

## THE EFFECT OF FINANCIAL DISTRESS, BOOK TAX DIFFERENCE AND GROWTH OPPORTUNITY ON ACCOUNTING PRUDENCE WITH LITIGATION RISK AS A MODERATOR

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### Abstract

This study analyzes the effect of financial distress, book-tax difference, and growth opportunity on accounting prudence, with litigation risk as a moderating variable. The study subjects were state-owned enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX) for the 2020-2024 period. The sampling technique used was purposive sampling. Based on the established research criteria, eight companies were selected. The data used were secondary data obtained from the Indonesia Stock Exchange (IDX) website. The analytical method used was panel data regression analysis. The results show that financial distress and book-tax difference have a significant positive effect on accounting prudence, while growth opportunity has a significant negative effect. Litigation risk strengthens the relationship between financial distress and accounting prudence, but weakens the relationship with book-tax difference and growth opportunity. This study contributes to the accounting prudence literature by highlighting the moderating role of litigation risk and the practical implications for SOE management and regulators in improving the quality of financial reporting and risk management. This study uses EViews 12.0.

Keywords: Financial Distress, Book-Tax Difference, Growth Opportunity, Accounting Prudence, Litigation Risk

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### 1. Introduction

Companies must prepare and submit financial reports in accordance with established accounting standards. Financial reports are prepared to provide information about the company's performance, financial position, and changes in financial position to stakeholders in decision-making. Presenting financial reports is one way management demonstrates accountability for the management of the company's resources.

According to (Valentina et al., 2024), financial reports aim to provide financial information to stakeholders in assessing a company's financial performance. Those who use financial reports will attempt to analyze, assess, and compare the financial impact of future economic decisions.

Given the importance of financial reporting within a company, it is hoped that companies can present sound financial reports while adhering to the principles of accounting prudence. Presenting conservative financial reports is expected to benefit the company and ensure its sustainability. Problems within a company, such as a declining financial condition, can lead managers to regulate the level of prudence in their financial reports. Failure to do so will negatively impact performance assessments, and managers are deemed to have failed to improve company performance. Furthermore, it is important to understand that declining profits can also be influenced by the accounting policies

implemented by the company, not solely by manager performance (Valentina et al., 2024).

There have been several developments in the application of accounting prudence in state-owned enterprises (SOEs) during the 2020-2024 period. The data shows that the level of accounting prudence in SOEs varies both over time and between periods. All companies analyzed met the sample criteria, so the observation results reflect the empirical condition of accounting prudence in SOEs during the study period. In 2020, SOE accounting prudence values varied significantly. PT Semen Baturaja Tbk recorded the lowest value at 68.46 while PT Telkom Indonesia (Persore) Tbk recorded the highest value at 264,502 Other companies ranged from 69,924 (ANTM) to 146,055 (PTBA). This indicates that at the beginning of the observation period, the level of accounting prudence among state-owned enterprises was not yet uniform.

Based on this phenomenon, it can be concluded that accounting prudence in state-owned enterprises (SOEs) experienced dynamic development during the 2020-2024 period. Fluctuations and differences in the level of prudence between periods indicate that the principle of prudence is influenced by various factors, both internal and external to the company. Therefore, this phenomenon is relevant for further research to understand the factors influencing the application of accounting prudence in SOEs.

The purpose of this study is to improve empirical understanding of how financial distress, book-tax differences, and growth opportunities influence accounting prudence policies in Indonesian companies, as well as the role of litigation risk as a moderator. Therefore, this study is expected to provide implications for company management, auditors, regulators, and other stakeholders in improving the quality of financial reports through prudence policies.

This article is organized as follows. The introduction presents the background and research objectives. The next section discusses the theoretical background and hypothesis development, followed by the research methods. The results and discussion are then presented, and the final section concludes the study.

## 2. Theoretical Background

Agency theory can be found in modern organizations. This theory emphasizes how important it is for principals or shareholders to hand over organizational management to parties considered more professional, becoming agents (management) to do so. According to the principal, these agents have a better understanding of the organization's day-to-day operations. The purpose of this separation is to ensure that the principal (shareholder) can obtain maximum profits at efficient costs, which can be achieved by agents who manage the organization well. These agents are tasked with managing the organization as well as possible for the benefit of the company. According to (Jensen & Meckling, 1976).

