The Impact of Constraining Auditor Behavior and Audit Committee Questioning on Non-GAAP Reporting Decisions

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ABSTRACT

Corporate managers often pursue voluntary non-GAAP reporting when mandatory reporting is limited, although regulators are concerned with how this reporting is utilized. While the level of flexibility external auditors exhibit during discussions over subjective GAAP reporting choices can influence management's GAAP reporting decisions, it is important to determine if this behavior affects subsequent non-GAAP reporting decisions. Additionally, recent calls for increased audit committee questioning of non-GAAP disclosures may also cause audit committees to influence non-GAAP reporting. In this dissertation, I conduct an experiment to examine how auditor flexibility and audit committee questioning influence non-GAAP preparation and earnings release disclosure choices of senior executives. I predict less flexible auditor behavior will enhance managers' psychological feeling of constraint, while audit committee questioning focused on non-GAAP measures can increase managers' self-assessment of reporting decisions, both of which will translate into more conservative non-GAAP reporting. However, given prior research indicating that corporate governance mechanisms can combine in complex ways, I predict a greater impact of audit committee questioning absent auditor constraint. Results indicate managers make less conservative non-GAAP preparation decisions and disclose more non-GAAP measures in the absence of constraint from inflexible auditors. However, absent this constraint, managers make more conservative non-GAAP preparation choices and present non-GAAP measures less prominently in earnings press releases when the audit committee questions non-GAAP disclosures. These results are driven by a thorough self-assessment of reporting decisions by managers expecting audit committee questioning. This

study provides evidence on how external auditors and audit committees influence various voluntary reporting decisions.

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GENERAL AUDIENCE ABSTRACT

Corporate managers can report their company's financial information to investors and other stakeholders in various ways. Some financial information is required to be reported in accordance with a set of formal accounting standards called United States Generally Accepted Accounting Principles (GAAP). Beyond this mandatory reporting, other financial information is disclosed voluntarily when company management believes this extra information is beneficial to investors. These voluntary disclosures— called non-GAAP measures— do not follow a set of accounting standards and can be disclosed with more discretion by company management than GAAP measures. The variation in how non-GAAP measures are prepared and disclosed concerns regulators, such as the Securities and Exchange Commission (SEC). Mandatory GAAP financial reporting is overseen by external auditors from public accounting firms, but auditors typically have very little formal oversight over non-GAAP reporting. Although company management ultimately decides how to disclose GAAP information, external auditors influence these reporting decisions by recommending choices during discussions over subjective GAAP issues. Sometimes auditors exhibit inflexible behavior during these discussions by being unwilling to consider management's reporting choices. This inflexibility limits or constrains the GAAP reporting choices of managers. However, prior research has not studied how this constraint impacts how managers make non-GAAP reporting choices. Further, GAAP reporting choices can also be influenced by the audit committee, which is a subgroup of members of the board of directors that is in charge of overseeing financial reporting and disclosure. Recent calls

from regulators have asked for increased audit committee questioning of non-GAAP disclosures, which may also cause audit committees to influence non-GAAP reporting.

Non-GAAP measures are often presented in earnings press releases, which are public announcements by a company that disclose information regarding results of operations or financial condition for a given period. Managers can make strategic decisions regarding the preparation of non-GAAP measures and the presentation of this information in earnings releases, both of which can influence investors' decision-making. In this dissertation, I conduct an experiment utilizing senior executives to examine how auditor flexibility and audit committee questioning influence these two types of non-GAAP reporting decisions: how to prepare non-GAAP measures and how to disclose them in earnings press releases. I predict less flexible auditor behavior will enhance managers' psychological feeling of constraint, while audit committee questioning focused on non-GAAP measures will increase managers' self-assessment of reporting decisions, both of which will translate into more conservative non-GAAP reporting. However, prior research indicates that corporate governance mechanisms, which are factors intended to help direct and monitor company management (such as auditors and audit committees), can combine in complex ways. Therefore, I predict a greater impact of audit committee questioning absent auditor constraint.

The results indicate managers make less conservative non-GAAP preparation decisions (i.e. are more likely to calculate non-GAAP earnings figures that deviate from their GAAP counterparts) and disclose more non-GAAP measures in the absence of constraint from inflexible auditors. However, absent this constraint, managers make more conservative non-GAAP preparation choices and present non-GAAP measures less prominently in earnings press releases when the audit committee questions non-GAAP disclosures. These results are driven by a thorough self-assessment of reporting decisions by managers expecting audit committee questioning. This study provides evidence on how external auditors and audit committees influence various voluntary reporting decisions. Given the ubiquity of non-GAAP reporting in recent years, this dissertation can provide valuable insights to regulators, investors, and other stakeholders on factors that influence managerial decision-making related to non-GAAP disclosures.

DEDICATION

To my best friend and wife, Shalin Hale. Thank you for absolutely everything. Without you, I would have never had the courage to begin this program, much less finish it. I wish I had something more exciting to dedicate to you!

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CHAPTER 1: INTRODUCTION

Senior executives, such as CFOs, play a key role in the mandatory and voluntary financial reporting process. These executives often choose to voluntarily disclose financial information if they feel that there are limitations in mandatory disclosures (Graham, Harvey, and Rajgopal 2005). Recently, firms have widely used voluntary non-GAAP financial disclosures, through channels such as earnings press releases, to provide additional information beyond what is required by GAAP in the financial statements (Rapoport and Michaels 2016).[1] There is significant variability in how non-GAAP measures are prepared and disclosed, and research shows companies can utilize non-GAAP reporting to disclose financial information in a more self-directed manner (e.g., Doyle, Jennings, and Soliman 2013). Regulators have expressed concern over the manner in which non-GAAP reporting is utilized, especially when this reporting presents an overly optimistic depiction of firm performance (SEC 2018a). Yet, research also indicates reporting decisions are partly driven by external auditors, who help interpret financial standards and induce compliance through discussions with clients (Gaynor, Kelton, Mercer, and Yohn 2016). Given that financial reporting is often considered a joint product of company management and the external auditor (Antle and Nalebuff 1991), the auditor's role in this process can be far-reaching. As a result, while non-GAAP disclosures can be pursued when managers wish to report information more autonomously, it is an empirical question if non-GAAP reporting is influenced by the degree to which managers perceive their reporting choices are constrained by auditors while preparing the GAAP-based financial statements.

Notably, regulators and industry best practices have recently noted inadequate monitoring of non-GAAP reporting and have called for increased audit committee oversight in this area

[1] Consistent with SEC guidance, non-GAAP measures refer to financial information that is calculated or presented in ways other than those permitted under generally accepted accounting principles, or GAAP (SEC 2002).

(McLevey 2016; CAQ 2018). As such, decisions on non-GAAP disclosures do not occur in isolation if audit committees oversee the extent of such disclosures. Prior research demonstrates that audit committees affect CFOs' GAAP disclosure judgments (Agoglia, Doupnik, and Tsakumis 2011). However, it is not known if audit committees would have the same effect on non-GAAP reporting judgments since audit committees have historically given more attention to the GAAP-based financial statements than other disclosures (Beasley, Carcello, Hermanson, and Neal 2009). One practice recommended by regulators is for the audit committee to increase oversight of non-GAAP reporting by asking questions of company management to ensure this information is disclosed in a useful manner (CAQ 2016; 2018), which should cause managers to assess their non-GAAP reporting decisions. In this dissertation, I examine if auditors' constraining behavior within GAAP reporting influences the way managers prepare and disclose non-GAAP disclosures, and if this effect is modified by the emphasis the audit committee places on non-GAAP measures during their questioning of disclosures. Since governance mechanisms can lead to complex effects on managers' behavior when paired together (Misangyi and Acharya 2014), it is important to examine how auditor behavior and audit committee questioning interact with one another in relation to non-GAAP reporting.

I will examine two aspects of non-GAAP reporting: the decision on how to prepare non-GAAP disclosures and on how to present or highlight them in earnings releases. With respect to the decision on how to prepare the non-GAAP disclosures, reporting non-GAAP information can be an attractive option for management because these measures can be individually tailored, within reason, in the way management wishes. For example, when calculating non-GAAP earnings measures, there is discretion in the adjustments management can choose to make from GAAP earnings to arrive at non-GAAP earnings (Doyle et al. 2013). The flexibility available to managers in preparing non-GAAP measures can be beneficial because it allows them to provide information that more aligns with their financial reporting goals. One such goal may be to portray positive firm performance, especially when non-GAAP metrics are used to help determine executive compensation (Audit Analytics 2019).

While financial reporting decisions are ultimately the responsibility of company management, prior research indicates auditors can significantly influence reporting decisions. Such research shows that accounting standard type *and* auditor type jointly impact reporting decisions of financial managers (Jamal and Tan 2010), but this research has not examined whether auditor behavior can impact voluntary non-GAAP disclosures. One important way auditors influence reporting decisions is through discussions with management on subjective aspects of the GAAP financial reporting process (Gibbins, McCracken, and Salterio 2007; Salterio 2012). At times, auditors can be inflexible during these interactions by being unwilling to consider arguments against their chosen positions or not acknowledging management's concerns (Bame-Aldred and Kida 2007; Gibbins, McCracken, and Salterio 2010). This inflexibility often compels managers to accept financial statements outcomes that are different from their desired positions (Gibbins, McCracken, and Salterio 2005). Thus, managers face restrictions from external auditors on what is allowable to report in the financial statements, but it is important to examine whether these restrictions carry over and influence other reporting decisions, such as preparing non-GAAP disclosures.

Likewise, audit committees also play an important role in overseeing financial reporting and ensuring the integrity of disseminated financial information (Carcello, Hermanson, and Ye 2011). Given that non-GAAP reporting has become ubiquitous and investors appear to react to this information (Curtis, McVay, and Whipple 2014), research should examine if managers respond to audit committee oversight of non-GAAP measures. Prior research suggests one of the most effective ways audit committees can provide oversight is by asking substantive questions of company management (Gendron, Bédard, and Gosselin 2004; Beasley et al. 2009; Pomeroy 2010; Kang, Trotman, and Trotman 2015; Kang 2019). Such questioning can extend beyond the financial statements, where audit committees can ask questions about the consistency, comparability, and transparency of non-GAAP disclosures to ensure the use of these voluntary measures is appropriate (CAQ 2016; 2018). However, research has demonstrated that governance mechanisms work in complex ways such that one mechanism can become more important in the absence of another (Misangyi and Acharya 2014; Oh, Chang, and Kim 2018). As such, audit committee questioning can impact managers' non-GAAP disclosures differently depending on the flexibility exhibited by external auditors during GAAP disclosure decisions.

I predict that managers will be more conservative in preparing non-GAAP earnings measures (i.e. less likely to make a larger exclusion from non-GAAP earnings) when an inflexible auditor constrains reporting behavior. As previously mentioned, auditors can seem inflexible when they restrict managerial decision-making within GAAP during discussions over subjective financial statement matters. Psychology research indicates that the effects of restricted or inhibited behavior can influence behavior beyond the situation in which the restriction originated (Botti, Broniarczyk, Häubl, Hill, Huang, Kahn, Kopalle, Lehmann, Urbany, and Wansink 2008; Bone, Christensen, and Williams 2014). For instance, when consumers face constraints to their purchasing behavior, this constraint may leave lasting feelings of decreased autonomy, which can subsequently affect future purchasing decisions (Algesheimer, Dholakia, and Herrmann 2005; Bone et al. 2014). Hence, when inflexible auditors constrain managers' decisions related to subjective GAAP matters, managers can still perceive their autonomy is limited in subsequent decisions, even though they generally have greater discretion in preparing non-GAAP measures. This feeling of constraint will likely cause managers to be hesitant to report non-GAAP measures that significantly deviate from the GAAP counterparts, which will lead to smaller exclusions from non-GAAP earnings. Conversely, when the auditor is more flexible, managers will feel less constrained, and are more likely to prepare non-GAAP earnings in a way that reflects desired outcomes (i.e., make a larger exclusion from non-GAAP earnings).

While I predict managers will pursue non-GAAP reporting more aggressively when auditors exhibit greater flexibility over financial statement reporting, I also expect audit committee questioning to interact with this effect. When audit committees question managers about the appropriateness of non-GAAP disclosures, managers are likely to anticipate continued questions about disclosure decisions, and will be careful to make decisions which they can reasonably justify to the audit committee (Kang 2019). Yet, the expected interaction is driven by research indicating combinations of governance mechanisms interact in complex ways, such that they may be substitutes of one another (Misangyi and Acharya 2014). For instance, monitoring by the board of directors and executive incentive alignment, two different governance factors, can both be individually important to self-serving management behavior, but are not doubly important when both factors are present (Rediker and Seth 1995). Also, an auditor's monitoring of financial reporting is more important when the audit committee does not have an active role (Beasley et al. 2009). In essence, there appear to be limits to the degree to which managers will curb aggressive behavior in response to governance components (Misangyi and Acharya 2014). For non-GAAP disclosure preparation decisions, the auditor's constraint is expected to act as a mechanism which constrains decision-making. The audit committee's influence, in combination with this constraint, is likely to be less impactful. In contrast, an audit committee that actively questions non-GAAP disclosures should have the greatest incremental impact on managers' decisions related to non-GAAP disclosures in the absence of a less flexible auditor that has already constrained managerial discretion. In the absence of both auditor constraint and audit committee questioning, managers are most able to reflect their desired accounting outcomes. Therefore, I predict that managers will be most likely to make larger exclusions from non-GAAP earnings measures when managers are not constrained from prior inflexible auditor behavior and when the audit committee does not actively ask questions regarding non-GAAP measures.

The second decision I will examine is how managers present information in earnings press releases.[2] Earnings releases can be an important way for company management to disclose and present information with more discretion than what is allowable within the financial statements (Davis, Piger, and Sedor 2012). While there are some requirements set forth by the SEC regarding earnings release presentation (SEC 2018a), they are much less rigid than the accounting standards that govern financial statement preparation. Accordingly, in earnings releases, management can disclose varying levels of GAAP and non-GAAP metrics to meet their reporting needs, and has discretion in the way information is presented. This discretion allows them to emphasize particular metrics in order to capture the reader's attention (Bowen, Davis, and Matsumoto 2005). One common way information can be emphasized in earnings releases is by presenting it early in the release, such as in the headline, where it will be salient to the reader (Huang, Nekrasov, and Teoh 2018). To note, the decisions related to the disclosure of non-GAAP measures in the earnings release are likely not entirely independent of decisions related to how the non-GAAP measures are prepared, which is the focus of the first part of my analysis. Since presentation decisions may partially be driven by how favorably non-GAAP measures

[2] Earnings releases are public announcements made by companies which contain information about the company's operations or financial performance (SEC 2018b) and are often important to capital market investors (Kothari 2001).

reflect financial results, decisions about disclosure presentation may follow a different pattern than what is expected for the initial preparation analysis. While research has begun to explore presentation effects on readers, little is empirically known about factors that influence decisions of those in charge of presenting earnings release disclosures, such as CFOs. Given that auditors and audit committees serve as important monitors of financial disclosures, it is important to consider their roles in influencing managers' earnings release disclosure presentation.

