



The Impact of Corporate Governance in Indonesia's Biggest Banks on Accounting Conservatism Through Audit Quality

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ABSTRACT: Banks are typically linked with conservative accounting practises due to the handling of big assets. This study investigates how company governance impacts accounting conservatism by focusing on audit quality. The analysis involves the independent variable corporate governance, the intervening variable audit quality, and the dependent variable accounting conservatism. This study focused on the 10 largest banks in Indonesia that were listed on the Indonesian stock exchange from 2015 to 2020. Using purposive sampling, 9 banks were selected for the study. Data collection was conducted using secondary data, the statistical method used was path analysis. This study's findings suggest that corporate governance has a negative impact on audit quality and accounting conservatism. Corporate governance negatively affects audit quality and through audit quality affects accounting conservatism.

Keywords: Accounting Conservatism, Corporate Governance, Audit Quality



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INTRODUCTION

In Indonesia, the banking industry is increasingly vital in financial intermediation, especially as economic growth and global uncertainty increase. In this context, accounting conservatism becomes crucial in managing risks and providing stakeholders accurate and reliable financial information. Accounting conservatism is an essential concept in financial accounting that emphasizes prudence in the recognition of profits and assets ([Popescu & Nişulescu, 2019](#)). The principle of conservatism is highly relevant in the banking industry due to its inherent risks and uncertainties. Studying how audit quality and corporate governance impact the practice of accounting conservatism in Indonesian banking companies is an important and intriguing research topic.

Corporate governance is the activity and process that governs the interaction of stakeholders having an interest in the organization. Accounting conservatism is a financial reporting method that is more cautious and prudent in recognizing income, assets, expenses, and liabilities. Studying how corporate governance impacts accounting conservatism is important since banking company

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policies play a crucial role in building confidence with shareholders and associated parties. Research by [Marziana et al., \(2016\)](#), and [Pasko et al., \(2021\)](#) revealed that firms with robust corporate governance practices are inclined to adopt a more cautious approach when disclosing their results. They point out that corporate awareness of good governance grows to strengthen internal control mechanisms that can result in more conservative revenue recognition.

Some research may not show a clear link between company governance and accounting conservatism. Research by [Almutairi & Quttainah, \(2019\)](#) research concluded that a strong board of directors does not have a substantial impact on accounting conservatism. A robust board of directors is crucial for supervising business management but may not directly influence conservative financial reporting rules.

Studying how corporate governance impacts audit quality in the banking sector is crucial due to the industry's stringent requirements and significant financial concerns. Corporate governance is crucial in ensuring that audit practices provide accurate and reliable financial reports. Research conducted by [Khamoussi, \(2016\)](#) research indicates that robust corporate governance, particularly in terms of oversight and openness, might enhance audit quality. Banking companies with solid governance tend to have better internal controls, ensuring that audit practices are carried out carefully and comprehensively, thus improving the quality of the resulting financial statements. Nevertheless, some studies show mixed results. Research by [Khamoussi, \(2016\)](#) research indicates a negative correlation between board size and audit quality in the banking sector. A correlation was discovered indicating that when the board size increases, it becomes more challenging for the board to oversee audit activities, potentially impacting audit quality.

A study on the impact of audit quality on accounting conservatism in the banking sector indicates that audit quality is crucial in influencing cautious practices in financial reporting ([Padmawati & Fachrurrozie, 2015](#)). Therefore, it is vital to understand how audit quality affects accounting conservatism in the banking industry. Research conducted by [Chen et al., \(2015\)](#) found that high audit quality can increase accounting conservatism in the banking industry. Given the high economic risks, Conservative policies in financial reporting are essential in this industry. High audit quality can provide confidence that the estimates and judgments made in the financial statements reflect the actual conditions, and this can encourage management to apply conservative policies in financial reporting. However, research by [\(2020\)](#) shows that high audit quality does not always positively impact accounting conservatism in the banking industry. They found that too much internal assurance provided by auditors can reduce accounting conservatism. This may be the tendency of management to rely on internal assurance rather than applying conservatism in the financial statements.

