

PAC ANNUAL CONFERENCE
PROFESSIONAL ACCOUNTING FUTURES

Unveiling Insights from Going Concern
Disclosures

Jingjing Wang

Assistant Professor, University of Calgary



Professional Accounting Centre

UNIVERSITY OF TORONTO

MISSISSAUGA

Unveiling Insights from Going Concern Disclosures

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Jingjing Wang

Assistant professor in Accounting

Haskayne School of Business

University of Calgary

haskayne
School of Business





»» Going concern assumption



Financial statements are normally prepared assuming the entity is a going concern and will continue in operation for the foreseeable future (IFRS).

Continuation of a reporting entity as a going concern is presumed as the basis for preparing financial statements unless and until liquidation becomes imminent (US GAAP).



If there is doubt about an entity's ability to continue as a going concern, warnings should be provided by managers/auditors.



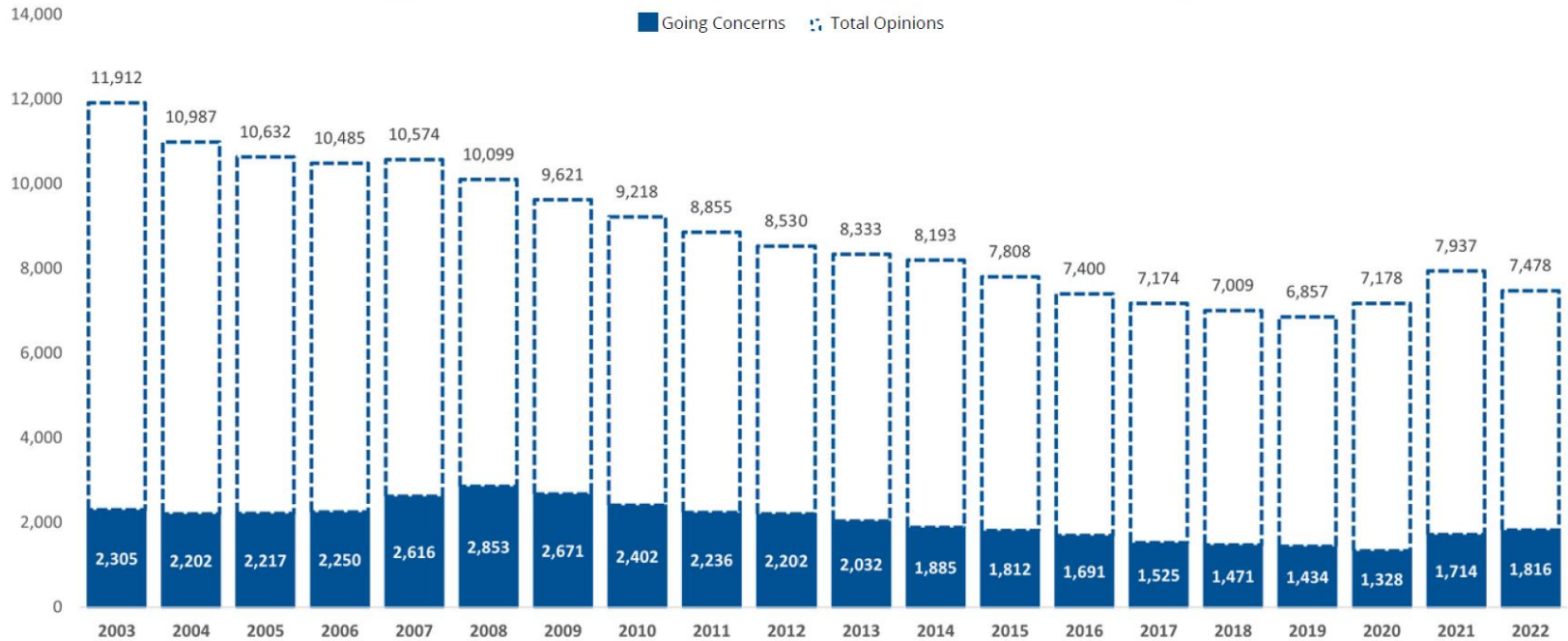
Significant media attention directed towards high-profile corporate collapses in several countries, prompting criticism of auditing profession and appropriateness of management disclosure guidelines (Bradbury et al. 2023)



» Going concern audit opinion – general trend

Report Population

Population is based on the fiscal year end of companies that filed an annual report.



Source: *Going Concerns A 20-Year Review, Audit Analytics, June 2023*



» The myth around going concern warning

Do bankrupt firms receive going concern opinion the year before?

- During the wave of “dot-com” failures in 2000, only 3 of 10 publicly held dot-com companies filed for bankruptcy received going concern opinions on most recent audit report (Weil 2011).
- 60% of bankruptcy filings are preceded by audit opinions that are modified for going-concern uncertainties, based on sample period of 2000-2010 (Carson et al. 2013).
- Over 60 percent of firms did not provide a management going concern opinion in MD&A, despite filing for bankruptcy in the next year, during 1995-2012 (Mayew et al. 2015).
- In KPMG's 2016 audit, dated March 1, 2017, Carillion was affirmed as a going concern. However, Carillion entered compulsory liquidation on January 15, 2018.

Do firms received going concern opinion go bankrupt immediately after?

- 98% of firms survive for at least 12 months after they are issued a going concern opinion, during 2000-2010 (Carson et al. 2013).
- View Systems Inc., a security technology products company incorporated in Colorado, has consistently received a going concern audit opinion since 2008, yet continues to operate.



» What kind of disclosure is relevant and useful

Timely and transparent disclosure of going concern uncertainties have been on the agenda of regulators and standard setters around the world (e.g., FASB, FRC, IAASB).

“Whether or not to prepare financial statements on a going concern basis is a binary decision, but the circumstances in which entities prepare financial statements on a going concern basis will vary widely.” (IFRS, 2021)

Involve forward-looking information, comprehensive analysis, and subjective assumptions. Cassell Bryan-Low, in “Auditors Fail to Foresee Bankruptcies” (Wall Street Journal, 2002) : “A KPMG spokesman ... said ... ‘the going-concern clause ... requires a great deal of judgment and is not something to be taken lightly.’”

