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Earnings Volatility and Leverage on Accounting Conservatism: Evidence from Indonesian Food and Beverage Companies

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A B S T R A C T

This research examines the effect of earnings volatility and leverage on accounting conservatism in food and beverage sub-sector companies listed on the Indonesia Stock Exchange. This research adopts a quantitative approach using secondary data from financial statements for the 2019-2023 period. The population consists of food and beverage sub-sector companies listed on the IDX, with a sample of 23 companies selected through purposive sampling. The independent variables are earnings volatility, measured by the standard deviation of EBIT, and leverage, measured by the debt-to-assets ratio. The dependent variable is accounting conservatism, measured using the Givoly and Hayn model. Hypothesis testing was conducted using multiple linear regression analysis with SPSS version 27. The findings indicate that earnings volatility has a negative and significant effect on accounting conservatism, suggesting that management tends to reduce conservatism application during high earnings fluctuations to avoid negative investor perceptions and maintain reporting stability. Meanwhile, leverage shows a positive and significant effect on accounting conservatism, indicating that companies with high leverage implement conservatism as a response to creditor monitoring demands.

KATA KUNCI

Konservatisme Akuntansi, Volatilitas Laba, *Leverage*, Subsektor Makanan dan Minuman, *Financial Reporting*

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A B S T R A K

Penelitian ini menguji pengaruh volatilitas laba dan *leverage* terhadap konservatisme akuntansi pada perusahaan sub sektor makanan dan minuman yang terdaftar di Bursa Efek Indonesia. Penelitian ini menggunakan pendekatan kuantitatif dengan data sekunder dari laporan keuangan periode 2019-2023. Populasi terdiri dari perusahaan sub sektor makanan dan minuman yang terdaftar di BEI, dengan sampel sebanyak 23 perusahaan yang dipilih melalui *purposive sampling*. Variabel independen adalah volatilitas laba yang diukur dengan standar deviasi EBIT dan *leverage* yang diukur dengan *debt-to-assets ratio*. Variabel dependen adalah konservatisme akuntansi yang diukur menggunakan model Givoly dan Hayn. Pengujian hipotesis dilakukan menggunakan analisis regresi linear berganda dengan SPSS versi 27. Hasil penelitian menunjukkan bahwa volatilitas laba berpengaruh negatif dan signifikan terhadap konservatisme akuntansi, mengindikasikan bahwa manajemen cenderung mengurangi penerapan konservatisme saat menghadapi fluktuasi laba tinggi untuk menghindari persepsi negatif investor dan menjaga stabilitas pelaporan. Sementara itu, *leverage* berpengaruh positif dan signifikan terhadap konservatisme akuntansi, menunjukkan bahwa perusahaan dengan *leverage* tinggi menerapkan konservatisme sebagai respons terhadap tuntutan monitoring kreditor.

1. Introduction

Financial statements are vital instruments in presenting relevant and reliable financial information to stakeholders for economic decision-making. Among the principles adopted in the process of financial reporting, one of them is the principle of conservatism. Statement of Financial Accounting Concepts (SFAC) No. 2 published by the Financial Accounting Standards Board (FASB) states that accounting conservatism is a cautious way of responding to uncertainty in order to make sure that business risks have been adequately considered and to prevent the presentation of overstated information [1]. Accounting conservatism leads to persistent negative accruals over a considerable amount of time, reflecting a tendency to report lower profits compared to the operating cash flow generated [2]. The principle of conservatism is a concept where expenses along with liabilities are recognized as soon as possible despite the uncertainty regarding the outcome, whereas income and assets are only recognized when there is a clear certainty that they will be received [3].

Companies that do not implement the principle of accounting conservatism will record excessively inflated profits, leading to inaccurate performance indicators in subsequent periods [4]. One example of irregularities in financial reporting in the sub-sector of food and beverage occurred at PT Tiga Pilar Sejahtera Food Tbk (AISA) from 2019 to 2020. The investigation

report by Ernst & Young revealed indications of overstatement by PT Tiga Pilar Sejahtera Food amounting to IDR 4 trillion, which included overstatements in revenue, inventory, and fixed assets accounts [5]. It can be observed that the company did not comply with accounting conservatism principles and management failed to exercise prudence in preparing financial statements, resulting in misleading information that misinformed stakeholders. This phenomenon indicates that the implementation of accounting conservatism principles in Indonesia is still relatively low.