Research shows that corporate governance significantly influences accounting conservatism in the banking industry through audit quality. Corporate governance includes organizational structure, audit committees, incentive policies, and information transparency that can influence conservative policies in financial reporting. Recent studies indicate that corporate governance can influence the connection between audit quality and accounting conservatism in the banking sector. Research by [Gao & Wagenhofer, \(2021\)](#) discovered a direct correlation between effective corporate governance

and superior audit quality, leading to enhanced accounting conservatism within the banking sector. Good corporate governance, including an influential audit committee, information transparency, and a good relationship between management and the board of directors, can provide confidence that financial statements reflect actual conditions. This motivates management to apply conservative policies in financial reporting to anticipate the risks and uncertainties associated with the banking business. However, [Nguyen et al., \(2020\)](#) discovered that the correlation between company governance and accounting conservatism via audit quality is not consistently favorable. They found that too much board intervention in the audit process can reduce conservative tendencies in financial reporting. Too much interference can reduce auditor independence and encourage management to implement more aggressive policies in financial reporting. This research examines whether corporate governance affects accounting conservatism through audit quality or whether corporate governance has a direct effect on accounting conservatism.

Research Framework

Corporate governance influences audit quality

[DeFond & Zhang, \(2014\)](#) discuss the role of the audit committee in the audit quality framework, which emphasizes the role of the audit committee in helping clients achieve the desired level of audit quality. [Zgarni et al., \(2016\)](#) that the more meetings the audit committee holds, the more effective it will be in carrying out the duties and responsibilities of the audit committee, so that the audit quality will be better and with frequent meetings, the audit committee has control over the company to obtain quality audit, and supported by research by [Gebrayel et al., \(2018\)](#). In this research, corporate governance has a negative effect on audit quality.

Corporate governance influences accounting conservatism

Corporate governance influences accounting conservatism. Under intense competition, some companies may want to show better financial performance or be more profitable to attract investors or shareholders. This may encourage them to adopt a less conservative approach in their accounting ([Nurmansyah et al., 2019](#)). The findings of this study are consistent with the findings of [Widiatmoko et al. \(2020\)](#), in their research which found that corporate governance influences accounting conservatism.

Audit quality influences accounting conservatism

Audit quality affects accounting conservatism. The results of this research are supported by research by [Sultana, \(2015\)](#) who also states that investors will be more inclined towards conservative accounting data produced by large KAPs (audit quality). The results of this research are supported by research by [Padmawati & Fachrurrozie, \(2015\)](#) where audit quality affects accounting conservatism.

Corporate governance influences accounting conservatism through audit quality

Corporate governance influences accounting conservatism through audit quality. With high audit quality, the relationship between good corporate governance practices [Gebrayel et al., \(2018\)](#), and accounting conservatism becomes stronger, because high audit quality can increase confidence in the financial information provided by the company [Zgarni et al., \(2016\)](#).

Hypotheses that can be taken are:

H1 : Corporate governance influences audit quality

H2: Corporate governance influences accounting conservatism

H3: Audit quality influences accounting conservatism.

H4: Corporate governance influences accounting conservatism through audit quality

METHOD

Population and Sample

In this study, the population is banking companies listed on the Indonesia Stock Exchange (IDX) from 2015 to 2020. Statistical tabulations indicate that there are 45 banking companies listed on the Indonesia Stock Exchange (IDX). The study utilized purposive selection to choose samples, specifically targeting banks that ranked in the top 10 based on assets in 2021. The sample is determined based on specific criteria and includes the 10 largest banks. Due to inadequate data from Bank Syariah Indonesia, 9 banks are required to meet the standards. The study utilizes accounting conservatism as the dependent variable, corporate governance as the independent variable, and audit quality as the mediating variable. The analytical methods utilized include descriptive analysis and path analysis.

Table 1. Criteria for sample selection

No	Information	Amount
1	Banking Firm that were listed between 2015 and 2020 on the BEI	45
2	Banking that is not included in the criteria for the 10 largest banks in Indonesia	(35)
3	Businesses without the information needed for this study	(1)
4	The companies tht were selected were used as research samples	9

Accounting Conservatism

[Shroff et al., \(2013\)](#) define conservatism as the act of decreasing earnings and reducing net assets when faced with negative news, without boosting earnings or net assets in reaction to positive

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news. Based on the research of [Givoly & Hayn, \(2000\)](#), This study measures conservatism using the accrual model. The method of measurement is based on [Givoly and Hayn's \(2000\)](#) definition of conservatism. The CONACC value obtained by a banking industry is calculated using a formula. A higher CONACC value indicates a more conservative banking industry, while a lower value indicates the opposite.

$$\text{CONACC it} = (\text{NI it} - \text{CFO it}) \times -1$$

Description:

