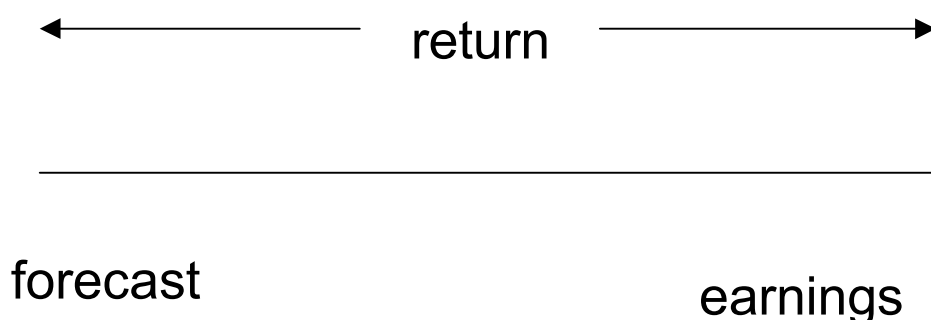


## **Street vs. GAAP earnings**

- **based on Bradshaw & Sloan, J of Accounting Research, March 2002, 41-66**
- **basic idea is that GAAP earnings has remained static for too long and hence markets use adjusted earnings in order to evaluate company performance**
- **adjustments include special items in Compustat and non cash items**
  - restructuring charges
  - impairments
  - R&D expenditure
  - merger and acquisition costs
  - stock compensation expense
  - goodwill amortisation
- **perhaps relate to negative accruals observed by Givoly & Hayn, JAE, 2000.**

- **Data : 1985-97, 98,647 company quarters**
- **Variables**
  - (R) stock returns measured from one quarter to the next
  - STREET = street earnings forecast error for each quarter = Street earnings - analysts forecast
  - GAAP = GAAP earnings forecast error for each quarter = GAAP earnings - analysts forecast
  - Post92, value =
    - 1 if observation is 1992 or later
    - 0 otherwise



$$\begin{aligned} R &= a + b.\text{Post92} \\ &+ c.\text{STREET} + d.\text{STREET}.\text{Post92} \\ &+ e.\text{GAAP} + f.\text{GAAP}.\text{Post92} \end{aligned}$$

- **a = constant**
- **b = shift in the constant from 1992**
  
- **c = coefficient on STREET earnings**
- **d= shift in coefficient on STREET earnings from 1992**
  
- **e = coefficient on GAAP earnings**
- **f= shift in coefficient on GAAP earnings from 1992**

<b>a</b>	<b>Post92</b>	<b>STREET</b>	<b>STREET.Post92</b>	<b>R2</b>
0.04	0.008	0.567	1.248	0.024
<i>36.9</i>	<i>5.0</i>	<i>23.8</i>	<i>25.7</i>	

<b>a</b>	<b>Post92</b>	<b>GAAP</b>	<b>GAAP.Post92</b>	<b>R2</b>
0.044	0.008	0.551	0.406	0.020
<i>37.3</i>	<i>5.3</i>	<i>24.7</i>	<i>12.0</i>	

**Note: figures in italics are t statistics**

- 
- from B&S, Table 1
  - stronger link after 1992 for both STREET and GAAP
  - stronger link for STREET
  - shift is 1.248

- growth in STREET earnings is larger than growth in GAAP earnings
- from Table 2

**% growth in eps**

	<b>STREET</b>	<b>GAAP</b>
<b>1993</b>	<b>10.4</b>	<b>7.7</b>
<b>1995</b>	<b>11.5</b>	<b>6.9</b>
<b>1197</b>	<b>10.2</b>	<b>6.4</b>

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- also difference in creasing over time, from Table 3

## The link with "special items"

- Can the difference between STREET and GAAP be explained by special items, SI?

- model is

$$\text{STREET} - \text{GAAP} = a + b \cdot \text{SI}$$

$$b = c + d \cdot \text{YEAR}$$

- this gives

$$\text{STREET} - \text{GAAP} = a + (c + d \cdot \text{YEAR}) \cdot \text{SI}$$

$$\text{STREET} - \text{GAAP} = a + c \cdot \text{SI} + d \cdot \text{YEAR} \cdot \text{SI}$$

- d measures the change in the coefficient on SI with time (YEAR)

	<b>a</b>	<b>SI</b>	<b>YEAR</b>	<b>YEAR.SI</b>	<b>R<sup>2</sup></b>
	-0.001	-0.345	0.0002	-0.034	0.25
<i>t stat</i>	-2.4	-49.2	5.9	-40.3	

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- Table 4
- difference increasing over time (0.0002)
- link with SI is getting stronger over time
- recall that GAAP - STREET are positive; SI is usually negative (hence the negative sign)

## Whose idea? managers or analysts?

- the order in which managers discuss STREET and GAAP earnings in the quarterly earnings announcement
- Table 5

	<b>GAAP only</b>	<b>GAAP then STREET</b>	<b>STREET then GAAP</b>
<b>1986-7</b>	<b>82.5%</b>	<b>11%</b>	<b>6.5%</b>
<b>1998-99</b>	<b>28.5%</b>	<b>28%</b>	<b>42%</b>

- seems that managers are proactive in promoting STREET earnings
- is it earnings management or identifying permanent earnings?