



Exploring the Impact of Accounting Prudence: The Role of Firm Size as a Moderating Factor

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Abstract

This study aims to examine the influence of information asymmetry, tax incentives, and litigation risk on accounting prudence, with firm size as a moderating variable. The research focuses on companies listed on the Jakarta Islamic Index (JII) during the 2020-2023 period. Accounting prudence is measured to understand how companies apply caution principles in financial reporting. The results of this study indicate that information asymmetry is not related to accounting prudence, tax incentives have a significant influence on accounting prudence, litigation risk affects accounting prudence, firm size does not moderate the relationship between information asymmetry and accounting prudence, and firm size does not moderate the relationship between tax incentives and accounting prudence. However, firm size strengthens the relationship between litigation risk and accounting prudence. The novelty of this research lies in the integration of firm size as a moderating variable in the relationship between litigation risk and accounting prudence, which has not been widely explored in the context of sharia-based companies in Indonesia. In addition, this study provides empirical insights into the application of accounting prudence in situations influenced by fiscal policies and potential legal risks. Future researchers are advised to expand the research scope by considering other variables, such as corporate social responsibility (CSR) or macroeconomic factors that may influence accounting prudence. Longitudinal research covering a more extended period is also expected to yield more comprehensive and robust results.

Keywords: Information Asymmetry; Tax Incentives; Litigation Risk; Accounting Prudence; Firm Size.

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INTRODUCTION

Indonesia is the most populous Muslim country in the world in terms of population. Almost 86.7% of Indonesia's total population is Muslim. Based on population, Indonesia is also the country with the largest Muslim population (Verawaty & Merina, 2015). The Muslim community needs an economic system that holds the teachings of Islam in order to be free from doubts and deviations from the teachings of Islam itself. This can trigger the emergence of companies in Indonesia that apply sharia rules in their operational activities (Aryani & Muliati, 2020). That way, people will increasingly trust and be interested in the products or services provided.

Sharia-indexed companies must also prepare financial reports to explain how their resources are managed by management. Companies use financial reports as one of the primary media to communicate their financial information to various parties who have an interest, whether it is internal or external parties, to make decisions. Therefore, it is hoped that its information will be precise and reliable; thus, the contents can be accounted for and useful for every party interested in the financial statements. Financial reports must have a purpose and follow accounting principles and rules based on established standards (Sun *et al.*, 2023).

Financial reports cannot be made carelessly in practice, but some rules and standards have been applied and determined to create and compile them. This needs to be done to make financial reports easy to understand (Stiawan *et al.*, 2022). The financial statements prepared by the company are certainly the main thing for company owners and management. In addition, many parties, such as investors, creditors, suppliers, and the government, need and are interested in the financial statements presented by the company (Mustikasari *et al.*, 2020).

Business operations, financing, and investment activities are essentially documented in the business's financial statements, assessing the effectiveness of the strategy the firm has adopted to reach its objectives. Financial Accounting Standards (SAK) regulate the preparation of financial statements, which are the basis for valuation and measurement methods prepared by the Institute of Indonesia Chartered Accountants (IAI). The principle of conservatism or the precautionary principle is that when the manager is faced with choosing accounting rules, the manager will determine the rules that produce small profits.



This principle can be interpreted as a principle of prudence, where an accountant prioritizes recognizing a loss over the recognition of future profits (Savitri, 2016).

Among others, fraudulent financial statements in Indonesia occurred at PT Antam, namely the utilization of Corporate Social Responsibility (CSR) funds. Companies, both provincial and district governments, utilize CSR funds as a result of excessive government intervention. The funds spent were bloated, especially in the construction of the Sangia Nibandera airport. In addition, former officials of PT Antam were charged with fraud to the detriment of state finances amounting to IDR100.8 billion. The Corruption Eradication Commission (KPK) Prosecutor claims that Dody Martimbang appointed PT Loco Montrado as a backup refinery firm without a board of directors' consent, directing Agung Kusumawardhana to locate a gold refining company based on shares. This certainly creates information asymmetry that occurs so that the company is less careful in preparing financial statements (Mustikasari et al., 2020). It is feared that in the next period, it will experience losses because it does not anticipate the worst possibility. In order not to misperceive the current period with the future period. Therefore, management must present prudence in its financial statements. The study conducted by Sugiyarti and Rina (2020) on the effect of tax incentives, financial distress, and earning pressure on accounting conservatism explains that tax incentives significantly influence accounting prudence. This is because companies tend to adopt tax-minimizing strategies by reporting lower profits to maximize tax burden savings. This approach aligns with the prudence principle, which emphasizes recognizing expenses or potential losses earlier, while revenue recognition is delayed until it is fully realized.

