Stock Crash and Jump: The Role of Accounting Information

Felizia Arni Rudiawarni [ab], I Made Narsa [c], Andry Irwanto [d]

[acd] Universitas Airlangga, Surabaya, Indonesia
[b] Universitas Surabaya, Surabaya, Indonesia

https://doi.org/10.35609/gcbssproceeding.2020.11(106)

ABSTRACT

Stock crashes (jumps) capture extreme negative (positive) returns) (Hutton et al., 2008; DeFond et al., 2015) and therefore have important implications for investors regarding their investment decisions they make. Investors make decisions based on the information they receive. Based on the value relevance literature, earnings are important information to determine the fundamental value of a firm (Beaver, 1968; Ball and Brown, 1968). The determination of accounting earnings is influenced by management policies. If management's policy in determining the amount of earnings is not appropriate, the quality of earnings as a representation of accounting information will decrease. Management's policy in determining earnings can be in the form of conservative or aggressive policies. Conservatism is divided into two types, namely conditional conservatism and unconditional conservatism (Beaver and Ryan, 2005; Basu, 2005). Conditional conservatism admits loss depending on the economic news, or ex-post conservatism. Conditional conservatism recognizes losses more timely than gains recognition (Basu, 1997), thus preventing managers from accumulating bad news (Kim and Zhang, 2016). The application of conditional conservatism causes undervaluation of the firm's stock price. Therefore, it is predicted that conditional conservatism will reduce the risk of future stock crashes. Unconditional conservatism records net assets at the lowest value since initial recognition or is said to be ex-ante conservatism (Beaver and Ryan, 2005). Unconditional conservatism prevents managers from admitting excessive net asset values (Kousenidis et al., 2014). However, unconditional conservatism is considered to create a hidden reserve ready to use when management is trying to pursue profit targets (Penman and Zhang, 2002; Ruch and Taylor, 2005). Therefore, unconditional conservatism is considered to increase the risk of future stock crashes. Accounting aggressiveness means recognizing gains more quickly and delaying recognition of losses (Battacharya et al., 2003) because of various personal motivations (Kothari, 2005). This accumulated bad news will at some point reverse and at that time, some bad news will flood the market immediately and make stock prices crash (Kim and Zhang, 2014). Therefore, accounting aggressiveness is predicted to increase the risk of future stock crashes. The conditions resulting from applying those accounting policies, affect the opposite in terms of stock jump. Studies contribute to the development of capital market researches.

Keywords: conditional conservatism, unconditional conservatism, aggressive accounting, stock crash, stock jump