing financial difficulties and is unable to fulfill its obligations to other parties such as creditors, bondholders and others. If in general the financial difficulties that occur are a stage before the occurrence of a bankruptcy, but not all companies that face financial distress will make a company bankrupt.

Through the financial conditions that occur in these difficult times will make investors think about replacing the manager because it can be assumed that the manager cannot manage the company properly. So that from this threat it can result in the accounting profit system being rearranged by the manager because going through these criteria can result in evaluating the manager's performance (Fitriani and Ruchjana, 2020). Thus, when a company's financial condition is experiencing problems, managers can play a role in making decisions in regulating the level of accounting conservatism in the company's financial statements. Through these conservative financial reports, it can prevent a company from increasing its profits and limiting the distribution of dividends which can indirectly help increase the availability of cash in debt payments and reduce financial distress that occurs (Rivandi and Ariska, 2019).

5. Accounting Conservatism

Conservatism is defined as the precautionary principle financial reporting in which recognizing and measuring assets and profits is not rushed and in recognizing losses and debts that are likely to occur is done immediately by a company (Savitri, 2016). Through this principle can result in the choice of accounting methods directed at reporting lower profits or assets and reporting higher debt.

According to Savitri (2016) profit and loss statements that apply accounting conservatism will delay the recognition of unrealized revenues and expenses incurred in that period because if the financial statements are optimistic, they will tend to have a higher value net profit compared to operating cash flow. In addition, conservatism can verify the net assets on the balance sheet in order to prevent management from taking action to increase the amount of its assets. So that conservatism can reduce the actions of managers in manipulating and overstatement of financial reports and can then improve financial performance, especially in terms of increasing cash flow and company value.

According to Hariyanto (2020) financial reports that are based on a prudent attitude will also have a good impact, and can reduce the occurrence of financial report errors which can result in misleading users of financial statements. Accounting conservatism in this study is measured using the accrual basis. The conservatism measurement is calculated using the Givoly Hayn formula (2002).

HYPOTHESES

Cash Flow is an indicator in determining loan repayment activities, controlling operational capacity, paying dividends and in creating good cash flow for new investments. It can be interpreted that high cash flow can show good performance of the company. So for companies that want to attract investors and generate high operating cash flows, companies can pay more attention to the level of accounting conservatism in the company (Randa, Afifudin and Hariri, 2021).

High cash flow will be able to show the effectiveness of the company in managing the company's operational activities and will also have a good impact on the performance of a company. Thus cash flow will help make predictions of future cash flows that are larger than aggressive companies. So that it will attract investors to invest and the company will be more conservative if the cash flow generated is higher and can help managers and investors achieve the desired goals while at the same time maintaining the company's survival in the long term. So that the hypothesis can be formulated as follows:

H1: Cash flow affects accounting conservatism

Managers will play a role in decision making and regulate the level of conservatism that exists in company reports when a company's financial condition is problematic. Conservatism can prevent the company's financial statements from increasing profits and limiting the amount of dividend distribution which can indirectly maximize the availability of cash for debt payments and reduce the opportunity for financial distress problems to arise (Rivandi and Ariska, 2019). So it is supported by research conducted by Tazkiya & Sulastiningsih (2020) showing the results that financial distress has a positive influence on accounting conservatism. This means that the higher the financial distress, it will encourage managers to raise the level of accounting conservatism in the company so that the prospects

are better and the quality of the company's managers is getting better. So that the hypothesis can be formulated as follows:
H2: Financial distress affects accounting conservatism

METHOD

This study uses a quantitative type of research where the population in this study is a manufacturing company listed on the Indonesia Stock Exchange in 2021. The sample criteria were taken using a purposive sampling technique. The type of data used in this study is secondary data that comes from the official website of the IDX. The data collection technique used in this research is documentation or information data collection. This research uses SPSS software. Data analysis techniques were carried out by means of descriptive analysis, classical assumption test, multiple linear regression test, and hypothesis testing. The definition and measurement of variables used in this study are as follows:

