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Geographic Financial Reporting and Growth Variables

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Abstracts:
The objective of this study is to investigate how growth variables affect the degrees of conservatism. This study extends Hwang and Kim (2012) by incorporating various *growth* variables in explaining the degrees of conservatism of *geographic* segmental earnings. This study posits that when the multinational firms' growth declines the negative economic shocks to the companies are incorporated into geographic segmental earnings differently. I employ the various growth variables at the firm-level versus segment-level and test how the impact of growth variables differentiates between the degrees of conservatism of geographic segmental earnings. Overall I find that firms with experiencing the declining growths are likely to incorporate those negative economic shocks into geographic segmental earnings differently. More importantly, the empirical findings suggest that the impacts of negative growth variables on geographic segmental earnings are more pronounced in domestic earnings than foreign earnings.
Keyword: Geographic segment, Segmental reporting, Conditional conservatism, Growth.

1. Introduction

Basu (2005) suggests the two types of accounting conservatism: conditional conservatism and unconditional conservatism. Unconditional conservatism is news-independent conservatism, or *ex ante* conservatism in the sense that it recognizes losses without any additional information, only resulting that net asset understatement is generated. More importantly, Basu (1997, 2005) highlights the importance of conditional conservatism, which is news-dependent conservatism, also regarded as *ex post* conservatism. The concept of conditional conservatism is defined as differential verification requirement. Higher degrees of verification are required to recognize good news as gains than to recognize bad news as losses (Basu 1997, 2005; Watts 2003a). Related to the roles of conditional conservatism, it plays important roles in the contracting and monitoring functions of corporate governance (Ball and Shivakumar 2005; Lara et al. 2009). Conservatism mitigates agency costs associated with managerial investment decisions through preventing managers from choosing negative NPV (net present value) investment projects and thus preventing managers' opportunistic behavior (Watts 2003a; Ball and Shivakumar 2005). Conservatism also increases debt contract efficiency. It triggers debt covenant violations more quickly, and then transfers decision rights from managers to debtholders, which provides benefits to both creditors by timely signaling default risk and borrowers by *ex ante* lowering interest rates (e.g., Watts 2003a; Qiang 2007; Zhang 2008; Beatty et al. 2008). Furthermore, it plays an information role between managers and equity investors, especially where the information asymmetry is severe (LaFond and Watts 2008). Conservatism, defined as timelier recognition of losses than gains, can provide a crucial *loss* information of firms in the environment where information quality is poor. Thus, accounting conservatism that plays these various roles in the capital market has been rigorously investigated in accounting research.

Hwang and Kim (2012) present that domestic earnings are more conservative than foreign earnings using various conservatism models employed in prior studies (e.g., Basu 1997; Ball and Shivakumar 2006; Roychowdhury and Watts 2007). They suggest that the incremental speed of negative return news incorporated into earnings relative to positive return news are significantly more pronounced in domestic operations than in foreign ones. Furthermore, they suggest that the two factors are likely to explain the differential conservatism; tax costs and financial leverage. The objective of this study is to extend Hwang and Kim (2012) by investigating how *growth* variables affect the levels of conservatism of geographic segment earnings. They argue that when there are negative economic shocks to the companies at the time of declining growth, accounting income is likely to incorporate those economic losses into their domestic earnings in a more timely fashion. Consistent with Hwang and Kim (2012), this study investigates various growth factors which might affect the degree of conservatism, and then try to explain the differential levels of conservatism of geographic segmental earnings from the supply side of conservatism.

I take into account various growth variables to test the effect on the levels of conservatism between geographic segmental earnings. I employ change in number of employees, total sales growth and total asset growth at the *firm-level* and segmental asset turnover, segmental asset growth and segmental sales growth, return on

segmental asset and segmental profit margin at the *segment-level*. Overall I find that the degrees of various growth variables are *negatively* associated with the levels of conditional conservatism. More specifically I find that the declining growth is more likely to increase the level of conservatism in domestic earnings than foreign ones. We conclude that firms with experiencing the negative growth variables are more likely to incorporate those negative economic shocks into domestic earnings than into foreign earnings.

Consequently, I find that the declining growth variables primarily increase the level of conservatism in domestic earnings. This study contributes to extant literature by introducing growth variables as a factor affecting the level of conservatism and showing that growth variables are more incorporated in domestic than foreign earnings.

The remainder of this paper is organized as follows: Section II develops the hypothesis development; Section III describes the data source, variable measurements, and empirical models used to test my hypotheses; Section IV presents the empirical results with a discussion of their implications and Section V concludes the paper.

2. Hypothesis development

To take a step further into analyzing the accounting effects of negative economic shocks to the company, I employ various *growth* variables at the firm-level as well as at the segment-level. When sales amounts are decreasing or companies are downsizing through reduction in employees or disposal of assets, accounting income is likely to incorporate those economic losses in a timely manner. Thus, I examine how the levels of conditional conservatism in domestic and foreign earnings vary with the deteriorating growth variables at the firm-level or segment-level.