CONNAC : The level of conservatism of company *i* at time *t*

NI it : Net income before exceptional items plus depreciation and amortization

CFO it : Cash flow from operating operations

Audit Quality

The study uses earnings quality as a proxy to assess audit quality. Audit quality in financial statements is frequently linked to the quality of earnings. The auditor's objective is to ascertain if the figures in the financial statements are accurately depicted and represent the true condition of affairs. [Sulaiman et al., \(2018\)](#) in their research assessed audit quality using the company's earnings quality approach. [Dichev et al., \(2012\)](#) assess earnings quality by the amount of discretionary accruals contained in earnings figures. Reported earnings can be manipulated based on management goals, with higher discretionary accruals indicating lower earnings quality ([Marai et al., 2020](#)). Audit quality is measured by a formula proxied on discretionary accruals using the [DeAngelo, \(1986\)](#) model. De Angelo's discretionary accrual model calculation is as follows:

1. Formula for calculating Total Accruals:

$$\text{TA it} = \text{NI it} - \text{CFO it}$$

Description:

TA it : Total accruals for business *i* in year *t*

NI it : The net income of business *i* in year *t*

CFO it : Cash flow from operational activities of business *i* in year *t*

2. Non Discretionary Accrual calculation is calculated by the formula:

$$\text{NDA it} = \text{TA it-1}$$

Description:

NDA it : Non-discretionary accrual of business *i* in year *t*

TA it-1 : Total accruals for company *i* in the previous year, *t-1*.

3. Discretionary Accrual is calculated using the following formula:

$$\text{DA it} = (\text{TA it} - \text{NDAit}) / \text{TA it-1}$$

Description:

DA it : Discretionary Accruals for business *i* in year *t*

TA it : Total accruals for business i in year t
TA it-1 : Total accruals for company i in the previous year, t-1.
NDA it : Non-Discretionary Accrual of firm i in year t

Corporate Governanace

Corporate governance is proxied by the audit committee's role in the audit quality framework, which emphasizes the audit committee's role in helping clients achieve the desired level of audit quality (Abbasi et al., 2020). Another objective, which is a logical consequence of implementing the audit committee's duties, is to empower and strengthen the independence of auditors, both internal and external auditors, and oversee the effectiveness of the company's internal control and risk management implementation. Zehri, (2016) suggests that audit committees can demand more significant audit effort from public accountants. More audit effort usually indicates that audit quality is also higher.

Audit Committee = Ln (number of Audit Committee)

RESULT AND DISCUSSION

Test classical assumptions

Normality test

The normality test utilizes the Kolmogorov-Smirnov normality test to compare the data distribution being assessed for normality with the conventional normal distribution. A significance level of ≥ 0.05 indicates that there is no statistically significant difference between the data being tested and the standard normal data, suggesting that the data being examined is standard. The Kolmogorov-Smirnov normality test yielded a score of 0.114, indicating that the data in this investigation follows a normal distribution..

Multicollinearity Test

In this study to test heteroscedasticity by looking at the results of the calculation of the variance inflation factor (VIF) 2 variables, it is less than 10, and the tolerance value is more than 0.1, so it can be said that multicollinearity between independent variables in the regression model is concluded that there is no heteroscedasticity in this study.

Heteroscedasticity Test

Graph test is done by looking at the plot graph between the predicted value of the dependent variable (ZPRED) and its residual (SRESID). From the plot graph test results, there is no clear pattern, and the points spread above and below the number 0 on the Y axis, so there is no heteroscedasticity.

Descriptive Analysis

Descriptive statistical studies provide a representation of research variables. The data in this study passed normality, heteroscedasticity, and multicollinearity tests. The study includes 10 banks, which account for 72% of total banking assets in Indonesia, providing an overview of the banking sector in the country.

Table 2. Descriptive Results

Variabel	N	Min	Max	Mean	Std. Deviation
Corporate Governance	54	3	8	4,644	1,310
Audit Quality	54	-99	92	-0,148	47,26
Accounting Conservatism	54	-31,56	45,93	-4.574	13,46

Source: Data processed with SPSS 24

Table 2 illustrates the results of descriptive calculations in this study. The statistical calculations show that corporate governance, proxied by the number of audit committees, averages 4.644, which indicates compliance with government regulations of having at least 3 people on the audit committee. The average audit quality assessment is -0.148, indicating that the average bank has good audit quality. Regarding accounting conservatism, the average bank has a score of -4.574, indicating that banks tend to be less conservative in their banking activities.

First path regression equation



Picture 1
The Effect of Corporate Governance on Audit Quality

This research introduces a novel regression model that analyzes the effects of exogenous variables on corporate governance (X_1) and audit quality (X_2) simultaneously and partially. Table 2 displays the outcome of regression analysis conducted with the SPSS 24 software, indicating that Corporate Governance has a notable impact on audit quality.