The factor that influences management to implement the principle of accounting prudence is information asymmetry. The information asymmetry that occurs in the company causes management to be able to take advantage of this opportunity, which benefits itself. The second factor is company size. Large companies must apply accounting prudence because they manage many assets; thus, companies must be careful, especially in revenue recognition. The third factor is litigation risk. The risk of litigation is an external factor that helps the company recognize revenue. Prudence refers to the principle of caution in financial reporting, which aims to avoid overstatement of assets and income. If companies engage in aggressive tax avoidance, this may reflect a lack of prudence

in tax and financial reporting, potentially leading to litigation risk and regulatory uncertainty (Restuti *et al.*, 2023).

Although various studies have discussed the importance of the prudential principle in accounting and the factors that influence it, studies regarding the application of the prudential principle in companies listed on the Islamic index are still limited. Most studies still focus on conventional companies, so few have explored how factors such as information asymmetry, firm size, and litigation risk affect accounting prudence in the context of Islamic companies. In addition, previous studies tend to see tax incentives as a factor that affects accounting conservatism in general without taking into account how Islamic companies respond to tax incentive policies in preparing their financial statements.

This study offers a new contribution by analyzing how information asymmetry, firm size, and litigation risk moderate the relationship between tax incentives and accounting prudence in companies listed on the Jakarta Islamic Index (JII). In contrast to previous studies that mostly focus on conventional companies, this study highlights the unique challenges faced by sharia-based companies in applying the accounting prudence principle. In addition, by considering fraud cases that occur in Islamic-based companies, this study also provides a new perspective on how external factors such as government intervention and taxation policies can affect the quality of financial statements of Islamic companies. Additionally, the novelty of this study lies in integrating firm size as a moderating variable in the relationship between litigation risk and accounting prudence, which has not been widely explored in the context of sharia-based companies in Indonesia.

Academically, this study enriches the literature on factors that influence prudence accounting, especially in a sharia-based corporate environment with different governance characteristics and accounting policies from conventional companies. From the practical side, the results of this study are expected to provide insight for company management, regulators, and investors in understanding the importance of prudence accounting as a form of transparency and accountability of financial statements. Therefore, the main objective of this study is to analyze the effect of information asymmetry, tax incentives, and litigation risk on prudence accounting and test the moderating role of company size in this relationship in companies incorporated in the JII for the period 2020-2023.



LITERATURE REVIEW

Agency Theory

Agency theory, first introduced in the economic literature, presents a theoretical model of the relationship between one party as principal and another party as agent (Jensen & Meckling, 1976). This concept focuses on the interaction between business owners and management. Agency problems can arise when there is a conflict of interest between the principal and the agent. The selection of agency theory for research on factors affecting prudent accounting is very appropriate because this theory highlights potential conflicts between stakeholders, such as shareholders, creditors, and management. Since prudent accounting aims to provide a more conservative and reliable picture of financial information, prudent accounting plays an important role in reducing the risks associated with such conflicts to protect the interests of stakeholders.

Accounting Prudence

Accounting Prudence, according to FASB Statement of Concept No. 2, is defined as prudent action in the face of uncertainty to ensure that uncertainties and risks in business situations have been considered (Savitri, 2016). Prudence reflects the principle of accounting conservatism, which prioritizes prudence in recognizing income or assets and expenses to reduce the profit reported by the company to reduce future risks. In this study, accounting prudence is measured using the net asset measure. The method used is the company's market-to-book ratio, where the ratio value is multiplied by a negative one so that positive values reflect a higher level of conservatism.

Information Asymmetry

Information asymmetry occurs due to differences in interests between managers and shareholders. Differences in business objectives cause the information needs desired by each party to be different. Information asymmetry can affect the principle of prudence because management has better access to internal information. Thus, they can take advantage of information asymmetry to influence the measurement and presentation of financial statements (Sun et al., 2023). In this study, information asymmetry is measured using bid-ask spread,



a measure of liquidity used to assess information asymmetry between earnings management and company shareholders (Sarah *et al.*, 2022).

