

Effect of Debt Covenant, Growth Opportunities, Political Cost, Bonus Plan, and Litigation Risk on Accounting Conservatism (Empirical Study of Manufacturing Companies Listed on the Indonesian Stock Exchange for 2019 – 2021 period)

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Abstract: Conservatism is a cautious reaction to uncertainties that occur in economic and business activities, so companies are required to be careful in financial reporting where companies are not in a hurry to recognize and measure assets and profits and immediately recognize possible losses and debts. The purpose of this study is to analyze and obtain empirical evidence about the effect of debt covenants, growth opportunities, political costs, bonus plans and litigation risk on accounting conservatism. The sample for this research is manufacturing companies in Indonesia during the 2019-2021 period which are listed on the Indonesia Stock Exchange (IDX). The results of this study indicate that debt covenants, growth opportunities, political costs, and litigation risk have no effect on accounting conservatism. While the bonus plan has an influence on accounting conservatism.

Keywords: Debt covenants, growth opportunities, political costs, bonus plans, litigation risk and accounting conservatism.

1. Introduction

The rapid development of business is accompanied by increasingly fierce competition between companies. Business development causes high challenges faced, so that the higher the uncertainty that must be faced by the company. One of the company's main goals is to increase the value of the company through increasing the prosperity of the owner or shareholders. In Indonesia, financial reports must be prepared based on the Statement of Financial Accounting Standards (PSAK) issued by the Indonesian Institute of Accountants (IAI), financial reports are a structured presentation of the financial position and financial performance of an entity. The objective of financial reports is to provide information about the financial position, financial performance and cash flows of an entity that is useful to the majority of users of financial statements in making economic decisions. Financial Accounting Standards (SAK) provide freedom for management in choosing the conservative accounting method used in preparing the company's financial statements. Therefore, the preparation of financial reports must be based on the basic principles of financial reporting, one of which is the principle of prudence which is called conservatism.

The principle of conservatism requires that profits and revenues will be recognized if they have been realized, while losses will be recognized immediately. There are pros and cons associated with this principle. Opposing parties argue that the application of the conservatism principle will result in financial reports that tend to be biased because they do not reflect the actual financial condition, where the value of assets will be understated from their true value. Meanwhile, those who support it argue that the application of the conservatism principle can avoid information asymmetry because it will produce profit information with careful calculations so that it is of higher quality (A'isyah, R. D., & Vestari, M. 2019)

Debt covenants are agreements that arise from the existence of an obligation contract that aims to maintain the company's financial position in the long term so that it remains in a corridor that allows it to be able to pay off its obligations. Thus the existence of this contract usually arises from long-term loans.

Growth opportunities are opportunities for a company to grow and develop in increasing profitable investments. An increase in growth opportunity will be followed by an increase in the level of accounting conservatism and vice versa if the growth opportunity decreases, the level of accounting conservatism will also decrease. (Azizah et al. 2022)

Political costs are costs or transfers of wealth that must be borne by companies related to various regulations, such as tax rates and labor demands, subsidies, and antitrust actions by the government, and so on. There are several companies that have a small total asset value in this study and receive great attention from the government so that these companies practice conservatism by using accounting procedures that defer profits from the current period to future periods (Wiecandy & Khairunnisa, 2020).

The bonus plan explains how company managers get bonuses based on the calculation and reporting of

profits earned by companies managed by managers so that the lower the managerial ownership, the higher the demand for accounting conservatism.

Litigation risk is a risk that can arise from various stakeholders related to company operations, both from investors, creditors, suppliers, the government, and so on.

This study replicates the research of Risa Dewi A'isyah and Mekani Vestari (2019) which examines bonus plans, debt covenants, political costs, and litigation risk on accounting conservatism. Another variable that might influence accounting conservatism is added to this study, namely growth opportunities which refer to the research of Matildis Yurnita Sea and Aspyan Noor (2022).

