**Labor mobility and conditional conservative accounting**


ABSTRACT

Firms having low employee labor mobility face demands by employees to signal employment stability. We argue that one way of addressing such demands is by adopting conditional conservative accounting to convey financial prudence and reduce the perceived future unemployment risk. However, conditional conservative accounting also imposes costs on firms, potentially limiting its use. Using a sample of U.S. firms, we examine how labor mobility influences conditional conservative accounting. Our findings show that firms with lower labor mobility exhibit more conditional conservative accounting than firms with more mobile employees. This relationship is especially pronounced when employees face higher unemployment risk, such as when firms are financially constrained or compete in highly competitive product markets.



*JEL classifications*: G12, G14, O32

*Keywords*: Employees, labor mobility, conservative accounting

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## 1. Introduction

Current research in economics provides evidence that labor market frictions have a first order effect on firms' financial decisions and their cost of capital (Favilukis et al., 2020; Gao et al., 2018; Chen et al., 2024). Extant accounting literature has largely overlooked the effect of rank-and-file employees on firms' financial decisions and instead focused on how firm financial reporting choices are influenced by explicit contracts with creditors (Watts and Zimmerman, 1986; DeFond and Jiambalvo, 1994; Dichev and Skinner, 2002), equity holders (Graham et al., 2005), and firm executives (Healy, 1985). Further, prior accounting literature has provided evidence that implicit contracts with customers and suppliers (Badertscher et al., 2012; Hui et al., 2012) of the firm shape financial reporting choices. In this study, we extend the stream of literature examining the effects of labor mobility on firm decision making and entrepreneurship (e.g, Sanati, 2018; Bai et al., 2024; Jeffers, 2024) by examining the relationship between labor mobility and conditional conservative accounting. Examining the impact of labor mobility on financial reporting choices is particularly timely given the recent debate in the U.S. surrounding the impact of labor mobility on economic activity (e.g. U.S. White House, 2016; U.S. Department of Treasury, 2016), and how the decline in job-to job transitions impacted wage growth (Bosler and Petrosky-Nadeau, 2016; Krueger and Posner, 2018).

Prior accounting literature examining the effect of rank-and-file employee characteristics on firm accounting policies has mostly focused on employee unionization. This literature shows that firms manage their earnings downwards and alter their voluntary disclosures to gain bargaining advantages in negotiating explicit contracts (Liberty and Zimmerman, 1986; DeAngelo and DeAngelo, 1991; Leung et al., 2009; Bova et al., 2015). Conversely, Dou et al. (2016) show that firms alter their financial reporting choices to influence employees' perception of the value of their implicit

contracts (e.g., the promise of job security) with their employer. Specifically, they show that firms manage their earnings upward to manage employee perceptions of future unemployment risk to reduce their labor costs.

Recent literature has started examining the relationship between rank-and-file employee characteristics other than employee unionization and firm accounting policies. Gao et al. (2018) shows that employee turnover likelihood is positively related to upward earnings management; Liu et al. (2021) finds that unemployment insurance is positively related to accounting conservatism while Chen et al. (2024) finds that reliance on high-skill labor is negatively related to accounting conservatism. Further, Lin et al. (2021) finds that employees prefer conservative accounting as evidenced from the positive relationship between employee board representation and accounting conservatism.

Taken together the above literature suggests that rank-and-file employee characteristics influence firm accounting policies. We extend this literature by examining whether labor mobility affects firms accounting conditional conservatism. Labor mobility is an important characteristic of the labor market given that more than ten percent of employees leave their job each quarter (Kuehn et. al., 2017). Notwithstanding the importance of labor mobility, the lack of a measure that captures labor mobility has hampered empirical research on the effects of labor mobility on firm decision-making.[1] Recent literature examining the effect of labor mobility on firm decision making has found

[1] Labor mobility can be split into within industry labor mobility and cross-industry labor mobility. Within industry labor mobility refers to the ease with which labor can move from one firm to another within the same industry. Cross-industry labor mobility refers to the ease with which labor can move from one industry to another. The correlation between these two types of labor mobility likely differs between occupations. For example, pilots have high within-industry labor mobility and low cross-industry labor mobility, while sales personnel have high within- and cross-industry mobility. In this study we concentrate on cross-industry labor mobility for three reasons: First, even employees with high intra-industry labor mobility will care about cross-industry labor mobility as only cross-industry labor mobility can reduce their exposure to idiosyncratic industry risk. Due to their low cross-industry labor mobility, pilots are fully exposed to shocks in the airline industry as demonstrated by the recent Covid-19 pandemic. An increase in pilot cross-industry labor mobility

that labor mobility is related to firm investment and leverage (Sanati, 2018; Bai et al. 2024). We build on this literature to examine the relationship between labor mobility and firm accounting policies, specifically conditional accounting conservatism.

Labor mobility captures the ease with which employees in an industry, occupation or geographic area can find alternative employment. Even though labor mobility is related to employee turnover, these are distinct constructs (D'Arcy et al., 2012). While labor mobility refers to the ability to move from one job to another, labor turnover refers to the number of employees that enter or exit the company. Hence, as opposed to labor mobility, turnover rates are definite (Sousa-Poza and Henneberger, 2004). The easier it is for an employee to move from one job to another the greater her labor mobility. In terms of occupations, the easier it is for an employee in an occupation to find employment in another industry, the greater the labor mobility in that occupation. While increased labor mobility typically leads to employee turnover (Morrison et al., 2006), these two constructs are not mutually exclusive. Specifically, employee mobility might be high, but employees stick to the same employer, hence employee turnover would be low. Similarly, employee mobility might be low, but employee turnover would be high since employees decide to drop out of the workforce. On a similar note, employee skills are related to employee mobility, but the two constructs are different (Sanati, 2018). Employees in occupations that require specific skills typically are less mobile as they can only find employment in a small number of industries, however there are skills that might be required by multiple industries. For example, computer engineering is a highly skilled occupation, however computer engineers are highly mobile since the computer engineering occupation is in

would reduce pilot exposure to shocks in the airlines industry. Second, the recent literature on labor economics emphasizes the importance of cross-industry mobility relative to intra-industry mobility (Kambourov and Manovskii, 2009) and sets out an indirect measure for cross-industry labor mobility. Third, intra-industry mobility is limited due to trade secret protection as well as non-compete agreements.

demand by several industries.[2]

In this study, we use a measure of labor mobility proposed by Donangelo (2014) to study the effect of labor mobility on firms' accounting choices. As labor mobility is unobservable, Donangelo (2014) proposes an indirect measure, which makes use of the dispersion of occupations across industries, to measure labor mobility. Occupation dispersion refers to the extent to which one occupation is demanded by different industries. Employees in occupations that are concentrated in a small number of industries typically consist of industry specialists with low labor mobility. An exemplary occupation for low mobility is "airline pilots and flight technicians" which are only employed by a small number of industries, with approximately 70% in "scheduled air transportation" alone. Therefore, they have less opportunities to find employment in other industries and are subject to higher unemployment risk through industry-specific shocks. Conversely, occupations dispersed across many industries require more general skills and hence have high labor mobility. An exemplary occupation for high labor mobility is "network and computer systems administrators", which is employed in 240 different industries.[3] The inability of employees to easily move from one industry to another exposes employees in low labor mobility occupations to greater unemployment risk. Hence, labor employed in low labor mobility occupations demand compensation to make up for greater unemployment risk. In this study, we examine whether firms operating in industries employing occupations with low labor mobility report more conservatively to reduce labor compensation costs.

Conditional conservatism is an important characteristic of financial reporting (Basu, 1997). It refers to the asymmetric verification thresholds for recognizing economic gains versus economic

2 Throughout our empirical analysis we control for labor turnover and employee skill to ensure that these constructs do not drive our results.

[3] Mobility and skill are distinct occupational characteristics. Measures of employee mobility and skill have been found to be weakly negatively correlated (Hass et al., 2020).

losses. These different thresholds result in the timelier recognition of losses than gains (Khan and Watts, 2009). In a standard agency problem, where manager incentives are not aligned with those of other stakeholders, managers have the incentive to withhold bad news (Healy and Palepu, 2001; Verrecchia, 2001; Kothari et al., 2009). Conditional conservatism attempts to attenuate the agency problem arising from the information asymmetry between the management of the firm and other stakeholders (Ball, 2001).

In interactions between rank-and-file employees and management, information asymmetry is typically pervasive (Dou et al., 2016). To the extent that financial reporting provides information about the future performance of the company, employees can use accounting information to appraise and price unemployment risk. Compensation differentials arising from differences in unemployment risk typically take the form of higher wages and benefits, and better working conditions (Smith, 1976; Abowd and Ashenfelter, 1981; Topel, 1984; Hamermesh and Wolfe, 1990). Further, accounting provides a signal of the likelihood that the firm will honor its long-term commitments to the employee. If conditional conservatism improves the timeliness of such signals, then we expect employees to demand that firms report more conservatively. Timelier recognition of losses ensures that employees have more time to take action to safeguard their interests. As unemployment risk is a function of labor mobility, we posit that the demand for conservative accounting is stronger in industries with a workforce that has lower labor mobility.

While the previous arguments provide demand-side reasoning for conditional conservative financial reporting, there are also arguments for firms to provide conditional conservative reporting when interacting with their employees. First, industries with low labor mobility typically consist of employees with industry-specific knowledge (Donangelo, 2014). The cost of replacing such industry-specific knowledge can be substantial (Dou et al., 2016). Second, Donangelo (2014) suggests that high labor mobility is a form of labor-induced operating leverage which increases the systematic risk

of the company. Higher risk causes equity holders to demand a higher required rate of return. As in the presence of low labor mobility the required rate of return is lower, we expect that reporting conservatively for firms with low labor mobility is less costly than for firms with high labor mobility.

However, conservative accounting is not without cost for the firm. Prior literature has shown that conservative accounting leads to more frequent debt covenant violations and losses (Givoly and Hayn 2000; Klein and Marquardt 2006; Zhang 2008), the threat of which might lead to suboptimal business decisions (Beneish and Press 1993; Falato and Liang 2016). Conservative accounting has also been found to impede corporate innovation, negatively affecting firm prospects (Chang, et al. 2013; Laux and Ray 2020). Further, Bandyopadhyay et al. (2010) and Chen et al. (2014) show that accounting conservatism reduces earnings persistence and the ability of current earnings to predict future earnings, potentially reducing the usefulness of current earnings to financial statement users. Finally, Liu et al. (2021) suggest that firms mitigate employee turnover costs by reducing conditional accounting conservatism to manage employee perceptions of unemployment risk. These perceptions are particularly pertinent in a low labor mobility environment, where the costs of replacing employees are likely substantial (Dou et al., 2016).

