

**THE INFLUENCE OF MANAGERIAL ABILITY TOWARDS  
ACCOUNTING CONSERVATISM  
(A Study in Non-Cyclical Companies Listed on IDX)**

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**Abstract**

The purpose of this study is to examine whether managerial ability affects positively to conditional and unconditional conservatism among non-cyclical companies listed on Indonesia Stock Exchange (IDX). The data used in this study uses secondary data taken from the company's annual report that is provided in Indonesian Stock Exchange website as well as Bloomberg's Financial Analysis (FA) and Equity Screening (EQS) for the period 2012 to 2022. In this study, the population are non-cyclical or consumer goods companies listed on the Indonesia Stock Exchange (IDX) and the sampling method used is purposive sampling technique. In the process of analysis, this research uses multiple linear regression with robust standard error method. The results of the analysis show that managerial ability affects in mixed way such as positive, negative and some even have no effect either to conditional conservatism. In addition, it affects positively to unconditional conservatism. To the best of the authors' knowledge, few studies have explored the influence of managerial ability on accounting conservatism. For non-cyclical firms, this study's result gives significant contribution which focuses on examining the association between managerial ability and accounting conservatism, which has not been widely used in local studies.

*Keywords* Managerial ability, Conditional conservatism, Unconditional conservatism.

**INTRODUCTION**

A fundamental aspect of financial reporting is the effective conveyance of financial information to stakeholders in a credible and timely way. This is essential because reliable reporting can provide significant information that considered to assist objectively in assessing a company's performance (Salehi et al., 2020). It should be particularly valuable and relevant in judging past, current, and upcoming occurrences in order to be trustworthy, devoid of significant inaccuracy, and presented faithfully (Iatridis, 2011). Consequently, entities with high-quality disclosure are expected to provide verifiable information to stakeholders regarding losses, financial failures, and other unfavorable financial events.

Indonesia as a member of the G20 has fully adopted the International Financial Reporting Standard (IFRS) into its domestic or local standards, namely the Statement of Financial Accounting Standards or more familiarly known as SAK (Ikatan Akuntan Indonesia, 2017). Through IFRS adoption, earnings quality becomes more reliable since it is standardized (Krismiaji et al., 2016; Yurt & Ergun, 2015). Based on IFRS 13 and PSAK 68, the financial statements use valuation method based on fair value. The growth or decline in the value of assets may occur due to bookkeeping using the fair value method (Deloitte, 2017). By adopting the fair value method for valuation, it is essential to undertake a self-assessment (competence

required) or engage an appraiser's services if there is no active market value. As a result, managers intend to use conservative accounting standards when faced with uncertainty.

The existence of financial scandals has made accounting conservatism include as one of financial reporting aspects that has received high attention in companies such as Enron, the United States energy-based company. In 2001, Enron and Arthur Andersen accounting firm displayed fictitious income data and modifications to the balance sheet in order to obtain a positive financial performance assessment which resulted in a loss of up to US\$ 11 billion or equivalent to Rp. 159.5 trillion. In Indonesia, the issue of financial statement manipulation was once enlivened by one of the well-known state-owned enterprises (SOE), PT Garuda Indonesia Persero Tbk (GIAA) which was shocking in 2019. Referring to its 2018 financial statements, PT Garuda Indonesia made a positive net profit, which was reinforced by a collaboration with PT Mahata Aero Teknologi. The cooperation value reaches US\$ 239.94 million or around 3.48 trillion in Rupiah. In fact, the assets are still remained receivables, with contracts in place for the next 15 years. Conversely, it was recorded in the first year, recognized as income, and classified as other income. Consequently, the company that previously made a loss then suddenly made a profit (Sandria, 2021).

Watts et al. (2003) suggests that conservatism in accounting is a crucial aspect in improving accounting information quality. Conservatism leads to financial accounting prudence since it employs anticipating probable future losses without taking into consideration the likelihood of revenue prospect. In compliance with this policy, an organization's net income is recorded as understated due to a high level of qualifying. As a result, this technique can be defined as a "play it safe" strategy. With this manner, conservative accounting aids to constraint manager's devious reporting behavior and benefits users of financial statements (Ball & Shivakumar, 2005). Conservative accounting also reduces the moral hazard (ethical risk) and bad selection problems that exist between management as agent and stakeholder as principal. It is done by restricting managers from changing earnings so that investors and lenders are not misled and make unprofitable investment decisions (Watts et al., 2003).

According to prior research from Watts et al. (2003), conservatism in financial reporting refers to precautionary behaviour, particularly in profit and loss verifiability. Conservatism is frequently divided into two subtypes: conditional and unconditional conservatism (Beaver & Ryan, 2005). Conditional conservatism is a form of conservatism exists based on market conditions, earnings, and news (Basu, 2005). There are believes of "asymmetry of earning timing" with high degree of verification which stems for accountants' preference to recognize loss earlier rather than profit (Roychowdhury & Watts, 2007). Unconditional conservatism, as contrast to conditional conservatism, is unaffected by economic dispatch. It illustrates the concept of a "systematic downward bias" in book value as opposed to trade value, which includes activities such as faster depreciation or amortization procedures and budgeting for more than is projected to be required in the future (Hejranijamil et al., 2020). Therefore, unconditional conservatism is based on financial balance sheets.