As Hwang and Kim (2012) explain that the operating leverage at the segment-level likely explains the differential level of conservatism between domestic and foreign earnings, the lower operating leverage in foreign sites is more likely to provide less probability of recognizing economic losses such as asset write-offs or impairments in foreign earning, thereby generating the lower levels of conservatism in foreign earnings. Thus, I predict that domestic earnings primarily incorporate the declining growth factors rather than foreign earnings, thereby leading to higher levels of conservatism in domestic earnings than in foreign earnings.

On the other hand, investors are more likely to demand higher conservatism in foreign operations. It is probable that foreign operations are more likely to face increased information asymmetry or uncertainty, especially when companies face some negative economic circumstances. Thus, investors are more likely to demand higher conservatism by anticipating the information role of conservatism in foreign operations.

H: The levels of growth variables do not affect the levels of conservatism of geographic segmental earnings.

3. Sample and Research Design

The data covers all firms with domestic and foreign earnings and stock return data disclosed during the period between 1984 and 2005. The accounting data is taken from the Compustat Annual Industrial and Compustat Segment File and stock return data is taken from the CRSP files. I restrict firms to the ones which are domiciled only in the United States. I also exclude financial firms and the 1% of extreme observations in each tail of each variable for each year.

Consistent with Hwang and Kim (2012), I construct a dataset by stacking the two regressions for each domestic earnings and foreign earnings. Thus, I derive the following regression equation.

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \boldsymbol{\beta_3} D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \boldsymbol{\gamma_3} F\_DRET_t * RET_t + \varepsilon_t \quad \ldots (3)$$

DEPS = the domestic pretax income (data#272) divided by number of shares (data#25) for firm i in fiscal year t, deflated by the market price per share (data#199) at the beginning of year t;

FEPS = the foreign pretax income (data#273) divided by number of shares (data#25) for firm i in fiscal year t, deflated by the market price per share (data#199) at the beginning of year t;

RET = the stock return on firm i from 9 months before fiscal year-end to the three months after fiscal year-end t (RET) or the stock return from 9 months before fiscal year-end to the three months after fiscal year-end t, less the corresponding CRSP equal weighted market return (ABRET);

DRET = a zero/one indicator variable if set equal to 1 if RET is less than 0;

The coefficients β_3 and γ_3 capture the incremental timeliness of *bad* news relative to good news in domestic and foreign earnings, respectively. I take into account various growth factors affecting conservatism to investigate how declining growth factors are incorporated into domestic and foreign earnings in the form of conservatism. I construct various subsamples according to the levels or signs of growth variables, run the regression analyses using equation (1), and then test the difference in the two coefficients, β_3 and γ_3. I employ change in number of employees, total sales growth and total asset growth at the firm-level, and segmental asset turnover, segmental asset growth, segmental sales growth, ROA (return on segmental asset) and segmental profit margin at the segment-level.

4. Empirical Results

Table 1 presents the descriptive statistics for variables employed in Basu's conservatism models explained in Section III. All statistics are consistent with Hwang and Kim (2012). Mean domestic EPS is less than mean foreign EPS but median domestic EPS is greater than median foreign EPS, suggesting that domestic EPS is negatively skewed. As expected, the standard deviation (volatility) of domestic EPS is much greater than that of foreign EPS.

Next, I examine whether firms' growth variables affect the level of conditional conservatism between domestic and foreign earnings. I take into account various growth variables at the firm-level including *the number of employees*, *total sales* and *asset growths* using RET (Panel A of Table 2) and ABRET (Panel B of Table 2).

Table 2 shows that as the growth is declining from *High* to *Low* the level of conservatism is increasing in both domestic and foreign earnings. More specifically, the conservatism of domestic earnings is increasing much higher than that of foreign earnings, as the growth variables are decreasing. The result is consistent with the two economic loss proxies of RET and ABRET and also consistent with the subsample compositions of *Low*, *Med* and *High* as well as the compositions of *Negative* and *Non-negative*. This indicates that domestic earnings reflect the growth properties more than foreign earnings do, implying that firm-level growth properties are more associated with domestic than foreign earnings. All of the firm-level growth variables including increases in *number of employees*, *sales growth* and *total asset growth* show the consistent results and the difference in the levels of conservatism between *low* growth and *high* growth is significant.

Table 3 shows the results of segment-level growth including *asset turnover*, *asset growth* and *sales growth*. Asset turnover is estimated by domestic (foreign) sales divided by domestic (foreign) assets. Asset growth is computed by the log difference between year t-1 and year t in each segmental asset, domestic and foreign assets, and also sales growth is computed by the log difference between year t-1 and year t in each segment sales, including both domestic and foreign sales. This presents the level of conservatism of domestic and foreign earnings when using two economic loss proxies of RET (Panel A of Table 3) and ABRET (Panel B of Table 3) in the subsamples constructed based on the levels of each growth variable.