Given it is ex-ante unclear whether in the presence of low labor mobility, the benefits of firm conditional accounting conservatism are greater than its costs, the effect of labor mobility on conditional accounting conservatism is an empirical question. To address this question, we use a sample of US listed firms. Our sample is at the cross-section of Compustat, CRSP and Execucomp and consists of 11,913 firm-year observations for the period 2003-2020. We follow the procedure in Khan and Watts (2009) to calculate our measure of conditional conservative accounting[4] and the procedure in Donangelo (2014) to calculate our measure of labor mobility. Further, in our empirical

[4] In robustness tests we use alternative research designs to measure conditional accounting conservatism and find consistent results.

analysis, we follow Hui et al. (2012) and control for variables which prior literature has shown to be associated with conservative accounting.

We find that low labor mobility is related to more conditional conservative accounting. Specifically, we find that one standard deviation reduction in labor mobility is related to a 4.1% increase in conditional conservative accounting. In cross-sectional tests, we find that the relation between labor mobility and conservative accounting is stronger when the firm is in poor financial condition and weaker when the firm operates in a weak competitive environment.

To ensure that our measure of labor mobility is not capturing other industry-specific characteristics, we exploit the implementation of the inevitable disclosure doctrine (IDD) as a quasi-natural experiment. The IDD is a legal doctrine adopted by state courts that offer firms legal protection from the potential disclosure of trade secrets by employees. Specifically, state courts can prevent employees from accepting a job offer at another firm or limit the scope of the job offer if the new employment would inevitably lead to disclosure of trade secrets (Gao et al., 2018). The implementation of IDD represents a plausibly exogenous shock to labor mobility, since it limits the possibility of employees potentially accepting job offers (Seamen, 2015). Using a difference-in-differences research design we compare changes in conservatism between firms located in states in which the IDD was implemented and firms located in states where IDD was not effective. In line with our expectations, we find that the implementation of IDD, hence the reduction of labor mobility, resulted in firms increasing their conservative accounting to a larger extent relative to firms located in states which did not implement IDD.

Finally, to link conditional conservative accounting to firm labor turnover, we conduct a changes analysis where we examine the association between changes in firm conditional conservative accounting and its labor turnover. In line with our reasoning, we find a negative association between conditional conservative accounting and labor turnover. This result suggests that an increase in

conditional conservative accounting is associated with a reduction in employee turnover.

This study contributes to multiple streams of literature. First, it contributes to the literature examining how firm interactions with its stakeholders shape their financial reporting choices. Specifically, we show how a characteristic of rank-and-file employees, labor mobility, influences conservative accounting. Prior literature (e.g., Liberty and Zimmerman, 1986; DeAngelo and DeAngelo, 1991; Leung et al., 2009; Bova et al., 2015) has largely focused on how employee unionization impact firm accounting policies, and only a few studies have examined how other employee characteristics influence firm decisions. Gao et al. (2018) examine how labor turnover likelihood influences upward earnings management, while Chen et al. (2024) examines how employee skill influences accounting conservatism. Two closely related studies are Liu et al. (2021) that finds that unemployment insurance is related to accounting conservatism and Lin et al (2021) that finds a positive relation between employee board representation and accounting conservatism. We extend this literature by examining how labor mobility, a characteristic distinct from employee turnover likelihood or employee skill, influences accounting conservatism. As previously discussed, while employee characteristics are inherently related, they are not mutually exclusive and inferences from examining one employee characteristic do not automatically extend to other characteristics. In this ambit, we contribute to the literature on conservative accounting by identifying another determinant of conservative accounting (Zhong, 2017).

Second, we contribute to the nascent literature on labor mobility and the effects of labor mobility on firm decision-making. Donangelo (2014) shows that labor mobility is a form of labor-induced operating leverage which increases firm exposure to systematic risk. This increased risk gives rise to an increase in returns required by shareholders. Further Sanati (2018) and Bai et al. (2024) find that labor mobility is related to firm investment and leverage decisions. Recent literature has also established a relation between firms' reporting characteristics and employee decision making.

Specifically, deHaan et al. (2022) present evidence that job search by current employees increases during earnings announcements and employees update their expectations of the employers' prospects consistent with learning from earnings announcements. In this study, we find that labor mobility not only affects how the firm operates and the consequent risk it faces but also influences its accounting choices. Specifically, we show that firms operating in industries with low labor mobility disclose bad news earlier than good news.

## 2. Literature review

### 2.1 Labor mobility

Labor mobility is a characteristic of the labor market that captures the ease with which employees can enter and exit the industry to find better job opportunities. The flexibility with which employees can find alternative employment is determined by the demand for their occupation across industries. Occupations demanded by a specific industry are determined by the productive technology common to firms in that industry (Neal, 1995; Parent, 2000; Kambourov and Manovskii, 2009). For example, firms in the health care industry have a less mobile workforce than firms in the wholesale trade industry, since the former employs occupations (e.g., doctors, health technicians, etc.) that require greater industry-specific knowledge[5] that are not demanded in other industries, while the latter industry employs occupations (e.g., salespersons, operations managers etc.) with more general skills. Further, prior literature (e.g., Balasubramanian et al., 2019; Marx et al., 2009; Johnson et al. 2024) found that higher noncompete agreement enforceability diminishes worker mobility and such effects are conditional on firm size, location choice, employment growth and business concentration (Kang and Fleming, 2020).

[5] Employees can also switch occupations; however, they will lose significantly more of their human capital compared to finding employment in the same occupation in a different industry (Kambourov and Manovskii, 2009).

Davis and Haltiwanger (2001) document that the ease with which employees can enter or exit an industry represents a significant risk for companies that effects shareholder required returns. However, research in this area is limited due to the difficulty in measuring labor mobility across diverse industries. Donangelo (2014) develops a measure of labor mobility using data on the distribution of workers across occupations and the dispersion of such occupations across industries. He shows that firms in highly mobile labor industries are exposed to higher systematic risk and concludes that labor mobility can be regarded as a labor-induced form of operating leverage that amplifies the risk and required return of a company. Using the Donangelo (2014) measure of labor mobility, Ghaly et al. (2017) show that firms operating in industries with lower labor mobility have lower cash holdings and Jeffers (2024) shows that firms in low labor mobility industries invest less. Further, Hass et al. (2020) show that labor mobility can curb managerial myopia.

## 2.2 Labor and financial reporting choices

Companies do not own the most important input to their production process: labor. In this regard, the provision of labor by employees is analogous to a supplier contract where willing individuals (employees) enter into a legally binding contract with a firm (employer) whereby they agree to provide their service in exchange for compensation.[6] Hui et al. (2012) finds that similar to creditors, suppliers prefer that firms report conservatively since they could incur significant costs if the firm goes out of business but gain little if the firm performs above expected levels.

Like suppliers, employees are concerned with the risk assumed when they provide their service to the firm, hence like suppliers they prefer conservative accounting (Lin et al., 2021). Risks assumed by employees determine the compensation demanded by employees in exchange for their

[6] Employment contracts typically give the firm limited control over employees. Notwithstanding this, the decision to join or leave the firm rests solely with the employees.

service. To the extent that low labor mobility increases unemployment risk, employees with low labor mobility demand more conservative accounting. Accounting research on whether and how financial reporting choices are influenced by the implicit claims of rank-and-file employees is limited.

The stream of research relating to union negotiations generally suggests that in the presence of unionized labor, managers make income-decreasing decisions to improve the bargaining position of the firm in labor contract negotiations. Specifically, in the presence of unionized labor, managers are less forthcoming about the future prospects of the firm (Kleiner and Bouillon, 1988, Leap, 1991, Hilary, 2006); invest less in R&D (Connolly et al., 1986); hold less cash (Klasa et al., 2009); manage earnings downwards (DeAngelo and DeAngelo, 1991, Mora and Sabater, 2008); are less tax aggressive (Chyz et al., 2013) and are more likely to miss analysts' forecasts (Bova, 2013).

A study closely related to ours is Leung et al. (2009) that examines the influence of unionization on firm's conditional conservative accounting practices. They find that conditional conservative accounting increases with higher union coverage. Employees demand conditional conservatism for at least three reasons (Leung et al., 2009). First, employees have an asymmetric payoff function with respect to the firm's net assets. When at maturity of wage payment, the net assets of the firm exceed wages payable, employees (most of whom typically receive fixed wages) do not receive any additional compensation irrespective of the degree to which firm net assets exceed wages payable. Conversely, if at maturity of wage payment, the net assets of the firm are lower than the wage bill, the limited liability feature of the firm causes employees to receive lower wages than those contracted. In this respect, employees are concerned with lower earnings and hence require assurances that earnings generated by the firm exceed wages payable. Second, employees use accounting information to evaluate their present and future compensation, including deferred compensation like defined benefit plans. In this respect, employees may accept lower present compensation in lieu of higher future compensation. Since accounting earnings provide information about economic rents

(Liberty and Zimmerman, 1986), rank-and-file employees demand conservatism in accounting earnings to reduce the possibility that management overstates earnings to extract economic rents, typically in the form of management compensation, they are not entitled to. Third, like shareholders, rank-and-file employees are important residual claimants (Black, 1999). They benefit when the firm prospers (e.g., through bonuses or greater potential for promotion) and lose when the firm suffers. Conservatism allows rank-and-file employees to identify management underperformance (e.g., by taking negative NPV projects) in a timely manner, hence enabling employees to take timely protective action to safeguard their interests (e.g., quitting job and looking for a new job).

On the other hand, there are at least two reasons why management might prepare more conservative accounting. First, the asymmetric timely recognition of gains versus loses understates firm net assets thus reducing labor union rent seeking behavior. This should enable management to gain bargaining advantages in union negotiations (Mautz and Richardson, 1992). Second, given that litigation risk is higher when the firm overstates performance, managers and auditors have an incentive to report conservative net asset values to reduce litigation costs.

Another stream of literature dealing with the influence of rank-and-file employees on firm reporting choices deals with firm incentives to manage earnings to reduce labor costs. Prior literature suggests that firms manage their financial statements to gain bargaining advantage with various stakeholders including employees (Bowen et al., 1995; Burgstahler and Dichev, 1997; Matsumato, 2002; Cheng and Warfield, 2005). Dou et al. (2016) uses changes in unemployment insurance provisions of U.S. states in which the firm is headquartered as an exogenous shock to test whether an increase in unemployment insurance reduces the incentive for firms to manage earnings. They find that firms partially unwind prior earnings management when there is an increase in state unemployment insurance consistent with the notion that firms manage employee perceptions of unemployment risk. In a similar vein Liu et al. (2021) use changes in unemployment insurance

provision of U.S. states to examine the relation between unemployment risk and conditional conservative accounting. The authors find a positive relation between increases in unemployment insurance (decrease in unemployment risk) and conservative accounting. Similarly, Gao et al. (2018) finds employee retention drives the positive relation between employee turnover likelihood and upward earnings management. Importantly firms reduce such earnings management when the likelihood of employee turnover decreases.