Tax Incentives

Tax incentives are tax breaks that the government offers to some taxpayers in the form of lower tax rates in an effort to lessen the amount of taxes that must be paid (Stiawan *et al.*, 2022). Companies can reduce the current tax value by delaying revenue recognition by applying the precautionary principle.

Litigation Risk

Litigation risk is a risk inherent in the company and reflects the possibility of threats of lawsuits from parties who feel harmed by the company (Kristina & Yuniarta, 2021). The principle of prudence ensures that companies are careful and conservative in measuring and disclosing information related to litigation risk, thus providing a more accurate picture of the potential impact of lawsuits on the company's financial condition.

Firm Size

Firm size is a scale that can be used to classify companies into three groups, namely small companies (small size), medium companies (medium size), and large companies (large size), by looking at several indicators such as profitability, company fixed assets, or others (Afriani *et al.*, 2021). In addition to high profits, large companies also have more complex management than small companies; thus, they tend to apply the principle of prudence to reduce high political costs.

Hypothesis

Following theoretical reviews and the problem's background, the following is the formulation of the study's hypothesis:

Effect of Information Asymmetry on Accounting Prudence

According to agency theory, information asymmetry occurs when managers have more access to internal knowledge and future business possibilities than shareholders do. According to Aryani and Muliati (2020), the higher the information asymmetry that occurs, it will increase the use of conservative



methods in presenting financial statements. This study agrees with those of Aryani and Muliati (2020), who found that accounting prudence is impacted by knowledge asymmetry. One of the main reasons for the importance of prudence in accounting is to reduce information asymmetry between management and shareholders. With prudence, companies tend to be more transparent in recognizing losses so that stakeholders can get a more realistic picture of the company's financial condition (Georgiou, 2024).

H1: Information asymmetry affects accounting prudence

The Effect of Tax Incentives on Accounting Prudence

In agency theory, low and relatively permanent profits can indicate to investors that management has implemented conservative accounting (Barus & Setiawati, 2015). Companies can obtain tax incentives by generating low profits to minimize their tax burden. This supports research by Kristina and Yuniarta (2021), which found that tax incentives affect accounting conservatism.

H2: Tax incentives affect accounting prudence

The Effect of Litigation Risk on Accounting Prudence

Agency theory is used in this study to explain how risks between stakeholders and management lead to agency conflicts (Kristina & Yuniarta, 2021). To prevent this conflict, management as an agent must face the company's life cycle by performing well. If management performs well, it will lead to positive financial reports, reducing the need for strict accounting prudence. However, if management's performance is poor, the preparation of financial statements must be more meticulous to ensure that nothing deviates from the company's objectives. This research is in line with research conducted by Majidah and Zelina (2022), which states that litigation risk affects accounting prudence. Accounting prudence is applied by tightening the verification standards of financial statements so that only good news that can actually be verified will be recorded. This can reduce litigation risk as companies tend to avoid overstatement of assets or profits that could be the basis of a lawsuit (Laux & Ray, 2020).

H3: Litigation risk affects accounting prudence

Firm Size Moderates the Relationship between Information Asymmetry and Accounting Prudence

Larger companies have a broader and more complex stakeholder structure in their management. In addition, large companies certainly have more information about the company's overall activities, allowing information inequality between management and shareholders. This makes the assumption that if the asymmetry is greater, the size of the company will increase the risk of information asymmetry that occurs. Consequently, the company must be careful in presenting its financial statements to the public. This is supported by research conducted by Aryani and Muliati (2020), which states that firm size affects accounting conservatism.

H4: Firm size strengthens the relationship between information asymmetry and accounting prudence.

Firm Size Moderates the Relationship between Tax Incentives and Accounting Prudence

A large company must have more expert resources to carry out more and more activities. Tax incentives are a type of tax break that the government offers to some taxpayers in the form of lower tax rates in an effort to reduce the total amount of taxes owed (Stiawan *et al.*, 2022). A large company certainly has a larger profit, and the tax burden paid will be even greater. This requires tax planning, one of which is by providing tax incentives. Therefore, the company can manage its tax burden by applying the principle of prudence. Prudence helps management control profits to avoid excessive taxation (Alvi *et al.*, 2023).