As shown in Hwang and Kim (2012), the foreign growth variables are on average larger than domestic growth variables. I construct the two subsample groups based on two standards. The sample is first divided into two subsamples: one where the domestic growth variable is larger than the foreign growth variable and the other where foreign growth variable is larger than domestic growth variable. Based on the level of the difference between domestic and foreign growth variables, another subsample group is constructed into three subgroups: *low*, *med* and *high*. I conjecture that higher levels of conservatism in domestic earnings are due to the lower growth in domestic than foreign operation. Thus, this test is to examine whether the lower growth in domestic operation are associated with the higher levels of conservatism of domestic earnings.

The results of Table 3 are based on the Fama-Macbeth (1973) regression. Consistent with previous results, it shows that the levels of conservatism of domestic earnings are significantly higher than that of foreign earnings. More importantly, related to the test of the association between segment-level growth and conservatism, I predict that the conservatism of domestic earnings is more pronounced when domestic operations are declining faster than foreign operations, thus increasing the difference in the level of conservatism between both operations. First, regarding *asset growth*, when domestic asset growth is less than foreign asset growth (*F_ATGROW* > *D_ATGROW*) and the difference in asset growth between both operations (*F_ATGROW* minus *D_ATGROW*) is *High*, the levels of conservatism of domestic earnings are significantly higher, 0.351 (*F_ATGROW* > *D_ATGROW*) vs. 0.223 (*D_ATGROW* > *F_ATGROW*) and 0.360 (High) vs. 0.232 (Low) in *F_ATGROW* minus *D_ATGROW*, thereby increasing the difference in conservatism between both earnings.

Second, related to segment *Sales growth*, the results are consistent but not as significant as asset growth. The results show that the coefficients of the subsample of *F_SGROW* > *D_SGROW* (*F_SGROW* is greater than *D_SGROW*) are larger than the coefficients in the subsample of *D_SGROW* > *F_SGROW* (*D_SGROW* is greater

than *F_SGROW*) but the difference between the subsamples is not significant. In addition, regarding the subsamples of *F_SGROW minus D_SGROW*, I expect the coefficients to show an increasing pattern across *Low*, *Med* and *High* subsamples, but the results do not.

The last variable of segment-level growth is *Asset turnover*, which shows segment-level operating efficiency and represents operating leverage. Higher asset turnover is likely to represent lower operating leverage. The subsamples constructed using asset turnover show similar results consistent with our prediction. Specifically, the coefficient (0.317) of subsample of *F_ATURN* > *D_ATURN* is greater than the coefficient (0.276) of the subsample of *F_ATURN* < *D_ATURN*. Consistently, the subsample of *High* of *F_ATURN minus D_ATURN* has a higher coefficient (0.303) than the subsample of *Low* of *F_ATURN minus D_ATURN* (0.269). Thus, these results suggest that the asset turnover affects the level of conservatism of domestic earnings significantly, hence, increasing the difference of conservatism between domestic and foreign earnings.

Notably, the results of asset turnover likely support the argument of the operating leverage theory for explaining the differential conservatism between domestic and foreign earnings. This is because lower asset turnover of domestic operations, which is considered higher operating leverage, are more likely to be associated with higher conservatism in domestic earnings, thus increasing the gap between both earnings.

Furthermore, I consider additional segment-level growth variables, *ROA* (=each segment pretax income divided by each segment assets) and *Profit Margin* (=each segment pretax income divided by segment sales). Table 4 represents Basu's coefficients of domestic and foreign earnings by subsamples constructed based on ROA and Profit Margin in using the two economic loss proxies, RET (Panel A of Table 4) and ABRET (Panel B of Table 4). I predict that the differential conservatism between domestic and foreign earnings is more pronounced when domestic ROA is less than foreign ROA. This is because domestic operations incorporate more negative economic news into the earnings, especially lower ROA in domestic operations, thus generating higher conservatism in domestic earnings, which leads to a significant differential conservatism between both earnings. As predicted, the empirical results show that domestic Basu coefficients, of the subsample where domestic ROA is less than foreign ROA (*F_ROA* > *D_ROA*), are significantly larger than those of subsample where domestic ROA is larger than foreign ROA (*D_ROA* > *F_ROA*). Also, the three subsamples constructed by the level of difference between foreign *ROA* and domestic *ROA* (*F_ROA minus D_ROA*) show an increasing pattern over Low, Med and High groups. In other words, as the foreign *ROA* is increasing relative to domestic *ROA*, the level of conditional conservatism in domestic earnings is monotonically increasing, implying that domestic earnings reflect more negative shocks such as lower *ROA*. Also, the results of ROA are likely to be consistent with the operating leverage theory in that higher ROA is associated with higher asset turnover and higher asset turnover is likely to be associated with lower operating leverage.

