Biases in market-based measure of the conditional conservatism[1]

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Abstract: In this paper we analyse the effects of outlier observations and endogeneity on the market-based measurement of conditional accounting conservatism. To address it, we apply a reverse engineering approach by using two alternative samples to estimate a measure of country-specific conditional conservatism – one including outliers and another without the multivariate influential observations identified. In the same way, we use on the sample without outliers two alternative estimation techniques – one affected by endogeneity and another specially designed to deal with the endogeneity problem. We apply this reverse engineering approach to the estimation of a comparative model of the conditional conservatism in order to analyse the effect of the International Financial Reporting Standards first adoption on the country-specific conditional conservatism. We report for both cases the two alternative results whose differences are only due to the outlier bias and the endogeneity bias, respectively. Our results prove the presence of these biases when outliers are not correctly identified and when the Ordinary Least Squares estimation technique is conducted. Moreover, these biases are large enough to result in misleading conclusions.

Keywords: Earnings conservatism; endogeneity; GMM-SYS; IFRS first adoption; market-based accounting research; multivariate outlier detection; OLS; panel data.