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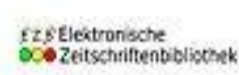
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Capital Adequacy and Earnings Conservatism of Rural Banks in the Province of Bali, Indonesia

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Abstract
Rural bank is a highly regulated industry by the government in Indonesia. The minimum of capital adequacy is one aspect of which is determined by the government, in this case Bank Indonesia. The purpose of this study is to examine the effect of the capital adequacy to earnings conservatism. Capital adequacy ratio is considered as a measure of the company's specific political spotlight as a proxy for the banking industry. This study is conducted in rural banks in the province of Bali. This research samples are determined by using stratified random sampling technique, obtained 60 units of rural banks with 120 observations. This study used the analysis technique of multiple linear regression. The analysis results showed that the capital adequacy ratio has negative effect on earnings conservatism. These results proved that the higher the government's attention to the rural banks, causing an increase in earnings conservatism. This is to avoid the high political cost by the rural banks.
Keywords: Capital adequacy ratio, Earnings conservatism, Political cost

1. Introduction

Conservatism is one of the principles that affect the assessment in accounting (Sterling, 1967). In addition, it is also an important accounting principles for several centuries (Basu, 1997). The principle of conservatism can affect the presentation of earnings, therefore some researchers such as: Pope and Walker, 1999; Basu, 1997; Givoly and Hayn, 2000; Giner and Rees, 2001; Holthausen and Watts, 2000; García-Lara and Mora, 2003; García -Lara and Mora, 2004; Raonic et al., 2004) called it as earnings conservatism. Conservatism principle is important because it can prevent the occurrence of earnings optimism. Watts (2003) stated that there are four explanations the importance of earnings conservatism, namely conservatism with regard to minimization of taxes, political cost, legitimacy of the shareholders and contractual explanation. Furthermore, Bushman and Piotroski (2006) stated political economy is another driving factor implementation of earnings conservatism. It indicates the government's intervention in the market. Bushman and Piotroski (2006) also explained that each country has their own political cost, so that should be considered in the explanation of earnings conservatism.

Political cost hypothesis that raised by Watts and Zimmerman (1986) suggest that when managers deal with the possibility of political pressure to transfer their prosperity, they will choose the accounting procedures that can reduce the transferred value. This action is taken to avoid government action to reduce the profitability of the company by implement more regulations or by other means.

The research of earnings conservatism with the explanation of political costs are relatively few. Bushman and Piotroski (2006) examined the earnings conservatism internationally, by using risk variable of expropriation and company ownership by the government to determine the difference in the international politics cost. The results showed that the managers will adjust their company's financial reporting to respond the government's involvement. If the companies believe that the shareholders prosperity to be expropriated, the managers are encouraged to act earnings conservatism. Conversely, when the government will intervene and the company is operating inefficiently, then the company will be motivated to show better performance by reducing the practice of accounting conservatism.

The regulation levels of companies in banking industry is tighter compared to other companies. The political cost is very relevant in the banking industry, as the government intends to prevent a systemic crisis that could result in damage to the economic order of the country. This can happen because the banking industry has an important role in supporting economic growth and national stability.

Bank serves to manage payment systems, suppliers of liquidity reserves and the channel of monetary policy issued by the government (Corrigan, 1982). Therefore, the operation of the banking industry should be monitored and controlled by the government, so that the banking industry is "safe and well". In this regard, compliance with regulatory capital requirements is an aspect of banking regulation that is most important. The regulators use capital adequacy as an indicator of bank's ability to offset a decline in their assets as a result of bank losses that caused by risky assets.

Regulatory of bank's capital adequacy is an instrument to protect the economy from the negative effects of the failure of banking operations. Therefore, compliance with the regulatory capital adequacy is an important aspect of banking operations. The capitals consists of core, supplementary, and additional

supplementary capitals. Based on this background, the principal problems of this study is whether the effect of the capital adequacy to the earnings conservatism of banking industry?