Moving on the second measure, the segment-level *Profit Margin* (or return on sales) is computed by the segment pretax income divided by segment sales. Similar to the previous prediction, I predict that when foreign profit margin is larger than domestic profit margin (*F_ROS* > *D_ROS*) or the amount of foreign profit margin minus domestic profit margin (*F_ROS minus D_ROS*) is increasing, the conservatism in domestic earnings is higher than in the opposite cases. As predicted, I find that the regression results are significantly consistent, showing that domestic operations primarily incorporate the bad news into their earnings, thus leading to much higher conservatism in domestic earnings. Foreign operations, however, do not. Specifically in the case of domestic earnings, the subsample *High* of *F_ROS minus D_ROS* has coefficients of 0.368 (t=6.65) and 0.312 (t=7.08) in RET and ABRET, respectively and the subsample *F_ROS* > *D_ROS* has coefficients of 0.367 (t=8.85) and 0.300(t=9.09) in RET and ABRET, respectively. As predicted, the subsamples of *Low* of *F_ROS minus D_ROS* and *F_ROS* > *D_ROS* have 0.124 (t=4.85) and 0.120 (t=5.08) in RET and 0.091 (t=4.55) and 0.096 (t=5.67) in ABRET, respectively. These results that negative economic shocks are primarily hitting domestic operations increase the differential conservatism between both earnings.

Lastly, Table 5 breaks the sample down four subsamples by using the sign of each growth variable in domestic and foreign operations. I expect that the incremental conservatism of domestic over foreign earnings would be highest when the domestic growths are negative and foreign growths are positive. I take into account three segment-level growth variables including sales growth, asset growth and asset turnover. Related to *assets growth*, the empirical results show that the levels of conservatism of domestic and foreign earnings are highest when each growth is *negative*, but it shows that domestic growth significantly increases the degree of domestic conservatism more, thus suggesting that negative domestic growth dominates the differential level of conservatism between both earnings. Then, related to *sales growth*, consistent with asset growth, the degree of conservatism is highest when domestic growth is negative. Especially when both growths are negative the degree of domestic conservatism is highest and thus the differential level of conservatism is highest. Lastly, related to *asset turnover*, the empirical results are not consistent with the previous growth variables. This is because asset turnover represents operating efficiency as well as operating leverage. The conservatism of

domestic earnings is much higher even when both signs of both growth variables are positive. From the empirical results of Table 5, I conclude that the growth of domestic operations has a more significant impact on the level of conservatism in domestic earnings than that of foreign operations does, thus explaining the differential level of conservatism.

4. **Conclusion**

In this study I explore the growth factors affecting conditional conservatism and investigate how various growth factors explain the levels of conservatism between domestic and foreign earnings. Specifically, I show the effects of the *growth* factors on the levels of conservatism and provide the explanations of the effects according to the two theories: operating leverage theory from the supply side of conservatism and information asymmetry theory from the demand side of conservatism.

To explain the empirical results of differential conservatism evidenced by Hwang and Kim (2012), I search for and test the possible factors that could affect the degree of differential conservatism, including various growth variables at the segment-level versus at the firm-level. Overall I find that firms' negative economic shocks are more incorporated in domestic earnings than foreign earnings, thus increasing the difference in the degrees of conservatism between both earnings; and as the growth of firms declines the higher the degree of conservatism of domestic earnings becomes.

This study builds on accounting literature by providing additional evidence that growth is likely to be a factor for conditional conservatism, and that firms are more likely to supply conservative accounting due to firms' characteristics or circumstances even if investors require somewhat different levels of conservatism. Likewise, this study contributes to the literature of geographic segmental earnings by suggesting that negative economic shocks to the firms affect the geographic segmental financial reporting.

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Table 1 Descriptive statistics for Basu's Conservatism Model

Variable	Mean	STD	Min	Q1	Median	Q3	Max
$DEPS_t$	0.008	0.196	-7.127	-0.013	0.040	0.088	0.534
$FEPS_t$	0.021	0.054	-0.656	0.000	0.012	0.036	0.619
RET_t	0.133	0.546	-0.958	-0.191	0.065	0.346	7.987
$ABRET_t$	-0.019	0.501	-1.282	-0.317	-0.069	0.191	7.442

DEPS (*FEPS*) represents the domestic (foreign) pretax income (data#272 or data#273) divided by number of shares (data#25) for firm i in fiscal year t, deflated by the stock price (data#199) at the beginning of fiscal year t; *RET* represents the stock return on firm i from 9 months before fiscal year-end to the three months after fiscal year-end t; *ABRET* represents the stock return from 9 months before fiscal year-end to the three months after fiscal year-end t, less the corresponding CRSP equal weighted market return;

