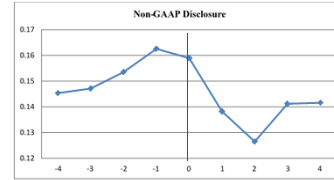# Non-GAAP Reporting following Debt Covenant Violations

- I examine two questions: (1) does the transfer of control rights following debt covenant violations affect firms' propensity to provide non-GAAP disclosures? and (2) does the quality of non-GAAP reporting vary following covenant violations?

- I find that while the frequency of non-GAAP reporting *declines* following covenant violations, the quality of non-GAAP reporting *improves* significantly along multiple dimensions. Specifically, when firms decide to report non-GAAP earnings after a covenant violation, the customized performance metric is (1) placed less prominently within the press release, (2) less likely to meet or beat analysts' forecasts when the GAAP number falls short, and (3) marginally less likely to exclude recurring expenses. Moreover, the significant association between non-GAAP exclusions and future GAAP operating earnings disappears following covenant violations, indicating improvement in exclusion quality.

- This study provides the first evidence that debtholders have on an important form of disclosure, non-GAAP reporting.

Non-GAAP Disclosure

Note: This figure plots the time-series of average non-GAAP disclosure frequency for violations before and after a covenant violation. To obtain a clear visual effect of covenant violations, a violation time-series is only included in the graphical analysis if no additional violations happened in the previous four quarters.

The effect of covenant violations on the aggressiveness of non-GAAP earnings disclosures

	(1) Pr(NGFIRST$_t$ = 1)	(2) Pr(CONSENSUS$_t$ = 1)	(3) Pr(RECUR$_t$ = 1)
VIOLATION$_{t-1}$	-0.059**	-0.076***	-0.026
	(-1.98)	(-3.32)	(-0.94)
SIZE$_t$	0.001	0.008	-0.002
	(0.13)	(1.44)	(-0.29)
MTB$_t$	0.001	0.003*	0.002
	(1.26)	(1.94)	(1.54)
STDROA$_t$	-0.016	0.099	0.425***
	(-0.19)	(1.37)	(4.77)
GAAPLOSS$_t$	0.029**	-0.061***	0.021
	(2.26)	(-4.97)	(1.59)
SPECIALCHG$_t$	0.050***	-0.057***	-0.140***
	(4.59)	(-5.34)	(-11.88)
NEGFE$_t$	0.024**	0.457***	0.063***
	(2.46)	(41.55)	(6.53)
ROA$_t$	-0.101	-0.160*	0.025
	(-0.99)	(-1.68)	(0.23)
RETURN$_t$	-0.009	0.074***	-0.018
	(-0.70)	(5.18)	(-1.37)
%INST$_t$	0.008	0.040*	0.009
	(0.33)	(1.80)	(0.35)
#ANALYST$_t$	0.002	0.001	0.002
	(1.46)	(1.20)	(1.52)
LITIGATE	0.035*	0.011	0.147***
	(1.66)	(0.52)	(5.55)
NGFIRST$_{t-1}$	0.363***		
	(23.17)		
CONSENSUS$_{t-1}$		0.108***	
		(9.21)	
RECUR$_{t-1}$			0.251***
			(21.67)
Covenant Controls	Yes	Yes	Yes
Higher-Order Covenant Controls	Yes	Yes	Yes
Year Effects	Yes	Yes	Yes

The effect of covenant violations on the non-GAAP exclusion quality

		(1) FUTGAAP	(2) FUTGAAP
EPS$_{NGt}$	β_1	3.015***	3.196***
		(12.74)	(13.83)
EPS$_{NGt}$ × VIOLATION$_{t-1}$	β_2	3.092	3.344
		(1.05)	(1.04)
TOTALEXCL$_t$	β_3	-0.691***	
		(-2.93)	
TOTALEXCL$_t$ × VIOLATION$_{t-1}$	β_4	1.207**	
		(2.23)	
BELOWLINE$_t$	β_5		0.609**
			(2.09)
SPECIALEXCL$_t$	β_6		-0.019
			(-0.22)
MGRRECUR$_t$	β_7		-2.521***
			(-4.96)
BELOWLINE$_t$ × VIOLATION$_{t-1}$	β_8		0.602
			(0.47)
SPECIALEXCL$_t$ × VIOLATION$_{t-1}$	β_9		0.540
			(1.29)
MGRRECUR$_t$ × VIOLATION$_{t-1}$	β_{10}		3.631**
			(2.22)
VIOLATION$_{t-1}$	β_{11}	-0.875	-0.998
		(-1.48)	(-1.46)
Constant	β_{12}	1.772**	1.370***
		(3.09)	(2.59)
Main Controls		Yes	Yes
Covenant Controls		Yes	Yes
Higher-Order Covenant Controls		Yes	Yes
Year Effects		Yes	Yes
Fiscal Quarter Effects		Yes	Yes
Industry Effects		Yes	Yes
H$_0$: $\beta_3 + \beta_4 = 0$		F = 0. 999 p-value = 0.318	
H$_0$: $\beta_7 + \beta_{10} = 0$			F = 0.516 p-value = 0.473
Observations		7,549	7,549
Adjusted R^2		0.4000	0.4296

I am in the process of preparing this article for submission to a top accounting journal

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