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R&D Cuts and Subsequent Reversals: Meeting or Beating Quarterly Analyst Forecasts

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ABSTRA

Among f R&D
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prevaler ndeed, our
findings outlays.

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Notes

[1]It is important to note that to the extent that such R&D cut reversals occur, such reversals are not a necessary, mechanical reversal arising from (or dictated by) the accrual accounting system, but rather, the result of deliberate operational/strategic decisions made by management. Such decisions are not subject to auditor scrutiny, and therefore are relatively less costly to implement in the fourth quarter.

[2]The standard example of this type of activity in the literature is captured by the Jones (1991) model of discretionary accruals, where the proxy for accruals-based manage and other paramet ent.

[3]We cho ompared to R&D ma naller economi vertising as an exam for some firms ate decline in sa trimming R&D exp ecause return to spending are less & Sougian educing R&D spendin

[4]There is no consensus on which forecast managers regard as the benchmark during the accounting period. When documenting annual real-activities management, Roychowdhury (2006) looks at the last consensus forecast before the annual earnings announcement, assuming it is an ex post proxy for what managers expect the final consensus to be when they make the real-activities decision in the year. Bhojraj et al. (2009) use the consensus forecasts as of the second month of the last quarter in each year to allow one month for real-activities management to occur. In unreported tests, we re-estimate the main regressions with two alternative benchmarks; one is the most recent analyst forecast up to three days before the current-quarter earnings announcement, and the other is the most recent analyst forecast made before the end of the quarter. Unreported results and inferences remain qualitatively unchanged.

[5]Information on quarterly R&D expenses became available in Compustat as of the first quarter of 1989.

[6]If a firm reports annual R&D expenses in quarter four and leave the interim R&D missing, we drop the observation.

[7]Brown and Pinello (2007) suggest that because annual financial reports are subject to more scrutiny, firms are slightly less likely to beat forecasts in Q4 than in interim quarters. Untabulated tests show that once we control for other relevant variables that explain the likelihood of beating forecasts, firms in our sample are also less likely to beat fore

[8]Followi ssion at the top and

[9]It is not Costs, 1974) whether rting, as other d, managers may cern is if quarterly allocate R&D cos uarterly R&D exp t that such discretio hat are correcte h quarter's R&D is n ccruals. However, we do not examine all noise/biases that potentially arise from the integral

reporting method, so the reader should exercise caution in making inferences. Further examination of this phenomenon is left for future research.

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