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Capital Allocation and Timely Accounting Recognition of Economic Losses

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PDF

Abstract

Abstract: This paper explores direct relations between corporate investment behavior and the timeliness of accounting recognition of economic losses (TLR) reflected in a country's accounting regime. We explicitly investigate the extent to which TLR influences investment decisions of firm managers. Given the asymmetric emphasis on negative outcomes inherent in TLR, we hypothesize that TLR will most strongly influence investment behavior when managers face deteriorating investment environments. We conjecture that TLR will have an asymmetric impact on investment behavior whereby TLR impacts firms' investment decisions in the face of declining investment opportunities, but not in the face of increasing in investment opportunities. Using firm-level investment decisions spanning twenty five countries, we find that investment responses to declining opportunities increases with TLR, while we find no evidence that TLR influences the sensitivity of investment to increasing investment opportunities. Our results are robust to alternative estimates of TLR, alternative estimates of investment responses to changing investment opportunities, and to controls for important country-level, industry-level, and firm-level variables that may impact firms' investment decisions.

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