Prediction of Financial Distress in the Pandemic Period with Accounting Conservatism as a Mediation Variable

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Abstract. The aim of this study is to examine the role of accounting conservatism in mediating the effect of firm size, leverage, profitability and the board of directors on financial distress. The population of this research was a manufacturing company listed on the Indonesia Stock Exchange (IDX) in 2018-2020. The research sample was determined through purposive sampling method. The data used was secondary data from annual reports of each company. The data analysis tool used descriptive analysis and path analysis. The results of the study showed that firm size, profitability, and accounting conservatism had a significant positive effect on financial distress directly, while leverage and the board of directors had a negative effect on financial distress. Accounting conservatism in this study was able to mediate the effect of firm size and profitability on financial distress, but was unable to mediate the effect of leverage and the board of directors on financial distress. Suggestions for management are to maintain the quality of company management, especially in terms of finance to prevent financial distress, as well as apply accounting conservatism in the company's financial report, so that the information presented in the financial statements can be used as a relevant basis for decision making and provide signals for management to be more responsive and careful in managing finances to overcome losses that may occur in the future.

Keywords: Firm size, Leverage, Profitability, Board of Directors, Accounting Conservatism, Financial Distress

1 Introduction

Economic activity is currently in an uncertain condition. Especially after the start of the free trade era which was marked by the ACFTA (ASEAN China Free Trade Area) on January 1, 2010 and then the full effect of AFTA (ASEAN Free Trade Area) in 2015, both of them certainly had some impacts for several companies. One of the impacts felt for companies in Indonesia is trade competition that is getting wider and tighter. For companies that cannot compete, it will be difficult to follow and survive, to the point of being threatened with bankruptcy. In addition, the Covid-19 pandemic that has attacked Indonesia since the beginning of 2020 has had a significant impact on the company. The Association of Indonesian Issuers (AEI) reported that more than 50 companies that listed shares on the IDX or issuers were experiencing cash flow difficulties due to the impact of the Covid-19 pandemic.

Fig. 1 shows that the last three years, namely 2018-2020 the number of companies delisted from the Exchange has increased and continues to last until November 2020. In addition, based on information obtained from kontan.id in 2018, there were 411 cases with 297 cases of

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PKPU (Debt Payment Suspension) and 194 bankruptcy cases in five commercial courts in Indonesia. Of these cases, the company sector most entangled is property companies with 69 PKPU cases and 22 bankruptcy applications, followed by the manufacturing sector with 69 PKPU applications and 17 bankruptcy applications.

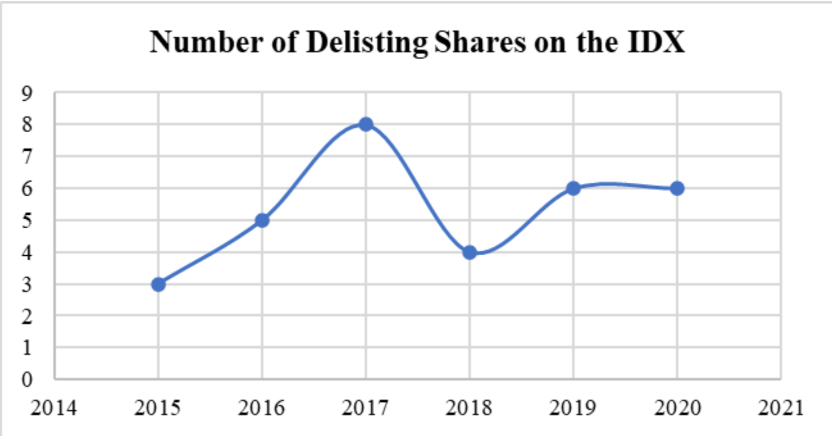

Fig. 1. Number of Delisting Shares on the IDX, 2015-2020
(IDX, November 2020)

This phenomenon shows the number of financial difficulties faced by the company. This financial difficulty is known as financial distress. Financial distress as a condition in which a company experiences a financial setback before bankruptcy [1]. Meanwhile, according to Brahmana [2], financial distress occurs because the company is not able to maintain stable financial performance so that the company experiences operating losses and net losses of this year, so that companies experiencing financial distress tend to have negative operating profits for two consecutive years, and if not making repairs it can lead to bankruptcy. This phenomenon shows that there are still companies that are indicated to be in financial distress, which should be a special concern for management to be able to be careful and take follow-up actions to reduce the possibility of falling into a worse condition [3].

