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## Does Capital Structure, Audit Quality, and Company Profitability Have an Impact on Accounting Conservatism?

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### Abstract

This study examines several factors that influence accounting conservatism: Capital Structure, Audit Quality, and Company Profitability. This study uses quantitative methods. All the manufacturing businesses included in this study are listed on the Indonesia Stock Exchange. Purposive sampling is the foundation of the sample selection technique. Panel regression, an analytical technique combining cross-sectional and time-series data, was employed in this study. The results showed that the capital structure variable did not affect accounting conservatism. Then, the audit quality variable significantly affects accounting conservatism, and the company's profitability variable does not affect accounting conservatism.

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## Introduction

Using various funding sources, the business's capital structure determines how it finances its overall operations and growth. To put it another way, the company's capital structure is the outcome of several circumstances that combine the financial choices made by business owners. Hence, a careful balance between debt and equity sources of financing is undoubtedly one of the main challenges for companies. Company information is essential for investors in the decision-making process. One source of information that investors rely on is financial reports. Reliable financial reports are quality financial reports. The quality of financial reports is determined by whether the information can be understood and meets users' decision-making needs. These financial reports must be free from misleading notions and material errors and can be relied upon so that these financial statements can be compared with previous periods. According to [Timoty et al. \(2022\)](#), helpful information is relevant. One indicator of the relevance of accounting information is the reaction of investors when the information is announced, which can be observed from stock movements ([Martinez et al., 2019](#)).

According to Modigliani and Miller (MM theory), the view that capital structure is irrelevant or does not affect firm value. Thus, determining the capital structure is not only guided by the value of a perfect market company. It is undeniable that the existence of the market still has various imperfections, such as asymmetric information. Furthermore, agency costs can make the capital structure relevant and affect the company's value based on many studies to understand the company's capital structure decisions. The quality of financial statements is related to the quality of earnings. Quality earnings are earnings that can predict future earnings and cash flows. Profits that have these qualities will get a good response from investors. The market response can be seen from the stock returns. The strength of the relationship between earnings quality and stock returns (market response) can be measured by the Earnings Response Coefficient (ERC) ([Iswanaji et al., 2021](#)).

Companies in the capital structure usually impact future sources of funds, namely the cost of capital, risk characteristics, liquidity position, investor returns, and company valuation, to become core financing decisions. Capital structure is concerned with how the company finances its overall operations and progress using various sources of funds. The company's capital structure is the consequence of some circumstances that combine the financing decisions made by the entrepreneur, the credit decisions made by the financier, and market conditions, all of which are influenced by asymmetric knowledge. Thus, the firm's capital structure and the idea that debt can be interpreted as an essential tool for managers is central to the financial and accounting literature. A manager needs to look at profitability to ensure the company's ability to earn profits and resources so that it earns profits and performs well ([Mardones & Cuneo, 2020](#)).

Financial theory frequently employs profitability to measure a company's core performance, which reflects managerial performance. The company's capacity for making a profit must be able to draw investors who will provide money to help it grow. Therefore, investors will pull their money out of the market with low profitability. Profitability could be better for the capital structure because there are businesses with high levels of profitability, many of which decide to apply the level of profitability to the company's activities rather than applying the value or level of debt; this measure is most often used in empirical testing of the effect of capital structure on profitability. Conservatism has a function to play a clear role in the contract and has a corporate governance monitoring function. However, it is difficult to know how conservatism affects contracts in the form of an unconditional accounting bias of known magnitude. Rational agents will only buy bias. Besides, if the bias is unknown, it will only reduce the efficiency of the contract ([Habibniya et al., 2022](#)).

Therefore, policymakers are brought on by reasonable worries about the current financial crisis. It has led to a stronger focus on conservatism or prudence. Academics have advantages and disadvantages. Proponents of the value relevance approach typically prefer the approach to financial reporting based on neutrality.