Table 2 Conditional conservatism by Firm-level Growth
Panel A. Regression by Growth at the firm level- Return

Variable		Mean	Median	RET Domestic β_3	RET Foreign γ_3	Adj.R^2		N
Growth in Employees	Low	-0.176	-0.099	0.390 (8.77***)	0.050 (7.25***)	0.144		15,801
	Med	0.023	0.021	0.253 (10.42***)	0.026 (3.87***)	0.237	Domestic *Low*- 0.248	15,802
	High	0.274	0.182	0.142 (7.11***)	0.018 (3.62***)	0.185	(5.29***)	15,803
	Negative	-0.150	-0.078	0.394 (9.36***)	0.050 (8.09***)	0.144		18,872
	Non -	0.166	0.091	0.188 (11.41***)	0.025 (6.42***)	0.200		28,534
Sales growth	Low	-0.144	-0.066	0.407 (7.94***)	0.057 (8.09***)	0.137		16,008
	Med	0.077	0.077	0.231 (8.64***)	0.011 (1.62)	0.251	Domestic *Low*- 0.224	16,010
	High	0.331	0.245	0.183 (9.08***)	0.033 (5.03***)	0.209	(5.03***)	16,009
	Negative	-0.174	-0.094	0.416 (7.48***)	0.055 (6.94***)	0.150		13,377
	Non -	0.190	0.125	0.197 (10.75***)	0.025 (5.54***)	0.217		34,650
Total asset growth	Low	-0.128	-0.069	0.398 (7.26***)	0.052 (6.26***)	0.167		14,410
	Med	0.060	0.059	0.148 (8.65***)	0.018 (1.50)	0.281	Domestic *Low*- 0.285	14,410
	High	0.310	0.223	0.113 (5.73***)	0.031 (4.88***)	0.280	(5.49***)	14,410
	Negative	-0.136	-0.076	0.398 (7.19***)	0.052 (6.44***)	0.172		13,588
	Non -	0.180	0.114	0.147 (7.53***)	0.025 (4.26***)	0.272		29,642

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients, $\beta_3$and γ_3, on DRET*RET terms for domestic and foreign earnings, respectively.

$DEPS_t$ or $FEPS_t$ =
$\beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t * RET_t + \varepsilon_t$

The regression is performed on the subsamples based on the levels of firm-level growth measures including growth in employees, sales growth and total asset growth. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition:
Growth in employees = log difference in the number of employees (data#29) from year t-1 to year t; *Sales growth* = log difference in the total net sales from year t-1 to year t; *Total asset growth* = log difference in the total assets from year t-1 to year t; *RET* = Return on firm i from 9 months before fiscal year-end to the three months after fiscal year-end t. *ABRET* = the stock return from 9 months before fiscal year-end to the three months after fiscal year-end t, less the corresponding CRSP equal weighted market return.

Panel B. Regression by Growth at the firm level - Abnormal return

Variable				ABRET				
		Mean	Median	Domestic β_3	Foreign γ_3	Adj.R^2		N
Growth in Employees	Low	-0.176	-0.099	0.328 (10.79***)	0.033 (5.89***)	0.140		15,801
	Med	0.023	0.021	0.215 (9.90***)	0.021 (3.29***)	0.235	Domestic *Low*- 0.191	15,802
	High	0.274	0.182	0.137 (6.88***)	0.016 (4.10***)	0.185	(2.28**)	15,803
	Negative	-0.150	-0.078	0.331 (11.10***)	0.034 (6.53***)	0.141		18,872
	Non -	0.166	0.091	0.167 (10.67***)	0.020 (7.19***)	0.200		28,534
Sales growth	Low	-0.144	-0.066	0.331 (9.44***)	0.039 (5.96***)	0.133		16,008
	Med	0.077	0.077	0.203 (9.96***)	0.009 (1.71)	0.250	Domestic *Low*- 0.178	16,010
	High	0.331	0.245	0.153 (10.31***)	0.028 (5.42***)	0.209	(2.16**)	16,009
	Negative	-0.174	-0.094	0.337 (8.77***)	0.039 (5.78***)	0.147		13,377
	Non -	0.190	0.125	0.175 (12.07***)	0.021 (5.45***)	0.217		34,650
Total asset growth	Low	-0.128	-0.069	0.328 (9.54***)	0.033 (4.77***)	0.161		14,410
	Med	0.060	0.059	0.143 (11.16***)	0.012 (2.76**)	0.280	Domestic *Low*- 0.149	14,410
	High	0.310	0.223	0.179 (2.62**)	-0.004 (-0.16)	0.291	(1.70*)	14,410
	Negative	-0.136	-0.076	0.326 (9.66***)	0.033 (4.61***)	0.166		13,588
	Non -	0.180	0.114	0.221 (2.41**)	0.005 (0.40)	0.282		29,642

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients on DRET*RET terms ($\beta_3$and γ_3) for domestic and foreign earnings,

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t * RET_t + \varepsilon_t$$

The regression is performed on the subsamples based on the levels of firm-level growth measures including growth in employees, sales growth and total asset growth. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition: See Panel A of Table 2.