Earnings volatility is one of the financial factors associated with accounting conservatism practices. Earnings volatility is defined as fluctuations or variability in the earnings of a company over time, a reflection of the level of uncertainty and business risk faced by the company [6]. Companies with high earnings volatility tend to face pressure to stabilize their financial reporting, prompting management to implement less conservative accounting policies in an effort to reduce reported profit fluctuations [7].

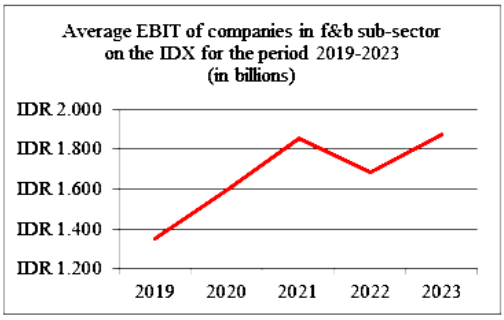

Figure 1. Earnings Volatility Chart

Figure 1 shows that the food and beverage sub-sector in Indonesia experienced significant fluctuations in Earnings Before Interest and Taxes (EBIT) during the 2019-2023 period. These fluctuations indicate earnings volatility, which can be caused by various factors. This phenomenon is relevant to examine given that high earnings volatility has implications for the quality of financial reporting.

Leverage is also a factor that is related to accounting conservatism. Leverage describes the proportion of company's capital structure that comes from debt financing, which is a reflection of the level of financial risk faced by the company [8]. Companies with high leverage face close scrutiny from creditors and financial institutions, which encourages management to adopt accounting practices that are more conservative as a form of prudence in financial reporting [9].

Previous research on the relationship between leverage and accounting conservatism has been conducted extensively, but there are still inconsistencies among the results. In addition, no research has specifically discussed the effect of earnings volatility on accounting conservatism. This research attempts to resolve the gap by using earnings volatility and leverage as independent variables and testing their direct effect on accounting conservatism. This research aims to add new knowledge and insight, provide empirical evidence regarding the effect of earnings volatility as well as leverage on accounting conservatism.

2. Research Method

This research refers to the Agency Theory proposed by Jensen and Meckling, which explains that the relationship between principals (owners) and agents (management) has the potential to cause conflicts of interest due to differences in objectives. Management has greater access to internal company information and therefore tends to act opportunistically [10]. Accounting conservatism is a condition where a company reports lower earnings than its operating cash flow. In this research, accounting conservatism measured through the accruals with the Givoly and Hayn model. The accrual value is the ratio between net income with operating cash flow. A negative accrual value indicates that net income is lower than operating cash flow, which is an indication of accounting conservatism principles application [11], [12]. The formula presented in Equation (1).

$$CONACC = \frac{NI + DEP - OCF}{Total\ Assets} \quad (1)$$

Where NI is current year profit. DEP is Depreciation of fixed assets. OCF is operating cash flow. Earnings volatility is the level of instability in a company's earnings from one period to another. Earnings volatility is measured using the standard deviation of EBIT during the 2019–2023 period. A greater standard deviation value indicates higher EBIT variation during that period, which indicates that the company's earnings are unstable [13]. The formula presented in Equation (2).

$$EVOL = \frac{EBIT\ Standard\ Deviation}{Total\ Assets} \quad (2)$$

Leverage is an indicator that shows how heavily a company utilizes debt financing to finance all of the assets that it has. The greater the proportion of debt to total assets, the higher the financial risk faced by the company, because the burden of repaying the debt and interest increases [14]. Leverage is measured in this research using Debt-to-Assets Ratio (DAR), which can be seen on Equation (3).

$$DAR = \frac{Total\ Liabilities}{Total\ Assets} \quad (3)$$

This research employs a quantitative approach using secondary data from financial statements. The population consists of food and beverage sub-sector companies listed on the Indonesia Stock Exchange. Using purposive sampling method, 82 samples were obtained from the period 2019 to 2023. Data analysis

was conducted using SPSS version 27, including classical assumption tests and multiple linear regression analysis.

3. Result and Discussion

3.1. Classical Assumption Test

The Kolmogorov-Smirnov normality test was conducted by making a comparison of the test results with the significance level. A greater significance value than 0.05 is an indication that the data shows a distribution that is normal.

