

Financial Reporting Regulation and the Reporting of Pro Forma Earnings

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A primary objective of the Sarbanes-Oxley Act is to bolster public confidence in the U.S. capital markets. The SEC aims to achieve this objective in part by regulating the use of alternate earnings measures (colloquially referred to as “pro forma” earnings) that differ from generally accepted accounting principles. This paper examines whether firms change their reporting practice in response to pro forma regulation. Specifically, it examines whether the use, calculation, and presentation of pro forma measures by S&P 500 companies changes between 2001 and 2003. We document three significant shifts in pro forma reporting in this period. First, the proportion of firms reporting pro forma earnings declines from 77 to 54 percent. Second, by 2003, pro forma is used in a less biased manner. Not only is the proportion of firms using pro forma earnings to increase reported income smaller than in 2001, but also the magnitudes of these increases are reduced. Third, in 2003, firms present pro formas in press releases in a much less prominent and less potentially misleading manner. These results suggest a strong impact of the recent regulation of pro forma reporting and provide important empirical evidence for policy makers.

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