The existence of obligations and needs that must be met in large numbers becomes one of the problems faced by the company, which if not balanced with good management will cause the company to experience financial difficulties or financial distress. Research by Rahmawati and Khoirudin [4] and Thim et al. [5] revealed that firm size had a significant positive effect on financial distress. The larger of firm size, it indicates that the company is more likely to use funding from external parties [6]. These funds can come from creditors or investors. In addition, the larger the firm size, it indicates that operational activities are increasingly complex and of course require greater operational needs. Fredrick [7] found that company size had a negative effect on financial distress. Meanwhile, Purwantara and Prasetyo [8]; Sastriana [6]; Cinantya and Merkusiwati [9] found that size of company had no effect on financial difficulties.

Another proxy that is predicted to affect the condition of the cooperation's financial difficulties is the company's ability to fulfill obligations to third parties. In this study, the leverage indicator is used. Leverage is one of the financial ratios that describe how much the company's wealth is obtained from third parties [3]. The greater the wealth sourced from third parties, the greater the obligations that must be fulfilled by the company which can result in a decrease in the company's financial performance. Financial distress itself starts from a condition where the company is no longer able to fulfill these obligations. Several previous studies have discussed the effect of leverage on financial distress, including Yudhistira's [10] research which revealed that leverage had a significant positive effect on financial difficulties, but this statement contradicted Ananto et al. [11]; Christine et al. [12] which found that leverage had a significant negative effect on financial distress. In contrast to Putri and Merkusiwati [13] who in their research found that leverage had no effect on financial distress.

Profitability includes all revenues received and costs incurred by the company in one period [11]. The greater the profitability of the company, it describes the company as having greater profits. If the profit generated by the company is greater, then the company has more funds that can be managed to fulfill its obligations to third parties and can overcome the occurrence of financial distress experienced by the firm. Therefore, the higher the profitability is, the lower the financial distress is. Andre [14] research results; Fathonah [15]; Rizki [16]; Wulandari [17] stated that profitability had a significant negative effect on financial distress. However, these results were not consistent with the research of Christine et al. [12] and Yudhistira [10] who suggested that profitability had a significant positive effect on financial distress. While other studies have found different results, namely leverage had no effect on financial distress [18] .

The board of directors is crucial components in corporate governance [6]. The greater of boards directors in a corporation, it creates a larger network with outside parties and ensures the availability of human resources to manage the company. With the larger number of the board, it can create various strategies and innovations that are increasingly varied to improve company performance. Therefore, by adding the board of directors has a direct impact on financial distress. Helena and Saifi's research [19] found that the board of directors and financial distress had a positive impact. This research was not support with Syofyan and Herawaty [20] which stated that the board of directors had decrease the level of financial distress. Meanwhile, another research supported by Putri and Merkusiwati [13] and Ananto et al. [11] revealed that the board of directors had no effect on financial distress.

Inconsistency of results found from several previous studies. Where there are still many studies that find no effect of firm size, leverage, profitability, and the board of directors on financial distress. This raises the researcher's suspicion that the four variables have an indirect effect on financial distress. Many other variables are thought to be able to influence financial distress, one of which is accounting conservatism. Accounting conservatism is defined as the precautionary principle in financial reporting where companies do not rush to recognize and measure assets and profits and immediately recognize losses and liabilities that may occur [21].

