Financial Statement Analysis

Sources of corporate financial information

[Beyer et al.](#) (2010) decompose quarterly stock return variance.

Their goal is to assess the relative contribution of management forecasts, analyst forecasts, SEC filings, issuance of earnings guidences, and actual earnings disclosures to the information reflected in security prices.

They estimate the following time-series regression for each sample firm (1994–2007):

$$CAR = \alpha + \beta_1 car^{EA} + \beta_2 car^{PRE-EA} + \beta_3 car^{MF} + \beta_4 car^{AF} + \beta_5 car^{SEC}$$

where *CAR* is cumulative abnormal returns.

Results

	Partial R^2	% of total
EA: Earnings announcements	2.3	8.2
PRE-EA: Earnings pre-announcements	3.2	11.3
MF: Management forecasts	15.7	55.2
AF: Analyst forecasts	6.1	21.6
SEC: SEC filings	1.0	3.6

- **Management forecasts provide ~55% of accounting-based information.**

- **Mandatory disclosures provide less than 12% (8.2%+3.6%) of the total accounting-based information used by investors.**
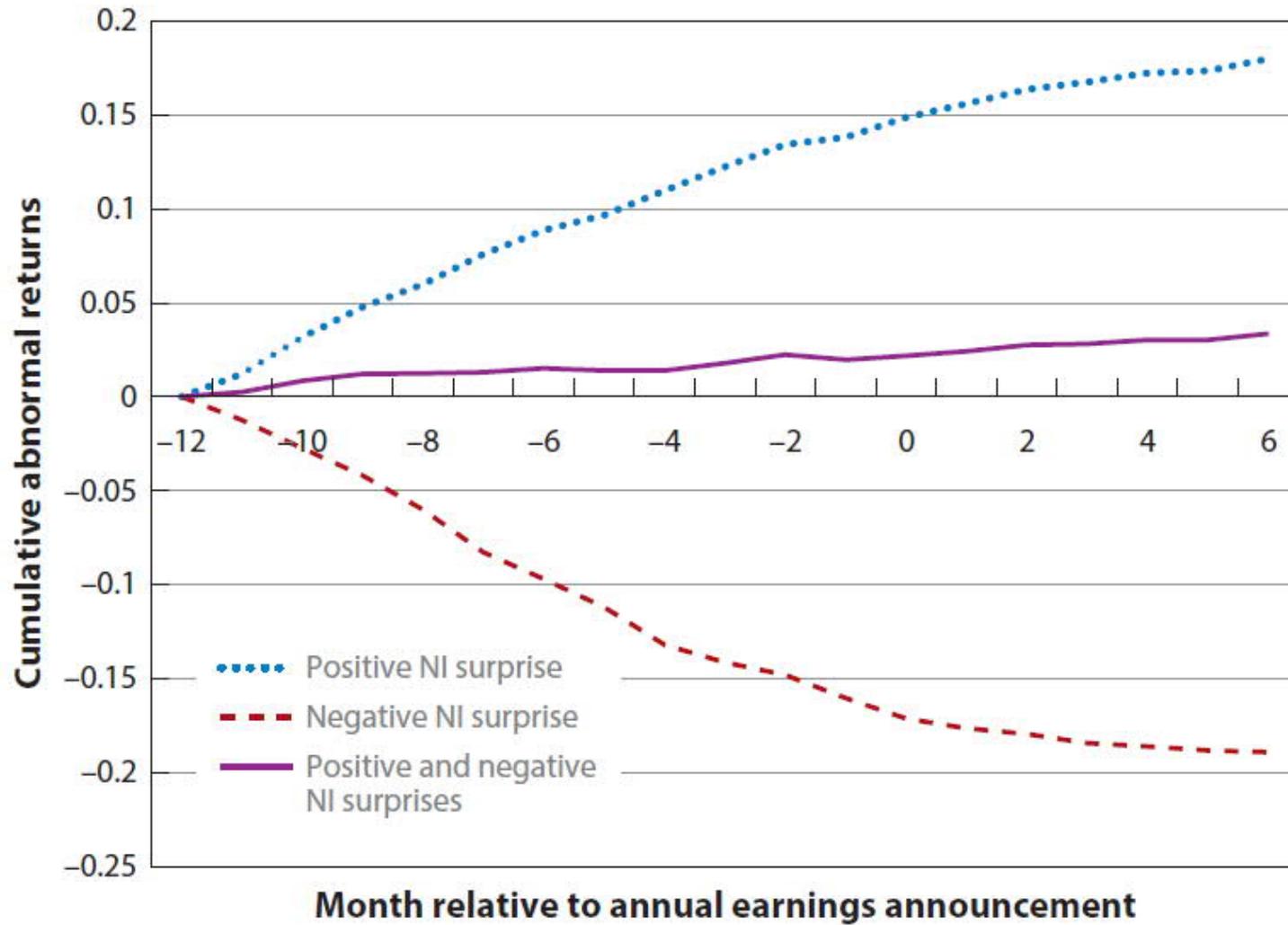
Interpretation

- The analysis ignores the interdependencies and complementarities of the individual sources of information.

- Quarterly earnings announcements are not timely in providing incremental information to capital markets.

