

ModernIR invented Market Structure Analytics™ for IR

Learn More



HOME (/) / ARTICLES (/ARTICLES/) / EARNINGS CALLS & FINANCIAL REPORTING

One in five firms intentionally misrepresents earnings, say CFOs

0 Comments

Tweet Share

February 25, 2016 | By Laurie Havelock

Survey also finds good disclosures include sustainability information and actual cash flows

Though it might sometimes be hard to work out what to include in an earnings release, researchers suggest some reports may not even be based on factual information.

According to a survey of 375 CFOs published recently in the *Financial Analysts Journal*, executives believe as many as one in five companies intentionally misrepresents its earnings, using 'discretion within [GAAP]'. Such misrepresentations are significant – about 10 cents on every dollar, the report authors estimate – and though most result in the overstatement of earnings, a third of companies intentionally lowball their earnings.

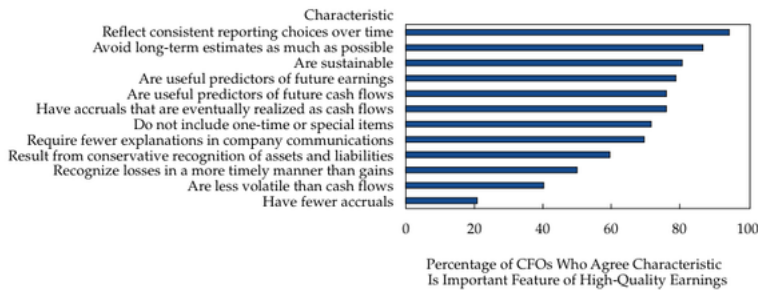
The study's authors also interviewed several CFOs to gain insight into how earnings mismanagement can remain undetected and when such activities cross the line into fraud. One CFO quoted in the report believes 'the chance that an analyst would spot an occasional instance of earnings management is low and only persistent abusers have a high chance of being detected.'

Respondents were quizzed about the motivation behind misrepresenting earnings, too, with most CFOs saying pressure from Wall Street to keep earnings consistent is the greatest driver. Other contributing factors include influencing executive compensation, avoiding violation of debt agreements and dodging adverse career consequences on the back of disappointing performance.

CFOs also give advice to analysts in the form of 'red flags' to look for in order to catch misrepresentation: of these, a lack of correspondence between earnings and cash flow is the most common answer, closely followed by deviations from peer and industry norms.

There's a warning, too, for companies that would persist in touching up their earnings releases. 'Most of the CFOs we interviewed believe the consequence of poor quality [of earnings], once discovered in the marketplace, is an increase in the cost of capital and/or a decrease in stock price,' reads the report. Investor confusion and reduced trust are also direct consequences, say other respondents.

On a more positive note, the CFOs interviewed pick out the characteristics of high-quality earnings releases. Maintaining consistent reporting choices and avoiding long-term estimates as much as possible are the top two choices, with sustainable earnings the third option – all factors that the report authors summarize as 'sustainable and predictable earnings'.



Source: *Financial Analysts Journal*, volume 72, number 1

The study was carried out by Duke University professors Ilia Dichev, John Graham, Campbell Harvey and Shiva Rajgopal. It targets 169 CFOs at public companies and 206 at private firms, and was carried out online with a sample provided by Duke University and CFO as part of the Global Business Outlook survey.

0 Comments

Tweet Share

[Conference calls: tricks of the trade \(/articles/disclosure-regulation/16401/conference-calls-tricks-trade/\)](/articles/disclosure-regulation/16401/conference-calls-tricks-trade/)

[Is there a good way to bury bad news? \(/articles/earnings-calls-financial-reporting/19772/disclosure-bury-bad-news/\)](/articles/earnings-calls-financial-reporting/19772/disclosure-bury-bad-news/)

[Off the radar \(/articles/sell-side/15713/radar/\)](/articles/sell-side/15713/radar/)

[Inside the black box of analyst decision making \(/articles/sell-side/20432/inside-black-box-analyst-decision-making/\)](/articles/sell-side/20432/inside-black-box-analyst-decision-making/)

[All over the map: IR south of the border \(/articles/stock-exchanges-listings/15525/all-over-map-ir-south-border/\)](/articles/stock-exchanges-listings/15525/all-over-map-ir-south-border/)

0 comments

You must be registered to comment.

Please [Sign In \(/accounts/login/?next=/articles/earnings-calls-financial-reporting/21287/one-five-firms-intentionally-misrepresents-earnings-say-cfos/\)](/accounts/login/?next=/articles/earnings-calls-financial-reporting/21287/one-five-firms-intentionally-misrepresents-earnings-say-cfos/) or [Register \(/accounts/register/\)](/accounts/register/).