While earnings releases are unaudited, auditors may still impact the preparation of these announcements because they serve as important gatekeepers in the overall capital market (PwC 2016; Roychowdhury and Srinivasan 2019). Indeed, emerging accounting research has presented evidence that auditors may have some influence over the information content of earnings releases, even though the auditor has limited oversight in this area (Chen, Krishnan, and Pevzner 2012; Bhaskar, Hopkins, and Schroeder 2019). For example, earnings releases of companies who employ a Big 4 auditor contain more GAAP information than companies with smaller auditors (Schroeder 2016). Additionally, audit committees can directly impact earnings release presentation because they are relied upon to provide a broader monitoring of the financial reporting process, which should include earnings releases (SEC 2018c). The audit committee’s oversight of earnings releases, including active questioning of GAAP and non-GAAP disclosures, may be especially important since auditors’ official capacity in this area is limited. The audit committee’s questioning over the usefulness of non-GAAP measures in earnings release can be essential to ensure a balanced presentation of these measures. Notably, regulators have expressed concern over the prominence given to these measures in earnings releases (SEC 2018b). Thus, I will determine how auditor constraint and audit committee questioning affect managers’ decisions on how to disclose and present non-GAAP measures in earnings releases.

When examining managerial decisions with respect to the presentation of non-GAAP information, I expect that the auditor's constraining behavior will carry over into decisions regarding earnings release disclosures. Specifically, when managers interact with a more flexible auditor, they will be more likely to disclose more non-GAAP earnings measures in the earnings release and present them with prominence (i.e., early in the earnings release), which represents an attempt to attract investor attention by emphasizing desired financial outcomes. As mentioned previously, psychology research indicates constraining behavior in one area can influence subsequent feelings and behavior (Botti et al. 2008). To the degree that managers still perceive constraint from their auditor, due to behavior that originated in the preparation of the financial statements, managers will be less likely to exhibit aggressive disclosure behavior. Hence, they will be less likely to prominently disclose non-GAAP measures in the earnings release.

However, I also expect the audit committee's questioning to interact with this effect. When the audit committee actively questions non-GAAP disclosures in earnings releases, it should direct managers to consider the usefulness and transparency of disclosure presentation choices (Cohen, Krishnamoorthy, and Wright 2010; Brown-Liburd, Wright, and Zamora 2016). If managers are aware of the effect that earnings release presentation has on investors (Elliott 2006), a more thorough examination of disclosure presentation caused by audit committee questioning should lead to a more subdued disclosure of non-GAAP measures by managers. Given that one governance mechanism often becomes more important in the absence of another (Misangyi and Acharya 2014), more extensive audit committee questioning is likely to have a larger effect in the absence of constraining auditor behavior (i.e., when managers have interacted with more flexible auditors, as opposed to less flexible auditors).

To answer my research questions, I conducted a 2 x 2 between participants experiment on 100 senior executives with financial backgrounds.[3] I manipulated auditor flexibility within the preparation of the GAAP-based financial statements and the focus of questioning by the audit committee regarding earnings release disclosures. In the experimental task, the participants were required to make judgments regarding the preparation of an earnings release for a hypothetical company. After learning about the company's background, participants were told about a disagreement with the hypothetical external auditor during the current year's audit over a potential goodwill impairment loss. The auditors believed an assumption used in the company's discounted cash flow analysis was too aggressive, and that the company needed to consider recognizing an impairment loss. The participants were told that management did not agree with the auditor's assessment and subsequently discussed the matter with the lead audit partner.

Perceived auditor flexibility was manipulated at two levels (more or less flexible). In the more flexible auditor conditions, the auditor was open to consider management's position on the accounting estimate in an amicable discussion process. In the less flexible auditor conditions, the auditor was reluctant to consider management's goodwill valuation and was challenging during the process. Importantly, after discussions with the auditor, the company ultimately booked a loss in the same amount across all conditions. Thus, there was no difference in the financial position based on the discussions. Rather, the manipulation focused on perceived auditor flexibility. The second manipulation was the focus of questions posed by the audit committee regarding earnings release disclosures (GAAP only or both GAAP and non-GAAP). While a strong, independent audit committee was present in all conditions, in the GAAP only questioning

[3] As explained in detail in the methodology section, the participants were recruited from Qualtrics Panels, a service that specializes in facilitating research with difficult-to-obtain individuals. Diligent screening and monitoring ensured a quality sample of highly experienced professionals with financial expertise (e.g. CFOs).

conditions, the audit committee only asked specific questions about GAAP disclosures in earnings releases, with no mention of non-GAAP disclosures. In the both GAAP and non-GAAP questioning conditions, the audit committee also asked specific questions regarding the nature of non-GAAP disclosures. The dependent variables were follow-up questions regarding earnings release disclosure judgments. First, to examine non-GAAP preparation decisions, participants were asked if they would report a non-GAAP earnings measure that excluded the recognized goodwill impairment loss. Second, to analyze earnings release disclosure choices, the participants were asked the likelihood of disclosing an extra non-GAAP earnings figure and where they were likely to disclose various earnings measures within the earnings release. Disclosure earlier in the release is a measure of increased prominence and indicates the company is highlighting these items to readers (Huang et al. 2018). Thereafter, participants concluded the experiment by responding to manipulation check, post-experimental, and demographic questions.

The results indicate that both auditor behavior and audit committee questioning have an effect on non-GAAP disclosure preparation. After the managers faced constraints from inflexible auditors in conversations over a subjective accounting matter, they were less likely to exclude the impairment loss from non-GAAP earnings. Thus, constrained decision-making from the GAAP financial statements appears to carry over into decisions regarding non-GAAP disclosures. Additionally, an interaction of auditor flexibility and the type of questioning by the audit committee was observed. After managers interacted with more flexible auditors, they were more likely to exclude the impairment loss from non-GAAP earnings when the audit committee only actively questioned GAAP disclosures. When the audit committee questioned both GAAP and non-GAAP earnings, this effect was attenuated. Importantly, the managers were most likely to exclude the loss when there was no constraint from the auditors and when there was no audit committee questioning over non-GAAP measures, which supports my hypothesis.

Furthermore, the results show that the impact of auditor behavior and audit committee questioning also extends into the manner in which non-GAAP measures are disclosed in earnings releases. Specifically, managers were less likely to disclose an additional non-GAAP earnings measure in the earnings release after being exposed to a less flexible auditor, while the audit committee limited the prominence with which this measure was presented. The results show that when audit committees question both GAAP and non-GAAP disclosures, managers are less likely to disclose non-GAAP earnings in the Headline or Highlights sections of the earnings release, as opposed to when the committee only questions GAAP disclosures. This effect of audit committee questioning is isolated in the more flexible auditor conditions, which again provides evidence that the audit committee's monitoring of non-GAAP disclosures appears to be particularly important when the auditor has not constrained reporting behavior. Hence, while constrained decision-making resulting from auditor behavior may have a lasting effect from financial statement preparation into earnings release disclosure amounts, the audit committee's influence appears to have a broader influence over non-GAAP disclosure presentation.

Finally, causal analysis indicates audit committee questioning leads to a lower likelihood that managers will disclose prominent non-GAAP measures due to the relevant factors considered when making these disclosure decisions. Specifically, path analysis was conducted to examine the less flexible and the more flexible auditor conditions separately. This analysis shows that when managers expect they will be asked to justify their non-GAAP disclosure decisions to the audit committee, the managers provide more distinct reasons to help explain these decisions. However, in the more flexible auditor condition only, this increase in thorough consideration leads to a lower likelihood of disclosing non-GAAP Earnings Per Share (EPS) in the headlines. In the less flexible auditor condition, there is no association between the number of factors considered and the headline presentation decision. Hence, these results provide support for the notion that audit committee questioning causes managers to self-assess disclosure choices, but that this effect only influences managers' disclosure choices in the absence of auditor constraint.

This dissertation makes several contributions to accounting research and practice. First, it adds to the literature on the relationship between GAAP and non-GAAP reporting. While recent literature has begun to establish how non-GAAP and GAAP reporting choices may be related (Guggenmos, Rennekamp, and Rupar 2019; Kyung, Lee, and Marquardt 2019), the auditor's role in this context has not previously been examined. The reported results may lead to consideration of how auditor behavior influences managerial decision-making outside of the financial statements and may help establish a stream of literature on managerial decision-making in this area. While there appear to be spillover effects between audited financial statements and the associated earnings releases (Schroeder 2016; Haislip, Myers, Scholz, and Seidel 2017), it has not been empirically tested how auditor behavior affects later voluntary disclosure choices.

Additionally, this project will be useful to regulators who continue to monitor non-GAAP reporting. The SEC has taken measures to improve non-GAAP reporting quality (SEC 2018), but continue to take issue with undue prominence in non-GAAP disclosure presentation (Audit Analytics 2018a; 2018c). Recent practitioner guidance suggests audit committees should take a larger role in questioning non-GAAP reporting (CAQ 2018; Deloitte 2018), so empirical research in this area is vital. This dissertation suggests the audit committee can help in this area, especially in the absence of auditor constraint. Relatedly, the results indicate the configuration of governance mechanisms may lead to substitution effects for different mechanisms. While extant research supports the notion that audit committee oversight and auditor monitoring are both individually effective in influencing aggressive reporting, my results indicate that there may be limits to their effectiveness when paired together. This finding may be useful to future researchers when considering how governance components interact with one another.

CHAPTER 2: BACKBROUND & HYPOTHESES DEVELOPMENT

Financial Reporting Overview

Financial reporting and disclosure decisions are the ultimate responsibility of an organization's senior management, including the CFO and similar executives (Gibbins, Salterio, and Webb 2001). Some financial reporting, such as the core financial statements, is mandatory and must follow a set of accounting standards like U.S. GAAP. Other types of disclosures, such as those made in press releases, are voluntary and are provided at the discretion of an organization's management. Voluntary reporting in earnings releases has become commonplace and the information content of the releases is significant (Collins, Li, and Xie 2009; Davis et al. 2012). When managers feel there are gaps in mandatory disclosures, they can turn to voluntary disclosure to overcome those limitations. While accounting standards inherently set constraints on managers' financial reporting decisions (Graham et al. 2005), one important element in the mandatory financial reporting process that may alter the degree of constraint within the reporting standards is the role of the external auditor. Auditors may influence the amount of discretion management has in reporting financial outcomes by heavily recommending certain disclosure choices (Antle and Nalebuff 1991). These recommendations may serve as limits on the entire range of disclosure options management has available absent auditor input. The limitations and the feeling of constraint from these limitations, in turn, may affect subsequent voluntary disclosure choices by management. Consequently, the impetus of managers' voluntary disclosure choices may be influenced by discussions with auditors while preparing the financial statements. Therefore, I will investigate how discussions over GAAP accounting issues shape management's decisions regarding voluntary reporting in earnings releases.

While the auditor's behavior can help shape financial reporting outcomes, audit committees also serve an important role in supervising the preparation of the audited financial statements. Regulators have suggested that the audit committee should actively ask questions to ensure the preparation and disclosure of non-GAAP information is useful to investors (CAQ 2018). Moreover, industry best practices indicate that the audit committee should actually oversee all aspects of financial reporting, including press releases and company filings with both GAAP and non-GAAP financial information (PwC 2016; Deloitte 2018). Therefore, the audit committee has the unique opportunity to oversee GAAP financial reporting in the financial statements and non-GAAP information presented elsewhere by asking questions of management regarding disclosure choices. Furthermore, it is important to consider how the auditor's behavior and the audit committee's questioning— two important components of corporate governance— combine to influence voluntary non-GAAP reporting decisions. This consideration is key because different governance mechanisms often behave in complex ways when paired together (Misangyi and Acharya 2014). Hence, the impact of the audit committee's questioning behavior on reporting decisions may be contingent upon the auditor's constraining behavior. I will explore the effects of the auditor and the audit committee's behavior on managerial decisions related to two aspects of voluntary disclosure: decisions on how to prepare non-GAAP disclosures and how to present them in earnings releases.

Non-GAAP Reporting

Non-GAAP measures, such as earnings that have been adjusted to account for nonrecurring or noncash items, provide new information to investors beyond what is required in the financial statements (Curtis et al. 2014).[4] The popularity of non-GAAP reporting has grown significantly in recent years, despite increased regulation in this area (Rapoport and Michaels

[4] Non-GAAP measures have commonly been called "pro forma" measures in earlier research related to this topic.

2016).[5] Company executives have indicated that they utilize non-GAAP reporting because of limitations in GAAP reporting (Francis and Linebaugh 2015). Prior accounting research has indicated that non-GAAP reporting can be useful for investors because it provides additional information about company performance (Bhattacharya, Black, Christensen, and Larson 2003; Lougee and Marquardt 2004). For example, non-GAAP earnings measures can exclude transitory or one-items, which may allow investors to obtain a more accurate depiction of a firm's core earnings than those portrayed by GAAP earnings (Curtis et al. 2014). However, in some cases, non-GAAP reporting may be also used inappropriately or opportunistically. (Bradshaw and Sloan 2002; Bowen et al. 2005; Doyle et al. 2013; Curtis et al. 2014). Ultimately, non-GAAP financial reporting has become ubiquitous for most large companies, yet there is still significant discretion in the ways in which this type of reporting is utilized. There are two broad ways in which managers can exercise discretion in non-GAAP reporting. First, they have flexibility in how non-GAAP measures are calculated or prepared. Second, they have flexibility in how non-GAAP measures are disclosed and presented, especially in earnings releases.

I will first examine how managers make decisions on how to prepare non-GAAP measures. Non-GAAP reporting can be attractive to managers because of the discretion available in the preparation of these measures. Specifically, managers can use non-GAAP reporting to express their preferred financial positions by making strategic choices in the calculation of non-GAAP measures. For example, they can choose which transactional or financial statement items to exclude in the preparation of adjusted non-GAAP earnings measures. Most related to this study, they can choose to exclude non-recurring or non-cash expenses in the non-GAAP earnings calculation, which will increase its value in comparison to GAAP earnings. Utilizing the inherent

[5] To illustrate, 97% of firms in the S&P 500 present non-GAAP metrics in SEC filings in 2017, up from 76% in 2006 (Audit Analytics 2018b).

flexibility available in preparing non-GAAP measures can be beneficial for managers because it allows managers to report outcomes that are more aligned with their financial reporting goals. One such goal may be to portray the company's performance in a favorable manner, which can be especially important when management compensation is partially determined by non-GAAP measures (Audit Analytics 2019; Kyung et al. 2019). Thus, not only do managers have the opportunity for more discretionary financial reporting by utilizing non-GAAP measures, they also have incentives to make strategic decisions while preparing these measures.