H5: Firm size strengthens the relationship between tax incentives and accounting prudence

Firm Size Moderates the Relationship between Litigation Risk and Accounting Prudence

Large companies tend to be more sensitive to political relations, in this case, the company's relationship with interested parties such as creditors, investors, suppliers, and regulators. Good political relations will encourage companies to make financial reports very carefully, and this allows the level of litigation risk



to be reduced so that the company will not receive legal threats. This is in line with research by Noviantari and Ratnadi (2015), which states that firm size has a positive effect on accounting conservatism, and research by Majidah and Zelina (2022), which states that litigation risk affects accounting prudence.

H6: Firm size strengthens the relationship between litigation risk and accounting prudence.

RESEARCH METHOD

This study takes a quantitative approach, consistent with the researchers' goals and techniques for gathering data. Deductive reasoning is the foundation for identifying and resolving research problems in quantitative research, which seeks to test or validate hypotheses. Secondary data from the official website, www.idx.co.id, was used. In the 2020–2023 timeframe, the study will examine how the independent variables, information asymmetry, firm size, and litigation risk affect the dependent variable, accounting prudence. The moderating role of tax incentives, which can either strengthen or weaken the relationship between the independent and dependent variables, will also be examined. Documentation and methods of literature study are used to obtain data.

A purposive sampling approach was employed to pick up the study sample. This method involves the application of specific criteria that are suited to the research requirements. Twelve firms were gathered as examples using this strategy. Companies listed on the JII between 2020 and 2023 were sampled in this study. Data analysis was carried out using the Structural Equation Modeling Partial Least Square (SEM-PLS) method to test the relationship between latent variables (Sholihin & Ratmono, 2021). SEM-PLS was chosen because of its ability to handle models involving many latent variables and accommodate variables with one indicator based on the argument that the indicator is theoretically sufficient to represent related variables. SEM-PLS is a flexible method and can be used despite the small number of indicators used as long as the assumptions of validity and reliability of the data are met (Hair et al., 2019).

RESULTS AND DISCUSSION

Results

Outer Model Analysis

Validity Test

The construct validity test is divided into two parts:

Table 1. *Result from Outer Loading Convergent Validity*

Variable	Outers Loading	Result
X1	1.000	>0,7
X2	1.000	>0,7
X3	1.000	>0,7
Z	1.000	>0,7
Y	1.000	>0,7
X1*Z	1.000	>0,7
X2*Z	1.000	>0,7
X3*Z	1.000	>0,7

Source: WarpPLS Processed Data (2024)

Table 1 indicates that all indicators are deemed legitimate as they satisfy the requirements by having an outer loading factor value greater than 0.7. Therefore, it can be concluded that the variables assessed using the loading technique and based on validity are both possible and acceptable.

Table 2. *Indicator Loading and Cross-Loading Measurement Results*

	X1	X2	X3	Y	Z
X1	1.000	0.000	0.000	0.000	0.000
X2	0.000	1.000	0.000	0.000	0.000
X3	0.000	0.000	1.000	0.000	0.000
Z	0.000	0.000	0.000	1.000	0.000
Y	0.000	0.000	0.000	0.000	1.000

Source: WarpPLS Processed Data (2024)



The results of Table 2 show that all indicators meet the discriminant validity value. This is because the results of the latent construct loading value exceed the loading value of other constructs. Thus, it can be concluded that the discriminant validity criteria can be adequately met (Sholihin & Ratmono, 2021).

Table 3. *Reliability Testing Measurement Results*

Variable	Composite Reliability	Cronbach's Alpha	Result
X1	1.000	1.000	Reliable
X2	1.000	1.000	Reliable
X3	1.000	1.000	Reliable
Z	1.000	1.000	Reliable
Y	1.000	1.000	Reliable

Source: WarpPLS Processed Data (2024)

Based on the results of Table 3, in terms of the outer model as a whole, seen from the reflective construct, it has met the criteria and is proven.

Inner Model Analysis

Inner model evaluation includes goodness of fit (model fit test). In determining the goodness of fit, it can be determined in 2 (two) ways, namely R squared, Q squared analysis, and general result output analysis (APC, ARS, and AVIF).