1. Accounting conservatism is measured using CONNACC formula.

$$\text{CONNACC} = \frac{NIit - CFOit}{TAit}$$

Description:

CONNACC = Degree of Accounting Conservatism

NIit = Profit before extraordinary item + depreciation of company i in year t

CFOit = Cash flow of company i operations in year t

TAit = Total assets of company i in year t

2. Cash flow is measured using the formula CFO.

$$CFO = \frac{Cash\ from\ operating\ activities}{Total\ Assets}$$

3. Financial distress is measured using the Z score version of the four variables model.

$$Z = 6{,}56\ (X1) + 3{,}26\ (X2) + 6{,}72\ (X3) + 1{,}05\ (X4)$$

Information:

X1 = Working capital / Total Assets

X2 = Retained Earnings / Total Assets

X3 = Profit Before Tax Interest / Total Assets

X4 = Capital Market Value / Total Debt

RESULTS AND DISCUSSION

The object used in this study is a manufacturing company listed on the Indonesia Stock Exchange for the period 2021. In this study, a purposive sampling technique was used to determine the research sample. From the manufacturing sector listed on the Indonesia Stock Exchange, 172 companies in the 2021 period will be selected according to predetermined criteria. Here are some analysis tests:

***Table 1** - Descriptive Statistics*

	N	Minimum	Maximum	Mean	Std. Deviation
Cash Flow	127	-.086	.381	.22127	.088050
Financial Distress	127	-4.199	19.026	5.55009	3.233537
Konservatisme Akuntansi	127	-.263	.218	.02191	.081373
Valid N (listwise)	127				

Source: Data processed, 2022

Based on the descriptive statistical tests that have been carried out with the first independent variable, namely cash flow. The results obtained show a maximum value of cash flow of 0.381, while the minimum value shows a result of -0.086 and the average cash flow of the sample companies is 0.221 and the standard deviation indicating the variation contained in cash flow is 0.088. The second independent variable is financial distress. Based on the results of the descriptive statistical test, it shows that the highest value of financial distress is 19.026. While the lowest value of financial distress is -4.199, meanwhile, the average value or mean financial distress is 5.550

The dependent variable in this study is accounting conservatism. Based on the descriptive statistical test, it shows that the highest value of accounting conservatism is 0.218. Meanwhile, the lowest value shows a result of -0.263 and the average or mean value in this study is 0.219 indicating that the sample companies in this study have a high level of accounting conservatism or prudent nature in financial reporting according to the CONNACC formula if the higher the value of CONNACC, the more conservative the company is.

***Table 2** - Multiple Linear Regression Results*

Coefficients[a]

Model		Unstandardized Coefficients		Standardized CoefficientsBeta	t	Sig.
		B	Std. Error			
1	(Constant)	-.177	.020		-9.079	.000
	Cash Flow	.681	.062	.737	11.028	.000
	Financial Distress	.009	.002	.346	5.182	.000

a. Dependent Variable: Konservatisme Akuntansi

Source: Data processed, 2022

The results of the multiple linear regression equation between cash flow and financial distress variables on accounting conservatism are Y = -0.177 + 0.681 X1 + 0.009 X2 + e. The constant value (a) is -0.177, meaning that if the independent variable, namely Cash flow (X1) and Financial distress (X2) is 0, then the dependent variable, namely Accounting Conservatism, will be worth -0.177.

The effect of cash flow on accounting conservatism obtained a regression coefficient of 0.681 with a statistical t value of 11.028 and a significance value of 0.000. These results indicate an influence, meaning that the higher cash flow will affect the higher accounting conservatism. The effect of financial distress on accounting conservatism obtained a regression coefficient of 0.009 with a statistical t value of 5.182 and a significance value of 0.000. These results indicate an influence, meaning that the higher financial distress will affect accounting conservatism.