- However, it is not correct to interpret this result to imply that earnings announcements are not relevant.

- Earnings likely play an important disciplining role on management, thus making management forecast credible and, hence, informative.

- Similarly, MF, AF, and PRE-EA are incorporated in investors' expectations of earnings.

Is the earnings number useful?

Ball and Brown (1968) design

- BB68 studied the relation between revision in stock price and change in accounting earnings.

- Does accounting earnings incorporate information that investors consider value-relevant? (Yes).

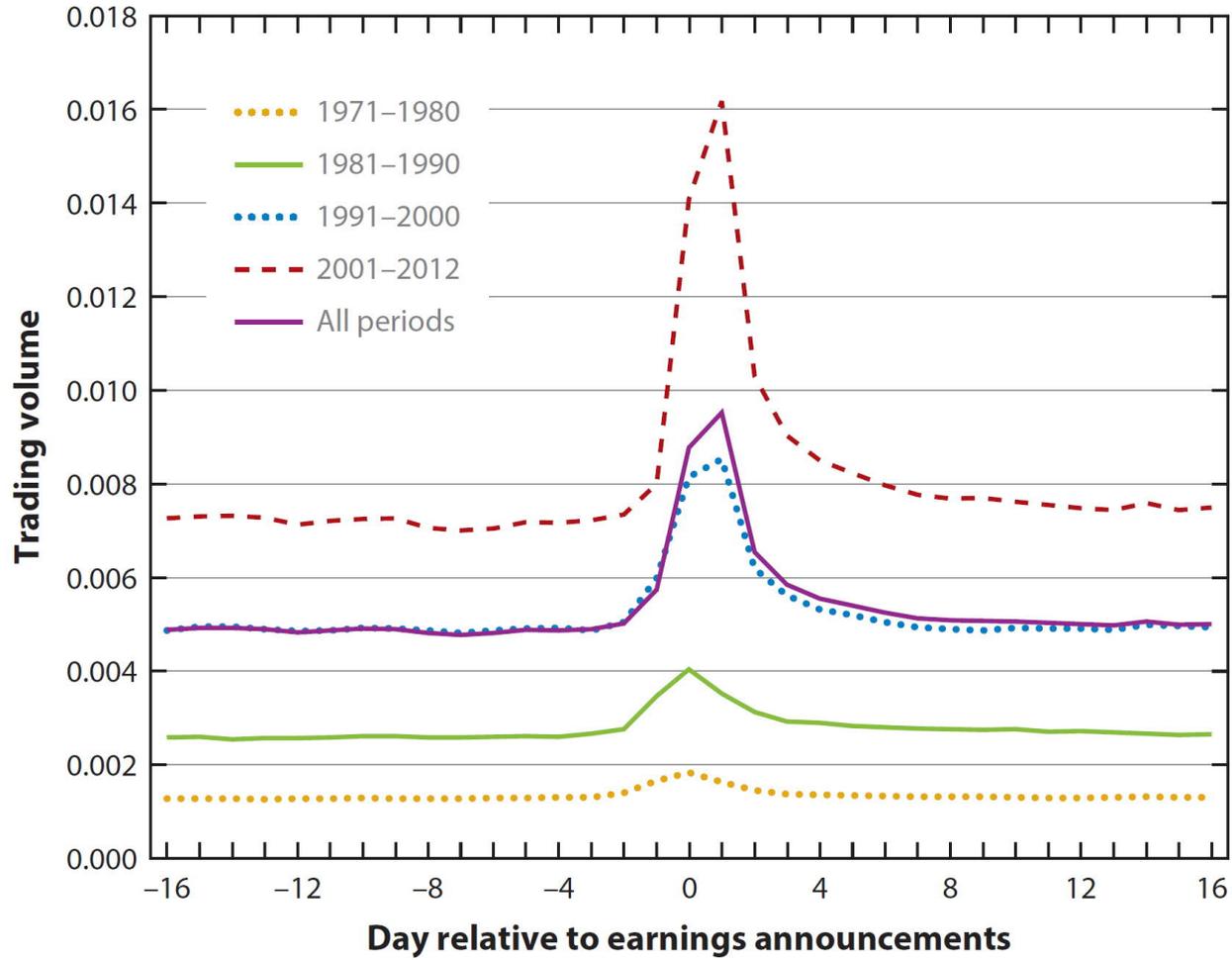- Does accounting earnings incorporate value-relevant information in a timely fashion? (No)

Cumulative abnormal returns

Month relative to annual earnings announcement

- ••••• Positive NI surprise
- – – – Negative NI surprise
- —— Positive and negative NI surprises

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Are Earnings Announcements Useful?

Beaver (1968) design

- He investigates whether earnings announcements lead to significant increases in trading volume and stock price volatility.

- The focus is on whether earnings announcements convey any news at all.

- His results provide strong support for the hypothesis that earnings announcements convey information to investors.

a Trading volume analysis

Legend:
- 1971–1980
- 1981–1990
- 1991–2000
- 2001–2012
- All periods

Y-axis: Trading volume (0.000 to 0.018)

X-axis: Day relative to earnings announcements (−16 to 16)

b Price residual analysis