1.1 Aim of Study
The capital adequacy for banks serves to accommodate the possibility of the risk of loss that may be encountered. The higher the capital adequacy ratio, the better the bank's ability to bear the risk of each loan or assets at risk. The regulators and stakeholders very concerned about capital adequacy of a bank, thus the government sets minimum capital adequacy which must be fulfilled by the banks. In this regard, this study aimed to examine the effect of the capital adequacy to earnings conservatism.

1.2 Significance of Study
Rural banks is a bank that conducting business in a conventional or based on sharia principles, which in their activities do not provide services in payment traffic. Rural banks activities is narrower than commercial banks since the rural banks may not accept demand deposits, foreign exchanges, and insurances. Activities that can be implemented by the rural banks is to collect funds from the public in the form of savings like time deposits, savings, or other similar forms, providing credit, finance and fund placement based on sharia principles in accordance with the provisions that has been set by Bank Indonesia, putting funds in Certificates of Bank Indonesia, certificates of deposit, and savings at other banks. This study provides additional knowledge about the earnings conservatism in the banking industries, which are still relatively few. The object of this study is specifically in rural banks and using specific measurements of government intervention in the banking industry, which is capital adequacy. This research is also expected to prove the motivation of political costs in rural banks.

2. Literature Review and Hypothesis Development
2.1 Positive Accounting Theory
The company is a nexus of contracts (Jensen and Meckling, 1976), because the company has a contractual relationship with various parties such as creditors, governments, communities and other parties with the interest in the company. Positive accounting theory related to the contractual view of the company when the accounting is used as an instrument to facilitate the formation and performance of contracts through contractual costs reduction that arising from the agency conflict.

Watts and Zimmerman (1986:200-221) using a positive accounting theory to explain and predict the behavior of managers in accordance with the selection procedures and accounting methods by managers to achieve certain goals. The following three hypotheses explain why managers make the selection method of accounting. Bonus plan, Debt or equity hypothesis, Size hypothesis. Positive accounting theory stated that the accounting option such as accounting conservatism can limit the opportunistic behavior of managers in transferring wealth to their personal interests.

2.2 Accounting Conservatism
Applicable accounting standards allow companies to choose the method of accounting that will be used, it has implications for the reporting of corporate earnings that tend to be conservative or optimistic. The selection of accounting methods can affect the value of company that eventually contain economic consequences. The concept of conservatism, according to Suwardjono (2005), stated that in uncertain circumstances, the management will use a selection of the accounting treatment which describes the circumstances that are less profitable, which implies the recognition of losses that are likely to occur and do not immediately recognize revenues or earnings that are likely to occur in the future.

Sterling (1967) proposed the hypothesis that conservatism is a fundamental principle of valuation in accounting. Accounting conservatism is defined by Bliss (1924) in Watts (2003), as not anticipate earnings but anticipate all losses. This means that earnings are not recognized before the legal claim can be verified, which shows that the real earnings will be generated. Earnings recognition is very dependent on verification. Meanwhile, Basu (1997) stated that accounting conservatism is a tendency for the accountants to conduct more verifications to recognize good news as an advantage of loss as bad news. This implies a higher level of verification required to recognize earnings, the higher the level of accounting conservatism.

Givoly and Hayn (2000) defines conservatism as a criteria for the selection of the accounting principles that lead to the minimization of cumulative reported earnings by slowing the revenue recognition, preceding the recognition of costs, lowering the asset's assessment and raising the debt assessment. Furthermore, Watts (2003) stated that conservatism is defined as a difference in the degree of verification required to recognize gains and losses. Asymmetry treatment on gains and losses caused understatement of assets value that can lead to earnings overstatement in the future, because the understatement of expenses. Wolk et al. (2000:144-145) defined conservatism of accounting in an effort to choose a generally acceptable accounting methods that are: (1) slowing revenue recognition, (2) raising expense recognition, (3) degrading asset valuation and (4)

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elevating debt ratings. This definition resulted in the persistent understatement of net asset value.