Table 4. *Model Fit Test Results*

Model Fit	Value Terms	Result	Description
Average Path Coefficient (APC)	P<0.05	0.176 (P=0.018)	Accepted
Average R-Squared (ARS)	P<0.05	0.959(P<0.001)	Accepted
Average adjusted R-squared (AARS)	P<0.001	0.953 (P<0.001)	Accepted



<i>Average block VIF (AVIF)</i>	Accepted if ≤ 5 Ideal ≤ 3.3	2.730	Ideal
<i>Average full collinearity VIF (AFVIF)</i>	Accepted if ≤ 5 Ideal ≤ 3.3	2.157	Ideal
<i>Tenenhaus GoF</i>	$0.1 < 0.25 < 0.36$ small < medium < large	0.979	Large
<i>Sympson's paradox ratio (SPR)</i>	Accepted if ≥ 0.7 ideal = 1	0.833	Accepted
<i>R-squared contribution ratio (RSCR)</i>	Accepted ≥ 0.9 ideal = 1	0.999	Accepted
<i>Statistical suppression ratio (SSR)</i>	Accepted ≥ 0.7	1.000	Accepted
<i>Q-Squared</i>	Accepted $Q^2 > 0$	0.896	Accepted
NLBCDR	Accepted ≥ 0.7	0.833	Accepted

Source: WarpPLS Processed Data (2024)

In this study, the goal of assessing the influence between variables and the overall effect of the relationship between variables is to determine the inner model. The causal link between latent variables that have been constructed using the theory's core ideas is described by the structural model, also known as the inner model (Sholihin & Ratmono, 2021). In the WarpPLS structural model test (inner model), blindfolding and bootstrapping techniques are used to aid. As seen in the above table, there are several test findings to ascertain the link between variables. It can be seen in the table that the APC, AARS, and ARS values have met the criteria, with APC and ARS values having $p < 0.05$ while AARS has a $p < 0.001$ value. The AVIF value of 2.730 and AFVIF 2.157 are included in the ideal category because ≤ 3.3 . The results of other inner model measurements are presented in the table above.



The R-squared test results are depicted in Table 4. In this table, there is a nominal 0.954, which, if presented to 95,5%, indicates that variable Y1 can be explained by variables X1, X2, X3, and X4 by 95.4%. At the same time, the remaining 4.6% is explained by other variables outside the study. The higher the R2 value indicates, the better the model (Sholihin & Ratmono, 2021). In this study, the value of R2 is moderate or quite good, characterized by a value of $R^2 > 0.50$. Meanwhile, the Q2 value must have a value greater than 0 ($Q2 > 0$) (Sholihin & Ratmono, 2021). Based on Table 4, which shows the Q-squared test results of 0.896, which is greater than 0, it can be stated that Q2 is accepted.

Path Analysis

Diagrammatic Path Interpretation

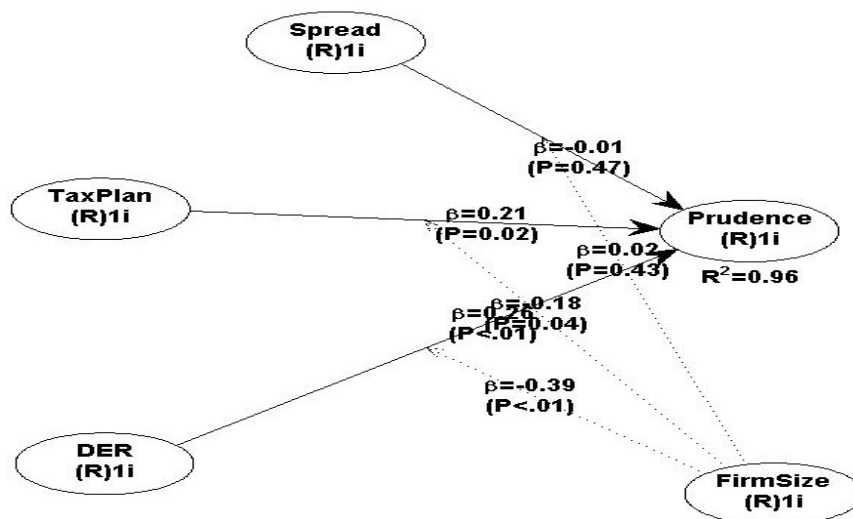


Figure 1. Hypothesis Test Results

Source: WarpPLS Processed Data (2024)

When the result of the p-value < 0.05 , the hypothesis can be declared acceptable, and if the p-value is greater than > 0.05 , the hypothesis is declared rejected or not accepted. The results of hypothesis testing in the study are presented as follows:

Table 5. *Path Coefficient and P-Value Results*

Hypothesis	Path Coefficient	P-Value	Result
X1>>Y	0.007	0.472	Rejected
X2>>Y	0.210	0.017	Accepted
X3>>Y	0.260	0.005	Accepted
X1*Z>>Y	0.388	<0.001	Accepted
X2*Z>>Y	0.177	0.036	Accepted
X3*Z>>Y	0.016	0.433	Rejected

Source: WarpPLS Processed Data (2024)

Testing the first hypothesis, that knowledge information asymmetry influences accounting prudence, yields a route coefficient of 0.007 with a p-value of 0.472 ($0.472 > 0.05$), according to Table 5 data. Since the p-value values are greater than or equal to 0.05, it may be stated that the results refute H1, indicating that knowledge asymmetry and accounting prudence are unrelated.

According to which tax incentives influence accounting prudence, the second hypothesis was tested, and the findings indicate that the path coefficient was 0.210, with a p-value of less than 0.017 ($0.017 < 0.05$). Thus, it may be said that the study's findings support the acceptance of H2 since they are consistent with the hypothesis's formulation, which claims that the two variables are positively correlated.

The results of the third hypothesis test of litigation risk related to accounting prudence resulted in a path coefficient of 0.260 and a p-value of 0.005 ($0.005 < 0.05$). Thus, it is concluded that the study results show that H3 is accepted because it is in accordance with the formulation of the hypothesis.

The results of the fourth hypothesis test, namely firm size, moderate the relationship between information asymmetry and accounting prudence, resulting in a path coefficient of 0.388 and a p-value < 0.001 ($0.001 < 0.05$). Thus, it is concluded that the research results show that H4 is accepted.

The results of testing the fifth hypothesis, namely firm size, moderate the relationship between tax incentives and accounting prudence, resulting in a path



coefficient of 0.177 and a p-value of 0.036 ($0.036 < 0.05$). Thus, it is concluded that the results of the study show that H5 is accepted.

The results of testing the sixth hypothesis, namely firm size, moderate the relationship between litigation risk and accounting prudence, resulting in a path coefficient of 0.016 and a p-value of 0.433 ($0.433 > 0.05$). Thus, it is concluded that the research results show that H6 is rejected.

Discussion

The effect of information asymmetry on accounting prudence

The agency theory states that information asymmetry occurs when managers (agents) have more information than owners (principals), which can lead to opportunistic behavior such as earnings management. Based on this theory, information asymmetry should encourage the application of accounting prudence to reduce conflicts of interest and improve the transparency of financial statements (Afriani et al., 2021).

However, the results showed that asymmetric information has no significant effect on accounting prudence. This indicates that the application of accounting prudence is not solely driven by the existence of asymmetric information but rather due to pressure from external parties, such as regulators and auditors, which aims to limit management's opportunistic behavior. This finding contradicts agency theory as it suggests that information asymmetry does not always influence more conservative accounting policies.

In relation to the research hypothesis, these results reject the hypothesis stating that information asymmetry has a positive effect on accounting prudence. Differences with previous studies, such as those conducted by Aryani and Muliati (2020), can be caused by differences in the method of measuring accounting prudence, where this study uses the Net Asset Measure, while previous studies use the Accrual Measure. This difference in measurement indicators can cause inconsistent results. As a result, further research needs to consider a more comprehensive measurement method.

The effect of tax incentives on accounting prudence

The results of this study indicate that firm size has a significant influence on accounting prudence, with a smaller significance value indicating a greater

influence. The hypothesis states that tax incentives have a positive effect on accounting prudence; thus, this indicates that tax incentives are used as a tool to reduce tax risk, which is in line with agency theory in reducing conflicts of interest. Conversely, if tax incentives actually weaken accounting prudence, then this reflects the opportunistic behavior of management, which can lead to earnings manipulation for particular interests.

Agency Theory explains the relationship between principals (shareholders) and agents (management) who often face conflicts of interest due to differences in objectives. In the context of tax incentives and accounting prudence, management as an agent has an incentive to prepare more conservative financial statements to minimize tax burden and reduce litigation risk. Applying the principle of prudence in accounting can be a management strategy in responding to tax incentive policies, especially in recognizing income and expenses more conservatively to avoid higher taxation. Thus, tax incentives can affect the level of accounting prudence through the mechanism described in Agency Theory, where management seeks to optimize their interests while still taking into account the expectations of shareholders.

