# Study shows how accounting practices distort economic reality

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Accounting standards don't properly reflect the difference between losses driven by investments and actual business performance shortfalls, according to new University at Buffalo School of Management research.

Forthcoming in the Review of Accounting Studies, the study found that Generally Accepted Accounting Principles (GAAP) mask the true value of companies by marking investments in intangibles like technology, brands and human capital as losses.

"Even as the economy boomed in 2019 following a decade of growth, about half of all public companies reported losses because accounting rules force them to report losses despite initial success," says Feng Gu, Ph.D., chair and professor of accounting and law in the UB School of Management. "This is just another indication of how broken accounting is. We need to treat intangible investments as real economic assets."

The researchers analyzed financial and market data of 172,000 firms from 1980 to 2018 to discover what would happen to a company's reported earnings if they recognized intangible investments as economic assets, rather than reporting them as losses.

Their results show that the losses attributed to the expensing of these investments are as informative as profits—and that GAAP losses have more favorable implications for a firm's future performance than real losses.

"GAAP losers are less likely to decline, more likely to reverse their losses, and even have better future stock performance than real losers or profitable firms," says Gu. "This is an alarming consequence for a group of highly dynamic and innovative firms that are the driving force behind the growing intangible revolution in our economy."

The research is available as a working paper in the *SSRN Electronic Journal*.

**More information:** Feng Gu et al, All Losses Are Not Alike: Real versus Accounting-Driven Reported Losses, *SSRN Electronic Journal*

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