2. Literature review and hypothesis

2.1 Positive Accounting Theory.

Positive accounting theory explains that managers have the drive or motivation to be able to maximize their performance. Watts and Zimmerman (1990) say there are three hypotheses in positive accounting theory:

1. Bonus plan Hypothesis

If the company plans a bonus based on net income, then the company will choose an accounting procedure that shifts the reporting of future earnings to the current period.

2. Debt covenant hypothesis.

Companies tend to reduce debt or equity ratios by increasing current profits by shifting from future profits. The aim is to reduce bankruptcy risk.

3. Political cost hypothesis.

Companies tend to reduce current profits by shifting to future profits. Aims to avoid union demands.

2.2 Agency Theory

Agency theory (agency theory) defines the existence of a relationship between the principal and agent. Jensen and Meckling (1976:308) express the notion of agency relations, namely: "Agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decisions making authority to the agent." Agency theory is the relationship between the agency structure of management (agent) and the owner (principal) who promise to behave cooperatively, but with different goals and different risk-facing behaviors. (Hardiyanti et al., 2022)

2.3 Accounting Conservatism

According to Statement of Financial Accounting Concepts (SFAC) No. 2, conservatism is defined as "a prudent reaction to uncertainty to try to ensure that the uncertainties and risks inherent in business situations are adequately considered". Conservatism is defined as a cautious reaction to uncertainties that occur in economic and business activities.

2.4 Debt Covenant

Debt covenants are agreements that arise from the existence of an obligation contract that aims to maintain the company's financial position in the long term so that it remains in a corridor that allows it to be able to pay off its obligations. Thus the existence of this contract usually arises from long-term loans. The size of this variable can be quantified through the value of long-term liabilities (A'isyah & Vestari, 2019). The results of previous research conducted by Hardiyanti et al. (2022) and Noviani & Homan, (2021) show that debt covenants affect accounting conservatism. Based on this description, the alternative hypothesis is as follows:

H₁: Debt covenants have an effect on accounting conservatism.

2.5 Growth opportunities

Growth opportunity is an opportunity for a company to be able to invest in a larger amount and also an opportunity to increase the value of the company. The greater the company's opportunity to grow, the greater the funds needed. Companies with high growth opportunities will tend to require large amounts of funds to finance the company's growth in the future. The amount of funds needed makes managers apply the principles of accounting conservatism so that investment financing can be fulfilled. (Azizah et al., 2022). The results of previous research conducted by Ursula & Adhvinna (2018) and Tamur (2022) Growth opportunity has a significant positive effect on accounting conservatism. Based on this description, the alternative hypothesis is as follows:

H₂: Growth opportunities have an effect on accounting conservatism.

2.6 Political Cost

Political costs will arise from conflicts of interest between the company and the government as representatives of the community who are authorized to transfer wealth from the company to the community in accordance with applicable regulations. The results of previous research conducted by Rizkillah (2019) and Ardilasari, (2018) show that political costs have a significant effect on accounting conservatism. Based on this description, the alternative hypothesis is as follows:

H₃: Political costs affect accounting conservatism.

2.7 Bonus plans

Bonus plans can be interpreted as managers who expect high compensation or bonuses through earnings management. The bonus plan explains how company managers get bonuses based on the calculation and reporting of profits earned by companies managed by managers. The results of previous research conducted by Novita (2017) and Jayanti (2016) show that the bonus plan proxied by managerial ownership has an effect on accounting conservatism. Based on this description, the alternative hypothesis is as follows:

H₄: Bonus plans have an effect on accounting conservatism.

2.8 Litigation Risk

Litigation risk is a risk that can arise from various stakeholders related to company operations, both from investors, creditors, suppliers, the government, and so on. The risk that arises from investors comes from the company's inability to distribute dividends and achieve capital gains. The results of previous research conducted by A'isya & Vestari (2019) and Erawati & Wea, (2021) show that litigation risk has a positive and significant effect on accounting conservatism in. Based on this description, the alternative hypothesis is as follows:

H₅: Litigation risk affects accounting conservatism.