The principle of conservatism will not recognize profits directly, but losses are recognized directly by the company, causing assets and profits to be reported in understates. Lower profits can cause the company to find it difficult to fulfill obligations to third parties, thus triggering financial distress in the company. Therefore, accounting conservatism can have a significant positive effect on financial distress. Previous research has proven that there was a significant effect of accounting conservatism on financial distress. One of them is Kao and Sie [22] which in their research stated that accounting conservatism had a significant positive effect on financial distress. In addition, research by Saremi and Shorvarzi [23] found significant negative results of accounting conservatism on financial distress.

Positive accounting theory explains that in cateris paribus conditions, large companies will tend to apply accounting conservatism in financial reporting in order to get attention from the government to reduce the political costs charged to the company [24]. Therefore, the positive measure is thought to have a significant positive effect on accounting conservatism. This is supported by the research of Awalia and Daljono [25] which found that firm size had a significant positive effect on accounting conservatism, but in contrast to Firmasari [26] who in his research stated that firm size had a significant negative effect on accounting conservatism, and was not in line with research Sumiari and Wirama [27]; Terzaghi et al. [28] and Hani [29] which stated that firm size had no effect on accounting conservatism.

This study aimed to determine the effect of firm size, leverage, profitability, and the board of directors on financial distress experienced by the company either directly or indirectly with accounting conservatism as a mediating variable. The addition of accounting conservatism variables in the research model becomes originality in this study.

2 Method

The research population was all manufacturing companies listed on the Indonesia Stock Exchange (IDX) which were listed throughout 2017 to 2019. Sampling was carried out by using purposive sampling technique and 174 units of analysis were obtained. The research data used secondary data in the form of annual reports from each company. The research variables included firm size, leverage, profitability, and the board of directors as independent variables, accounting conservatism as a mediating variable and financial distress as the dependent variable. The firm size is total asset, leverage measured using total asset divided by equity. The profitability measured with return on asset, board of directors is total of directors in company. The accounting conservatism measured using market to book equity (market value of common equity divided by book value of common equity). Hypothesis testing used path analysis (path analysis). The use of path analysis created two regression models in one study. The regression model in this study is as follows:

Y_{FD} = a + b1LEV+ b2PROFIT + b3SIZE + b4DD + b5KON + e2.......................(1)

Y_{KON} = a + b1LEV + b2PROFIT + b3SIZE + b4DD + e1..(2)

3 Results and Discussion

Hypothesis testing uses path analysis through two regression equations. To ensure that data used feasible and goodness of fit was obtained to test the research hypothesis, the classical assumption test was completed. The classical assumption test used to test the two regression models in this study included tests for normality, autocorrelation, multicollinearity, and heteroscedasticity. From the result of assumption test, it was described that both regression models had passed the classical assumption and were declared fit.

Table 1. Regression Analysis Output of Model 1 (Financial Distress as Dependent Variable)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-2,553	1,040		-2,455	,015
Size	,136	,039	,251	3,497	,001
Lev	-,030	,013	-,151	-2,419	,017
Profit	3,226	,633	,393	5,095	,000
BD	-,067	,022	-,207	-3,019	,003

AC	,017	,007		,170	2,334	,021
a. Dependent Variable: FD						

(Output of IBM SPSS Statistic, 2020)

3.1 Firm Size and Financial Distress

From Table 1, the company size had a significant positive impact on financial distress with a coefficient score of 0.136 and sig. 0.001. These results can be interpreted that the larger the firm size, the higher the value of financial distress. This was because larger companies had increasingly complex operational activities, and were not matched by good management, resulting in unstable income earned by the company and causing various risks that may befall the company, including the risk of financial distress. The results of this study supported the research of Rahmawati and Khoirudin [4] which revealed that firm size had a significant positive impact on the level of financial distress, but was not support with Purwantara and Prasetyo [8]; Sastriana [6] and Cinantya and Merkusiwati [9] who in their research found that firm size and financial distress had no effect.