Disclosure responsibility and incentive:

- Management vs auditor responsibility. Are auditors offering a sufficient evaluation of management's assessments regarding going concern?
- Litigation risk vs self-fulfilling prophecy.

Disclosure content:

- How to define going concern uncertainty. What is the threshold for substantial doubt?
- How long is the foreseeable future? Difference between US GAAP and IFRS.
- Where to provide disclosure?
- Format of disclosure.

» US Going Concern Related Standards

GAAP



No formal guidance about management's responsibility to evaluate and provide disclosures on going concern

Diversity in practice

GAAS



Auditors have responsibility to evaluate whether there is substantial doubt in going concern

Not a timely signal



» Disclosure Considerations

Liquidation Basis

If yes, liquidation basis
(Subtopic 205-30)

Conditions or Events

Negative financial trends;
indicator of financial
difficulties; internal and
external matters

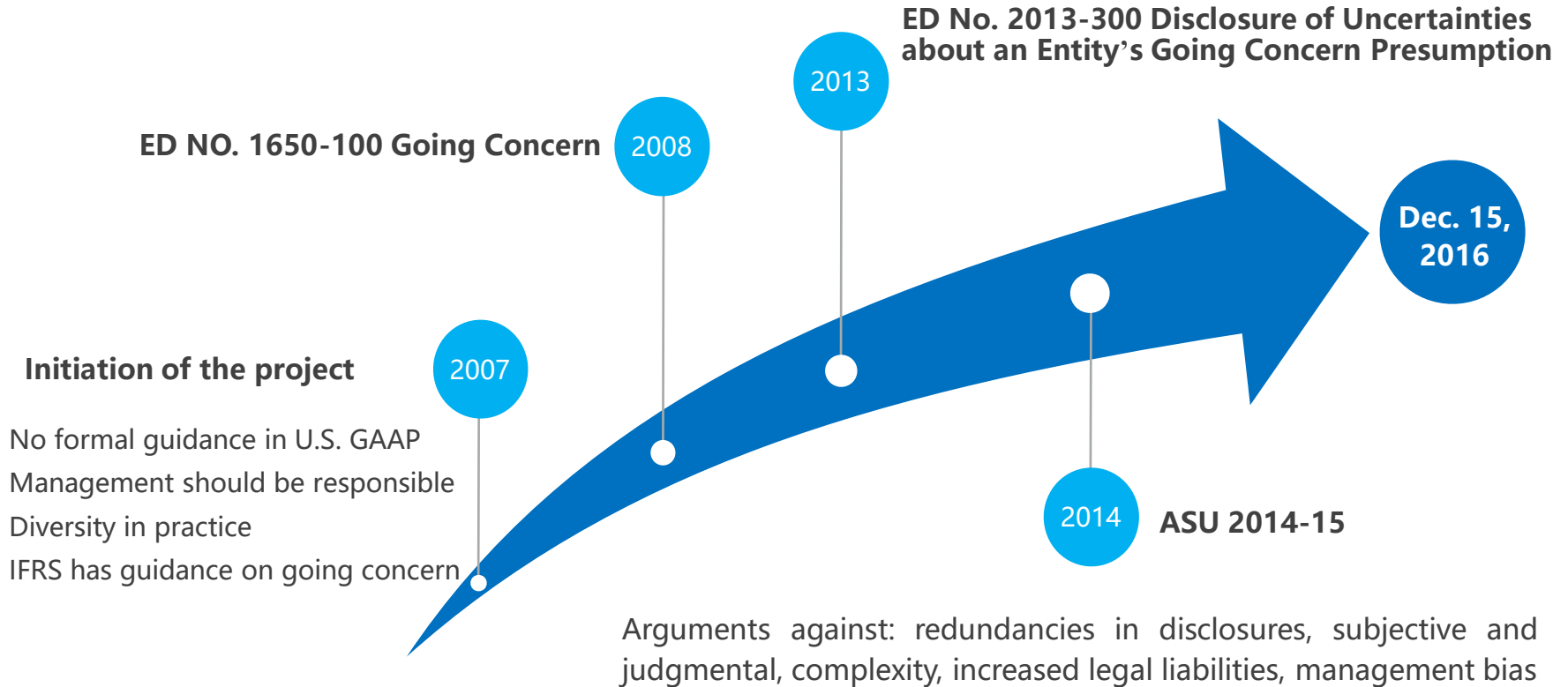
Mitigation Plans

E.g., dispose an asset or
business; borrow money
or restructure debt;
reduce or delay
expenditures; increase
ownership equity
Probable (1) effectively
implement; (2) mitigate
the substantial doubt

Disclosure

Conditions or events;
evaluation and
mitigation plans
Explicit statement that
there is substantial
doubt in going concern

Standard-setting Timeline



» New Going Concern Standard (ASU 2014-15)

Main Provisions

In connection with preparing financial statements for each annual and interim reporting period, management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued.

Compared with GAAS

- Definition of Substantial Doubt
- Evaluation Frequency
- Forward-looking Window



»» Definition of Substantial Doubt

ASU 2014-15 (FASB)