Prior research supports the notion that managers make strategic choices about which items to exclude when defining non-GAAP earnings measures (Heflin and Hsu 2008; Black, Christensen, Kiosse, and Steffen 2017a) when traditional financial reporting environments are more restrictive. For instance, Doyle et al. (2013) show that firms are more likely to strategically define non-GAAP measures in earnings announcements to meet analyst forecasts when within-GAAP earnings management is limited due to balance sheet constraints. Also, Black, Christensen, Joo, and Schmardebeck (2017b) find that companies use non-GAAP exclusions more aggressively when they are unable to meet financial expectations through regular operating performance, accruals earnings management, or real earnings management. Both of these results suggest that the strategic preparation of non-GAAP reporting may be used as a substitute for traditional earnings management when there are restrictions in the GAAP reporting environment.

Relatedly, Guggenmos et al. (2019) examine the relationship of non-GAAP reporting availability on GAAP financial reporting. They find when non-GAAP earnings disclosures are to be made in addition to GAAP disclosures, managers are willing to book a larger loss that causes GAAP earnings to miss a benchmark. This result is attributed to a decreased importance in GAAP measures when non-GAAP measures are also disclosed. Essentially, the managers in

Guggenmos et al. (2019) are willing to recognize a lower GAAP earnings number when they know that a non-GAAP earnings measure will be disclosed to help offset the bad news transmitted in the GAAP measure. Their findings support the overall notion that managers perceive that voluntary non-GAAP reporting can provide information and shape investor perceptions when GAAP reporting does not sufficiently meet their financial reporting objectives.

Yet, this prior research also neglects an important aspect of the financial reporting process- the external auditors- who help shape financial reporting decisions. Financial reporting decisions are not just driven by accounting standards and regulations, but also by how auditors guide reporting behavior within these standards. Indeed, Jamal and Tan (2010) find evidence that accounting standard type and auditor type jointly affect reporting decisions of financial managers. Therefore, while the restriction of certain accounting standards or provisions may lead managers to pursue non-GAAP reporting, it is important to consider the auditor's role in this context. Specifically, the level of flexibility that auditors exhibit in discussions on subjective accounting issues may impact the degree to which managers feel their financial reporting decisions are constrained or limited, which may carry over into subsequent disclosure decisions.

Auditor-Client Discussions

Within the framework of GAAP, there are situations where the standards are unclear or absent of guidance. These areas allow for significant leeway or flexibility in preparation, and management must make decisions about what is most appropriate to report or disclose. For example, complex estimates and fair value determinations, such as those involved with the valuation of goodwill, often involve ambiguous inputs and inexact forecasts. These areas require significant management judgment to finalize (Gibbins et al. 2010; Bratten, Gaynor, McDaniel, Montague, and Sierra 2013). In these circumstances, there is often a range of possible reporting outcomes from which management must decide which to report.

Yet, company management does not make these judgments entirely alone. When there are subjective accounting issues, management often discusses these issues with their external auditor (Antle and Nalebuff 1991; Gibbins et al. 2001; Gibbins et al. 2007). In order to provide reasonable assurance that the financial statements are free from material misstatement, the auditors must evaluate management's representations to ensure they comply with GAAP and are an appropriate depiction of the organization's financial outcomes and position. The auditors face significant risk of negative outcomes, such as litigation or reputation damage, if the financial statements are misstated (DeAngelo 1981; Gibbins et al. 2001), so they have incentives to ensure that the statements are of high quality. Hence, they may be heavily involved in helping determine the most appropriate way to treat subjective reporting issues.

During these discussions, auditors and their clients can propose and defend their positions on preferred accounting treatments (Gibbins et al. 2001). They can also discuss various aspects of the issue and express concerns with one another (Gibbins et al. 2005). These discussions may be lengthy, and the final outcome may lie close to management's initial positions, the auditor's recommended position, or somewhere in between (Gibbins et al. 2005). Given the importance of these discussions and the significant role the auditor has in the process, financial statements can often be considered a joint product of management and external auditors (Antle and Nalebuff 1991; Gaynor et al. 2016). Therefore, while the financial statements are prepared by management, managers do not always get the opportunity to report their desired financial positions or outcomes. When the auditors are heavily involved in the discussions and take strong stands on their proposed positions, management's behavior and reporting choices may be constrained by their auditor's rigid or inflexible behavior. This study will examine how auditors' constraining behavior over subjective GAAP issues guides subsequent disclosure choices where there is flexibility in providing and presenting disclosures, such as in earnings press releases.

Constraining Auditor Behavior

While auditors have incentives for clean financial reporting (Antle and Nalebuff 1991), company management also has various incentives. One of their primary objectives is often to portray the most favorable firm performance to please investors and other stakeholders by meeting financial expectations (Graham et al. 2005; Brown-Liburd et al. 2016). But, importantly, management also has incentives to acquiesce to the auditor in discussions in order to maintain a clean reporting reputation, minimize audit delays, and avoid qualified audit opinions (Salterio 2012). This set of incentives leads to a structure in which audit partners can exhibit significant control over accounting issues because of the power and status they have over financial managers (McCracken, Salterio, and Schmidt 2011). Consequently, the flexibility auditors exhibit when debating with management can significantly impact the financial statement preparation process and outcomes.

Prior research supports the notion that auditors can exhibit varying amounts of flexibility in discussions with company management. At times, auditors may refuse to compromise on accounting issues, limit concessions, and be unwilling to seriously consider management's stance on subjective matters (Bame-Aldred and Kida 2007; McCracken et al. 2011; Brown-Liburd et al. 2016).[6] Even though most auditors likely wish to maintain a positive working relationship with their clients, they can still display relatively contentious behavior, which sends the signal that they are unwilling to cooperate with management to come to a common

[6] Interestingly, Bame-Aldred and Kida (2007) suggest that auditors are less flexible than manager counterparts during accounting discussions.

agreement (Bame-Aldred and Kida 2007). Such behavior limits management's reporting discretion. Alternatively, auditors can demonstrate more problem-solving behavior, which indicates that they are willing to compromise and come to an agreement on the most appropriate accounting treatment (Sanchez, Agoglia, and Hatfield 2007; Brown-Liburd and Wright 2011; Cheng, Tan, Trotman, and Tse 2017). In this case, management may feel as if they have more autonomy in preparing the financial statements as desired. In summary, auditors can interact with their clients in different ways during discussions over accounting issues, and when auditors are relatively inflexible in discussions, managers may feel that their reporting decision-making ability is constrained.

Notably, the flexibility auditors demonstrate in discussions with management can have a significant impact on financial reporting outcomes by affecting the decision-making of financial managers. Managers make less aggressive reporting decisions, are less likely to make concessions, and are less satisfied with reporting outcomes when auditors exhibit relatively inflexible or contentious behavior (Perreault and Kida 2011; Brown-Liburd et al. 2016). This effect is persistent, as the way auditors behave during prior period discussions may even shape the decisions of managers in a later period (Brown-Liburd and Wright 2011; Cheng et al. 2017) Since management decision-making is the basis of a significant portion of the financial statements, the way auditors behave during the audit of financial statements influences reporting and disclosure outcomes. Hence, not only can auditors be inflexible in accounting discussions with management, which can limit financial reporting decision-making, but these decisions can actually lead to outcomes in the financial statements that are contrary to the ones managers wish to report. While prior research shows how auditor behavior influences financial reporting decisions within GAAP, this research has not examined how the consequences of differential auditor behavior extends past the financial statements. In this dissertation, I will examine the effect of inflexible auditor behavior on disclosure decisions beyond the GAAP-based financial statements. Psychology theory on how individual's perceive and react to constraints on their behavior will guide my predictions.

The Effect of Auditor Constraint on Non-GAAP Disclosure Preparation

The constraint that external auditors put on management's GAAP reporting decisions can potentially impact their non-GAAP disclosure choices. Psychology research indicates that individuals are generally attune to situational constraints, which affects decision-making in various contexts (Botti et al. 2008). For instance, marketing research shows that consumers' perceptions of products or brands are influenced by marketing campaigns or product options perceived to limit the consumers' choices (Clee and Wicklund 1980; Fitzsimons 2000; Fishbach and Finkelstein 2010; Wang, Krishna, and McFerran 2017; Dailey and Ülkü 2018). This awareness of constraint may stem from a primary human motivation to be in control of one's own outcomes and to have the choice to behave in desired ways (Patall, Cooper, and Robinson 2008). Importantly, this research shows that restrictions to decision-making has lasting effects, such that the feeling of constraint extends beyond the situation in which the constraint originated. For example, when individuals are denied certain buying options, they may experience decreased feelings of self-esteem and autonomy that last into future decision-making environments (Bone et al. 2014). Additionally, when consumers perceive their freedom of choice is restricted, this perceived constraint can impact future purchasing decisions (Algesheimer et al. 2005).

Prior research has also shown that constraints to behavior are recognized in negotiations (Curhan, Neale, and Ross 2004; Bendersky and Curhan 2009). In this setting, negotiators perceive that the opponent's proposals constrain their freedom to obtain the desired outcome

(Curhan et al. 2004). Further, the subjective value of a negotiation process and outcome, such as the perceived behavior of the opposing negotiator, can impact future decisions or negotiations (Curhan, Elfenbein, and Eisenkraft 2010). This directly relates to auditor-client interactions, where discussions over accounting issues resemble negotiations. When auditors and client management have different opinions on how to resolve subjective reporting elements, managers likely view auditor-proposed outcomes as limits to their financial reporting autonomy. This perceived limitation is likely to impact subsequent decisions by the managers.

As it relates to decisions on how to prepare non-GAAP financial measures, auditors can exhibit inflexible behavior in discussions with managers regarding financial reporting within GAAP, which these managers will likely perceive as constraints to their decision-making behavior (Bame-Aldred and Kida 2007; Gibbins et al. 2007). When these constraints are perceived, psychology theory suggests that managers will feel a decrease in the discretion to report desired financial outcomes and that this feeling can persist beyond the discussion regarding the GAAP matter, such as in the preparation of non-GAAP disclosures. Thus, while non-GAAP reporting can be used by managers to prepare financial measures that more closely reflect their desired outcomes, this ability is influenced by the degree to which they perceive their financial reporting options are limited by the auditor. To note, this feeling of constraint over non-GAAP reporting can exist even though auditors have limited official oversight in non-GAAP disclosure preparation (Deloitte 2018).[7] That is, only the perception of constraint is necessary for individuals to feel as if decision-making is limited (Farquhar and Pratkanis 1993),

[7] Auditing standards indicate auditors should read Management's Discussion and Analysis portion of the annual report (PCAOB 2017) to ensure consistency with the financial statements, so non-GAAP measures disclosed in that section might be reviewed by the auditor. But, auditors have no formal requirements to review earnings press releases, so non-GAAP information disclosed in that format is likely not reviewed by the auditor at all. Hobson, Mayew, Peecher, and Venkatachalam (2017) suggest that experienced audit partners may informally review earnings conference calls, but are not required to perform any procedures on this information.

suggesting that managers who merely feel as if their reporting options are constrained will alter their decisions in response to the constraint.

As mentioned previously, non-GAAP reporting, by nature, has more flexibility in preparation and disclosure presentation. Non-GAAP measures are produced by making exclusions from GAAP financial measures. In particular, when calculating non-GAAP net income, management can decide to exclude the amount of a specific transaction or accounting outcome, such as goodwill impairment, which effectively eliminates that transaction's impact on net income. Making larger exclusions from non-GAAP earnings results in less conservative measures that deviate further from GAAP earnings. Alternatively, managers can make the decision to exclude none of a transaction amount (i.e., keep its effect in the earnings calculation), which results in a more conservative non-GAAP earnings metric that doesn't deviate from its GAAP counterpart. I expect that when managers feel as if auditors have constrained their financial reporting options, due to inflexible behavior exhibited during financial statement discussions, the managers will be less likely to exclude the value of this outcome in the calculation of non-GAAP earnings.[8] Alternatively, when auditors exhibit more flexible behavior, managers will not feel the same level of constraint from the auditors' behavior and will be more likely to make a larger exclusion from non-GAAP earnings. This exclusion results in a non-GAAP earnings metric that is less conservative and more closely aligned with the value management originally desired to report. Accordingly, I propose the following:

[8] Given the accounting issue in question is an income-decreasing impairment loss, a decision to exclude this in the non-GAAP earnings measure will increase non-GAAP earnings in comparison to GAAP earnings. The case is discussed in more detail in the following section.

H1a: Managers are more likely to make a larger exclusion from non-GAAP earnings measures when the auditor exhibits more flexibility during discussions regarding a GAAP accounting treatment, as opposed to when the auditor exhibits less flexibility.

Audit Committee Non-GAAP Reporting Oversight

While I expect auditors' flexibility to influence the nature of non-GAAP reporting, another important contextual feature of the financial reporting environment that may also play a role is the behavior of the audit committee. In fact, the committee's role in overseeing non-GAAP financial reporting is especially important to consider because this information is not audited (Deloitte 2018). Thus, while the auditor's behavior from financial statement discussions may carry over into decisions regarding the preparation of non-GAAP disclosures, the audit committee has a more direct role in ensuring non-GAAP reporting is done in an appropriate manner.

Extant research shows that strong audit committees impact financial reporting decisions of financial managers within GAAP (Ng and Tan 2003; Agoglia et al. 2011; Brown-Liburd et al. 2016). Specifically, effective audit committees may dampen management attempts at aggressive financial reporting and alter negotiation strategies in discussions with auditors. Yet, despite recent calls for increased audit committee involvement in the evaluation of non-GAAP measures, there is very little empirical research testing how audit committees affect non-GAAP reporting. Some preliminary evidence indicates that effective governance can impact non-GAAP reporting. Non-GAAP exclusions are smaller and of higher quality following the appointment of accounting experts, as opposed to nonaccounting experts, to the audit committee (Seetharaman, Wang, and Zhang 2014). In addition, strong corporate governance, such as board independence, may improve the quality of non-GAAP earnings in the absence of regulatory intervention (Frankel, McVay, and Soliman 2011; Jennings and Marques 2011).

However, it is unclear how effective audit committees can improve the quality of non-GAAP reporting because there are varying degrees to which audit committees can be active in their oversight roles. The existence of a strong audit committee in itself may not be enough to provide proper oversight of financial reporting. Even if an audit committee is composed of members that are independent and have a high degree of accounting expertise, they may not effectively monitor financial reporting if they are not active in performing oversight duties. Some audit committees take on a more passive or ritualistic role, where they don't rigorously supervise management's reporting choices (Cohen, Krishnamoorthy, and Wright 2008; Beasley et al. 2009). To truly provide value, audit committees should be active in analyzing reporting decisions and communicating with management and auditors during the process (Cohen et al. 2010). One useful oversight activity is the proactive questioning of managerial reporting decisions. Particularly, I will examine if questioning of non-GAAP disclosure decisions will cause managers to give careful consideration to these judgments.