3.2 Leverage and Financial Distress

Leverage had a significant negative effect on financial distress with a coefficient value of -0.030 and Sig. value of 0.017. Companies that had a high leverage ratio showed that the company had obtained a large source of loan funds from external parties. Therefore, with the existence of these loans, the company had sufficient funds to be managed and utilized to overcome the financial problems that occurred, so that the financial distress that occurred in the company would decrease. The research result were not support with the research conducted by Putri and Merkusiwati [13] which stated that leverage had no effect on financial distress and was not in line with Ananto et al. [11] who found that leverage had a significant negative effect on financial distress.

3.3 Profitability and Financial Distress

The results showed that profitability had a positive effect on financial distress, because it had a Sig. value less than 0.05 namely 0.000 with a coefficient value of 3.226. This means that the greater the company's profitability would increase the occurrence of financial distress. This could happen due to several factors, including the large amount of liabilities that must be borne or the existence of poor financial management from the company's management which caused the company to experience financial distress despite having high profitability. The results of this study were in line with Christine et al. [12] and Yudhistira [10] whose research suggested that profitability had a significant positive effect on financial distress, but it was not in line with Andre's [14] research; Fathonah [15]; Rizki [16] and Wulandari [17] which stated that profitability had a significant negative effect on financial distress.

3.4 Board of Directors and Financial Distress

The results showed that the board of directors had a significant negative effect on financial distress with a coefficient -0.067 and Sig. 0.003. The result interpreted that the more the board of directors of a company could cause the level of the company's financial distress to decrease, because with the more presence of boards could create better and more varied strategies to manage the company, and overcome the company's financial problems. The results of this study were in line with Syofyan and Herawaty [20] which in their research stated that the board of directors had a significant negative effect on the possibility of financial distress. Putri and Merkusiwati [13] and Ananto et al. [11] who revealed that the board of directors had no effect on financial distress, and was not in line with Helena and Saifi [19] who found the board of directors had a significant positive effect on financial distress..

3.5 Accounting Conservatism and Financial Distress

The results of the research showed that the coefficient value of accounting conservatism on financial distress was 0.017 with Sig. 0.02, it can be interpreted that accounting conservatism had a significant positive effect on financial distress. This was because companies that applied the principle of accounting conservatism in financial reporting would produce pessimistic financial statements, where the value of profits would appear in the financial statements in lower amounts, if this continued to happen, management would have difficulty fulfilling the company's obligations. This could give a signal to stakeholders that the company was experiencing financial distress. Therefore, the higher of accounting conservatism relate to the higher the value of a company's financial distress. This research was in line with the research of Kao and Sie [22] which in their research stated that accounting conservatism had a significant positive effect on financial distress, but it was not in line with the research of Saremi and Shorvarzi [23] which found other results, namely accounting conservatism had a significant negative effect on financial distress.

Table 2. Regression Analysis Output of Model II (Accounting Conservatism as Dependent Variable)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-6,661	1,434		-4,644	,000
	Size	,240	,056	,319	4,307	,000
	Lev	-,041	,017	-,147	2,361	,019
	Profit	5,237	,704	,484	7,444	,000
	BD	-,151	,196	-,055	-,771	,442

a. Dependent Variable: KON

(Output of IBM SPSS Statistic, 2020)

3.6 Firm Size and Accounting Conservatism

Referring to Table 2, it was known that firm size had a positive effect on accounting conservatism with a coefficient 0.240 and Sig. 0.000. The result can be interpreted that the larger the firm size was, it could make the company increase the application of accounting conservatism, because the larger a company, the more careful management would be in managing finances, especially in recognizing assets or profits so that the resulting financial statements showed quality information to be used as the basis for making the right decisions and minimizing negative impacts that may occur in the future, in addition to minimizing the political costs of the company. This research was supported by the research of Awalia and Daljono [25] which found that firm size had a significant positive effect on accounting conservatism, but contrary to Firmasari [26] who in his research stated that firm size had a significant negative effect on accounting conservatism, and was not in line with research Sumiari and Wirama [27]; Terzaghi et al. [28] and Hani [29] which stated that firm size had no effect on accounting conservatism.

