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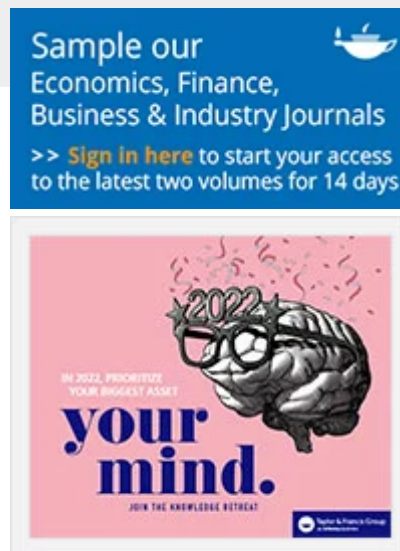
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Original Articles

Do First and Third Quarter Unaudited Financial Reports Matter? The Portuguese Case

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Abstract

In this paper we investigate the incremental information content of a sample of 1,751 quarterly financial reports, issued in Portugal between 1994 and 2004. Specifically, we examine price and volume reactions to financial reports issued in: (1) the first and third quarters, which are unaudited; (2) the second quarter, which is subject to limited

audit; and (3) the fourth quarter (the annual report) which is subject to a full audit. We conclude that unaudited first and third quarter financial reports that include

condensed income statements and balance sheets convey enough new information to the market to spur significant price and trading reactions. This conclusion holds before and after the first and third quarter reports were made mandatory in 1999. We also found that the incremental information content of the second quarter report dropped after 1999, presumably because part of its information content was usurped by the newly required first quarter reports. Finally, we found evidence that mandatory audited reports announcements spur more significant price reactions than mandatory unaudited financial reports. In contrast to evidence from other countries, we found that smaller firms' disclosures do not generate a larger reaction than large firms' disclosures.

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Notes

1. French rules, for example, require quarterly publication of revenues from sales and supply of services, although the balance sheet and earnings are published yearly (Gajewski and Quéré, 2001).

2. Directive published in the Official Gazette No. L 390, of 31 December 2004 and available at <http://europa.eu.int/eur-lex/>

3. Such statements must provide: (i) an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer and its controlled undertakings; and (ii) a general description of the financial position and performance of the issuer and its controlled undertakings during the relevant period. Thus, these statements do not necessarily

include the earnings number, condensed income statements, balance sheets or other usual elements of financial statements.

4. On or before 20 January 2010, the European Commission must present a report on the transparency of quarterly management reports to the European Parliament and Council. In this way, a new opportunity will arise to introduce a mandatory system.
5. Firms always bear the costs of preparing necessary information, but the direct costs of issuing a disclosure can be virtually nil. In Portugal, for example, firms disclose their financial reports via the internet site of CMVM (the Portuguese Securities Market Commission) without any extra cost or charge.
6. 'Financial report announcement' is the first announcement of the earnings number, plus the income statement, balance sheet and other elements of financial information. Note that there is no prior announcement of the earnings number.
7. For an in-depth review of the literature on the relationship between capital markets and financial statements in general, see Kothari (2001) and Healy and Palepu (2001).
8. A sizable body of research indicates that corporate governance affects the quality and the frequency of reports released by management, and information asymmetry in the equity market around quarterly earnings announcements (e.g. Kanagaretnamet al., 2007). It is therefore plausible that (Continental) European and American managers, due to their differing corporate governance systems exercise different degrees of discretion in unaudited reports.
9. For a survey of the European evidence, see Dumontier and Raffournier (2002).
10. An interim financial statement reporting protocol became mandatory in Finland in 1986. The minimum three items that should be reported in Finnish interim financial statements are: (i) Profit (Loss) after financing income/expense; (ii) Other income/expense; (iii) Profit (Loss) before appropriations and taxes. For more details see Schadewitz (1996).
11. In Spain, while the annual report is fully audited and the half-year report has a limited audit, the first and third quarter financial reports are unaudited. Information reported in the first and third quarters includes revenues, earnings before taxes, net earnings, shareholders' equity and the average number of employees. To see the type

of information required in detail, consult the circular of the CNMV (the Spanish securities market commission), Annex V, at www.cnmv.es

12. In France, interim reports are submitted to various levels of control by statutory auditors. These levels are certification, attestation and verification, by decreasing order of importance. While the annual report is certified and the half-year report is attested, the first and third quarter revenues are merely verified (Gajewski and Quéré, 2001).

