

PAC ANNUAL CONFERENCE

PROFESSIONAL ACCOUNTING FUTURES

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Investors Use of Accounting Estimates during Macroeconomic Uncertainty

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Professional Accounting Centre

UNIVERSITY OF TORONTO

MISSISSAUGA

Economic Uncertainty and Financial Reporting

A User's Perspective – Sell-Side Equity Research

- **Economic uncertainty leads to lower confidence in outlook**
 - Management teams are more reluctant to provide guidance
 - Negatively impacts investor sentiment
 - Raises corporate's cost of capital
- **From a financial reporting perspective, uncertainty reduces the utility of historical financial statements**
 - Prior period not an accurate reflection of the anticipated future economic conditions
- **An Example – Impact of inflation on outlook:**
 - More difficult to forecast
 - Wider dispersion of estimates
 - Less certainty
 - Lower multiples: Empirical evidence of a negative correlation between P/E's and (expected) inflation

Economic Uncertainty and Financial Reporting

What Can Professional Accountants Do to Alleviate Banking Scandals?

- **Capital Markets/Banking Sector Has Been Rife with Scandals**
 - The Financial Crisis was not the end of scandals in the world of banking
 - Current predicament of Credit Suisse highlights the ongoing issues
 - ◆ I fully admit that Barclays has hardly been a paragon of virtue
- **Accountants Need to Retain a High Degree of Skepticism**
 - Accountants and Auditors need to use judgement
 - Users of financial statements must put reporting in context
 - ◆ Be aware of underlying motives and incentives