Accounting conservatism is different from earnings management. Manipulation of accounting in the current period of earnings management is different from the accounting that reflects a permanent accounting policies. For example, a conservative depreciation policy, which is always calculate high depreciation will result in lower earnings that relatively permanent. However, a high depreciation costs that only occur for one period will have temporary effect on earnings decline, which will raise up in the future. Therefore, conservative accounting does not produce lower earnings quality due to persistently lower earnings recognition.

Conservative accounting, not only with regard to the selection of accounting methods, but also estimates the relatively low result of book assets' value. Conservative accounting is the selection of accounting principles that lead to the minimization of cumulative earnings reported, like slowing revenue recognition, preceding cost recognition, so that the earnings will decline relatively permanent (Watts, 2003). Conservatism should occur every year. For this statement, Givoly and Hayn (2000) predict that conservatism generate the accumulation of non-operating cumulative negative accrual continuously (Watts, 2003). Givoly and Hayn (2000) found the understatement of net assets (market to book ratio is more than 1 and non-operating cumulative negative accrual permanently from time to time) is empirical evidence of the existence of conservatism.

2.3 Type of Accounting Conservatism

Accounting conservatism is defined in different understandings. Based on Basu (1997) definition, stockholders, bondholders and creditors need faster information about bad news than good news. Ball, et al (2007) refers this definition as earnings conservatism. There is another term, balance sheet conservatism, which means that the presentation of shareholders' equity is lower (Lara and More, 2004). Furthermore, Beaver and Ryan (2005) distinguish accounting conservatism to unconditional and conditional conservatism.

Unconditional conservatism does not depend on the news (ex ante). The book value of net assets on the balance sheet is understated due to the recognition criteria which more stringent and the using of a specific accounting method for the measurement. Conditional conservatism depends on the news (ex post) and has no effect on the income statement.

2.4 Conservatism Explanation

Basu (1997), Watts (2003) and Qiang (2007) stated that there are some explanations of accounting conservatism such as: contracting, litigation, taxation and regulatory accounting.

1) Explanation Contracting. Conservatism is part of the efficiency technologies which are applied in the organization or company in contracts with various parties. The contract is an important reason for conservatism. Watts and Zimmerman (1986) found that the contract of various parties by the companies using accounting numbers to reduce agency costs which associated with the company. The contract, which is often a concern is the relationship between the manager and the bondholders. The problem is the company wants to invest in high-risk projects with a hope of getting the highest earnings, but when the project fails, the company's losses are relatively small compared to the bondholders. On the other hand, if the project is successful, the bondholders do not receive profit sharing. Therefore, the lenders prefer conservative accounting. Beatty, et al (1995) and Zhang (2008) examined the effect of debt contracts to accounting conservatism.

2) Litigation Explanation. When the company reported too large net assets, then the opportunity to make high litigation costs than the company reported net assets will be lower. For example, the lawsuits by shareholders against the company, because they assume that the company commit fraud on their bookkeeping. If the net assets were estimated too low, then the litigation costs will be lower. Watt (2003) stated that the litigation under the Securities Acts in U.S encourage conservatism. Another part of the cost of litigation is a political cost.

3) Income Tax Explanation. Watts (2003) linked the conservatism with the taxation for the following reasons. Companies will lower revenue reporting to reduce income tax payments. Companies put off the tax debt for the foreseeable future, resulting in lower corporate taxes in the current fiscal year. The revenue is reported lower by recognize the costs in full amount and only recognize half of the earnings. The previous explanation of accounting conservatism is only for the country where the income tax and accounting earnings are linked to one another.

4) Regulatory Explanation. The rules factors and regulations can encourage the company use accounting conservatism in financial reporting. The excess in reporting net assets will cause the company to deal with the bigger problem than the company reporting a lower earnings. The reason why the regulator prefers conservatism with regard to the lower political consequences (Watts, 2003). Lobo and Zhou (2006) proved that the accounting regulatory has effect on the level of accounting conservatism.