This study reveals that companies with large sizes, as measured by total assets, tend to have less effective supervision, increasing the likelihood of earnings management practices. The larger the company, the higher the political cost (Afrizal *et al.*, 2020). Large companies usually have lower information asymmetry because they disclose more information to the public, which reduces the need to apply conservative accounting. In large companies, more complex managerial systems often prompt management to adopt more aggressive accounting practices to demonstrate high profits, which tends to reduce the application of accounting conservatism (Stiawan *et al.*, 2022).

This study also shows that the provision of tax incentives by the government, as regulated in PMK RI No. 40 of 2023, can affect accounting prudence policies in companies (Kemenkeu, 2023). With a reduction in the applicable tax rate, managers tend to minimize the corporate tax burden, encouraging the application of accounting prudence in the years before the new tax rate is enacted. The results indicate that the smaller the tax burden borne by the company, the higher the level of accounting prudence applied; thus, the financial statements become more conservative (Mujannah *et al.*, 2021).



This shows that with tax incentives, companies are more careful in preparing financial statements to minimize the tax burden.

This study is in line with the results of research by Stiawan et al. (2022) and Sugiyarti and Rina (2020), which found that tax incentives affect accounting conservatism. However, this study differs from Alvi et al.'s (2023) research, which found that tax incentives do not affect prudence accounting. This difference may be due to differences in the objects and research periods used.

The Effect of Litigation Risk on Accounting Prudence

The agency theory states that litigation risk acts as a disciplinary mechanism that limits management's opportunistic behavior in the presentation of financial statements. When litigation risk is high, management tends to be more careful in recognizing revenue and recording expenses to avoid lawsuits from investors or regulators. The hypothesis in this study states that litigation risk has a positive effect on accounting prudence, which is in line with agency theory because management will prefer conservative policies to minimize potential legal sanctions. Thus, litigation risk becomes an external factor that strengthens the application of accounting prudence by reducing the possibility of management manipulating earnings for personal gain.

This finding is consistent with research conducted by Andani and Nurhayati (2021). When the risk of litigation in a company is relatively high, managers tend to be more motivated to apply accounting conservatism. Increased litigation risk is often caused by high corporate profits, leading to high dividends distributed and low debt payments, which encourages creditors to sue the company to pay off its debts. In order to reduce litigation risk, managers are more encouraged to apply the principle of conservatism so that debt recognition is accelerated and reported profits are not too high. This helps companies avoid high litigation risk (Meisy & Astuti, 2023). In addition, regulations and law enforcement that apply in the accounting environment also encourage managers to be more careful in accounting practices to avoid legal sanctions. Stricter law enforcement can increase the potential for litigation. Consequently, companies will be more careful in applying accounting principles.

Firm Size Moderates the Effect of Information Asymmetry on Accounting Prudence

The accepted hypothesis shows that information asymmetry has a significant effect on accounting prudence moderated by company size in JII companies. From an agency theory perspective, information asymmetry occurs when management (agents) have more information than owners (principals), leading to opportunistic behavior such as earnings management. Accounting prudence should be applied to make financial statements more conservative to reduce this risk. However, the impact of asymmetric information on accounting prudence may vary depending on firm size, which acts as a moderating variable. In large firms, external oversight mechanisms, such as stricter regulations, institutional investor oversight, as well as the involvement of more competent auditors, tend to be stronger, which may weaken the relationship between information asymmetry and accounting prudence as management has pressure to report financials transparently without having to apply excessive conservatism. In contrast, in small firms, where external oversight is weaker, information asymmetry is more likely to drive the adoption of accounting prudence as a defensive measure to avoid litigation risk or investor distrust. Therefore, agency theory explains that firm size may moderate the effect of information asymmetry on accounting prudence, with large firms tending to have higher transparency pressures, while small firms may rely more on conservative accounting policies to manage information uncertainty (Afriani *et al.*, 2021).