Accounting conservatism can reduce cash value by playing a role in audit quality. His findings, especially in developing nations where the government is concentrated and institutional ownership structure, not only lead to incorrect conclusions about the effect of accounting conservatism and cash value but also confirm the positive relationship between accounting conservatism and cash value. Thus, the auditor's willingness and objectivity in reporting financial distortions can be used to assess the quality of an audit. Additionally, numerous investigations have demonstrated that Iran's audit quality is subpar ([Hejranijamil et al., 2020](#)).

Research results in [Hasbi \(2021\)](#), Show that findings not only support a positive correlation between accounting conservatism and cash value but also strengthen this relationship in the absence of a high-quality audit mechanism. As a result, it is recommended that to enhance audit quality, and one should set audit fees, modify audit procedures, create continuing professional education, issue and apply rigorous accounting standards, and create ongoing audits. Agency relationship conservatism and cash retention rules impact cash value; thus, audit quality and company expansion should be significant factors. Factors influencing accounting conservatism are Capital Structure, Audit Quality, and Company Profitability. These variables were selected due to the inconsistent results in previous studies, so further research is needed ([Guo et al., 2020](#)). This study examines several factors that influence accounting conservatism: Capital Structure, Audit Quality, and Company Profitability.

Conservation is one of the essential features of accounting. Of course, that was long Before legal developments, including restricted equity liability, extensive litigation, regulatory and regulatory standards, auditing, stock exchanges, public debt, and fractional equity ownership. Although accounting rules require conservative accounting, management can choose how much its reporting should be conservative. While conditional conservation must be considered, such as determining if a trigger for impairment exists, unconditional conservation may also need to be considered if the accounting standards contain requirements for incurring or recognizing all development costs ([Anagnostopoulou et al., 2020](#); [Jaimuk et al., 2020](#); [Sugiyanto & Febrianti, 2021](#)).

Conservatism has unconsciously been included in most accounting standards. The two types of accounting conservatism are conditional conservatism and unconditional conservatism. Unconditional conservatism, or independent news, assumes that unrecorded goodwill will result from the accounting process when assets and liabilities are first recorded. When situations are unfavourable, such as utilizing lower prices or market value in inventory assessment, book value is written as conditional or news-dependent conservatism ([Anagnostopoulou et al., 2020](#)). Defines Conservatism as a criterion for choosing accounting procedures that result in the cumulative minimization of transferred revenue with later revenue recognition, faster expense reporting cognition, lower asset valuation, and greater liability valuation. Another aspect of conservatism is an asymmetry in earnings reporting when lousy news is reacted to more rapidly and comprehensively than positive news. Accounting numbers are unable to be neutral and hence faithfully represent reality because of conservative bias ([Laux & Ray, 2020](#)).

Capital structure is the ratio or balance of long-term debt to equity—the content and proportion of long-term debt and equity of the company's assigned preferred and common stock. The optimal capital structure is a capital structure that can balance risk and return to maximize share prices; of course, ownership and share control are family or state ownership, weaker institutional arrangements and legal structures, the importance of political relations, and government intervention. Companies with more conservative financial reporting should adjust their capital structure towards their goals more quickly, especially in companies that rely more on external financing for adjustments ([Rahman et al., 2021](#)). The firm's capital structure and the assumption that a manager can interpret debt as an essential tool are central to the financial and accounting literature. Managers need to ensure that their company's resources are well-spent. However, ongoing reforms in the legal and regulatory frameworks and governance practices in developing countries allow for the gradual development of their financial systems. So that it motivates researchers to conduct research.

The problem of capital structure that still prevails in developing markets differs from the problems in developed markets today. This makes cross-country comparisons more dominant. The capital structure shows how a company finances an operational activity or how to finance company assets (Salem et al., 2021).

