

ISSN: 2715-9848 (On line) ; 2715-9828 (Print)

ILOMATA

INTERNATIONAL JOURNAL OF



TAX AND ACCOUNTING


Yayasan Sinergi Kawula Muda

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
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



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



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DOI: <https://doi.org/10.61194/ijt.v7i2.2158>

Keywords: Financial distress, leverage, profitability, foreign ownership, prudence

ABSTRACT
 This study aims to analyze the influence of financial distress, leverage, profitability, and firm size on the implementation of the prudence principle

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Universitas Trisakti

Florus Daeli
Universitas Trisakti

Indra Widiarto
University of East London

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This study aims to analyze the influence of financial distress, leverage, profitability, and firm size on the implementation of the prudence principle (accounting prudence) in the Indonesian banking sector, with foreign ownership as a moderating variable. Although prudence is crucial for banking stability, the current literature still shows inconsistent findings and limited evidence regarding the moderating role of global governance, which is a major gap in this study. The data analysis in this study was performed using SPSS software using a multiple linear regression approach. This model examines the influence of fundamental factors on the principle of prudence in the banking sector, using foreign ownership as a moderating variable to improve the accuracy of the empirical estimation results for a total of 129 data observations. Conversely, profitability had a significant negative effect, reflecting managers' tendency to be optimistic when financial performance improves to maintain market reputation. The unique contribution of this study lies in the finding that foreign ownership significantly attenuates the negative effect of profitability on prudence, demonstrating its role as an external monitoring mechanism in reducing managerial optimism bias. However, foreign ownership was not found to moderate the effects of financial distress or leverage. This study enriches the literature on agency theory in the context of emerging markets and offers practical implications for regulators to integrate foreign ownership structures as a supervisory instrument to enhance transparency and more robust banking risk management.

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Moderation of Foreign Ownership on the Relationship between Determinants and the Principle of Prudence in the Banking Sector

Vinola Herawaty^{1*}, Florus Daeli², Indra Widiarto³

¹²Universitas Trisakti, Indonesia, ³University of East London, United Kingdom
Correspondence: vinola.herawati@trisakti.ac.id

Abstract

This study aims to analyze the influence of financial distress, leverage, profitability, and firm size on the implementation of the prudence principle (accounting prudence) in the Indonesian banking sector, with foreign ownership as a moderating variable. Although prudence is crucial for banking stability, the current literature still shows inconsistent findings and limited evidence regarding the moderating role of global governance, which is a major gap in this study. The data analysis in this study was performed using SPSS software using a multiple linear regression approach. This model examines the influence of fundamental factors on the principle of prudence in the banking sector, using foreign ownership as a moderating variable to improve the accuracy of the empirical estimation results for a total of 129 data observations. Conversely, profitability had a significant negative effect, reflecting managers' tendency to be optimistic when financial performance improves to maintain market reputation. The unique contribution of this study lies in the finding that foreign ownership significantly attenuates the negative effect of profitability on prudence, demonstrating its role as an external monitoring mechanism in reducing managerial optimism bias. However, foreign ownership was not found to moderate the effects of financial distress or leverage. This study enriches the literature on agency theory in the context of emerging markets and offers practical implications for regulators to integrate foreign ownership structures as a supervisory instrument to enhance transparency and more robust banking risk management.

KEYWORDS

financial distress; leverage; profitability; foreign ownership; prudence.

Introduction

Investors' decisions are significantly influenced by the quality of information accompanying the company financial statements, as the information contained in these statements is a primary consideration in determining which companies to invest in. Therefore, for financial statements to provide benefits to investors and for their information to be accountable, companies must apply rules, accounting principles, and objectives based on generally accepted accounting standards. Several things that are of particular concern in preparing financial statements are related to the concepts applied by the company in recognizing and measuring what financial events must be recognized, when a financial event will be recognized and how each financial event can be recognized, measured or recorded in accordance with the accounting system used by the company. In modern accounting standards, entities often face uncertainty when preparing relevant financial statements that faithfully represent economic phenomena. According to the Conceptual Framework published by the IASB, prudence is defined as the exercise of caution in making estimates under conditions of uncertainty, so that assets or revenues are not overstated and liabilities or expenses are not understated. Unlike traditional conservatism, which tends to be biased, prudence within the IFRS framework is an integral part of neutrality; it prohibits the creation of hidden reserves or excessive asset depreciation, as this would diminish the quality of information and the objectivity of financial statements.

The Financial Accounting Standards (SAK) applicable in Indonesia provide companies with the freedom to choose the accounting method to be used in preparing financial reports. The benefit of the freedom given to management is that companies can produce financial reports that align with their wishes. Due to the freedom granted to companies, the principle of prudence must be applied to prevent excessive optimism held by the company and the uncertainty it experiences from affecting the financial report results (Sulastrri & Anna, 2018). As an example, on the Oke Finance website, there is information that PT Garuda Indonesia is suspected of making odd financial reports or is considered to have violated the principle of conservatism or what is now called prudence, because this company issued financial reports for 2018 whose values were much different compared to the financial reports in 2017. In 2017, the company suffered a loss of \$216,500,000, while in 2018, the company recorded a net profit of \$809,850,000, resulting in inversely proportional values. Due to the significant differences in values, on April 2, 2019, this case began to be brought to the public's attention. According to the information contained in Oke Finance, there was a recognition of income from PT Mahata Aero Teknologi that should not have been recognized in that year. This problem was also reinforced by statements from the former Garuda Indonesia board of commissioners, namely Chairul Tanjung and Dony Oskaria, who considered that Garuda Indonesia's 2018 financial report was not in accordance with the Financial Accounting Standards Statement. The implementation of the principle of prudence was also not carried out properly because the company was indeed allowed to recognize potential income, but not as much as the value recognized by PT Garuda Indonesia because the value was very significant and according to the provisions, the income had not been met because the settlement was carried out in stages, which means that if the income was recognized directly in its entirety in that year, the company's value would be inversely proportional to the actual company value and would indirectly reduce the quality of the financial report.

In line with the case study, it is evident that fraudulent manipulation of financial statements can occur due to various underlying factors, including leverage, profitability, and financial distress. A company can be declared to be in financial distress when management is unable to pay its debts to creditors. Financial difficulties may compel shareholders to dismiss firm executives, as they are perceived as being incapable of managing the company effectively. This can encourage managers to change profits, which are a benchmark for manager performance, by regulating the level of accounting conservatism so that the higher the level of difficulty of a company, which is reflected in the smaller value of financial distress, the more it will encourage managers to present non-conservative financial statements.

Then, the leverage represented by DAR describes the relationship between the company's debt and its assets, as well as its capital, which determines how much the company is financed by debt (Rossa Putri et al., 2020). Several previous studies have stated that high leverage will make companies more careful because high debt levels can be a threat to the company's survival, so creditors have greater rights to know and supervise the company's operations.

Profitability measures a management team's ability to generate a profit within a specified period. This study uses Return on Equity (ROE) as an indicator of profitability, which shows the efficiency of using equity to generate profits. A high ROE indicates that the company is able to generate large profits from its capital. However, previous studies have found that the higher the ROE, the lower the company's compliance with the principle of prudence. The principle of prudence is considered controversial because it is considered to reduce

the value of income and increase costs so that reported profits are lower than actual. However, on the other hand, this principle is considered beneficial because it produces more accurate financial reports and higher-quality profits and prevents opportunistic behavior by managers in financial statement-based contracts.

Previous studies on accounting conservatism, also known as prudence, have yielded several pros and cons. Research conducted by Rivandi & Ariska (2019) used independent variables of capital intensity, dividend payout ratio and financial distress. The study's results indicated that capital intensity has a positive effect, the dividend payout ratio has no effect on prudence, and financial distress harms prudence. Research conducted by Sulastrri & Anna (2018) used independent variables of financial distress and leverage. The study's results indicated that both variables influence conservatism. In addition, research conducted by Afriani et al. (2021) utilized independent variables, including financial distress, leverage, liquidity, litigation risk, foreign ownership, and institutional ownership. The study's results indicated that all independent variables, except institutional ownership, exert a considerable influence on prudence.

Inconsistencies in the literature on accounting conservatism or the precautionary principle are evident in the influence of several key variables in the 2022–2025 period. For example, Haryani (2022) found that capital intensity had a significant positive effect on the application of the precautionary principle, indicating that companies with large fixed assets tend to be more conservative to avoid the risk of overvaluation. However, this finding was refuted by Lestari et al. (2023), who showed that capital intensity had no effect on conservatism because management focused more on operational efficiency than on prudent accounting policies. A similar phenomenon occurred with the variable of financial distress; Nugraha (2024) reported that financial pressure drives companies to be more cautious to maintain creditor confidence, while Zahra and Santoso (2022) found a negative effect, where companies threatened with bankruptcy tended to abandon the precautionary principle and turn to aggressive accounting practices to embellish their financial statements. These differences in results highlight the existence of an empirical gap that requires moderating variables, such as foreign ownership, to explain these dynamics more comprehensively.

In a study conducted by Putra & Sari (2020), the independent variables used were financial distress, leverage, and profitability. The study's results showed that all independent variables, except financial distress, had a significant effect on prudence. Therefore, the existence of this opposite makes further research even more interesting to follow.

The motivation of this study is to determine whether certain statements regarding the results of previous studies remain relevant when the independent variables studied are changed or combined from existing studies. In this study, the independent variables used are leverage, represented by the debt-to-asset ratio; profitability, represented by the return on equity; and financial distress. Additionally, this study incorporates a moderating variable of foreign ownership (Alvino & Sebrina, 2020). Unlike previous studies, which tended to be partial, this study positions foreign ownership not merely as an additional variable but as an essential external monitoring mechanism to overcome managerial ambivalence in applying the prudential principle. We fill a theoretical gap by demonstrating that foreign ownership can mitigate information asymmetry and opportunistic pressures that often lead to inconsistencies in the effects of capital intensity and financial distress on conservatism. Thus, this study offers a fundamental distinction

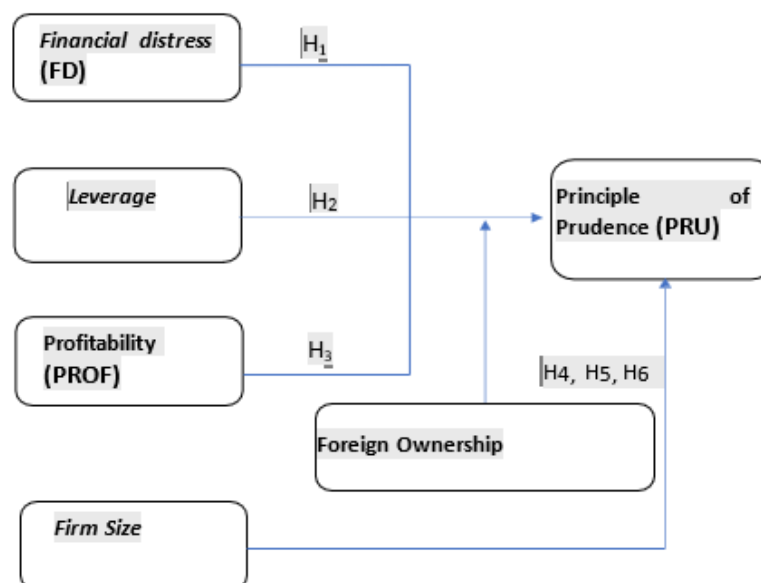


Figure 1. Conceptual Framework

by reconceptualizing the role of global governance structures in disciplining financial reporting in emerging markets, going beyond simply expanding conventional statistical variables. This study uses the firm size variable as a control variable. The inclusion of control variables is expected to enhance the accuracy of the study and facilitate readers' understanding of the relationship between variables. The data sample used in this study is from a banking sector company over the last few years. The use of this sector has not been widely used in previous studies, making this study even more interesting.

Agency Theory

Agency theory illustrates that there are differences in interests in terms of goals and decision-making, where the principal aims to prosper himself through the profits obtained by the company, while the agent aims to obtain compensation and loans so that psychological and economic needs are met (Hastuti & Rasyid, 2021). For example, suppose the company has a large profit in that period. In that case, the manager can carry out his role effectively, and from the value of the profit, the company can distribute dividends to its investors, thereby strengthening the trust given by investors. All capital or credit borrowing processes are streamlined to facilitate the company's operations (Wu & others, 2024).

The relationship between agency theory and prudence is that as the capital invested by shareholders becomes denser, the supervisory function carried out on management performance will also be tightened (Abu Orabi et al., 2024; Yang & others, 2023). Therefore, management must carry out its role carefully, as resource owners closely monitor their performance. This is done to ensure that there is no financial report that has been engineered by management. This study extends the agency theory framework by integrating a global monitoring perspective, where foreign ownership acts as a "governance police" held to higher transparency standards than domestic investors. This theoretical contribution explains that the presence of foreign shareholders effectively suppresses agency costs by reducing cross-border information asymmetry, which forces management to adopt the precautionary principle as a signal of financial reporting credibility. Furthermore, this paper redefines the role of foreign ownership beyond simply providing capital to becoming an institutional catalyst that mitigates management's opportunistic behavior under conditions of financial distress. Thus, this study offers the novel proposition that the effectiveness of the precautionary principle in

minimizing agency conflicts depends heavily on the external monitoring structure brought by the foreign entity.

Agency conflicts encourage managers (agents) to exploit information asymmetry through opportunistic financial reporting to secure compensation. Therefore, the application of the prudence principle becomes an important control mechanism for principals to limit managers' ability to overstate profits. In conditions of financial distress and high leverage, agency risk increases because managers tend to conceal losses to avoid breaching debt contracts, which logically requires a higher level of prudence to protect creditors' interests. Conversely, strong profitability reduces agency pressure to manipulate earnings, while the presence of foreign ownership serves as an external monitoring mechanism that strengthens the application of the prudence principle in mitigating managers' moral hazard behavior.

Conceptual Framework

Based on the theory above, the conceptual framework of this study is illustrated in Figure 1.

The Influence of Financial Distress on the Implementation of the Principle of Prudence

Financial distress is a stage where a company experiences a decline in its financial condition, and this typically occurs before the company is declared bankrupt or liquidated (Kariani & Budiasih, 2017). In a study conducted by Aryani & Muliati (2020), the higher level of financial distress reflected in the decreasing value of financial distress or when the company experiences greater losses will encourage managers to weaken the application of the principle of prudence because managers must save the company's finances by recognizing income early so that the resulting financial reports do not show values that can disappoint investors and lead to changes in management. This statement is supported by research from Afriani et al. (2021), which indicates that financial distress has a significant negative impact on the application of the principle of prudence. Therefore, in this study, the hypothesis that will be used is: H₁: Financial distress has a negative influence on the application of the Prudence principle.