Audit Committee Questioning of Non-GAAP Measures

Prior research has consistently suggested that one of the most effective ways audit committees can govern management is by actively asking questions about the financial reporting process (Gendron et al. 2004; Beasley et al. 2009; Cohen et al. 2010; Pomeroy 2010; Kang et al. 2015; Kang 2019). Committees that frequently ask specific questions of management signal that they are active in reviewing financial reports, which makes management analyze their own reporting decisions to ensure these decisions will stand up to the anticipated questioning (Beasley et al. 2009). In turn, this anticipated questioning may lead to less aggressive reporting behavior by managers who would have to justify their reporting decisions to the audit committee (Gendron and Bédard 2006; Cohen et al. 2010; Brown-Liburd et al. 2016; Kang 2019). However, prior research focuses primarily on how audit committees impact financial reporting *within* GAAP, and not processes for oversight outside of the financial statements.

As noted, best practices suggest that the audit committee review all earnings disclosures, including non-GAAP measures disclosed in filings and press releases (PwC 2016; Deloitte 2018). This review can include questions on the transparency, consistency, and comparability of non-GAAP measures (CAQ 2016). These questions should encourage management to consider the usefulness of the disclosure non-GAAP measures. Research has not determined whether managers respond to audit committee questioning on non-GAAP measures in the same way they respond to questioning of GAAP financial reporting. Even if a strong audit committee frequently asks questions about the core financial statements and related GAAP disclosures, management may not perceive the committee is monitoring non-GAAP disclosures unless they have exhibited a history of actively asking specific questions about non-GAAP disclosures. If the committee explicitly asks questions about non-GAAP measures, management should exhibit less aggressive behavior, consistent with research on the effect the committee's questioning behavior has on managerial decision-making within GAAP (Agoglia et al. 2011; Brown-Liburd et al. 2016).

However, the effectiveness of questioning by the audit committee as a mechanism to attenuate more aggressive non-GAAP preparation decisions is likely contingent upon the degree of auditor flexibility. Prior research on corporate governance indicates that configurations or combinations of multiple governance mechanisms interact in complex ways such that, instead of acting as complements to one another, they may act as substitutes (Misangyi and Acharya 2014; Oh et al. 2018). For example, monitoring by the board of directors can be an effective mechanism to decrease aggressive executive behavior, but is less effective when the executive's behavior is already altered by another governance factor, such as incentive alignment (Rediker and Seth 1995). A similar substitution effect is observed in examining multiple governance mechanisms on decisions related to corporate social responsibility (Oh et al. 2018). This is likely because there are limits to the degree to which managers will alter behavior that ultimately benefit themselves, in response to various governance or monitoring mechanisms (Misangyi and Acharya 2014). Similarly, Beasley et al. (2009) note that an auditor can have a greater role in financial reporting oversight when the audit committee does not take an active monitoring role, even if the committee is composed of strong, independent members.

Thus, while the audit committee's questioning can be effective at causing managers to exhibit less aggressive reporting behavior, the effect is likely contingent upon the degree of auditor flexibility. As it relates to non-GAAP earnings preparation, the audit committee's questioning is not expected to influence managers' exclusion likelihood decisions when the auditor is less flexible because the managers' reporting behavior is already constrained by the auditor's behavior. However when the auditor is more flexible, the audit committee's questioning of non-GAAP measures can have a significant impact because the managers are not constrained by auditor behavior. Thus, in my setting, managers are only expected to make larger exclusions from non-GAAP earnings (i.e., act in the least conservative manner) when they have not been exposed to constraining auditor behavior and when the audit committee does not actively question non-GAAP measures. I make the following interaction hypothesis regarding the preparation of non-GAAP measures:

H1b: Managers' non-GAAP exclusion likelihood will be highest when the audit committee only questions GAAP financial measures and the auditor exhibits more flexible behavior, as opposed to when the audit committee questions both GAAP and non-GAAP measures and/or when the auditor exhibits less flexible behavior

Earnings Releases

The second type of voluntary reporting decision I will examine is how managers disclose and present non-GAAP measures in earnings releases. It is important to note that the two types of decisions examined in this dissertation— decisions on how to prepare non-GAAP measures and decisions on how to present them in the earnings release— may not be entirely independent of one another. For instance, when the choices of exclusions in non-GAAP earnings calculation leads to more favorable outcomes, this may lead to an increased likelihood of prominent disclosure in the earnings release. Yet, it is important to examine these decisions somewhat independently in relation to auditor constraint and audit committee questioning. That is, the way these variables impact these two types of managerial decisions may not be entirely the same (e.g., audit committee questioning over non-GAAP exclusions may be perceived differently than the presentation of disclosures, especially in combination with varying levels of auditor constraint). These differences lead to a somewhat different prediction regarding the interaction pattern between the two decision types (i.e., the interaction proposed in H1b above is not identical to the interaction proposed in H2b and H3b below).

Earnings releases are voluntary public announcements by a company which disclose material information regarding results of operations or financial condition for a given period (SEC 2018b). These releases are often made available around the time the audited financial statements are completed and filed, and are used to highlight a company's performance (Bhaskar et al. 2019).[9] Earnings releases are an important mechanism for self-directed voluntary disclosures because they contain timely, relevant information for investors (Collins et al. 2009). Indeed, research has shown that earnings announcements contain valuable information to the market (Kothari 2001; Li and Ramesh 2009). Management has greater freedom to disclose the information it wishes, within reason, in earnings releases compared to what is allowed by GAAP in the financial statements. Earnings releases may contain GAAP-based information from the financial statements and non-GAAP information, and the mix of items chosen for disclosure is largely at the discretion of management.[10]

Prior research indicates that managers do strategically make choices regarding the amount of non-GAAP metrics disclosed in earnings releases. For instance, non-GAAP reporting increases in frequency in earnings press releases after the adoption of voluntary clawback provisions, which penalize managers for financial misreporting and effectively restrict opportunistic reporting choices within GAAP (Kyung et al. 2019). Additionally, managers often disclose more non-GAAP metrics in earnings releases when they fail to reach financial targets through other means, such as accruals-based or real earnings management (Doyle et al. 2013; Black et al. 2017b). Together, research implies that managers are more likely to disclose non-GAAP measures when they wish to report information beyond what is allowed in the GAAP reporting environment. However, this research does not address how auditor behavior or audit committee questioning plays a role in these disclosure decisions.

[9] While companies can announce "unaudited" earnings in releases prior to the completion of the audit (Marshall, Schroeder, and Yohn 2018), significant revisions to these numbers after audit completion is not common (Bronson, Hogan, Johnson, and Ramesh 2010). Companies also commonly announce unaudited quarterly earnings. However, the experimental task in this paper is focused on an earnings release issued after the completion of a fiscal year.
[10] They may also disclose non-financial information, which is not covered in this study.

Further, managers also have greater discretion in determining what information to highlight or emphasize to investors in earnings releases, which can determine how the information contained in the release is perceived by investors (Frederickson and Miller 2004; Elliott 2006; Marques 2010; Huang et al. 2018). One common way in which managers can emphasize information in earnings releases is by disclosing the information early on in the release, as opposed to later. Particularly, disclosing information in the headline of the release can draw investor attention to this information (Huang et al. 2018). Investors are often considered to have limited attention to devote to company disclosures (Hirshleifer and Teoh 2003). Therefore, when a company strategically discloses certain financial measures in an earnings release headline, investors are more likely to act on this information, as opposed to information further down in the body of the release.[11]

Indeed, research supports the notion that managers deliberately present financial information in earnings releases in an attempt to influence investor behavior. For example, Huang et al. (2018) find managers use opportunistic headline disclosures to emphasize optimistic financial information. Other recent research implies that discretionary disclosure prominence is used for both GAAP and non-GAAP reporting (Bentley, Stubbs, Tian, and Whited 2019; Chen, Gee, and Neilson 2020). Importantly, prior research also shows that investors are influenced by the order in which disclosures are made in earnings releases (Elliott 2006; Cheng, Roulstone, and Van Buskirk 2020). Taken together, this research suggests that the presentation of financial disclosures, particularly the order of information, is an important component of voluntary reporting that managers exercise discretion over. Yet, given that auditors can significantly impact

[11] In a follow-up survey after the experiment, the participants confirmed that their companies gave significant consideration to the placement (order) of disclosures in earnings releases, with the expectation that investors will devote the greatest amount of their attention to the headline. The survey is discussed in more detail in the results section.

decisions related to financial reporting outcomes, it is important to consider if decision-making related to earnings release presentation is affected by the degree of auditor constraint.

The Effect of Auditor Constraint on Earnings Release Disclosure & Presentation

Earnings releases are unaudited and external auditors have little direct oversight over earnings release preparation. However, recent research does provide some evidence of a relationship between auditors or audit outcomes and earnings releases. For instance, Schroeder (2016) find that companies utilizing a Big 4 auditor for their financial statement audits issue more GAAP measures in earnings releases. This result is indicative of a spillover effect from the level of quality of the audited financial statements to earnings release disclosures. Additionally, earnings announcements issued after a completed audit contain higher quality earnings measures (e.g., less likely to meet or beat expectation) in comparison to announcements issued before the audit is completed (Marshall et al. 2018). Again, this result supports the notion that the content or quality of earnings release disclosures may be partially driven by the financial statement audit. Finally, Chen et al. (2012) show that audit fees and the likelihood of auditor resignation are higher for companies that disclose opportunistic non-GAAP measures in earnings releases, which also suggests another link between auditors and earnings release disclosures. While research has begun to explore this link, it has not been determined how auditor behavior in financial statement discussions carry over into voluntary earnings release disclosures.

As mentioned previously, psychology research indicates that constraining behavior in one area can influence subsequent behavior in other area (Botti et al. 2008). When auditors constrain managerial decision-making in the financial statements, managers will likely feel as if their financial reporting freedom is restricted, which can carry over into earnings release disclosures. Hence, even though strategically disclosing information, especially non-GAAP measures, in earnings releases can be beneficial for managers in influencing investor behavior, managers may not feel as if this option is available to them in the presence of an inflexible auditor. However, in the absence of constraint from an inflexible auditor, managers likely feel more freedom to disclose non-GAAP information in the manner desired.

There are two ways in which managers can pursue more aggressive non-GAAP disclosure choices in earnings releases when they have interacted with a more flexible auditor. First, they may simply disclose more non-GAAP measures. There is a significant collection of non-GAAP measures managers can choose to disclose (e.g., EBITDA, adjusted EBITA, adjusted net income, adjusted net income per share, etc.). When crafting earnings releases, they can choose to disclose a higher number of non-GAAP measures if they reflect desired results (Frederickson and Miller 2004; Marques 2006; Kolev, Marquardt, and McVay 2008). Experienced financial managers have indicated they believe investors will devote greater attention to non-GAAP measures when both non-GAAP and GAAP measures are disclosed (Guggenmos et al. 2019). Therefore, when managers face more flexible auditors and feel less constraint in their decision-making capabilities, they can respond by reporting more non-GAAP measures in the earnings release. Formally, I predict the following (in alternative form):

> **H2a:** Managers are more likely to disclose more non-GAAP earnings measures in earnings press releases, when the auditor exhibits more flexibility during discussions regarding a GAAP accounting treatment, as opposed to when the auditor exhibits less flexibility.

Second, managers may purposefully emphasize non-GAAP earnings by assigning them greater prominence in the earnings release. Since earnings releases often contain multiple GAAP and non-GAAP disclosures, in addition to other non-financial information, managers can choose which pieces of material to emphasize to investors. Given that investors seemingly devote attention to prominently displayed disclosures (Huang et al. 2018), these presentation choices can be especially impactful. As noted, a common way that managers can assign varying levels of prominence to different disclosures is by placing them in a particular order in the release (Bowen et al. 2005; Elliott 2006; Marques 2010). By placing disclosures earlier in the release, such as in the headline, managers are signaling that these measures are more important than information disclosed later. Thus, when managers wish to emphasize non-GAAP measures after discussions with more flexible auditors, they can place them in an upfront, prominent position in the earnings release. I predict the following related to the presentation of non-GAAP measures:

> **H3a:** Managers are more likely to disclose non-GAAP earnings prominently in earnings press releases when the auditor exhibits more flexibility during discussions regarding GAAP accounting treatments, as opposed to when the auditor exhibits less flexibility.

Audit Committee Questioning in Earnings Release Disclosures

While the auditor's constraining behavior originating in financial statement discussions is expected to influence subsequent earnings release disclosures, the audit committee is directly tasked with overseeing these disclosures. Regulatory bodies have called for audit committees to take a more active role in this area and take a more holistic approach to financial reporting oversight (CAQ 2018; SEC 2018b). Moreover, the New York Stock Exchange actually requires audit committees to discuss earnings press releases and guidance provided outside of the financial statements (NYSE 2004). To fulfill this responsibility the audit committee can utilize questioning over non-GAAP disclosures in earnings releases. This questioning behavior by the audit committee can diminish heightened disclosure and emphasis of non-GAAP reporting because managers will anticipate that their disclosure judgments will be scrutinized by the audit committee, and that they would have to justify or provide additional information about their disclosure choices. In turn, the managers will evaluate their earnings release disclosure choices and focus on the objective value of non-GAAP reporting. However, the efficacy of audit committee oversight likely depends on the level of auditor constraint. Since individual governance mechanisms become more important in the absence of another (Misangyi and Acharya 2014), the incremental impact of audit committee questioning should be greater when the auditor is more flexible. This is because the absence of auditor constraint leaves managers further away from their "limits" on the degree to which they will curb aggressive reporting behavior in response to governance oversight. Therefore, audit committee questioning over non-GAAP disclosures in earnings releases is able to have a greater impact on decision-making in the absence of constraining auditor behavior.

While H2a predicts that managers will provide more non-GAAP measures in the earnings release when pursuing heightened non-GAAP reporting, I also predict that when the audit committee questions the usefulness of non-GAAP disclosures, managers will be wary of issuing too many of these disclosures, which may be perceived as aggressive financial reporting. This is consistent with prior research showing audit committee behavior can decrease aggressive GAAP reporting (Ng and Tan 2003; Agoglia et al. 2011; Brown-Liburd et al. 2016). A similar effect is expected in these non-GAAP disclosure choices because managers will expect that the audit committee will question the increased level of disclosure. Managers will therefore be more reserved in choice of non-GAAP disclosures since these choices may have to be justified to the audit committee. This effect is expected to be greater when managers have interacted with more flexible auditors who have not constrained reporting behavior. As such, I predict the following:

> **H2b:** The difference in the likelihood of disclosing non-GAAP measures in earnings releases made in the presence of an audit committee that actively questions non-GAAP disclosures, versus an audit committee that only questions GAAP disclosures, will be greater when the auditor exhibits more, as opposed to less, flexible behavior.