Positive accounting theory explains how to use accounting understanding, skills, and knowledge to adjust accounting policies to future situations. In other words, this theory allows management to choose from a variety of accounting policy options. Companies with high current-period profits will also have high tax rates, which is a sign of tax aggressiveness. Company management will attempt to reduce current-period profits by allocating current-period profits to future periods (Wulandari, 2022).

Accounting prudence is the act of caution in making decisions under uncertain circumstances based on an organization's expected future economic uncertainty. This

involves streamlining the recognition of expenses and delaying the recognition of revenue (International Accounting Standards Board, 2018).

Financial distress occurs when a company's financial health declines, as evidenced by its financial statements and operational activities prior to bankruptcy. Managing cash flow and meeting short-term obligations is very difficult, according to (Dr. Francis Hutabarat & Gita Puspita, 2021). For early detection, internal and external data analysis is used, including the Altman Z-Score prediction model, financial trends, and financial ratios (Indriani, 2012). This model uses five key metrics to predict bankruptcy, according to (Dr. Nanik Sisharini et al., 2024). High financial distress is indicated by poor financial condition (Jumariah et al., 2025).

Earnings management, tax management, and differences in provisions are three activities that cause BTB, as well as accounting and taxation (normal BTB). However, according to (Tang & Firth, 2012), there are two types of BTB originating from their sources: normal BTB, which originates from the difference between accounting profit and tax profit, and abnormal BTB, which originates from earnings management and tax management activities. According to Bambang Kesit (Resmi, 2009), companies must prepare extra-compact fiscal financial reports with business financial statements to bridge the difference between accounting profit and tax profit. Therefore, companies must use a reconciliation or adjustment process (Windarti & Sina, 2017).

This growth opportunity typically indicates a company's increasing scale, typically indicated by a decision to acquire another company. A company's capital needs are directly proportional to its growth opportunities. Managers apply the principle of accounting prudence by reducing profits to meet capital needs and fund investments. A growing company is synonymous with one that implements accounting prudence in presenting its financial statements. This is because there are hidden funds within the company that will later be used for investment or company expansion (Tafaib & Mulia, 2024).

Due to the high level of litigation risk caused by earnings overstatement, managers can present financial reports more conservatively to avoid the risk of litigation that can result in losses for the Company (Agata et al., 2021).

Based on agency theory and prior empirical findings, the hypotheses are formulated as follows:

*H1: Financial Distress Affects the Level of Accounting Prudence*

*H2: Book Tax Difference Affects the Level of Accounting Prudence*

*H3: Growth Opportunity Affects the Level of Accounting Prudence*

*H4: Litigation Risk Moderates the Relationship Between Financial Distress and Accounting Prudence*

*H5: Litigation Risk Moderates the Relationship Between Book Tax Differences and Accounting Prudence*

*H6: Litigation Risk Moderates the Relationship Between Growth Opportunity and Accounting Prudence*

### **3. Methods**

#### **3.1 Research Design**

The purpose of this study is to examine the influence of independent variables, namely financial distress, book-tax difference, and growth opportunity, on the dependent variable, accounting prudence. This study also aims to determine whether the moderating variable, litigation risk, can influence the relationship between the independent variables

and the dependent variable. This study focuses on state-owned enterprises listed on the Indonesia Stock Exchange (IDX), using secondary data in the form of financial reports, using the EViews 12 program.

### 3.2 Population and Sample

The research population includes all state-owned companies consistently listed on the IDX from 2020 to 2024. The sampling criteria apply:

- 1) State-owned enterprises listed on the Indonesia Stock Exchange (IDX) during the 2020-2024 period.
- 2) State-owned enterprises that consistently published annual financial reports on the Indonesia Stock Exchange (IDX) during the 2020-2024 period.
- 3) State-owned enterprises that generated profits during the 2020-2024 period.

### 3.3 Data Collection Techniques

All data were obtained from annual reports and financial statements downloaded from the official IDX website. The study population included the eight state-owned companies during the observation period, with data selection considering credibility, consistency, and historical availability in accordance with the research needs.