2.5 Capital Adequacy

The capital adequacy is a common symptom that experienced by banks in developing countries. The capital adequacy may come from two things, the first is due to the small amount of capital, and the second is the poor quality of the capital. Furthermore, bank supervisors must be satisfied that banks should have enough capital, both quantity and quality. In addition, the shareholders or the management of banks should actually be responsible for the capital that already being invested. The assessment of capital is intended to evaluate the adequacy of bank capital to cover the current risk exposure and anticipate the future risk exposures. The standard set by Bank Indonesia on the minimum capital requirement or Capital Adequacy Ratio (CAR) is at 8 percent. CAR is calculated to measure how strong bank capital to cover the risks that exist in the bank. This ratio is used to assess the health and safety of banks in terms of capital owners. The higher the risk of CAR, the better the performance of the bank. The high or low CAR of a bank will be influenced by two factors: the amount of capital owned by the bank and the number of Risk Weighted Assets (RWA) managed by the bank.

2.6 Hypothesis Development

Earnings conservatism according to Basu (1997) refers to tendency the accountant to perform a higher level of verification. When the company reported an earning, it is called the good news, but when the company suffered a loss is referred as bad news. Ball and Shivakumar (2005) asserted that the accounting profit decline reflects the economic loss. Therefore, the accounting earning is the quality attributes of accounting information.

Nichols et al (2008) analyzed the effect of ownership structure on the earnings conservatism in the banking industry. They proved that the public bank served more level of conditional conservatism than private banks. Bushman and Piotroski (2006) and Watts (2003) revealed that political economy is one of the drivers to implement the accounting conservatism. A company located in countries with high government interventions will recognize the good news faster than the bad news on earnings reporting compared to companies located in countries with less government interventions. This indicates that government intervention which too tight on the company may cause the company to avoid the governments through the implementation of discretionary to describe that the condition of the company is better.

The choice of existing accounting method is a way how the management to deal with the political supervision. Bushman and Piotroski (2006) and Borja, et al (2009) stated that the accounting information is an important part which can be used by the government to interfere the company's decision. Banks are the industries that are vulnerable to government intervention and the choice of accounting method can be used to increase political control. One of the government's policy is to determine the minimum standards on capital adequacy.

This study used capital adequacy to measure the level of regulatory intervention. Supervision and control of regulator will be more rigorous to banking company. If the capital adequacy of banks is getting low, then the level of earnings conservatism will increase. Watts (2003), stated that the regulators will warn the companies that do not report bad news in their financial statements, than if the companies do not report the good news. Therefore, the capital adequacy has negative effect on earnings conservatism. Based on previous explanations, the hypothesis of this research as follows.

Hypothesis 1: The lower the capital adequacy, then the higher the levels of earnings conservatism.

3. Research Methodology

3.1 Population and Sample

The population in this study are all rural banks in Bali in 2016. The total population of more than 136 units with details in each regencies as shown in Table 1.

Table 1: Unit of Rural Banks in Every Regency/City in Bali Province

No.	Regency/City	Unit
1	Badung	52
2	Bangli	3
3	Singaraja	7
4	Denpasar	13
5	Gianyar	28
6	Karangasem	4
7	Klungkung	5
8	Jembrana	3
9	Tabanan	24
	Total	139

Source: www.bi.go.id, 2016

This study used sampling technique of stratified random sampling, according to the regency or city in the province of Bali. The minimum sample size that should be taken is determined by using a formula such as

following.

$$n = \frac{N}{1+Ne^2}$$ ……………………………………………………………………………..… (1)

Explanation:

n   : The sample size

N   : The population size

e   : The percentage of allowances due to sampling error that can be tolerated by 10 percent

      The minimum number of samples taken to determine the level of allowances of 10 percent based on the formula (1) are as much as 58 units of rural banks. The samples used in this study as many as 60 units of 40 percent of the population. Allocation of sample units in each level is determined proportionally. As for the distribution of the samples are presented in Table 2.