Audit quality is the possibility of an auditor finding and reporting an error or mistake that can occur in an accounting system. So that the quality of the audit can be known whether the auditor has carried out the audit. Based on the Public Accountant Professional Standard (SPAP), the audit is carried out by an auditor who meets the requirements, namely meeting the requirements or audit standards. The existence of audit quality can provide reasonable confidence in financial reporting and credible information for users. High audit quality in companies can boost the openness of revealed information, promote the efficiency of the capital markets, and decrease earnings management. Audit quality is always crucial to improve report quality and ensure corporate accountability, which decreases earnings management. Nevertheless, because there is a Sharia audit framework, Islamic banks utilize the same audit framework as their rivals (Bajaj et al., 2020).

One of the factors that affect the value of the company is the profitability of the company. Earnings per share, return on assets, and return on equity can be used to gauge profitability. The company uses the profit from the sale of the firm's investment to determine the management's effectiveness. Users of financial statements can forecast future cash flows using profit and loss computations. The ability of a corporation to make a profit can be used to evaluate its performance. A firm's capital structure can be impacted by profitability, as a corporation typically generates more earnings to meet the need for money for expansion from inside companies. The benefit and purpose of the ratio are to measure the company's ability to earn profits over a certain period. Assessing the size of the company's profit from the previous year to the following year and assessing whether, from time to time, its profits are growing (Khalilov & Osma, 2020).

According to Alves (2020), the company's capital structure and the assumption that a manager can interpret debt as an important tool are central to the financial and accounting literature, where managers need to ensure that their company resources are not wasted. Capital structure is the composition of a company's debt and equity, which is often calculated based on the relative size of the various sources of company funding. Meanwhile, according to Brigham and Houston, the company's capital structure is a combination of the company's capital and debt—the relationship between accounting conservatism and company capital structure. More conservative financial reporting adjusts capital structure towards faster targets, especially in companies relying on external financing. The positive effect of conservatism on the speed of adjustment is concentrated in firms with low leverage. Accounting conservatism plays a vital role in facilitating the adjustment of the capital structure of the company under leverage to the target.

Audit quality is most often defined, which states that the probability of a public accountant is to find and disclosing all violations in the application of his client's accounting. Based on the Public Accountant Professional Standard (SPAP), the audit conducted by the auditor is of high quality if it meets the requirements or auditing standards. Lowering the cash value on accounting conservatism in connection with the moderating role of audit quality (Wati et al., 2020). The company's profitability is a valuable tool for determining how much of a rate of return will be generated by its investment activity. Because internal resources are growing, profitability impacts the company's value because it might reflect the advantages of financial investment. Profitability can affect the company's value by using Tobin's Q. Increasing company performance can create value for the company so that a good company value will attract more investors and the interests of other parties to participate in the company. Estimates of accounting conservatism will affect insiders' chances of speculating on good and bad news and, thus, the profitability of insider trading. Of course, greater conservatism is conditionally associated with lower or higher profitability of insider sales. So the evidence is limited that conservatism affects purchasing profitability (Muhammad et al., 2021).

## Methods

This research uses quantitative methods in the framework of investigations or investigations that are managed, systematic, data-based, critical, objective, and scientific toward a particular problem to find answers or related solutions, which are generally obtained through structured questions. The population of this study is all manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2019-2022 period that report complete financial statements and are published in the Indonesian Capital Market Directory 2019-2022. The sample selection technique is based on purposive sampling, a sampling method limited to certain types that can provide the desired information by setting specific criteria to obtain a sample of 30 out of 242 units of analysis. In this study, panel regression, a method that combines cross-sectional and time-series data, was utilized for data analysis (Martinez et al., 2019). The relationship between capital structure, corporate governance, firm profitability, and accounting conservatism is explicable within the context of some of these variables. The sampling technique used by the author is purposive sampling, which is a sampling technique by selecting samples from among the populations according to what the researcher wants.

### Multiple Linear Regression Analysis

This study uses multiple linear regression. Multiple linear regression analysis is an analytical tool for predicting the effect value of two or more independent variables on the dependent variable to prove whether there is a functional or causal relationship between two or more independent variables and one dependent variable. In multiple regression, one dependent variable with more than one independent variable influences it. The following is the research model formula:

$$AC = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Information: AC is accounting conservatism,  $\alpha$  is constant, CS is capital structure, IC is inspection quality, Prof is profitability,  $\beta$  is regression coefficient

There are two ways to use the regression model in this study, namely the Chow test and the Hausman test.

