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Voluntary disclosure of balance sheet information in quarterly earnings announcements ☆

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Abstract

We investigate a pervasive voluntary disclosure practice—managers including balance sheets with quarterly earnings announcements. Consistent with expectations, we find that managers voluntarily disclose balance sheets when current earnings are relatively less informative, or when future earnings are relatively more uncertain. Specifically, balance sheet disclosures are more likely among firms: (1) in high technology industries; (2) reporting losses; (3) with larger forecast errors; (4) engaging in mergers or acquisitions; (5) that are younger; and (6) with more volatile stock returns. This is consistent with managers disclosing balance sheets in response to investor demand for value relevant information to supplement earnings.

JEL classification: M41; D82; G12

Keywords: Capital market; Voluntary disclosure

1. Introduction

Empirical research investigating voluntary management disclosure tends to focus on earnings disclosures, management forecasts, and to a lesser extent, overall

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disclosure levels.[1] However, a relatively pervasive voluntary disclosure practice that is not investigated in prior research is management's inclusion of balance sheet information along with quarterly earnings announcements. The purpose of this study is to describe the characteristics of voluntary balance sheet disclosures, and to investigate management's incentives to include balance sheet information in their quarterly earnings announcements.

We examine all quarterly earnings announcements included in the Wall Street Journal ProQuest database for the 12 quarters ending with the third quarter of 1995. Our analysis finds that 52% of the 2,551 firms in our sample include a balance sheet in at least one quarterly earnings announcement, and that 37% of the 23,086 quarterly earnings announcements we identify include a balance sheet. We also find that the percentage of quarterly earnings announcements containing balance sheets grows from 31% to 46% over the period we analyze. In addition, once firms begin including balance sheets in their quarterly earnings announcements they tend to continue, with just 35% ceasing to include balance sheets once they initiate disclosure. Therefore, we conclude that including balance sheets in earnings announcements is a pervasive voluntary disclosure practice that is growing over the period we examine.

We argue that managers have incentives to voluntarily include balance sheet information along with quarterly earnings announcements when current earnings are relatively less informative, or when future earnings are relatively more uncertain. In these settings investors are likely to have a greater demand for additional value relevant information—such as balance sheets—to help assess firm value. We test our conjecture by developing several hypotheses that identify settings in which investors are likely to find *current earnings relatively less informative*, or *future earnings relatively more uncertain*. Consistent with our predictions, a logit analysis finds that managers are more likely to disclose balance sheet information along with quarterly earnings announcements for firms: (1) in high technology industries; (2) reporting losses; (3) with larger forecast errors; (4) engaging in mergers or acquisitions; (5) that are younger; and (6) with more volatile stock returns. These findings are consistent with managers disclosing balance sheet information when investors demand additional value relevant information to help assess firm value.

To investigate the robustness of our logit results we also examine the price–earnings and the returns–earnings associations of firms with and without voluntary balance sheet disclosures. Comparing the R^2 in regressions of quarterly earnings on share price across disclosure and non-disclosure observations indicates that earnings explain a significantly lower proportion of share value among firms that make balance sheet disclosures. This is consistent with firms supplementing their earnings disclosures with balance sheet information when earnings are less value-relevant. However, comparing the R^2 in regressions of quarterly earnings on stock returns across disclosure and non-disclosure observations indicates that there is no difference in the explanatory power of earnings across the two groups. Thus, our

[1] For example, Skinner (1994), Frankel et al. (1995), McNichols and Wilson (1995), Lang and Lundholm (1996), Botosan (1997), Tasker (1998), and Frankel et al. (1999).