Table 3 Conditional conservatism by Growth at the Segment-level

Panel A. Regression by segment-level growth: Return (RET)

Growth Variables					RET		
			Mean	Med.	Domestic β_3	Foreign γ_3	Adj.R^2
Asset Growth	*D_ATGROW*	*D_*	0.186	0.120	0.223	0.086	0.148
	> F_ATGROW	*F_*	-0.097	-0.027	(5.34***)	(4.04***)	
	F_ATGROW	*D_*	-0.006	0.016	0.351	0.045	0.155
	> D_ATGROW	*F_*	0.282	0.184	(7.72***)	(5.11***)	
	F_ATGROW	Low	-0.353	-0.205	0.232	0.087	0.145
	minus				(4.76***)	(3.87***)	
	D_ATGROW	Med.	0.043	0.042	0.259	0.045	0.199
					(6.02***)	(5.03***)	
		High	0.447	0.304	0.360	0.062	0.135
					(7.14***)	(3.51***)	
Sales Growth	*D_SGROW*	*D-SGROW*	0.157	0.109	0.306	0.042	0.142
	> F_SGROW	*F- SGROW*	-0.100	0.000	(7.49***)	(3.97***)	
	F_SGROW	*D- SGROW*	-0.004	0.028	0.311	0.047	0.149
	> D_SGROW	*F- SGROW*	0.275	0.178	(7.73***)	(7.58***)	
	F_SGROW	Low	-0.300	-0.152	0.288	0.047	0.129
	minus				(6.98***)	(4.23***)	
	D_SGROW	Med.	0.051	0.050	0.341	0.034	0.187
					(9.52***)	(2.92**)	
		High	0.456	0.288	0.293	0.047	0.132
					(6.02***)	(6.92***)	
Asset Turnover	*D_ATURN*	*D_ATURN*	1.665	1.505	0.276	0.046	0.161
	> F_ATURN	*F_ATURN*	1.107	1.078	(9.59***)	(4.08***)	
	F_ATURN	*D_ATURN*	1.070	1.012	0.317	0.057	0.155
	> D_ATURN	*F_ATURN*	1.912	1.576	(5.93***)	(6.80***)	
	F_ATURN	Low	-0.717	-0.485	0.269	0.052	0.153
	minus				(7.37***)	(4.10***)	
	D_ATURN	Med.	0.084	0.078	0.324	0.062	0.184
					(5.84***)	(5.94***)	
		High	1.301	0.783	0.303	0.049	0.139
					(5.86***)	(4.71***)	

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients on DRET*RET terms (β_3 and γ_3) for domestic and foreign earnings,

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t * RET_t + \varepsilon_t$$

The regression is performed on the subsamples based on the levels of segment-level growth measures including asset turnover, asset growth and sales growth. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition: *Asset growth (D_ATGROW* or *D_ATGROW)* is computed by taking the log difference in domestic (or foreign) assets between year t and year t-1, available in Compustat Segment File; Sales growth (*D_SGROW* or *F_SGROW*) is computed by taking the log difference in domestic (or foreign) sales between year t and year t-1, available from in Compustat Segment File; *Asset turnover* (*D_ATURN* or *F_ATURN*) is computed domestic (or foreign) sales divided by average domestic (or foreign) assets, segment sales and asset data are available in Compustat Segment Files; RET = Return on firm i from 9 months before fiscal year-end to the three months after fiscal year-end t. ABRET = the stock return from 9 months before fiscal year-end to the three months after fiscal year-end t, less the corresponding CRSP equal weighted market return.

Panel B. Regression by Segment-level growth: Abnormal Return (ABRET)