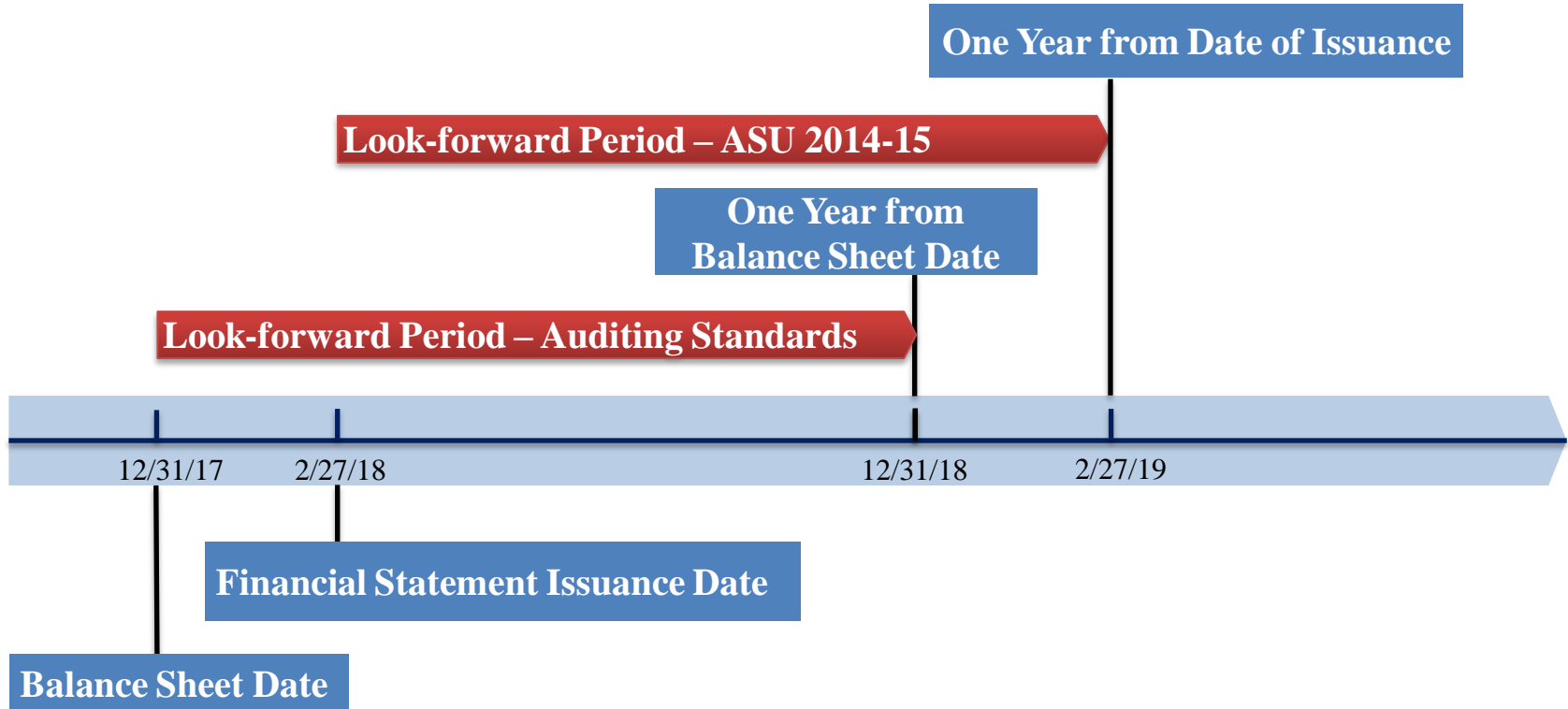
Substantial doubt about an entity's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is **probable** that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). The term probable is used consistently with its use in Topic 450 on contingencies

AS 2415 (PCAOB)

The auditor has a responsibility to evaluate whether there is **substantial doubt** about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited



»» Look-forward Period





» Going Concern Assessment – Auditor vs Management

- Threshold for management (“probable”– 70% and above) is higher than for auditors (50-70% based on Boritz 1991), affected by the level of distress
- Auditors are conservative and not willing to remove going concern opinion unless the problems have been resolved (Mutchler 1985), while managers are biased towards reporting optimistic results and reluctant to disclose going concern issues (Mayew et al. 2015, Boritz and Sun 2004, Uang et al. 2006)
- Auditors have access to some insider information but not as much as managers

Major Differences

Excerpts from Comment Letters

- *Although management may have a biased opinion, their opinion would likely be more accurate than an auditors’ opinion.*
- *The proposed amendments would provide incremental benefits by introducing an enhanced degree of rigor around management’s process for identifying and evaluating going concern uncertainties and thereby improve the timeliness and quality of disclosures*
- *The assessment of the Company’s ability to meet its future obligations is inherently judgmental, subjective and susceptible to change. The inputs include, but are not limited to, cash flow forecast, operating budget, and long-term plans.*



»» Going Concern Evaluation Inconsistencies

| Co Name | Year End | File Date | Auditor | GC Management Disclosure |
|----------------------------|-------------|---------------|-------------------|---|
| Southcross Energy Partners | Dec 31 2017 | March 1 2018 | Deloitte & Touche | ...absent additional amendments to its Revolving Credit Agreement or waivers of the <i>March 31, 2019</i> requirement to comply with the Consolidated Total Leverage Ratio (as defined in the Fifth Amendment), the Partnership is not expected to be able to comply with such financial covenant as of such date, which would trigger an event of default, and result in substantial doubt regarding SXE's ability to continue as a going concern as early as the end of the first quarter of 2018. |
| Sears Holdings | Jan 28 2017 | March 21 2017 | Deloitte & Touche | ...substantial doubt exists related to the Company's ability to continue as a going concern. We believe that the actions discussed above are probable of occurring and mitigating the substantial doubt raised by our historical operating results and satisfying our estimated liquidity needs 12 months from the issuance of the financial statements. However, we cannot predict, with certainty, the outcome of our actions to generate liquidity, including the availability of additional debt financing, or whether such actions would generate the expected liquidity as currently planned. |
| Kona Grill | Dec 31 2017 | March 22 2018 | EY | These conditions together with recent debt covenant violations and subsequent debt covenant waivers and debt amendments, raise substantial doubt about the Company's ability to continue as a going concern. |



ASU 2014-15 and IFRS

Liquidation basis – Subtopic 205-30

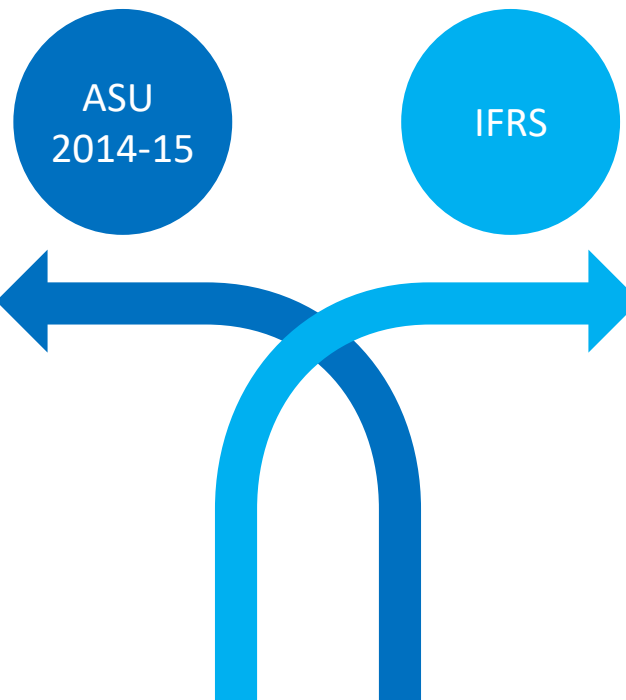
GC basis “unless and until its liquidation becomes imminent”