Table 3. Linear Regression Test Results

	Standardized Coefficients Beta	t	Sig.
Corporate Governance	-0,324	-2,474	0,017

a Dependent Variable: Audit Quality

From table 3, it can be concluded that Corporate Governance affects audit quality. First Path Analysis Regression Equation:

$$X_2 = -0.324X_1 + e$$

Corporate governance hurts audit quality, so the more significant the corporate governance, in this case, the greater the number of audit committees, the smaller the implementation of audit quality. Table 3 shows that Corporate Governance harms audit quality, indicated by the calculation of p of 0.017, which is <0.05. So, with the description above, the first hypothesis is that Corporate Governance hurts audit quality.

Second path multiple regression equation

The research used a second path regression model to analyze the partial and simultaneous effects of Corporate Governance (X_1) and Audit quality (X_2) on Accounting Conservatism (Y_1). Table 3 displays the outcomes of a regression study conducted with the SPSS 24 software, indicating a strong impact of Corporate Governance and Audit quality on Accounting Conservatism.

Table 4. Multiple Linear Regression Test Results

	Standardized Coefficients Beta	t	Sig.
Corporate Governance	-0,395	-3,227	0,002
Audit Quality	-0,549	-4,483	0,000

a Dependent Variable: Accounting Conservatism

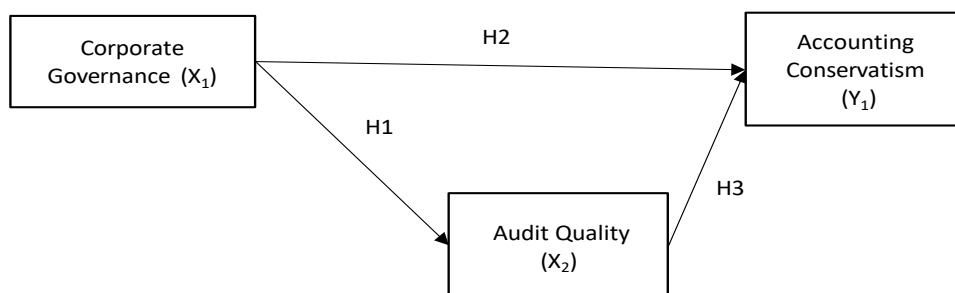
From table 4, it can be concluded that Corporate Governance and audit quality affect Accounting Conservatism. The regression equation is :

Directly

$$Y_1 = -0.395X_1 - 0.549X_2 + e$$

Indirectly

$$Y_1 = -0.177X_1 - 0.549X_2 + e$$



Picture 2
The Effect of Corporate Governance on Accounting Conservatism through Audit Quality

Directly

The study finds that Corporate Governance has a negative impact on accounting conservatism, meaning that stronger Corporate Governance leads to less accounting conservatism. The study finds that Corporate Governance has a negative impact on accounting conservatism, meaning that stronger Corporate Governance leads to less accounting conservatism. This is supported by the results in Table 4, which show a p-value of $0.002 < 0.05$. Therefore, the hypothesis that Corporate Governance harms accounting conservatism is confirmed. Additionally, the study suggests that audit quality may also undermine accounting conservatism. Table 4 shows that stronger audit quality is associated with lower accounting conservatism ($p < 0.05$), supporting the hypothesis that audit quality affects accounting conservatism.

Direct and Indirect Influence Testing

The Sobel test can be used to determine the direct or indirect relationship. The Sobel test assesses whether the Corporate Governance variable influences accounting conservatism either directly or indirectly through audit quality. The Sobel test results indicate a significance value of 0.032, which is less than 0.05, suggesting that Corporate Governance influences accounting conservatism via audit quality.

Corporate governance's impact on audit quality

This study suggests that corporate governance negatively impacts audit quality, indicating that having more audit committees can enhance audit quality. [DeFond & Zhang, \(2014\)](#) examine the audit committee's function within the audit quality framework, focusing on how it assists clients in attaining the targeted audit quality. [Zgarni et al., \(2016\)](#) that the more meetings the audit committee holds, the more effective it will be in carrying out the duties and responsibilities of the audit committee, so that the audit quality will be better. The effectiveness of the Audit Committee in carrying out its duties and responsibilities is positively correlated with the frequency of its meetings. Therefore, holding more meetings can lead to better audit quality, and is supported by research by [Gebrayel et al., \(2018\)](#) that meetings, the size of the audit committee can improve audit

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quality, this is following agency theory, agent and principle conflicts require an audit committee as an arbiter in overcoming existing problems, by often conducting meetings so that they better understand the problem so that it can be resolved.

