Using Unstructured and Qualitative Disclosures to Explain Accruals

with Jared Jennings (WashU in St. Louis) and Richard Frankel (WashU in St. Louis)

Research Question:

Does Management's Discussion and Analysis Contain Relevant Information for Explaining the Accrual Process?

ABSTRACT:

We examine the usefulness of support vector regressions (SVRs) in assessing the content of unstructured, qualitative disclosures by relating MD&A-based SVR-accrual estimates (*MD&A accruals*) to actual accruals. We find that *MD&A accruals* explain a statistically and economically significant portion of firm-level accruals and identify more persistent accruals. We find that the explanatory power of *MD&A accruals* is higher for more readable 10-Ks, thereby providing evidence for the construct validity of the readability measures. To highlight the flexibility of the SVR method, we apply it to other dependent variables and disclosures. We find that MD&A-based cash-flow forecasts produced by SVR predict next period's cash flows. We apply SVR to conference call transcripts and find accruals estimates have similar explanatory power to *MD&A accruals*. Finally, the explanatory power of *MD&A accruals* increases between 1994 and 2013.

Explanatory Power of MDA Accruals$_{i,t}$

This table includes all firm/year observations from 1994 to 2013 with sufficient data to calculate the dependent and independent variables. The dependent variable is working capital accruals (Accruals$_{i,t}$). Column 1 reports the explanatory power of MDA Accruals$_{i,t}$. Column 2 benchmarks the explanatory power of MDA Accruals$_{i,t}$ to the modified Dechow and Dichev model. The models include industry and year fixed effects as additional independent variables (unreported). Standard errors are clustered by firm. All continuous variables are winsorized at the 1% and 99% levels. *, **, and *** represent significance at the 10%, 5%, and 1% levels, respectively.

	[1]	[2]
Intercept	0.035***	0.085***
	(7.710)	(11.310)
MDA Accruals$_{i,t}$	0.544***	
	(24.119)	
CFO$_{i,t-1}$		0.056***
		(15.364)
CFO$_{i,t}$		-0.355***
		(-24.400)
ΔSales$_{i,t}$		0.069***
		(16.666)
PPE$_{i,t}$		-0.015***
		(-3.475)
Neg CFO$_{i,t}$		0.017***
		(6.232)
CFO$_{i,t}$ * Neg CFO$_{i,t}$		0.437***
		(27.692)
#OBS	74,080	74,080
Adjusted R^2	0.097	0.153

Status:

Presented at the *Journal of Accounting and Economics* Conference, November 2016

Future Plans:

Revise and resubmit to the *Journal of Accounting and Economics*

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