3. Research Methods

3.1 Population and Sample

Population of manufacturing companies listed on the Indonesia Stock Exchange. The sample for this research is a manufacturing company during 2019-2021 using a purposive sampling method. The criteria used by the authors in this research sample are as follows:

Tabel 1: Sample Selection Process

No	Research Sample Criteria	Total
1	Manufacturing companies listed on the Indonesia Stock Exchange during the 2019-2021 period	193
2	Manufacturing companies that present financial statements for each observation period	-21
3	The company presents financial reports using the rupiah currency	-31
4	The company presents financial reports according to the required information	-68
	Research samples that fit the criteria	73
	Total observation 2019-2021	219
	<i>Data outliers</i>	(23)
	Number of Clean Samples	196

Based on the classification in Table 1, it shows that the number of manufacturing companies during the 3-year period, namely from 2019 to 2021, which were listed on the Indonesia Stock Exchange (IDX) were 219 companies. Because there are several companies that do not pass the classical assumption test, outlier data is used and a clean data of 196 is obtained.

Table 2: Variable Measurement

Variable	Indicator	Sumber
Accounting Conservatism (KA)	$Total\ Akrua\ l = \frac{((Net\ Income + Depreciation) - Operating\ Cash\ flow) \times (-1)}{Total\ Assets}$	Sea & Noor, (2022).
Debt Covenant		Sea & Noor,

(DC)	$Debt\ Asset\ Ratio = \frac{Total\ Liabilities}{Total\ Assets}$	(2022).
Growth Opportunities (GO)	$Market\ to\ Book\ Value\ Ratio(MBV) = \frac{Closing\ Price\ per\ Share}{Book\ value\ per\ share}$	Sea & Noor, (2022).
Political Cost (PC)	$SIZE = Ln\ Total\ Assets$	Wiecandy & Khairunnisa, (2020)
Bonus Plan (BP)	$MOWN(Managerial\ Ownership) = \frac{Total\ Managerial\ Shares}{Total\ Outstanding\ Shares}$	Novita,(2017)
Litigation Risk (LR)	$DER = \frac{Total\ Debt}{Total\ Equity}$	Wiecandy & Khairunnisa, (2020)

3.2 Engineering data analysis techniques

Data analysis used in this study is to use multiple linear regression analysis which is used to determine the effect between variables. There are three hypothesis testing techniques used in this study, namely the simultaneous regression test (F test), the coefficient of determination and the partial regression test (t test).

$$KA = \alpha + \beta_1 DC_1 + \beta_2 GO_2 + \beta_3 PC_3 + \beta_4 BP_4 + \beta_5 LR_5 + e$$

Information:

- KA = Accounting Conservatism
- α = Constant
- β_1 = Debt Covenant Regression Coefficient
- DC = Debt Covenant
- β_2 = Regression Coefficient Growth opportunities
- GO = Growth opportunities
- β_3 = Political Cost Regression Coefficient
- PC = Political Cost
- β_4 = Bonus plan regression coefficient
- BP = Bonus plan
- β_5 = Litigation Risk Regression Coefficient
- LR = Litigation Risk
- e = Item or Variable Error being studied

4. Results and Discussion

4.1 Descriptive statistics.

Descriptive statistics are a test to see the quality of research data which is interpreted by looking at the minimum value, maximum value, average, and standard deviation of the sample. The results of the descriptive statistical calculations are as follows:

Table 2: Statistical Descriptive Analysis

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Debt Covenant	196	0,06	0,91	0,4171	0,18457
Growth Opportunities	196	0,14	10,92	1,8274	1,7904
Political Cost	196	25,05	33,54	28,1392	1,58541
Bonus Plan	196	0	2	0,1806	0,30556
Litigation Risk	196	0,07	10,28	0,9885	1,16055
Accounting Conservatism	196	-0,83	0,21	-0,2304	0,18535

Source: SPSS data processing results

The following are the results of calculating descriptive statistics from the table above:

1. The debt covenant variable (X1) has a minimum value of 0.06 and a maximum value of 0.91, while the average value is 0.4171 or 41.71% with a standard deviation of 0.18457. Where the average value is higher than the standard deviation value, then this means that the sample company has a debt covenant level of 0.4171 or 41.71%.