Disclosure

When substantial doubt in GC and when substantial doubt is alleviated as a result of mitigation plans

Assessment period

Within one year



Liquidation basis – no separate guidance

GC basis “unless management either intends to liquidate the entity or to cease trading [operations], or has no realistic alternative but to do so”(paragraph 25, IAS 1)

Disclosure

When management is aware of material uncertainties related to events/conditions that may cast significant doubt in GC

Assessment period

At least one year, no upper limit



» International Studies - Canada

- In 2008, *IAS 1-25* was adopted into Canadian GAAP and managers are required to assess and disclose going concern uncertainties
- *IAS 1* is not clear regarding the timing and content of going concern disclosures and there is significant diversity in practice (IFRS Interpretations Committee 2013)
- Many disclosures do not contain the explicit statement “cast significant doubt” and thus going concern risk is not highlighted (Ontario Securities Commission 2010)
- Since 2010, *CAS 570* has required auditors to include EOM paragraph on going concern, previously it was prohibited if appropriate disclosures are provided by managers
- ✓ Market reactions: before *CAS 570*, negative market reactions associated with severe but not weak management going concern disclosures. After *CAS 570*, the market reacts more to weak disclosures accompanied by audit EOM (Bédard et al. 2019)
- ✓ Management’s propensity to disclose going concern: increased by *IAS 1-25* for highly distressed firms; decreased by *CAS 570* for less distressed firms (Bédard et al. 2017)



Management Going Concern Disclosure, Mitigation Plan, and Failure Prediction— Implications from ASU 2014-15



Market Reaction

Negative market reactions to disclosures of substantial doubt in going concern



Mitigation Plans

Can alleviate negative market reactions (particular types)

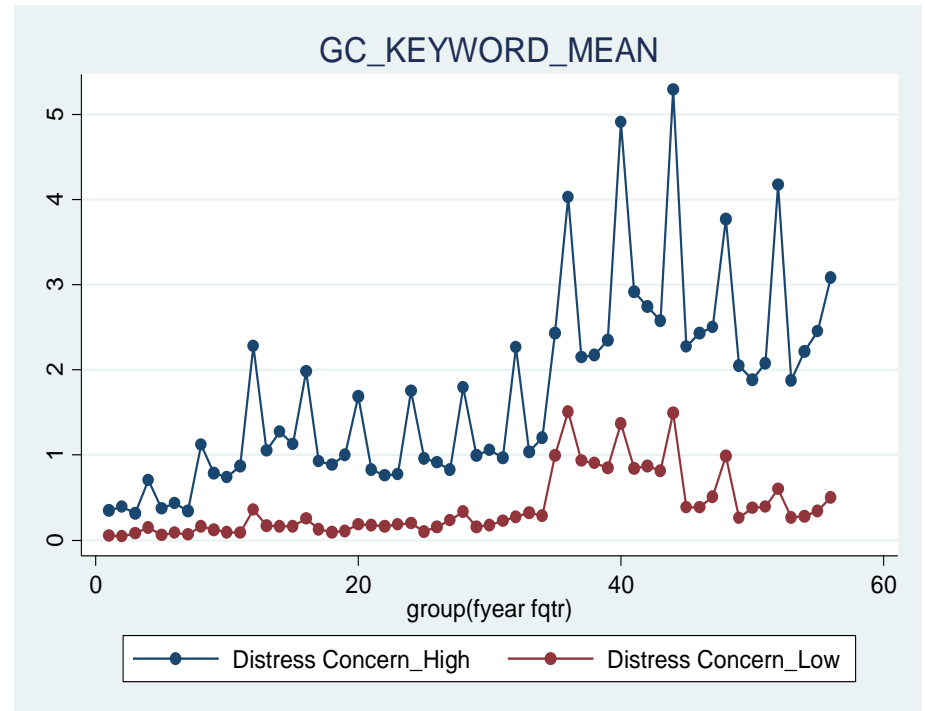
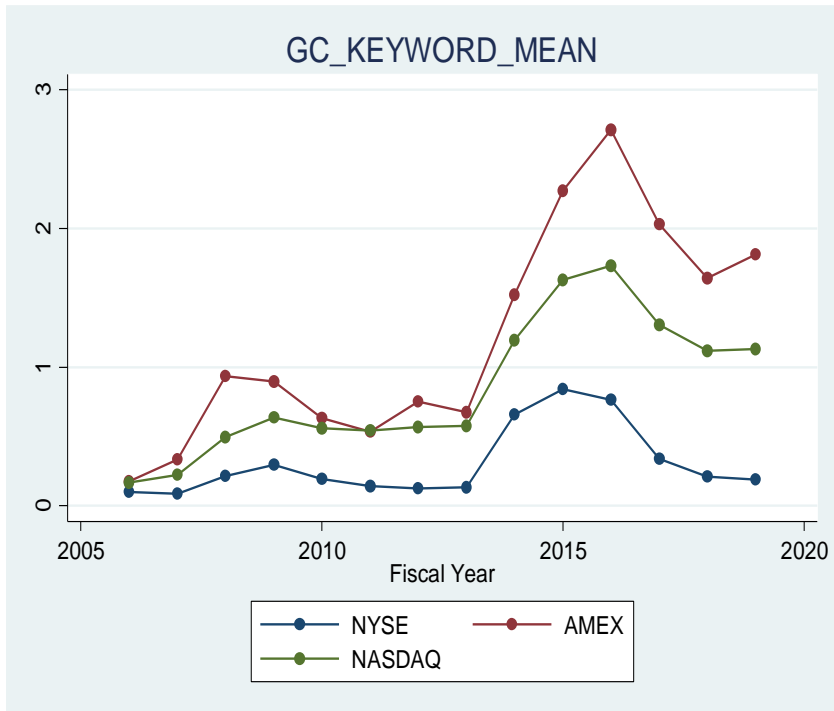
Highly detailed and contextual textual analysis



Future Viability

Going concern status and mitigation plan discussions can signal firm failures

» The Impact of ASU 2014-15 – GC Discussion Trend



»» Going Concern Disclosure Examples (Notes)

Substantial Doubt Exists

The Company's inability to raise funds to carry out its business plan will have a severe negative impact on its ability to remain a viable company. These conditions **raise substantial doubt** about the Company's ability to continue as a going concern.