The Influence of Leverage on the Implementation of the Prudence Principle

The use of high leverage inherently increases an entity's financial risk, thus directly affecting the application of the prudent principle. When a company relies heavily on debt, small

fluctuations in earnings or increases in interest rates can significantly worsen the debt burden and potentially trigger financial failure (Blake, 2022; Kozlov, 2023). Therefore, highly leveraged entities must apply the prudent principle more strictly, which is manifested in more conservative risk management policies, more careful monitoring of cash flows, and setting realistic debt limits. Without extra caution, the risk of bankruptcy or liquidity problems increases drastically, threatening the continuity of the company's operations and reputation.

In this study, leverage is represented by the debt-to-asset ratio. In the study by Juvenrio & Mulyani (2017), it was found that leverage, represented by the debt-to-asset ratio, has a significant positive effect on influencing the application of the principle of prudence. This is because the higher a company's debt, the wider the creditors' access to company information, which aims to ensure that the company maintains proper records properly so that creditors will supervise all company records more and will certainly affect the application of a higher level of prudence because the opportunity for management to cheat is smaller due to this supervision. Therefore, in this study, the hypothesis that will be used is:
H2: Leverage has a positive influence on the implementation of the Prudence principle.

The Influence of Profitability on the Implementation of the Prudence Principle

The profitability of an entity significantly influences the application of the prudent principle. Highly profitable companies tend to have a stronger financial position, allowing them to absorb unexpected losses and invest in better risk management (Al-Nimer et al., 2021). However, high profitability can also give rise to moral hazard, where management becomes overconfident and less cautious in decision-making, potentially ignoring risks in favor of greater profits (Eltweri & others, 2024). Therefore, even highly profitable entities must adhere to the prudent principle, ensuring that their growth and investment strategies do not compromise long-term stability and the ability to weather market volatility.

Profitability can be used to measure the ability of company managers to generate profits in the form of profit, sales value, equity or the number of assets owned by the company (Kurniawan & Suryaningsih, 2019). In this study, the ratio used is the return on equity, which measures the level of efficiency in generating profits or returns from the use of equity. If the level of profitability is higher, it means that the company has been effective in utilizing all its capital to generate profits. Research conducted by Abdurrahman & Ermawati (2019) yielded results indicating that profitability has a negative effect on the application of the principle of prudence. High profitability values prove that the use of equity can generate substantial profits, indicating that the utilization of company capital is effective. On the other hand, the higher the company's profit, it means that it sends a signal that the business sector is well-run, indicating good prospects for shareholders, who therefore do not strictly demand the application of the principle of prudence, as management is considered to have carried out its duties well. Through the explanation above, it can be concluded that:

H3: Profitability has a negative influence on the application of the Prudence principle.

The Effect of Foreign Ownership on the Relationship between Financial Distress and the Implementation of the Prudence Principle

Foreign ownership can moderate the relationship between financial distress and prudent practices through several mechanisms. Foreign investors, especially large institutions, often have better resources, experience, and

expertise in corporate governance and risk management than domestic investors. They tend to demand higher levels of transparency and accountability, and push for stricter prudent practices, even when firms are in financial distress (Alobaid et al., 2024). This pressure from foreign shareholders can force management to take conservative actions, such as writing down risky assets, accelerating loss recognition, or reducing high-risk activities, thereby preventing financial distress from escalating into a more severe crisis and ensuring more conservative financial reporting (Kashani & Mousavi Shiri, 2022).

In the study of the relationship between financial distress variables and prudence variables, the hypothesis posits a negative relationship between the two variables. With this foreign ownership, it is expected to weaken the relationship between the two variables. Foreign investors provide loans to companies with the goal of generating a profit. The existence of increasingly large foreign ownership in a company will certainly make agents or managers who manage the company more stringent in implementing the principle of prudence. Implementing the principle of prudence is believed to reduce information asymmetry and increase transparency in the preparation of financial reports, thereby avoiding opportunistic actions from management. In other words, the relationship between foreign ownership and prudence is positive. Therefore, it can be concluded that the hypothesis used is:

H4: Foreign ownership weakens the relationship between financial distress and the application of the Prudence principle.

The Effect of Foreign Ownership on the Moderating of the Relationship between Leverage and the Implementation of the Prudence Principle

Foreign investors, especially institutions with a global reputation, often bring higher corporate governance standards and stricter risk management practices (García-Nieto & others, 2024). They tend to be more sensitive to the financial risks arising from high leverage, as they may face greater scrutiny from regulators in their home countries and have experience with financial crises in global markets (Shmelev & Gilardi, 2025). As a result, foreign shareholders may encourage management to adopt more conservative debt policies and apply the principle of prudence more disciplined, even if there is a temptation to take on higher risks through leverage in pursuit of growth (Sneideriene & Legenzova, 2025). This means that, under the influence of foreign ownership, the negative impact of leverage on the principle of prudence can be minimized, because there is an external incentive to maintain financial stability.

In the study of the relationship between leverage variables and the application of the principle of prudence, the hypothesis is that leverage has a positive effect on the application of this principle. This study goes beyond simply confirming a linear relationship by revealing that in the banking industry, leverage serves as a stricter disciplinary mechanism because it involves simultaneous oversight from regulators and bondholders. The novelty of these results lies in identifying the role of foreign ownership in strengthening this leverage function; foreign investors bring global risk management standards that demand greater transparency through faster loss recognition (the precautionary principle). Contrary to conventional studies, these findings suggest that pressures from capital structure not only mitigate agency risk but also force banks to adopt more conservative accounting standards to maintain access to international capital markets. Thus, this study provides new insights into how the integration of foreign capital and liability burdens creates a unique supervisory synergy in promoting financial reporting integrity in the banking sector. The presence of foreign owners as one of the shareholders has an impact that strengthens the relationship between the two variables. This is because an increase in foreign ownership means there is a

greater ability to provide opinions. Then, the manager, in making decisions, does not benefit both parties. In that case, the manager is in a vulnerable position within the company because foreign owners can vote to change agents or managers. Therefore, it can be concluded that the hypothesis used is:

H5: Foreign ownership strengthens the relationship between leverage and the application of the Prudence principle.

The Effect of Foreign Ownership That Moderates the Relationship Between Profitability and the Implementation of the Prudence Principle

Foreign ownership can play a significant moderating role in the relationship between profitability and prudent management. Although high profitability is often associated with healthy financial conditions, there is the potential for management to become overconfident and take excessive risks, ignoring prudent management in the pursuit of higher returns (Shmelev & Gilardi, 2025). However, foreign investors, especially those from more mature markets with tight regulation, tend to bring with them a stronger corporate governance culture and a greater emphasis on long-term risk management. They often demand greater transparency and more conservative accounting practices, even when the company is at its peak profitability. This pressure from foreign shareholders can encourage management to adhere to prudent management practices, such as establishing adequate reserves, recognizing expenses promptly, and avoiding aggressive practices that could potentially undermine future stability, thereby minimizing the moral hazard that may arise from high profitability (Sneideriene & Legenzova, 2025).

The relationship between profitability and the application of the principle of prudence has a significant negative influence. The presence of foreign owners weakens the relationship between the two variables. This is because foreign owners cannot directly monitor the company's performance; therefore, they can indirectly influence the company's performance through the financial reports produced by the company. Therefore, foreign owners demand that management report the company's performance in the financial statements accurately and truthfully or continue to apply the principle of prudence. In other words, investors expect the company's financial management and reporting to be transparent and not prioritize personal interests, which suggests that the relationship between foreign ownership and prudence is positive. Therefore, it can be concluded that the hypothesis used is:

H6: Foreign ownership weakens the relationship between profitability and the application of the Prudence principle.

Methods

Research Design

This study uses a Multiple Linear Regression analysis technique with a Pooled Data approach. This approach is based on the assumption of homogeneity of characteristics between banks within the observation period, so the analysis is conducted by combining all observations into a single unit (common effect). This technique differs from formal panel data estimation (FE/RE) because it does not isolate individual intercepts but instead focuses on the overall generalizability of the model. To ensure the validity of the Pooled OLS model, a comprehensive diagnostic procedure is carried out through the Classical Assumption Test, including tests for multicollinearity, heteroscedasticity, and autocorrelation to ensure the estimated parameters are unbiased and consistent. Furthermore, hypothesis testing is conducted through Moderated Regression Analysis (MRA) using SPSS

software to detect the interaction effect of foreign ownership on the causal relationship being tested.

Operational Definition of Variables and Measurement

This study utilizes several variables that have been previously studied, drawing on research conducted by previous researchers related to Prudence. Thus, the study aims to investigate whether there is a relationship between the variables examined, including financial distress, leverage, profitability, and the prudence variable as the dependent variable, foreign ownership as a moderating variable, and firm size as a control variable. The explanation is as follows.

Dependent Variable

Prudence. In this study, the dependent variable used is the prudence principle. Prudence is the convergence of the principle of prudence in recognizing assets, expenses and income so that companies can reduce the risk of uncertainty in the future by reducing the company's profits (Aristiani et al., 2017). One way to apply this principle is to recognize all losses when the loss occurs, even though it has not occurred, while not recognizing any income if the income has not occurred (Rivandi & Ariska, 2019). To measure the level of prudence of a company, we can use the Accrual formula as follows:
Prudence = (((Net Income + Depreciation) – CFO) / Total Asset) X -1.

Variable Independent

Independent variables are variables that influence and become factors in dependent variables or bound variables.

Financial distress

Financial distress is a stage where a company's financial condition declines, and usually, this stage occurs before the company experiences liquidation or bankruptcy (Kariani & Budiasih, 2017). The company's inability to meet liquidity and solvency obligations is the initial step in financial distress. Financial distress is a situation where a company must take corrective action due to the company's inability to make payments on its obligations with the current operating cash flow (Rivandi & Ariska, 2019).

In this study, financial distress was measured using the Springate model introduced by Gordon L. V. Springate in 1978. By using this method, a company can be declared to have the potential to go bankrupt when the value of the calculation is <0.862 and will be declared to have the potential to be healthy if the value is > 0.862. If the calculation is less than or even smaller than the value of 0.862, the company is considered less effective in utilizing the assets and capital owned by the company to generate profits for the company. In addition, if the company uses more funding with debt, the risk of the company experiencing financial distress is greater because the company's burden will be added to the interest on the loan, and if the company experiences a decrease in income, there is a possibility that the company will not be able to pay its debts. However, if the company makes better use of its assets and reduces capital from debt, the possibility of the company experiencing financial distress becomes smaller (Fatmawati & Wahyuningtyas, 2021). The financial distress formula with the Springate method is represented by:

Note: $X1 = (\text{Current assets} - \text{Current Liabilities}) / \text{Total Assets}$, $X2 = \text{Earnings Before Interest and Tax} / \text{Total Assets}$, $X3 = \text{Profit before tax} / \text{Current Liabilities}$, $X4 = \text{Income} / \text{Total Assets}$.

Leverage

Leverage is the amount of debt used by a company to finance its business activities. Leverage is a ratio that can show management's ability to fulfill all obligations owned by the company itself. In this study, leverage is represented by the

debt-to-asset ratio, where this ratio functions to find out how much funds are lent by creditors to meet the financing of all company assets (Kurniawan & Suryaningsih, 2019). The measurement of this variable uses a formula such as:
Leverage (DAR) = Total Debt / Total Assets

Profitability

Profitability is a tool for analyzing company performance or as a basis for assessing the condition of management. Profitability is used to determine the ability of management to generate profits, where these profits can be assessed and measured (Putra & Sari, 2020). In this study, the profitability ratio used is the return on equity. Return on equity is one of the tools to determine the amount of return generated by the company in utilizing the capital invested by investors. The ROE formula used in this study is:

$$\text{Profitability (ROE)} = \text{Net Profit After Tax} / \text{Total Equity}.$$

Moderating Variable (Foreign Ownership)

Foreign ownership in this study is measured using the foreign share ownership ratio, which is the percentage of shares owned by foreign parties (individuals or institutions) compared to the total number of shares outstanding. This measurement is consistent with previous research that examined the influence of ownership structure on company accounting policies. In this study, foreign ownership can be formulated as follows:

$$\text{Foreign Ownership} = \frac{\text{amount of foreign ownership shares}}{\text{number of shares outstanding}} \times 100\%$$

Control Variable (Firm Size)

Firm size is divided into two, namely large and small, where the larger size of a company reflects greater profits and the implementation of a more difficult management system. Therefore, large companies are usually faced with various problems, one of which is political costs. Companies with large revenues usually encourage the government to raise taxes and ask for higher public service costs. Therefore, large companies usually apply high conservatism in order to reduce their profits. This statement can be concluded that firm size functions to determine whether a company is categorized as a small or large company. In this study, firm size is represented by the formula:

$$\text{Firm size} = \text{Ln}(\text{Total Assets}).$$

Analysis Method

The data analysis technique used in this study was multiple linear regression analysis using SPSS software. This method was chosen to test the direction and magnitude of the influence of several independent variables on a single dependent variable, either simultaneously or partially. The regression equation that will be used in this study is:

$$\text{Prudence} = \alpha + \beta_1\text{Si} + \beta_2\text{DAR} + \beta_3\text{ROE} + \beta_4\text{KA} + \beta_5\text{Si.KA} + \beta_6\text{DAR.KA} + \beta_7\text{ROE.KA} + \beta_8\text{FZ} + \varepsilon$$

Information:

Prudence = Prudence level of a company

α = Constants

β = Regression Coefficient

Si = *Financial distress is calculated using the Springgate model.*

DAR = *Leverage is represented by the Debt to Asset Ratio*

ROE = *Profitability is represented by the Return on Equity ratio*

FZ = *Firm Size*

KA = *Foreign Ownership*

ε = *Error*

Descriptive Statistics

Descriptive statistical analysis explains or provides

information related to data that will comprehensively explain conditions and factors. Descriptive statistical analysis is also a method that can reveal problems by processing, analyzing, researching and interpreting data and can also conclude that it can be used as a reference to provide suggestions systematically so that they are easy to understand.