Managers' capacity utilization to run a corporation is included as one of crucial factor in high-value financial reporting. As a type of corporate accountability to its stakeholders, the manager's ability is also significant. Several studies have found a link between non-financial firm financial reporting and a variety of managerial variables (Francis et al., 2008; Koh, 2011). According to these researches, managers play an essential part in financial reporting and have a significant impact on earnings through their operational actions (Choi et al., 2015). High-ability managers may employ conservatism to increase their credibility for cautious reporting methods and evade a potentially negative status for covering upcoming unfortunate presentation (Haider et al., 2021). Demerjian et al. (2012) argues lower earnings noise is one of the outcomes of efficient management that is knowledgeable about future economic

conditions. Better background and education are cited as key variables in establishing unique procedures for voluntary disclosure and improved reporting quality by competent managers (Bamber et al., 2010). With the specific abilities possessed by managers, it is increasingly difficult for competitors from a business to compete because of a dominant source of high-quality outcomes (Hatch & Dyer, 2004).

In Indonesia, non-cyclical or consumer goods sector is included as one of sectors whose production is highly demanded by many people. Indonesia Stock Exchange recorded a growth of 3.15%, the highest growth for the period 16 – 23 June 2022 for non-cyclical consumer goods. The primary consumer goods sector is mostly occupied by company that has big capital and defensive characteristics (Sugeng Adji Soenarso, 2022). Companies in this sector is crucial for society since it sell people's daily needs, such as instant food and beverages, toothpaste, soap, etc. Furthermore, the existence of social restrictions during Community Activities Restrictions Emergency Enforcement in COVID-19 period makes people tend to anticipate by increasing the supply of primary consumption goods or basic necessities. Hence, consumer non-cyclical sector also had a more stable performance compared to several other sectors during this period (Filbery, 2021). However, even though the shares of this non-cyclical consumer sector company are defensive, it does not always mean that this company has optimal financial conditions (Haider et al., 2021; Mahadi, 2021). Internal factors from company management that are pessimistic or optimistic can be seen in the company's financial statements in each reporting period. Therefore, it indicates that managers play important role to maintain good quality output not only in terms of products but also financial reporting.

Prior research conducted by Haider et al. (2021) provides empirical verification that there is positive association among high ability managers and conservatism in accounting. This research found that competent managers apply their outstanding abilities and experience to report conservative practices based on efficient contracts. Subsequently, high-competent managers adhere to conservatism in order to protect their reputations and future employment opportunities. It also supported with other study that shows positive effect of managerial ability to quality of financial reporting as part of accounting conservatism (García-Meca & García-Sánchez, 2018). In line with notion by Demerjian et al. (2013), it was found that the quality of earnings which is also part of conservatism has a constructive effect on high-quality management. In contrast, there are findings that support the notion that managerial aptitude is negatively connected with accounting conservatism. One of the studies shows that there is an adverse correlation between managerial ability and information risk (Petkevich & Prevost, 2018). Followed research by (Salehi et al., 2020) shows the findings where managerial overconfidence has an adverse effect on accounting conservatism, especially in the conditional way.

This research corresponds to studies carried out by Haider et al. (2021). The idea of this study is to scrutinize the influence of managerial ability on accounting conservatism on non-cyclical companies listed on Indonesia Stock Exchange. The difference in this study with previous research is the selection of sample using cyclical companies in Indonesia whereas previous research used Australian firms. This research uses Indonesian non-cyclical companies as sample since the research number on relationship managerial ability and accounting conservatism is still relatively low in Indonesia. In previous local studies, researchers frequently use independent variables such as managerial as well as institutional proprietorship, debt treaty, growth prospects, and audit committee. Furthermore, the type of accounting conservatism is not defined whether it is conditional or unconditional (Prastiwi Brilianti et al., 2013; Risdiyani et al., 2015; Septian & Anna, 2014; Sugiarto & Fachrurrozie, 2018). On the other hand, given the similarities in reporting requirements between the two territories, investigating the influence of managerial ability on accounting conservatism in Indonesia is a

noteworthy experimental endeavor. Both in Indonesia and Australia use the International Financial Reporting Standards (IFRS) which is principle-based. In its implementation, accountants will be given the authority to determine an accounting process such as greater flexibility for reporting assets, liabilities, and losses. Hence, professional judgment is needed in the form of highly skilled managers choose to exercise conservatism.

## **THEORETICAL FRAMEWORK, HYPOTHESES DEVELOPMENT**

The gap of knowledge asymmetry between the principal and the agent is implied by agency theory (Jensen & Meckling, 1976). Further study by Mitchell & Meacham (2011) states that agency theory is based on a connection between one party, the principal, who delegates certain tasks and decisions to another party, the agent. Principals delegate responsibilities to agents with the expectation that the agents will fulfill the tasks in the principals' best interests (Eisenhardt, 1989; Raith et al., 2009). As a theoretical foundation, agency theory may define conservatism as an instrument for navigating agency concerns that come from asymmetry of information among contractual parties. Conservatism, for instance, inhibits a manager's ability to overstate revenue to optimize salary structures (Raith et al., 2009). Accounting conservatism is important in this scenario for suppressing manager's opportunistic behavior related to contracts that employ financial reports. Financial statements that are presented conservatively will avoid management's opportunistic behavior such as exaggerating the amount of profit (Watts et al., 2003).

Positive accounting theory outlines why accounting policy is important for companies as well as individuals in financial reporting. Furthermore, it can forecast the accounting policies that corporations will choose under particular scenarios (Watts & Zimmerman, 1986). As this theory may reflect earnings management methods in businesses, it can be used to explain the nature of managers who act opportunistically and forecast the manager's poor performance, which is compensated for by an increase in company profits. Positive accounting theory assumes that by allowing managers to pick accounting policy based on personal goals, managers will rationally choose effective accounting policies (Ursula & Adhivinna, 2018).

