Relationship Between Accounting Changes and Stock Prices: Problems of Measurement and Some Empirical Evidence

Shyam Sunder

Generally accepted accounting principles allow alternative treatments of several types of accounting events. Financial accounting policy-making bodies such as the Accounting Principles Board and the Securities and Exchange Commission rule on the admissibility of various accounting procedures and on changes from one procedure to another. For this purpose, they need information about the effect of accounting procedures and changes in accounting procedures on the interests of various economic agents in society. Admissibility of alternative procedures implies that corporate managers must select one of the available procedures for their use. For making such selections, managers need information about the relationship of accounting procedures with corporate objectives. In making their investment decisions, investors too need information not only about the meaning of various accounting procedures but also about the relationship of these procedures with stock prices. In this paper, I report on a study of the relationship between alternative inventory cost flow assumptions (LIFO and FIFO) with the behavior of stock prices. The belief that an understanding of this relationship is relevant to the three classes of decision-makers mentioned above provides the justification for the study.