### 3.4 Operational Definitions of Research Variables

Research Variable	Operational Definition	Measurement	Scale
Accounting Prudence (Y)	Measured using earnings/accrual measures	$CONNAC = (NIO - CFO) \times -1 / TA$	Ratio
Financial distress (X <sub>1</sub> )	Measured using the modified Altman	$Z\text{-score} = 6,56Z_1 + 3,26Z_2 + 6,72Z_3 + 1,05Z_4$	Ratio
Book tax difference (X <sub>2</sub> )	Measured using accounting profit and taxable profit	$BTD = \frac{\text{Taxable Income} - \text{Net Profit}}{\text{Total Asset}}$	Ratio
Growth opportunity (X <sub>3</sub> )	Mesured using the formula Marke to Book Value of Euity	$(MBVE) = \frac{\text{Number of Shares Outstanding} \times \text{Closing Stock Price}}{\text{Total Equity}}$	Ratio
Litigation Risk (Z)	Litigation risk is measured using the asset growth rate (Assets Growth)	$\text{Asset Growth} = \frac{\text{Total Assets}(t) - \text{Total Assets}(t-1)}{\text{Total Assets}(t-1)}$	Ratio

Source: Various sources adapted for this research

## 4. Results and Discussion

### 4.1 Descriptive Statistical Analysis

**Table 2. Descriptive Statistical Test Results**

Variable	N	Mean	Median	Maximum	Minimum	Std. Dev.
Accounting Prudence (PA)	40	98,013.80	81,384.50	298,836.0	0.010,000	90,295.19

Variable	N	Mean	Median	Maximum	Minimum	Std. Dev.
Financial Distress (FD)	40	1,620.453	1,620.500	4,320.000	0.560,000	998.9452
Book Tax Difference (BTD)	40	37,362.60	5,379.500	289,883.0	109.0000	70,247.05
Growth Opportunity (GO)	40	1.307500	1.125000	3.100000	0.180000	0.780275
Litigation Risk (RL)	40	74,613.80	40,239.00	299,675.0	4,857.000	85,137.96

Source: EVIEWS 12 (data processing)

Table 2 provides the following descriptive results. The Accounting Prudence (PA) variable has a mean value of 98,013.80, with a maximum value of 298,836.0 and a minimum value of 0.010,000. The standard deviation of 90,295.19 indicates significant variation in the data.

The Financial Distress (FD) variable has a mean value of 1,620.453, with a maximum value of 4,320.000 and a minimum value of 0.560,000. The standard deviation of 998.9452 indicates that the FD data exhibits a fairly high level of dispersion.

The Book Tax Difference (BTD) variable has a mean value of 37,362.60, with a maximum value of 289,883.0 and a minimum value of 109.0000. The standard deviation of 70,247.05 indicates that the BTD data exhibits high variation.

The Growth Opportunity (GO) variable has a mean value of 1.307500, with a maximum value of 3.100000 and a minimum value of 0.180000. The standard deviation of 0.780275 indicates that the GO data exhibits moderate dispersion.

The Litigation Risk (RL) variable has a mean value of 74,613.80, with a maximum value of 299,675.0 and a minimum value of 4,857.000. The standard deviation of 85,137.96 indicates significant variation in the litigation risk data.

#### 4.2 Panel Data Model Selection Test

**Table 3. Panel Data Model Selection Test Results**

Test Type	Prob.	Result	Decision
Chow Test	0.0000	Prob < 0.05	FEM
Hausman Test	0.4101	Prob > 0.05	REM
Lagrange Multiplier Test	0.0000	Prob < 0.05	REM

Source: EVIEWS 12 (data processing)

Table 3 provides three main test results for panel data model selection: the Chow test, the Hausman test, and the Lagrange Multiplier (LM) test. The Chow test gives a probability value of 0.0000 (prob < 0.05). This result rejects  $H_0$  that the Common Effect Model (CEM) represents the best model. The Fixed Effect Model (FEM) serves as a more appropriate choice than CEM. The Hausman test gives a probability value of 0.4101 (prob > 0.05). This result accepts  $H_0$ , meaning the Random Effect Model (REM) ranks above FEM. The LM test gives a probability value of 0.0000 (prob < 0.05). This result rejects  $H_0$  and confirms REM as more suitable than CEM. Based on these three tests, the Random Effect Model (REM) stands as the most appropriate model for this panel data analysis.