## 3. Hypothesis development

We conjecture that labor mobility impact firm conditional conservative accounting in two ways. On one hand we posit that low labor mobility increases firm conservative accounting. Coase (1937) transaction cost theory suggests that self-interested contracting parties behave opportunistically under uncertainty and information asymmetry. Further, as transactions become more complex it is more difficult to ex-ante write complete contracts to deter opportunistic behavior. Williamson (1979) argues that opportunism is central to transaction cost theory and is especially pertinent in transaction specific investments involving human and physical capital. Transaction cost theory suggests that it is very difficult to write long-term contracts which cover all contingencies specified in long-term agreements. Further, transaction cost theory suggests that parties involved in long-term contracting will behave opportunistically by creating assets that have appropriable 'quasi-rents' (Klein et al., 1978; Klein, 2000). In this context, accounting provides labor with a timely signal as to the likelihood that the firm will honor long-term implicit claims (Bowen et al., 1995; Burgstahler and Dichev, 1997).

We argue that the increased timeliness with which conditional conservative financial reporting signal potential future costs (e.g., arising from potential lay-offs, decreased compensation etc.) leads

to employee demand for the firm to prepare financial statements exhibiting conservative reporting.[7] In this respect prior literature (e.g., Lin et al., 2021) shows that employees prefer conservative accounting. Low labor mobility amplifies employee demand for firm reporting conservatism because for these employees the asymmetric payoff from firm economic performance is even greater. Further, employees tend to possess firm specific capital, which makes employee turnover particularly costly for the firm since this would destroy firm-specific knowledge. Hence, it is in the interest of the firm to heed the demands of employees by providing conservative reporting. Based on this argumentation we expect a negative relation between labor mobility and accounting conservatism.

However, conservative accounting comes at the expense of increased debt covenant violations and losses (Givoly and Hayn 2000; Klein and Marquardt 2006; Zhang 2008), the threat of which might lead to suboptimal business decisions (Beneish and Press 1993; Falato and Liang 2016). Further, prior literature has shown that conservative accounting is related to lower corporate innovation, potentially negatively affecting firm prospects (Laux and Ray 2020). Further, Bandyopadhyay et al. (2010) and Chen et al. (2014) show that accounting conservatism reduces earnings persistence and the ability of current earnings to predict future earnings, hence potentially reducing the usefulness of current earnings to financial statement users. Finally, Liu et al. (2021) suggest that firms mitigate employee turnover costs by reducing conditional accounting conservatism to manage employee perceptions of unemployment risk. Specifically, using changes in unemployment insurance benefits as an exogenous shock to unemployment risk, Liu et al. (2021) finds a positive relation between unemployment insurance benefits and conditional conservative accounting. In explaining their results, Liu et al. (2021) suggest firms use conditional conservative

[7] While other financial reporting characteristics (e.g. transparency or reliability) are important in providing financial information that is useful for employee decision-making, the asymmetric timeliness in the recognition of gains vs. losses resulting from conditional conservative financial reporting enables timely signaling of future costs to employee. This timely signaling allows employees to take appropriate corrective actions to mitigate potential future costs.

accounting to manage employees' perception of unemployment risks such that firms apply lower conditional conservative accounting to give the impression of lower unemployment risks. To the extent that employee perception of high unemployment risk is costly to firms, firms will apply lower conditional conservative accounting. These perceptions are particularly pertinent in a low labor mobility environment, where the costs of losing and replacing employees are likely substantial (Dou et al., 2016). Based on this argumentation we expect a positive relation between labor mobility and accounting conservatism.

The argumentation above provides different reasons for why firms might increase or decrease conditional accounting conservatism when faced with changes in labor mobility. As *ex-ante* it is unclear whether the benefits of conditional conservative accounting outweigh its costs when employees face changes in employee mobility, we present our hypothesis in the null form:

> *H1: There is no relation between labor mobility and firm conditional accounting conservatism.*

## 4. Research design

### 4.1 Measuring conditional accounting conservatism

Given the importance of accounting conservatism as a qualitative characteristic of financial reporting, it has been subject to numerous academic research (e.g., Ball et al., 2000; Givoly and Hayn, 2000; Holthausen and Watts, 2001; Mak et al., 2011; Lawrence et al., 2013, 2018; Breuer and Windisch, 2019). Watts (2003) provides a summary of some of the measures of accounting conservatism, with the Basu (1997) flow measure of accounting conservatism being most popular (Ryan, 2006). The Basu (1997) measure of accounting conservatism is typically either estimated cross-sectionally for an industry-year or over a time-series for multiple firm-years. Both approaches have limitations. The cross-sectional approach assumes that firms within an industry are homogenous

and that thus, all firms within that industry exhibit the same degree of accounting conservatism (e.g., Patatoukas and Thomas, 2011; Ball et al., 2013a; Collins et al., 2014), while the time-series approach assumes that firm specific accounting conservatism is invariant over time (Ball et al., 2013b; Patatoukas and Thomas 2016; Banker et al., 2016; Banker et al., 2017).

Because of these limitations, we use the firm-year measure of conservative accounting (*C-Score)* proposed by Khan and Watts (2009) in our main analysis.[8] The *C-Score* is based on the Basu (1997) cross-sectional measure of conservative accounting. Eq.1 below shows the regression model used to compute the Basu (1997) measure of conservative accounting.

$$X_i = \beta_1 + \beta_2 D_i + \beta_3 R_i + \beta_4 D_i R_i + \varepsilon_i \quad \text{(Eq.1)}$$

*X* and *R* refer to the earnings and returns of firm *i,* while *D* is an indicator variable, which takes the value of one when firm returns are negative. $\beta_3$ captures the timeliness of good news while $\beta_4$ captures the incremental timeliness of bad news relative to good news. Khan and Watts (2009) express timeliness as a linear function of size, market-to-book and leverage. Eq.2 shows the annual cross-sectional regression model when the timeliness coefficients (i.e., $\beta_3$ and $\beta_4$) in Eq.1 are expressed as linear functions of firm-specific characteristics: size (*Size);* market-to-book (*MTB)* and financial leverage (*Leverage).*

$$X_i = \beta_1 + \beta_2 D_i + R_i(\mu_1 + \mu_2 Size_i + \mu_3 MTB_i + \mu_4 Leverage_i) + D_i R_i(\lambda_1 + \lambda_2 Size_i + \lambda_3 MTB_i + \lambda_4 Leverage_i) + (\delta_1 Size_i + \delta_2 MTB_i + \delta_3 Leverage_i + \delta_4 D_i Size_i + \delta_5 D_i MTB_i + \delta_6 D_i Leverage_i) + \varepsilon_i \quad \text{(Eq.2)}$$

Like Khan and Watts (2009) we run Eq.2 as annual cross-sectional Fama-Macbeth pooled regressions for each year in the sample period. This approach allows the coefficients in Eq.2 to vary annually.

[8] An extensive literature discusses the properties of alternative approaches to measure conditional conservatism. We find robust results when using alternative approaches (e.g., Ball et al., 2013b) as well as additional controls (e.g., Banker et al., 2016; Banker et al., 2017).

We use the coefficients from the triple interactions in Eq. 2, which capture the relation between the incremental timeliness of bad news relative to good news and firm-specific characteristics to compute our measure of conservative accounting *C-Score.* Eq. 3 shows the equation used to calculate *C-Score*, a measure which increases in conservative accounting, and which varies with cross-sectional variation in firm-specific characteristics and with time-series variation in both $\lambda_1$and firm-specific characteristics.

$$C - Score_i = \lambda_1 + \lambda_2 Size_i + \lambda_3 MTB_i + \lambda_4 Leverage_i \quad \text{(Eq.3)}$$

4.2 Measuring labor mobility

We construct our measure of labor mobility following the literature on labor economics. The mobility of an employee is determined by the demand for the skills of the employee. Employees with occupations that are employed in many industries have comparatively high mobility as they can easily find new employment. Employees with occupations that are employed by only a few industries will face more difficulties in finding new employment in another industry because they can only work in few industries. We therefore calculate our measure of labor mobility in two steps. First, for each occupation we calculate how concentrated employment of that occupation is across industries. Second, for each industry we calculate the average mobility of its workforce weighted by its salary. For both steps, occupation is defined using the Standard Occupation Classification System (SOC) and data on employment in industries is derived from the Bureau of Labor Statistics.[9] More specifically, we follow the approach by Donangelo (2014) and calculate *Mobility* as follows:

[9] We combine occupations that do not require significant skills in one combined occupation class, as our measure of labor mobility won't apply for those occupations. We follow Donangelo (2014) and classify occupations as not requiring significant skills if they have a specific vocational preparation level (SVP) of less or equal than four as classified by the Department of Labor in the Handbook of Occupational Titles.

$$CONC_{j,t} = \left(\frac{emp_{i,j,t}}{\sum_i emp_{i,j,t}}\right)^2 \quad \text{(Eq.4)}$$

$$Mobility_{i,t} = \left(\sum_j CONC_{j,t} \times \frac{emp_{i,j.t}\, x\, wage_{i,j,t}}{\sum_j emp_{i,j,t} wage_{ij,t}}\right), \quad \text{(Eq.5)}$$

where $emp_{i,j,t}$ is the number of workers assigned to occupation *j* (at the five-digit SOC code level) in industry *i* (four-digit NAICS code level) at time *t* and $wage_{i,j,t}$ is the median annual wage for workers in industry *i* assigned to occupation *j* at time *t*. To facilitate interpretation, unlike Donangelo (2014) we do not take the inverse of *Mobility,* hence in our empirical analysis higher (lower) values of *Mobility* correspond to lower (high) labor mobility. Occupations with very low mobility include funeral attendants (SOC 394020), semiconductor processors (SOC 519140) and elevator installer and repairers (SOC 474020); while occupations with very high mobility include general and operations managers (SOC 111020), first-line supervisors of production and operating workers (SOC 511010) and bookkeeping, accounting and auditing clerks (SOC 433030).[10] Finally, we standardize our measure by subtracting the mean and dividing it by its standard deviation on an annual basis at the industry level. We do so because we cannot compare different values of labor mobility across time, and hence our identification relies on cross-sectional variation across industries.

4.3 Empirical design

We follow Hui et al. (2012) and test our predictions using the following OLS regression model:

$$C\_Score_{it} = \alpha_{it} + \beta_1 Mobility_{jt} + \beta_2 High\ Skill_{it} + \beta_3 Labor\ Turnover_{it} + \beta_4 Size_{it} + \beta_5 MTB_{it} + \beta_6 Leverage_{it} + \beta_7 Litigation\ Risk_{it} + \beta_8 Cash\ Flow_{it} + \beta_9 CFOStd_{it} + \beta_{10} Unionization_{jt} +$$

[10] Note that labor mobility is not related to labor skill. For example, pilots are highly skilled however they have low mobility as they mainly work in two industries (scheduled air transportation and nonscheduled air transportation). This example also highlights that interacting labor mobility with labor skill can be misleading as the two measures might be driven by different occupations in an industry. Indeed, using the measure of labor skill of Belo et al. (2017) we find that the Pearson correlation between labor mobility and labor skill is -0.03.

$$\beta_{11} Auditor\ Specialization_{it} + \beta_{12} SelfHHI_{jt} + \beta_{13} Spread_{it} + \beta_{14} Payout_{it} + \beta_{15} Default\ Risk_{it} + \beta_{16} Vega_{it} + \gamma_t + \varepsilon_{it},$$

(Eq. 6)

where *C-Score*$_{it}$ is the Khan and Watts (2009) measure of conservative accounting for firm *i* in year *t* and *Mobility* is labor mobility in industry *j* in year *t*. First, we control for labor skill and labor turnover, two constructs which are related but distinct from labor mobility, to ensure that these employee characteristics do not confound the relation between labor mobility and conditional conservative accounting. Following Donangelo (2014), we define *High Skill* as the fraction of workers in occupations with Specific Vocational Preparation (SVP) above six while we follow Phua et al. (2018) to calculate *Labor Turnover* as the ratio of cancelled stock options to total non-executive stock-options at the beginning of the year.