Our cash and cash equivalents at December 31, 2016, coupled with net proceeds from our rights offering of \$10.5 million and with anticipated revenues outside of the United States **will be sufficient** to satisfy our anticipated cash requirements, including capital expenditures, working capital requirements, long term debt and other liquidity requirements through at least the next twelve months.

Substantial Doubt Does Not Exist



» Overall Market Reactions (RQ1)

H1: After the adoption of ASU 2014-15, management disclosures of going concern uncertainties – concluding substantial doubt in going concern exists - are associated with ***negative*** market reactions.

Counterarguments:

- Disclosures may not present new or incremental information; MD&A and risk factor section - *Regulation S-K, Item 303(a) and 503(c)*
- Investors learn about going concern issues through other channels such as earnings announcements



» Sample Selection and Composition

TABLE 1
Sample Selection and Composition

Panel A: Sample Selection Procedure

| | <u>Observations</u> | <u>Distinct Firms</u> |
|--|---------------------|-----------------------|
| All 10-Ks and 10-Qs filed on the SEC's EDGAR website for fiscal years 2015 to 2018 | 81,628 | 6,393 |
| With data available for calculating control variables | 72,053 | 6,005 |
| With data available for calculating <i>CAR</i> | 59,055 | 4,845 |
| <i>POST</i> = 0 | 26,010 | 4,204 |
| <i>POST</i> = 1 | 33,045 | 4,358 |
| 10-K | 14,929 | 4,608 |
| 10-Q | 44,126 | 4,759 |

Panel B: Sample Composition

| | <u><i>POST</i> = 0</u> | | <u><i>POST</i> = 1</u> | |
|---------------------|------------------------|-------------------|------------------------|-------------------|
| | <u>10-K</u> | <u>10-Q</u> | <u>10-K</u> | <u>10-Q</u> |
| <i>GC_DOUBT</i> = 1 | 142 (132) | 556 (203) | 516 (335) | 1,081 (344) |
| <i>GC_DOUBT</i> = 0 | 4,330 (3,671) | 20,982 (4,095) | 9,941 (4,111) | 21,507 (4,108) |

➤ Overall Market Reactions (RQ1)

Management disclosures of going concern uncertainties - concluding substantial doubt in going concern exists - are associated with *negative* market reactions.

| VARIABLES | (1) POST=0 | (2) POST=1 | (3) 10-Q | (4) 10-K |
|--------------------------|---------------|-----------------|-----------------|---------------|
| <i>POST</i> | | | -0.002 | 0.004 |
| <i>GC_DOUBT</i> | 0.005 | -0.019** | -0.009 | -0.007 |
| <i>POST × GC_DOUBT</i> | | | -0.016** | -0.005 |
| Observations | 26,010 | 33,045 | 44,126 | 14,929 |
| Unique Firms | 4,204 | 4,358 | 4,759 | 4,608 |
| Adjusted R-squared | 0.024 | 0.027 | 0.026 | 0.012 |
| Year-quarter FE, Firm FE | Yes | Yes | Yes | Yes |



» Control Variables

- Earnings news: earnings surprise and reporting lag
- Firm characteristics: size, market to book ratio, and leverage
- Financial performance: return on assets, changes in return on assets, cash flow, distress (Altman-Z), and exit value
- Visibility: analyst coverage
- Financial report type: indicator variable on filing type
- Audit quality: indicator variable on big-four auditors
- Length and tone of 10-Ks and 10-Qs, level of earnings management, institutional holdings, going concern disclosures in MD&A

» Mitigation Plans and Market Reactions (RQ2)

RQ2: The negative market reactions from disclosing a substantial doubt in GC can be alleviated by mitigation plans that enhance short-term liquidity and/or improve long-term profitability.

Effective plans:

- Bring a significant amount of liquidity within twelve months
- Beneficial to firms from a long-term strategic perspective



➤ Mitigation Plans and Market Reactions (RQ2)

- Two types of turnaround strategies (Hofer 1980) : operating and strategic
 - Operating: cost-cutting, asset reduction, revenue increasing, and combination
 - Strategic: for competing in the same business and entering a new business
- Short-term and long-term cash flow impact are both essential (Bruynseels and Willekens 2012)
 - Acquisition and cost reduction (cooperative arrangements) positively (negatively) associate with future audit going concern opinion
- Behn et al. (2001): negative relation between the ability to obtain new financing (through equity issues and additional borrowing) and the likelihood of going concern audit opinion



» Mitigation Plans and Market Reactions (RQ2)

“The company is using cash from selling real estate to pay down debt, and Sears’ cash balance has grown.”

“Little investment in improving the store and customer experiences, a turnaround strategy hinged on cutting costs rather than increasing revenue, and too-little-too-late programs put in place to reinvigorate business turned Sears’ path to bankruptcy into a drawn-out funeral procession.”

Sears

“To come back on top, Delta would have to further strengthen its culture and pursue more-innovative strategies. Delta’s operational improvements have focused on enhancing the customer experience and creating a stronger, more balanced network as a result of the addition of more than 60 new international routes.”