Table 1. Normality Test Results

		Unstandardized Residual
N		82,00000000
Normal Parameters[a,b]	Mean	0.00000000
	Std. Deviation	0.03272637
Most Extreme Differences	Absolute	0.06700000
	Positive	0.06700000
	Negative	-0.06000000
Test Statistic		0.06700000
Asymp. Sig. (2-tailed)		0.20000000[c,d]

Referring to Table 1, the Asymp.Sig (2-tailed) value in the Kolmogorov-Smirnov test shows a value of 0.200, which is above the significance level of 0.05, thus indicating that the data is normally distributed. This research used the Glejser test for heteroscedasticity test, with the criterion that if the Sig. value exceeds 0.05, no heteroscedasticity is found in the regression model

Table 2. Heteroscedasticity Test Results

Variable	Sig.
Earnings Volatility	0.942
Leverage	0.598

Referring to Table 2, earnings volatility has a Sig. value of 0.942 > 0.05 and leverage shows a Sig. value of 0.598 > 0.05, an indication of no heteroscedasticity in this research regression model. Multicollinearity test determines if a correlation is present between variables in the regression model. If the tolerance value is below 0.10 with the VIF exceeding 10, a multicollinearity is detected.

Table 3. Multicollinearity Test Results

Variable	Tolerance	VIF
Earnings Volatility	0.996	1,004
Leverage	0.996	1,004

Referring to Table 3, the outcomes of the multicollinearity test demonstrate that the tolerance value exceeds 0.10 and the VIF value is not below 10. This is an indication that the independent variables in the research can be used because no multicollinearity is present. The Durbin-Watson test is used for this research autocorrelation testing**.** This test is conducted to assess whether a correlation is present between one period with another.

Table 4. Autocorrelation Test Results

Model	R	R Square	Std. Error of the Estimate	Durbin-Watson
1	0.613[a]	0.376	0.033138	1.714

Referring to Table 4, the Durbin-Watson value obtained is 1.714. With the number of independent variables (k) of 2 and the number of samples (n) of 82, according to the Durbin-Watson table, the lower limit (dl) is 1.5915 and the upper limit (du) is 1.6913. No autocorrelation is found because 1.714 is within the range of 1.6913 < 1.714 < 2.3087.

3.2. Coefficient of Determination Test (R^2)

This test was conducted to evaluate the capacity of the model in explaining the proportion of the dependent variable, namely accounting conservatism, which is simultaneously affected by independent variables, namely earnings volatility and leverage. The outcomes of the coefficient of determination test on Table 5 show that the R Square (R^2) value is 0.376 or equal to 37.6%. This means that accounting conservatism, can be explained by 37.6% by earnings volatility and leverage. Whereas the remaining 62.4% is explained by various factors that are not in this current research.

Table 5. Coefficient of Determination Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.613[a]	0.376	0.0360	0.033138

3.3. Model Fit Test (F Test)

This test intends to determine the overall validity of the regression model, which is to discover whether the independent variables collectively explain the dependent variable. As can be seen from the Table 6, the Sig. value obtained is 0.000, which is below the significance margin of 0.05. This finding is an indication that the multiple linear regression model is declared fit to describe the correlation between the independent with the dependent variables.

Table 6. Model Fit Test Results (F Test)

Model	*Sum of Squares*	df	*Mean Square*	F	*Sig.*
Regression	0.052	2	0.026	23.772	0.000[b]
1 Residual	0.087	79	0.001		
Total	0.139	81			

3.4. Hypothesis Test (t Test)

The conduct of this test is to partially test hypotheses, to determine how far each independent variable affects the dependent variable. This test is performed by referring to each variable's significance value, through the use of a significance level of 0.05 (α = 5%). A Sig. value exceeding 0.05 signifies the rejection of the hypothesis. Conversely, a significance value below 0.05 signifies the acceptance of the hypothesis.