Table 2: Unit of Samples in Every Regency/City in Bali Province

No.	Regency/City	Unit
1	Badung	22
2	Bangli	1
3	Buleleng	4
4	Denpasar	6
5	Gianyar	12
6	Karang Asem	2
7	Klungkung	2
8	Negara	1
9	Tabanan	10
	Total	60

Source: Data processed, 2016

3.2 Data Sources

The data of this research is secondary data, the annual financial statements rural banks in 2013, 2014 and 2015. Data were obtained from the official website of Bank Indonesia, namely www.bi.go.id. The required data is the capital adequacy ratio, total assets and net incomes. The data analyzed were in 2014 and 2015, while the necessary data is the data from the year of 2013 to determine the change in total assets and change in net income.

3.3 Variables and Measurements

The independent variables in this study are capital adequacy, which measured by the Capital Adequacy Ratio (CAR). The assessment of capital is intended to evaluate the adequacy of bank capital to cover the current risk exposure and anticipate the future risk exposures. The standards that set by Bank Indonesia on the minimum capital requirement or CAR is at 8 percent. CAR is calculated to measure how strong bank capital to cover the risks that exist in the bank. This ratio is used to assess the health and safety of banks in terms of capital owners. The higher the risk of CAR, the better the performance of the bank. The high or low CAR of a bank will be influenced by two factors: the amount of capital owned by the bank and the number of Risk Weighted Assets (RWA) managed by the bank. RWA is the sum of the posts of assets after every post multiplied by its weight. CAR value that used in this study is cited from the financial statements of each rural banks.

      The dependent variable in this study is earnings conservatism, which calculated by the approach that developed by Ball and Shivakumar (2005). The approach of Ball and Shivakumar (2005) appropriately used to measure the earnings conservatism in the banking industry, because the faster the recognition of the loss or decline in earnings is the main key of financial reporting banks (Nichols, et al, 2008).The disclosure reason of loss or decline in earnings is a type of bank risk intermediation and regulation of capital adequacy related to the ability of banks to absorb losses and remain solvent for depositors.

3.4 Analysis Techniques

This study hypothesis is proven through testing data by multiple regression model. The measurement of earnings conservatism with the model of Ball and Shivakumar by adding CAR (Capital Adequacy Ratio) and consider the testing of increase and decrease in earnings, as used by Nichols et al. (2008) and Borja et al. (2009). This study also considered the size of the company as a control variable. There are two reasons why the variables of size is used. First, large companies tend to adopt conservative accounting for the cost of politics (Watts and Zimmerman, 1986). Large companies generally will be more intensively monitored by the government. Second, the existence of information asymmetry. Large companies choose accounting conservatism to minimize the earnings thus the government's attention will be decreased. The formula used is as follows.

$\Delta NI_{it} = \beta_0 + \beta_1 D\Delta NI_{it-1} + \beta_2 \Delta NI_{it-1} + \beta_3 D\Delta NI_{it-1}.\Delta NI_{it-1} + \beta_4 CAR_{it} + \beta_5 D\Delta NI_{it-1}.CAR_{it} + \beta_6 \Delta NI_{it-1}.CAR_{it} + \beta_7 D\Delta NI_{it-1}.\Delta NI_{it}.CAR_{it} + \beta_8 SIZE_{it} + \beta_9 D\Delta NI_{it-1}.SIZE_{it} + \beta_{10} \Delta NI_{it-1}.SIZE_{it} + \beta_{11} D\Delta NI_{it-1}.\Delta NI_{it-1}.$

$SIZE_{it} + {}^{u}{}_{i}$ ………………………………………………………….…………… (2)

Explanation:

ΔNI_{it} : The change of profit for the year t-1 to year t that calculated based on the book value of total assets

$D\Delta NI_{it-1}$: The dummy variable, given the value of 1 if the earning is negative and 0 when the earning is positive

ΔNI_{it-1} : The change of net profit a year before

CAR_i : The capital adequacy ratio that quoted from the financial statements BPR

$SIZE_{it}$: The size of the company that measured by total assets

Based on earnings conservatism, the more quickly to recognize the economic benefits in the accounting earnings will be deferred, then the earnings will increase persistently that indicated by β_2. Otherwise, the more quickly to recognize the economic loss is transitory that indicated by a negative value of β_3. The decrease in the level of earnings conservatism is proved by the value of $\beta_6 < 0$ and the level of earnings conservatism is high when the value of $\beta_7 > 0$.

