Market perceptions of discretionary accruals by debt renegotiating firms during economic downturn

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Abstract

This study addresses how a stock market prices earnings components around a sudden and severe economic downturn. In particular, the study examines the market valuation of discretionary accruals for debt renegotiating Malaysian firms during the Asian financial crisis. Our analysis shows that negative discretionary accruals for debt renegotiating firms are associated with higher market values of equity and are not related to the firms' future earnings. These findings are consistent with investors placing a positive value on the probability that negative accruals increase the likelihood that concessions can be extracted from lenders during renegotiation. In contrast, discretionary accruals for a control sample of non-debt renegotiating firms are not significantly associated with stock prices but are positively associated with future earnings.

JEL classification

M410; M210

Keywords

Earnings management; Financial distress; Discretionary accruals; Debt renegotiation; Malaysia

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