 **DELTA**



» Textual Analysis (RQ2)



Classification

Reading of the going concern notes in the financial reports

Examples in ASU 2014-15



Dictionary

Highly **detailed**, **contextual**, and **specific** to management mitigation plan discussions

Lists of keywords to describe each major plan type

Python: NLTK, Gensim



Measurement

Intensity of discussions on each major plan type



» Mitigation Plans and Market Reactions (RQ2)

| Plan category | Word examples | GC Note example |
|---------------|---|--|
| DEBT | loan, line_credit, promissory_notes, credit facilities | ...we expect to require additional capital...may decide to engage in equity or debt financings or enter into credit facilities. |
| RESTRUCTURE | extend_maturity, waive | The Company entered into an Eleventh Amendment...reflects the following changes: (i) waived certain provisions of the Credit Agreement. |
| EQUITY | closed_public_offering, common_share, secondary_public_offering | ...access to capital resources through potential public or private issuance of debt or equity securities. |
| REVENUE | brand, strategic_partnership, innovation, introduction_new_ product, lead_product_candidate | To address the immediate impact of this decreased liquidity, we developed certain operating plans that focus on increased revenue growth... |
| ASSET_SALE | dispose_asset, dispose, disposition, divest | In order to mitigate conditions or events that would raise substantial doubt about its ability to continue as a going concern: ...Dispose of one or more product lines... |
| MA | merger, merger_acquisition, | The Company continues to evaluate its strategic alternatives, which may include a potential merger. |
| COST | cost_cutting, reduced_headcount, reduced_spending | The Company believes that its quality control, headcount reduction and cost cutting initiatives . . . will restore positive operating cash flows and profitability during the next year. |

» Going Concern Disclosures and Firm Viability (RQ3)


RQ3: Management disclosures of going concern uncertainties and discussions on mitigation plans are associated with a firm's future viability.

- Corporate failure defined as:
 - Filing under either Chapter 7 or 11 of the bankruptcy code
 - Performance-driven delisting
 - D (“default”) rating issued by a leading credit rating agency (S&P)



$$P_{t-1}(FAILURE_{it} = 1) = 1 / (1 + \exp(-\alpha - \beta x_{i,t-1}))$$

Going Concern Disclosure and Firm Failures

| Variables | (1) | | (2) | | (3) | | (4) | | (5) | | (6) | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|---------|------|---------|------|---------|------|
| | Baseline | | Mgmt GC | | Mgmt GC | | Mgmt GC | | Mgmt GC | | Mgmt GC | |
| | Pre | Post | Pre | Post | Pre | Post | Pre | Post | Pre | Post | Pre | Post |
| <i>NITA</i> | -1.621** (-2.461) | 0.647 (0.798) | -1.811** (-2.576) | 1.471 (1.591) | -1.806** (-2.562) | 1.368 (1.481) | | | | | | |
| <i>TLTA</i> | 1.592*** (6.660) | 2.022*** (7.518) | 1.500*** (6.115) | 1.697*** (5.998) | 1.545*** (6.191) | 1.743*** (6.106) | | | | | | |
| <i>EXRET</i> | -1.844*** (-3.474) | -2.214*** (-3.331) | -1.749*** (-3.261) | -1.830*** (-2.862) | -1.697*** (-3.152) | -1.844*** (-2.888) | | | | | | |
| <i>SIGMA</i> | 1.500*** (5.568) | 0.393 (1.253) | 1.325*** (4.812) | -0.089 (-0.267) | 1.328*** (4.792) | -0.054 (-0.160) | | | | | | |
| <i>RSIZE</i> | -0.820*** (-8.841) | -1.084*** (-9.907) | -0.802*** (-8.570) | -0.967*** (-8.735) | -0.816*** (-8.649) | -0.975*** (-8.777) | | | | | | |
| <i>AUD_GC</i> | | | | | -0.345 (-1.239) | -0.401 (-1.388) | | | | | | |
| <i>MDA_GC</i> | | | | | 0.476 (0.773) | 0.793 (1.402) | | | | | | |
|  <i>GC_DOUBT</i> | | | 0.641* (1.869) | 1.926*** (5.204) | 0.371 (0.581) | 1.405** (2.189) | | | | | | |
| <i>DEBT</i> | | | -0.052 (-0.554) | 0.046 (0.488) | -0.052 (-0.532) | 0.032 (0.329) | | | | | | |
| <i>RESTRUCTURE</i> | | | 0.147*** (3.266) | 0.024 (0.530) | 0.143*** (3.154) | 0.017 (0.387) | | | | | | |
| <i>EQUITY</i> | | | -0.216* (-1.927) | -0.045 (-0.654) | -0.203* (-1.798) | -0.049 (-0.706) | | | | | | |
| <i>REVENUE</i> | | | -0.122 (-1.305) | -0.283** (-2.410) | -0.121 (-1.273) | -0.288** (-2.420) | | | | | | |
| <i>COST</i> | | | -0.011 (-0.176) | -0.005 (-0.068) | -0.012 (-0.187) | -0.001 (-0.015) | | | | | | |
| <i>ASSET_SALE</i> | | | 0.015 (0.135) | -0.001 (-0.004) | 0.011 (0.091) | 0.024 (0.157) | | | | | | |
| <i>MA</i> | | | 0.092 (0.449) | 0.013 (0.060) | 0.107 (0.531) | -0.001 (-0.003) | | | | | | |
| Observations | 79,195 | 102,840 | 79,195 | 102,840 | 79,195 | 102,840 | | | | | | |
| Pseudo R ² | 0.300 | 0.267 | 0.319 | 0.298 | 0.321 | 0.301 | | | | | | |

Mitigation Plans

» Additional Analyses and Robustness Tests

Additional Analyses

- Alternative event windows
- Adding additional control variables
- Alternative failure prediction model

- New, repeat, stop disclosure
- Concrete Plans
- Investor Sophistication
- Propensity Score Matching
- Likelihood of increasing cash flows

Robustness Tests

» Contributions

FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2014-15
August 2014

Presentation of Financial Statements—
Going Concern (Subtopic 205-40)

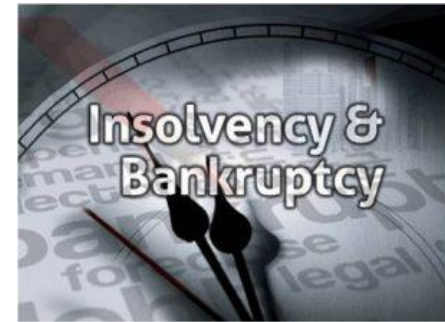
New Accounting Standard

Provide initial and **timely** evidence on the new and controversial standard



Textual Analysis

Highly **detailed and contextual** Dictionary on mitigation plans is useful to firms, investors, and regulators