3.7 Leverage and Accounting Conservatism

The results of this study indicated that leverage had a significant positive effect on accounting conservatism, with a coefficient 0.041 and Sig. 0.019. These results can be interpreted that the higher the leverage of company, it would increase the application of accounting conservatism of the company itself. This was because the higher the leverage indicated the greater the conflict that may occur between the principal and the agent and the principal and the principal, to overcome this, there would be a contractual request to the company's management to apply accounting conservatism. The results of this study were supported by research Yuliarti and Yanto [30] which suggested that leverage had a significant positive effect on accounting conservatism in contrast to Viola and Diana [31] and Putri et al. [32] who in her research stated that leverage had a significant negative effect on accounting conservatism.

3.8 Profitability and Accounting Conservatism

The results of this study supported the assumptions formulated previously. From Table 2, it was described that the profitability coefficient showed 5.237 with a Sig. 0.000. It can be interpreted that the higher level of profitability of a corporation, it could cause the company to increase the application of accounting conservatism in financial reporting. This was intended as a form of corporate earnings management to suppress fluctuations that were too high in the company's profit value and prevented excessive transfer of company assets by the principal. The results of this study were supported by the research of Pratanda and Kusmuriyanto [33] and Rohadi [34] which suggested that profitability had a significant positive effect on financial distress, in contrast to Yuliarti and Yanto [30] which in their research stated that profitability had a significant negative effect on accounting conservatism.

3.9 Board of Directors and Accounting Conservatism

The results of the study indicated that the board of directors had no effect on accounting conservatism, because based on Table 2. It was known that the coefficient of the board of directors showed a value of -0.151 with Sig. value greater than 0.05 namely 0.442. This was because the board of directors in this study was proxied by the number of members of the board of directors, while the policy of implementing or not applying accounting conservatism in company financial reporting depended on the personal aspect of each member of the board of directors, not the number of members. In addition, the determination of policies was not only the will of the board of directors, but also adjusted to the conditions and needs of the corporation itself. The results of this study were consistent with research by Ammy [35] and Jarboui [36] which proved that the board of directors had a significant positive effect on accounting conservatism.

3.10 Firm Size on Financial Distress through Accounting Conservatism as a Mediation Variable

Based on the results of the Sobel test presented in Table 3, it was known that the indirect effect coefficient showed a value of 0.00408 with P 0.015. Therefore, the results of this study were consistent with the tenth hypothesis that had been formulated previously which stated that firm size has a significant positive effect on financial distress through accounting conservatism as a mediating variable.

Table 3. Sobel Test Results of the Effect of Firm Size on Financial Distress through Accounting Conservatism

Input	Coefficient of Direct Effect	*Standard Error*	Coefficient of Indirect Effect	P *(2-Tailed)*
A	0,240	0,000	0,00408	0,015
B	0,017	0,007		

(Secondary Data Processed, 2020)

The larger the firm size was, it caused management to be more careful and increasingly apply accounting conservatism in financial reporting in order to produce good financial information to serve as the basis for making company decisions so that it could reduce negative possibilities that may occur in the future. The higher the application of accounting conservatism was carried out by management, it would result in the company's level of financial distress increasing, this was because financial statements based on the principles of accounting conservatism would produce values that tended to be understated where company profits and assets would be recorded at a low value. Therefore, the higher the firm size, the higher the application of accounting conservatism, which in turn would have an impact on the increasing value of financial distress.

3.11 Leverage on Financial Distress through Accounting Conservatism as a Mediation Variable

The results of the study showed that leverage had no effect on financial distress through accounting conservatism as a mediating variable. Based on the results of the Sobel test presented in Table 4, it was known that the indirect effect coefficient showed a value of 0.004 with P 0.087. These results rejected the eleventh hypothesis that had been previously formulated.