Table 7. Model Fit Test Results (F Test)

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.003	0.010		0.344	0.732
	Earnings Volatility	-0.820	0.126	-0.579	-6.504	0.000
	Leverage	0.056	0.021	0.238	2.669	0.009

Referring to the t test outcomes in Table 7, the interpretation of the hypothesis testing results is explained as follows:

a. The first hypothesis states that earnings volatility negatively and significantly affects accounting conservatism, meaning that an inverse relationship is present between the two variables. From the test results in Table 4.11, a regression coefficient value of -0.820 was obtained, indicating a negative relationship, and a significance value of 0.000. Due to the significance value falling below 0.05, an interpretation can be made that earnings volatility significantly affects accounting conservatism, so H_1 is accepted.

b. The second hypothesis states that leverage positively and significantly affects accounting conservatism. This means that a direct relationship is present between leverage with accounting conservatism. From the outcomes in Table 4.11, the regression coefficient value is 0.056, indicating a positive direction, and the significance value is 0.009. Given the Sig. value is below 0.05, an interpretation can be drawn that leverage significantly affects accounting conservatism, thus H_2 is accepted.

3.5. The Effect of Earnings Volatility on Accounting Conservatism

The hypothesis test shows that earnings volatility negatively and significantly affects accounting conservatism. This finding indicates that a higher level of earnings volatility of a company is an indication of lower level of the applied accounting conservatism. When a company experiences high earnings fluctuations, management tends not to strictly apply the principle of conservatism for fear of worsening investors' perceptions of company performance stability. High earnings volatility encourages management to focus more on stabilizing financial reporting rather than applying the principle of prudence, which could potentially exacerbate the instability.

This research findings are backed by the basic concept of accounting conservatism, which requires immediate recognition of losses but delayed recognition of gains. In the framework of Financial Accounting Standards in Indonesia, particularly PSAK 1 on Financial Statement Presentation, it is stated that financial statements must be prepared on an accrual basis and with prudence. However, this standard also allows flexibility in the selection of accounting policies as long as they are in accordance with the company's conditions. High earnings volatility creates opportunities for management to exercise accounting judgment in ways that present financial performance more favorably, specifically through the selection of depreciation schedules that minimize front-loaded expense allocations or through the capitalization of expenditures that would otherwise be immediately charged against earnings [15]. This practice shows that although the principle of conservatism is recognized in the conceptual framework, its application is highly dependent on the volatility of the company's performance.

The correlation between earnings volatility and the choice of accounting method can be seen in several areas of accounting policy regulated in PSAK. For example, in PSAK 14 on Inventories, companies can choose between the First In First Out (FIFO) method or the weighted average method for inventory valuation. When raw material prices fluctuate significantly, this choice of method will have a different impact on reported earnings. Companies with high earnings volatility tend to choose methods that produce more stable earnings than methods that conservatively reflect current economic conditions. In addition, in PSAK 16 on Fixed Assets, companies have the option to use various depreciation methods. In conditions of high volatility, management tends to avoid recognizing asset impairment, which is an application of conservatism, as this will further increase the fluctuation in reported earnings.

From the perspective of agency theory, the negative correlation between earnings volatility and accounting conservatism reflects a conflicting interest between principals (shareholders) and agents (management). Agency theory explains that management, as agents, has more complete information than principals regarding the condition of the company, including the choice of accounting policies to be used [10]. When earnings volatility is high, there is greater information asymmetry because it is difficult for principals to distinguish whether earnings fluctuations are caused by external factors or opportunistic actions by management. In these circumstances, management faces pressure to show stable performance to principals in order to maintain their position and compensation. Accounting conservatism, which requires the earlier recognition of losses, will actually make earnings appear lower or more volatile, which can worsen the assessment of management's performance. Therefore, management tends to reduce the application of conservatism to protect their personal interests.

This negative relationship can also be explained through the bonding and monitoring mechanisms in agency theory. Accounting conservatism actually functions as a bonding mechanism that limits opportunistic behavior by management by forcing the earlier recognition of bad

news. However, when earnings become highly volatile, managers are more likely to avoid using this bonding mechanism, as the immediate recognition of losses would intensify the existing fluctuations [16]. From a monitoring perspective, shareholders incur higher costs to supervise management in conditions of high volatility because it is difficult to distinguish between normal and abnormal fluctuations. These monitoring limitations provide management with room to reduce conservatism, which increases information asymmetry and aggravates agency conflicts.