2. The growth opportunities variable (X2) has a minimum value of 0.14 and a maximum value of 10.92. while the average value is 1.8274 or 182.74% with a standard deviation of 1.79040. Where the average value is higher than the standard deviation value, this means that the sample companies have a growth opportunity rate of 1.8274 or 182.74%.
3. The results of the descriptive statistical calculations, then the political cost variable (X3) has a minimum value of 25.05 and a maximum value of 33.54. while the average value is 28.1392 or 2813.92% with a standard deviation of 1.58541. Where the average value is higher than the standard deviation value, this means that the sample companies have a political cost level of 28.1392 or 2813.92%.
4. The bonus plan variable (X4) has a minimum value of 0.00 and a maximum value of 2. while the average value is 0.1806 or 18.06% with a standard deviation of 0.30556. Where the standard deviation value is higher than the average value, this means that the sample companies have a bonus plan rate of 0.30556 or 30.556%.
5. The litigation risk variable (X5) has a minimum value of 0.07 and a maximum value of 10.28. while the average value is 0.9885 or 98.85% with a standard deviation of 1.16055. Where the standard deviation value is higher than the average value, this means that the sample companies have a litigation risk level of 1.16055 or 116.055%.
6. The accounting conservatism variable (Y) has a minimum value of -0.83 and a maximum value of 0.21. while the average value is -0.2304 or -23.04% with a standard deviation of 0.18535. Where the standard deviation value is higher than the average value, this means that the sample companies have an accounting conservatism level of 0.18535 or 18.535%.

4.2 The Traditional Assumption Test

1. Normality Test.

Table 3: One-Sample Kolmogorov-Smirnov Test

<i>One-Sample Kolmogorov-Smirnov</i>	<i>Monte Carlo Sig. (2-tailed)</i>	Information
0,093	0,64	Normal distributed data

Source: SPSS data processing results

The normality test results show the Monte Carlo value. Sig. (2-tailed) of $0.64 > 0.05$. This shows that the data in this study are normally distributed.

2. Multicollinearity Test

Table 4: Multioliniarity Test

Variable	Tolerance	VIF	Information
Debt Covenant	0,381	2,626	Multicollinearity Does Not Occur
Growth Opportunities	0,994	1,006	Multicollinearity Does Not Occur
Political Cost	0,976	1,025	Multicollinearity Does Not Occur
Bonus Plan	0,924	1,083	Multicollinearity Does Not Occur
Litigation Risk	0,389	2,571	Multicollinearity Does Not Occur

Source: SPSS data processing results

The results of the multicollinearity test above show that the independent variables have tolerance > 0.10 and VIF < 10 . So it can be concluded that the data in the study are free of multicollinearity.

3. Autocorrelation Test.

Table 5: Autocorrelation Test

<i>Durbin-Watson</i>	Information
1,957	No Autocorrelation Occurs

Source: SPSS data processing results

The results of the autocorrelation test showed that the Durbin-Watson value was 1.957. The Durbin Watson value of the research data is between -2 and 2, which means that there is no autocorrelation in the

regression equation.

4. Heteroscedasticity Test

Table 6: Heteroscedasticity Test

Variable	Sig.	Information
Debt Covenant	0,897	There is no Heteroscedasticity
Growth Opportunities	0,646	There is no Heteroscedasticity
Political Cost	0,97	There is no Heteroscedasticity
Bonus Plan	0,959	There is no Heteroscedasticity
Litigation Risk	0,825	There is no Heteroscedasticity

Source: SPSS data processing results

The heteroscedasticity test above shows that all independent variables in the study have a sig value. which is more than 0.05 or 5%. So it can be concluded that the research data does not have heteroscedasticity problems.