Similarly, when not constrained by auditors within GAAP reporting, managers can increase the prominence in the presentation of non-GAAP measures by disclosing them earlier in an earnings release, which is the predicted response in H3a. Yet, audit committees can ask questions about the presentation of non-GAAP measures to ensure they are not given undue prominence in relation to other disclosures (PwC 2016; CAQ 2018; Deloitte 2018). Managers are predicted to disclose non-GAAP measures more prominently in the absence of constraint because these measures reflect more positive economic outcomes than the GAAP counterparts. Since this increased prominence is expected in the presence of a more flexible auditor, audit committee questioning can serve to recalibrate management's judgments in this regard and lead them to consider the significance of the presentation of non-GAAP measures absent auditor constraints. When management expects questioning about the presentation of non-GAAP measures, they are expected to provide more thoughtful consideration to the placement of non-

GAAP measures because of the expected questioning. Formally, I predict the following interaction:

> **H3b:** The difference in the likelihood of disclosing non-GAAP measures prominently in earnings releases made in the presence of an audit committee that actively questions non-GAAP disclosures, versus an audit committee that only questions GAAP disclosures, will be greater when the auditor exhibits more, as opposed to less, flexible behavior.

CHAPTER 3: METHODOLOGY

Participants

100 senior executives with financial backgrounds completed the experimental task. The sample consisted of: 37 Officers/Directors/Presidents, 33 CFOs/Financial Executives, 15 Managers, and 15 Other Positions. Senior executives are the appropriate participants for this research because they are a key member of the financial reporting process. Relevant to this experiment, executives with financial backgrounds often hold discussions with external auditors regarding GAAP disclosures and interact with audit committees at various points in the financial reporting cycle. In addition, they provide a vital input in making disclosure decisions in earnings releases (Deloitte 2014; EY 2014). Pilot tests of the experimental task were also conducted using senior undergraduate and graduate students at a large state university in the Southeast. These pilot tests are discussed in more detail below.

The participants were obtained by utilizing Qualtrics Panels, a web-based research service that has been used to recruit difficult-to-obtain experimental participants in prior accounting research (Brown-Liburd and L. Zamora 2015; Pyzoha 2015; Buchanan, Commerford, and Wang 2019; Bentley, Lambert, and Wang 2020). Such research organizations provide online research solutions, including the recruitment and use of its research panels. Panel participants are recruited by invitation only through a controlled member verification process that only enrolls previously validated individuals from business partners. This approach allows the research organizations to strategically obtain access to hard-to-reach audiences, such as the financial managers needed for this study. Once potential participants have been identified based on the sample requested, they are e-mailed an invitation to participate. The participants are compensated for completing the instrument with various incentives, including: cash, airline miles, gift cards, and hotel points (Bentley et al. 2020). However, many participants opt to donate the monetary equivalent of their incentive to charitable organizations (Pyzoha 2015).

While the Qualtrics Panels service only delivered the instrument to a pool of appropriate subjects based on preliminary discussions about the research project, participants were also required to pass a set of screening questions to ensure they had the particular experience and knowledge necessary to complete the task. Specifically, the participants were required to have: experience working as a financial manager/executive with a U.S. publicly-traded company; experience discussing accounting issues with external auditors; familiarity with non-GAAP financial measures; and experience in helping to prepare earnings press releases. If they did not report experience in these areas, they did not proceed to the experimental task. Additionally, the participants were required to answer three questions testing their fundamental accounting knowledge.[12] If the participants did not respond to these questions correctly, they did not proceed to the experimental task. This screening approach is similar to that used by Guggenmos et al. (2019) and Bentley et al. (2020). Beyond the initial screening, I also worked with a Qualtrics Project Manager to monitor the quality of responses during data collection. As part of the quality monitoring process, the instrument included a comprehension check question that ensured participants paid attention to the case materials. In all, the screening process and monitoring of responses during collection ensured that the highest quality responses possible were collected and retained for analysis.

Participant Characteristics

I examined several demographic aspects of the 100 participants in the final sample to gain further insights on the characteristics of these individuals (untabulated). First, the overall

[12] Specifically, the questions were related to goodwill and goodwill impairment. The questions can be found in the appendix.

range of work experience for the participant group is 20-25 years, which confirms that the participants were selected from pools of highly experienced professionals. Furthermore, the average age of the 100 participants that compose my final sample is 42.89, which also indicates that these individuals should have significant professional work experience. Importantly, a one-way ANOVA indicates the age of the participants does not significantly differ across experimental conditions ($F = 0.78$; $p = 0.51$). Additionally, 23 of the 100 participants are female and the proportion of participants' gender does not differ across experimental groups (Chi-Square = 4.41; $p = 0.23$). Finally, the participants also reported the industry in which their current company operates. A variety of industries were reported, including Financial Services, Technology, Retail, Manufacturing, Professional Services, and Healthcare. Again, industry classification does not differ across experimental conditions (Fisher's Exact = 12.923; $p = 0.95$). Thus, the insights and decisions in the experiment appear to come from a varied group of participants, but the distribution across conditions is consistent.

To gain an additional understanding of the specific expertise of the participants, they were also asked to rate their experience (1 = No experience; 9 = Considerable experience) across five categories related to the financial reporting process. The five experience categories were: preparing financial statements, discussing subjective accounting matters with auditors, preparing earnings releases, interacting with audit committees, and preparing/examining non-GAAP financial measures. The results of these questions are presented in Table 1. Reassuringly, the participants reported significant experience in all five categories (overall mean > 7.30 in all categories). Furthermore, one-way ANOVAs indicate that none of the experience ratings differed across experimental conditions (all p's > 0.20). Together, this analysis indicates that the participants had the requisite experience to complete the experimental task, which should strengthen external validity, and demonstrate that the results are not driven by differences in participant demographics.

Experimental Design & Research Task

This study utilized a 2x2 between-participants design with random assignment, with auditor flexibility and audit committee questioning focus as the independent variables. The experiment was administered through Qualtrics, an online research platform. The financial manager participants were asked to take the role of CFO for a hypothetical electronics company called Crisp Electronics, Inc. They were told the study involved judgments regarding the preparation of an earnings press release. Part of the duty they were to assume as the CFO was to act as the head of the disclosure committee. Disclosure committees are often the group within an organization that help draft the earnings releases, among other duties (Deloitte 2014; EY 2014). Before beginning the case materials, the participants were provided with a template of an earnings release example that labeled and described the different sections of an earnings release. This template was available for reference at any subsequent point during the experiment. The case started with participants reading background information for Crisp, a public company that had exhibited strong financial performance in recent years. Due to this strong performance, Crisp planned on raising additional capital at the beginning of next fiscal year. Consistent with prior research, this detail is included to increase the salience of the incentive to report a strong earnings performance (Agoglia et al. 2011). Part of the background information included a copy of Crisp's earnings press releases from the previous fiscal year. The prior year's earnings release was included to provide participants with insight on how Crisp previously disclosed GAAP and non-GAAP information. For example, the prior year's earnings release discloses one non-GAAP earnings measure (Adjusted Net Earnings) in the body of the release, but is not highlighted with prominence since it is not disclosed early in the release. Therefore, while Crisp has a precedent of disclosing some non-GAAP information, there is potential for more aggressive non-GAAP reporting in future earnings releases if Crisp's management discloses multiple non-GAAP earnings measures or discloses the non-GAAP measures more prominently (i.e. earlier in the press release).

Additionally, the participants read about Crisp's audit committee, which is composed of three independent members who all have financial expertise and meet in person frequently. The audit committee has also been proactive in identifying accounting issues and addressing them. These features are characteristics of strong audit committees identified in prior accounting research (Cohen et al. 2008; Agoglia et al. 2011; Brown-Liburd and Wright 2011; Carcello et al. 2011). They were then told that after the draft of the earnings release was completed (which incorporates participants' disclosure decisions), it would be reviewed by the company's CEO and the audit committee, although the CEO heavily relies on the CFO's discretion in this area. At this point, the participants were exposed to the first part of the audit committee questioning manipulation, as discussed in more detail below. The participants were also introduced to Crisp's hypothetical audit firm, including the audit partner. They were informed that they have had a good relationship with the auditors and had not had any significant issues in past audits.

Then, the participants were given information about the current year's financial statement preparation. They were told that in the role of CFO, they had overseen this process and that the statements had been nearly completed. However, a potential accounting issue arose in the fourth quarter of the current year. The issue revolved around the possible need to recognize goodwill impairment related to the acquisition of a printing software company several years prior. Crisp had never needed to recognize goodwill impairment for this reporting unit in the past, but a decline in Crisp's stock price in the fourth quarter of the year, following the announcement of a new product by a competitor, necessitated further examination. Using a discounted cash flow analysis, Crisp determined that, at most, a $1 million impairment loss may need to be recognized based on their model. The participants were given the assumptions used in the fair value model.

However, participants were told that the audit team took issue with their fair value estimate. Specifically, the auditors believe Crisp's sales growth assumption was too high due to the increased competition in the industry. Using the auditors' preferred sales growth estimate, which was lower than the range Crisp was using as an assumption in the model, the auditors believed that a $2.5 million impairment loss was more appropriate to record in the financial statements. Then, the participants were informed that they engaged in discussions with the audit partner on the most appropriate treatment of the fair value estimation and subsequent impairment. This type of subjective accounting issue is what would commonly be subject to discussion between company management and the external auditor in the preparation of financial statements (Gibbins et al. 2001; Hatfield, Agoglia, and Sanchez 2008; Fu, Tan, and Zhang 2011).

The participants were then debriefed on discussions that they had with the partner regarding the impairment issue. During this section, they were exposed to the auditor flexibility manipulation, which is discussed in more detail below. After the summary of the discussions, participants in all conditions were told that the discussions led to Crisp recognizing a $2 million impairment loss, which caused earnings to be lower than expected. Notably, prior research indicates that managers may be more likely to utilize non-GAAP reporting when GAAP earnings are lower than expected (Doyle et al. 2013). Thus, my experimental setting is relevant to examining non-GAAP reporting decisions. After the auditor discussions, the participants were reminded of their role as CFO in making judgments in the earnings release. Directly before making these judgments, the participants were reminded of the audit committee questioning manipulation. Audit committees often review earnings releases before they are issued to the public, so it is reasonable for managers to expect an interaction with the audit committee as they organize earnings releases (Beasley et al. 2009).

The participants were asked to make judgments related to the preparation of non-GAAP earnings measures and how to disclose and present various measures in company's upcoming earnings release. First, they were told that Crisp would continue to make adjustments from GAAP earnings to arrive at the non-GAAP adjusted earnings figure, which was disclosed in the previous year's earnings release. However, since this was the first time Crisp had recognized a goodwill impairment loss, participants had to make a decision on how to treat this item (i.e., whether to exclude it or not in the calculation of adjusted net earnings). Next, they decided whether to disclose an additional non-GAAP earnings measure in the earnings release and where to present GAAP and non-GAAP earnings measures in the earnings release. These judgments serve as the dependent variables in this experiment, and are discussed in greater detail below. After the dependent variable measurements, the participants responded to questions for manipulation checks, post-experimental questions, and demographic information. Finally, the participants completed a brief survey on their opinions and experiences related to earnings release disclosures and non-GAAP financial measures. Figure 1 provides a flowchart of the experimental task.

Manipulated Independent Variables

The first independent variable is the flexibility the audit partner exhibited during the discussions on the goodwill impairment loss that Crisp recognized in its financial statements. Per the case materials, while preparing the financial statements, the auditors and Crisp's management had a difference of opinion regarding the value of the goodwill impairment and held discussions to resolve the issue. The variable was manipulated at two levels: less flexible and more flexible. The auditor's behavior in these conditions is derived from prior literature on flexibility in auditor-client discussions (Bame-Aldred and Kida 2007; McCracken et al. 2011; Brown-Liburd et al. 2016). In the less flexible condition, the partner was relatively contentious and unwilling to seriously consider Crisp's preferred lower impairment figure. For example, the participants were told that the partner did not fully acknowledge the company's concerns about the impairment amount and that it seemed as if the partner's mind was already made up on the matter. He argued that Crisp's sale growth assumption in the fair value estimation was too high and was resolute on this position. Ultimately, the discussion with the partner in this condition was difficult. Conversely, in the more flexible condition, the partner was open to considering the CFO's position on the impairment. He listened to the company's concerns and acknowledged the arguments for recognizing a lower impairment loss. The discussion was described as amicable. Importantly, in all conditions, a $2 million impairment loss was ultimately recognized by Crisp. Therefore, the client's preferred position, the auditor's position, and the ending goodwill impairment figure were all the same. The only difference is the perception of how the auditor behaved during the discussions. [13]

The second independent variable is the focus of questioning the audit committee typically poses during its review of the earnings press releases. Prior accounting research has shown that exhibiting questioning behavior is an important way in which the audit committee can actively

[13] Prior research suggests that financial reporting discussions can be considered a triadic relationship between external auditors, the audit committee, and client management (e.g., Brown-Liburd et al. 2016). To mitigate concerns that my manipulation changed client management's assessment of the external auditor or the audit committee, the participants were asked to rate the perceived competency of both the external auditors and the audit committee. As discussed in detail in the results section, there were no differences in perceived competency for either group across experimental conditions.

cause managers to assess disclosure decisions (e.g., Kang 2019). Although, the intent of my manipulated variable is to test the importance of the focus of this questioning behavior, as opposed to the mere presence or absence of the behavior. This variable was manipulated at two levels: GAAP only questioning and both GAAP and non-GAAP questioning. In the GAAP only questioning condition, the participants were told that the audit committee typically asks questions related to GAAP measures from the financial statements. For example, they check for consistency in the presentation and calculation of GAAP measures. However, there was no mention of the audit committee questioning non-GAAP measures. In the GAAP and non-GAAP questioning condition, the audit committee specifically asks about non-GAAP measures in addition to the GAAP measures. Hence, not only will they review the financial measures from the financial statements, they will also check for the consistency, comparability, and usefulness of non-GAAP metrics. Per regulator and practitioner guidance, these are the types of questions audit committees should ask about non-GAAP information (PwC 2016; CAQ 2016, 2018; Deloitte 2018). To note, audit committees typically devote significant attention to GAAP disclosures (Beasley et al. 2009), so it was not realistic to include a condition in which the audit committee only questioned non-GAAP disclosures and not GAAP disclosures. The participants are first introduced to the audit committee questioning behavior in the introduction section so that they aware of this oversight as they read through the case materials. The audit committee's questioning behavior is mentioned again before the participants provide their disclosure decisions as a reminder that the earnings release will be reviewed by the CEO and the audit committee before being disseminated to the public.