Table 3 *- Simultaneous Test Results*

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.419	2	.209	62.425	.000[b]
	Residual	.416	124	.003		
	Total	.834	126			
a. Dependent Variable: Konservatisme Akuntansi						
b. Predictors: (Constant), Financial Distress, Cash Flow						

Source: Data processed, 2022

The result of the simultaneous test is 62,425 with a probability value of 0.000 which is smaller than the significance level of 0.05 (sig < 0.05). Other tests as a comparison obtained the value of F table at degrees of freedom 2 and 124 at alpha 5 percent of 3.069. These results show the calculated F value is more than the F table value (F hit > F table) and the significance value is less than 0.05 (sig < 0.05)so it can be stated that there is a significant effect between cash flow and financial distress on accounting conservatism in general. simultaneous.

Table 4 *- Partial Test Results*

Coefficients[a]			
Model		t	Sig.
1	(Constant)	-9.079	.000
	Cash Flow	11.028	.000
	Financial Distress	5.182	.000
a. Dependent Variable: Konservatisme Akuntansi			

Source: Data processed, 2022

Partial cash flow test obtained t value of 11.028 with a significance value of 0.000. As a comparison, the value of t table at 124 degrees of freedom and 5 percent alpha is 1.979. These results show the t-count value is more than the t-table value (t hit > t table) and the significance value is less than 0.05 (sig <0.05) so that it is stated that there is an effect of cash flow on accounting conservatism partially.

Partial test of financial distress obtained t value of 5.182 with a significance valueof 0.000. As a comparison, the value of t table at 124 degrees of freedom and 5 percent alpha is 1.979. These results show the t-count value is more than the t-tablevalue (t-hit > t-table) and the significance value is less than 0.05 (sig <0.05), so itis stated that there is a significant effect between financial distress on accounting conservatism partially.

Based on the results of the tests that have been carried out, it shows that cash flow has an effect on accounting conservatism. The cash flow statement from operating activities can be an indicator to determine whether the company's operatingactivities can generate sufficient cash flow to pay off debt, maintain the company's operating capacity, pay dividends and meet new investments or not. So if in a conservative company, assets and profits will show a small value and high cash flow will be able to attract investors to invest more (Priyono and Suhartini, 2022).The positive effect of operating cash flow can also indicate that the company's performance is in good condition and will earn increasing profits. So along with increasing profits, accounting conservatism can also increase (Halim, 2021). The results of this study are in line with the results of research conducted by Harini et al. (2020) who found that high cash flow will be able to show the results of achieving company effectiveness in managing the company's operational activities and in the performance of a company. So that it will attract investors to invest and the company will be more conservative in order to achieve the desired goals while maintaining the company's survival in the long term. This means that the higher the cash flow will have a significant effect on accounting conservatism.

Based on the results of the tests that have been carried out, it shows that financial distress has an effect on accounting conservatism. The results of this study are in line with the results of research conducted by Tazkiya & Sulastiningsih (2020) which found that through conditions of financial distress such as financial distress can create a threat for managers to rearrange the company's accounting profit system so that the higher the financial distress, it can encourage managers to raise the level of accounting conservatism in the company's accounting so that prospects are good and the quality of company managers is getting better. Through conservative financial statements, it can also prevent a company from increasing profits and limiting the distribution of dividends which can indirectly increase the availability of cash in debt payments and reduce financial distress conditions that occur.

CONCLUSION

Based on the results of data analysis and discussions that have been carried out, the results show that cash flow has an effect on accounting conservatism. This is because if the cash flow of a company is of high value, the company will pay more attention to the conservative level of the company. Because if the cash flow is of high value but does not apply accounting conservatism, the cash inflows and cash outflows owned by the company will show great results and will indicate that the cash flow statement is overstate and attracts less investor attention. Meanwhile, ifthe company applies cash flow accounting conservatism, it will look more stable. In addition, financial distress also affects accounting conservatism. This is because if the company experiences financial distress, it can encourage managers toincrease the level of accounting conservatism in the company so that the prospects are good and the quality of company managers is getting better.

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