#### 1. Chow test

This test was carried out to compare or choose which model is the best between the Common Effect and the Fixed Effect. Which model is chosen can be known by looking at the probability significance value of the Cross-Section Chi-Square. If the value is  $>0.05$  then the selected model is Common Effect, if  $<0.05$  then the selected model is Fixed Effect.

#### 2. Hausman's test

This test was carried out aiming to compare or choose which model is the best between Fixed Effects and Random Effects. Which model is chosen can be known by looking at the probability value of the Cross-Section random. If the value is  $> 0.05$ , then the selected model is Random Effect, which is more appropriate than the Fixed Effect model.

Table 1. Sampling Results

Sample Criteria	Amount
Companies listed on the Indonesia Stock Exchange for the 2015-2019 period are in the group of manufacturing companies.	242
Companies that do not have complete data for this study.	59
Manufacturing companies that present financial statements in currencies other than the rupiah.	20
Companies that are not listed on the IDX in a row during the 2019-2022 observation period.	133

The number of samples during the 2015-2019 research year period.

30

Source: [www.bps.go.id](http://www.bps.go.id), 2023

This test is required to determine the most suitable model between the expected effect and fixed-effect models. In the standard effect model, cross-section and all-time series data are combined (pooled) and estimated using the OLS (Ordinary Least Squares) method. The Least Square Dummy Variable model refers to inserting a dummy variable when estimating panel regression parameters with the Fixed Effect Model. The evolution of earlier researchers is seen through the analysis and comparison of the suggested hypotheses: (1) The impact of accounting conservatism on capital structure. Given that the value is more significant than 0.05 and the probability values in the table above, H0 is accepted, and H1 is denied.

## Result and Discussion

### PANEL DATA REGRESSION RESULTS

Data from observations of multiple people or cross-sectional units, each seen across some consecutive period units, are called panel data. One-way component models refer to panel regression models only impacted by a single cross-sectional or time unit. In contrast, two-way component models refer to panel regression models impacted by cross-sectional and time units. There are three methods we can use to estimate panel data regression. Thus, testing is required to identify which method is best for the given data. Methods for general effects, fixed effects, and random effects are included in the panel data analysis methodology.

Table 2. Descriptive Statistics

	Accounting Conservatism	Capital Structure	Inspection Quality	Profitability
Mean	3703721.	0.009177	0.044849	0.034179
Median	2599426.	0.008305	0.021614	0.031398
Maximum	10218675	0.024146	0.126131	0.321970
Minimum	-641955.1	-0.000384	-0.009706	-0.004137
Std. Dev.	3597755.	0.008145	0.043832	0.025761
Skewness	0.705438	0.560477	0.682665	0.579021
Kurtosis	2.073001	2.099236	1.925008	1.844587
Jarque-Bera	1.899933	1.378610	2.013154	1.230087
Probability	0.386754	0.501925	0.365468	0.112498
Sum	59259532	0.146835	0.717577	0.812732
Sum Sq. Dev.	1.94E+14	0.000995	0.028818	0.012498
Observations	16	16	16	16
Cross sections	4	4	4	4

Data source processed, 2023

This test is required to determine the most suitable model between the expected effect and fixed-effect models. The OLS (Ordinary Least Squares) method estimates meters in the standard effect model, which mixes (pooled) time series and cross-sectional data. This method is frequently referred to as the Least Square Dummy Variable model since it introduces a dummy variable to estimate panel regression parameters using the Fixed Effect Model. Between the Common Effect and Fixed Effect models, which model to be used should be determined using the Chow test. According to the above table, H0 is rejected if the prob value on the Chi-square cross-section is less than alpha (0.0000 0.05).