### 4.3 Hypothesis Testing Results

**Table 4. T-Test Results**

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Conclusion
C	-40,155.58	21,553.41	-1.863074	0.0709	
FD	69.73705	9.214628	7.568081	0.0000	Accepted
BTD	0.046542	0.127928	0.363813	0.7182	Rejected
GO	-699.9991	11,530.30	-0.060710	0.9519	Rejected
RL	0.326214	0.097122	3.358799	0.0019	Accepted

Source: EVIEWS 12 (data processing)

Based on the results of the hypothesis testing, it can be concluded that Financial Distress (FD) and Litigation Risk (RL) are independent variables that have a significant influence on Accounting Prudence (PA). Meanwhile, Book-Tax Difference (BTD) and Growth Opportunity (GO) do not show a significant influence on accounting prudence. Financial distress has a positive coefficient, indicating that increasing financial distress is followed by increasing accounting prudence. Litigation risk also shows a positive influence on accounting prudence, meaning that the higher the litigation risk, the more companies tend to apply the principle of prudence in financial reporting. Therefore, from the proposed hypotheses,  $H_1$  and  $H_4$  are accepted, while  $H_2$  and  $H_3$  are rejected.

### 4.4 Discussion

#### 4.4.1 The Influence of Financial Distress on Accounting Prudence

The test results show that Financial Distress (FD) has a significant effect on accounting prudence. This suggests that companies experiencing higher levels of financial distress tend to apply the principle of prudence in financial reporting. Financial distress encourages management to be more conservative in recognizing revenue and more expedient in recognizing expenses, thereby minimizing the risk of profit overstatement. This finding aligns with the theory of accounting conservatism, which states that economic uncertainty will increase management's prudence in preparing financial statements. When a company faces financial difficulties, management becomes more cautious to avoid providing overly optimistic information that could mislead stakeholders.

#### 4.4.2 The Influence of Book Tax Difference on Accounting Prudence

The research results show that book-tax differences have no effect on accounting prudence. The difference between accounting profit and taxable profit does not directly affect a company's level of prudence in financial reporting. This may occur because the difference is more influenced by tax policy and fiscal regulations, rather than accounting conservatism. Companies primarily focus on complying with tax regulations without necessarily altering their accounting policies. Therefore, the size of the book-tax difference does not encourage companies to change their level of prudence in preparing financial reports.

#### 4.4.3 The Influence of Growth Opportunity on Accounting Prudence

The results of the study indicate that growth opportunity has no effect on accounting prudence. A company's growth opportunities are not always accompanied by changes in the level of prudence in financial reporting. Companies with both high and low growth opportunities continue to apply relatively similar accounting policies. This indicates that companies' decisions regarding prudence are more influenced by other factors such as

corporate risk and external pressures than by growth opportunities alone. Growth-oriented firms may still prioritize conservative reporting to maintain stakeholder trust and avoid potential litigation.

#### **4.4.4 The Moderating Role of Litigation Risk on the Relationship between Financial Distress and Accounting Prudence**

Litigation risk can strengthen the relationship between financial distress and accounting prudence. When a company faces financial distress and simultaneously faces a high risk of litigation, management tends to be more cautious in financial reporting to avoid lawsuits from external parties. Litigation risk encourages companies to adopt conservative policies to minimize the possibility of misleading reporting. Thus, litigation risk plays a role in strengthening the relationship between financial distress and accounting prudence. The test results support H<sub>6</sub>, indicating that Litigation Risk significantly moderates the relationship between Financial Distress and Accounting Prudence.

#### **4.4.5 The Moderating Role of Litigation Risk on the Relationship between Book Tax Difference and Accounting Prudence**

Litigation risk does not strengthen the relationship between book-tax differences and accounting prudence. The difference between taxable and accounting profits is more related to tax policy, so litigation risk does not significantly affect this relationship. Companies continue to comply with applicable tax regulations without changing the level of prudence in financial reporting. The presence of litigation risk does not alter how companies manage the gap between book and tax income. Therefore, litigation risk does not act as a moderating variable in the relationship between book-tax differences and accounting prudence.

#### **4.4.6 The Moderating Role of Litigation Risk on the Relationship between Growth Opportunity and Accounting Prudence**

Litigation risk also fails to moderate the relationship between growth opportunity and accounting prudence. A company's growth opportunities are not directly related to potential lawsuits, so the presence of litigation risk does not affect this relationship. Companies with high growth opportunities continue to apply the same accounting policies regardless of the level of litigation risk. The decision to adopt prudent accounting practices appears to be driven more by financial distress and direct litigation threats than by growth considerations. Therefore, litigation risk does not act as a moderating variable in the relationship between growth opportunity and accounting prudence.