Data Feasibility Test

Normality Test

Functions to find out whether the regression result data is normally distributed or not, which is represented in the form of an error value (e). Data is said to be valid if the regression result data is normally distributed or approaches the standard value that has been set based on testing with the Kolmogorov-Smirnov normality test in the SPSS program, which the researcher uses. The technique (Asymptotic Significance) can be implemented in making decisions, including: a) The regression result is said to be normal if the probability value exceeds 0.05, b) The regression result is said to be abnormal if the probability value does not reach 0.05.

Multicollinearity Test

This test is used to determine whether the regression results in each variable in the research have a correlation or not, and if there is a correlation, then the data is said to be multicollinear. A regression data result is likely good if there is no correlation between variables. If there is a correlation between variables, the solution step is to remove the variables that cause multicollinearity.

To see or detect whether there is multicollinearity, it can be seen from the Variance Inflation Factor (VIF) and Tolerance values. In the regression model, guidelines that are free from multicollinearity are those that have a tolerance value close to 1. The limit of VIF is 10. It is said that there is no multicollinearity when the VIF value does not reach 10. The calculation equation is as follows:

$$\text{VIF} = \frac{1}{\text{Tolerance}} \quad \text{or,} \quad \text{Tolerance} = \frac{1}{\text{VIF}}$$

Autocorrelation Test

Functions to find out whether there is a correlation between variables or not by considering the changing time interval. It is said that autocorrelation occurs if the related variables do not have a partner. So, in this study, the focus will also be on autocorrelation testing in SPSS. Especially for time series variables, because the data taken can be influenced by data in the previous period, it is important to conduct autocorrelation testing so that no data contains autocorrelation. Here is how to prove this test using Durbin-Watson by looking at the following:

1. It is said that there is no autocorrelation if $(4 - dU) > dW > dU$.
2. It is said that there is autocorrelation if $(4 - dL) < dL < dW$.
3. It cannot be concluded that there is autocorrelation if $dW = dU = dL = (4 - dU) = (4 - dL)$.

Heteroscedasticity Test

Functions in understanding whether or not there is heteroscedasticity in the regression test that is carried out. In understanding whether there is a difference in variance in the residual value of the research results between one person and another, this test needs to be carried out. To make it easier to carry out this test, you can do the Glejser Test, namely: a) it is said that there is no heteroscedasticity if the significance value exceeds 0.05, b) it is said that there is heteroscedasticity if the significance value does not exceed or is equal to 0.05. Heteroscedasticity Test.

Hypothesis Testing

Simultaneous Test (F-test)

The F-statistical test is usually used to show whether all

independent variables used in this research model have a joint influence on the dependent variable. The method used to see the relationship is by looking at how big the value of the probability of significance is. If it is known that the probability has a significance of less than 5%, then the independent variable will show a significant joint influence on the dependent variable.

Coefficient of Determination

The coefficient of determination (R²) is a basis for measuring how well the model in the study can explain its dependent variables, if the value of the coefficient of determination has a value between zero and one. The value of the coefficient of determination (R²), which is small, illustrates that the independent variables explain very limited variables. Conversely, if the value results are close to the value of one, it means that the independent variables provide almost all of the information needed to predict the dependent variable. However, suppose the use of the coefficient of determination has a weakness, with the presence of a biased value result against the number of independent variables entered into the research model, to avoid such biased results. In that case, the adjusted R² value is used, where the adjusted R² value is able to describe the value going up or down if there is an addition of one of the independent variables.

Partial Test (T-test)

The t-statistic test is usually used to show how much influence one independent variable, as an explanatory variable, can individually explain the dependent variable. This t-test has the function of finding out how the influence between the independent variable has a significant influence on the dependent variable and reviewing the influence of the independent variable on the dependent variable.

Sample

The type of this research is quantitative research. Where the purpose of this study is to analyze the population and samples related to the data used to adjust the research instrument, statistical data analysis and hypothesis testing. The population is all subjects that are used as objects in the study. The population used as objects in this study is a banking company that publishes annual financial reports ending on December 31 and is listed on the Indonesia Stock Exchange from 2020 to 2022.

A sample is a subset of a population that has characteristics and can describe the population used in the study. The technique used in sampling is the purposive sampling method, which is a non-random sampling technique whose information is obtained with certain criteria. The following are the criteria used in the purposive sampling method in this study:

1. Banking companies that are listed in BESEI throughout the period 2020 to 2022.
2. Publish audited financial statements and annual reports throughout the research period.

3. The form of financial reporting in rupiah form is reported at the end of each year from 2020 to 2022, which has been recorded on the IDX.
4. Have a complete data report throughout the period 2020 – 2022 on the required variables.

Data source

This study uses a secondary data collection method, namely data obtained indirectly from publicly available third-party sources but still relevant to the research objectives. The processed data includes audited financial reports and annual reports from banking sub-sector companies listed on the Indonesia Stock Exchange (IDX) for the observation period 2020–2022. All data was accessed through the official Indonesia Stock Exchange website (www.idx.co.id) and the official websites of each relevant bank to ensure complete information regarding foreign ownership structures and required financial ratios.

Result and Discussion

Descriptive statistics

This study will use descriptive statistical tests on the samples used to understand the characteristics of the data analyzed. The results of the descriptive statistical tests are presented as follows.

Based on [Table 1](#), the number of samples used in this study was 129. Then, the dependent variable used in this study was the application of the principle of prudence. After testing, an average value of -0.0170 was obtained, where this value was smaller than the standard deviation value of 0.0872, so it can be concluded that the data on the application of the principle of prudence varied or were not concentrated.

Financial distress as an independent variable using the formula from Springate produces an average value of -0.0178, where the value is smaller than the standard deviation value of 0.2745, so it can be concluded that the financial distress data varies and is not concentrated. The highest value of financial distress with a value of 0.9240. The lowest value of financial distress data with a value of -0.7667.

Leverage as an independent variable represented by the debt-to-asset ratio produces an average value of 0.7848, where the value is greater than the value of its standard deviation of 0.1578, so it can be concluded that the leverage data does not vary or is homogeneous and concentrated. The highest value of leverage data. The lowest value of leverage data with a value of 0.0524.

Profitability as an independent variable, represented by the return on equity ratio, produces an average value of 0.0274, where this value is smaller than the value of its standard deviation, which is 0.1093, so it can be concluded that the profitability data varies and is not concentrated. The highest value of the data with a value of 0.2595 in 2020. The lowest value of the profitability data with a value of -0.3848.

Foreign ownership as a moderating variable produces an average value of 0.4072, which is greater than the value of its standard deviation of 0.3409, so it can be concluded that foreign ownership data does not vary or is homogeneous and

Table 1. Descriptive Statistical Test

	PRU	FD	LEV	PROF	KA	FS
Mean	-0.0170	-0.0178	0.7848	0.0274	0.4072	17.4311
Median	-0.0100	-0.0624	0.8284	0.0336	0.2901	17.1139
Maximum	0.2637	0.9240	0.9321	0.2595	0.9900	21.1366
Minimum	-0.3128	-0.7667	0.0524	-0.3848	0.0000	13.4071
Std. Dev	0.0872	0.2745	0.1578	0.1093	0.3409	1.7710
Observations	129	129	129	129	129	129

Source: Processed Data

concentrated. The highest value of foreign ownership data is 0.9900 in 2020. The lowest value of foreign ownership data is 0.0000.

Firm size as a control variable produces an average value of 17.4311, which is greater than the standard deviation value of 1.7710, so the firm size data does not vary or is homogeneous and concentrated. The highest value of the firm size data is 21.1366 in 2021. The lowest value of the firm size data is 13.4071.

Model Selection and Model Evaluation

The Chow test is used to determine the best model between the CEM and FEM models, as presented in Table 2. The CEM model is selected if the Cross-Section Chi-Square value is greater than 0.05. Meanwhile, if the Cross Section Chi-Square value is less than 0.05, the selected model is FEM.

The results of the Chow Test above show the value of the cross-section chi-square probability of 0.0000, where this value is smaller than the significance level of 0.05, so the selected model is the fixed effect model (FEM).

The Hausman test is used to determine the best model between the FEM and REM models, as presented in Table 3. The FEM model will be selected if the value of the Random Cross-section is smaller than 0.05. If the value of the Random Cross-section is greater than 0.05, the REM model will be selected.

Classical Assumption Test

Multicollinearity Test

The results of the multicollinearity test are presented in Table 4. The correlation coefficient between KA and KA*LEV is 0.9718, or above 0.85, indicating a multicollinearity problem. However, according to Gujarati & Porter (2009), this multicollinearity problem cannot be corrected because even if one of the variables fails this test, the estimator remains BLUE, assuming that all other variables remain constant and there is no relationship between the disturbance variables, so the regression equation remains consistent and efficient. The interaction coefficient is negative and significant, but the hypothesis expects a strengthening of positive moderation. The manuscript should clearly distinguish between statistical significance and theoretical support. Revise the interpretation to state that the sign contradicts the hypothesis and explain the economic meaning of this negative interaction more carefully. This finding contradicts the research hypothesis that foreign ownership will strengthen the application of the prudential principle in highly leveraged banks. Economically, this negative sign indicates that in banks with dominant foreign ownership, increasing leverage is actually followed by a decrease in the level of prudence. This suggests the possibility that foreign investors in the Indonesian banking sector are more risk-tolerant in pursuit of asset growth or aggressive returns, resulting in weaker oversight of accounting conservatism policies when banks expand through debt.

Heteroscedasticity Test

Based on the results of the heteroscedasticity test attached in Table 5, it can be concluded that the data used in this study does not have heteroscedasticity problems in the regression model. This is supported because the probability value of each independent variable is above the significance value of 0.05.

MRA REGRESSION ANALYSIS

The fixed effect model regression equation produced based on the data in Table 6 is as follows:

$$\text{Prudence} = -3,4487 + 0,1728 \text{ Si} + 0,6926 \text{ DAR} - 0,4122 \text{ ROE} + 0,2753 \text{ KA} - 0,6324 \text{ Si.KA} - 0,5056 \text{ DAR.KA} + 0,7203 \text{ ROE.KA} +$$

0,1690 FS.

Determination Coefficient Test and F Test

The determination coefficient test is used to determine how much influence the independent variable has on the dependent variable being studied. The value of the large or small influence of the independent variable on the dependent variable can be seen from the adjusted R-square value, where, as seen from Table 7, the influence is 0.3286 (32.86%). With a value of 32.86%, it can be concluded that the independent variable used in this study can only explain the dependent variable (application of the principle of prudence) by 32.86%, while the remaining value or 67.14%, can be explained by other variables not used in this study.

A simultaneous significance test is used to determine the feasibility of a regression model used in the study. From Table 7, the F probability value is 0.0006, which means the F value <0.05, so we can conclude that all independent variables together have a significant influence on the independent variables used in this study.

Partial Significance Test

If we look at Table 8, the results of this test are the variables leverage, profitability, and foreign ownership that affect the relationship between financial distress and the application of the principle of prudence, foreign ownership that affects the relationship between leverage and the application of the principle of prudence and foreign ownership that affects the relationship between profitability and the application of the principle of prudence have a significant influence. Meanwhile, the relationship between financial distress and foreign ownership does not have a significant influence.

Financial distress does not affect the application of the principle of prudence

Based on the results of the hypothesis test, it can be concluded that financial distress does not affect the application of the principle of prudence. This may be because, in conditions of financial distress, companies need additional funds for operations and debt repayment, which increases the level of leverage. The application of the principle of prudence in this situation risks producing understated financial reports, which can lead to negative perceptions from creditors. The insignificant effect of financial distress on the principle of prudence can be explained through the perspective of signaling theory, where companies threatened with bankruptcy tend to avoid conservatism to prevent transmitting negative signals to the market and creditors. An empirical study by Zahra and Santoso (2022) found that distress often triggers managers to relax their prudential practices to present a more stable financial performance and maintain access to external financing. Therefore, this behavior reflects a strategic defense mechanism where the need for short-term liquidity overrides adherence to conservative reporting principles, as also found in emerging market contexts.

Table 2. Uji Chow

Effect Test	Statistic	d.f.	Prob.
Cross-section F	2.1860	(42.78)	0.0014
Cross-section Chi-square	100.3589	42	0.0000

Source: Processed data

Table 3. Hausmanqtest

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	24.2839	8	0.0021

Source: Processed data

Table 4. Multicollinearity Test

	Correlation Coefficient Value							
	FD	LEV	PROF	FS	KA	KA*FD	KA*LEV	KA*PROF
FD	1.0000	-0.5490	0.4017	-0.0773	0.0788	0.7304	-0.0334	0.2440
LEV	-0.5490	1.0000	-0.0007	0.2200	-0.0021	-0.4635	0.1932	-0.0112
PROF	0.4017	-0.0007	1.0000	0.5177	-0.0573	0.3144	-0.0580	0.7262
FS	-0.0773	0.2200	0.5177	1.0000	0.1703	-0.1312	0.2309	0.3454
KA	0.0788	-0.0021	-0.0573	0.1703	1.0000	-0.0525	0.9718	-0.0271
KA*FD	0.7304	-0.4635	0.3144	-0.1312	-0.0525	1.0000	-0.1898	0.4415
KA*LEV	-0.0334	0.1932	-0.0580	0.2309	0.9718	-0.1898	1.0000	-0.0446
KA*PROF	0.2440	-0.0112	0.7262	0.3454	-0.0271	0.4415	-0.0446	1.0000

Source: Processed data

Table 5. Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.2806	0.3696	-0.7592	0.4500
FD	-0.0061	0.0455	-0.1330	0.8946
LEVERAGE	-0.0518	0.0931	-0.5564	0.5795
PROFITABILITY	0.0793	0.0732	1.0834	0.2820
FS	0.0209	0.0202	1.0369	0.3030
KA	-0.0219	0.0873	-0.2507	0.8027
KA*FD	0.0959	0.0886	1.0825	0.2824
KA*LEV	0.0239	0.1221	0.1958	0.8452
KA*PROF	-0.2505	0.1209	-2.0731	0.0915

Source: Processed data

Table 6. MRA Regression Table

Variable	Coefficient
C	-3.4487
FD	0.1728
LEVERAGE	0.6926
PROFITABILITY	-0.4122
KA	0.2753
FS	0.1690
KA*FD	-0.6324
KA*LEV	-0.5056
KA*PROF	0.7203

Source: Processed data

Table 7. Table of Determination Coefficient Testi(R) and Simultaneous Significance Test (F)

R-Square	0.5909	F-Statistic	2.2532
Adjusted R-Square	0.3286	Prob (F-Statistic)	0.0006

Source: Processed data

As a result, companies tend to avoid applying accounting prudence to maintain access to external financing. This finding is in line with research by Haryadi et al. (2020) and Frianto & others (2024)), which shows that the effect of financial distress on prudence is positive but not significant, which means that the company's financial difficulties do not affect the application of the principle of prudence. Another reason is that companies, especially those that go public, are usually audited by independent auditors. In conditions of financial distress, auditors will be stricter in assessing the application of the principle of prudence to prevent manipulation of financial statements (Arum & others, 2023). So, the pressure to continue to follow accounting standards can maintain prudence even though the company's condition is bad.