The previous table uses a fixed effect, and the table above uses a random effect model, all of which show that the independent variable significantly affects the dependent variable, namely accounting conservatism.



However, it has yet to determine which model to use; therefore, the Hausman test is needed to find out more. The Fixed Effect and the Random Effect models are up for comparison using Hausman's test to determine which model is superior. The probability of a random cross-section is more than alpha ( $\alpha$ ) ( $0.7187 > 0.05$ ), as shown in the table above, hence  $H_0$  is accepted. Thus, the Fixed Effect Model is the model that is appropriate for use in panel data regression (FEM). The Chow test aims to choose a model between the expected effect and the fixed effect. To determine which model was selected by comparing the significance value with the probability value of the chi-square cross-section. The selected model is the common effect if the value exceeds  $>0.05$  (5%). If it  $<0.05$  (5%), the selected model is the fixed effect.

Table 3. Chow Test Results

Effects Test	Statistic	d.f.	Prob.
Cross-section F	6.520441	(3,10)	0.0102
Cross-section Chi-square	17.342109	3	0.0006

Data source processed, 2023

Based on Table 2, it is known that the probability value of the chi-square cross-section is 0.0006, or in other words, it has a probability value that is smaller than the significance value of 0.05 (5%), so it can be concluded that the regression model is the most appropriate for this study is a fixed effect. The Hausman test was carried out to choose which model is better, the fixed effect or the random effect. This test is carried out by comparing the random cross-section probability value less than 0.05, and then the selected model is the fixed effect. Conversely, if the random cross-section probability value is more significant than 0.05, the selected model is the random effect.

Table 4. Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.312500	2	0.8553

Data source processed, 2023

Based on Table 3, it is known that the random cross-section probability value is 0.8553, or in other words, it has a probability value that is greater than the significance value of 0.05 (5%), so it can be concluded that the regression model is the most appropriate to be a model The regression in this study is a random effect.

Table 5. Statistical Test Results t

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig
Constant	-2-156	-475	-067	-754	-000
Accounting Conservatism	-234	-456	765	-664	-442
Capital Structure	-005	-009	456	711	-003
Inspection Quality	-887.	- 021	765	-662	-553
Profitability	-074	-078	964	997	-782

Data source processed, 2023

## 1. Test T Test

The T-test is used to demonstrate how much the independent variables' influence on them is partial. The independent variable significantly affects the dependent variable if profitability's significance value is less than 0.05 (5%) If the significance level is less than 0.05, the hypothesis is accepted; if it is greater than 0.05, the hypothesis is rejected.

The t-test interpretation results are as follows:

- a. T-test to determine whether accounting conservatism is impacted by capital structure. Given that the value is greater than 0.05 and the probability values in the table above, H0 is accepted and H1 is denied. This demonstrates that accounting conservatism is unaffected by capital structure.
- b. T-test examining the relationship between audit quality and accounting conservatism H0 is rejected and H1 is approved based on the probability values in the above table, which yield a value of 0.0014 0.05. This demonstrates how audit quality influences the conservatism of accounting.
- c. T-test to determine whether accounting conservatism is impacted by corporate profitability. According to the likelihood values' outcomes in the previous table, the value.

## 2. Test F Test

To examine the combined impact of the independent factors on the independent variables, utilize the F test. H0 is rejected and H1 is approved if the F count exceeds the F table and vice versa. According to the above table's F test results, the independent variables in this study model are simultaneously capital structure, audit quality, and firm profitability, with a Prob value (F-statistic) of 0.007847 0.05. (simultaneously). have an important impact. for accounting liberalism.

### a. R<sup>2</sup> test

The termination coefficient is used to calculate how much the independent variables' combined influence on the dependent variable amounts to. The percentage change in the dependent variable dependent brought on by the independent variable independent is higher if R<sup>2</sup> is greater. The percentage change in the dependent variable dependent brought on by the independent variable independent is decreasing if R<sup>2</sup> is growing smaller. The independent variable's contribution to the influence is 58.8%, as can be seen from the table above, where the coefficient of determination (r-square) is 0.58873. While other unrestrained variables affected the remaining 41.2% of the population. The accounting conservatism variable in this study is thought to be influenced by several factors, including capital structure, audit quality, and company profitability. Based on the results of panel data regression assisted by the Eviews 9 analysis tool, hypothesis testing has been carried out.

