THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Department of Accounting

Aggressive Pro Forma Reporting in the Post-SOX Environment:
Do Managers Use Conference Calls to Influence Analysts' Exclusions?

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Abstract

The frequency of non-GAAP or "pro forma" reporting has continued to increase in the U.S. in spite of regulation imposed by the Sarbanes-Oxley Act of 2002 and Regulation G (issued in 2003). As a result, the SEC recently renewed its emphasis on non-GAAP reporting in 2010 by declaring it a "fraud risk factor." Given this renewed emphasis by the SEC, we revisit three measures of aggressive pro forma reporting in the post-SOX period to investigate the extent to which regulation has curbed potentially misleading disclosures. Consistent with the intent of Congress and the SEC, we find that managers generally report adjusted earnings metrics more cautiously in the post-SOX period. Specifically, we find that managers tend to exclude less recurring items upon which analysts disagree and they use pro forma exclusions less frequently to (1) convert a GAAP operating loss to a pro forma profit or (2) go from missing analysts' expectations based on GAAP operating earnings to meeting expectations on a pro forma basis. These results suggest that SOX and Regulation G have, to some extent, accomplished their intended purposes with respect to non-GAAP reporting. However, recent research finds that managers provide "pro forma" earnings guidance to convince analysts to "buy in" on their aggressive earnings exclusions. This evidence suggests that in the post-SOX environment, managers seek validation from analysts for controversial exclusions. The main purpose of this study is to explore whether, in addition to earnings guidance in public press releases, managers also use conference calls to convince analysts to endorse the exclusion of recurring items. The results indicate that analysts are more likely to exclude recurring items from their earnings forecasts when managers hold a conference call during the quarter than when they do not. Moreover, since analysts appear to be swayed by conversations with managers in conference calls, managers are less likely to aggressively exclude incremental recurring items beyond what analysts exclude from their forecasts when they hold a conference call than when they do not. This evidence is consistent with the notion that managers use conference calls to influence analysts' perceptions of aggressive pro forma reporting.