Companies listed on the JII must comply with sharia principles, which include transparent and accountable financial reporting (Afriani *et al.*, 2021). These principles demand high ethical standards in the presentation of financial statements; thus, the pressure to apply accounting prudence becomes more stringent. In the context of the JII, the importance of sharia principles in financial reporting also reduces the possibility of firm size moderating the relationship between information asymmetry and accounting prudence. Sharia standards emphasize honesty, fairness, and openness, which minimizes the difference in treatment between large and small companies in presenting financial statements.

Firm Size Moderates the Effect of Tax Incentives on Accounting Prudence

The results of hypothesis testing prove that company size can moderate the relationship between tax incentives and accounting prudence; thus, H5



in this study can be accepted. Based on agency theory, conflicts of interest between management (agents) and owners (principals) occur due to unbalanced information, where management has an incentive to present favorable financial statements for their own interests, such as obtaining bonuses or reducing taxes paid. In this context, tax incentives can encourage the application of accounting prudence because management tends to choose more conservative accounting policies to reduce taxable income and avoid tax audit risks.

However, the effect of tax incentives on accounting prudence is not universal and may be moderated by firm size. Large firms generally have stronger governance and receive greater scrutiny from regulators and investors, making them more likely to apply prudence in financial reporting to maintain their reputation and avoid tax litigation. In contrast, small companies with weaker supervisory structures may be more flexible in utilizing tax incentives to reduce tax burden without overly considering accounting prudence. Therefore, within the agency theory framework, firm size as a moderating variable plays a role in determining the extent to which tax incentives affect the application of accounting prudence, with large firms more likely to apply accounting conservatism than small firms (Sugiyarti & Rina, 2020).

This finding aligns with Watts' (2003) view that accounting prudence reduces conflicts of interest in financial reporting, especially in the context of firms under regulatory pressure and high scrutiny (Safrina et al., 2020).

Firm Size Moderates the Effect of Litigation Risk on Accounting Prudence

The sixth hypothesis of this study cannot be accepted because the hypothesis test findings show that the relationship between accounting prudence and lawsuit risk cannot be moderated by company size. Company size does not strengthen or weaken the effect of litigation risk on the application of accounting prudence. This indicates that both large and small companies incorporated in the JII have no significant difference in their accounting response to litigation risk. Other factors, such as internal company policies or compliance with sharia standards, may be more dominant in influencing accounting prudence. This finding is in line with previous research showing that the relationship between firm size and litigation risk is not always significant in all contexts (Maulina & Triyono, 2023).



In addition, large companies usually have more adequate resources to deal with litigation risk compared to small companies. They can access qualified legal and financial services to ensure that their accounting policies comply with applicable standards, including in terms of accounting prudence (Meisy & Astuti, 2023). Therefore, firm size may not be strong enough to strengthen the relationship, as large firms tend to have more resources to manage legal risks without significantly increasing accounting prudence. The rejection of this hypothesis can also be caused by the unique characteristics of companies in the JII, which generally have a high level of compliance with sharia principles. This makes companies, regardless of their size, focus more on accountability and transparency to avoid legal risks and maintain their reputation in the market. In addition, strict regulations and supervision from capital market authorities may also be a factor in homogenizing accounting behavior. Company size may not act as a significant moderating variable, as the accounting prudence mechanism is more determined by sharia compliance and overall risk management (Andini *et al.*, 2020).

In agency theory, litigation risk should encourage management to apply accounting prudence to avoid legal sanctions that could harm the company. However, the results of the study, which show that litigation risk has no significant effect on accounting prudence moderated by company size, can be interpreted as an indication that both large and small companies have other mechanisms for dealing with potential litigation. Thus, agency theory in this context suggests that the moderating factor of firm size does not strengthen the relationship between litigation risk and accounting prudence, as firms tend to rely on other strategies beyond accounting prudence in the face of legal risk.

CONCLUSION

This study demonstrates that accounting prudence is unaffected by knowledge asymmetry but is influenced by tax incentives and litigation risk. Additionally, firm size does not moderate the effect of knowledge asymmetry and tax incentives on accounting prudence but amplifies the impact of litigation risk. These findings imply that firms need to consider tax incentives and litigation risk in crafting more prudent accounting policies to increase transparency and reduce the potential for financial statement manipulation. For regulators, the results of



this study can be the basis for formulating policies that encourage the application of accounting prudence, especially in industries with a high level of litigation risk. As a suggestion, future research can add or change independent variables to identify other factors influencing accounting prudence and use samples from companies outside the JII to obtain more generalizable results.

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