## Discussion

### The Effect of Capital Structure on Accounting Conservatism

In testing the first hypothesis in this study, the results showed that capital structure did not affect conservatism. This is because the research sample is not all multinational companies. Companies with a domestic scale tend to have a low level of information asymmetry. The influence between capital structure and conservatism tends to be low. This is supported by research by [Liu \(2019\)](#), which states that conservatism affects financial leverage and increases global diversification. Companies with high diversification tend to have a high level of information asymmetry. The relationship between conservatism and capital structure is higher when the company is global. It can be concluded that the company does not rely on external financing, which impacts adjusting the capital structure to targets that need to be faster. Moreover, the level of leverage is not low, so it affects the adjustment speed. Loss recognition is associated with higher debt capacity, resulting in a higher level of financial leverage, one of which is the debt ratio.

This research is strengthened by research results from [Ashma' and Rahmawati \(2019\)](#), a company with a high capital structure indicates that the company will be more dynamic. The company will be more motivated to continue to improve its performance so that its debts can be fulfilled. Companies with optimal profits will



make external parties respond negatively to the company, making them reluctant to invest in it. This study's results align with research conducted by [Hasbi \(2019\)](#), who stated that capital structure hurts conservatism. The greater the company's leverage, the quality of the profits generated cannot increase or even decrease. Investors do not consider a company's profitability as a determining factor that they use as a basis for investing. Profitability cannot determine that companies with high profitability have high earnings quality. Profitability also cannot determine whether the company can generate persistent profits. Investors consider profitability to be unable to determine a company's ability to earn actual profits following predicted earnings. So,  $H_{a1}$  is rejected. This result does not follow the research results of ([Evia et al., 2022](#); [Permatasari et al., 2023](#)). However, these results are the same as those of [Alves \(2020\)](#) study that profitability has no significant effect on ERC.

The capital structure is the equity and liabilities that fund a company ([Ermawati et al., 2023](#)). A company's financial stability and insolvency risk depend on the funding source and the type and amount of assets it has. Companies with a large proportion of debt will have higher debt and interest payments, so they have the possibility of insolvency during periods of decreased income or difficult times. A company with high financial leverage means it has much debt to outsiders. This means the company has a high financial risk due to financial distress due to high debt ([Daud & Syarifuddin, 2008](#)). Company age affects the possibility of companies to improve financial reporting ([Mardones & Cuneo, 2020](#)). Companies that have been established for a long time show stability, and investors can review the company's performance from year to year. New companies have less experience and are often unstable. In addition, new companies will have access to more limited external funding than experienced companies. However, [Maduma and Naibaho \(2022\)](#) stated that age progressively weakens firm performance. The ageing phenomenon of firms is related to organizational rigidity, making it difficult to find, accept, and implement innovation signals from the right fit.

The regression coefficient value for the capital structure variable (DER) is 0.100, which means that every 100% change in the debt-to-equity ratio will relatively increase the quality of earnings (earnings response coefficient) by 10%. Then, through the results of the t statistical test, a t value of 0.743 was obtained with a significance level greater than 0.05, namely 0.462. Thus, it can be concluded that capital structure has no significant effect on earnings quality (earnings response coefficient), so  $H_{a5}$  is rejected. Possibly, the thing that causes this hypothesis to be rejected is the inefficiency of the capital market. This inefficient market is caused by the existence of two kinds of investors: investors with fundamental and technical analysis skills and investors who are naive or often called noise traders. Market conditions can also explain this behaviour. When the market is bullish, investors become optimistic, so they do not pay too much attention to fundamental factors. Meanwhile, when market conditions are bearish, investor confidence in investing weakens even though fundamental factors show promising conditions ([Ainiyah & Sinta, 2019](#)). This follows the research of [Ainiyah and Sinta \(2019\)](#), which also shows that capital structure has no significant effect on ERC.