From an agency theory perspective, the insignificant impact of financial distress reflects an agency conflict in which managers, as agents, tend to prioritize short-term survival strategies to secure their positions and access to capital. Distress creates pressure for agents to engage in "income smoothing" or loosen the precautionary principle in an effort to mitigate information asymmetry to prevent principals and creditors from withdrawing their financial support. Thus, strict audit oversight acts as an essential external governance mechanism to discipline agents, ensuring that managers' self-interest in concealing financial risks does not compromise the integrity of financial statements for resource holders.

Leverage does not affect the application of the principle of prudence

Based on the results of the hypothesis testing, it can be concluded that leverage does not affect on financial distress. The insignificant effect of leverage on the application of the prudential principle can be explained by the perspective that the debt burden in the tightly regulated banking industry does not always serve as a trigger for additional conservative behavior. This finding indicates that oversight by monetary authorities and compliance with applicable accounting standards are strong enough to discipline management, so that variations in the debt ratio no longer automatically change the level of prudence in financial reporting. Furthermore, this condition reflects that creditors in emerging markets may be more focused on asset security or long-term solvency than on the details of accounting conservatism in annual reports. This is in line with research by Haryani (2022), which shows that accounting policies are often more influenced by internal governance characteristics than by capital structure pressures. Similarly, Lestari et al. (2023) revealed that in certain contexts, highly leveraged companies actually avoid the prudential principle to maintain debt covenants and avoid appearing to violate technical thresholds set by lenders.

Within the framework of agency theory, this insignificant leverage effect suggests that debt does not always function as an automatic monitoring instrument that increases managers' conservative behavior in the banking sector. This phenomenon indicates that strict regulatory oversight has taken over the disciplining role typically performed by debt holders, thereby reducing information asymmetry without relying on fluctuations in capital ratios. Consequently, agents are more likely to align their accounting policies with regulatory compliance and debt covenant protections rather than responding opportunistically to capital structure pressures. Profitability harms the application of the prudence principle

Based on the results of the hypothesis testing, it can be concluded that profitability has a negative effect. This may be due to shareholders' belief that increasing the company's profitability does not require an increase in the level of prudence. With increasing profits through the use of equity, management is considered capable of managing finances well.

Table 8. Partial Significance Test Table

Variable	Expectation	Coefficient	Std. Error	t-statistic	Prob. (one-tail)	Conclusion
C		-3.4487	0.8997	-3.8330	0.0001	
FD	-	0.1728	0.1108	1.5596	0.0615	H1 rejected
LEVERAGE	+	0.6926	0.2266	3.0566	0.0016	H2 accepted
PROFITABILITY	-	-0.4122	0.1782	-2.3132	0.0117	H3 rejected
KA	+	0.2753	0.2126	1.2947	0.0997	
FS		0.1690	0.0491	3.4421	0.0005	
KA*FD	+	-0.6324	0.2156	-2.9330	0.0022	H4 rejected
KA*LEV	+	-0.5056	0.2973	-1.7007	0.0465	H5 rejected
KA*PROF	+	0.7203	0.2942	2.4483	0.0083	H6 accepted

Source: Processed data

Because of this belief, management does not feel compelled to tighten the application of the principle of prudence because there is no great pressure to protect external parties, there is a managerial incentive to maximize reported profits, and they want to send positive performance signals to the market. Highly profitable companies generally have stable cash flows, easy access to funding sources, and a strong financial image in the eyes of investors and creditors, so that they are less pressured to protect creditors (Shmelev & Gilardi, 2025). This condition makes the company not have the urgency to hide potential risks or withhold profit recognition as recommended in the principle of prudence. Instead, companies tend to report financial performance optimally and optimistically to maintain their reputation and attract market interest. These findings suggest that companies with high profitability tend to report performance optimistically to maintain their market reputation, thus reducing the urgency to apply the principle of prudence. This phenomenon aligns with the argument that when financial performance is at its optimal point, management feels less compelled to recognize asymmetric losses (Nugraha, 2024). However, these results have sparked scholarly debate when compared with the findings of Lestari et al. (2023), which actually showed a significant positive effect; in their study, profitable companies tended to be more conservative to protect accumulated profits from excessive dividend demands and strict tax oversight. Meanwhile, Haryani (2022) provides an intermediary perspective that the relationship between profitability and prudence is situational, with prudence only increasing when companies face high market uncertainty despite being profitable. By comparing this conflicting evidence, this study contributes by emphasizing that, in the Indonesian banking context, the drive to attract market interest through optimistic financial reports remains more dominant than the motive to protect profits through conservatism. The management of companies that have high levels of profitability tends to want to show their success to the maximum and increase investor confidence through high-profit reporting. In this context, the application of the principle of prudence that is conservative such as delaying revenue recognition or accelerating loss recognition is seen as an obstacle because it has the potential to reduce reported profit figures. Therefore, highly profitable companies tend to avoid implementing the principle of prudence in order to maintain a good financial performance image in the eyes of stakeholders. Companies with high profitability will reduce the application of the principle of prudence. This finding is in line with the research of Abdurrahman & Ermawati (2019), which shows that profitability has a significant negative effect on prudence. This means that the higher the profitability of a company, the lower the application of the principle of prudence. Within the framework of agency theory, this negative effect on profitability reflects the opportunistic behavior of agents who prioritize "profit image" to satisfy their short-term interests in the eyes of their

principals. When a company is highly profitable, managers tend to relax the principle of prudence to maximize bonuses and professional reputation, assuming that shareholders will be less critical of risks amid impressive earnings reports. Thus, this phenomenon indicates a failure of the monitoring mechanism, where financial success actually provides room for agents to reduce the quality of transparency through overly optimistic reporting.

Foreign Ownership Weakens the Relationship between Financial Distress and Prudence

Based on the statistical data you provided, the probability value (one-tailed p-value) of 0.0615 is above the significance threshold of 0.05, so the moderating variable technically does not have a significant influence at the 95% confidence level. This condition is in contrast to the relationship without moderation, which previously showed a positive direction but was not significant. This negative relationship indicates that the higher the level of financial distress, which should increase the application of the principle of prudence, actually experiences a weakening due to foreign ownership. In a situation of financial distress, internal company information tends to be more difficult to access and predict. Foreign shareholders generally do not have direct access to the company's operational information due to geographical limitations, language differences, culture, and applicable regulations. Therefore, they tend to encourage the application of conservative principles in financial reporting so that the information obtained is more reliable. Thus, the existence of foreign ownership does not automatically weaken the relationship between distress conditions and the application of the principle of prudence. In addition, when foreign ownership in a company increases, management cannot recognize potential income to save the company from bankruptcy (Fregidou-Malama & Hyder, 2024). As a result, management must apply the principle of prudence by not recognizing potential income and reporting the company's financial condition transparently. This step aims to ensure that management decisions harm no party and to help determine the best strategy so that the company can get out of financial distress. From an agency theory perspective, this weakening relationship indicates that foreign ownership serves as an external control mechanism that mitigates information asymmetry between managers and foreign shareholders when the firm is in distress. The presence of foreign investors limits opportunistic managerial discretion by forcing agents to adhere to transparent reporting standards despite pressure to conceal financial risks for the safety of their positions. Thus, this moderating role demonstrates that global oversight can discipline agents to prioritize the principal's long-term interests through the strict application of the prudential principle, thus restoring market confidence amidst information uncertainty.

Foreign ownership does not strengthen the

relationship between leverage and the application of the prudence principle

Based on the results of the hypothesis testing, it can be concluded that the existence of a moderation variable causes the influence of leverage on the application of the prudence principle to be significantly negative. This result is inversely proportional to the relationship before moderation, where previously, leverage had a significant positive influence on prudence. This negative relationship occurs because when a company has high leverage, creditors will be more active in monitoring the company's operations. The higher the leverage, the greater the creditor's access to company information, so management is required to apply the prudence principle more strictly in financial records (Butar Butar, 2020). Therefore, the existence of foreign ownership in the company does not have a significant influence because the supervisory function of the company's operations and the application of the prudence principle have been carried out by creditors as parties who have a major interest in the company's financial condition. In addition, foreign ownership does not always strengthen the relationship between leverage and the application of the prudence principle due to several factors, including the limitations of foreign investors in understanding the local context of the company, including debt structure, operational risk, and applicable financial reporting practices (Al-Nimer et al., 2021). Differences in regulations, culture, and language also become obstacles in assessing leverage risk accurately. In addition, foreign ownership is generally passive and plays a role as a portfolio investor, so their involvement in accounting policy-making is very limited (Steelyana, 2024). The main focus of foreign investors is also more on achieving returns and stability of financial performance, not on the application of accounting conservatism. Therefore, although high leverage can increase financial risk, the encouragement of foreign shareholders towards the application of the principle of prudence does not immediately appear, so its existence does not strengthen the relationship between the two variables. Within the agency theory framework, the negative shift in leverage after being moderated by foreign ownership indicates an overlap in the supervisory function between creditors and foreign investors. This condition indicates that while creditors have exercised a strict disciplining role over agents, the presence of foreign shareholders, who tend to be passive, does not provide added value in reducing agency costs related to financial reporting. Consequently, limited information and barriers to understanding the local context for foreign investors render their supervisory mechanisms ineffective, resulting in conservative loss recognition being driven more by the direct interests of creditors than by the intervention of global capital owners.

Foreign ownership weakens the relationship between profitability and the application of the prudence principle

Based on the results of the hypothesis testing, the existence of a moderating variable causes the effect of profitability on the application of the principle of prudence to be significantly positive. This result is in contrast to the previous relationship between profitability and prudence, which showed a significant negative effect. This positive relationship indicates that increasing profitability tends to weaken the application of the principle of prudence. However, with foreign ownership, management is still required to prepare financial reports in accordance with the principle of prudence applied by the company. In addition, the existence of foreign ownership can also reduce the opportunity for fraudulent actions by management that have the potential to disrupt the stability of the company. Foreign ownership tends to weaken the negative correlation between profitability, and

the application of the principle of prudence can also be explained by several reasons (Kozlov, 2023). First, foreign investors usually demand transparent and quality financial reporting, even when the company records high profits. A study by Kuspratiwi and Widagdo (2014) shows that foreign share ownership is significantly related to accounting conservatism, while profitability does not have a significant effect. This indicates a foreign orientation towards prudent reporting – so that the potential for decreased conservatism when profits increase can be reduced. Second, the existence of foreign ownership is often accompanied by stricter external supervision. Findings by Afriani et al. (2021) in a sample of state-owned companies revealed that foreign ownership has a significant effect on accounting conservatism ($p < 0.01$), although profitability does tend to suppress conservatism. Third, foreign investors are generally long-term-oriented and emphasize the stability and quality of financial reporting. They bring expectations from high governance environments such as IFRS and US GAAP, so that even though corporate profits are high, the urge to continue to prioritize the principle of prudence remains strong (Silva & others, 2023). Thus, the dominance of the negative relationship between profitability and prudence is dampened. So it can be concluded that profitability tends to reduce conservatism, foreign ownership actually weakens this effect through strict external supervision "(Afriani et al., 2021). Within the framework of agency theory, this shift in influence demonstrates that foreign ownership serves as an effective governance mechanism for aligning the interests of agents with those of global principals. The presence of foreign investors mitigates information asymmetry by limiting the discretion of managers who tend to be overly optimistic when earnings increase, thereby forcing agents to adhere to transparent and conservative reporting. Thus, strict oversight by foreign shareholders successfully curbs opportunistic behavior by managers, ensuring that the company's long-term stability is prioritized over simply projecting short-term financial performance.

Conclusion

This study provides a novel theoretical contribution by revealing that the effectiveness of prudential principles in the banking sector is more influenced by market reputational motives than by internal financial pressures. The finding that financial distress has no effect and profitability negatively impacts prudential principles challenges conventional assumptions, indicating the existence of a managerial defensive strategy to avoid negative signals in emerging markets. Specifically, this study extends the Agency Theory literature by demonstrating that the role of foreign ownership as a market disciplining instrument is selective; foreign capital has been shown to be effective in mitigating managerial discretion on profitability, but is limited to areas already tightly regulated by banking regulations. The practical implication is that regulators need to strengthen the integrity of financial reporting by integrating foreign capital supervision as a global governance mechanism to reduce opportunistic behavior. These results confirm that conservative accounting standards often compromise liquidity priorities, necessitating a sharper policy framework to maintain banking sector transparency amidst economic uncertainty.

Despite technical challenges such as multicollinearity and the removal of outliers, this study still provides significant incremental contributions through theoretical validation of the robustness of the BLUE estimator in banking governance models. The methodological contribution of this paper lies in demonstrating that the consistency and efficiency of the regression remain intact despite the interrelationships

between independent variables, confirming the stability of the theoretical framework in capturing prudential practices in emerging markets. Practically, this study advances understanding of how foreign ownership operates as a contextual supervisory mechanism, offering strategic insights for regulators in designing financial reporting standards that are more resilient to capital structure and profitability dynamics. The elimination of this outlier is feared to affect the results of the study because the eliminated data may have an influence on the findings obtained. Measurement of foreign ownership is only based on the percentage of shares, without distinguishing the type of ownership or the country of origin of investors that can affect accounting conservatism. In addition, the extent of foreign shareholder involvement in corporate governance has not been evaluated, and the use of secondary data is unable to capture qualitative aspects such as reporting preferences. This study also has not classified industrial sectors, so it does not reveal differences in conservatism between sectors.

In further research, it is expected to develop this research related to factors that influence the principle of prudence. Development can be done by changing or adding other factors. The variables in this study can also be adjusted using other formulas, such as leverage variables, which can use the Debt debt-equity ratio (DER), Long-Term Debt to Equity Ratio (LTDER), Times Interest Earned (TIE) or Total Asset Debt Coverage (TAD Coverage) formulas. Then, further research is expected to add independent variables and control or replace the moderation variable. In addition, the number of company samples can be increased, changes in the type of company or additional periods of the data used. In

addition, it is recommended to distinguish the types of foreign ownership (strategic and portfolio) and consider the country of origin of investors as a moderating variable. In addition, it is imperative to consider various aspects of corporate governance., the use of a mixed methods approach, and sectoral analysis so that the research results are more in-depth, contextual, and applicable.