Top management which filled by highly skilled human resource is considered as a key component of a business and is believed to have a significant impact on corporate outcomes (Fee & Hadlock, 2003). Managerial competence is seen as an essential human capital asset for both the organization (Fee & Hadlock, 2003; Francis et al., 2008; Mishra, 2014) and stakeholders (Yuan et al., 2019). In particular, managers with great competency are related to increased business value (Park et al., 2016; Yung & Chen, 2018). Thus, managers frequently make operational, investment, and financing company decisions that affect firm trait and performance (Bertrand & Schoar, 2003). Another stream of study addresses how more capable managers are more likely to participate in rent-seeking behavior. For instance, Francis et al. (2008) mentions that reputable CEOs who place too much emphasis on career advancement have the possibility to adopt activities that reduce earnings quality. In addition, reputable CEOs who are under pressure from various stakeholders may be more prone to manipulating results than CEOs who are not reputable (Malemendier & Tate, 2009).

Accounting conservatism is a crucial aspect of financial reporting. Conservative accounting techniques are used to depict a company's financial condition. It is one of the most important accounting issues because it demonstrates how economic values are mapped into earnings. As a result, financial reporting must be made with a high degree of verification and caution (Zhong & Li, 2017). Accounting conservatism is broadly divided into conditional and unconditional conservatism. Conditional conservatism is characterized by "asymmetry in earnings timing" and "news-dependent." It derives from accountant's preference for high-level verification of the recognition of positive rather than bad dispatch in report (Roychowdhury &

Watts, 2007). Consequently, companies tend to recognize losses or expenses more often before they actually occur. Unconditional conservatism, on the other hand, illustrates the concept of a "systematic downward bias" in book value compared to market value, implying that conservatism is unaffected by economic opinions or "news-independent" conservatism (Basu, 2005; Beaver & Ryan, 2005; Zhong & Li, 2017). With the constant application from board of directors, this form of conservatism leads to continually declining asset valuations. It entails depreciation and long-term asset amortize action at a greater rate than the predicted economic scale, as well as immediate expensing of the cost of internally generated intangible assets.

More capable managers comprehend their company's operations, macroeconomic conditions, technology, industry demand, and invest in high-value projects. Increasing corporate profits and considerable reporting quality such as earning management can be carried out efficiently by highly able managers (P. R. Demerjian et al., 2013). Different levels of verification in recognizing gains and losses are imposed by conditional conservatism, which is more emphasis on market-based or news-dependent conservatism views (Basu, 2005). Hence, managers can use their improved understanding to integrate conservatism into debt arrangements in order to guarantee and expand their market reputation.

In accordance with agency theory, it explains that the manager as an agent will use their expertise to execute the wants from the principal (Jensen & Meckling, 1976; Risdiyani et al., 2015). In addition, accounting positive theory describes that managers will choose the best method to maximize the earnings management (Hariyanto, 2020; Sugiarto & Fachrurrozie, 2018; Watts & Zimmerman, 1986). By implementing conditional conservatism, managers able to anticipate all forms of losses that will occur so that companies can make the right decisions to avoid all forms of losses that can threaten the sustainability of the company's operations (Zhang, 2008).

Companies which publish high-quality information tend to have a larger firm size, stock trading activity, and outsider ownership implying greater visibility. With great visibility, good profitability and liquidity metrics will incentivize managers to administer superior exposure to investors. Therefore, these solid financial results give a favorable impression to the stakeholders (Haider et al., 2021). In continuing with the notion that contracting debt is highly connected with conservatism, the reported earnings of enterprises with significant leverage tend to be more conservative. This phenomenon is possible to occur because of earlier recognition of losses to anticipate future losses (Roychowdhury & Watts, 2007). As part of financial reporting mechanism, conditional accounting conservatism is also proved to be influenced by high quality discloser which is the manager itself (P. R. Demerjian et al., 2013; García-Meca & García-Sánchez, 2018; Hasan et al., 2022). In addition, research conducted by Iatridis (2011) shows firm which has better quality of disclosure tend to apply higher level of conditional conservatism. The first hypothesis that will be examined is based on the prior explanation:

*H1. Managerial ability affects positively to conditional accounting conservatism.*

Managers with high competence may choose to report their company's financial condition with higher levels of accounting conservatism (Haider et al., 2021). Supported notion by Mishra (2014) states that competent managers having unique expertise to perform complex tasks effectively. Complex task such as the determining of accounting process on asset acquisition and generation of expected unrecorded goodwill from liabilities are part of unconditional conservatism action (Basu, 2005). Therefore, there is possibility that highly able manager applies unconditional conservatism in order to help company to produce high quality of reporting.

Within the framework of agency and positive accounting theory, which recognizes the contracting benefits of conservatism, highly capable managers could generate an incentive for

cautious accounting reporting. In accordance with agency theory, it explains that the manager as an agent will use their expertise to realise the desires of the principal (Jensen & Meckling, 1976; Risdiyani et al., 2015). As part of financial reporting users, managers able to facilitate earning management by applying unconditional conservatism (Ruch & Taylor, 2015). In line with positive accounting theory, it displays that manager will choose the best method to maximize earnings management (Watts & Zimmerman, 1986; Sugiarto & Fachrurrozie, 2018; Hariyanto, 2020).