Second, we follow Hui et al. (2012) and control for factors which prior literature has shown to be associated with conservative accounting. We control for the size, *Size,* of the firm since prior literature has shown that larger firms report less conservatively (Giner and Rees, 2001; LaFond and Watts, 2008; LaFond and Roychowdhury, 2008). We include in our model *MTB,* the market-to-book ratio since firms with high growth opportunities likely face higher contracting costs (Watts, 2003), hence report more conservatively. *Leverage* refers to financial leverage and controls for debtholders demand for conservative accounting, which is likely to be stronger when the firm has high financial leverage (Hui et al., 2012). We control for litigation risk, *Litigation Risk,* since Beaver (1993), Watts (1993, 2003) and Basu (1997) suggest that the propensity of being involved in litigation is positively related to conservative accounting. We control for cash flow from operations, *Cash Flow,* since firms with low cash flows find conservative accounting practices more costly than other firms, hence we expect cash flow to be positively associated with conservative accounting (Hui et al., 2012). To control for the demand for conservative accounting from debt holders arising from the shareholder-bondholders conflict, we include *CFOStd,* the standard deviation of cash flows over the preceding six

years, and *Payout*, the amount of common dividends and stock repurchases scaled by book assets. Companies with high cash flow volatility and high payout ratios likely face greater shareholder-bondholder conflict, hence greater demand by bondholders for conservative accounting (Basu, 1995; Givoly and Hayn, 2000; Watts, 1993; Ahmed et al., 2002). While we expect a positive coefficient on both *CFOStd* and *Payout*, the coefficient on *Payout* might also be negative, since firms with high dividends typically have high cash flows and low growth opportunities (Ahmed et al., 2002). Prior literature shows that firms report more conservatively in the presence of high unionization (Liberty and Zimmerman, 1986; Leung et al., 2009) and auditor bargaining power to lower their costs (Basu et al., 2001; Krishnan, 2005). Hence, in our model we control for union and audit bargaining power by including *Unionization,* the proportion of workers in the firms' industry, which are members of a union, and *Auditor Specialization,* measuring the industry market share of the auditor.

Further, we control for the firms' competitive environment using the Herfindahl-Hirschman index (*SelfHHI)* which captures product market competition in the firms' industry. *Spread* is the average daily bid-ask spread of stock price over a year for the firm and it is used to proxy for information asymmetry between the shareholders and the management of the firm. Greater information asymmetry leads to a greater demand by shareholders for conservative accounting (LaFond and Watts, 2008), hence we expect a positive coefficient on this variable. *Default Risk* is the Altman Z-index and controls for the potential relation between bankruptcy risk and conservative accounting. We include *Vega* to control for the sensitivity of CEO compensation to the reported performance of the firm. Specifically, we expect that as the sensitivity of CEO compensation to the performance of the firm increases, CEOs will have a stronger incentive to hide bad news, which will lead to lower conservative accounting. Hence, we expect a negative coefficient on *Vega.* Finally, we include year fixed effects, $\gamma_t$, to control for changes in legal scrutiny of a firm financial reporting

over time (Basu, 1997). All our empirical analysis is run with standard errors clustered at the firm level.[11]

4.4 Sample selection

We collect information on firm fundamentals from Compustat, stock price information from CRSP and executive compensation data from Execucomp. Information on unionization across industries is obtained from the Union Membership and Coverage Database of the CPS (see Hirsch and Macpherson, 2003 for details). Variable definitions are provided in Appendix 1. We create our labor mobility measures using data of the Occupational Employment Survey (OES) from the Bureau of Labor Statistics (BLS) and the Current Population Survey (CPS) of the Census Bureau. The Occupational Employment Statistics (OES) program administered by the Bureau of Labor Statistics conducts surveys that track employment across occupations and industries in around 200,000 establishments every six months over three-year cycles. Each industry was surveyed annually after 1997, and the survey represents approximately 57% of employees in the U.S. The dataset defines occupations using the Standard Occupational Classification (SOC) with 444 broad occupations. To match different occupational codes, we use the crosswalk provided by the National Crosswalk Service Centre. Industries in the dataset are defined using the four-digit North American Industry Classification System (NAICS). Like Donangelo (2014) we drop industries denoted as "Miscellaneous" (NAICS xxx9) since firms in these industries are unlikely to share a common workforce. Wage data are derived from the OES/BLS datasets. Census Current Population Survey (CPS) is obtained from the Integrated Public Use Microdata Series of the Minnesota Population Center and BLS Annual Employer Costs for Employee Compensation (ECEC) (King et al., 2010).

[11] Results are robust to clustering standard errors at the industry level.

Wage data by occupation from CPS is merged with OES data. Where this is not possible, like Donangelo (2014) we use the average wage of a broad occupational group from ECEC.

Our final sample consists of 11,913 firm-year observations for years 2003-2020.[12] In Table 1, we show the summary statistics for the variables used in the main analysis. The descriptive statistics shown in Panel A of Table 1 are generally in line with prior literature. For example, Khan and Watts (2009) report that the mean and standard deviation of *C-Score* are 0.105 and 0.139 respectively. Our *C-Score* has a mean of 0.10 and a standard deviation of 0.16. Further, like Khan and Watts (2009) the first quartile of *C-Score* is positive suggesting that conservative accounting is a widespread feature of financial reporting. In Panel B of Table 1 we report the Pearson correlation matrix for the variables used in our main analysis. Results suggest that our measure of conservative accounting, *C-Score,* is negatively correlated with *High Skill, Size, MTB, Cash Flow, Auditor Spec., Payout, Default Risk* and *Vega* while positively correlated with *Mobility, Labor Turnover, Leverage, CFOStd, SelfHHI* and *Spread*. Care should be taken in interpreting these results since the Pearson correlation only tests for the linear relation between two variables (i.e., it is a bivariate test), without controlling for other variables that might influence these relations. Notwithstanding this, a correlation matrix is potentially useful in signaling potential multicollinearity between the independent variables. The size of the correlation coefficients suggest that multicollinearity is unlikely in our setting. Further, the results for a Variance Inflation Factor (VIF) test shown at the top of Panel B of Table 1 suggest that it is unlikely that multicollinearity influences our empirical analysis.

[Insert Table 1 about here]

[12] The sample starts in 2003 as this the first year when option data becomes available on Compustat.

We further show labor mobility across industries in Table 2. In Panel A we show the industries that have the highest and lowest labor mobility. Panel B shows average labor mobility across industries at the one-digit SIC code level. As shown in Table 2, labor mobility varies significantly across industries.

[Insert Table 2 about here]

## 5. Empirical results

### 5.1 Labor mobility and conservative accounting

We present our main findings on the effect of labor mobility on conservative accounting in Table 3. We find a positive and significant coefficient on *Mobility* [Coeff: 0.006] implying that firms with a less mobile workforce exhibit more conservative accounting. This result is significant at the 1% level and provides support for the argument that low labor mobility increases the demand for conservative accounting. The economic significance of these results suggests that a one standard deviation increase in our measure of labor mobility, *Mobility,* is associated with a 4.1% increase in conservative accounting, as captured by *C-Score,* for the average firm in our sample.[13]

The results on the other control variables are generally in line with the results in Hui et al. (2012). Like Leung et al. (2009), we find that greater industry unionization (*Unionization)* is associated with greater conservative accounting. The positive and significant coefficient on *Spread* suggests that firms exposed to greater information asymmetry as captured by the bid-ask spread report more conservatively. Finally, in line with our expectations we find that firms operating in industries

[13] Economic significance is calculating by multiplying the coefficient on *Mobility* in Table 3 (0.006) by the standard deviation of *Mobility* as in Panel A Table 1 (0.69) and dividing by mean *C-Score* as in Panel A Table 1 (0.1).

that are more concentrated (*SelfHHI*) and firms with a CEO compensation structure, which is more sensitive to changes in share prices (*Vega*), report less conservatively.

[Insert Table 3 about here]

5.2 Labor mobility, conservative accounting and firm financial condition

The relation between labor mobility and conservative accounting is a function of the financial condition of the firm. Prior literature has shown that employees are able to accurately observe the financial condition of their firm. Brown and Matsa (2016) find that job seekers' perception is positively correlated to the true financial condition of the firm while Dyck et al. (2010) and Stubben and Welch (2020) conclude that employees have relevant information about their employer as a byproduct of their work. Employees with low labor mobility demand greater conservative accounting from their employer if their employer is in a poor financial condition since these employees have greater unemployment risk. The asymmetric recognition of losses versus gains provides these employees with more timely information about the firm, which allows them to better price their risk exposure.

Hui et al., (2012) suggests that conservative accounting is more costly for firms with low reported cash flows and hence, suggests that firms in poor financial condition are less likely to report conservatively. However, not heeding employee demand for conservative accounting is also costly for the firm. Specifically, Dou et al. (2016) suggests that firms bear two costs from exposing employees to unemployment risk. First, firms must compensate employees for unemployment risk through wages, benefits and better working conditions (Smith, 1976; Abowd and Ashenfelter, 1981; Topel, 1984; Li, 1986; Hamermesh and Wolfe, 1990). Second, firms exposing their employees to greater unemployment risk bear greater recruitment and search costs as potential employees shy away from the firm in the presence of greater unemployment risk (Brown and Matsa, 2016).

The above discussion suggests that the relation between labor mobility and conservative accounting is stronger when the firm is in poor financial condition. We proxy for the financial position of the firm using two alternative measures. First, we use the firm's cash holdings scaled by total assets as low cash holdings make it more likely that the firm encounters financial difficulties. Second, we use the financial constraints index developed by Kaplan and Zingales (1997) to proxy for external capital demand. We define an indicator variable *Cash Holdings* which takes the value of one when the cash holdings of the firm are below the sample median, and zero otherwise. Similarly, we define an indicator variable *Financial Constraints* which takes the value of one when the financial constraints index of the firm is above the sample median, and zero otherwise. An indicator value of one represents firms that face relatively high financial constraints.

