Political Connections Moderate Profitability, Liquidity, And Accounting Conservatism on Earnings Quality (Case Study of Manufacturing Companies Listed on the IDX from 2020 to 2023)

Sri Ayem[1] Umi Wahidah[2] Nur Anita Chandra Putry[3] Puji Lestari[4]

[1234]*Universitas Sarjanawiyata Tamansiswa, Yogyakarta, 55165, Indonesia*

[1] sri.ayem@ustjogja.ac.id
[2] umi.wahidah@ustjogja.ac.id
[3] chandra.putry@ustjogja.ac.id
[4]pujilestariiii002@gmail.com

Abstract: This research **aims** to identify the factors that influence earnings quality in manufacturing companies in Indonesia. The quality of earnings reported by companies is a crucial factor for investors and stakeholders in making the right decisions. This study's motivation comes from Indonesia's unique business environment, where political connections can significantly influence corporate practices and financial reporting. The research **method** used a quantitative approach through purposive sampling techniques on manufacturing companies listed on the IDX from 2020 to 2023. The **results** of the study show that profitability has a negative effect on earnings quality while accounting conservatism has a positive effect on earnings quality. However, liquidity has no effect on earnings quality. The **implications** of this study suggest that stakeholders should not solely rely on profitability as an indicator of earnings quality, as it may not reflect true financial health. Instead, a focus on accounting conservatism is recommended to enhance earnings quality. Furthermore, the moderating role of political connections indicates a need for increased scrutiny of companies with political ties to ensure transparent and reliable financial reporting. These insights can guide policymakers in developing regulations that promote better financial practices and accountability in Indonesia's capital market.

Keywords: political connections, conservatism, earnings quality, liquidity, profitability.

1 Introduction

In a competitive business world, companies must manage their finances effectively, particularly in generating and maintaining profit quality, which serves as a key indicator of strength for stakeholders [1]. Earnings quality can be defined as the ability of reported earnings to reflect the actual economic performance of the company, without any manipulation or influence from aggressive accounting policies [2]. High earnings quality indicates reliable and sustainable profits, boosting investor confidence [3].

Factors affecting earnings quality include both financial and non-financial aspects, such as political connections. Profitability, or a company's ability to generate profits, positively correlates with earnings quality, as profitable companies tend to have stable cash flows [4]. Liquidity, which measures a company's ability to meet short-term obligations, also enhances earnings quality through better cash flow management [5] [6].

L. Rini Sugiarti et al. (eds.), *Proceedings of the 1st International Conference on Social Environment Diversity (ICOSEND 2024)*, Advances in Social Science, Education and Humanities Research 905,
https://doi.org/10.2991/978-2-38476-366-5_12

Accounting conservatism promotes careful revenue recognition and quicker expense recognition, improving earnings quality by reducing the risk of overstatement [7]. Companies applying this principle report more reliable earnings [8]. In developing countries like Indonesia, political connections significantly influence business dynamics, acting as a moderating variable in the relationship between profitability, liquidity, and accounting conservatism on earnings quality. While these connections can enhance access to resources, they may also pressure companies to manipulate financial statements [9].

Based on this background, this study aims to analyze how political connections moderate the effect of profitability, liquidity, and accounting conservatism on earnings quality in manufacturing companies listed on the IDX from 2020 to 2023, providing insights into the interactions among financial factors, accounting practices, and political aspects in corporate financial reporting in Indonesia.

2 Method

This quantitative study uses secondary data from the financial statements of manufacturing companies from 2020 to 2023, obtained from the Indonesia Stock Exchange website at https://www.idx.co.id. Data analysis was conducted using SPSS version 22, with purposive sampling based on specific criteria. The research is grounded in agency theory, which posits a conflict of interest between management (agents) and shareholders (principals), as management may prioritize personal interests over those of shareholders. In the context of profits, management may have incentives to manipulate financial reports to show better performance than actually exists, in order to meet targets or to obtain higher compensation incentives, [10] The data supporting this discussion is summarized in the Table 1.