Dependent Variables

The dependent variables are responses to questions the participants provided about Crisp's voluntary financial reporting. The dependent variable measurements covers the two primary decision types that are being analyzed in this dissertation: decisions on how to prepare non-GAAP measures and the decisions on how to disclose and present presentation of financial information in earnings releases. First, to examine decisions related to the preparation of non-GAAP measures, participants were asked to make a judgment about the calculation of a non-GAAP earnings measure. Specifically, the first question required the participants to rate how likely they were to recommend that the goodwill impairment be excluded from the non-GAAP Adjusted Net Earnings figure (i.e., added back to GAAP Net Earnings) on a 9-point scale (1 = Extremely unlikely; 9 = Extremely likely). They were also asked how much of the impairment loss they would exclude in the calculation of Adjusted Net Earnings (any amount up to the entire \$2 million impairment loss). [14]

Next, the participants were presented with questions to determine how they would disclose and present non-GAAP measures in Crisp's earnings release for the fourth quarter and most recent fiscal year. Initially, they were asked how likely they were to recommend that Crisp disclose non-GAAP Adjusted Net Earnings per Share (EPS) in the earnings release (1 = Extremely unlikely; 9 = Extremely likely). This decision is important because Crisp did not discuss Adjusted Net EPS in the body of the prior year's release, rather Crisp only disclosed total Adjusted Net Earnings in the previous year. The final four dependent variable questions pertain

[14] Following the dependent variable measurements, the participants were asked: "Will excluding the goodwill impairment loss in the calculation of 'Adjusted Net Earnings' increase or decrease 'Adjusted Net Earning'" (a non-GAAP measure)?" The response options were "increase" or "decrease". 23 out of the 100 participants incorrectly answered "decrease". Excluding these participants in the primary analysis leads to inferentially similar results, so they are retained in the sample.

to the presentation of GAAP and non-GAAP information. Specifically, they were asked where they would like to discuss or display non-GAAP Adjusted Net Earnings, non-GAAP Adjusted EPS, GAAP Net Earnings, and GAAP EPS. They were given six options for the presentation of these measures in the release: Headline/title, Highlights/subtitle, first or second paragraph, further down in the body of the release, in the financial tables at the end of the release, or not at all. These options align with the earnings release template that the participants had available for reference during the experiment. These placements have been found to be relevant to investors in prior literature on non-GAAP disclosure presentation (Bowen et al. 2005; Marques 2010; Elliott 2006). This dependent variable measures the prominence with which managers wish to assign to the disclosure of non-GAAP information in comparison to GAAP information. Presenting disclosures earlier in the release is considered a more prominent presentation than disclosure of information later in the release (Elliott 2006; Huang et al. 2018).

Post-Experimental Questions, Manipulation Checks, & Survey

Following the dependent variable measurements, the participants were presented with a free response question that asked them to list the factors they considered when making the non-GAAP preparation and earnings release disclosure decisions. This question is important because it provides the participants the opportunity to explain their decisions. Since the audit committee's questioning of non-GAAP measures is expected to cause managers to perform a more thorough assessment of their disclosure choices, this free response question will help determine if this assessment process has occurred. Following this question, the participants answered manipulation check questions to determine if the participants recognized the auditor flexibility manipulation and the focus of audit committee questioning. They were also asked a non-GAAP knowledge check question and a comprehension check question to test their recall of case materials. Next, they responded to several questions regarding their perceptions of auditor constraint and anticipated audit committee questioning. The final part of the main experiment was a section of demographic questions that were asked to gather background information about the participants, including their experience in crafting financial statements, preparing earnings releases, analyzing non-GAAP information, and interacting with auditors and audit committees.

After the main experiment was administered, a follow-up survey was administered to collect information about disclosures based on experience and perceptions of the participants. This section is included to provide a broader set of information about how financial managers view earnings releases disclosures, with a focus on non-GAAP financial disclosures. This data can be useful to collect since direct evidence of this information is relatively scarce in prior research. The survey questions ask participants their opinions on the importance of non-GAAP financial measures, the reasons to provide non-GAAP disclosures to investors, and how often auditor and audit committees review non-GAAP disclosures, in addition to other items. The full survey can be found in the Appendix along with the other experimental materials.

Pretesting of Experimental Materials

The experimental materials went through several rounds of pretesting with different groups to ensure validity of the manipulations and realism of the overall case. First, the instrument was pretested with five accounting doctoral students, all with at least four years of professional accounting experience and seven accounting faculty members, all with considerable professional and academic accounting experience. One of the PhD students had significant experience helping to prepare earnings releases as the Chief Operating Officer of an international company. This round of testing was intended to gauge the realism of the task, the clarity of instructions, and the estimated length of completion. Based on feedback from the participants, changes were made to the instrument to clarify wording, eliminate confounding case details, and strengthen the manipulations.

Next, a second round of pretesting was completed with 101 senior undergraduate accounting students, accounting graduate students, and MBA students.[15] The primary purpose of this round of pretesting was to ensure clarity of case details and to test the strength of the manipulations. The results of the pretest indicated the auditor flexibility manipulation was operating as intended, while the audit committee questioning manipulation was not. Following this, changes were made to strengthen and clarify the audit committee questioning manipulation.

A third round of pretesting was completed with 46 senior undergraduate accounting students to determine if the audit committee questioning manipulation was stronger following the revisions. The results indicated that both manipulation checks were operating as intended. Finally, the case materials were given to two additional accounting doctoral students and the current CFO of a privately-held corporation, who has significant experience disseminating financial information to stakeholders. The primary purpose of this final review to ensure clarity of case materials and gauge realism of the task. Slight modifications were made to the instrument to increase case clarity, based on feedback from these participants.

[15] Specifically, the test was completed by 18 undergraduate accounting students, 32 accounting graduate students, and 51 MBA students.

CHAPTER 4: DATA ANALYSIS & RESULTS

Manipulation Check & Post-Experimental Questions

Prior to reporting the results of the primary variables, Table 2 presents the results of the manipulation check questions. To test the audit committee questioning manipulation, participants were asked to rate the degree to which the audit committee posed questions that directly asked management to justify decisions on the disclosure of GAAP financial measures, as opposed to both GAAP and non-GAAP financial measures (1 = GAAP Only; 9 = Both GAAP & Non-GAAP). I performed an independent samples t-test to test for a difference in means between the audit committee questioning focus conditions. The results show that participants in the both GAAP and non-GAAP questioning conditions (mean = 6.57) provided a higher rating than those in the GAAP only conditions (mean = 5.63) [t =1.88; p = 0.03, one-tailed]. This result indicates this manipulation operated as intended. To test the auditor flexibility manipulation, the participants were asked how open participants felt the audit partner was in considering the participants' position regarding the goodwill impairment loss (1 = Not open at all; 9 = Very open). An independent samples t-test for auditor flexibility shows participants in the more flexible conditions (mean = 6.92) provided a higher rating than those in the less flexible conditions (mean = 5.54) [t = 3.24; p < 0.01, one-tailed]. Thus, the auditor flexibility manipulation also appears to have operated as intended.[16]

Additionally, the manipulations of the independent variables are not intended to alter the managers' perceptions of the auditor's or the audit committee's competency in the experimental task. Therefore, I measured the participants' perceptions of auditor and audit committee

[16] Another manipulation check question for auditor flexibility asked participants to rate the degree to which they perceived the audit partner already had his mind made up about booking a higher goodwill impairment loss (1 = Mind not made up; 9 = Mind definitely made up). The effect of auditor flexibility for this question did not reach statistical significance.

competency to rule out the potential alternate explanation that reporting decisions are influenced by differences in these measures. Table 2 presents the perceived competency ratings the participants provided for the auditor and the audit committee. On a 9-point scale (1 = Not competent at all; 9 = Very competent), the audit committee was perceived to be highly competent (overall mean = 7.11). Also, importantly, a one-way ANOVA shows that the rating did not significantly differ across experimental condition ($F = 1.17$; $p = 0.33$, two-tailed). Similarly the participants indicated a belief that the auditors were competent in the performance of their audit (overall mean = 6.82), and this rating did not differ across experimental conditions, per a one-way ANOVA ($F = 0.96$; $p = 0.42$, two-tailed). This analysis provides confidence that results are not driven by differences in the perceived competency in the audit committee. [17]

Examination of Assumptions in Statistical Methods

Before performing the primary statistical analysis and hypothesis testing, it is important to examine the relevant assumptions of statistical methods used in analysis. To examine decisions related to the preparation of non-GAAP measures, the participants were asked to rate how likely they were to recommend that the goodwill impairment loss be excluded from Crisp's non-GAAP Adjusted Net Earnings figure (1 = Extremely unlikely; 9 = Extremely likely). Also, to examine decisions related to earnings release disclosures, the participants were asked how likely they were to disclose non-GAAP EPS in Crisp's earnings release (1 = Extremely unlikely; 9 = Extremely likely). The analysis of these continuous dependent variables is done with a 2x2 analysis of variance (ANOVA). The three basic assumptions of the ANOVA model are:

[17] To gauge perceptions of restriction from the auditor, the participants were asked to rate how they felt the auditor: dictated their behavior, pressured them to take certain actions, restricted their autonomy to choose, and tried to make decisions for them in regard to the goodwill impairment loss (ratings were provided with 9-point Likert scales where 1 represented the least restriction and 9 represented the most restriction). Independent sample t-tests do not detect a statistically significant difference between auditor flexibility conditions for any of these questions ($p > 0.23$, one tailed for all questions).

independence of observations, normal distribution of the dependent variables, and homogeneity of variance.

The assumption of independent observations is met through experimental design, which randomly assigned participants to one of the four experimental conditions. The second assumption, normality of the dependent variables is analyzed using the Shapiro-Wilk test for normality. This test indicates potential violations of the normality assumption for both of the continuous dependent variables. While ANOVA is robust to modest violations of normality (Ferguson and Takane 2005; Schmider, Shields, and Whittington 2010), I supplement the analysis with the non-parametric Mann-Whitney rank-sum test. The inferences from the primary analysis discussed later in this section remain unchanged using this alternative test. The final assumption, the between-group homogeneity of variance, is analyzed using Levene's test. The test indicates a potential violation of the assumption for the goodwill impairment exclusion likelihood variable ($p < 0.05$). ANOVA is generally considered robust to violations of the homogeneity of variance assumption when cell sizes are close to equal (Boneau 1960). The samples sizes in my four experimental groups are nearly equal, so the conclusions drawn from my analysis should be reliable. Nevertheless, I supplement my primary analysis with nonparametric tests: the independent samples Kruskal-Wallis test and a contrast test that does not assume equal variances. The inferences drawn from these tests are consistent with those from the primary analysis discussed below.

Additionally, my primary analysis of the presentation of non-GAAP EPS in the earnings release is conducted using Chi-Square tests. These tests require mutually exclusive independent variable categories, independence of observations, and that no more than 20% of cells have expected counts less than five (Yates, Moore, and McCabe 1999). The first two assumptions are met through random participant assignment and experimental design. The final assumption, which is presumed to have been met when the sample size is large, is verified through the Chi-Square analysis indicating no cells have an expected count less than five. To supplement this Chi-Square analysis, I also utilize binary logistic regression, which requires relatively low multicollinearity among independent predictors in addition to the assumptions for Chi-Square testing. The Pearson correlation between the two independent variables— auditor flexibility and audit committee questioning focus— is 0.02, which is low enough for this final assumption to be satisfied (Tabachnick and Fidell 2012). Taken together, this examination of assumptions provides assurance that the inferences drawn from the statistical analyses presented below are reliable.

Hypothesis Testing

Non-GAAP Earnings Calculation: Goodwill Impairment Exclusion Likelihood

The first set of hypotheses examines how managers prepare non-GAAP financial measures. H1a predicts managers are more likely to make a larger exclusion from non-GAAP earnings when exposed to more (versus less) flexible auditor behavior due to a lack of constraint that carries over from financial statement discussions. To measure this hypothesis, the participants are asked to rate how likely they are to recommend that the goodwill impairment loss, which was recognized in the company's financial statements per the case materials, be excluded from the non-GAAP Adjusted Net Earnings figure (1 = Extremely unlikely; 9 = Extremely likely). Managers can choose to exclude the value of the impairment loss if they wish to remove its effect on the non-GAAP earnings figure. Table 3 presents the results of the analysis of this dependent variable. Panel A provides descriptive statistics for this variable by experimental condition, while the 2x2 ANOVA with auditor flexibility (more or less flexible) and audit committee questioning focus (GAAP only or both GAAP and non-GAAP) is presented in Panel B. The ANOVA shows a significant main effect of auditor flexibility on the likelihood to exclude the goodwill impairment from non-GAAP Adjusted Net Earnings ($F = 5.78$; $p < 0.01$, one-tailed). Further, a t-test (untabulated) shows the exclusion likelihood in the more flexible auditor conditions (mean = 6.86; SD = 2.15) is significantly higher than in the less flexible auditor conditions (mean = 5.70; SD = 2.58) [$t = 2.44$, $p < 0.01$, one-tailed]. Thus, H1a is supported, as managers are more likely to make a larger exclusion from non-GAAP earnings when the auditor is more flexible. This implies a less conservative preparation of non-GAAP earnings in the absence of auditor constraint.

H2b predicts an interaction effect between auditor flexibility and audit committee questioning focus such that managers are most likely to exclude a larger amount of the impairment loss from non-GAAP earnings when there is no auditor constraint (i.e., the auditor is more flexible) and when the audit committee only questions GAAP disclosures. The ANOVA in Panel B indicates a marginally significant interaction effect for auditor flexibility and audit committee questioning focus ($p = 0.10$, one-tailed). However, the interaction in the ANOVA is designed to test for a disordinal interaction, and may not be a powerful test for an ordinal interaction, such as the one predicted in H2b (Buckless and Ravenscroft 1990). Therefore, Panel C presents the results of a contrast test that is more appropriate to test my hypothesis. Specifically, as suggested by Guggenmos, Piercey, and Agoglia (2018), I use contrast weights that reflect my predicted pattern of results, based on the theoretical development in Chapter 2. The prediction that the non-GAAP exclusion likelihood is higher in the More Flexible Auditor / GAAP Only Questioning condition than in the other 3 conditions results in a contrast coding of: -1 (Less Flexible Auditor / Both GAAP & Non-GAAP Audit Committee Questioning), -1 (Less

Flexible Auditor / GAAP Only Audit Committee Questioning), -1 (More Flexible Auditor / Both GAAP & Non-GAAP Audit Committee Questioning), 3 (More Flexible Auditor / GAAP Only Audit Committee Questioning). The planned contrast is significant ($t = 7.60$, $p < 0.01$), providing support for H1b. Furthermore, using analysis suggested by Guggenmos et al. (2018), the residual variance from the contrast is insignificant ($t = 0.55$, $p = 0.58$), which provides support that the contrast fits the data well. Together, the results support H1b. The audit committee's questioning of non-GAAP disclosures leads to a lower exclusion likelihood, which reflects a more conservative preparation of non-GAAP measures, but only when the manager is not already constrained by less flexible auditors. Thus, in combination, weaker governance mechanisms lead to the largest exclusion likelihood, a less conservative preparation option, when the auditor is more flexible and the audit committee only questions GAAP disclosures.