4.3 Multiple Linear Regression Test Results.

Table 7: Multiple Linear Regression Test Results.

Variable	Regression Coefficient	Std. Error	T _{count}	Sig.
(Constant)	-0,142	0,237	-0,601	0,548
Debt Covenant	-0,179	0,114	-1,567	0,119
Growth Opportunities	0,007	0,007	0,917	0,36
Political Cost	-0,001	0,008	-0,073	0,942
Bonus Plan	-0,145	0,044	-3,278	0,001
Litigation Risk	0,018	0,018	1,009	0,314

Source: SPSS data processing results

The results of testing the linear regression model above show the regression equation as follows:

$$KA = -0,142 - 0,179DC + 0,007GO - 0,001PC - 0,145BP + 0,018LR + e$$

- The constant value of the result is -0.142 which means that the variable debt covenants, growth opportunities, political costs, bonus plans, and litigation risk are assumed to be constant or equal to zero, accounting conservatism is -0.142.
- The coefficient value of the debt covenant (DC) is -0.179 which can be interpreted that the more debt covenants, the accounting conservatism will decrease. And conversely, if there are fewer debt covenants, the accounting conservatism will increase.
- The value of the coefficient of growth opportunities (GO) is 0.007 which can be interpreted that the more growth opportunities there are, the accounting conservatism will increase. And conversely, if there are fewer growth opportunities, the accounting conservatism will decrease.
- The coefficient of political cost (PC) is -0.001 which means that the more political cost, the less accounting conservatism. And conversely, if there is less political cost, the accounting conservatism will increase.
- The value of the bonus plan coefficient (BP) is -0.145 which can be interpreted that the more bonus plans, the accounting conservatism will decrease. And vice versa, if there are fewer bonus plans, the accounting conservatism will increase.
- The litigation risk coefficient (LR) is 0.018 which means that the more litigation risk, the higher the accounting conservatism. And conversely, if there is less litigation risk, the accounting conservatism will decrease.

4.4 Results of Model Accuracy Testing

1. Simultaneous Significant Test (F Test)

Table 8: Simultaneous Significant Test (F Test)

Dependent Variable	F	Sig.	Information
Accounting Conservatism	2,44	0,036	Significant

Source: SPSS data processing results

Based on the table above, the value of F (2.440) with sig. 0.036 is smaller than the alpha error rate (0.05), so that the debt covenants, growth opportunities, political costs, bonus plans, and litigation risk variables jointly affect accounting conservatism.

2. Partial Test (T test)

Table 9: Partial Test (T test)

Variable	T	Sig.	Information
Debt Covenant	-1,567	0,119	The hypothesis is rejected
Growth Opportunities	0,917	0,36	The hypothesis is rejected
Political Cost	-0,073	0,942	The hypothesis is rejected
Bonus Plan	-3,278	0,001	Hypothesis accepted
Litigation Risk	1,009	0,314	The hypothesis is rejected

Source: SPSS data processing results

3. Determination Coefficient Test (R²).

The coefficient of determination (R²) measures how far the ability of the research model to apply the regression model in explaining the effect of the independent variables on the dependent variable. The results of the determination can be seen in the table below:

Table 10: Determination Coefficient Test (R²).

R	R Square	Adjusted R Square
0,246	0,06	0,036

Source: SPSS data processing results

Based on the calculation results above, the adjusted R² obtained a value of 0.036. This means that accounting conservatism variables can be explained by debt covenants, growth opportunities, political costs, bonus plans, and litigation risk variables of 3.6%. While the remaining 96.4% is explained by other variables not included in this study.

