ABSTRACT

Accounting conservatism is a principle that requires companies or entities to prepare and report company financial accounts cautiously in which companies are not hasting to recognize and measure assets and profits and are not readily recognizing losses and liabilities that may be incurred. The objective of this paper is to examine and provide empirical evidence on whether companies that have agency costs of free cash flow at a certain degree will make more conservative financial reports. Agency costs of free cash flow, as referred from (Jensen 1986b), is defined as a type of loss of firm value in which companies are prone to overinvest which results in investors discounting the value of cash and, consequently, the corporate value. In this paper the author calls the companies that have high agency costs of free cash flow as J-type firms and non-J-type firms for the companies that have low agency costs of free cash flow. The author determines the J-type firms by indicating companies that have high amount of excess cash and low growth opportunities proxied by Tobin's Q and vice versa for the non-J-type firms. In addition, this study examines the effect of leverage, dividends, corporate governance in influencing the relationship between the degree of agency cost of free cash flow and the degree of conservatism in the company's financial statements. This study uses accrual measure conservatism. The research sample consists of manufacturing companies in around G20 countries for 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018 and 2019. The data were obtained and filtered by using the purposive sampling method. The number of observation in this research is 3858. This study is using multiple regression for data analysis.

Keywords: accounting conservatism, agency cost, free cash flow, J-type firms.

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