As a supplementary measure of managers' decisions related to the preparation of non-GAAP earnings, the participants were also asked how much of the impairment loss they would choose to exclude (any amount from $0 to $2 million). In untabulated analysis, a two-way ANOVA shows no effect (simple main effects or interaction effects) of auditor flexibility or audit committee questioning focus for this dependent variable. The overall mean across experimental conditions is $1.25 million. Excluding a partial amount of a financial statement transactional item in the calculation of non-GAAP earnings, such as excluding part of a goodwill impairment loss, is not explicitly prohibited by the SEC. However, the SEC generally discourages the use of individually-tailored accounting treatments in non-GAAP reporting (SEC 2018a). Therefore, managers may be hesitant to make partial exclusions in practice and inferences from the analysis of this dependent variable should be taken cautiously.

Earnings Release Disclosure Presentation

The next set of analyses is related to decisions on how to present non-GAAP measures in earnings releases. H2a predicts managers are more likely to disclose more non-GAAP earnings measures in an earnings release when faced with more flexible auditor behavior. To test this hypothesis, participants were asked to rate how likely they were to recommend that the company in the experiment disclose non-GAAP Adjusted EPS in the earnings release (1 = Extremely unlikely; 9 = Extremely likely). Managers who wish to emphasize non-GAAP figures would be more likely to disclose this figure. As mentioned in the Methodology section, Adjusted EPS is not disclosed in the body of the prior year earning's release, which provides the participants with the ability to highlight this figure by disclosing it in the current year's release. Table 4 presents the results from this analysis. Panel A shows the descriptive statistics across conditions, while Panel B provides the results of the two-way ANOVA for non-GAAP EPS disclosure likelihood. The ANOVA shows a significant main effect for auditor flexibility ($F = 3.00$; $p < 0.05$, one-tailed). Further, a t-test (untabulated) indicates the likelihood of disclosure in the less flexible auditor conditions (mean = 6.58; SD = 2.06) is significantly lower than the likelihood of disclosure in the more flexible auditor conditions (mean = 7.26; SD = 1.82) [$t = 1.75$, $p < 0.05$, one-tailed]. This finding provides support for H2a, as managers are more likely to pursue a heightened level non-GAAP disclosure by reporting an additional non-GAAP earnings measure in the earnings release when the auditor is more flexible, as opposed to less flexible.

H2b predicts an interaction effect, where active audit committee questioning of non-GAAP measures has a greater effect on non-GAAP disclosure likelihood when the auditor is more flexible. The ANOVA in Panel B does not show a significant interaction effect ($p = 0.37$ two-tailed). Additionally, a t-test (untabulated) shows there is no statistical difference in disclosure likelihood between the GAAP only audit committee questioning condition (mean = 7.27; SD = 1.97) and the both GAAP and non-GAAP questioning condition (mean = 7.25; SD 1.67) [$t = 0.037$; $p = 0.49$, one-tailed]. Thus, H2b is not supported. Together, the results indicate that the auditor's constraining behavior carries over into earnings release disclosure decisions regarding the number of non-GAAP measures to disclose. However, given that investors devote attention to prominently displayed information (Elliot 2006), it is especially important to consider the presentation of disclosures in the earnings release, beyond the overall disclosure likelihood.

The third set of hypotheses examines how prominently managers chose to present non-GAAP metrics. Specifically, H3a predicts that managers will choose to present non-GAAP earnings measures more prominently when their auditor exhibits more flexible behavior, while H3b proposes that the audit committee's questioning will have also an impact on presentation discussion when the auditor is more flexible. To measure this effect, the managers were asked where they would be likely to discuss or display non-GAAP Adjusted Net Earnings, non-GAAP Adjusted EPS, GAAP Net Earnings, and GAAP EPS in the earnings release. Managers wishing to prominently display non-GAAP metrics could choose to disclose them earlier in the release. Prior research suggests that disclosure in the headline of the earnings release is an especially important way for companies to make information salient to investors (Huang et al. 2018). When managers disclose information in the headline, they are likely attempting to strategically present the disclosures they most wish investors to respond to. Additionally, my follow-up survey, discussed in more detail later in this section, validates this prior research. In the survey, the participants indicated that they believe investors devote the greatest amount of attention to the headline in an earnings release. Therefore, I will focus the analysis on the dichotomous decision that managers will disclose non-GAAP EPS in the Headline or Highlights (Subtitle) section of the earnings release. This analysis is presented in Table 5.

Panel A presents the results of the Chi-Square test indicating the proportion of participants choosing to disclose non-GAAP EPS in the Headline/Highlights is different in at least one experimental condition (Chi-Square value = 6.87; $p = 0.08$). To follow-up on this omnibus test, I also present the results of Chi-Square tests on the effect of audit committee questioning focus within the different auditor flexibility conditions. The results show that within the less flexible auditor conditions, there is no difference in the number of participants who chose to disclose non-GAAP EPS in the Headline/Highlights between the GAAP only audit committee questioning condition (14/25 participants; 56.0%) and the both GAAP and non-GAAP audit committee questioning condition (13/25 participants; 52.0%) [Chi-Square value = 0.08; $p = 0.50$, one-tailed]. However, within the more flexible auditor conditions, the number of participants choosing to disclose non-GAAP EPS in the Headlines is significantly higher in the GAAP only audit committee questioning condition (15/26 participants; 57.7%) than in the both GAAP and non-GAAP questioning conditions (6/24 participants; 25.0%) [Chi-Square value = 5.48; $p = 0.02$, one-tailed].

I supplement this analysis in Panel B with a binary logistic regression, where the dependent variable equals 1 when the participant chose to disclose non-GAAP EPS in the Headline or Highlights section. While there is no significant coefficient for the auditor flexibility variable (Beta = -0.07; $p = 0.45$, one-tailed), there is a significant coefficient for audit committee questioning focus (Beta = -1.41; $p = 0.01$, one-tailed). More importantly for my hypothesis testing, there is also a moderately significant coefficient on the auditor flexibility * audit committee questioning focus interaction (Beta = 1.25; $p = 0.07$, one-tailed). Taken as a whole, these results do not support H3a, as the auditor's constraint does not appear to have the expected effect on the presentation of non-GAAP EPS. However, H3b is supported, as audit committee questioning of non-GAAP disclosures does lead to a lower likelihood of prominent earnings release presentation for non-GAAP EPS in the presence of a more flexible auditor, but not a less flexible auditor.[18]

Additionally, I also analyzed the presentation choices of the three other financial measures that participants provided judgments for (untabulated): non-GAAP Adjusted Net Earnings (in total), GAAP Net Earnings (in total), and GAAP EPS. Overall, 50% of participants chose to disclose GAAP Net Earnings and 41% chose to disclose GAAP EPS in the Headline/Highlights, with no differences across experimental conditions for either measure ($p >$ 0.50 for both measures). It is not surprising that the presentation of GAAP earnings metrics was not impacted by the auditor's constraint or audit committee questioning because there was no difference in the GAAP outcomes from auditor discussions, nor any difference in the level of audit committee questioning over GAAP disclosures across conditions. Thus, there is no theoretical reason to expect that managers would alter their decisions related to GAAP earnings release disclosures based on the manipulations.

Additionally, 51% of participants overall chose to disclose non-GAAP Adjusted Earnings in the Headline/Highlights with no significant difference across experimental conditions (Chi-

[18] I also performed the same analysis discussed above, but isolated the presentation of disclosures to the Headline only, as opposed to the Headline and the Highlights sections together (untabulated). In the template provided to participants (shown in appendix A), the Headline and the Highlights were shown as distinct options for presentation choice in the earnings release. However, prior research does not always make the distinction between these two options (Bowen et al. 2005; Marques 2010), so it is reasonable to treat these sections as one. Further, both of these sections are distinctly separate from the remaining body of the earnings release, so would likely both be used to make information salient to investors. Thus, my primary analysis examines these sections in conjunction with one another. However, if I isolate the Headline section, results are inferentially similar to those in Table 5 where the number of participants choosing Headline disclosure is different between audit committee questioning conditions within the more flexible auditor conditions (Chi-Square value = 3.91; $p = < 0.05$, one-tailed) but not within the less flexible auditor conditions (Chi-Square value = 2.38; $p > 0.10$, one-tailed).

square value = 1.46; p = 0.71). While it may be expected that the presentation choices for non-GAAP Adjusted Earnings would be similar to those for non-GAAP EPS, the non-GAAP EPS measure is potentially the most compelling metric to examine because it was not disclosed in the prior year's earnings release. Thus, while the presentation choice for non-GAAP Adjusted Earnings may be influenced by where this measure was disclosed in the prior year's release, the presentation choice for non-GAAP EPS should be more reflective of the participants' deliberate decision.

The Effect of Expected Justification on Earnings Release Disclosure Presentation

To provide additional detail on the causal mechanisms underlying the disclosure choices, I performed path analysis that examined the effect of expected audit committee questioning and the thoroughness of consideration given to disclosure choices. These variables are important to consider in this path analysis because prior research indicates audit committee questioning should cause financial managers to perform a more thorough self-assessment of disclosure choices when they anticipate those choices will need to be justified to the audit committee (e.g., Kang 2019). Thus, if this process has the same effect for audit committee questioning of non-GAAP disclosure presentation choices, it should be observable through path analysis in the absence of auditor constraint (i.e., with a more flexible auditor). Expected audit committee questioning is measured as the degree to which participants felt as if they would have to justify non-GAAP disclosure choices to the audit committee (1 = Did not feel I would be asked to justify; 9 = Definitely felt I would be asked to justify).[19]

[19] A similar measure was derived from the question "I anticipated that the audit committee would ask specific questions about my decisions regarding the disclosure, calculation, and/or presentation of non-GAAP financial measures." However, when this alternate measure was included in the path analysis above, it did not produce good model fit, so it is excluded from the analysis.

The thoroughness of disclosure consideration was derived from the qualitative responses provided by participants to the question: "Please list the factors that you considered when determining the disclosure and presentation of the non-GAAP adjusted earnings measures discussed above.” Specifically, responses were analyzed to determine the number of distinct factors relevant to disclosure choice in the earnings release. Relevant factors included those that acknowledged the informative value of disclosures to investors (such as consistency and transparency), those that acknowledged an opportunity to benefit the company (such as increasing stock price), and those that acknowledged a more neutral aspect of the company’s financial outcomes (such as the value of earnings). The factors were coded into these categories and summed for each participant. Ultimately, the number of factors considered by the participants should be reasonable measure of the degree to which they thoroughly considered their disclosure decisions.

Based on these measures, I performed a multi-group path analysis that allowed for separate analysis of the less flexible auditor conditions and the more flexible auditor conditions. This analysis is presented in Figure 2. First, I note the model fit statistics indicate the model fits the data well (TLI = 10.415; RMSEA = 0.001; Chi-Square 0.644, $p = 0.53$), which allows for reliable inferences to be drawn from the analysis. In both more and less flexible auditor paths, expected justification to the audit committee is associated with a higher number of factors considered in making the disclosure decision. The standardized regression coefficient is 0.44 ($p < 0.01$, one-tailed) in the less flexible auditor conditions, and 0.35 ($p < 0.05$, one-tailed) in the more flexible auditor conditions. As expected, this implies participants provide a more thorough assessment of their disclosure choices when they expect they will have to justify their decisions to the audit committee. In the next step of the path analyses, I determined if the number of factors considered was associated with prominent non-GAAP disclosure in the earnings release. The analysis shows that the number of relevant factors considered was negatively associated with the likelihood of disclosing non-GAAP EPS in the earnings release in the more flexible auditor condition only (standardized regression coefficient = -0.23, $p < 0.10$, one-tailed) while there was no association in the less flexible auditor conditions (standardized regression coefficient = -0.01, $p = 0.48$, one-tailed). These findings imply that while expected audit committee questioning can impact managers' level of consideration devoted to disclosure choices regardless of auditor behavior, this increased level of consideration only leads to more subdued non-GAAP disclosure presentation in the presence of a more flexible auditor. Ultimately, this analysis supports the notion that audit committee questioning is most effective when managerial decision-making is not already constrained by the auditor's behavior.

Post-Experimental Survey

After completing the main experiment, participants were asked to complete a brief survey regarding their experiences and opinions regarding non-GAAP disclosure and presentation. This survey is intended to obtain direct evidence of managers' perceptions of non-GAAP reporting. Such evidence supplements my experimental analysis and may be informative to future researchers in this area. Table 6 provides selected responses from this survey. First, Panel A provides an indication of how managers use non-GAAP disclosures. The participants were asked how frequently they use non-GAAP disclosures to provide information to investors when limitations exist in GAAP reporting (1 = Not often at all; 9 = Very often). The responses suggest that participants use these disclosures frequently (mean = 6.88; median = 7). In addition, the participants were asked to rate how important they believe non-GAAP disclosures are to investors in earnings releases (1 = Not important at all; 9 = Very important). Overall, the participants rated these disclosures as highly important (mean = 7.31; median = 8). An untabulated one sample t-test shows that the mean response to this question is significantly higher than the scale midpoint ($t = 12.51$, $p < 0.001$). Corroborating prior empirical research, these responses directly confirm that non-GAAP reporting is an important way for managers to provide information to investors.

Further, the participants were also asked to rate the level of consideration their respective companies typically give to the placement of disclosures (how early or late) in earnings releases (1 = No consideration at all; 9 = Significant consideration). The results in Panel B of Table 6 indicate managers indeed devote significant consideration to these placement decisions (mean = 7.36; median = 7). To follow-up on how managers perceive investors will devote attention to the order of earnings release disclosures, the participants were asked to allocate expected investor attention (totaling 100%) to each section of the earnings release.[20] Confirming prior research (Huang et al. 2018), the managers indicated they believe investors devote the greatest amount of attention to the Headline. Paired t-tests (untabulated) verify that the average expected investor attention allocated to the Headline is significantly greater than any other section ($p < 0.10$, two-tailed in each test). Further, nearly one-half (45.10% out of 100%) of expected investor attention was allocated to the Headline and Highlights/Subtitle sections (mean = 25.56% for the Headline; mean = 19.54% for the Highlights/Subtitle). These responses support the notion that the strategic placement of disclosures in earnings releases is a way in which managers can influence investor behavior. Importantly, these results also validate the experimental analysis of earnings release disclosure decisions presented earlier.