Before testing the hypothesis, the testing tool data using multivariate regression statistical model with Ordinary Least Square (OLS) method requires to perform classical assumption or assumption of the model. Test models of research should be done so that results are not biased by non-fulfillment of the testing terms of the model. The classical assumptions that used in this study are the test of linearity, multicollinearity, heteroscedasticity, autocorrelation and normality residual of predicted values. If all the classic assumption tests are match, then generate a linear estimator of accounting conservatism, not biased, and has a minimum variance (Best Linear Unbiased Estimator = BLUE). After obtaining the results of the regression, then the evaluation results of the regression that includes an assessment of how well (goodness of fit) regression model explaining the variation of the variable accounting conservatism through the coefficient of determination.

4. Result and Discussion

4.1 Research Result

The company used as a study sample are 60 units of rural banks in regency or city in the province of Bali. The amount of data being analyzed for two years, year 2014 and 2015, so the number of observations are 120 companies. Descriptive statistical test results are presented in Table 2.

Table 3: Descriptive Statistics Test Results

Variable	N	Minimum Value	Average Value	Maximum Value	Standard Deviation Value
ΔNI_{it}	120	-9.888.383.000	6.703.448.220	19.187.410.000	12.332.485.719
$D\Delta NI_{it-1}$	120	0	0,472	1	0,278
ΔNI_{it-1}	120	-10.166.107.000	1.035.951.570	11.625.124.000	2.618.698.437
CAR_{it}	120	10	21,82	53	10,17
$SIZE_{it}$	120	4.009.055.000	46.572.754.900	449.942.979.000	62.720.630.906

Source: Data processed, 2016

Based on the descriptive statistics test results, the average value of change in the book value of rural bank's total assets in Bali province is Rp 6.703.448.220. There is a negative change in the book value of total assets by Rp 9.888.383.000. The rural banks that have negative earnings changes are 47,20 percent. The average value in earnings changes for the rural bank in the previous year is Rp 1.035.951.570. The value of the minimum capital adequacy of the rural bank at least 10 percent, while the average value of capital adequacy is 21,82 percent. This means that the average value has exceeded the minimum capital adequacy requirement that set by Bank Indonesia at 8 percent of risk weighted assets.

Before testing the hypothesis, the capital must first be tested with the classical assumption, as for the classical assumption test results are presented in Table 4 below. The linearity test is conducted to test the model specification that used in this study is correct (linear) or not. This study used Lagrange Multiplier test for linearity test models, because this study sample consists of 120 observations (more than 100 observations). Based on Table 4, it is known that the value of C^2 count (n x R^2) or (6 x 0,006) = 0,0360, smaller than C^2 table (0,0360 < 1.145), this means that regression model that used in this study is the linear model or not wrong in specification. Multicolinearity test using the approach of variance inflation factor (VIF). The cut off value commonly used to indicate the presence of multicollinearity is that the tolerance value $\leq$ 0,10, or equal to the VIF value $\geq$ 10. The analysis showed that the VIF in the range of 1,039 up to 1,227 smaller than 10, this means that there is no indication of multicollinearity. Similarly, when using a value of tolerance, there is no multicollinearity because the tolerance value of each variable ranges from 0,860 up to 0,947, greater than 0,10.