Author contributions

The authors made equal contributions to the current research throughout its entirety, from the formulation of the issue to the final findings and solution.

Acknowledgements

The author would like to express gratitude to Bali State Polytechnic for the facilities and academic assistance used in the production of this study. We also extend our gratitude to the supervisor and all those who contributed to the preparation of this scientific work

Conflict of interest

The authors assert that the work described in this paper was not influenced by any competition for pecuniary interests or personal relationships.

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Moderation of Foreign Ownership on the Relationship between Determinants and the Principle of Prudence in the Banking Sector

ABSTRACT

This study aims to analyze the influence of financial distress, leverage, profitability, and firm size on the implementation of the prudence principle (accounting prudence) in the Indonesian banking sector, with foreign ownership as a moderating variable. Although prudence is crucial for banking stability, the current literature still shows inconsistent findings and limited evidence regarding the moderating role of global governance, which is a major gap in this study. The data analysis in this study was performed using SPSS software using a multiple linear regression approach. This model examines the influence of fundamental factors on the principle of prudence in the banking sector, using foreign ownership as a moderating variable to improve the accuracy of the empirical estimation results for a total of 129 data observations. Conversely, profitability had a significant negative effect, reflecting managers' tendency to be optimistic when financial performance improves to maintain market reputation. The unique contribution of this study lies in the finding that foreign ownership significantly attenuates the negative effect of profitability on prudence, demonstrating its role as an external monitoring mechanism in reducing managerial optimism bias. However, foreign ownership was not found to moderate the effects of financial distress or leverage. This study enriches the literature on agency theory in the context of emerging markets and offers practical implications for regulators to integrate foreign ownership structures as a supervisory instrument to enhance transparency and more robust banking risk management.

KEYWORDS: Financial distress; leverage; profitability; foreign ownership; prudence;

INTRODUCTION

Investors' decisions are significantly influenced by the quality of information accompanying the company financial statements, as the information contained in these statements is a primary consideration in determining which companies to invest in. Therefore, for financial statements to provide benefits to investors and for their information to be accountable, companies must apply rules, accounting principles, and objectives based on generally accepted accounting standards. Several things that are of particular concern in preparing financial statements are related to the concepts applied by the company in recognizing and measuring what financial events must be recognized, when a financial event will be recognized and how each financial event can be recognized, measured or recorded in accordance with the accounting system used by the company. In modern accounting standards, entities often face uncertainty when preparing relevant financial statements that faithfully represent economic phenomena. According to the Conceptual Framework published by the IASB, prudence is defined as the exercise of caution in making estimates under conditions of uncertainty, so that assets or revenues are not overstated and liabilities or expenses are not understated. Unlike traditional conservatism, which tends to be biased, prudence within the IFRS framework is an integral part of neutrality; it prohibits the creation of hidden reserves or excessive asset depreciation, as this would diminish the quality of information and the objectivity of financial statements.

The Financial Accounting Standards (SAK) applicable in Indonesia provide companies with the freedom to choose the accounting method to be used in preparing financial reports. The benefit of the freedom given to management is that companies can produce financial reports that align with their wishes. Due to the freedom granted to companies, the principle of prudence must be applied to prevent excessive optimism held by the company and the uncertainty it experiences from

affecting the financial report results (Sulastri & Anna, 2018). As an example, on the Oke Finance website, there is information that PT Garuda Indonesi is suspected of making odd financial reports or is considered to have violated the principle of conservatism or what is now called prudence, because this company issued financial reports for 2018 whose values were much different compared to the financial reports in 2017. In 2017, the company suffered a loss of \$216,500,000, while in 2018, the company recorded a net profit of \$809,850,000, resulting in inversely proportional values. Due to the significant differences in values, on April 2, 2019, this case began to be brought to the public's attention. According to the information contained in Oke Finance, there was a recognition of income from PT Mahata Aero Teknologi that should not have been recognized in that year. This problem was also reinforced by statements from the former Garuda Indonesia board of commissioners, namely Chairul Tanjung and Dony Oskaria, who considered that Garuda Indonesia's 2018 financial report was not in accordance with the Financial Accounting Standards Statement. The implementation of the principle of prudence was also not carried out properly because the company was indeed allowed to recognize potential income, but not as much as the value recognized by PT Garuda Indonesia because the value was very significant and according to the provisions, the income had not been met because the settlement was carried out in stages, which means that if the income was recognized directly in its entirety in that year, the company's value would be inversely proportional to the actual company value and would indirectly reduce the quality of the financial report.

In line with the case study, it is evident that fraudulent manipulation of financial statements can occur due to various underlying factors, including leverage, profitability, and financial distress. A company can be declared to be in financial distress when management is unable to pay its debts to creditors. Financial difficulties may compel shareholders to dismiss firm executives, as they are perceived as being incapable of managing the company effectively. This can encourage managers to change profits, which are a benchmark for manager performance, by regulating the level of accounting conservatism so that the higher the level of difficulty of a company, which is reflected in the smaller value of financial distress, the more it will encourage managers to present non-conservative financial statements (Haryadi et al., 2020).

Then, the leverage represented by DAR describes the relationship between the company's debt and its assets, as well as its capital, which determines how much the company is financed by debt (Rossa Putri et al., 2020). Several previous studies have stated that high leverage will make companies more careful because high debt levels can be a threat to the company's survival, so creditors have greater rights to know and supervise the company's operations.

Profitability measures a management team's ability to generate a profit within a specified period (Aissyah et al., 2020). This study uses Return on Equity (ROE) as an indicator of profitability, which shows the efficiency of using equity to generate profits. A high ROE indicates that the company is able to generate large profits from its capital. However, previous studies have found that the higher the ROE, the lower the company's compliance with the principle of prudence (Nassar & Twerqi, 2021). The principle of prudence is considered controversial because it is considered to reduce the value of income and increase costs so that reported profits are lower than actual. However, on the other hand, this principle is considered beneficial because it produces more accurate financial reports and higher-quality profits and prevents opportunistic behavior by managers in financial statement-based contracts.

Previous studies on accounting conservatism, also known as prudence, have yielded several pros and cons. Research conducted by Rivandi and Ariska (2019) used independent variables of capital intensity, dividend payout ratio and financial distress. The study's results indicated that capital

intensity has a positive effect, the dividend payout ratio has no effect on prudence, and financial distress harms prudence. Research conducted by Sulastri and Anna (2018) used independent variables of financial distress and leverage. The study's results indicated that both variables influence conservatism. In addition, research conducted by Afriani et al. (2021) utilized independent variables, including financial distress, leverage, liquidity, litigation risk, foreign ownership, and institutional ownership. The study's results indicated that all independent variables, except institutional ownership, exert a considerable influence on prudence.

Inconsistencies in the literature on accounting conservatism or the precautionary principle are evident in the influence of several key variables in the 2022–2025 period. For example, Haryani (2022) found that capital intensity had a significant positive effect on the application of the precautionary principle, indicating that companies with large fixed assets tend to be more conservative to avoid the risk of overvaluation. However, this finding was refuted by Lestari et al. (2023), who showed that capital intensity had no effect on conservatism because management focused more on operational efficiency than on prudent accounting policies. A similar phenomenon occurred with the variable of financial distress; Nugraha (2024) reported that financial pressure drives companies to be more cautious to maintain creditor confidence, while Zahra and Santoso (2022) found a negative effect, where companies threatened with bankruptcy tended to abandon the precautionary principle and turn to aggressive accounting practices to embellish their financial statements. These differences in results highlight the existence of an empirical gap that requires moderating variables, such as foreign ownership, to explain these dynamics more comprehensively.

In a study conducted by Putra and Sari (2020), the independent variables used were financial distress, leverage, and profitability. The study's results showed that all independent variables, except financial distress, had a significant effect on prudence. Therefore, the existence of this opposite makes further research even more interesting to follow.

The motivation of this study is to determine whether certain statements regarding the results of previous studies remain relevant when the independent variables studied are changed or combined from existing studies. In this study, the independent variables used are leverage, represented by the debt-to-asset ratio; profitability, represented by the return on equity; and financial distress. Additionally, this study incorporates a moderating variable of foreign ownership. Unlike previous studies, which tended to be partial, this study positions foreign ownership not merely as an additional variable but as an essential external monitoring mechanism to overcome managerial ambivalence in applying the prudential principle. We fill a theoretical gap by demonstrating that foreign ownership can mitigate information asymmetry and opportunistic pressures that often lead to inconsistencies in the effects of capital intensity and financial distress on conservatism. Thus, this study offers a fundamental distinction by reconceptualizing the role of global governance structures in disciplining financial reporting in emerging markets, going beyond simply expanding conventional statistical variables. This study uses the firm size variable as a control variable. The inclusion of control variables is expected to enhance the accuracy of the study and facilitate readers' understanding of the relationship between variables. The data sample used in this study is from a banking sector company over the last few years. The use of this sector has not been widely used in previous studies, making this study even more interesting.

Agency Theory

Agency theory illustrates that there are differences in interests in terms of goals and decision-making, where the principal aims to prosper himself through the profits obtained by the company, while the agent aims to obtain compensation and loans so that psychological and economic needs

are met (Hastuti & Rasyid, 2021). For example, suppose the company has a large profit in that period. In that case, the manager can carry out his role effectively, and from the value of the profit, the company can distribute dividends to its investors, thereby strengthening the trust given by investors. All capital or credit borrowing processes are streamlined to facilitate the company's operations (Wu et al., 2024).

The relationship between agency theory and prudence is that as the capital invested by shareholders becomes denser, the supervisory function carried out on management performance will also be tightened (Abu Orabi et al., 2024; Yang et al., 2023). Therefore, management must carry out its role carefully, as resource owners closely monitor their performance. This is done to ensure that there is no financial report that has been engineered by management. This study extends the agency theory framework by integrating a global monitoring perspective, where foreign ownership acts as a "governance police" held to higher transparency standards than domestic investors. This theoretical contribution explains that the presence of foreign shareholders effectively suppresses agency costs by reducing cross-border information asymmetry, which forces management to adopt the precautionary principle as a signal of financial reporting credibility. Furthermore, this paper redefines the role of foreign ownership beyond simply providing capital to becoming an institutional catalyst that mitigates management's opportunistic behavior under conditions of financial distress. Thus, this study offers the novel proposition that the effectiveness of the precautionary principle in minimizing agency conflicts depends heavily on the external monitoring structure brought by the foreign entity.

Agency conflicts encourage managers (agents) to exploit information asymmetry through opportunistic financial reporting to secure compensation. Therefore, the application of the prudence principle becomes an important control mechanism for principals to limit managers' ability to overstate profits. In conditions of financial distress and high leverage, agency risk increases because managers tend to conceal losses to avoid breaching debt contracts, which logically requires a higher level of prudence to protect creditors' interests. Conversely, strong profitability reduces agency pressure to manipulate earnings, while the presence of foreign ownership serves as an external monitoring mechanism that strengthens the application of the prudence principle in mitigating managers' moral hazard behavior.

Conceptual Framework

Based on the theory above, when applied to a conceptual framework, it yields the following diagram:

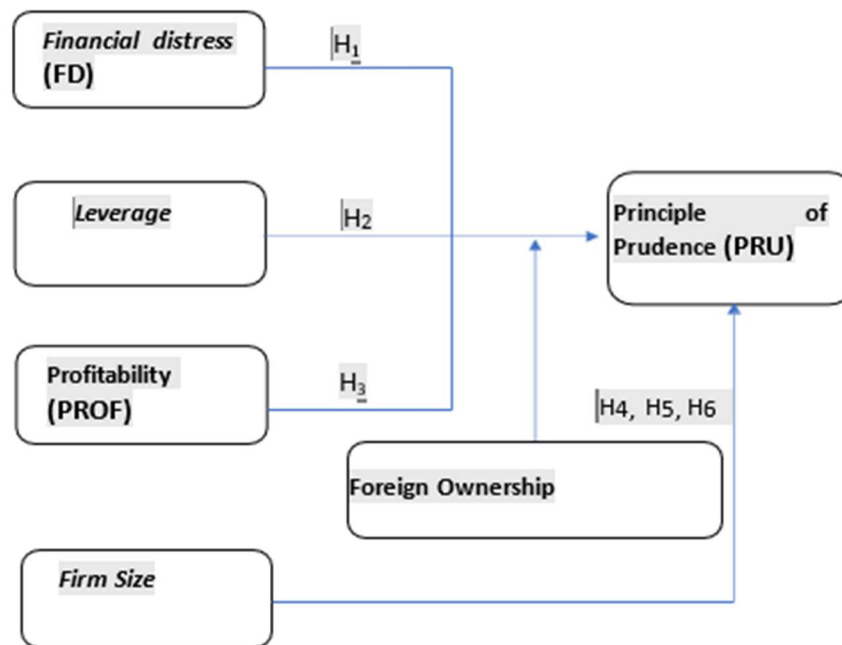


Figure 1. Conceptual Framework

The Influence of Financial Distress on the Implementation of the Principle of Prudence

Financial distress is a stage where a company experiences a decline in its financial condition, and this typically occurs before the company is declared bankrupt or liquidated (Kariani & Budiasih, 2017). In a study conducted by Aryani and Muliati (2020), the higher level of financial distress reflected in the decreasing value of financial distress or when the company experiences greater losses will encourage managers to weaken the application of the principle of prudence because managers must save the company's finances by recognizing income early so that the resulting financial reports do not show values that can disappoint investors and lead to changes in management. This statement is supported by research from Afriani et al. (2021), which indicates that financial distress has a significant negative impact on the application of the principle of prudence. Therefore, in this study, the hypothesis that will be used is:

H1: Financial distress has a negative influence on the application of the Prudence principle.

The Influence of Leverage on the Implementation of the Prudence Principle

The use of high leverage inherently increases an entity's financial risk, thus directly affecting the application of the prudent principle. When a company relies heavily on debt, small fluctuations in earnings or increases in interest rates can significantly worsen the debt burden and potentially trigger financial failure (Blake, 2022; Kozlov, 2023). Therefore, highly leveraged entities must apply the prudent principle more strictly, which is manifested in more conservative risk management policies, more careful monitoring of cash flows, and setting realistic debt limits.