TABLE 1. Company Criteria

No	Criteria	Sum
1	Manufacturing companies listed between 2020 and 2023 on the IDX	72
2	Manufacturing companies that use foreign currency to disclose their financial statements	0
3	Manufacturing companies that experienced losses during 2020-2023	(6)
4	Companies with extreme data	(20)
5	Number of companies that meet the criteria	48
6	**Total Sample (46 x 4 Years)**	184

The dependent variable in this study is earnings quality. The formula for the earnings quality is:

$$Earnings\ quality = \frac{Operating\ Cash\ Flow}{Net\ Income} x100\%$$

Meanwhile, the independent variables in this study are profitability, liquidity, accounting conservatism, and the moderating variable of political connections which are measured using the formula :

Profitability is measured using :

$$ROA = \frac{Profit\ After\ Tax}{Total\ Asset}$$

Liquidity is measured using :

$$Quick\ Ratio = \frac{Current\ Asset - Inventory}{Current\ Liability}$$

Accounting Conservatism is measured using:

$$CONACC = \frac{(NIO + DEP - CFO) \times (-1)}{TA}$$

Political connections are measured using dummy variables:

$$KPi\ = \begin{cases} i & if\ the\ company\ has\ political\ connections \\ 0\ if\ the\ cmpany\ does\ not\ have\ political\ connections \end{cases}$$

3 Analysis Design and Hypothesis Testing

The results of normality, multicollinearity, heteroscedasticity, and autocorrelation tests indicate that the research data meets the classical assumptions in regression analysis. Since all assumptions are met, the multiple linear regression model can be applied. The regression model equation used in this study is as follows:

$$\boldsymbol{KL = \propto\ + \beta_1 PROF + \ \beta_2\, LIQ + \beta_3 CONS + \beta_4 PROF * KP\ + \beta_5 LIQ * K} \\ \boldsymbol{+ \beta_4 CONS * KP + \epsilon}$$

Dimana :

KL = Earning Quality
$\propto$ = Konstanta
PROF = Profitability
LIQ = Likuidity
CONS = Accounting Convervatism
KP = Political Connection
β_1-β_2 = Regression Coefficient
ϵ = Error

4 Results and Dıscussıon

4.1 Result

The research data consists of 265 samples obtained from 66 companies over a period of 4 years. The initial data population contains extreme values (outliers) and does not follow a normal distribution. Therefore, the final number of samples used in the analysis was 182 after data cleaning. The data supporting this discussion is summarized in the Table 2.

TABLE 2. Results Test F

	Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	9,681	4	2,420	3,421	,010b
	Residual	125,214	177	,707		
	Total	134,895	181			

(Source: SPSS 22 data processing results, 2024)

The results of the regression analysis show that the developed model is overall significant (F = 3.421; p < 0.01), indicating that the independent variables, namely political connections, accounting conservatism, liquidity, and profitability, are able to jointly influence earnings quality. The data supporting this discussion is summarized in the Table 3.

TABLE 3. Results Test t

Model		B	t	Sig.
1	(Constant)	1,182	4,280	,000
	Profitability	-,321	-2,170	,031
	Liquidty	,223	1,069	,287
	Accounting Conservatism	,254	2,199	,029

(Source: SPSS 22 data processing results, 2024)

The test results indicate that profitability has an unstandardized beta value of -0.321 and a significance value of 0.031, suggesting a negative effect on earnings quality, thus not supporting H1. This implies that as profitability increases, earnings quality tends to decrease. The liquidity variable shows a significance value of 0.287, greater than 0.05, indicating it does not significantly affect earnings quality, so H2 is not supported. Conversely, accounting conservatism has a significance value of 0.029, supporting H3, as it positively affects earnings quality. Higher conservatism in financial statements correlates with better earnings quality. Supporting data is summarized in Tables 4.