Corporate Failure

Management going concern opinion and mitigation plan discussions can signal firms' future viability



**Management Going Concern
Disclosure, Mitigation Plan,
and Failure Prediction –
Implications from ASU 2014-15**



**Unforthcoming Going Concern
Disclosure**



» Management Going Concern (GC) Disclosure

Importance

- GC disclosure is highly relevant to stakeholders, especially during substantial economic uncertainties (e.g., COVID 19).
- Management, instead of auditor, is responsible for GC assessment. Research rarely examines the quality of management GC disclosure.
- Standard setters around the world are revising standards to improve the informativeness of GC disclosure.



Consideration

- GC assessment is judgemental and involves forward-looking information.
- Managers tend to withhold bad news.
- Market reacts negatively to the disclosure of substantial doubt in GC.
- Self-fulfilling prophecy.
- Reputation damage and legal consequence following untruthful disclosure (SEC rule; ASU 2014-15).



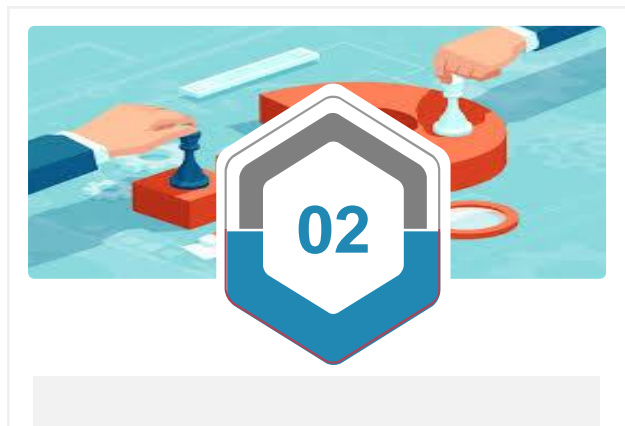


» Summary



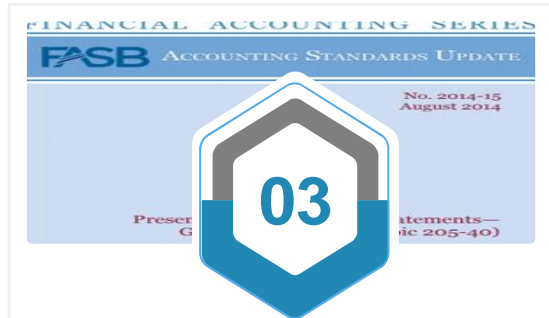
Understand and predict unforthcoming/strategic GC disclosure

- Define and measure
- Linguistic features extracted from conference calls



Predicted probability of unforthcoming disclosure

- Existence of GC note
- Substantial doubt in GC
- Length of GC note
- Specificity of GC note
- Forward-looking of GC note



ASU 2014-15 as quasi-natural experiment; partition on:

- Litigious industry
- Analyst coverage
- Institutional ownership
- News coverage



» Literature - Unforthcoming Disclosure

General

- Opportunistic disclosure position: propensity to seek firm-specific advantage in disclosing financial information. (Gibbins et al. 1990).
- In the revelation of negative outcomes, management is prone to behave opportunistically, including employing a concealment strategy (Sutton and Callahan 1987).
- Impression management: select information to release and present that distorts readers' perceptions (e.g., Osma and Guillamón-Saorín 2011). Managers minimize the repercussions of negative news (Subramanian et al. 1993).
- Strategic disclosure strategy: discloses all observed successes and withholds all failures (Shin 2003) .

GC Specific

Bierstaker and DeZoort (2019): Managers *most likely to recommend GC disclosure* when financial distress is high and the recovery plan focuses on debt and equity.

Uang, Citron, Sudarsanam, and Taffler (2006) examine directors' GC reports for U.K. firms. Directors' statements convey *arbitrary and unhelpful* messages to users.

Mayew, Sethuraman, and Venkatachalam (2015): *Only 39 percent* of bankrupt firms explicitly discussed possibility of ceasing as a GC before bankruptcy.



» Conference Call and Linguistic Feature

Linguistic Features

- Deceptive language (Larcker and Zakolyukina 2012; Hope and Wang 2018)
- Impression management through non-GAAP measures (Adhikari and Duru 2006)
- Litigation and fraud (Loughran and McDonald 2011)
- Macro information (Baker et al. 2019) - management's attributional behavior (e.g., Aerts 2005)
- Liquidity (Campbell et al. 2014)
- Length and tone (Li 2008; Loughran and McDonald 2011)

Reasons of employing conference calls

Managers discuss current financial condition and future strategies - relevant to GC ability.

Take place before but very close to the filing of 10Ks and 10-Qs - timely indicators.

Serve as effective and spontaneous communication channel, especially Q&A session.



» Linguistic Features and Unforthcoming GC Disclosure

| VARIABLES | (2) <i>UNFORTHCOMING</i> |
|-----------------------|-----------------------------|
| <i>LENGTH</i> | 0.112 |
| <i>REF</i> | 2.434*** |
| <i>POSEXTR</i> | -0.030 |
| <i>ANX</i> | -0.135 |
| <i>NON_GAAP</i> | 0.576* |
| <i>LIQUIDITY</i> | -0.322*** |
| <i>NET_TONE</i> | 0.013 |
| <i>LITIGATION</i> | -1.003** |
| <i>MACRO</i> | 1.057** |
| Observations | 2,273 |
| Industry FE | Yes |
| Year & Quarter FE | Yes |
| Pseudo R ² | 0.0840 |

Linguistic features associated with unforthcoming disclosure:

- Deceptive language “reference to general knowledge” (+)
- More non-GAAP (+)
- Macro information (+)
- Litigation and liquidity matters (-)

Unforthcoming:

No GC disclosure one year before a firm being delisted from stock exchanges due to financial/performance reasons.