YOUR CURRENT LEVEL **UNREGISTERED**

Register for free to receive these extras

- ✓ Read three articles online per month
- ✓ Weekly editorial newsletter
- ✓ 30-day free trial subscription

[REGISTER NOW! \(/ACCOUNTS/REGISTER/\)](/accounts/register/)

FROM AROUND THE WEB

Improve Your Website Technology and Security ([https://servedbyadbutler.com/redirect.spark?](https://servedbyadbutler.com/redirect.spark?MID=151862&plid=479963&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47241&tc=1&mt=1456427202908645&hc=335d8892cf6be60e4cb73cf8ef3527d3a0ff532&locatic)

[MID=151862&plid=479963&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47241&tc=1&mt=1456427202908645&hc=335d8892cf6be60e4cb73cf8ef3527d3a0ff532&locatic](https://servedbyadbutler.com/redirect.spark?MID=151862&plid=479963&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47241&tc=1&mt=1456427202908645&hc=335d8892cf6be60e4cb73cf8ef3527d3a0ff532&locatic)
Equisolve

The Activist Landscape ([https://servedbyadbutler.com/redirect.spark?](https://servedbyadbutler.com/redirect.spark?MID=151862&plid=479966&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47242&tc=1&mt=1456427203006577&hc=f4431f8002a1dc151e36842c0524b6d046d3da2f&locatic)

[MID=151862&plid=479966&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47242&tc=1&mt=1456427203006577&hc=f4431f8002a1dc151e36842c0524b6d046d3da2f&locatic](https://servedbyadbutler.com/redirect.spark?MID=151862&plid=479966&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47242&tc=1&mt=1456427203006577&hc=f4431f8002a1dc151e36842c0524b6d046d3da2f&locatic)
Nasdaq Corporate Solutions

Investor Activism & Options Trading ([https://servedbyadbutler.com/redirect.spark?](https://servedbyadbutler.com/redirect.spark?MID=151862&plid=479969&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47243&tc=1&mt=1456427203102632&hc=723f228ffc7ae44b14349a0af08602ae4ac93528&locatic)

[MID=151862&plid=479969&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47243&tc=1&mt=1456427203102632&hc=723f228ffc7ae44b14349a0af08602ae4ac93528&locatic](https://servedbyadbutler.com/redirect.spark?MID=151862&plid=479969&setID=179581&channelID=0&CID=0&banID=0&PID=0&textadID=47243&tc=1&mt=1456427203102632&hc=723f228ffc7ae44b14349a0af08602ae4ac93528&locatic)
Q4 Web Systems



WHITE PAPERS

NEW FORDHAM UNIVERSITY ([/WHITEPAPERS/164/](/whitepapers/164/))

[Legal risks posed by corporate access events \(/whitepapers/164/\)](/whitepapers/164/)

NEW SHARON MERRILL ASSOCIATES ([/WHITEPAPERS/163/](/whitepapers/163/))

[Leveraging institutional shareholder relationships to reduce activism risk \(/whitepapers/163/\)](/whitepapers/163/)

NEW BERENBERG ([/WHITEPAPERS/162/](/whitepapers/162/))

[Berenberg's 11 rules of roadshowing \(/whitepapers/162/\)](/whitepapers/162/)

NEW BANK OF AMERICA MERRILL LYNCH ([/WHITEPAPERS/161/](/whitepapers/161/))

[IR Magazine Global Roadshow Report 2015 \(/whitepapers/161/\)](/whitepapers/161/)

NASDAQ CORPORATE SOLUTIONS ([/WHITEPAPERS/160/](/whitepapers/160/))

Responding to activism: A blueprint for IR (/whitepapers/160/)

IPREO (/WHITEPAPERS/159/)

Consensus estimates: What does the investment community use? (/whitepapers/159/)

NASDAQ CORPORATE SOLUTIONS (/WHITEPAPERS/156/)

Investor Targeting: Harnessing the data (/whitepapers/156/)

Q4 WEB SYSTEMS (/WHITEPAPERS/149/)

Top 5 best practices for IR websites (/whitepapers/149/)

MONTHLY IR POLL

Should listed companies be required to report four times a year?

- Yes
- No
- Unsure

Done



ARTICLES

RESEARCH

EVENTS

IR SERVICES (/SUPPLIERS/FILTER/)

JOBS (/JOBS/)