Growth Variables			ABRET Domestic β_3	ABRET Foreign γ_3	Adj.R^2	N
Asset Growth	*D_ATGROW* > *F_ATGROW*		0.212 (6.82***)	0.053 (6.73***)	0.135	9,573
	F_ATGROW > *D_ATGROW*		0.283 (9.60***)	0.028 (3.57***)	0.152	12,978
	F_ATGROW minus *D_ATGROW*	Low	0.205 (5.31***)	0.051 (5.57***)	0.133	7,516
		Med.	0.232 (6.82***)	0.033 (4.07***)	0.194	7,518
		High	0.295 (8.87***)	0.028 (2.98***)	0.133	7,517
Sales Growth	*D_SGROW* > *F_SGROW*		0.242 (8.05***)	0.029 (8.16***)	0.137	13,723
	F_SGROW > *D_SGROW*		0.255 (9.20***)	0.028 (5.55***)	0.143	21,279
	F_SGROW minus *D_SGROW*	Low	0.234 (7.58***)	0.030 (6.59***)	0.123	11,666
		Med.	0.261 (7.91***)	0.017 (2.03**)	0.182	11,668
		High	0.249 (8.28***)	0.030 (5.52***)	0.127	11,668
Asset Turnover	*D_ATURN* > *F_ATURN*		0.240 (9.46***)	0.038 (3.21***)	0.158	9,963
	F_ATURN > *D_ATURN*		0.257 (9.45***)	0.040 (7.19***)	0.148	12,571
	F_ATURN minus *D_ATURN*	Low	0.224 (8.00***)	0.034 (2.85***)	0.148	7,510
		Med.	0.256 (7.46***)	0.051 (5.67***)	0.171	7,512
		High	0.260 (9.45***)	0.034 (5.80***)	0.134	7,512

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients on DRET*RET terms (β_3 and γ_3) for domestic and foreign earnings,

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t{*}RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t{*}RET_t + \varepsilon_t$$

The regression is performed on the subsamples based on the levels of segment-level growth measures including asset turnover, asset growth and sales growth. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition: See Panel A of Table 3

Table 4 Conditional conservatism by segment-level growth II
Panel A: Regression by Segment-level growth II: Return

Growth Variables					RET		
			Mean	Med.	Domestic β_3	Foreign γ_3	Adj.R^2
ROA	*D_ROA*	*D-*	0.139	0.129	0.165	0.082	0.380
	> *F_ ROA*	*F- ROA*	0.017	0.046	(5.30***)	(7.19***)	
	F_ ROA	*D-*	-0.003	0.026	0.348	0.041	0.178
	> *D_ ROA*	*F- ROA*	0.144	0.127	(10.29***)	(4.20***)	
	F_ ROA	Low	-0.151	-0.110	0.160	0.075	0.397
	minus				(4.95***)	(5.42***)	
	D_ ROA	Med.	0.024	0.023	0.242	0.055	0.280
					(7.45***)	(5.63***)	
		High	0.225	0.177	0.380	0.055	0.230
					(8.40***)	(4.60***)	
Profit Margin	*D_ROS*	*D_*	0.136	0.110	0.120	0.054	0.400
(ROS)	> *F_ROS*	*F_*	0.008	0.034	(5.08***)	(5.67***)	
	F_ROS	*D_*	-0.090	0.011	0.367	0.047	0.175
	> *D_ROS*	*F_*	0.112	0.097	(8.85***)	(5.82***)	
	F_ROS	Low	-0.161	-0.100	0.124	0.056	0.402
	minus				(4.85***)	(5.50***)	
	D_ROS	Med.	0.019	0.017	0.227	0.048	0.264
					(6.44***)	(6.12***)	
		High	0.322	0.174	0.368	0.054	0.235
					(6.65***)	(5.56***)	

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients on DRET*RET terms ($\beta_3$and γ_3) for domestic and foreign earnings

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t * RET_t + \varepsilon_t$$

The regression is performed on the subsamples based on the levels of segment-level growth including ROA and Profit Margin. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition: ROA (*D_ROA* or *F_ROA*) = domestic or foreign pretax income (data#272 or data#273) divided by average domestic or foreign assets (Compustat Segment Files).; ROS (*D_ROS* or *F_ROS*)= domestic or foreign pretax income (data#272 or data#273) divided by domestic or foreign sales (Compustat Segment File); *D_SGROW* (or *F_SGROW*)= log difference in domestic (or foreign) sales between year t and year t-1, segment sales data are available in Compustat Segment File; *D_ATGROW* (or *F_ATGROW)* = log difference in domestic (or foreign) assets between year t and year t-1, segment assets are available in Compustat Segment File; RET = Return on firm i from 9 months before fiscal year-end to the three months after fiscal year-end t. ABRET = the stock return from 9 months before fiscal year-end to the three months after fiscal year-end t, less the corresponding CRSP equal weighted market return.

