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Friday 22\textsuperscript{th} May 209  
3pm to 4.30pm  
Location Quad 2063

THE IMPACT OF DEFAULT RISK ON THE BASU MEASURE OF ACCOUNTING CONVERSATISM

The Basu (1997) asymmetric timeliness model is a widely applied measure of conditional conservatism in accounting research. In this paper, we analytically and empirically examine the relationship between the Basu (1997) measure of accounting conservatism and default risk. Our analytical model is based on Merton’s (1974) well-known contingent-claims model of equity, and incorporates aspects of the related earning behaviors. From this analytical model, we show that the Basu asymmetric timeliness coefficient is biased upward when a firm’s default risk increases, and the higher the default risk is, the greater is the bias. Our initial empirical evidence is consistent with our analytical propositions.