

8th Annual International Conference on Accounting and Finance (AF 2018)

Title: Employee Turnover Likelihood and Earnings Management: Evidence from the Inevitable Disclosure Doctrine

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Abstract

We explore how laws and regulations affect firms' accounting choices. Our tests exploit U.S. state courts' staggered recognition of the Inevitable Disclosure Doctrine (IDD), which reduces employees' ability to switch employers. We find a significant decrease in upward earnings management for firms headquartered in states that recognize the IDD relative to firms headquartered elsewhere. Our results are robust to alternative earnings management measures, and they are not explained by either unobservable local economic conditions or the impact of the IDD on firms' profitability. The effect of the IDD is stronger for firms relying more on human capital and for firms whose employees have higher ex-ante turnover likelihood, confirming the employee retention channel. Overall, our results support the view that retaining employees is an important motive for corporate earnings management.