Panel B: Regression by Segment-level growth II: Abnormal return

Growth Variables			ABRET Domestic β_3	ABRET Foreign γ_3	Adj.R^2	N
ROA	*D_ROA* > *F_ ROA*	*D- F- ROA*	0.114 (5.91***)	0.058 (6.75***)	0.377	9,043
	F_ ROA > *D_ ROA*	*D- F- ROA*	0.281 (10.96***)	0.033 (4.28***)	0.172	12,264
	F_ ROA minus *D_ ROA*	Low	0.120 (5.91***)	0.061 (6.30***)	0.394	7,102
		Med.	0.152 (5.14***)	0.042 (4.89***)	0.275	7,103
		High	0.306 (9.57***)	0.045 (4.50***)	0.228	7,102
Profit Margin (ROS)	*D_ROS* > *F_ROS*	*D_ F_*	0.096 (5.67***)	0.042 (5.60***)	0.399	14,680
	F_ROS > *D_ROS*	*D_ F_*	0.300 (9.09***)	0.031 (6.82***)	0.170	19,369
	F_ROS minus *D_ROS*	Low	0.091 (4.55***)	0.042 (4.68***)	0.400	11,349
		Med.	0.153 (7.75***)	0.036 (5.40***)	0.256	11,351
		High	0.312 (7.08***)	0.037 (6.49***)	0.234	11,349

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients on DRET*RET terms ($\beta_3$and γ_3) for domestic and foreign earnings

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t * RET_t + \varepsilon_t$$

The regression is performed on the subsamples based on the levels of segment-level growth including ROA and Profit Margin. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition: See Panel A of Table 4.

Table 5
Conditional conservatism by segment-level growth III

	Sign of Domestic growth	Sign of Foreign growth	RET Domestic β_3	RET Foreign γ_3	RET Adj.R^2	ABRET Domestic β_3	ABRET Foreign γ_3	ABRET Adj.R^2	N
Assets growth	positive	negative	0.130 (2.59**)	0.047 (3.61***)	0.168	0.179 (4.71 ***)	0.041 (3.79***)	0.169	4,346
	positive	positive	0.146 (7.21***)	0.018 (2.42)	0.366	0.117 (7.87***)	0.018 (3.76***)	0.364	11,335
	negative	negative	0.346 (6.42***)	0.040 (6.16***)	0.130	0.283 (9.27***)	0.025 (5.01***)	0.129	25,637
	negative	positive	0.312 (7.62***)	0.009 (0.50)	0.120	0.277 (9.25***)	0.001 (0.06)	0.114	5,406
Sales growth	positive	negative	0.240 (6.01***)	0.012 (1.35)	0.168	0.207 (10.03***)	0.015 (3.01***)	0.170	10,605
	positive	positive	0.162 (12.65***)	0.028 (3.75***)	0.265	0.155 (10.17***)	0.022 (3.56***)	0.264	18,913
	negative	negative	0.414 (6.78***)	0.046 (4.48***)	0.154	0.308 (7.71***)	0.030 (4.58***)	0.147	10,560
	negative	positive	0.333 (7.17***)	0.064 (5.14***)	0.131	0.285 (7.73***)	0.035 (2.94***)	0.129	6,646
Asset turnover	positive	negative	0.172 (1.72)	0.009 (1.07)	-0.043	0.075 (1.08)	-0.087 (-0.89)	0.010	1,325
	positive	positive	0.310 (9.92***)	0.057 (7.74***)	0.145	0.255 (10.85***)	0.036 (7.48***)	0.139	22,534
	negative	negative	0.309 (7.02***)	0.021 (3.67***)	0.147	0.257 (9.71***)	0.015 (3.14***)	0.147	21,266
	negative	positive	0.276 (2.69**)	0.083 (2.47**)	0.210	0.282 (3.14***)	0.070 (2.26**)	0.228	1,599

1. This table presents the results of the Fama-MacBeth regression using Basu (1997)'s model. The numbers are the estimated coefficients on DRET*RET terms ($\beta_3$and γ_3) for domestic and foreign earnings

$$DEPS_t \text{ or } FEPS_t = \beta_0 + \beta_1 D\_DRET_t + \beta_2 D\_RET_t + \beta_3 D\_DRET_t * RET_t + \gamma_0 + \gamma_1 F\_DRET_t + \gamma_2 F\_RET_t + \gamma_3 F\_DRET_t * RET_t + \varepsilon_t$$

The regression is performed on the subsamples based on the levels of segment-level growth, more specifically depending on the signs of growth in domestic and foreign operations. Thus, each growth variable constructs four different subsamples. T-statistics are reported in parentheses. ***Significant at the 1% level, **significant at the 5% level, * significant at the 10% level.

2. Variable definition: *Asset turnover* (*D_ATURN* or *F_ATURN*) is computed domestic (or foreign) sales divided by average domestic (or foreign) assets; *Asset growth (D_ATGROW* or *D_ATGROW)* is computed log difference in domestic (or foreign) assets between year t and year t-1, available in Compustat Segment File; *Sales growth* (*D_SGROW* or *F_SGROW*) is computed by taking the log difference in domestic (or foreign) sales between year t and year t-1, available from in Compustat Segment File; RET = Return on firm i from 9 months before fiscal year-end to the three months after fiscal year-end t. ABRET = the stock return from 9 months before fiscal year-end to the three months after fiscal year-end t, less the corresponding CRSP equal weighted market return.