- Negative income before extraordinary items
- Negative retained earnings
- Negative net worth
- Negative working capital
- Negative cash flows



At least four
& no GC
disclosure

Mutcher (1985)
Audit Analytics (2021)



Probability of Unforthcoming and Existence of GC Note and GC Conclusion

| VARIABLES | (1) | (2) | (3) | (4) | (5) | (6) |
|----------------------------------|--|------------------|------------------|---|-----------------|-----------------|
| | Dep. Var. <i>GC_NOTE_EXIST</i> GC Uncertainty Indicator: 0-3 | | | Dep. Var. <i>GC_DOUBT</i> GC Uncertainty Indicator: 0-3 | | |
| <i>PROB_UNFORTHCOMING</i> | -0.028*** | -0.022*** | -0.037*** | -0.014*** | -0.012** | -0.019** |
| <i>SIZE</i> | | -0.024*** | -0.028*** | | -0.012*** | -0.015*** |
| <i>BTM</i> | | 0.016*** | 0.021*** | | 0.008*** | 0.010** |
| <i>LEVERAGE</i> | | 0.092*** | 0.120*** | | 0.049*** | 0.064*** |
| <i>CASHFLOW</i> | | -0.053*** | -0.077*** | | -0.043*** | -0.065*** |
| <i>INCOME</i> | | -0.117*** | -0.123*** | | -0.074** | -0.078** |
| <i>BIG_FOUR</i> | | -0.001 | -0.005 | | -0.005* | -0.009** |
| <i>INSTOWN</i> | | 0.000 | -0.007 | | -0.006* | -0.013** |
| Observations | 81,388 | 80,057 | 45,626 | 81,388 | 80,057 | 45,626 |
| Adjusted R-squared | 0.561 | 0.572 | 0.568 | 0.442 | 0.451 | 0.434 |
| Controls | No | Yes | Yes | No | Yes | Yes |
| Firm FE & Year FE | Yes | Yes | Yes | Yes | Yes | Yes |



Probability of Unforthcoming and GC Note Length, Specificity, and Forward-looking

| <i>Dependent Variable:</i> VARIABLES | (1) | (2) | (3) | (4) | (5) | (6) |
|---|-----------------------|-----------------|-----------------|----------------|--------------------|----------------|
| | <i>GC_NOTE_LENGTH</i> | | <i>NUMBER</i> | | <i>FL_SENTENCE</i> | |
| <i>PROB_UNFORTHCOMING</i> | -0.275** | -0.251** | -0.378** | -0.344* | -0.326** | -0.291* |
| <i>SIZE</i> | | -0.012 | | 0.024 | | 0.022 |
| <i>BTM</i> | | 0.020 | | 0.117 | | 0.019 |
| <i>LEVERAGE</i> | | 0.185 | | 0.357* | | 0.133 |
| <i>CASHFLOW</i> | | -0.075 | | -0.210 | | -0.120 |
| <i>INCOME</i> | | -0.056 | | -0.053 | | -0.244 |
| <i>BIG_FOUR</i> | | -0.007 | | 0.061 | | -0.037 |
| <i>INSTOWN</i> | | -0.226 | | 0.025 | | -0.189 |
| Observations | 1,767 | 1,754 | 1,767 | 1,754 | 1,767 | 1,754 |
| Adjusted R-squared | 0.724 | 0.727 | 0.685 | 0.690 | 0.660 | 0.659 |
| Controls | No | Yes | No | Yes | No | Yes |
| Firm FE & Year FE | Yes | Yes | Yes | Yes | Yes | Yes |



Probability of Unforthcoming and Capital Expenditure

| VARIABLES | (1) | (2) |
|----------------------------------|-----------------|-----------------|
| | Dep. Var. CAPEX | |
| <i>PROB_UNFORTHCOMING</i> | -0.003** | -0.004** |
| <i>SIZE</i> | | -0.010*** |
| <i>BTM</i> | | -0.008*** |
| <i>LEVERAGE</i> | | -0.014*** |
| <i>CASHFLOW</i> | | 0.009*** |
| <i>INCOME</i> | | 0.044*** |
| <i>BIG_FOUR</i> | | -0.000 |
| <i>INSTOWN</i> | | 0.002* |
| Observations | 76,472 | 76,050 |
| Adjusted R-squared | 0.077 | 0.103 |
| Controls | No | Yes |
| Firm FE & Year FE | Yes | Yes |



» Changes After ASU 2014-15 – Partition on Litigious Industry

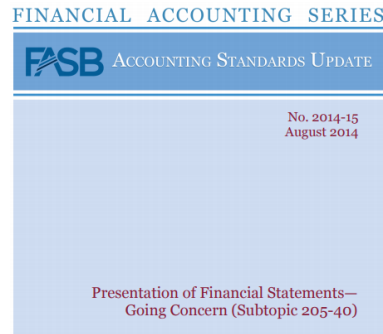
| VARIABLES | (1) Dep. Var. <i>PROB_UNFORTHCOMING</i> | (2) |
|--------------------------------|--|-----------|
| <i>POST</i> | -0.078*** | -0.078*** |
| <i>LITIGIOUS</i> × <i>POST</i> | -0.013*** | -0.012*** |
| <i>SIZE</i> | | 0.010*** |
| <i>BTM</i> | | -0.017*** |
| <i>LEVERAGE</i> | | -0.023*** |
| <i>CASHFLOW</i> | | -0.087*** |
| <i>INCOME</i> | | 0.099*** |
| <i>BIG_FOUR</i> | | -0.005*** |
| <i>INSTOWN</i> | | 0.007** |
| Observations | 81,388 | 80,057 |
| Adjusted R-squared | 0.593 | 0.597 |
| Controls | No | Yes |
| Firm FE & Year FE | Yes | Yes |

Litigious industry
(Francis, Philbrick,
Schipper 1994):

- Biotechnology
- Computers
- Electronics
- Retailing



» Contribution and Conclusion



Textual Analysis

Quantify management's *strategic* (non)disclosure incentive regarding GC

New Accounting Standard

Provide initial and **timely** evidence on the new and controversial standard

Other Disclosure Settings

Methodology can be applied to examine *other* disclosures



Thank you!



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