We present the results for this analysis in Table 4. In the first column of the table, we present the results when we interact *Cash Holdings* with *Mobility* while in the second column of the table, we present the results when we interact *Financial Constraints* with *Mobility.* In both specifications, we find that the coefficient on *Mobility* is positive and significant suggesting that the previously observed positive relation between labor mobility and conservative accounting is robust to controlling for financial position. Further, we find that the interaction between *Mobility* and our measures for poor financial position is positive and significant. This result suggests that the relation between labor mobility and conservative accounting is stronger for firms in a poor financial position.

[Insert Table 4 about here]

5.3 Labor mobility, conservative accounting, and operating environment

The competitive environment in which the firm operates likely has an influence on the relation between labor mobility and conservative accounting. Specifically, a firm which operates in a low competitive environment has less demand for conservative accounting, since unemployment risk is

lower. Moreover, firms operating in a low competitive environment are also less likely to supply conservative accounting. For example, Dhaliwal et al., (2009) suggests that firms operating in less competitive industries are more likely to hide bad news and hence report less conservatively, while Basu (2005) and Qiang (2007) suggest that firms operating in a low competitive environment have greater unconditional conservatism to reduce their regulatory and political costs. Given the negative relation between conditional and unconditional conservatism, firms operating in less concentrated industries are less likely to have conditional conservatism.

We use three different measures to capture the operating environment of the firm. Our first measure is *Product Market Competition* that captures the firm's industry concentration and takes on the value of one if the firm operates in a 3-digit SIC code industry with below sample median concentration, and zero otherwise. We measure concentration using the Herfindahl-Hirschman-Index of firm sales. However, even firms operating in the same industry will be in different product market positions. We therefore also consider the relative position of the firm relative to its competitors. We define an indicator variable *Product Market Power* that takes the value of one if the firm has above sample median product market power, and zero otherwise. We measure product market power following Peress (2010) as the price-cost-margin. Firms with high (low) price-cost margin are considered to have high (low) product market power. Firms with high product market power have a dominant market position and hence are less likely to face financial distress. The low likelihood of financial distress reduces unemployment risk, which should reduce labor demand for conservative accounting. Finally, unemployment risk is likely lower for firms operating in industries exhibiting high growth. Thus, we expect labor demand for conservative accounting to be weaker for firms operating in high growth industries. We define an indicator variable *Industry Growth* that takes on the value of one if the average industry growth at the 3-digit SIC industry code level is above the sample median, and zero otherwise.

We present the results for this analysis in Table 5. The results for the regression analysis when competitive environment is captured by *Product Market Competition, Product Market Power* and *Industry Growth* are presented in columns 1, 2 and 3 respectively. In line with our expectations, we find that in the three specifications, the coefficient on *Mobility* is positive and significant, suggesting that the positive relation between *Mobility* and conservative accounting is robust to controlling for the competitive environment. Moreover, we find that in an environment with weak competition the effect of labor mobility on conservative accounting is weaker. Specifically, for the three specifications, the coefficients on the interaction terms are negative and significant.

[Insert Table 5 about here]

5.4 Inevitable Disclosure Doctrine (IDD)

The mobility of workers can bear significant costs on firms because workers can potentially take proprietary knowledge with them to their new employers. This would give the new employer an unfair advantage and might disincentivize firms from innovation due to the fear of losing this information to competitors. To reduce this threat several states have adopted the Inevitable Disclosure Doctrine (IDD) which prevents the worker from moving to a different employer if there is the risk of proprietary knowledge loss (Dey and White, 2021). Hence, these laws, which are likely quasi-exogeneous, significantly reduce the mobility of workers.

We estimate a difference-in-difference model, where we compare changes in conservative accounting between firms located in states which experience the adoption of the IDD and firms located in states which do not adopt the IDD.[14] We estimate the following difference-in-difference model using OLS:

[14] Following previous research, we use information from SEC Filings (and Compustat before 1996) on the location of a firm headquarters to proxy for a firm's location.

$$C - Score_{i,t} = \beta_0 + \beta_1 Treatment * Post_i + \sum \beta_j Control_{j,i,t} + \gamma_t + \vartheta_i + \varepsilon_{i,t}, \quad \text{Eq. (7)}$$

where *Treatment*Post* is an indicator variable that takes the value of one for firms located in states which adopted the IDD for the period after the adoption and zero otherwise. *Control* refers to the vector of control variables used in Eq. (6)[15] and add state level unemployment rate and state level GDP growth as additional controls. The latter two control variables are added to capture changes in state-level economic conditions. The inclusion of firm and year fixed effects in this specification subsume the main effects for *Treatment* and *Post* such that the coefficient on *Treatment*Post* captures the causal effect of the adoption of IDD on a firm's conservative accounting. To ensure that the heterogenous timing of the treatment effect does not bias our results, we run this test as a stacked regression like Cengiz et al. (2019).

Table 6 shows the results for this analysis. In line with our expectations, the coefficient on the *Treatment* is positive and significant at the 1% level. This result suggests that firms subject to the adoption of the IDD report more conservatively after the adoption of the IDD compared to firms not affected by the adoption. As the adoption of the IDD is related to a reduction in labor mobility, these results provide support for an association between labor mobility and conservative accounting.

[Insert Table 6 about here]

Further, since a difference-in-difference analysis as in Eq. (7) rests on the parallel trend assumption holding, where absent the treatment event, treatment and control firms have similarly changing conservative accounting, we undertake tests to ensure this assumption holds in our setting. Specifically, we plot average C-Score across treatment and control firms around the adoption of the IDD in Figure 1. As shown in Figure 1, up to the year prior the introduction of IDD, conservative

[15] We exclude *Labor Turnover* as this variable is only available after 2003 and most IDD events are before 2000.

accounting for both treatment and control firms trended similarly. In the year in which IDD was introduced and in subsequent years treatment firms experience a larger increase in conservative accounting relative to control firms, hence buttressing the notion that lower labor mobility from the implementation of IDD increased conservative accounting for treatment firms.

[Insert Figure 1 about here]

Finally, in line with our story that employees with low labor mobility demand firm conditional conservative accounting we should find a negative association between an increase in conditional conservative accounting and labor turnover. To test for this relation, we use Eq. (8):

$$LaborTurnover_{i,t} = \beta_0 + \beta_1 \Delta C - Score + \sum \beta_j Control_{j,i,t} + \gamma_t + \partial_j + \varepsilon_{i,t}, \qquad \text{Eq. (8)}$$

where the dependent variable is *Labor Turnover.* We follow Phua et al. (2018) and calculate the firm level measure of *Labor Turnover* as the ratio of the number of non-executive stock options that are cancelled, terminated, forfeited or expired to the number of non-executive stock options outstanding at the beginning of the year. The independent variable of interest is $\Delta C - Score$ which is the yearly change in the Khan and Watts (2009) conservative accounting score. We include year, $\gamma_t$ and industry, $\partial_j$, fixed effects in this specification.

We report the results for this analysis in Table 7. In line with our reasoning, we find a negative association between change in conditional conservative accounting and labor turnover. This relation suggests that an increase in conditional conservative accounting is associated with a reduction in labor turnover.

[Insert Table 7 about here]

5.5 Robustness

We subject our results to the following robustness tests: First, to ensure that our measure of labor mobility, *Mobility* is not capturing some other industry characteristic not related to labor mobility, we introduce industry fixed effects in our empirical model. The inclusion of industry fixed effects addresses the possible mechanical relation between variables calculated at the industry level. Second, to ensure that our results are not driven by the distribution of our independent variable of interest, *Mobility* we transform this variable into an indicator variable *MobilityD.* This variable takes the value of one when *Mobility* is above the sample median and zero otherwise. Finally, the accounting literature proposed alternative approaches to measure conservative accounting. We therefore follow LaFond and Roychowdhurry (2008) and repeat our main analysis using the Basu (1997) model.

We show the results for the robustness tests in Table 8. Panel A of Table 8 shows the results when we introduce industry fixed effects in our model. Like our main results we find that the coefficient on *Mobility* is positive and significant at the 5% level suggesting that *Mobility* is not capturing industry-specific characteristics other than labor mobility. In Panel B of Table 8 we show the results when we substitute our continuous measure of labor mobility with an indicator variable *MobilityD.* The results of this specification suggest that our baseline results are not driven by the distribution of our labor mobility variable. In Panel C we show the results when using the Basu (1997) model in capturing conservative accounting. Conservatism is captured by the coefficient on the interaction *Mobility # Return # D*. We find a positive and significant coefficient providing further evidence for the relation between labor mobility and conservative accounting.

[Insert Table 8 about here]

## 6. Conclusion

In this study, we examine whether labor mobility of rank-and-file employees influence firm conservative accounting. Labor mobility refers to the ease with which workers can enter or leave an industry. Conservative accounting is an important characteristic of financial reporting (Basu, 1997), which refers to the asymmetric verification thresholds of gains versus losses, where losses are recognized in a timelier manner than gains (Khan and Watts, 2009). Conservative accounting attempts to attenuate the agency problem arising from the information asymmetry between the management of the firm and other stakeholders (Ball, 2001). Using a sample of US listed firms, we find that low labor mobility is related to higher conservative accounting. In cross-sectional analysis, we find that this relation is stronger when the firm is in poor financial condition and weaker when the firm operates in a weaker competitive environment.

Inferences from this study contribute to the stream of literature examining how firm interactions with its stakeholders shape their financial reporting choices by showing that a labor characteristic, labor mobility, influences accounting conservatism. Further, the study contributes to the nascent literature on the consequences of labor mobility, by showing that labor mobility influences firm accounting choices. Moreover, inferences from this study are relevant to regulators in assessing the consequences of policies intended to stifle or encourage labor mobility. In this respect in examining the consequences of initiatives undertaken by institutions such as the United Nations, through its International Organization for Migration (IOM, 2024) and the International Labor Organization (ILO, 2015), the European Union (Barslund and Busse, 2016) and the U.S. Department of Labor (OECD, 2020) to encourage labor mobility, one should also consider the effect such policies have on firm accounting choices.