According to the research from Haider et al (2021), the finding shows there is significant relationship between higher managerial ability for both type of accounting conservatism. Managers may opt to use unconditional conservatism over conditional conservatism to derive corporate tax liability as part of tax planning. For instance, managers record additional costs such as inventory reserves from real transactions rather than losses recognized from 'unreal' transactions as non-deductible (Qiang, 2007). Correspondingly, the decision of regulators to promote unconditional conservatism is influenced by the demand and preferences of its members. Furthermore, because of the substantial obstructive shocks caused by conditional conservatism, which are broadly undesired, these constituencies are more likely to support for unconditional conservatism (Qiang, 2007; Watts et al., 2003). The second hypothesis that will be examined is based on the prior explanation:

*H2. Managerial ability affects positively to unconditional accounting conservatism.*

## RESEARCH METHODOLOGY

The approach in this study is a mixed approach between cross sectional and time series, which called as panel data. The types of panel data which used in this study is unbalanced panel data means the cross-sectional unit has an uneven amount of time series observations (Gujarati & Porter, 2011). Furthermore, multiple linear regression test is utilized as an approach to provide the statistical data for hypothesis test in this study. Multiple linear regression test is done to explain and forecast the direction of the relationship between dependent and independent variables (Ghozali, 2016).

### *Population and statistical sample*

The sampling method used for this study is “purposive sampling” technique. In the purposive sampling technique, the sample is selected according to the criteria which suits the best for the purpose of study. The sample in this study the criteria used are:

- Non-cyclical companies listed on Indonesian Stock Exchange in 2012 – 2022.
- Non-cyclical companies which report financial statement on Indonesian Stock Exchange in 2012 – 2022.
- Non-cyclical firms who utilize Rupiah currency in their financial accounts.

**Table 1**  
**Variable Operational Definition**

Variable	Code	Indicator/ Proxy/ Measurement	Source
<i>Independent Variable</i> Managerial ability (X1)	Ind_Ad_ROA	Industry-adjusted ROA $= \text{yearly } \frac{\text{Net Profit After Tax}}{\text{Total Assets}} - \text{ROA from a non cyclical sectors}$	(Baik et al., 2011; Milbourn, 2003; Rajgopal et al., 2006)
	DEA	Firm efficiency $= \frac{\text{Sales}}{\text{COGS} + \text{S\&A} + \text{PPE} + \text{Ops Lease} + \text{R\&D} + \text{Goodwill} + \text{Other Int.Asset}}$	(Demerjian et al., 2012)
<i>Control Variable</i> Firm size	FS	Natural log of total assets	(Haider et al., 2021)
<i>Control Variable</i> Leverage	Leverage	$\text{DER} = \frac{\text{Total Debt}}{\text{Shareholders Equity}}$	(Krishnan & Visvanathan, 2008)
<i>Control Variable</i> Sales growth	Sales Growth	$\text{Sales Growth} = \frac{\text{Sales}_t - \text{Sales}_{t-1}}{\text{Sales}_{t-1}}$	(Ahmed & Duellman, 2007)

<i>Control Variable</i> Book Value per Share	BVPS	BVPS $= \frac{\text{Common Stockholders Equity} - \text{Shareholder's Equity - Preferred Equity}}{\text{Total Shares Outstanding}}$	(Balachandran & Mohanram, 2011)
<i>Control Variable</i> Compound Annual Growth Return	CAGR	$\text{CAGR} = \left( \frac{\text{Ending Value}}{\text{Starting Value}} \right)^{\frac{1}{N}} - 1$ N = number of year	(Horne & Wachowicz, 2008)
<i>Dependent Variable</i> Accounting conservatism (Y1)	EPS/Price <sub>t-1</sub>	Timeliness of earnings $= \frac{\text{Earning before Extraordinary Items}}{\text{Market Capitalization}} = \frac{\text{Profits after Tax}}{\text{Market Capitalization}}$	(Basu et al., 1997)
	CONS_ACC	Average total accruals $= \frac{(\text{Net Income} + \text{Depreciation} - \text{Cash Flow from Operation})}{\text{Total Assets}} \times (-1)$	(Givoly & Hayn, 2000)
	CONS_B/M	Book-to-market ratio $= \frac{\text{Common Shareholder's Equity}}{\text{Market Capitalization}} = \frac{\text{Total Equity}}{\text{Market value of Equity}} \times (-1)$	(Beaver et al., 2000)
	CONS_C	Balance sheet approach $= \frac{\text{R\&D Reserves} + \text{Advertisement Reserves} + \text{Inventory Reserves}}{\text{Net Operating Assets}}$	(Penman & Zhang, 2002)

### Dependent Variables

The dependent variable which used in this study consist of accounting conservatism. The variable is measured using timeliness of earnings ( $EPS/Price_{t-1}$ ), accrual-based approach ( $CONS\_ACC$ ), and market-based approach ( $CONS\_BM$ ) as part of conditional conservatism. Meanwhile, balance sheet approach ( $CONS\_C$ ) will be used as measurement for unconditional conservatism.

#### a) Timeliness of earnings ( $EPS/Price_{t-1}$ )

According to Basu et al. (1997), conditional conservatism is measured by the market reaction approach to the information disclosed by the company. Basu et al. (1997) applies the punctuality disproportion of earnings approach finds that future stock returns reflect how rapidly a firm's earnings display unfavorable news. Negative stock returns are considered bad dispatch, while positive stock returns are considered good dispatch. Conservatism is measured by forming a regression between stock returns and earnings (Basu et al., 1997). The following regression equation can be defined as follows:

$$EPS_t / P_{t-1} = \beta_0 + \beta_1 NEG_t + \beta_2 RETURN + \beta_3 NEG_t * RETURN + \varepsilon \dots (1)$$

where:

$EPS_t / P_{t-1}$  = Earnings before unusual costs (profit after tax) divided by market capitalization at the commencement of period.