4.5 Discussion.

1. The effect of debt covenants on accounting conservatism

Based on the test, it is known that debt covenants have no effect on accounting conservatism, with a significant level of 0.119 which is stated to be greater than the significance of 0.05. This means that H1 is rejected because it does not meet the set criteria. The results of this study indicate that debt covenants do not influence manufacturing company managers to apply conservative accounting methods. This could be because some companies will continue to extend their debt contracts even though they are subject to additional costs for extending the debt on the grounds that the company still needs funds for its operational activities. Company managers will choose accounting methods that can increase their company's profits in reducing the cost of renegotiating debt contracts when the debt contracts will expire.

2. The effect of growth opportunities on accounting conservatism.

Based on the test, it is known that growth opportunities have no effect on accounting conservatism, with a significant level of 0.360 which is greater than a significant level of 0.05. This means that H2 is rejected because it does not meet the set criteria. The results of this study indicate that manufacturing companies that apply conservatism are not always synonymous with companies that are growing. This could be due to the fact that not all managers of manufacturing companies apply conservative accounting methods by minimizing profits to be able to meet financing for the investment required for their growth. Growing companies require large funds which are likely to come mostly from external parties (investors). Therefore, companies that are growing

tend to choose accounting methods that are more optimistic in order to attract investors to invest their money.

3. The effect of Political cost on accounting conservatism.

Based on the test, it is known that political costs have no effect on accounting conservatism, with a significant level of 0.942 which is greater than the significance of 0.05. This means that H3 is rejected because it does not meet the set criteria. The results of this study indicate that the application of accounting conservatism by manufacturing companies is not based on how big or small the size of the company is. This could be due to the fact that not all large companies are more sensitive to political costs. Large companies are more focused on displaying large profits in order to attract investors and gain the trust of the public compared to using conservative accounting methods to minimize political costs.

4. Effect of bonus plans on accounting conservatism.

Based on the test, it is known that the bonus plan has an effect on accounting conservatism, with a significant level of 0.001 which is smaller than the significance of 0.05. This means that H4 is accepted because it meets the specified criteria. The results of this study indicate that the application of accounting conservatism by manufacturing companies is in accordance with the positive accounting theory which states that managers will act in line with the bonuses given. managers of companies that have bonus obligations will tend to choose procedures that transfer profits from the coming period to the current period (Watts and Zimmerman, 1990).

5. Effect of Litigation risk on accounting conservatism.

Based on the test, it is known that litigation risk has no effect on accounting conservatism, with a significant level of 0.314 which is stated to be greater than the significance of 0.05. This means that H5 is rejected because it does not meet the set criteria.

5. Conclusion

This study aims to determine the effect of debt covenants, growth opportunities, political costs, bonus plans and litigation risk on accounting conservatism. The sample used is a manufacturing company listed on the Indonesia Stock Exchange (IDX) for the 2019-2020 period. The results of testing and analysis in this study are as follows:

1. Debt covenants have no effect on accounting conservatism which shows a sig. $0.119 > 0.05$. This could be because some companies will continue to extend their debt contracts even though they are subject to additional costs for extending the debt on the grounds that the company still needs funds for its operational activities.
2. Growth opportunities have no effect on accounting conservatism which shows a sig. $0.360 > 0.05$. The results of this study indicate that companies that are growing tend to choose accounting methods that are more optimistic in order to attract investors to invest their money.
3. Political cost has no effect on accounting conservatism which shows the value of Sig. $0.942 > 0.05$. The results of this study indicate that not all large companies are more sensitive to political costs.
4. The bonus plan has an effect on accounting conservatism which shows the value of Sig. $0.001 > 0.05$. The results of this study indicate that the lower the managerial ownership, the higher the demand for accounting conservatism.
5. Litigation risk has no effect on accounting conservatism which shows the value of Sig. $0.314 > 0.05$. This indicates that the implementation of various regulations in Indonesia has been quite careless with the sanctions.

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