However, it is not following research conducted by [Hasan et al., \(2020\)](#) that audit meetings (describing good governance) do not affect audit quality, meaning that the greater the number of audit committee meetings, the less likely it is to employ a robust external monitoring mechanism and is supported by research [Alqatamin, \(2018\)](#). Good corporate governance in the Indonesian banking industry enhances audit quality by facilitating effective oversight of the audit process. Robust corporate governance can promote transparency, accountability, and integrity in conducting audits, enhancing audit quality in the banking sector.

The Effect of Corporate Governance on Accounting Conservatism

This study indicates that corporate governance negatively impacts accounting conservatism. Specifically, the findings indicate that as the audit committee becomes more involved, bank management becomes less conservative. In highly competitive environments, some companies may be motivated to present more favorable financial performance to attract investors or shareholders. This may encourage them to adopt a less conservative approach in their accounting ([Nurmansyah et al., 2019](#)). The results of this study follow the research of [Widiatmoko et al. \(2020\)](#), which showed that corporate governance had a notable adverse effect on accounting conservatism. [Nasr & Ntim, \(2018\)](#) stated that there is an influence between corporate governance and accounting conservatism.

Audit Quality's Impact on Accounting Conservatism

This study found that audit quality negatively impacts accounting conservatism. Increasing audit quality leads to more accounting conservatism. This means that the increasing audit quality causes an increase in accounting conservatism. The results of this study are supported by [Sultana, \(2015\)](#) research, also states that investors will be more likely to conservative accounting data generated from large KAP (Audit Quality). The results of this study are supported by research by [Padmawati & Fachrurrozie, \(2015\)](#) where audit quality affects accounting conservatism. the role of corporate governance in improving audit quality in the Indonesian banking industry. In addition, the results of this study are also expected to provide policy recommendations to improve corporate governance practices and audit quality in the Indonesian banking industry and positively contribute to the development of the banking industry in Indonesia. high-quality audits can provide confidence in the reliability of the company's financial statements, thereby encouraging the application of conservative accounting practices to avoid potential distortion of financial information. Careful and detailed audits will strengthen the practice of accounting conservatism, prioritizing prudence in revenue and loss recognition. This research contradicts the results of [Sultana, \(2015\)](#) which states that audit quality does not affect accounting conservatism. Audit quality has no impact on accounting conservatism in Indonesia due to the strict oversight of banks by the OJK and Bank Indonesia. Government oversight ensures that banks adhere to the precautionary principle to prevent any impact on accounting conservatism due to audit quality.

The Effect of Corporate Governance on Accounting Conservatism through Audit Quality

Corporate governance impacts accounting conservatism via audit quality, as demonstrated by this study. Audit quality can moderate the relationship between corporate governance and accounting conservatism. With high audit quality, the relationship between good corporate governance practices and accounting conservatism will be stronger because high audit quality can strengthen confidence in the financial information presented by the company. This study provides a new understanding of the importance of the relationship between corporate governance, audit quality, and accounting conservatism in Indonesia's banking industry. The results suggest that banking businesses should focus on investing in audit methods that adhere to high standards and promote the establishment of robust corporate governance to enhance financial stability and stakeholder confidence.

CONCLUSION

Corporate governance affects accounting conservatism through audit quality. When good corporate governance practices are well implemented, it can create a favorable environment for improving audit quality. High audit quality will help ensure that the financial statements of banking companies reflect their true financial condition and reduce the risk of manipulation or misuse of financial information. In addition, research also shows that higher accounting conservatism in the banking industry can benefit stakeholders, such as investors, regulators, and creditors. Accounting conservatism can increase the confidence and reliability of the financial information presented, thus helping to reduce uncertainty and promote better investment decisions. Therefore, banking companies need to consider implementing good corporate governance practices through strict supervision and transparency in financial reporting to improve accounting conservatism and audit quality, thus providing long-term benefits for all stakeholders.

This research aims to enhance the banking industry in Indonesia by exploring the impact of audit quality and corporate governance on accounting conservatism. The findings offer valuable insights for stakeholders in the banking industry, regulators, and the academic community. Additionally, this study's results are anticipated to establish a basis for enhancing accounting conservatism practices, ultimately enhancing financial information quality and transparency in Indonesia's banking industry.

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