13. For a review see Core (2001) and Healy and Palepu (2001).

14. Recall that the NYSE began advocating quarterly reports in 1910 and the SEC began requiring them in 1970.

15. The Appendix includes a copy of the official sheet that Portuguese firms must disclose in Q1 and Q3.

16. Because in some cases the financial reports could be disclosed during the previous trading day, we performed robustness tests (not reported), one day prior to and one day after the analyzed dates. Furthermore, we also performed tests using five- and seven-day post-announcement windows. In all cases, the conclusions remain essentially unaltered. Any of these unreported results may be requested from the authors.

17. We also calculated the metrics for estimation windows corresponding to the 62 trading days prior to the event date, excluding the 10 trading sessions surrounding the disclosure date ($t = -62, \dots, -11$). The conclusions remained essentially unchanged.

18. We also calculated abnormal stock price volatility as in Landsman and Maydew (2002), and the risk-adjusted return using the market model. The conclusions remained essentially unchanged.

19. The trading volume ratios were also calculated as proposed by Harris and Gurel (1986), by comparing the relative turnover of security i scaled by market turnover on the event date to the identical ratio of the control period. We also calculated the trading volumes as described by Landsman and Maydew (2002). The conclusions remained unchanged.

20. Average AVOL is, by construction, null in the estimation window. Thus, the Student t -test reported in columns [1], [3] and [7] of Panel II tests the null hypothesis

that AVOL in the three-day post-announcement window equals zero. Wilcoxon Test Stats reported in the same columns refer to the Wilcoxon test, with the null hypothesis that Average AVOL in the three-day post-announcement window is zero. The Squared Ranks Test for Variances Stat reported in the same columns test whether trading volumes scaled by their standard deviation (V_{it}/σ_i) are identically distributed in the post-announcement window and estimation window, except possibly for different means. All other tests in Panel II are similar to the tests in Panel I.

21. In supplementary tests, we also found price and trading volume reactions to good news and to bad news in all quarters (except the price reaction to third quarter bad news, which is not significant). In this exercise, the financial reports disclosed were 'good news' if the cumulative abnormal returns (calculated with the market model) for the three-day post-announcement period were positive and 'bad news' if these cumulative abnormal returns were negative.

22. Hereafter we focus on the mandatory sample, because it is relevant to Question 3.

23. The z-Stat of this test is -3.26 , and p-value is 0.1%.

24. The PSI20 is an index formed from the 20 most liquid stocks on the Euronext Lisbon and they are exclusively large cap stocks. Following Pellicer and Rees (1999), we use an index formed from the most liquid stocks of the market to distinguish between large and small firms.

25. For full sample (results not reported), for the few instances when the null hypothesis of equality between PSI20 and non-PSI20 averages is rejected (t-test), we infer that the PSI20 sample average is higher.

26. Note that most of the papers cited herein focus on old data, and Buchheit and Kohlbeck (2002), studying a period from 1975 to 1997, found evidence that small firms exhibit a decreasing price reaction to financial reports announcements over time, while larger firms exhibit an increasing price reaction to financial reports announcements.

27. We compare our data with the Pellicer and Rees (1999) sample because the Spanish market is smaller than the other markets analyzed in the cited literature (UK and USA). We obtained the number of listed companies on the Madrid Stock Exchange from The World Federation of Exchanges web page. We obtained the IBEX35 data from the site www.ibex35.com and Datastream.



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