$NEG_t$  = A dummy variable equal to 1 if  $RETURN < 0$ , otherwise 0.

$RETURN$  = Return period of 12 months, commencing three months after the previous fiscal year's ending.

$NEG_t * RETURN$  = Interaction term between  $NEG_t$  and  $RETURN$

$\varepsilon$  = Error term

#### b) Accrual-based approach accounting conservatism ( $CONS\_ACC$ )

In this study, the measurement method used for conditional conservatism is accruals-based approach which discovered by Givoly & Hayn (2000). In line with several literatures (Ahmed & Duellman, 2007; Ahmed & Henry, 2012; Krishnan & Visvanathan, 2008), the proxy measures conservatism through average total accruals ( $CONS\_ACC$ ) as net income added to depreciation, then deducted by cash flow from operations. After the deduction process, it is divided by total assets. The value of  $CONS\_ACC$  is then multiplied by -1. The higher the value, the higher the average total accrual which means the company is indicated have higher conservatism.

#### c) Market-based approach accounting conservatism ( $CONS\_BM$ )

The third measurement method used for conditional conservatism is market-based approach suggested by Beaver et al. (2000). The proxy measures conservatism through book-to-market ratio which is calculated by dividing total equities (book value of equity) with market value of equity or market capitalization. Then, it will be multiplied by -1. The higher the value of CONS\_BM, the higher the book-to-market ratio which means the company equity is undervalued and apply high conservatism.

d) Balance sheet approach accounting conservatism (CONS\_C)

The calculation of the other type of accounting conservatism, unconditional conservatism, can be calculated using the method suggested by Penman & Zhang (2002), namely the balance sheet approach. It is measured by dividing the total of all reserves utilized for future purposes by the firm's net operating assets at the end of period. A higher CONS\_C score implies that firms are more conservative in their accounting practices.

### *Independent Variables*

This study's independent variable is managerial ability, which is defined as a wide-ranging set of abilities for making superior strategic judgements in order to efficiently transfer corporate resources (such as capital, labor, and intellectual assets) into revenue or firm value in comparison to its industry counterparts (Baik et al., 2011; P. R. Demerjian et al., 2013). The variable is measured using industry-adjusted ROA and DEA firm efficiency.

a) Industry-adjusted ROA (*Ind\_Ad\_ROA*)

Industry-adjusted ROA is calculated by deducting yearly ROA of a firm to ROA of non-cyclical sector. The proxy has been widely used as measurement adopted in several study (Baik et al., 2011; Milbourn, 2003; Rajgopal et al., 2006). The higher the value, the higher the return on assets or profitability of a firm in a specific sector.

b) Firm Efficiency (*DEA*)

Firm efficiency is generally calculated by dividing sales by cost of goods sold, tangible assets and intangible assets. In this study, firm efficiency is measured using Data Envelopment Analysis (DEA) method which developed by Demerjian et al. (2012) and has been widely adopted in the accounting context (e.g. Haider et al., 2021). The efficiency metric assigns a value between 0 and 1, with firms with a value of 1 being extremely efficient and those with a value close to 0 being less efficient.

### *Control Variables*

In this study, the control variables used consist of firm size, leverage, sales growth, book value per share, and compound annual return.

a) Firm size (FS)

Firm size is identified by the natural log of total asset in certain period. The higher the value, means the firm size will be also higher (Haider et al., 2021).

b) Leverage

Leverage shows how much the company uses debt from external parties to finance the company's operations or to expand. Leverage is calculated using Debt to Equity Ratio (DER) by dividing total debt to shareholder equity. The higher the value, the higher the debt of equity ratio which means the leverage will be also higher (Krishnan & Visvanathan, 2008).

c) Sales growth

Sales growth is calculated by dividing the current sales which already deducted with preceding year sales. The higher the value, means the sales growth also will be higher (Ahmed & Duellman, 2007).

d) Book Value per Share (BVPS)

Allocating the common stockholder's equity by the number of outstanding shares is done in order to determine the book value per share (BVPS). This metric could indicate how much a company's stock is worth. If the BVPS value exceeds the market value per share, the company's stock is considered undervalued. According to the understanding, the larger the number, the higher the BVPS (Balachandran & Mohanram, 2011).

e) Compound Annual Growth Return (CAGR)

CAGR is calculated by dividing the value of an investment at the end of a period by its value at the commencement of that period. Then, it will be multiplied by an exponent of one divided by the number of years. Lastly, it subtracted one from the subsequent result. The interpretation of the number means that the higher number, the higher compound annual return (Horne & Wachowicz, 2008).

### Research models

The first regression model is used to test the first hypothesis, which aims to examine the relationship between conditional accounting conservatism based on timeliness of earning approach ( $EPS/Price_{t-1}$ ) as dependent variable and managerial ability ( $Ind\_Ad\_ROA$  and  $DEA$ ) as independent variable.

$$EPS/Price_{t-1} = \alpha + \beta_1 Ability + \beta_2 Neg + \beta_3 Return + \beta_4 Neg * Return + \beta_5 Neg * Return * Ability + \beta_6 Firm\_Size + \beta_7 Leverage + \beta_8 Sales\_Growth + \beta_9 BVPS + \beta_{10} CAGR + \varepsilon \dots (2)$$

The second regression model is used to test the first hypothesis, which aims to examine the relationship between conditional accounting conservatism based on accrual approach ( $CONS\_ACC$ ) as dependent variable and managerial ability ( $Ind\_Ad\_ROA$  and  $DEA$ ) as independent variable.