In the sub sector of food and beverage on IDX, this phenomenon manifests across various corporations that have faced marked profit instability resulting from commodity price variations and transformations in consumer spending patterns, especially amid the COVID-19 outbreak and the following period of economic recuperation [17]. When facing high earnings volatility due to these factors, company management tends to use more flexible accounting policies in terms of revenue and expense recognition. Some companies delay recognizing inventory write-downs even when there are indications of a decline in market value, or use longer asset useful life estimates to reduce annual depreciation expenses. This shows that in industries that are vulnerable to external volatility, accounting conservatism application is often ignored to maintain financial reporting stability.

This finding is consistent with previous research which found that the more unstable a company's earnings condition is, the lower the tendency to be cautious in financial reporting. This can occur because such instability creates pressure to present more optimistic performance results [6], [7].

3.6. The Effect of Leverage on Accounting Conservatism

The hypothesis test shows that leverage positively and significantly affects accounting conservatism. This finding implies that a higher level of corporate leverage is an indication of higher level of accounting conservatism. Companies with high leverage face greater financial risks, so creditors demand greater transparency and prudence in financial reporting. This condition encourages management to implement the principle of accounting conservatism as a form of responsiveness to the need for credible information for creditors and other stakeholders.

In PSAK 55 on Financial Instruments: Recognition and Measurement, it is stipulated that companies must recognize impairment losses in a timely manner. Accounting conservatism serves as a mechanism to provide early warning to creditors when a company is facing financial problems, allowing creditors to take protective measures before conditions deteriorate. Highly leveraged companies implement conservative accounting policies such as the use of accelerated depreciation methods, the creation of higher allowance for doubtful accounts, and the faster recognition of asset impairment. The use of accounting conservatism reflects a company's commitment to careful risk oversight, helping reassure creditors and potentially leading to better credit terms [18].

Conservatism is a principle that recognizes losses more quickly but recognizes gains more slowly, providing a higher level of verifiability because losses are generally easier to verify than gains, which are still potential [19]. Creditors, as the parties bearing the main risk of corporate failure, require verifiable information to assess a company's capacity of meeting its debt obligations. In practice, highly leveraged companies tend to use more pessimistic estimates in various areas of accounting, such as the estimated economic life of assets or project completion rates. This approach reduces the possibility of overstating assets and profits, which could mislead creditors in assessing the company's actual financial condition.

On the basis of agency theory, the positive relationship between leverage and accounting conservatism reflects effective corporate governance mechanisms in overcoming agency conflicts between shareholders, management, and creditors. Management may have an incentive to present overly optimistic information in order to avoid technical default on debt covenants. Accounting conservatism serves to reduce this conflicts by limiting management's ability to present overstated information. By applying conservatism, management signals to creditors that they are committed to presenting reliable information and will not take actions that are detrimental to the interests of creditors.

For example, PT Indofood Sukses Makmur Tbk (INDF), one among the largest companies in the sub sector of food and beverage listed on IDX, possesses a significant debt structure in its financing. In the financial reports for the 2019-2023 period, Indofood has consistently applied a conservative approach in its financial reporting, which can be identified through the Givoly and Hayn model. This model measures the level of conservatism based on accruals, where persistent negative accruals indicate a high level of conservatism because its show that accounting profits tend to be lower than operating cash flows [11].

Observations of Indofood's financial statements show that the company has had consistent negative accruals for five consecutive years, indicating the implementation of the principle of prudence in the recognition of income as well as expenses. This shows that highly leveraged companies such as Indofood understand the importance of accounting conservatism as a strategy to maintain creditor trust, comply with debt covenants, and ultimately reduce long-term capital costs, while providing protection for investors against overstated risks in financial statements. This finding is

supported by previous research which it is stated that leverage positively affects conservatism [8], [20].

4. Conclusion

This research examined the earnings volatility along with leverage that affect accounting conservatism. Earnings volatility have significant negative effects on accounting conservatism. This indicates that when a company's earnings volatility increases, management tends to reduce the implementation of accounting conservatism principles to avoid negative investor perceptions of the company's unstable performance. Management utilizes flexibility in selecting accounting methods to maintain the stability of financial reporting, even though it sacrifices the principle of prudence that should be applied. Leverage have significant positive effects on accounting conservatism. This confirms that a higher level of a company's leverage indicates higher application of accounting conservatism as a mechanism to reduce information asymmetry. Conservatism serves as a form of responsiveness to strict monitoring by creditors, compliance with debt covenants, and efforts to maintain stakeholder trust through more prudent and verifiable financial reporting.

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