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## Appendix

Variable definitions

| Variable | Definition |
|---|---|
| **Dependent Variable** | |
| *C-Score* | Conservative accounting measure as defined in Khan and Watts (2009). |
| **Independent Variables** | |
| *Mobility* | Standardized measure of labor mobility calculated at the three-digit SIC/four-digit NAICS code level following Donangelo (2014). Lower (higher) values indicate higher (lower) labor mobility. |
| *High Skill* | Fraction of employees having an SVP of above 6. |
| *Labor Turnover* | Ratio of cancelled stock options to total non-executive stock-options following Phua et al. (2018). |
| *Size* | Natural log of market value of equity. |
| *MTB* | Market to book ratio. |
| *Leverage* | Long-term debt divided by total assets. |
| *Litigation Risk* | Litigation risk probability following Kim and Skinner (2012). |
| *Cash Flow* | Ratio of operating cash flow to total assets. |
| *CFOstd* | Standard deviation of *Cash Flow* over the prior six years. |
| *Unionization* | Percentage of unionized workers in a firm's three-digit CIC (census industry classification) industry. |
| *Auditor Specialization* | Industry market share of the auditor. |
| *SelfHHI* | Herfindahl-Hirschman index value of sales concentration the industry in which the firm operates, deflated by 1,000. |
| *Spread* | Average daily closing bid-ask spread during the year. |
| *Payout* | Common dividends. |
| *Default Risk* | Altman's Z-Score. |
| *Vega* | Sensitivity of CEOs option portfolio to stock volatility. |
| **Other Variables Used in Robustness/Further Analyses** | |
| *Labor Intensity* | An indicator variable that takes the value of one, if average labor intensity, calculated as the rate of employees to capital investment, for each two-digit SIC code industry-year is above the sample median and zero otherwise. |

| | |
|---|---|
| *Cash Holdings* | An indicator variable that takes the value of one, if the cash to total assets ratio is below the sample median and zero otherwise. |
| *Financial Constraints* | An indicator variable that takes the value of one, if the KZ-Index of financial constraints (Kaplan and Zingales, 1997) is above the sample median and zero otherwise. |
| *Product Market Competition* | An indicator variable that takes the value of one, if the Herfindahl-Hirschman index value of sales concentration of the industry in which the firm operates at the two-digit SIC code level is above the sample median and zero otherwise. |
| *Product Market Power* | An indicator variable that takes the value of one, if the price-cost-margin (Peress, 2010) is above the sample median and zero otherwise. |
| *Industry Growth* | An indicator variable that takes the value of one, if sales growth of the industry in which the firm operates at the two-digit SIC code level is above the sample median and zero otherwise. |
| *MobilityD* | An indicator variable that takes the value of one, if labor mobility of the industry in which the firm operates at the three-digit SIC code/four-digit NAICS code level is above the sample median and zero otherwise. |
| *Return* | Annual buy-and-hold stock return. |
| *D* | An indicator variable that takes the value of one if *Return* is negative and zero otherwise. |
| *NI* | Annual income before extraordinary items scaled by market value of equity. |
| *Unemployment Rate* | Annual state unemployment rate. |
| *GDP growth* | Annual state GDP growth. |
| *Quick Ratio* | Total Current Assets less Inventories scaled by Total Current Liabilities. |
| *SALESstd* | Standard deviation of sales over the last 6 years. |
| *Tangible Assets* | Total tangible assets scaled by Total Assets. |
| *Loss* | A dummy variable equal to 1 if net income before extraordinary items for the year is negative and 0 otherwise. |

**FIGURE 1**

**Inevitable Disclosure Doctrine (IDD)**

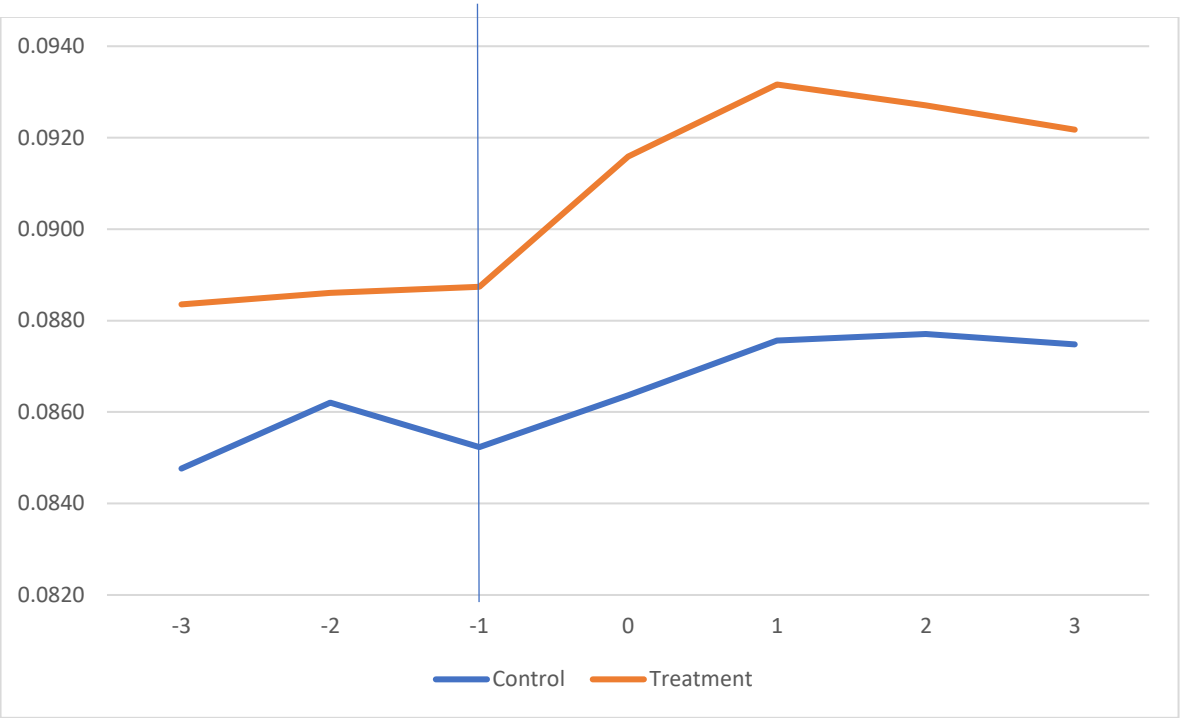


Figure 1: This figure shows conditional conservatism around the adoption of the Inevitable Disclosure Doctrine (IDD) in treatment and control firms.

**TABLE 1**

**SUMMARY STATISTICS**

Panel A: Descriptive statistics

| | N | Mean | Median | SD | P25 | P75 |
|---|---|---|---|---|---|---|
| C-Score | 11913 | 0.10 | 0.10 | 0.16 | 0.02 | 0.18 |
| Mobility | 11913 | 0.10 | 0.18 | 0.69 | -0.29 | 0.54 |
| High Skill | 11913 | 0.65 | 0.67 | 0.08 | 0.60 | 0.71 |
| Labor Turnover | 11913 | 0.09 | 0.04 | 0.15 | 0.01 | 0.10 |
| Size | 11913 | 7.53 | 7.45 | 1.46 | 6.53 | 8.52 |
| MTB | 11913 | 3.02 | 2.29 | 3.19 | 1.45 | 3.65 |
| Leverage | 11913 | 0.22 | 0.20 | 0.18 | 0.09 | 0.32 |
| Litigation Risk | 11913 | 0.35 | 0.00 | 0.48 | 0.00 | 1.00 |
| Cash Flow | 11913 | 0.10 | 0.10 | 0.08 | 0.06 | 0.14 |
| CFOStd | 11913 | 0.05 | 0.03 | 0.04 | 0.02 | 0.06 |
| Unionization | 11913 | 0.08 | 0.05 | 0.10 | 0.02 | 0.11 |
| Auditor Specialization | 11913 | 0.26 | 0.25 | 0.16 | 0.14 | 0.35 |
| SelfHHI | 11913 | 0.09 | 0.06 | 0.07 | 0.04 | 0.10 |
| Spread | 11913 | 0.02 | 0.01 | 0.03 | 0.00 | 0.02 |
| Payout | 11913 | 0.07 | 0.00 | 0.20 | 0.00 | 0.04 |
| Default Risk | 11913 | 21.97 | 4.79 | 52.81 | 2.75 | 9.83 |
| Vega | 11913 | 0.11 | 0.04 | 0.18 | 0.01 | 0.13 |

Panel B: Pearson correlation matrix

| | C-Score | Mobility | High Skill | Labor Turnover | Size | MTB | Leverage | Litigation Risk | Cash Flow | CFOStd | Union | Auditor Spec. | SelfHHI | Spread | Payout | Default Risk | Vega |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| VIF | | 1.09 | 1.35 | 1.09 | 2.47 | 1.15 | 1.31 | 1.27 | 1.15 | 1.25 | 1.30 | 1.11 | 1.22 | 1.47 | 1.49 | 1.34 | 1.43 |
| C-Score | 1.00 | | | | | | | | | | | | | | | | |
| Mobility | 0.00 | 1.00 | | | | | | | | | | | | | | | |
| High Skill | -0.06*** | 0.20*** | 1.00 | | | | | | | | | | | | | | |
| Labor Turn. | 0.20*** | -0.01 | 0.06*** | 1.00 | | | | | | | | | | | | | |
| Size | -0.37*** | 0.03*** | 0.01 | -0.13*** | 1.00 | | | | | | | | | | | | |
| MTB | -0.38*** | 0.00 | 0.09*** | -0.09*** | 0.02*** | 1.00 | | | | | | | | | | | |
| Leverage | 0.08*** | 0.04*** | -0.05*** | 0.04*** | 0.23*** | -0.05*** | 1.00 | | | | | | | | | | |
| Lit. Risk | 0.00 | -0.13*** | 0.17*** | 0.11*** | -0.14*** | 0.11*** | -0.11*** | 1.00 | | | | | | | | | |
| Cash Flow | -0.27*** | 0.00 | -0.03*** | -0.13*** | 0.14*** | 0.16*** | -0.08*** | 0.01 | 1.00 | | | | | | | | |
| CFOStd | 0.12*** | 0.01 | 0.08*** | 0.09*** | -0.39*** | 0.13*** | -0.14*** | 0.13*** | -0.06*** | 1.00 | | | | | | | |
| Union | 0.02* | 0.03*** | -0.20*** | -0.08*** | 0.18*** | -0.08*** | 0.12*** | -0.40*** | -0.03*** | -0.11*** | 1.00 | | | | | | |
| Auditor Spec. | -0.12*** | 0.01 | -0.11*** | -0.04*** | 0.27*** | 0.02* | 0.06*** | -0.08*** | 0.05*** | -0.14*** | 0.13*** | 1.00 | | | | | |
| SelfHHI | 0.04*** | -0.10*** | -0.38*** | 0.00 | 0.08*** | -0.05*** | 0.05*** | -0.07*** | 0.00 | -0.08*** | 0.12*** | 0.10*** | 1.00 | | | | |
| Spread | 0.39*** | -0.02** | -0.01 | 0.19*** | -0.45*** | -0.13*** | -0.03*** | 0.03*** | -0.27*** | 0.22*** | -0.02** | -0.16*** | -0.02* | 1.00 | | | |
| Payout | -0.18*** | -0.03*** | -0.00 | -0.05*** | 0.52*** | 0.13*** | 0.07*** | -0.04*** | 0.09*** | -0.15*** | 0.11*** | 0.13*** | 0.08*** | -0.15*** | 1.00 | | |
| Default Risk | -0.03*** | 0.02*** | 0.07*** | -0.03*** | -0.28*** | 0.13*** | -0.43*** | 0.11*** | 0.12*** | 0.19*** | -0.11*** | -0.08*** | -0.07*** | 0.03*** | -0.08*** | 1.00 | |
| Vega | -0.25*** | 0.02*** | 0.06*** | -0.12*** | 0.47*** | 0.13*** | 0.01 | 0.05*** | 0.11*** | -0.13*** | -0.03*** | 0.12*** | -0.01 | -0.19*** | 0.38*** | -0.04*** | 1.00 |

Table 1: This table presents summary statistics. The sample period is 2003-2020. Panel A shows descriptive statistics; Panel B the Variance Inflation Factors (VIF) and Pearson correlation matrix. *Mobility* is the standardized measure of labor mobility calculated at four-digit NAICS code level following Donangelo (2014). Lower (higher) values indicate higher (lower) labor mobility. All other variables are defined in the Appendix. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively.