$$CONS\_ACC = \alpha + \beta_1 Ability + \beta_2 Firm\_Size + \beta_3 Leverage + \beta_4 Sales\_Growth + \beta_5 BVPS + \beta_6 CAGR + \varepsilon \dots (3)$$

The third regression model is used to test the first hypothesis, which aims to examine the relationship between conditional accounting conservatism based on market approach ( $CONS\_BM$ ) as dependent variable and managerial ability ( $Ind\_Ad\_ROA$  and  $DEA$ ) as independent variable.

$$CONS\_BM = \alpha + \beta_1 Ability + \beta_2 Firm\_Size + \beta_3 Leverage + \beta_4 Sales\_Growth + \beta_5 BVPS + \beta_6 CAGR + \varepsilon \dots (4)$$

The fourth regression model is used to test the second hypothesis, which aims to examine the relationship between unconditional accounting conservatism based on balance sheet approach ( $CONS\_C$ ) as dependent variable and managerial ability ( $Ind\_Ad\_ROA$  and  $DEA$ ) as independent variable.

$$CONS\_C = \alpha + \beta_1 Ability + \beta_2 Firm\_Size + \beta_3 Leverage + \beta_4 Sales\_Growth + \beta_5 BVPS + \beta_6 CAGR + \varepsilon \dots (5)$$

## RESULTS

### Descriptive Statistics

According to Table 2, it can be assumed that the data were mostly scattered unevenly and vary varied since the value of mean was greater than standard deviation. Meanwhile,  $DEA$ ,

firm size, leverage, and *BVPS* were found to be evenly distributed and not experienced significant variation. In relation to dummy variable, which used to see proportion of negative earnings, Table 3 shows 46.193 percent of businesses have negative return on investment, while the remaining 53.807 percent have the opposite one.

**Table 2**  
**Descriptive Statistical Test**

Variable	N	Mean	Std. Dev.	Min	Max
EPS/Price <sub>t-1</sub>	197	0.7966013	0.9162378	0.004077	2.395695
CONS_ACC	197	-0.2258941	0.2026201	-0.6334099	0.0273306
CONS_BM	197	-0.000579	0.0005003	-0.0015669	-0.0000668
CONS_C	197	0.0191378	0.029171	0	0.0708444
Ind_Ad_ROA	197	-2.118487	5.144577	-8.392985	4.127015
DEA	197	0.763179	0.1181208	0.588706	0.950367
Return	197	0.0280452	0.248245	-0.3372093	0.5
Neg*Return	197	-0.0856887	0.119405	-0.3372093	0
Neg*Return*Ind_Ad_ROA	197	0.068556	0.1093489	0	0.2511045
Neg*Return*DEA	197	0.0556393	0.0891195	0	0.2048545
Firm Size	197	29.10959	1.754879	25.3614	32.82039
Leverage	197	34.47579	34.03247	0	99.01
Sales Growth	197	6.14269	12.14881	-14.76	26.05
BVPS	197	788.8968	731.9036	116.85	2118.85
CAGR	197	6.086497	6.497435	-4.73	15.67
<b>Valid N (listwise)</b>	<b>197</b>				

**Table 3**  
**Descriptive Statistics for Dummy Variable Negative Earnings**

Dummy Variable	Category	Category Description	Frequency	Percentage (%)
Neg	1	If Return is negative (-)	91	46.193%
	0	If Return is positive (+)	106	53.807%

#### Model Significant Test

The Chow, Hausman, and Lagrange Multiplier (LM) tests were used to identify the best model for panel data regression. The Chow test was used to compare common and fixed effect; the Hausman test was used to compare random and fixed effect; and the Lagrange Multiplier (LM) test was used to compare common and random effect (Gujarati & Porter, 2011). Based on Table 4, it is found that the model used for odd number regression is random effect model (REM) while for even regression is fixed effect model (FEM).

**Table 4**  
**Model Significant Test**

H.	Reg.	Dependent Variable	Independent Variable	Model Significance Test	Value	Model Result	
	1st	EPS/Price <sub>t-1</sub>	Ind_Ad_ROA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.3442	Random
				LM	Prob Chi-square	0.0000	
H1.	2nd	CONS_ACC	Ind_Ad_ROA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.0032	Fixed
				LM	Prob Chi-square		
	3rd	CONS_BM	Ind_Ad_ROA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.1821	Random
				LM	Prob Chi-square	0.0000	
H2.	4th	CONS_C	Ind_Ad_ROA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.0001	Fixed
				LM	Prob Chi-square		
	5th	EPS/Price <sub>t-1</sub>	DEA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.0981	Random
				LM	Prob Chi-square	0.0000	
H1.	6th	CONS_ACC	DEA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square		Fixed
				LM	Prob Chi-square		
	7th	CONS_BM	DEA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.3276	Random
				LM	Prob Chi-square	0.0000	
H2.	8th	CONS_C	DEA	Chow	Prob. F	0.0000	
				Hausman	Prob Chi-square	0.0000	Fixed
				LM	Prob Chi-square		

## Multicollinearity Test

From the multicollinearity test shown in Table 5 and Table 6, it is obtained that there are no variables that have a correlation value more than 0.90. Therefore, it can be concluded that there is no linear relationship between each independent variable or means non-multicollinear.