TABLE 4. Results Test Moderated Regression Analysis (MRA)

		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	.675	.228		2.960	.003
	Profitability*Political Connection	.591	.300	.446	1.971	.050
	Liquidity*Political Connection	.522	.430	.154	1.212	.227
	Conservatism*Political Connection	.527	.440	.275	1.198	.233

(Source: SPSS 22 data processing results, 2024)

Furthermore, Moderated Regression Analysis (MRA) was used to test the moderating variable. The interaction between profitability and political connections showed a significance value of 0.050, indicating that political connections moderate the effect of profitability on earnings quality, thus supporting H4. In contrast, the interaction of liquidity and political connections had a significance value of 0.227, suggesting that political connections do not moderate the relationship between liquidity and earnings quality, so H5 is not supported. Similarly, the interaction of conservatism and political connections yielded a significance value of 0.494, indicating that political connections do not moderate the relationship between accounting conservatism and earnings quality, thus H6 is also not supported.

4.2 Discussion

The test results show that profitability has a negative effect on earnings quality. This finding indicates that companies that focus on increasing profitability may use more aggressive accounting practices, such as earlier revenue recognition, which can result in earnings reports that do not reflect actual economic conditions. This has the potential to reduce earnings quality because managers may ignore conservative accounting principles in an effort to show good performance. The results of this study are supported by several studies [11][12] which state that profitability has a negative effect on earnings quality.

The results of the hypothesis test show that liquidity does not have a significant effect on earnings quality. Which indicates that the level of company liquidity, which reflects the company's ability to meet its short-term obligations, does not have a direct effect on the quality of the profits generated. This may be due to the fact that earnings quality is more influenced by other factors, such as accounting policies applied and earnings management practices than simply the availability of cash or liquid assets. The results of this study are supported by previous studies [13] [14] which indicate that liquidity had no effect on earnings quality.

The results of the analysis show that accounting conservatism has a positive effect on earnings quality. This finding indicates that the higher the level of conservatism in preparing financial statements, the better the quality of earnings generated. Accounting conservatism, which requires companies to be more careful in recognizing revenue and measuring assets, can help prevent overstatement of earnings and provide a more realistic picture of the company's financial performance. By implementing the principle of conservatism, companies can protect investors from misleading information and ensure that reported earnings reflect more accurate conditions. This finding is supported by previous research [15] [16] state that accounting conservatism has a positive effect on earnings quality.

The tests show that political connections can enhance the impact of profitability on earnings quality. This aligns with agency theory, which suggests that external factors like political connections influence the relationship between owners and managers. Strong political ties provide companies with better access to resources and decision-making support, improving performance and earnings quality. The study found that companies with high profitability and political connections tend to exhibit better earnings quality, as high profitability indicates strong profit generation. Notably, no prior research has examined the role of political connections in moderating the influence of profitability on earnings quality. However, regarding the influence of profitability on earnings quality, it is in line with related research [17] [18] which states that profitability has a significant positive influence on earnings quality.

The tests show that political connections do not moderate the relationship between liquidity and earnings quality, indicating they do not significantly affect this relationship. This aligns with agency theory, suggesting that while political connections can influence managerial decisions, they do not enhance earnings quality in the context of liquidity. The study found that high liquidity alone does not ensure good earnings quality, even with political connections. Additionally, no prior research has examined the role of political connections in moderating the effect of liquidity on earnings quality. However, regarding the effect of liquidity on earnings quality, it is in line with [13] and [14], which state that liquidity does not have a significant effect on earnings quality.

The results indicate that political connections do not moderate the relationship between accounting conservatism and earnings quality, meaning they do not significantly influence the impact of conservatism on earnings quality. While accounting conservatism is generally seen as a practice that enhances earnings quality through careful revenue recognition, political connections do not contribute to this improvement in this context. Additionally, no prior studies have examined the role of political connections in moderating the effect of liquidity on earnings quality. However, regarding the effect of accounting conservatism on earnings quality, it is in line with previous research [17] who states that accounting conservatism does not have a significant effect on earnings quality. Meanwhile, the effect of political connections on earnings quality is in line with Safitri & Titisari [18] who state that profitability has a significant positive effect on earnings quality.