Table 4: Classical Assumption Test Results

Variable	Linearity	Multicollinearity Test		Heteroscedasticity Test	Normality Test	Autocorrelation Test
		Tolerance	VIF			
$D\Delta NI_{it-1}$		0,897	1,115	0,557		
ΔNI_{it-1}		0,963	1,039	0,692		
$D\Delta NI_{it-1}\Delta NI_{it-1}$		0,930	1,076	0,461		
CAR_{it-1}		0,815	1,227	0,280		
$D\Delta NI_{it-1} . CAR_{it-1}$		0,842	1,188	0,874		
$\Delta NI_{it-1} . CAR_{it-1}$		0,618	1,618	0,589		
$D\Delta NI_{it-1}\Delta NI_{it-1}. CAR_{it-1}$		0,987	1,013	0,970		
$SIZE_{it}$		0,930	1,075	0,426		
$D\Delta NI_{it-1} . SIZE_{it}$		0,930	1,075	0,958		
$\Delta NI_{it-1} . SIZE_{it}$		0,905	1,105	0,933		
$D\Delta NI_{it-1}\Delta NI_{it-1} . SIZE_{it}$		0,585	1,710	0,894		
Residual					1,265	
D-W						2,107
C^2	0,0360					

Source: Data processed, 2016

Multicolinearity test results showed that there is no correlation between the independent variables. Heteroscedasticity test using the Glejser method. The test is conducted by calculating the value of the regression model residuals. The results of the residual then become absolute. Furthermore, the absolute value of residuals are regressed with each independent variable. Table 4 shows that there is no heteroscedasticity problem in the variables that have been tested in the regression model, because the probability value (significance) for each independent variable is greater than 0,05. This means that there is no relationship between the amounts of data and residual, thus when the data is added, the residual (errors) will not increase. Autocorrelation test is performed to determine the correlation between the interference errors in period t (now) and in period t-1 (previous). Autocorrelation test in this study using a measuring instrument of Durbin-Watson (DW). The value of DW is 2,107 in the position of DU (1,906) < DW (2,107) < 4-DU (2,240). This means that there is no positive or negative autocorrelation in the interference errors. Normality test is a test to determine the normality (normal or not) residual or error terms. Table 4 showed that the residual value of 0,317 with a significance level greater than 0,05, this can be said that the interference errors that occurred in this regression model follow the pattern of normal distribution of data. After the regression model qualified the classical assumption test, the next step is testing the hypothesis of this study. Results of regression testing are presented in Table 5 below.

Table 5: Regression Test Results

Variable		Beta Coefficient (β)	t Value	Level of Significance
$D\Delta NI_{it-1}$	β_1	-0,058	-0,038	0,049
ΔNI_{it-1}	β_2	0,235	0,804	0,043
$D\Delta NI_{it-1}\Delta NI_{it-1}$	$\beta 3$	-0.186	-0,024	0.009
CAR_{it-1}	β_4	-0,025	-0,416	0,046
$D\Delta NI_{it-1} . CAR_{it-1}$	β_5	0,054	0,053	0,958
$\Delta NI_{it-1} . CAR_{it-1}$	β_6	-0,016	-0,085	0,033
$D\Delta NI_{it-1}\Delta NI_{it-1}. CAR_{it-1}$	β_7	0,241	0,113	0,039
$SIZE_{it}$	β_7	0,601	3,819	0,000
$D\Delta NI_{it-1} . SIZE_{it}$	β_8	-0,126	-0,056	0,955
$\Delta NI_{it-1} . SIZE_{it}$	β_9	0,147	1,095	0,279
$D\Delta NI_{it-1}\Delta NI_{it-1} . SIZE_{it}$	β_{10}	-0,084	-0,213	0,833
F test = 51,47, sig 0,000		Adjusted R Square = 0,48		

Source: Data processed, 2016

Results of regression test showed that there is a persistent asymmetry between the good news and the bad news regardless of the CAR. Earnings increased more persistent with the value of $\beta_2 = 0,235$, positive and statistically significant. The decline of profit in the previous year will reverse in subsequent periods, this is indicated by the value of $\beta_3 = -0,186$, negative and statistically significant. The effect of capital adequacy ratio (CAR) on earnings conservatism showed that the CAR has negative effect on earnings conservatism ($\beta_6 = -0,016$, negative and statistically significant or $\beta_6 < 0$). The earnings will reverse higher than the decline of earnings ($\beta_7 =$

0,241, positive and statistically significant).