**Table 5**  
**Pearson Correlation Matrix 1**

	Ind_Ad _ROA	Firm Size	Leverage	Sales Growth	BVPS	CAGR	Neg	Return	Neg *Return	Neg *Return *Ind_Ad _ROA
<b>Ind_Ad_ROA</b>	1.0000									
<b>Firm Size</b>	0.3989	1.0000								
<b>Leverage</b>	-0.5111	0.0663	1.0000							
<b>Sales Growth</b>	0.2481	0.1887	0.0700	1.0000						
<b>BVPS</b>	0.1171	0.3889	-0.1301	0.1239	1.0000					
<b>CAGR</b>	0.3079	0.4829	0.0965	0.4945	0.1119	1.0000				
<b>Neg</b>	-0.1202	0.0059	0.0614	0.0443	0.0030	0.0146	1.0000			
<b>Return</b>	0.2285	0.0575	-0.0566	0.2389	-0.0222	0.2493	-0.0110	1.0000		
<b>Neg*Return</b>	0.1742	0.1076	-0.0371	0.1797	0.0219	0.2510	-0.0248	0.8115	1.0000	
<b>Neg*Return*</b>										
<b>Ind_Ad_ROA</b>	-0.5704	-0.1845	0.2674	-0.1471	0.0066	-0.1724	-0.0280	-0.5857	-0.6175	1.0000

**Table 6**  
**Pearson Correlation Matrix 2**

	DEA	Firm Size	Leverage	Sales Growth	BVPS	CAGR	Neg	Return	Neg *Return	Neg *Return *DEA
<b>DEA</b>	1.0000									
<b>Firm Size</b>	0.3916	1.0000								
<b>Leverage</b>	0.0753	0.0663	1.0000							
<b>Sales Growth</b>	0.2983	0.1887	0.0700	1.0000						
<b>BVPS</b>	0.1728	0.3889	-0.1301	0.1239	1.0000					
<b>CAGR</b>	0.4383	0.4829	0.0965	0.4945	0.1119	1.0000				
<b>Neg</b>	-0.0262	0.0059	0.0614	0.0443	0.0030	0.0146	1.0000			
<b>Return</b>	0.0718	0.0575	-0.0566	0.2389	-0.0222	0.2493	-0.0110	1.0000		
<b>Neg*Return</b>	0.0331	0.1076	-0.0371	0.1797	0.0219	0.2510	-0.0248	0.8115	1.0000	
<b>Neg*Return</b>										
<b>*DEA</b>	-0.1605	-0.1847	0.2678	-0.1465	0.0041	-0.1718	-0.0286	-0.5865	-0.6216	1.0000

## Hypothesis Test

Given the results obtained from Table 7, it is clear that managerial ability has various partial effect on accounting conservatism. According to the first and third regression model, it illustrates that *Ind\_Ad\_ROA* is positively significant and suggests that higher level managerial ability improves the level of conditional conservatism in the form of *EPS/Price<sub>t-1</sub>* and *CONS\_BM*. The results of the test are in line with the previous study by Roychowdhury & Watts (2007), Iatridis (2011), and Haider et al. (2021) which state high quality disclosers as part of managerial ability tend to exhibit higher conditional conservatism.

**Table 7**  
**T-Statistical Test**

Independent Variable:	Ind_Ad_ROA								DEA							
	EPS/Price <sub>t-1</sub>		CONS_ACC		CONS_BM		CONS_C		EPS/Price <sub>t-1</sub>		CONS_ACC		CONS_BM		CONS_C	
Model Regression:	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	t	P>t	t	P>t	t	P>t	t	P>t	t	P>t	t	P>t	t	P>t	t	P>t
Managerial Ability	2.16	0.031	-4.18	0.000	3.42	0.001	2.06	0.045	0.78	0.433	-2.37	0.022	-0.6	0.546	2.09	0.042

Firm Size	0.05	0.961	-0.32	0.753	0.74	0.460	0.41	0.681	0.26	0.794	-0.76	0.452	0.94	0.348	0.64	0.525
Leverage	-1.14	0.255	1	0.321	0.69	0.489	-0.86	0.396	-2.28	0.022	2.4	0.021	-0.05	0.956	-0.97	0.339
Sales Growth	-1.07	0.286	2.35	0.023	-1.92	0.055	-0.51	0.611	-0.49	0.625	1	0.324	-0.55	0.580	-0.31	0.758
BVPS	1.63	0.104	0.21	0.834	-1.55	0.121	3.56	0.001	1.79	0.074	-0.15	0.883	-0.79	0.427	3.48	0.001
CAGR	1.98	0.048	-1.24	0.223	1.23	0.219	-0.44	0.661	1.44	0.150	-0.24	0.809	1.25	0.210	-1.44	0.155
Neg	1.09	0.277							0.85	0.394						
Return	-0.75	0.453							-0.6	0.549						
Neg*Return	2.51	0.012							2.03	0.042						
Neg*Return*Managerial Ability	1.02	0.309							0.29	0.774						
cons	0.28	0.782	-0.08	0.933	-1.09	0.274	-0.45	0.654	-0.14	0.891	0.69	0.496	-1.19	0.235	-0.89	0.376

It is also found that the first hypothesis is rejected on second and fifth model. Both of these regressions which use *Ind\_Ad\_ROA* and *DEA* as measurement for managerial ability, demonstrate negative influence to accrual-based conditional conservatism (*CONS\_ACC*). These results are in line with researches conducted by Salehi et al. (2020) and Petkevich & Prevost (2018) which show an adverse relationship between managerial ability and conditional conservatism. In addition, these findings are in accordance with several studies which show proof that high-ability managers are linked to more detrimental profits quality (Francis et al., 2008; Malemendir & Tate, 2009; Gul et al., 2018; Demerjian et al., 2020). Furthermore, the first hypothesis is also rejected on sixth and seventh regression model since it has no effect on timeliness of earnings ( $EPS/Price_{t-1}$ ) and market-based conditional conservatism (*CONS\_BM*). In the circumstances which highly effective manager has implemented well timeliness earning and market-based conditional conservatism, it can be concluded that the higher the level of managerial ability does not determine the higher the level of conditional conservatism.