Table 4. Sobel Test Results of the Effect of Company Leverage on Financial Distress through Accounting Conservatism

Input	Coefficient of Direct Effect	*Standard Error*	Coefficient of Indirect Effect	P *(2-Tailed)*
A	0,041	0,017	0,000697	0,087
B	0,017	0,007		

(Secondary Data Processed, 2020)

In the direct effect, it had been explained that higher leverage could increase the occurrence of financial distress, but with accounting conservatism as a mediating variable, leverage no longer had a significant effect on the company's financial distress. There were various factors that caused this. Researchers suspected that this happened because with the application of corporate accounting conservatism, the size of the leverage would not affect the amount of profit generated by a company, so it did not affect the company's financial distress.

3.12 Profitability on Financial Distress through Accounting Conservatism as a Mediation Variable

The twelfth hypothesis was supported by research results which revealed that profitability had a significant positive effect on financial distress through accounting conservatism as a mediating variable. Based on the results of the Sobel test presented in Table 5, it was known that the indirect effect coefficient showed a value of 0.004 with P 0.087. These results can be interpreted that the higher the profitability of a company, it would cause the company's management to increasingly apply the company's accounting conservatism and result in the company's financial distress value increasing.

Table 5. Sobel Test Results of the Effect of Company Profitability on Financial Distress through Accounting Conservatism

Input	Coefficient of Direct Effect	*Standard Error*	Coefficient of Indirect Effect	P *(2-Tailed)*
A	5,237	0,704	0,089029	0,020
B	0,017	0,007		

(Secondary Data Processed, 2020)

Management would further increase the application of accounting conservatism in the company's financial reporting when the company had higher profitability as a form of earnings management to avoid higher profit fluctuations while avoiding opportunistic actions by agents and principals. On the other hand, the application of higher accounting conservatism may indicate greater financial distress, this could occur because the application of accounting conservatism resulted in understated financial statements and reported earnings would tend to be lower.

3.13 Board of Directors on Financial Distress through Accounting Conservatism as a Mediation Variable

The results of this study rejected the thirteenth hypothesis that had been formulated previously. Based on the results of the Sobel test presented in Table 6, it was known that the indirect effect coefficient showed a value of 0.004 with P 0.087. These results could be interpreted that the board of directors had no effect on financial distress through accounting conservatism as a mediating variable.

Table 6. Sobel Test Results of the Effect of Company Profitability on Financial Distress through Accounting Conservatism

Input	Coefficient of Direct Effect	*Standard Error*	Coefficient of Indirect Effect	P *(2-Tailed)*
A	-0,151	0,196	0,002567	0,462
B	0,017	0,007		

(Secondary Data Processed, 2020)

This could happen because of several factors including the proxy used to measure the board of directors; in this study the board of directors was proxied by the number of boards of directors owned by a company. The application of accounting conservatism depended on the self-awareness of stakeholders including the board of directors; therefore, the large number of boards of directors owned by a company did not affect the application of accounting conservatism of the company, and did not affect the possibility of financial distress.

4 Conclusion

Conclusion of this study was that size, profitability, also accounting conservatism directly had a significant positive effect on financial distress, while leverage and the board of directors had a significant negative effect on financial distress. Meanwhile, based on the indirect effect, firm size, and profitability had a significant positive effect on financial distress through accounting conservatism as a mediating variable, while leverage and the board of directors had no effect on financial distress through accounting conservatism as a mediating variable. Suggestions for management are to maintain the quality of company management, especially in terms of finance to prevent financial distress, and apply accounting conservatism in the company's financial reporting, so that the information presented in the financial statements can be used as a relevant basis for decision making and provide signals for management to be more responsive and careful in managing finances to overcome losses that may occur in the future. Suggestions for further researchers are the use of other proxies to measure the variables of the board of directors, in addition to expanding the scope of research both in terms of the observation period, research object and variables used.

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