### **The Effect of Audit Quality on Accounting Conservatism**

In testing the second hypothesis in this study, the results showed that audit quality affected accounting conservatism. These results align with research by [Yazar Soyadi et al. \(2019\)](#) that audit quality impacts increasing accounting conservatism. The need for accounting conservatism is related to the increased credibility of accounting information. Accounting information is said to be of quality if it meets several aspects, such as understandability, relevance, reliability, and materiality. To produce quality information, it is necessary to audit the financial statements. So, audit quality will also affect the quality of a company's accounting information. In other words, audit quality affects the level of accounting conservatism.

The results of these studies are strengthened by research by [Daryaei et al. \(2020\)](#); audit quality is considered one of the essential issues affecting accounting conservatism. Audit quality is also an attribute assessed by market equity. High-quality audit services can improve the quality and credibility of financial reports from

the point of view of other people. These parties make contracts, especially those not preparing financial reports. The reliability and accuracy of financial information have a fundamental role in ensuring audit quality. In particular, the generation of conservatism, in the wake of accounting scandals in the United States (US) and many European countries, has highlighted the importance of audit quality.

Companies audited by Big Four public accounting firms (KAP) have a better reputation than companies audited by non-Big Four. Having a good reputation will make the company more trusted by investors. Earnings information from companies audited by the Big Four has a higher quality than non-Big Four companies. The research results by [Teoh and Wong \(1993\)](#) show that companies audited by large KAPs have higher ERC values than those audited by other KAPs. Capital structure is a factor that influences ERC ([Daud & Syarifuddin, 2008](#)). A company with high financial leverage means it has much debt to outsiders. This means the company has high financial risk due to financial distress due to high debt. The research results of [Daud and Syarifudin \(2008\)](#) show that the higher the company's debt, the lower the ERC value of the company.

[Teoh and Wong \(1993\)](#) state that audit quality has a positive relationship with earnings quality measured by ERC. If it is associated with ERC, then high audit quality, which is positively associated with earnings quality, will also be positively associated with market response. Audit quality is seen from the size of the KAP. KAPs affiliated with Big Four KAPs have a better reputation than KAPs affiliated with Non-Big Four KAPs. KAPs affiliated with the Big Four can produce audits of better quality. Long-standing companies show stability, and investors can review the company's performance yearly. New companies have less experience and are often unstable. In addition, new companies will have access to more limited external funding than experienced companies. However, [Saidu and Aifuwa \(2020\)](#) stated that age progressively weakens firm performance. The ageing phenomenon of companies is related to organizational rigidity, which makes it difficult for companies to find, accept, and implement innovation signals from the market.

The regression coefficient value for the audit quality variable (KAP) is 0.346, which means that every 100% change in Auditor Quality will increase earnings quality (ERC) by 34.6%. Then, through the results of the t statistical test for Quality Auditor, obtained a t value of 3.242 with a significance level less than 0.05, equal to 0.002. Based on these results, it can be concluded that audit quality has a significant positive effect on earnings quality (ERC), so  $H_{a4}$  is accepted. The explanation is that investors consider the audit quality produced by large KAPs to be higher quality than that of small KAPs. Investors consider large KAPs more capable of producing more credible financial reports. The results of this study are based on the research of [Teoh and Wong \(1993\)](#).

### **The Effect of Company Profitability on Accounting Conservatism**

Testing the third hypothesis in this study shows that profitability does not affect conservatism. This aligns with [Solichah and Fachrurrozie's \(2019\)](#) research that profitability has no significant effect on accounting conservatism. High accounting conservatism is associated with higher future profitability for under-levered companies. Profitability in the company does not affect accounting conservatism because the company does not pay attention to political costs as a burden that must be avoided. One form of political cost is the tax burden.