## TABLE 2

## LABOR MOBILITY BY INDUSTRY

Panel A: Industries with highest and lowest labor mobility

Top 15 Industries by Labor Mobility
Rubber Product Manufacturing (3262)
Metal and Mineral (except Petroleum) Merchant Wholesalers (4235)
Grocery and Related Product Merchant Wholesalers (4244)
Clay Product and Refractory Manufacturing (3271)
Dairy Product Manufacturing (3115)
Beer, Wine, and Distilled Alcoholic Beverage Merchant Wholesalers (4248)
Fiber, Yarn, and Thread Mills (3131)
Other Furniture Related Product Manufacturing (3379)
Other Food Manufacturing (3119)
Animal Food Manufacturing (3111)
Waste Collection (5621)
Couriers and Express Delivery Services (4921)
Seafood Product Preparation and Packaging (3117)
Specialized Freight Trucking (4842)
General Freight Trucking (4841)

Bottom 15 Industries by Labor Mobility
Offices of Dentists (6212)
Elementary and Secondary Schools (6111)
Scheduled Air Transportation (4811)
Personal Care Services (8121)
Logging (1133)
Legal Services (5411)
Rail Transportation (4821)
Colleges, Universities, and Professional Schools (6113)
Junior Colleges (6112)
Other Professional, Scientific, and Technical Services (5419)
Postal Service (4911)
Building Equipment Contractors (4911)
Offices of Physicians (6211)
Agents and Managers for Artists, Athletes, Entertainers, and Other Public Figures (7114)
Building Finishing Contractors (2383)

Panel B: labor mobility by industry

| One-digit SIC code | Industry Description | N | Mean | Median | SD | P25 | P75 |
|---|---|---|---|---|---|---|---|
| 1 | Mining and Construction | 767 | 0.62 | 0.59 | 0.19 | 0.53 | 0.70 |
| 2 | Manufacturing of food and kindred products, textile and apparel, furniture and paper products, chemicals and allied products | 2122 | -0.18 | 0.00 | 0.63 | -0.47 | 0.30 |
| 3 | Manufacturing of rubber, leather, metal, industrial, electronic and transportation products | 3693 | -0.11 | -0.07 | 0.55 | -0.47 | 0.36 |
| 4 | Transportation, Communications, Electric, Gas and Sanitary Service | 1097 | 0.17 | 0.37 | 0.62 | -0.25 | 0.65 |
| 5 | Wholesale and Retail Trade | 1704 | -0.15 | 0.05 | 0.68 | -0.48 | 0.32 |
| 6 | Finance, Insurance and Real Estate | 231 | 0.55 | 0.76 | 0.51 | 0.13 | 0.92 |
| 7 | Accommodation, personal, business and recreational services | 1631 | 0.33 | 0.33 | 0.58 | -0.12 | 0.81 |
| 8 | Health, finance, legal, educational, social and cultural services | 668 | 1.30 | 1.26 | 0.31 | 1.09 | 1.58 |
| | Total | 11913 | 0.10 | 0.18 | 0.69 | -0.29 | 0.54 |

Table 2: This table presents summary statistics for our measure of labor mobility by industry. Panel A shows the industries with highest (lowest) labor mobility. Panel B shows the average labor mobility across industries at the one-digit SIC code level.

**TABLE 3**

**LABOR MOBILITY AND CONSERVATIVE ACCOUNTING**

| | Predicted Sign | C-Score |
|---|---|---|
| **Mobility** | + | 0.006*** |
| | | (0.006) |
| High Skill | | -0.021 |
| | | (0.432) |
| Labor Turnover | | 0.087*** |
| | | (0.000) |
| Size | ? | -0.033*** |
| | | (0.000) |
| MTB | ? | -0.017*** |
| | | (0.000) |
| Leverage | + | 0.112*** |
| | | (0.000) |
| Litigation Risk | + | 0.008 |
| | | (0.105) |
| Cash Flow | ? | -0.214*** |
| | | (0.000) |
| CFOStd | + | 0.089* |
| | | (0.051) |
| Unionization | + | 0.051* |
| | | (0.052) |
| Auditor Specialization | ? | -0.014 |
| | | (0.249) |
| SelfHHI | - | 0.090*** |
| | | (0.003) |
| Spread | + | 1.214*** |
| | | (0.000) |
| Payout | ? | 0.051** |
| | | (0.042) |
| Default Risk | | -0.000 |
| | | (0.240) |
| Vega | - | -0.037** |
| | | (0.015) |
| Constant | | 0.324*** |
| | | (0.001) |
| Year Fixed Effects | | YES |
| Standard Errors clustered by firm | | YES |
| Observations | | 11913 |
| Adjusted $R^2$ | | 0.415 |

Table 3: This table presents the results for the relation between labor mobility and conservative accounting. *Mobility* is the standardized measure of labor mobility calculated at the four-digit NAICS code level following Donangelo (2014). Lower (higher) values indicate higher (lower) labor mobility. All other variables are defined in the Appendix. p-values are shown in parentheses below the coefficient. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively.

**TABLE 4**

**LABOR MOBILITY, CONSERVATIVE ACCOUNTING AND FIRM FINANCIAL POSITION**

| | Cash Holdings | Financial Constraints |
|---|---|---|
| | C-Score | C-Score |
| Mobility | 0.006* | 0.005* |
| | (0.055) | (0.084) |
| **Mobility*Financial Position** | 0.004*** | 0.003** |
| | (0.008) | (0.021) |
| Financial Position | 0.014*** | 0.001*** |
| | (0.000) | (0.000) |
| High Skill | 0.001 | 0.003 |
| | (0.966) | (0.899) |
| Labor Turnover | 0.090*** | 0.087*** |
| | (0.000) | (0.000) |
| Size | -0.034*** | -0.034*** |
| | (0.000) | (0.000) |
| MTB | -0.017*** | -0.017*** |
| | (0.000) | (0.000) |
| Leverage | 0.107*** | 0.111*** |
| | (0.000) | (0.000) |
| Litigation Risk | 0.010** | 0.009* |
| | (0.034) | (0.057) |
| Cash Flow | -0.212*** | -0.216*** |
| | (0.000) | (0.000) |
| CFOStd | 0.115*** | 0.117** |
| | (0.009) | (0.011) |
| Unionization | 0.051* | 0.040 |
| | (0.056) | (0.126) |
| Auditor Specialization | -0.012 | -0.015 |
| | (0.313) | (0.225) |
| SelfHHI | 0.096*** | 0.095*** |
| | (0.001) | (0.001) |
| Spread | 1.201*** | 1.180*** |
| | (0.000) | (0.000) |
| Payout | 0.051** | 0.066*** |
| | (0.041) | (0.010) |
| Default Risk | -0.000 | -0.000 |
| | (0.542) | (0.445) |
| Vega | -0.035** | -0.037** |
| | (0.019) | (0.013) |
| Constant | 0.304*** | 0.320*** |

| | | |
|---|---|---|
| | (0.003) | (0.001) |
| Year Fixed Effects | YES | YES |
| Standard Errors clustered by firm | YES | YES |
| Observations | 11913 | 11913 |
| Adjusted $R^2$ | 0.416 | 0.418 |

Table 4: This table presents the results when examining the relation between labor mobility and conservative accounting as a function of the financial position of the firm. *Financial Position* is variable *Cash Holdings* in the regression results shown in the first column of the table and variable *Financial Constraints* in the regression results shown in the second column of the table. *Mobility* is the standardized measure of labor mobility calculated at the four-digit NAICS code level following Donangelo (2014). Lower (higher) values indicate higher (lower) labor mobility. All other variables are defined in the Appendix. p-values are shown in parentheses below the coefficient. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively.

**TABLE 5**

**LABOR MOBILITY, CONSERVATIVE ACCOUNTING AND FIRM OPERATING ENVIRONMENT**

| | Product Market Competition C-Score | Product Market Power C-Score | Industry Growth C-Score |
|---|---|---|---|
| Mobility | 0.010*** | 0.006** | 0.007** |
| | (0.009) | (0.033) | (0.012) |
| **Mobility * Operating Environment** | -0.034*** | -0.015*** | -0.006* |
| | (0.003) | (0.001) | (0.055) |
| Operating Environment | 0.092*** | 0.016 | 0.006 |
| | (0.002) | (0.290) | (0.671) |
| High Skill | -0.021 | -0.023 | -0.022 |
| | (0.438) | (0.377) | (0.422) |
| Labor Turnover | 0.087*** | 0.088*** | 0.087*** |
| | (0.000) | (0.000) | (0.000) |
| Size | -0.033*** | -0.034*** | -0.033*** |
| | (0.000) | (0.000) | (0.000) |
| MTB | -0.017*** | -0.017*** | -0.017*** |
| | (0.000) | (0.000) | (0.000) |
| Leverage | 0.112*** | 0.113*** | 0.112*** |
| | (0.000) | (0.000) | (0.000) |
| Litigation Risk | 0.008* | 0.008 | 0.008 |
| | (0.089) | (0.116) | (0.107) |
| Cash Flow | -0.215*** | -0.211*** | -0.214*** |
| | (0.000) | (0.000) | (0.000) |
| CFOStd | 0.088* | 0.085* | 0.088* |
| | (0.052) | (0.062) | (0.052) |
| Unionization | 0.052** | 0.046* | 0.051* |
| | (0.046) | (0.079) | (0.051) |
| Auditor Specialization | -0.013 | -0.015 | -0.014 |
| | (0.268) | (0.205) | (0.250) |
| Spread | 1.212*** | 1.206*** | 1.214*** |
| | (0.000) | (0.000) | (0.000) |
| Payout | 0.051** | 0.052** | 0.051** |
| | (0.043) | (0.042) | (0.042) |
| Default Risk | -0.000 | -0.000 | -0.000 |
| | (0.238) | (0.210) | (0.242) |
| Vega | -0.036** | -0.037** | -0.037** |
| | (0.016) | (0.014) | (0.015) |
| SelfHHI | | 0.008 | 0.060*** |
| | | (0.709) | (0.006) |
| Constant | 0.323*** | 0.324*** | 0.324*** |
| | (0.002) | (0.002) | (0.001) |

| | | | |
|---|---|---|---|
| Year Fixed Effects | YES | YES | YES |
| Standard Errors clustered by firm | YES | YES | YES |
| Observations | 11913 | 11913 | 11913 |
| Adjusted $R^2$ | 0.415 | 0.416 | 0.415 |

Table 5: This table presents the results when examining the relation between labor mobility and conservative accounting as a function of the firm operating environment. *Operating Environment* is variable *Product Market Competition* in the regression results shown in the first column of the table, is variable *Product Market Power* in the regression results shown in the second column of the table and is variable *Industry Growth* in the regression results shown in the third column of the table. *Mobility* is the standardized measure of labor mobility calculated at the four-digit NAICS code level following Donangelo (2014). Lower (higher) values indicate higher (lower) labor mobility. All other variables are defined in the Appendix. p-values are shown in parentheses below the coefficient. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively.

