

ABSTRACT

This research studies the existence and determinant of accounting conservatism, especially related to financial distress condition considering manager incentive due litigation risk as an external factor of the company and company business strategy as an internal factor. The objectives of this research are: (1) to investigate the effect of financial distress toward accounting conservatism; (2) to investigate the effect of litigation risk on the relationship between financial distress and accounting conservatism; (3) to investigate the effect of business strategy on the relationship between financial distress and accounting conservatism.

To measure the accounting conservatism, the author uses regression of panel data based on book to market equity ratio of 109 companies from 2005 – 2010. To measure the litigation risk and business strategy, the author uses confirmatory analysis. The data technique analysis that is used to test the hypotheses is linier regression.

Result of the research shows that financial distress has positive significant effect toward the accounting conservatism. Higher the financial distress brings the manager applied more conservatism accounting method. The result supports the first hypothesis. The second hypothesis testing indicates that Litigation risk moderates the relationship between financial distress and accounting conservatism. Litigation risk has positive and significant effect to the model. Therefore, litigation risk strengthens positive effect of financial distress toward accounting conservatism. The result supports the hypothesis H2. Business strategy has positive significant effect and moderates the relationship between financial distress and accounting conservatism. When the company adopts the prospector strategy, it strengthens the positive effect of financial distress toward the accounting conservatism. The result supports the hypothesis H3

This research shows litigation risk can be assumed as external factor of the company that motivate manager in responding the financial distress related to conservative financial report. In addition, business risk as internal factor of the company also affects the manager when counter the financial distress related to conservatism.

Key words: conservatism, financial distress, litigation risks, strategy types