In line with the results of the study by [Sari \(2020\)](#), conservatism is the principle of immediately responding to debts and costs, while profits and assets are only sometimes considered, even though there is a high chance of this occurring. Thus, the advantages contained in the financial statements imply the concept of prudence to reduce the risks that will occur. However, this principle causes earnings to fluctuate because earnings are understated when reported now and can become an overstatement of future reporting. This study analyzes the factors influencing accounting conservatism: managerial ownership, leverage, firm size, and profitability. Managerial ownership, leverage, firm size, and profitability provide an overview of the

implementation of accounting conservatism in the presentation of financial statements. Thus, managerial ownership, leverage, firm size, and profitability can simultaneously influence.

Profitability is the company's ability to generate profits. Company profitability can be seen from the profit generated compared to the funds invested in assets or company equity. This will show whether the company effectively carries out its operational activities. According to [Caroline et al. \(2023\)](#), companies with high profitability have a more significant earnings response coefficient than companies with low profitability. Profitable companies can complete operations currently being carried out, which is indicated by profit. Profit reflects the result of using the company's resources. Research by [El-Habashy \(2019\)](#) shows that the earnings response coefficient positively relates to profitability.

Profitability is the company's ability to generate profits and is crucial in showing company performance. According to [Kieso et al. \(2018\)](#), profitability ratios are used to measure a company's income or operating success in a certain period. The profitability ratio in this study is proxied by Return on Assets (ROA). Revenue affects a company's ability to obtain funding through debt and equity. Revenue also affects the company's liquidity and ability to grow. Consequently, both creditors and investors are interested in evaluating the strength of earnings, namely profitability. Analysts also often use profitability to test management's effectiveness in operating. Investors do not consider a company's profitability as a determining factor that they use as a basis for investing. Profitability cannot determine that companies with high profitability have high earnings quality. Profitability also cannot determine whether the company can generate persistent profits. Investors consider profitability to be unable to determine a company's ability to earn actual profits per predicted earnings. So,  $H_0$  is rejected. This result is not under the research results of [Kurniawati et al., \(2021\)](#). However, these results are the same as the results of [Gunawan and Putra \(2021\)](#) study that profitability has no significant effect on ERC.

## Conclusion and Recommendation

The research examines the influence of profitability, audit quality, and capital structure. There are 15 companies included in the research criteria, and the number of observations from this study is 45. The results of the normality test that has been carried out indicate that all the variables used in the study are typically distributed. The results of the classical assumption test that has been carried out indicate that the regression model used in the study meets the requirements of the classical assumption test. The test results for the coefficient of determination show a correlation coefficient (R) of 76.6% and state that the regression model can explain the variation of the dependent variable by 56.4%, as indicated by the value of Adjusted R Square. The results of this study indicate that there is an influence between audit quality and accounting conservatism. Meanwhile, the capital structure and company profitability do not affect accounting conservatism. The results of the data analysis that has been carried out show that partially, the capital structure does not affect accounting conservatism of  $0.1136 > 0.05$ , so  $H_0$  is accepted, and  $H_1$  is rejected. Partially, audit quality affects accounting conservatism by  $0.0014 < 0.05$  so that  $H_0$  is rejected and  $H_1$  is accepted. The company's profitability partially does not affect accounting conservatism of  $0.9068 > 0.05$ , so  $H_0$  is accepted, and  $H$  is rejected. Simultaneously, capital structure, audit quality, and company profitability significantly affect accounting conservatism as indicated by the Prob value (F-statistic) of  $0.007847 < 0.0$ .

Results The purpose of this research is to see the extent to which other factors or indicators can affect a company's prudence level. So, in this study, applying accounting conservatism can avoid the uncertainty and risks in a company. Things that can be given for improvement for future researchers is to add other independent variables such as corporate governance, investment efficiency, leverage, and investment opportunity sets, which may have more influence on accounting conservatism. Further researchers can also add more than two accounting conservatism measurement tools to get more comprehensive results.

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