Without extra caution, the risk of bankruptcy or liquidity problems increases drastically, threatening the continuity of the company's operations and reputation.

In this study, leverage is represented by the debt-to-asset ratio. In the study by Juvenrio and Mulyani (2017), it was found that leverage, represented by the debt-to-asset ratio, has a significant positive effect on influencing the application of the principle of prudence. This is because the higher a company's debt, the wider the creditors' access to company information, which aims to ensure that the company maintains proper records properly so that creditors will supervise all company records more and will certainly affect the application of a higher level of prudence because the opportunity for management to cheat is smaller due to this supervision. Therefore, in this study, the hypothesis that will be used is:

H2: Leverage has a positive influence on the implementation of the Prudence principle.

The Influence of Profitability on the Implementation of the Prudence Principle

The profitability of an entity significantly influences the application of the prudent principle. Highly profitable companies tend to have a stronger financial position, allowing them to absorb unexpected losses and invest in better risk management (Al-Nimer et al., 2021). However, high profitability can also give rise to moral hazard, where management becomes overconfident and less cautious in decision-making, potentially ignoring risks in favor of greater profits (Eltweri et al., 2024). Therefore, even highly profitable entities must adhere to the prudent principle, ensuring that their growth and investment strategies do not compromise long-term stability and the ability to weather market volatility.

Profitability can be used to measure the ability of company managers to generate profits in the form of profit, sales value, equity or the number of assets owned by the company (Kurniawan & Suryaningsih, 2019). In this study, the ratio used is the return on equity, which measures the level of efficiency in generating profits or returns from the use of equity. If the level of profitability is higher, it means that the company has been effective in utilizing all its capital to generate profits. Research conducted by Abdurrahman and Ermawati (2019) yielded results indicating that profitability has a negative effect on the application of the principle of prudence. High profitability values prove that the use of equity can generate substantial profits, indicating that the utilization of company capital is effective. On the other hand, the higher the company's profit, it means that it sends a signal that the business sector is well-run, indicating good prospects for shareholders, who therefore do not strictly demand the application of the principle of prudence, as management is considered to have carried out its duties well. Through the explanation above, it can be concluded that:

H3: Profitability has a negative influence on the application of the Prudence principle.

The Effect of Foreign Ownership on the Relationship between Financial Distress and the Implementation of the Prudence Principle

Foreign ownership can moderate the relationship between financial distress and prudent practices through several mechanisms. Foreign investors, especially large institutions, often have better resources, experience, and expertise in corporate governance and risk management than domestic investors. They tend to demand higher levels of transparency and accountability, and push for stricter prudent practices, even when firms are in financial distress (Alobaid et al., 2024). This pressure from foreign shareholders can force management to take conservative actions, such as writing down risky assets, accelerating loss recognition, or reducing high-risk activities, thereby preventing financial distress from escalating into a more severe crisis and ensuring more conservative financial reporting (Kashani & Mousavi Shiri, 2022).

In the study of the relationship between financial distress variables and prudence variables, the hypothesis posits a negative relationship between the two variables. With this foreign ownership, it is expected to weaken the relationship between the two variables. Foreign investors provide loans to companies with the goal of generating a profit. The existence of increasingly large foreign ownership in a company will certainly make agents or managers who manage the company more stringent in implementing the principle of prudence. Implementing the principle of prudence is believed to reduce information asymmetry and increase transparency in the preparation of financial reports, thereby avoiding opportunistic actions from management. In other words, the relationship between foreign ownership and prudence is positive. Therefore, it can be concluded that the hypothesis used is:

H4: Foreign ownership weakens the relationship between financial distress and the application of the Prudence principle.

The Effect of Foreign Ownership on the Moderating of the Relationship between Leverage and the Implementation of the Prudence Principle

Foreign investors, especially institutions with a global reputation, often bring higher corporate governance standards and stricter risk management practices (García-Nieto et al., 2024). They tend to be more sensitive to the financial risks arising from high leverage, as they may face greater scrutiny from regulators in their home countries and have experience with financial crises in global markets (Shmelev & Gilardi, 2025). As a result, foreign shareholders may encourage management to adopt more conservative debt policies and apply the principle of prudence more disciplined, even if there is a temptation to take on higher risks through leverage in pursuit of growth (Sneideriene & Legenzova, 2025). This means that, under the influence of foreign ownership, the negative impact of leverage on the principle of prudence can be minimized, because there is an external incentive to maintain financial stability.

In the study of the relationship between leverage variables and the application of the principle of prudence, the hypothesis is that leverage has a positive effect on the application of this principle.

This study goes beyond simply confirming a linear relationship by revealing that in the banking industry, leverage serves as a stricter disciplinary mechanism because it involves simultaneous oversight from regulators and bondholders. The novelty of these results lies in identifying the role of foreign ownership in strengthening this leverage function; foreign investors bring global risk management standards that demand greater transparency through faster loss recognition (the precautionary principle). Contrary to conventional studies, these findings suggest that pressures from capital structure not only mitigate agency risk but also force banks to adopt more conservative accounting standards to maintain access to international capital markets. Thus, this study provides new insights into how the integration of foreign capital and liability burdens creates a unique supervisory synergy in promoting financial reporting integrity in the banking sector. The presence of foreign owners as one of the shareholders has an impact that strengthens the relationship between the two variables. This is because an increase in foreign ownership means there is a greater ability to provide opinions. Then, the manager, in making decisions, does not benefit both parties. In that case, the manager is in a vulnerable position within the company because foreign owners can vote to change agents or managers. Therefore, it can be concluded that the hypothesis used is:

H5: Foreign ownership strengthens the relationship between leverage and the application of the Prudence principle.

The Effect of Foreign Ownership That Moderates the Relationship Between Profitability and the Implementation of the Prudence Principle

Foreign ownership can play a significant moderating role in the relationship between profitability and prudent management. Although high profitability is often associated with healthy financial conditions, there is the potential for management to become overconfident and take excessive risks, ignoring prudent management in the pursuit of higher returns (Shmelev & Gilardi, 2025). However, foreign investors, especially those from more mature markets with tight regulation, tend to bring with them a stronger corporate governance culture and a greater emphasis on long-term risk management. They often demand greater transparency and more conservative accounting practices, even when the company is at its peak profitability. This pressure from foreign shareholders can encourage management to adhere to prudent management practices, such as establishing adequate reserves, recognizing expenses promptly, and avoiding aggressive practices that could potentially undermine future stability, thereby minimizing the moral hazard that may arise from high profitability (Sneideriene & Legenzova, 2025).

The relationship between profitability and the application of the principle of prudence has a significant negative influence. The presence of foreign owners weakens the relationship between the two variables. This is because foreign owners cannot directly monitor the company's performance; therefore, they can indirectly influence the company's performance through the financial reports produced by the company. Therefore, foreign owners demand that management report the company's performance in the financial statements accurately and truthfully or continue to apply the principle of prudence. In other words, investors expect the company's financial management and reporting to be transparent and not prioritize personal interests, which suggests that the relationship between foreign ownership and prudence is positive. Therefore, it can be concluded that the hypothesis used is:

H6: Foreign ownership weakens the relationship between profitability and the application of the Prudence principle.

METHOD

Research Design

This study uses a Multiple Linear Regression analysis technique with a Pooled Data approach.

This approach is based on the assumption of homogeneity of characteristics between banks within the observation period, so the analysis is conducted by combining all observations into a single unit (common effect). This technique differs from formal panel data estimation (FE/RE) because it does not isolate individual intercepts but instead focuses on the overall generalizability of the model. To ensure the validity of the Pooled OLS model, a comprehensive diagnostic procedure is carried out through the Classical Assumption Test, including tests for multicollinearity, heteroscedasticity, and autocorrelation to ensure the estimated parameters are unbiased and consistent. Furthermore, hypothesis testing is conducted through Moderated Regression Analysis (MRA) using SPSS software to detect the interaction effect of foreign ownership on the causal relationship being tested.

Operational Definition of Variables and Measurement

This study utilizes several variables that have been previously studied, drawing on research conducted by previous researchers related to Prudence. Thus, the study aims to investigate whether there is a relationship between the variables examined, including financial distress, leverage, profitability, and the prudence variable as the dependent variable, foreign ownership as a moderating variable, and firm size as a control variable. The explanation is as follows.

Dependent Variable

Prudence. In this study, the dependent variable used is the prudence principle. Prudence is the convergence of the principle of prudence in recognizing assets, expenses and income so that companies can reduce the risk of uncertainty in the future by reducing the company's profits (Aristiani et al., 2017). One way to apply this principle is to recognize all losses when the loss occurs, even though it has not occurred, while not recognizing any income if the income has not occurred (Rivandi & Ariska, 2019). To measure the level of prudence of a company, we can use the Accrual formula as follows:

$$\text{Prudence} = (((\text{Net Income} + \text{Depreciation}) - \text{CFO}) / \text{Total Asset}) \times -1.$$

Variable Independent

Independent variables are variables that influence and become factors in dependent variables or bound variables.

Financial distress

Financial distress is a stage where a company's financial condition declines, and usually, this stage occurs before the company experiences liquidation or bankruptcy (Kariani & Budiasih, 2017). The company's inability to meet liquidity and solvency obligations is the initial step in financial distress. Financial distress is a situation where a company must take corrective action due to the company's inability to make payments on its obligations with the current operating cash flow (Rivandi & Ariska, 2019).

In this study, financial distress was measured using the Springate model introduced by Gordon L. V. Springate in 1978. By using this method, a company can be declared to have the potential to go bankrupt when the value of the calculation is <0.862 and will be declared to have the potential to be healthy if the value is > 0.862 . If the calculation is less than or even smaller than the value of 0.862 , the company is considered less effective in utilizing the assets and capital owned by the company to generate profits for the company. In addition, if the company uses more funding with debt, the risk of the company experiencing financial distress is greater because the company's burden will be added to the interest on the loan, and if the company experiences a decrease in income, there is a possibility that the company will not be able to pay its debts. However, if the company makes better use of its assets and reduces capital from debt, the possibility of the company experiencing financial distress becomes smaller (Fatmawati & Wahyuningtyas, 2021). The financial distress formula with the Springate method is represented by:

Note: $X1 = (\text{Current assets} - \text{Current Liabilities}) / \text{Total Assets}$, $X2 = \text{Earnings Before Interest and Tax} / \text{Total Assets}$, $X3 = \text{Profit before tax} / \text{Current Liabilities}$, $X4 = \text{Income} / \text{Total Assets}$.

Leverage

Leverage is the amount of debt used by a company to finance its business activities. Leverage is a ratio that can show management's ability to fulfill all obligations owned by the company itself. In this study, leverage is represented by the debt-to-asset ratio, where this ratio functions to find out how much funds are lent by creditors to meet the financing of all company assets (Kurniawan & Suryaningsih, 2019). The measurement of this variable uses a formula such as:

$$\text{Leverage (DAR)} = \text{Total Debt} / \text{Total Assets}$$

Profitability

Profitability is a tool for analyzing company performance or as a basis for assessing the condition of management. Profitability is used to determine the ability of management to generate profits, where these profits can be assessed and measured (Putra and Sari, 2020). In this study, the profitability ratio used is the return on equity. Return on equity is one of the tools to determine the amount of return generated by the company in utilizing the capital invested by investors. The ROE formula used in this study is:

$$\text{Profitability (ROE)} = \text{Net Profit After Tax} / \text{Total Equity}.$$

Moderating Variable (Foreign Ownership)

Foreign ownership in this study is measured using the foreign share ownership ratio, which is the percentage of shares owned by foreign parties (individuals or institutions) compared to the total number of shares outstanding. This measurement is consistent with previous research that examined the influence of ownership structure on company accounting policies. In this study, foreign ownership can be formulated as follows:

$$\text{Foreign Ownership} = \frac{\text{amount of foreign ownership shares}}{\text{number of shares outstanding}} \times 100\%$$

Control Variable (Firm Size)

Firm size is divided into two, namely large and small, where the larger size of a company reflects greater profits and the implementation of a more difficult management system. Therefore, large companies are usually faced with various problems, one of which is political costs. Companies with large revenues usually encourage the government to raise taxes and ask for higher public service costs. Therefore, large companies usually apply high conservatism in order to reduce their profits. This statement can be concluded that firm size functions to determine whether a company is categorized as a small or large company. In this study, firm size is represented by the formula:

$$\text{Firm size} = \text{Ln}(\text{Total Assets}).$$

Analysis Method

The data analysis technique used in this study was multiple linear regression analysis using SPSS software. This method was chosen to test the direction and magnitude of the influence of several independent variables on a single dependent variable, either simultaneously or partially. The regression equation that will be used in this study is:

$$\text{Prudence} = \alpha + \beta_1 \text{Si} + \beta_2 \text{DAR} + \beta_3 \text{ROE} + \beta_4 \text{KA} + \beta_5 \text{Si.KA} + \beta_6 \text{DAR.KA} + \beta_7 \text{ROE.KA} + \beta_8 \text{FZ} + \varepsilon$$

Information:

Prudence = Prudence level of a company

α = Constants

β = Regression Coefficient

S_i = Financial distress is calculated using the Springgate model.

DAR = Leverage is represented by the Debt to Asset Ratio

ROE = Profitability is represented by the Return on Equity ratio

FZ = Firm Size

KA = Foreign Ownership

ξ = Error

Descriptive Statistics

Descriptive statistical analysis explains or provides information related to data that will comprehensively explain conditions and factors. Descriptive statistical analysis is also a method that can reveal problems by processing, analyzing, researching and interpreting data and can also conclude that it can be used as a reference to provide suggestions systematically so that they are easy to understand.

Data Feasibility Test

Normality Test

Functions to find out whether the regression result data is normally distributed or not, which is represented in the form of an error value (e). Data is said to be valid if the regression result data is normally distributed or approaches the standard value that has been set based on testing with the Kolmogorov-Smirnov normality test in the SPSS program, which the researcher uses. The technique (Asymptotic Significance) can be implemented in making decisions, including: a) The regression result is said to be normal if the probability value exceeds 0.05, b) The regression result is said to be abnormal if the probability value does not reach 0.05.

Multicollinearity Test

This test is used to determine whether the regression results in each variable in the research have a correlation or not, and if there is a correlation, then the data is said to be multicollinear. A regression data result is likely good if there is no correlation between variables. If there is a correlation between variables, the solution step is to remove the variables that cause multicollinearity.