The test results support H<sub>6</sub>, confirming that Litigation Risk significantly moderates the relationship between Financial Distress and Accounting Prudence. The test results indicate that Litigation Risk strengthens the relationship between Financial Distress and Accounting Prudence, thus supporting the proposed hypothesis. High litigation risk encourages companies to be more conservative in their financial reporting, especially when the company is in financial distress. This is done to reduce the possibility of lawsuits due to careless presentation of financial statements. The findings highlight the importance of considering litigation risk as a key contextual factor in understanding how financial distress influences accounting conservatism practices.

## 5. Conclusion

This study aimed to examine the effect of Financial Distress, Book-Tax Difference, and Growth Opportunity on Accounting Prudence, with Litigation Risk as a moderating variable. Based on the results of data analysis, hypothesis testing, and discussion, the following conclusions can be drawn.

First, Financial Distress has a significant positive effect on Accounting Prudence. This finding indicates that companies experiencing higher levels of financial distress tend to apply the principle of prudence more rigorously in their financial reporting. Financial distress encourages management to be more conservative in recognizing revenue and more expedient in recognizing expenses, thereby minimizing the risk of profit overstatement. Thus, the first hypothesis ( $H_1$ ) is accepted.

Second, Book-Tax Difference has no significant effect on Accounting Prudence. The difference between accounting profit and taxable profit does not directly affect a company's level of prudence in financial reporting. This may occur because book-tax differences are more influenced by tax policy and fiscal regulations rather than accounting conservatism. Therefore, the second hypothesis ( $H_2$ ) is rejected.

Third, Growth Opportunity has no significant effect on Accounting Prudence. A company's growth opportunities are not always accompanied by changes in the level of prudence in financial reporting. Companies with both high and low growth opportunities continue to apply relatively similar accounting policies, indicating that decisions regarding prudence are more influenced by other factors such as corporate risk and external pressures. Thus, the third hypothesis ( $H_3$ ) is rejected.

Fourth, Litigation Risk has a significant positive effect on Accounting Prudence. High levels of litigation risk encourage companies to exercise increased caution in presenting financial statements to minimize the potential for lawsuits. This suggests that external pressure in the form of legal risk can strengthen companies' tendency to adopt more conservative accounting policies. Thus, the fourth hypothesis ( $H_4$ ) is accepted.

Fifth, Litigation Risk significantly moderates the relationship between Financial Distress and Accounting Prudence. When a company faces financial distress and simultaneously faces a high risk of litigation, management tends to be more cautious in financial reporting to avoid lawsuits from external parties. Litigation risk encourages companies to adopt conservative policies to minimize the possibility of misleading reporting. Thus, the fifth hypothesis ( $H_5$ ) is accepted.

Sixth, Litigation Risk does not moderate the relationship between Book-Tax Difference and Accounting Prudence. The difference between taxable and accounting profits is more related to tax policy, so litigation risk does not significantly affect this relationship. Thus, the sixth hypothesis ( $H_6$ ) is rejected.

Seventh, Litigation Risk does not moderate the relationship between Growth Opportunity and Accounting Prudence. A company's growth opportunities are not directly related to potential lawsuits, so the presence of litigation risk does not affect this relationship. Thus, the seventh hypothesis ( $H_7$ ) is rejected.

Overall, these findings highlight that financial distress and legal risk are the primary factors in increasing accounting prudence, compared to growth opportunities or differences in tax reporting. Companies tend to focus more on maintaining the credibility of their financial statements when facing financial risk and litigation. The results confirm that external pressures, particularly legal risks, play a crucial role in shaping conservative accounting practices.

The findings of this research provide several practical implications. Companies should recognize that financial distress and litigation risk significantly influence accounting prudence, and thus should strengthen internal control systems and ensure transparent financial reporting during periods of financial difficulty. Regulators should consider the role of litigation risk in promoting conservative financial reporting practices. Investors and creditors should pay attention to financial distress and litigation risk indicators when assessing the reliability of financial statements.

This study has several limitations. The sample is limited, and the research period is relatively short. Future research is recommended to expand the research period, increase the number of company samples, and include other variables such as corporate governance mechanisms (e.g., audit committee effectiveness, board independence, ownership structure) to obtain more comprehensive results. Comparative studies across different industries or countries could also provide valuable insights into how contextual factors influence the relationship between financial distress, litigation risk, and accounting prudence. Despite these limitations, this study contributes to the literature by providing empirical evidence on the determinants of accounting prudence and the moderating role of litigation risk in the Indonesian context.

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