5 CONCLUSİON

Earnings quality in Indonesian manufacturing companies is influenced by various internal and external factors. The analysis reveals that profitability negatively affects earnings quality, indicating that higher profits do not necessarily mean better accounting quality. Liquidity does not significantly impact earnings quality, suggesting that it is not a direct determinant. In contrast, accounting conservatism positively affects earnings quality by promoting earlier loss recognition and delayed profit recognition, which helps reduce financial statement manipulation.

Political connections serve as a moderating factor, enhancing the relationship between profitability and earnings quality, but do not influence the relationship between liquidity or conservatism and earnings quality. This study highlights the significant role of political connections in shaping accounting practices in Indonesia, offering insights into the impact of non-financial factors on earnings quality, which is valuable for stakeholders in decision-making and policy formulation.

6 Recommendatıon

Given that profitability negatively affects earnings quality while accounting conservatism positively influences it, further research is recommended to explore the interaction of internal and external factors affecting earnings quality across various Indonesian industries. This should include an analysis of political connections as a moderating factor and the impact of local culture and business ethics on accounting practices. Longitudinal studies tracking changes in earnings quality over time and comparisons with similar countries could provide deeper insights. Such research aims to enhance understanding of business dynamics and accounting practices in developing countries.

Statement Of Scientific Ethics. The author assumes full responsibility for the scientific ethics and legal aspects of this article published in the EPESS journal. This includes maintaining research integrity, ensuring data accuracy, and respecting the rights of all contributors. The author is accountable for the originality, honesty, and adherence to applicable research ethics standards in this work.

Acknowledgements. The authors would like to express their deepest gratitude to Sarjanawiyata Tamansiswa University that has fully supported this research. The support from lecturers and the entire academic community has been a source of invaluable motivation and inspiration, so that the authors can complete this research well. Hopefully, this cooperation and support can continue to be established for the advancement of science and education in the future.

References

1. Jonathan and M. N. Machdar, “Pengaruh Kualitas Laba Terhadap Nilai Perusahaan Dengan Reaksi Pasar Sebagai Variabel Intervening,” *Jurnal Riset Manajemen dan Bisnis (JRMB) Fakultas Ekonomi UNIA*, vol. 3, no. 1, pp. 67–76, Feb. 2018.
2. L. Rahmadani and N. Nelvirita, “Pengaruh Investment Opportunity Set (IOS), Likuiditas, dan Efisiensi terhadap Kualitas Laba: Studi Empiris pada Perusahaan Subsektor Perbankan yang Terdaftar di Bursa Efek Indonesia 2018-2021,” *JURNAL EKSPLORASI AKUNTANSI*, vol. 6, no. 2, pp. 565–577, May 2024, doi: 10.24036/jea.v6i2.1194.
3. R. Septiano, S. Aminah, and S. Laynita, “Pengaruh Pertumbuhan Laba dan Likuiditas terhadap Kualitas Laba Perusahaan Manufaktur Industri Dasar dan Kimia yang Terdaftar di Bursa Efek Indonesia 2017-2020,” *Jurnal Inovasi Penelitian*, vol. 2, no. 10, Mar. 2022.
4. N. Soly and N. Wijaya, “Faktor-Faktor Yang Mempengaruhi Kualitas Laba Pada Perusahaan Manufaktur,” *Jurnal Bisnis dan Akuntansi*, vol. 19, no. 1, pp. 47–55, 2017.
5. P. G. Wati and I. Putra, “Pengaruh Ukuran Perusahaan, Leverage, Dan Good Corporate Governance Pada Kualitas Laba,” *E-Jurnal Akuntansi*, vol. 19, no. 1, pp. 137–167, Apr. 2017.
6. A. H. Alsharif, N. Z. M. Salleh, S. A. Al-Zahrani, and A. Khraiwish, “Consumer Behaviour to Be Considered in Advertising: A Systematic Analysis and Future Agenda,” *Behavioral Sciences*, vol. 12, no. 12, p. 472, Nov. 2022, doi: 10.3390/bs12120472.
7. R. L. Watts, “Conservatism in Accounting Part I: Explanations and Implications,” *Accounting Horizons*, vol. 17, no. 3, pp. 207–221, Sep. 2017, doi: 10.2308/acch.2003.17.3.207.
8. R. Maulia and I. Handojo, “Pengaruh Koservatisme Akuntansi, Investment Opportunity Set, dan Faktor Lainnya Terhadap Kualitas Laba,” *Jurnal Bisnis dan Akuntansi*, vol. 24, no. 1, pp. 193–204, Jun. 2022.
9. P. K. Chaney, M. Faccio, and D. Parsley, “The quality of accounting information in politically connected firms,” *Journal of Accounting and Economics*, vol. 51, no. 1–2, pp. 58–76, Feb. 2011, doi: 10.1016/j.jacceco.2010.07.003.
10. H. Husein, A. P. Saleh, D. Kriswantini, and S. F. R. Bonara, “Deteksi Manipulasi Laporan Keuangan Menggunakan Model Beneish M-Score pada BUMN yang Terdaftar di Pasar Modal,” *Jurnal Akuntansi*, vol. 18, no. 1, pp. 1–10, 2023.
11. D. Masruroh and Apollo, “The Effect of Profitability, Liquidity and Leverage on Earning Quality with Company Size as a Moderation Variable,” *Journal of Economics, Finance and Accounting Studies*, vol. 5, no. 5, pp. 124–130, Oct. 2023, doi: 10.32996/jefas.2023.5.5.13.