4.2 Discussion

The study hypothesis revealed that the lower capital adequacy, the higher the earnings conservatism. The hypothesis is supported by the results of data analysis that showed the capital adequacy ratio has negative effect on earnings conservatism. This means that the high capital adequacy ratio, the lower the level of earnings conservatism of rural banks in Bali province. The results of this study confirms that the rural banks will be faster to report a decrease in the capital adequacy ratio (bad news), compared to report an increase in the capital adequacy ratio (good news). These results are conducted by rural banks to avoid government intervention over the company. The government will pay more attention to the rural banks that are slow in presenting the financial statements.

The results of this study also supported by the test results that indicate earnings increased persistently, while the earnings decline will reverse in the next period is higher than the amounts of earnings decline. The earnings decline resulted in decrease in the net asset value of the company, this may result in lowering the value of capital adequacy of the company, thus the company tried to convey this information earlier than if the company experienced an increase in earnings. These results are consistent with the hypothesis of the study, due to the increased level of conservatism of earnings as a result of a decrease in the capital adequacy ratio of the rural banks. The results of the study support the statement of Bushman and Piotroski (2005) that political economy is one of the drivers to implement the earnings conservatism. Borja, et al (2009) also proved that the banking company's capital adequacy ratio has negative effect on earnings conservatism. Therefore, the rural banks will perform the earnings conservatism to avoid government intervention which are too tight to the company. Watts (2003) confirmed that the regulator will warn the companies that do not promptly report bad news in their financial statements, than if the companies do not report the good news.

The capital adequacy ratio of the rural banks is very important, because this ratio reflects the quantity and quality of the capital which held by a rural bank. CAR is used to assess the bank's health and safety of the minimum amounts of the bank's capital availability, as well as how strong the bank capital will able to cover the bank's risks. Given the importance of this ratio, Bank Indonesia set the rules about rural banks responsibility to provide the minimum amounts of CAR at 8 percent.

The company size also affects the level of rural bank's earnings conservatism. The larger the size of the company, the higher the levels of earnings conservatism. Bushman and Piotroski (2006) revealed the selection method of accounting is an instrument for management to deal with the political supervision. Accounting information is part of the information that used by the politicians to intervene the decisions that will be made for the company.

The banking industry has an important role in supporting economic growth and national stability. Regulated companies usually deal with the political pressure and public scrutiny (Watts, 2003). This means that the higher the level of investor protection, the required level of the earnings conservatism is also higher. The earnings conservatism may reduce the political costs. The political cost is very relevant in the banking industry, because the government needs to prevent a systemic crisis or reduce the adverse consequences of society (Nichols, et al, 2008). This is likely to cause the banking industry tend to choose accounting methods to reduce the cost of politics. Banks are the industries that are vulnerable to government intervention. Therefore, the regulation through the determination of accounting methods that can be used by the banking company is one of the way which used by the government to increase the political control.

5. Conclusion and Recommendation

5.1 Conclusion

Based on the results of data analysis, it can be concluded that the capital adequacy of rural banks has negative effect on earnings conservatism. This means that the higher capital adequacy ratio led to the lower level of earnings conservatism. These results are consistent with the statement of Watts (2003) that there is asymmetry in the political costs. The political cost is very relevant in the banking industry, because the government needs to prevent a systemic crisis or reduce the adverse consequences of society (Berger, et al, 1995; Berger, et al, 2008; Nichols, et al, 2008). Therefore, the increased attention of a company by the government (regulator) led to the increased of earnings conservatism.

5.2 Recommendation

This study has limitations in the data of rural bank's published report. If the data are available, further research is expected to test the accounting conservatism from the side of accounting earnings presentation with different conservatism measurement and also extend the study period.

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