**TABLE 6**

**Inevitable Disclosure Doctrine**

| | C-Score | C-Score |
|---|---|---|
| Treatment | 0.009* | 0.006*** |
| | (0.084) | (0.004) |
| High Skill | | 0.021 |
| | | (0.547) |
| Size | | -0.038*** |
| | | (0.000) |
| MTB | | -0.015*** |
| | | (0.000) |
| Leverage | | 0.141*** |
| | | (0.000) |
| Litigation Risk | | 0.007 |
| | | (0.506) |
| Cash Flow | | -0.177*** |
| | | (0.000) |
| CFOStd | | 0.092** |
| | | (0.016) |
| Unionization | | 0.036 |
| | | (0.106) |
| Auditor Specialization | | -0.023** |
| | | (0.027) |
| SelfHHI | | 0.060 |
| | | (0.145) |
| Spread | | 0.191*** |
| | | (0.000) |
| Payout | | -0.096*** |
| | | (0.001) |
| Default Risk | | -0.000* |
| | | (0.072) |
| Vega | | -0.026** |
| | | (0.038) |
| Unemployment Rate | | 0.198*** |
| | | (0.000) |
| GDP growth | | 0.005 |
| | | (0.274) |
| Constant | -0.030*** | 0.021 |
| | (0.000) | (0.547) |
| Firm and Year Fixed Effects | YES | YES |
| Standard Errors clustered by firm | YES | YES |
| Observations | 57291 | 57291 |

| | | |
|---|---|---|
| Adjusted $R^2$ | 0.149 | 0.364 |

Table 6: This table presents results for tests for causality. We use the adoption of the Inevitable Disclosure Doctrine (IDD) as exogenous shocks on labor mobility. *Treatment* takes the value of 1 when the firm operates in a state affected by the adoption of the IDD and after the event. All other variables are defined in the Appendix. p-values are shown in parentheses below the coefficient. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively.

## TABLE 7

## EMPLOYEE TURNOVER ANALYSIS

| | Labor turnover |
|---|---|
| **ΔC-Score** | **-0.050**$^{***}$ |
| | **(0.007)** |
| Size | -0.018$^{***}$ |
| | (0.000) |
| MTB | -0.009$^{***}$ |
| | (0.000) |
| Quick Ratio | -0.003 |
| | (0.193) |
| Leverage | 0.082$^{***}$ |
| | (0.000) |
| CFOstd | 0.043$^{***}$ |
| | (0.002) |
| SALESstd | -0.003 |
| | (0.327) |
| Tangible Assets | -0.069$^{***}$ |
| | (0.000) |
| Loss | 0.084$^{***}$ |
| | (0.000) |
| Labor Intensity | 0.004 |
| | (0.954) |
| Constant | 0.338$^{***}$ |
| | (0.000) |
| Industry and Year Fixed Effects | YES |
| Robust standard errors | YES |
| Observations | 6013 |
| Adjusted $R^2$ | 0.129 |

Table 7: This table presents the results for an analysis examining the association between conditional conservative accounting and labor turnover. Δ*C-Score* is change in conservative accounting calculated using the Khan and Watts (2009) approach. p-values are shown in parentheses below the coefficient. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively

## TABLE 8

## ROBUSTNESS TESTS

Panel A: Industry fixed effects

| | (1)<br>C-Score |
|---|---|
| **Mobility** | 0.010*** |
| | (0.009) |
| High Skill | 0.037 |
| | (0.376) |
| Labor Turnover | 0.084*** |
| | (0.000) |
| Size | -0.036*** |
| | (0.000) |
| MTB | -0.016*** |
| | (0.000) |
| Leverage | 0.089*** |
| | (0.000) |
| Litigation Risk | -0.007 |
| | (0.456) |
| Cash Flow | -0.251*** |
| | (0.000) |
| CFOStd | 0.043 |
| | (0.340) |
| Unionization | 0.024 |
| | (0.581) |
| Auditor Specialization | -0.014 |
| | (0.229) |
| Self HHI | 0.041 |
| | (0.395) |
| Spread | 1.142*** |
| | (0.000) |
| Payout | 0.051** |
| | (0.046) |
| Default Risk | -0.000 |
| | (0.189) |
| Vega | -0.029** |
| | (0.049) |
| Constant | 0.314*** |
| | (0.002) |
| Industry and Year Fixed Effects | YES |
| Standard Errors clustered by firm | YES |
| Observations | 11913 |

| | |
|---|---|
| Adjusted $R^2$ | 0.428 |

Panel B: Measuring labor mobility as an indicator variable

| | (1)<br>C-Score |
|---|---|
| **MobilityD** | 0.004** |
| | (0.033) |
| High Skill | -0.013 |
| | (0.629) |
| Labor Turnover | 0.088*** |
| | (0.000) |
| Size | -0.033*** |
| | (0.000) |
| MTB | -0.017*** |
| | (0.000) |
| Leverage | 0.113*** |
| | (0.000) |
| Litigation Risk | 0.007 |
| | (0.146) |
| Cash Flow | -0.214*** |
| | (0.000) |
| CFOStd | 0.088* |
| | (0.052) |
| Unionization | 0.053** |
| | (0.047) |
| Auditor Specialization | -0.013 |
| | (0.268) |
| SelfHHI | 0.090*** |
| | (0.004) |
| Spread | 1.212*** |
| | (0.000) |
| Payout | 0.050** |
| | (0.046) |
| Default Risk | -0.000 |
| | (0.274) |
| Vega | -0.036** |
| | (0.016) |
| Constant | 0.316*** |
| | (0.000) |
| Firm and Year Fixed Effects | YES |
| Standard Errors clustered by firm | YES |
| Observations | 11913 |
| Adjusted $R^2$ | 0.414 |

Panel C: Different measures of conservative accounting

| | (1)<br>NI | (2)<br>NI |
|---|---|---|
| D | -0.065** | -0.049 |
| | (0.037) | (0.232) |
| MTB | -0.001* | -0.001 |
| | (0.090) | (0.525) |
| Leverage | -0.072*** | -0.146*** |
| | (0.000) | (0.000) |
| Size | 0.007*** | 0.032*** |
| | (0.000) | (0.000) |
| Litigation Risk | -0.019*** | -0.006 |
| | (0.003) | (0.601) |
| Unionization | 0.096*** | 0.069 |
| | (0.003) | (0.174) |
| High Skill | 0.058 | 0.127* |
| | (0.102) | (0.059) |
| Labor Turnover | -0.038*** | -0.006 |
| | (0.006) | (0.776) |
| Default Risk | -0.000 | 0.000 |
| | (0.189) | (0.700) |
| Mobility | -0.002 | -0.000 |
| | (0.567) | (0.955) |
| MTB # D | -0.001 | -0.000 |
| | (0.571) | (0.863) |
| Leverage # D | 0.077*** | 0.039 |
| | (0.001) | (0.259) |
| Size # D | 0.003 | 0.002 |
| | (0.206) | (0.597) |
| Litigation Risk # D | -0.001 | 0.001 |
| | (0.942) | (0.949) |
| Union # D | -0.007 | -0.014 |
| | (0.861) | (0.710) |
| High Skill # D | 0.052 | 0.054 |
| | (0.212) | (0.316) |
| Labor Turnover # D | -0.053** | -0.029 |
| | (0.023) | (0.445) |
| Default Risk # D | 0.000 | -0.000 |
| | (0.504) | (0.534) |
| Mobility # D | 0.001 | 0.002 |
| | (0.820) | (0.653) |
| Return | -0.029 | -0.053 |
| | (0.373) | (0.414) |
| MTB # Return | 0.002** | 0.004** |
| | (0.012) | (0.026) |

| | | |
|---|---|---|
| Leverage # Return | -0.041** | -0.040 |
| | (0.042) | (0.473) |
| Size # Return | 0.014*** | 0.010** |
| | (0.000) | (0.033) |
| Litigation Risk # Return | 0.003 | 0.013 |
| | (0.702) | (0.418) |
| Union # Return | -0.098** | -0.058 |
| | (0.014) | (0.422) |
| High Skill # Return | -0.095** | -0.026 |
| | (0.032) | (0.788) |
| Labor Turnover # Return | -0.084*** | -0.062* |
| | (0.000) | (0.094) |
| Default Risk # Return | 0.000 | 0.000 |
| | (0.331) | (0.810) |
| Mobility # Return | 0.008 | 0.006 |
| | (0.142) | (0.547) |
| MTB # Return # D | -0.017*** | -0.021*** |
| | (0.000) | (0.000) |
| Leverage # Return # D | 0.380*** | 0.300*** |
| | (0.000) | (0.006) |
| Size # Return # D | -0.036*** | -0.016* |
| | (0.000) | (0.099) |
| Litigation Risk # Return # D | 0.001 | -0.030 |
| | (0.977) | (0.397) |
| Union # Return # D | 0.415*** | 0.112 |
| | (0.000) | (0.560) |
| High Skill # Return # D | 0.576*** | 0.321*** |
| | (0.000) | (0.005) |
| Labor Turnover # Return # D | 0.311*** | 0.321** |
| | (0.000) | (0.010) |
| Default Risk # Return # D | -0.001** | -0.001** |
| | (0.036) | (0.047) |
| **Mobility # Return # D** | 0.021*** | 0.019** |
| | (0.009) | (0.012) |
| Constant | -0.044 | -0.337*** |
| | (0.433) | (0.000) |
| Year Fixed Effects | YES | YES |
| Industry Fixed Effects | YES | NO |
| Firm Fixed Effects | NO | YES |
| Standard errors clustered by firm | YES | NO |
| Observations | 11913 | 11913 |
| Adjusted $R^2$ | 0.199 | 0.136 |

Table 8: This table presents the results for the robustness tests. Panel A shows the results when we include industry fixed effects in Eq. 6; Panel B shows the results when labor mobility is expressed as an indicator variable, *MobilityD*,

which takes the value of 1 when *Mobility* is above the sample median and 0 otherwise, and Panel C shows the results when we use the Basu (1997) model as a different empirical approach. Model (1) includes year and industry fixed effects; model (2) includes year and firm fixed effects. All variables are defined in the Appendix. The p-values are shown in brackets under the relevant coefficient. ***, **, * indicate significance at 1%, 5%, and 10% level, respectively.