12. W. Salah, "The Effect of Firm Characteristics on Earnings Quality: The The Effect of Firm Characteristics on Earnings Quality: The Moderating Role of Firm Size Moderating Role of Firm Size," *Business Administration, Economics and Political Science*, vol. 2, pp. 188–206, 2018.
13. S. Aryanto, M. Mukhzarudfa, W. Wiralestari, and A. A. Muhamat, "An analysis of factors that affect earnings quality on Islamic commercial banks: The case at Indonesia and Malaysia," *al-Uqud : Journal of Islamic Economics*, vol. 7, no. 1, pp. 110–125, Jan. 2023, doi: 10.26740/aluqud.v7n1.p110-125.
14. H. Mauliansyah, Z. Umar, E. MJ, and A. Fata, "PENGARUH PROFITABILITAS, LIKUIDITAS DAN UKURAN PERUSAHAAN TERHADAP KUALITAS LABA PADA PERUSAHAAN MANUKFAKTUR SEKTOR TEKSTIL DAN GARMEN YANG TERDAFTAR DI BURSA EFEK INDONESIA PERIODE 2018-2020," *Jurnal Akuntansi Muhammadiyah*, vol. 13, no. 1, Jun. 2023, doi: 10.37598/jam.v13i1.1782.
15. E. S. E. Agha and Norfadzilah Rashid, "An Interconnection between Earnings Quality and Earnings Management in the Business Environment," *Economit Journal: Scientific Journal of Accountancy, Management and Finance*, vol. 3, no. 2, pp. 67–76, Apr. 2023, doi: 10.33258/economit.v3i2.872.
16. L. R. Anggraeni and L. W. Widati, "Pengaruh Leverage, Likuiditas, Profatibilitas, Konservatisme dan Ukuran Perusahaan terhadap Kualitas Laba," *Owner*, vol. 6, no. 1, pp. 336–347, Jan. 2022, doi: 10.33395/owner.v6i1.588.
17. L. Septiani, "PENGARUH PROFITABILITAS, LIKUIDITAS, DAN KONSERVATISME AKUNTANSI TERHADAP KUALITAS LABA DENGAN UKURAN PERUSAHAAN SEBAGAI VARIABEL PEMODERASI PADA PERUSAHAAN SEKTOR PROPERTI, REAL ESTATE DAN KONSTRUKSI BANGUNAN YANG TERDAFTAR DI BEI TAHUN 2020-202," *Jurnal Akuntansi*, 2024.
18. N. Safitri and H. K. Titisari, "Determinan kualitas laba pada perusahaan food and baverage periode 2016-2019 ," *Akuntabel*, vol. 18, no. 1, pp. 91–98, 2021.