To see or detect whether there is multicollinearity, it can be seen from the Variance Inflation Factor (VIF) and Tolerance values. In the regression model, guidelines that are free from multicollinearity are those that have a tolerance value close to 1. The limit of VIF is 10. It is said that there is no multicollinearity when the VIF value does not reach 10. The calculation equation is as follows:

$$VIF = \frac{1}{Tolerance} \quad \text{or,} \quad Tolerance = \frac{1}{VIF}$$

Autocorrelation Test

Functions to find out whether there is a correlation between variables or not by considering the changing time interval. It is said that autocorrelation occurs if the related variables do not have a partner. So, in this study, the focus will also be on autocorrelation testing in SPSS. Especially for time series variables, because the data taken can be influenced by data in the previous period, it is important to conduct autocorrelation testing so that no data contains autocorrelation. Here is how to prove this test using Durbin-Watson by looking at the following:

1. It is said that there is no autocorrelation if $(4 - dU) > dW > dU$.
2. It is said that there is autocorrelation if $(4 - dL) < dL > dW$.
3. It cannot be concluded that there is autocorrelation if $dW = dU = dL = (4 - dU) = (4 - dL)$.

Heteroscedasticity Test

Functions in understanding whether or not there is heteroscedasticity in the regression test that is carried out. In understanding whether there is a difference in variance in the residual value of the research results between one person and another, this test needs to be carried out. To make it easier to carry out this test, you can do the Glejser Test, namely: a) it is said that there is no heteroscedasticity if the significance value exceeds 0.05, b) it is said that there is heteroscedasticity if the significance value does not exceed or is equal to 0.05. Heteroscedasticity Test.

Hypothesis Testing

Simultaneous Test (F-test)

The F-statistical test is usually used to show whether all independent variables used in this research model have a joint influence on the dependent variable. The method used to see the relationship is by looking at how big the value of the probability of significance is. If it is known that the probability has a significance of less than 5%, then the independent variable will show a significant joint influence on the dependent variable.

Coefficient of Determination

The coefficient of determination (R^2) is a basis for measuring how well the model in the study can explain its dependent variables, if the value of the coefficient of determination has a value between zero and one. The value of the coefficient of determination (R^2), which is small, illustrates that the independent variables explain very limited variables. Conversely, if the value results are close to the value of one, it means that the independent variables provide almost all of the information needed to predict the dependent variable. However, suppose the use of the coefficient of determination has a weakness, with the presence of a biased value result against the number of independent variables entered into the research model, to avoid such biased results. In that case, the adjusted R^2 value is used, where the adjusted R^2 value is able to describe the value going up or down if there is an addition of one of the independent variables.

Partial Test (T-test)

The t-statistic test is usually used to show how much influence one independent variable, as an explanatory variable, can individually explain the dependent variable. This t-test has the function of finding out how the influence between the independent variable has a significant influence on the dependent variable and reviewing the influence of the independent variable on the dependent variable.

Sample

The type of this research is quantitative research. Where the purpose of this study is to analyze the population and samples related to the data used to adjust the research instrument, statistical data analysis and hypothesis testing. The population is all subjects that are used as objects in the study. The population used as objects in this study is a banking company that publishes annual financial reports ending on December 31 and is listed on the Indonesia Stock Exchange from 2020 to 2022.

A sample is a subset of a population that has characteristics and can describe the population used in the study. The technique used in sampling is the purposive sampling method, which is a non-random sampling technique whose information is obtained with certain criteria. The following are the criteria used in the purposive sampling method in this study:

1. Banking companies that are listed in BESEI throughout the period 2020 to 2022.
2. Publish audited financial statements and annual reports throughout the research period.
3. The form of financial reporting in rupiah form is reported at the end of each year from 2020 to 2022, which has been recorded on the IDX.
4. Have a complete data report throughout the period 2020 – 2022 on the required variables.

Data source

This study uses a secondary data collection method, namely data obtained indirectly from publicly available third-party sources but still relevant to the research objectives. The processed data includes audited financial reports and annual reports from banking sub-sector companies listed on the Indonesia Stock Exchange (IDX) for the observation period 2020–2022. All data was accessed through the official Indonesia Stock Exchange website (www.idx.co.id) and the official websites of each relevant bank to ensure complete information regarding foreign ownership structures and required financial ratios.

RESULTS

Descriptive statistics

This study will use descriptive statistical tests on the samples used to understand the characteristics of the data analyzed. The results of the descriptive statistical tests are presented as follows.

Table 1. Descriptive Statistical Test

	PRU	FD	LEV	PROF	KA	FS
Mean	-0.0170	-0.0178	0.7848	0.0274	0.4072	17.4311
Median	-0.0100	-0.0624	0.8284	0.0336	0.2901	17.1139
Maximum	0.2637	0.9240	0.9321	0.2595	0.9900	21.1366
Minimum	-0.3128	-0.7667	0.0524	-0.3848	0.0000	13.4071
Std. Dev	0.0872	0.2745	0.1578	0.1093	0.3409	1.7710
Observations	129	129	129	129	129	129

Source: Processed Data

Based on Table 1, the number of samples used in this study was 129. Then, the dependent variable used in this study was the application of the principle of prudence. After testing, an average value of -0.0170 was obtained, where this value was smaller than the standard deviation value of 0.0872, so it can be concluded that the data on the application of the principle of prudence varied or were not concentrated.

Financial distress as an independent variable using the formula from Springate produces an average value of -0.0178, where the value is smaller than the standard deviation value of 0.2745, so it can be concluded that the financial distress data varies and is not concentrated. The highest value of financial distress with a value of 0.9240. The lowest value of financial distress data with a value of -0.7667.

Leverage as an independent variable represented by the debt-to-asset ratio produces an average value of 0.7848, where the value is greater than the value of its standard deviation of 0.1578, so it

can be concluded that the leverage data does not vary or is homogeneous and concentrated. The highest value of leverage data. The lowest value of leverage data with a value of 0.0524.

Profitability as an independent variable, represented by the return on equity ratio, produces an average value of 0.0274, where this value is smaller than the value of its standard deviation, which is 0.1093, so it can be concluded that the profitability data varies and is not concentrated. The highest value of the data with a value of 0.2595 in 2020. The lowest value of the profitability data with a value of -0.3848.

Foreign ownership as a moderating variable produces an average value of 0.4072, which is greater than the value of its standard deviation of 0.3409, so it can be concluded that foreign ownership data does not vary or is homogeneous and concentrated. The highest value of foreign ownership data is 0.9900 in 2020. The lowest value of foreign ownership data is 0.0000.

Firm size as a control variable produces an average value of 17.4311, which is greater than the standard deviation value of 1.7710, so the firm size data does not vary or is homogeneous and concentrated. The highest value of the firm size data is 21.1366 in 2021. The lowest value of the firm size data is 13.4071.

Model Selection and Model Evaluation

The Chow test is used to determine the best model between the CEM and FEM models. The CEM model is selected if the Cross-Section Chi-Square value is greater than 0.05. Meanwhile, if the Cross Section Chi-Square value is less than 0.05, the selected model is FEM.

Table 2. Uji Chow

Effect Test	Statistic	d.f.	Prob.
Cross-section F	2.1860	(42.78)	0.0014
Cross-section Chi-square	100.3589	42	0.0000

Source: Processed data

The results of the Chow Test above show the value of the cross-section chi-square probability of 0.0000, where this value is smaller than the significance level of 0.05, so the selected model is the fixed effect model (FEM).

The Hausman test is used to determine the best model between the FEM and REM models. The FEM model will be selected if the value of the Random Cross-section is smaller than 0.05. If the value of the Random Cross-section is greater than 0.05, the REM model will be selected.

Table 3. Hausman test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	24.2839	8	0.0021

Source: Processed data

**Classical Assumption Test
Multicollinearity Test**

Table 4. Multicollinearity Test

	Correlation Coefficient Value							
	FD	LEV	PROF	FS	KA	KA*FD	KA*LEV	KA*PROF
FD	1.0000	-0.5490	0.4017	-0.0773	0.0788	0.7304	-0.0334	0.2440
LEV	-0.5490	1.0000	-0.0007	0.2200	-0.0021	-0.4635	0.1932	-0.0112

PROF	0.4017	-0.0007	1.0000	0.5177	-0.0573	0.3144	-0.0580	0.7262
FS	-0.0773	0.2200	0.5177	1.0000	0.1703	-0.1312	0.2309	0.3454
KA	0.0788	-0.0021	-0.0573	0.1703	1.0000	-0.0525	0.9718	-0.0271
KA*FD	0.7304	-0.4635	0.3144	-0.1312	-0.0525	1.0000	-0.1898	0.4415
KA*LEV	-0.0334	0.1932	-0.0580	0.2309	0.9718	-0.1898	1.0000	-0.0446
KA*PRF	0.2440	-0.0112	0.7262	0.3454	-0.0271	0.4415	-0.0446	1.0000

Source: Processed data

The results of the multicollinearity test are presented in Table 4. The correlation coefficient between KA and KA*LEV is 0.9718, or above 0.85, indicating a multicollinearity problem. However, according to Gujarati & Porter (2009), this multicollinearity problem cannot be corrected because even if one of the variables fails this test, the estimator remains BLUE, assuming that all other variables remain constant and there is no relationship between the disturbance variables, so the regression equation remains consistent and efficient. The interaction coefficient is negative and significant, but the hypothesis expects a strengthening of positive moderation. The manuscript should clearly distinguish between statistical significance and theoretical support. Revise the interpretation to state that the sign contradicts the hypothesis and explain the economic meaning of this negative interaction more carefully. This finding contradicts the research hypothesis that foreign ownership will strengthen the application of the prudential principle in highly leveraged banks. Economically, this negative sign indicates that in banks with dominant foreign ownership, increasing leverage is actually followed by a decrease in the level of prudence. This suggests the possibility that foreign investors in the Indonesian banking sector are more risk-tolerant in pursuit of asset growth or aggressive returns, resulting in weaker oversight of accounting conservatism policies when banks expand through debt.

Heteroscedasticity Test

Table 5. Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.2806	0.3696	-0.7592	0.4500
FD	-0.0061	0.0455	-0.1330	0.8946
LEVERAGE	-0.0518	0.0931	-0.5564	0.5795
PROFITABILITY	0.0793	0.0732	1.0834	0.2820
FS	0.0209	0.0202	1.0369	0.3030
KA	-0.0219	0.0873	-0.2507	0.8027
KA*FD	0.0959	0.0886	1.0825	0.2824
KA*LEV	0.0239	0.1221	0.1958	0.8452
KA*PROF	-0.2505	0.1209	-2.0731	0.0915

Source: Processed data

Based on the results of the heteroscedasticity test attached in Table 5, it can be concluded that the data used in this study does not have heteroscedasticity problems in the regression model. This is supported because the probability value of each independent variable is above the significance value of 0.05.

MRA REGRESSION ANALYSIS

Table 6. MRA Regression Table

Variable	Coefficient
C	-3.4487
FD	0.1728
LEVERAGE	0.6926
PROFITABILITY	-0.4122
KA	0.2753
FS	0.1690
KA*FD	-0.6324
KA*LEV	-0.5056
KA*PROF	0.7203

Source: Processed data

The fixed effect model regression equation produced based on the data in Table 6 is as follows:
 Prudence = -3,4487 + 0,1728 Si + 0,6926 DAR – 0,4122 ROE + 0,2753 KA – 0,6324 Si.KA – 0,5056 DAR.KA + 0,7203 ROE.KA + 0,1690 FS.

Determination Coefficient Test and F Test

Table 7. Table of Determination Coefficient Test (R) and Simultaneous Significance Test (F)

R-Square	0.5909	F-Statistic	2.2532
Adjusted R-Square	0.3286	Prob (F-Statistic)	0.0006

Source: Processed data

The determination coefficient test is used to determine how much influence the independent variable has on the dependent variable being studied. The value of the large or small influence of the independent variable on the dependent variable can be seen from the adjusted R-square value, where, as seen from Table 7, the influence is 0.3286 (32.86%). With a value of 32.86%, it can be concluded that the independent variable used in this study can only explain the dependent variable (application of the principle of prudence) by 32.86%, while the remaining value or 67.14%, can be explained by other variables not used in this study.

A simultaneous significance test is used to determine the feasibility of a regression model used in the study. From Table 7, the F probability value is 0.0006, which means the F value <0.05, so we can conclude that all independent variables together have a significant influence on the independent variables used in this study.

Partial Significance Test

Table 8. Partial Significance Test Table

Variable	Expectation	Coefficient	Std. Error	t-statistic	Prob. (one-tail)	Conclusion
C		-3.4487	0.8997	-3.8330	0.0001	
FD	-	0.1728	0.1108	1.5596	0.0615	H1 rejected
LEVERAGE	+	0.6926	0.2266	3.0566	0.0016	H2 accepted
PROFITABILITY	-	-0.4122	0.1782	-2.3132	0.0117	H3 rejected
KA	+	0.2753	0.2126	1.2947	0.0997	
FS		0.1690	0.0491	3.4421	0.0005	
KA*FD	+	-0.6324	0.2156	-2.9330	0.0022	H4 rejected

KA*LEV	+	-0.5056	0.2973	-1.7007	0.0465	H5 rejected
KA*PROF	+	0.7203	0.2942	2.4483	0.0083	H6 accepted

Source: Processed data

If we look at Table 8, the results of this test are the variables leverage, profitability, and foreign ownership that affect the relationship between financial distress and the application of the principle of prudence, foreign ownership that affects the relationship between leverage and the application of the principle of prudence and foreign ownership that affects the relationship between profitability and the application of the principle of prudence have a significant influence. Meanwhile, the relationship between financial distress and foreign ownership does not have a significant influence.

DISCUSSION

Financial distress does not affect the application of the principle of prudence

Based on the results of the hypothesis test, it can be concluded that financial distress does not affect the application of the principle of prudence. This may be because, in conditions of financial distress, companies need additional funds for operations and debt repayment, which increases the level of leverage. The application of the principle of prudence in this situation risks producing understated financial reports, which can lead to negative perceptions from creditors. The insignificant effect of financial distress on the principle of prudence can be explained through the perspective of signaling theory, where companies threatened with bankruptcy tend to avoid conservatism to prevent transmitting negative signals to the market and creditors. An empirical study by Zahra and Santoso (2022) found that distress often triggers managers to relax their prudential practices to present a more stable financial performance and maintain access to external financing. Therefore, this behavior reflects a strategic defense mechanism where the need for short-term liquidity overrides adherence to conservative reporting principles, as also found in emerging market contexts. As a result, companies tend to avoid applying accounting prudence to maintain access to external financing. This finding is in line with research by Haryadi et al. (2020) and Frianto et al. (2024), which shows that the effect of financial distress on prudence is positive but not significant, which means that the company's financial difficulties do not affect the application of the principle of prudence. Another reason is that companies, especially those that go public, are usually audited by independent auditors. In conditions of financial distress, auditors will be stricter in assessing the application of the principle of prudence to prevent manipulation of financial statements (Arum et al., 2023). So, the pressure to continue to follow accounting standards can maintain prudence even though the company's condition is bad.