On the contrary, the second hypothesis is accepted since values of the statistics of the T-test passed the provisions. It shows that *Ind\_Ad\_ROA* and *DEA* will contribute significantly to increasing the level of unconditional conservatism proxied using *CONS\_C*. In this study, the result is in accordance with the research which done by Watts (2003), Qiang (2007), and Haider et al. (2021) which state that unconditional accounting conservatism is significantly higher when the firm is filled with highly able managers.

**Table 8**  
**F-Statistical Test**

	Independent: Ind_Ad_ROA		Independent: DEA	
	F-values	Prob. F	F-values	Prob. F
$EPS/Price_{t-1}$	39.60	0.0000	30.00	0.0009
<i>CONS_ACC</i>	6.50	0.0001	3.97	0.0028
<i>CONS_BM</i>	17.94	0.0064	8.42	0.2087
<i>CONS_C</i>	6.38	0.0001	7.38	0.0000

**Table 9**  
**R-Squared Test**

	Independent: Ind_Ad_ROA		Independent: DEA	
	R-squared		R-squared	
$EPS/Price_{t-1}$	0.1613		0.1591	

CONS_ACC	0.7120	0.3606
CONS_BM	0.3825	0.1959
CONS_C	0.0071	0.0159

Referring to the simultaneous test results, managerial ability is shown influencing in a significant way for all models, except for the seventh model regression. Table 8 can be interpreted that managerial ability with the help of control variables consisting of firm size, leverage, sales growth, book value per share, and compound annual growth return has a significant effect on all types of conditional conservatism, except for the seventh model which uses a market-based approach (X1: DEA; Y1: CONS\_BM). Moreover, Table 9 and Table 10 illustrates accounting conservatism is mostly influenced by low level rate of managerial ability, except second model (X1: Ind\_Ad\_ROA; Y1: CONS\_ACC).

**Table 10**  
**Summary of Classical and Hypothesis Test**

Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Independent Variables	Ind_Ad_ROA				DEA			
Dependent Variables	EPS/Price <sub>t-1</sub>	CONS_ACC	CONS_BM	CONS_C	EPS/Price <sub>t-1</sub>	CONS_ACC	CONS_BM	CONS_C
	Timeliness of earnings	Accrual-based	Market-based	Balance-sheet	Timeliness of earnings	Accrual-based	Market-based	Balance-sheet
Effect Model	Random	Fixed	Random	Fixed	Random	Fixed	Random	Fixed
<b>1. Classical Assumption Test</b>								
1.4. Autocorrelation	X	✓	X	✓	X	✓	X	✓
<b>2. Hypothesis Test</b>								
2.1. T-Test (Partial)	Influence positively (H <sub>1</sub> accepted)	Influence negatively (H <sub>1</sub> rejected)	Influence positively (H <sub>1</sub> accepted)	Influence positively (H <sub>2</sub> accepted)	Not influencing (H <sub>1</sub> rejected)	Influence negatively (H <sub>1</sub> rejected)	Not influencing (H <sub>1</sub> rejected)	Influence positively (H <sub>2</sub> accepted)
2.2. F-Test (Simultaneous)	Significantly influential	Significantly influential	Significantly influential	Significantly influential	Significantly influential	Significantly influential	Not influencing	Significantly influential
2.3. Coefficient of Determination (R <sup>2</sup> )	Influence by 16.13%	Influence by 71.20%	Influence by 38.25%	Influence by 0.71%	Influence by 15.91%	Influence by 36.06%	Influence by 19.59%	Influence by 1.59%
	Low	High	Low	Very low	Low	Low	Low	Very Low

Notes: All regression model for hypothesis test use "robust standard error" model.

## CONCLUSION

This study aims to examine the influence of managerial ability on both types of accounting conservatism which are conditional and unconditional conservatism of non-cyclical companies listed in Indonesian Stock Exchange based on IDX-IC from 2012 to 2022. The total number of samples used after purposive sampling, missing value removal, and outlier elimination was 197. According to the processes of data collection, analysis, and interpretation of outcomes, the conclusions that can be drawn that managerial ability has various effects on conditional conservatism where the effect depends on the type of conditional conservatism approach used. Some of the approaches have had a significant effect both positively and negatively. However, there is also approach methods that have no effect. Conversely, it is found that managerial ability has positive and significant effect on unconditional conservatism. In addition, managerial ability is found to have simultaneous effect with control variable to conditional and unconditional conservatism.

This study provides several contributions. This study provides insights into managerial ability effects for Indonesian non-cyclical firms, an important area currently under-researched. As a result, there are implications for investors, regulators, and other stakeholders when assessing managerial ability in financial reports, particularly in the non-cyclical industry.

Furthermore, this study adds to an existing repository of knowledge on accounting conservatism and managerial abilities.

Like other research, this research has limitations. Particularly, among the limitations comes the selected sample. Given that this research excludes other sectors from the sample, the findings can only be generalized to non-cyclical companies. It should also be mentioned that this study is limited to the Indonesian context. As a result, the findings of the study may not be applicable to different countries with distinct organizational environments and regulatory requirements. Considering the study's results, it may only be applied to non-cyclical companies listed on IDX. As a result, additional research can broaden this study by including other industries in other comparable countries. Lastly, future research can expand this study by including additional variables related to the issue in order to more precisely test the relationship between managerial ability and accounting conservatism.

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