Non-GAAP earnings disclosures and IFRS

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A Brief Summary

- Research Questions (in Australia after IFRS)
  - If FV-related items lead to more Non-GAAP disclosures
  - If Non-GAAP disclosures are useful for financial analysts?
- Sample
  - Six group of items (FINST, REVAL,IMPAIR, AMORT,MERGER, OTHER)
  - From ASX 200's financial statements, managers' adjustments and analysts' adjustments
  - 576 (371 with Non-GAAP disclosures) firm-year observations of Australian Firms over 2008 to 2010

A Brief Summary (cont.)

- Research Methodology & Findings
  - Logistic regression models to analyze if the FV items (reported and analyst adjustments) explain the reporting of non-GAAP earnings (Table 6 Panel A and Panel B)
    - When three FV-related items are combined, the results are significant regardless if dummy variable or net amounts are used
    - The individual FV-related items do not consistently show significance
  - 2SLS regression model to analyze if NONGAAP (along with reconciliation and mentioned in three company reporting medias) reduce forecast errors and forecast dispersion (Table 8)

Comments

- An interesting paper dealing with an important accounting problem
- Unique data
  – Fair Value items
  – Australian Sample
  – IFRS
  – Voluntary disclosure with reconciliation
  – Analysts adjustments of detailed items
- However,…

Novelty of Research Questions

- Previous literatures suggest that Pro forma earnings are often opportunistically used to meet or beat benchmarks
- Investors misprice the Pro forma earnings and the reconciliation of Pro forma earnings and GAAP earnings mitigate the mispricing
- Pro forma earnings are informative under certain conditions
- *What and why will FV adjustments in Australia for Non-GAAP earnings differ?*
- *What is the motivation question?*

Tension

- If there is more non-recurring income, then it is likely that firms will provide adjustments to report pro forma (NONGAAP) earnings, so why will we NOT see such an empirical evidence?
- If more information is provided in the financial statements (e.g. Non-GAAP earnings and reconciliation), why will the forecasts not been improved?

Tension (cont.)

What can be interesting?

- a contrast between the three FV-related adjustments and other adjustments
- It may be even interesting if we do not see such evidence. E.g. if fair value reporting is ignored by the market, then managers may not need to worry about their adjustments
- identifying situations that managers tend to disclose Non-GAAP earnings and when and how this disclosure will help financial analysts forecasts

Missing Link between RQ1 and RQ2

- RQ1 seems to focus on the FV-related items
  – Reported in financial statements
  – Financial analysts adjustments
- RQ2 focuses on the effect of NONGAAP on financial analysts performance
  – How can this imply that the FV-related adjustments are informative?

Empirical Analyses

- Table Presentations
  - Table 1-5, Table 7 are all descriptive statistics
  - Table 6 reports analyses for RQ1
  - Table 8 reports analyses for RQ2
- Sample Description is confusing
  - E.g. Table 2, n=576 for all adjustments (many zeros, may be based on available data only)
  - Table 4 Panel C where does the 249 comes from?

Table 6

Panel A Items in financial statements	(1)	(2)	(3a)	(3b)
Dependent variable = release of non-GAAP	Coeff.	Coeff.	Coeff.	Coeff.
Intercept	1.189	2.191	0.879	2.058
$COUNT_{FS}$	0.565***			
$MAGNIT_{FS}$		0.706*		
$FININST_{FS}$			-0.149	0.001
$REVAL_{FS}$			1.220***	0.796
$IMPAIR_{FS}$			0.741***	1.181*
$AMORT_{FS}$			0.254	-2.22
$MERGER_{FS}$			1.233***	55.997**
$OTHER_{FS}$			0.469*	0.227
MINING	-0.856	-0.747	-0.581	-0.72

Table 6 (cont.)

Panel B Items with analysts' adjustments	(1)	(2)	(3a)	(3b)
Dependent variable = release of non-GAAP	Coeff.	Coeff.	Coeff.	Coeff.
Intercept	2.159	2.374	2.908	4.487
$COUNT_{AA}$	0.887			
$MAGNIT_{AA}$		1.257**		
$FININST_{AA}$			0.438	3.826**
$REVAL_{AA}$			1.005**	0.644
$IMPAIR_{AA}$			0.196	0.412
$AMORT_{AA}$			1.279*	117.231**
$MERGER_{AA}$			1.119***	18.977***
$OTHER_{AA}$			1.368***	6.737***
MINING	-0.932	-0.743	-0.559	-0.68
FIN	-0.165	0.378	-0.141	0.405

Empirical Analyses (cont.)

- The descriptions of variable definitions are very confusing
- What are the implications of the results?
  - Which FV element is significant in predicting Non-GAAP disclosure? Will analyst forecasts adjustment more important than reported in the statements?
  - Consider combining the dummy, the dollar amount and financial analysts forecasts in a regression
  - Even if we can conclude the importance of any individual element, so what do we learn?
- The relation between Non-GAAP disclosure and financial analysts adjustment is confusing

Empirical Analyses (cont.)

- Table 8 reports the relation between NONGAAP and AFE and FD (3 month before year-end)
  - Which adjustment contribute to this relation
  - Why not 9/6 month before year-end?
- In other words, what mechanism facilitates the better forecast performance for firms
- Analysis of management vs analysts adjustments
  - What is the reporting time line of management and analysts adjustments?

Empirical Analyses (cont.)

- The paper also finds that management adjustments are more conservative than analysts adjustments

→ NONGAAP disclosures are not opportunistic but more informative

  - But why most adjustments are upward earnings adjustments?
  - Can we really rely on analysts adjustments to imply management adjustments are not opportunistic?

- Studies (e.g. Choi and Young) show that opportunism of NONGAAP disclosures is conditional on earnings expectations

→ Some cross-sectional tests shall be helpful.

Suggestions

- Focus on the novelty of the research; why is it important to investigate the relation between IFRS FV remeasurement and Non-GAAP disclosures?
- Discuss the controversy (importance) of FV reporting, e.g. why these items "involve unrealized gains or losses and possible measurement error and uncertainty"
- Be consistent in investigating the uniqueness of FV remeasurement (RQ1) and the usefulness of NONGAAP (RQ2)
- Conduct cross-sectional analyses to corroborate main results
- Improve table presentation (e.g. combine descriptive statistics)
- Many descriptions need clarification
- Abundant errors needed to be carefully checked through

Thanks！