From an agency theory perspective, the insignificant impact of financial distress reflects an agency conflict in which managers, as agents, tend to prioritize short-term survival strategies to secure their positions and access to capital. Distress creates pressure for agents to engage in "income smoothing" or loosen the precautionary principle in an effort to mitigate information asymmetry to prevent principals and creditors from withdrawing their financial support. Thus, strict audit oversight acts as an essential external governance mechanism to discipline agents, ensuring that managers' self-interest in concealing financial risks does not compromise the integrity of financial statements for resource holders.

Leverage does not affect the application of the principle of prudence

Based on the results of the hypothesis testing, it can be concluded that leverage does not affect on financial distress. The insignificant effect of leverage on the application of the prudential principle can be explained by the perspective that the debt burden in the tightly regulated banking industry does not always serve as a trigger for additional conservative behavior. This finding indicates that oversight by monetary authorities and compliance with applicable accounting standards are strong enough to discipline management, so that variations in the debt ratio no longer automatically change the level of prudence in financial reporting. Furthermore, this condition reflects that creditors in emerging markets may be more focused on asset security or long-term solvency than on the details of accounting conservatism in annual reports. This is in line with research by Haryani (2022), which shows that accounting policies are often more influenced by internal governance characteristics than by capital structure pressures. Similarly, Lestari et al. (2023) revealed that in certain contexts, highly leveraged companies actually avoid the prudential principle to maintain debt covenants and avoid appearing to violate technical thresholds set by lenders.

Within the framework of agency theory, this insignificant leverage effect suggests that debt does not always function as an automatic monitoring instrument that increases managers' conservative behavior in the banking sector. This phenomenon indicates that strict regulatory oversight has taken over the disciplining role typically performed by debt holders, thereby reducing information asymmetry without relying on fluctuations in capital ratios. Consequently, agents are more likely to align their accounting policies with regulatory compliance and debt covenant protections rather than responding opportunistically to capital structure pressures.

Profitability harms the application of the prudence principle

Based on the results of the hypothesis testing, it can be concluded that profitability has a negative effect. This may be due to shareholders' belief that increasing the company's profitability does not require an increase in the level of prudence. With increasing profits through the use of equity, management is considered capable of managing finances well. Because of this belief, management does not feel compelled to tighten the application of the principle of prudence because there is no great pressure to protect external parties, there is a managerial incentive to maximize reported profits, and they want to send positive performance signals to the market. Highly profitable companies generally have stable cash flows, easy access to funding sources, and a strong financial image in the eyes of investors and creditors, so that they are less pressured to protect creditors (Shmelev & Gilardi, 2025). This condition makes the company not have the urgency to hide potential risks or withhold profit recognition as recommended in the principle of prudence. Instead, companies tend to report financial performance optimally and optimistically to maintain their reputation and attract market interest. These findings suggest that companies with high profitability tend to report performance optimistically to maintain their market reputation, thus reducing the urgency to apply the principle of prudence. This phenomenon aligns with the argument that when financial performance is at its optimal point, management feels less compelled to recognize asymmetric losses (Nugraha, 2024). However, these results have sparked scholarly debate when compared with the findings of Lestari et al. (2023), which actually showed a significant positive effect; in their study, profitable companies tended to be more conservative to protect accumulated profits from excessive dividend demands and strict tax oversight. Meanwhile, Haryani (2022) provides an intermediary perspective that the relationship between profitability and prudence is situational, with prudence only increasing when companies face high market uncertainty despite being profitable. By comparing this conflicting evidence, this study contributes by emphasizing that, in the Indonesian banking context, the drive to attract market interest through optimistic financial reports remains more dominant than the motive to protect profits through conservatism.

The management of companies that have high levels of profitability tends to want to show their success to the maximum and increase investor confidence through high-profit reporting. In this context, the application of the principle of prudence that is conservative such as delaying revenue recognition or accelerating loss recognition is seen as an obstacle because it has the potential to reduce reported profit figures. Therefore, highly profitable companies tend to avoid implementing the principle of prudence in order to maintain a good financial performance image in the eyes of stakeholders. Companies with high profitability will reduce the application of the principle of prudence. This finding is in line with the research of Abdurrahman and Ermawati (2019), which shows that profitability has a significant negative effect on prudence. This means that the higher the profitability of a company, the lower the application of the principle of prudence. Within the framework of agency theory, this negative effect on profitability reflects the opportunistic behavior of agents who prioritize "profit image" to satisfy their short-term interests in the eyes of their principals. When a company is highly profitable, managers tend to relax the principle of prudence to maximize bonuses and professional reputation, assuming that shareholders will be less critical of risks amid impressive earnings reports. Thus, this phenomenon indicates a failure of the monitoring mechanism, where financial success actually provides room for agents to reduce the quality of transparency through overly optimistic reporting.

Foreign Ownership Weakens the Relationship between Financial Distress and Prudence

Based on the statistical data you provided, the probability value (one-tailed p-value) of 0.0615 is above the significance threshold of 0.05, so the moderating variable technically does not have a significant influence at the 95% confidence level. This condition is in contrast to the relationship without moderation, which previously showed a positive direction but was not significant. This negative relationship indicates that the higher the level of financial distress, which should increase the application of the principle of prudence, actually experiences a weakening due to foreign ownership. In a situation of financial distress, internal company information tends to be more difficult to access and predict. Foreign shareholders generally do not have direct access to the company's operational information due to geographical limitations, language differences, culture, and applicable regulations. Therefore, they tend to encourage the application of conservative principles in financial reporting so that the information obtained is more reliable. Thus, the existence of foreign ownership does not automatically weaken the relationship between distress conditions and the application of the principle of prudence. In addition, when foreign ownership in a company increases, management cannot recognize potential income to save the company from bankruptcy (Fregidou-Malama & Hyder, 2024). As a result, management must apply the principle of prudence by not recognizing potential income and reporting the company's financial condition transparently. This step aims to ensure that management decisions harm no party and to help determine the best strategy so that the company can get out of financial distress. From an agency theory perspective, this weakening relationship indicates that foreign ownership serves as an external control mechanism that mitigates information asymmetry between managers and foreign shareholders when the firm is in distress. The presence of foreign investors limits opportunistic managerial discretion by forcing agents to adhere to transparent reporting standards despite pressure to conceal financial risks for the safety of their positions. Thus, this moderating role demonstrates that global oversight can discipline agents to prioritize the principal's long-term interests through the strict application of the prudential principle, thus restoring market confidence amidst information uncertainty.

Foreign ownership does not strengthen the relationship between leverage and the application of the prudence principle

Based on the results of the hypothesis testing, it can be concluded that the existence of a moderation variable causes the influence of leverage on the application of the prudence principle to be significantly negative. This result is inversely proportional to the relationship before moderation, where previously, leverage had a significant positive influence on prudence. This negative relationship occurs because when a company has high leverage, creditors will be more active in monitoring the company's operations. The higher the leverage, the greater the creditor's access to company information, so management is required to apply the prudence principle more strictly in financial records (Butar Butar, 2020). Therefore, the existence of foreign ownership in the company does not have a significant influence because the supervisory function of the company's operations and the application of the prudence principle have been carried out by creditors as parties who have a major interest in the company's financial condition. In addition, foreign ownership does not always strengthen the relationship between leverage and the application of the prudence principle due to several factors, including the limitations of foreign investors in understanding the local context of the company, including debt structure, operational risk, and applicable financial reporting practices (Al-Nimer et al., 2021). Differences in regulations, culture, and language also become obstacles in assessing leverage risk accurately. In addition, foreign ownership is generally passive and plays a role as a portfolio investor, so their involvement in accounting policy-making is very limited. The main focus of foreign investors is also more on achieving returns and stability of financial performance, not on the application of accounting conservatism. Therefore, although high leverage can increase financial risk, the encouragement of foreign shareholders towards the application of the principle of prudence does not immediately appear, so its existence does not strengthen the relationship between the two variables. Within the agency theory framework, the negative shift in leverage after being moderated by foreign ownership indicates an overlap in the supervisory function between creditors and foreign investors. This condition indicates that while creditors have exercised a strict disciplining role over agents, the presence of foreign shareholders, who tend to be passive, does not provide added value in reducing agency costs related to financial reporting. Consequently, limited information and barriers to understanding the local context for foreign investors render their supervisory mechanisms ineffective, resulting in conservative loss recognition being driven more by the direct interests of creditors than by the intervention of global capital owners.

Foreign ownership weakens the relationship between profitability and the application of the prudence principle

Based on the results of the hypothesis testing, the existence of a moderating variable causes the effect of profitability on the application of the principle of prudence to be significantly positive. This result is in contrast to the previous relationship between profitability and prudence, which showed a significant negative effect. This positive relationship indicates that increasing profitability tends to weaken the application of the principle of prudence. However, with foreign ownership, management is still required to prepare financial reports in accordance with the principle of prudence applied by the company. In addition, the existence of foreign ownership can also reduce the opportunity for fraudulent actions by management that have the potential to disrupt the stability of the company. Foreign ownership tends to weaken the negative correlation between profitability, and the application of the principle of prudence can also be explained by several reasons (Kozlov, 2023). First, foreign investors usually demand transparent and quality financial reporting, even when the company records high profits. A study by Kuspratiwi and Widagdo

(2014) shows that foreign share ownership is significantly related to accounting conservatism, while profitability does not have a significant effect. This indicates a foreign orientation towards prudent reporting – so that the potential for decreased conservatism when profits increase can be reduced. Second, the existence of foreign ownership is often accompanied by stricter external supervision. Findings by Afriani et al. (2021) in a sample of state-owned companies revealed that foreign ownership has a significant effect on accounting conservatism ($p < 0.01$), although profitability does tend to suppress conservatism. Third, foreign investors are generally long-term-oriented and emphasize the stability and quality of financial reporting. They bring expectations from high governance environments such as IFRS and US GAAP, so that even though corporate profits are high, the urge to continue to prioritize the principle of prudence remains strong (Silva et al., 2023). Thus, the dominance of the negative relationship between profitability and prudence is dampened. So it can be concluded that profitability tends to reduce conservatism, foreign ownership actually weakens this effect through strict external supervision "(Afriani et al., 2021). Within the framework of agency theory, this shift in influence demonstrates that foreign ownership serves as an effective governance mechanism for aligning the interests of agents with those of global principals. The presence of foreign investors mitigates information asymmetry by limiting the discretion of managers who tend to be overly optimistic when earnings increase, thereby forcing agents to adhere to transparent and conservative reporting. Thus, strict oversight by foreign shareholders successfully curbs opportunistic behavior by managers, ensuring that the company's long-term stability is prioritized over simply projecting short-term financial performance.

CONCLUSION

This study provides a novel theoretical contribution by revealing that the effectiveness of prudential principles in the banking sector is more influenced by market reputational motives than by internal financial pressures. The finding that financial distress has no effect and profitability negatively impacts prudential principles challenges conventional assumptions, indicating the existence of a managerial defensive strategy to avoid negative signals in emerging markets. Specifically, this study extends the Agency Theory literature by demonstrating that the role of foreign ownership as a market disciplining instrument is selective; foreign capital has been shown to be effective in mitigating managerial discretion on profitability, but is limited to areas already tightly regulated by banking regulations. The practical implication is that regulators need to strengthen the integrity of financial reporting by integrating foreign capital supervision as a global governance mechanism to reduce opportunistic behavior. These results confirm that conservative accounting standards often compromise liquidity priorities, necessitating a sharper policy framework to maintain banking sector transparency amidst economic uncertainty.

Despite technical challenges such as multicollinearity and the removal of outliers, this study still provides significant incremental contributions through theoretical validation of the robustness of the BLUE estimator in banking governance models. The methodological contribution of this paper lies in demonstrating that the consistency and efficiency of the regression remain intact despite the interrelationships between independent variables, confirming the stability of the theoretical framework in capturing prudential practices in emerging markets. Practically, this study advances understanding of how foreign ownership operates as a contextual supervisory mechanism, offering strategic insights for regulators in designing financial reporting standards that are more resilient to capital structure and profitability dynamics. The elimination of this outlier is feared to affect the results of the study because the eliminated data may have an influence on the findings obtained. Measurement of foreign ownership is only based on the percentage of shares, without

distinguishing the type of ownership or the country of origin of investors that can affect accounting conservatism. In addition, the extent of foreign shareholder involvement in corporate governance has not been evaluated, and the use of secondary data is unable to capture qualitative aspects such as reporting preferences. This study also has not classified industrial sectors, so it does not reveal differences in conservatism between sectors.

In further research, it is expected to develop this research related to factors that influence the principle of prudence. Development can be done by changing or adding other factors. The variables in this study can also be adjusted using other formulas, such as leverage variables, which can use the Debt debt-equity ratio (DER), Long-Term Debt to Equity Ratio (LTDER), Times Interest Earned (TIE) or Total Asset Debt Coverage (TAD Coverage) formulas. Then, further research is expected to add independent variables and control or replace the moderation variable. In addition, the number of company samples can be increased, changes in the type of company or additional periods of the data used. In addition, it is recommended to distinguish the types of foreign ownership (strategic and portfolio) and consider the country of origin of investors as a moderating variable. In addition, it is imperative to consider various aspects of corporate governance., the use of a mixed methods approach, and sectoral analysis so that the research results are more in-depth, contextual, and applicable.

AUTHOR'S CONTRIBUTION STATEMENT

The authors made equal contributions to the current research throughout its entirety, from the formulation of the issue to the final findings and solution.

CONFLICTS OF INTEREST

The authors assert that the work described in this paper was not influenced by any competition for pecuniary interests or personal relationships.

SOURCE OF FUNDING STATEMENTS

Funding for this investigation was not procured.

ACKNOWLEDGMENTS

The author would like to express gratitude to Bali State Polytechnic for the facilities and academic assistance used in the production of this study. We also extend our gratitude to the supervisor and all those who contributed to the preparation of this scientific work.

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