



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

Department of Accounting

Earnings Quality: Evidence from the Field

Prof Illia Dichev
Goizueta Business School, Emory University

Date: 14 November 2012

Time: 4.00-5.30pm

Venue: NAB.2.08

Abstract

We provide new insights into earnings quality from a survey of 169 CFOs of public companies and indepth interviews of 12 CFOs and two standard setters. Our key findings include (i) high-quality earnings are sustainable and are backed by actual cash flows; they also reflect consistent reporting choices over time and avoid long-term estimates; (ii) about 50% of earnings quality is driven by non-discretionary factors; (iii) about 20% of firms manage earnings to misrepresent economic performance, and for such firms 10% of EPS is typically managed; (iv) CFOs believe that earnings manipulation is hard to unravel from the outside but suggest a number of red flags to identify managed earnings; and (v) CFOs disagree with the direction the FASB is headed on a number of issues including the sheer number of promulgated rules, the top-down approach to rule-making, the de-emphasis of the matching principle, and the overemphasis of fair value accounting. CFOs lament that a rules-based culture makes the audit function centralized and mechanical, and stunts the development of audit professionals.