[20] These sections are the same sections described earlier in the main experiment and were discussed in the template provided to the participants.

CHAPTER 5: CONCLUSION

Summary & Contributions

This dissertation is the first study to examine how constraining behavior by auditors influences subsequent disclosure choices in unaudited earnings releases and how audit committees also influence these decisions through active questioning. I find that when managers are exposed to less flexible auditors during discussions on subjective GAAP accounting issues, they make more conservative decisions related to the preparation of non-GAAP earnings measures. This effect is likely due to a lasting feeling of constraint that managers feel resulting from the auditor's behavior during financial statement discussions. Hence, the constraint carries over from the financial statement preparation into subsequent decision-making. However, I also find that the auditor's behavior interacts with the focus of the audit committee's questioning. When the audit committee asks specific questions about non-GAAP reporting, this questioning only leads to more conservative decisions related to the preparation of non-GAAP earnings in the presence of a more flexible auditor. The audit committee's influence is not meaningful when combined with a less flexible auditor that has already constrained reporting choices. Hence, the auditor's behavior and audit committee's questioning act as substitutions, as opposed to complements, in relation to managers' decisions regarding non-GAAP earnings.

Further, these effects extend into how non-GAAP measures are disclosed in earnings releases. Specifically, constraining behavior from inflexible auditors leads to a lower likelihood that managers will disclose more non-GAAP earnings measures in the earnings release, while the audit committee limits the prominent disclosure of these measures in earnings releases absent auditor constraint. Causal analysis indicates managers will give more careful consideration to their non-GAAP presentation choices when they expect greater scrutiny of their disclosure decisions by the audit committee. Thus, the audit committee's impact on financial reporting decision-making can be far-reaching when it actively extends questioning behavior to include questions related to non-GAAP disclosures. Together, the results show that auditor behavior and audit committee questioning can have a significant impact on financial reporting decision-making beyond the financial statements, and that these two factors interact in complex ways in relation to non-GAAP reporting.

The findings add to recent literature on how restrictions in mandatory reporting affect the disclosure of voluntary non-GAAP information (Doyle et al. 2013; Black et al. 2017b; Kyung et al. 2019), which is important since prior research largely omits the role of external auditors (Black and Christensen 2018). This study is the first to empirically examine how auditor flexibility influences the way managers pursue alternative reporting channels, which can inform future researchers in this area. Relatedly, this study also extends literature on auditor-client discussions, which typically focus on decision-making within the confines of traditional GAAP financial reporting (Salterio 2012). The findings of this study show that auditor-client discussions can have effects beyond the financial statements.

More broadly, this dissertation adds to the literature on non-GAAP reporting. Given its importance to investors, (Elliott 2006; Marques 2010), it is vital to consider factors that may influence non-GAAP reporting decisions. Notably, auditor constraining behavior and audit committee questioning behavior are largely unobservable, so this study highlights a behavioral motivation for non-GAAP reporting. Behavioral methodology can be beneficial to examine financial reporting decisions because this methodology can control for many factors in the financial reporting environment that may impact these decisions (Libby, Rennekamp, and Seybert 2015). Thus, these methods can help alleviate concerns of endogeneity often present in archival research. Given that behavioral research in this area is relatively sparse, this study can serve to supplement the growing archival research on this topic. In addition, regulators have given increased attention to the manner in which non-GAAP measures are presented (SEC 2002; SEC 2018a). Non-GAAP reporting remains a concern for regulators and is one of the most frequently cited topics of concern in SEC comment letters (Heflin and Hsu 2008; Kolev et al. 2008; Audit Analytics 2018b, 2018c), which highlights the variation with which these measures are prepared and disclosed. This study may help inform the discussions of regulators related to non-GAAP disclosure and presentation.

Furthermore, this study can help inform discussions on the role audit committees have in overseeing non-GAAP reporting and earnings releases, which are areas in which audit committees have recently been called upon to assume greater responsibility (PwC 2016; CAQ 2018; Deloitte 2018). It is important for both regulators and organizations to be aware of how managers respond to audit committee questioning of non-GAAP disclosures because their decisions ultimately determine the information disseminated to investors. Beyond that, my findings providence evidence of a complex interaction between auditor behavior and audit committee questioning, both of which are important governance components. While extensive research has been dedicated to examining how different governance mechanisms independently influence financial reporting decisions and outcomes, it is worthwhile to consider how combinations of these mechanisms interact with each other. If certain governance components act as substitutes due to “limitations” in the degree to which managers will curb aggressive behavior, as suggested by Misangyi and Acharya (2014) and supported by my findings, this discovery would be valuable to future researchers examining corporate governance effects.

This dissertation also provides contributions to the earnings release literature. Prior research indicates that earnings releases have informational value and are important to investors (Kothari 2001; Davis et al. 2012). Furthermore, the way earnings releases are constructed can influence investor reactions (Frederickson and Miller 2004; Elliott 2006; Huang et al. 2018). Yet, the auditor's role in earnings releases has been under-examined. Recent literature indicates that there may be spillover effects between the audited financial statements and the associated earnings release (Schroeder 2016; Haislip et al. 2017; Bhaskar et al. 2019). The current study can supplement this recent stream of research by identifying how auditor behavior within GAAP financial reporting affects managerial decisions related to non-GAAP reporting in earnings releases. Furthermore, this study can help launch research on managerial decision-making related to earnings announcements and other disclosures outside of the financial statements. To my knowledge, no existing studies directly ask managers to make judgments regarding earnings releases, despite the ubiquity of this reporting mechanism. Given the high level of flexibility available in earnings release preparation, it is important to study the ways in which managers make reporting decisions in this context.

Limitations & Opportunities for Future Research

This study may be subject to limitations due to experimental design and participant availability. First, while the experimental task and dependent variable measurements are relatively novel, it should be noted that the disclosure choices the participants are asked to make are far from comprehensive. Although there is a large pool of information from which managers can choose to include in earnings releases, I have chosen to ask relatively specific questions about a few number of items. This choice allows me to more accurately answer the proposed research questions. Further, the format of the earnings release utilized in my experiment is consistent with the format used in prior research (e.g., Elliott 2006), and has been demonstrated by archival literature on earnings releases (Bowen et al. 2005; Huang et al. 2018)

Also, there may be limitations in the participant pool that was utilized for this study. As discussed earlier, I used a web-based research organization to recruit senior executives with financial backgrounds to participate in this study. While these organizations screen for appropriate participants to complete the task and questions within the study also verify the suitable experience and knowledge needed to make the required judgments in the experimental task, the sample pool is limited to participants that have made themselves available for research studies. However, recent studies have successfully utilized these services to recruit difficult-to-obtain individuals, which should help alleviate concerns about this method (Brown-Liburd and L. Zamora 2015; Pyzoha 2015; Guggenmos et al. 2019; Bentley et al. 2020). Additionally, my study asks the participants to make individual judgments regarding earnings release disclosures. In reality, there are likely several individuals within an organization who must make these judgments collectively. However, senior executives, such as the ones utilized in my experiment, are involved in disclosure decisions and are often the leaders of disclosure committees (Deloitte 2014; EY 2014). As such, their judgments would likely significantly influence decisions in this regard. Further, the screening of participants and monitoring of responses both before and during the data collection process (discussed in detail in the methodology section) ensure that the participants are appropriate for this study.

Finally, this study may suffer from the inability to capture all of the complexities of interactions between different members of the financial reporting process. However, the design of the experiment should capture the essence of the financial reporting environment relevant to this particular research study, which has allowed me to examine the proposed hypotheses with sufficient confidence. Also, the use of narratives to reflect auditor-client discussions has been used in prior research and is appropriate for the current study (Bame-Aldred and Kida 2007; Hatfield et al. 2008; Perreault and Kida 2011).

This paper can provide several promising avenues for future research. First, future research may consider other ways in which auditors can influence voluntary disclosures. While this study focuses on non-GAAP financial reporting, financial managers also have choices regarding the disclosure of nonfinancial information, such as corporate social responsibility metrics or key performance indicators (e.g., number of subscribers). It may be useful to consider if auditor behavior can influence these disclosures, since they are seemingly further removed from the audited financial statements. Additionally, future research could be conducted to determine the extent that audit committee oversight influences voluntary disclosures. While my results indicate the audit committee questioning can impact the prominence of non-GAAP measures in earnings releases, it would be informative to know if this questioning had similar effects on other presentation aspects (e.g., formatting of earnings releases, tone of presentation in earnings calls in investors). Further, my results suggest a complex interaction between auditor behavior and audit committee questioning. Future research can examine how other combinations of governance mechanisms interact (i.e., function as substitutes or as complements) to affect decision-making and financial reporting outcomes.

In addition, future research can examine decision-making on other disclosures made outside of the financial statements, such as investor conference calls and investor presentations. There is a substantial amount of discretion in how these voluntary reporting channels are utilized, so it would be useful to consider how managers make judgments about the presentation of information through these channels. Also, future research may examine the decisions of other key members of an organization who would help make earnings release disclosure judgments, such as investor relations officers and legal counsel. As mentioned above, financial managers likely drive disclosure decisions in earnings releases, but a closer examination of other individuals involved in the process may be warranted.

Figure 1: Flowchart of Experimental Task

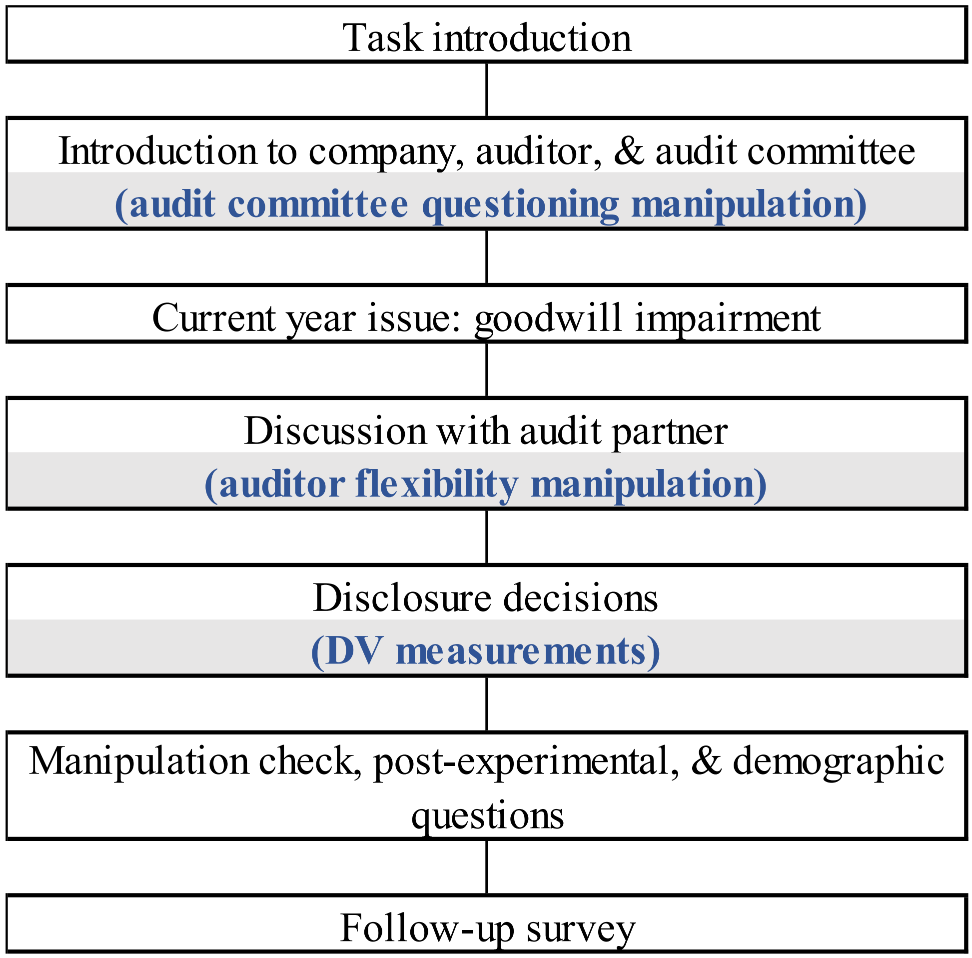
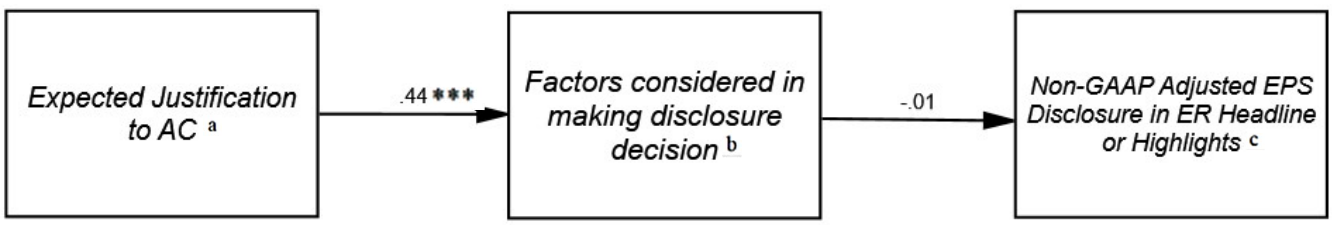


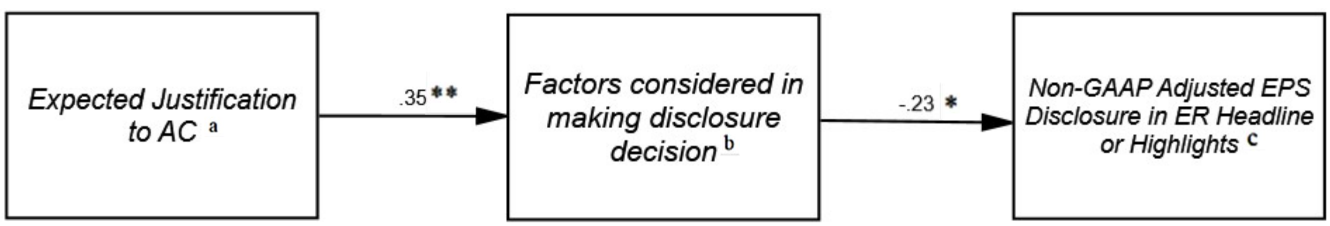
Figure 2

Path Analysis- Non-GAAP EPS Presentation in Headlines/Highlights

LESS FLEXIBLE AUDITOR:



MORE FLEXIBLE AUDITOR:



Notes:

Goodness of model fit is indicated by: TLI = 10.415, CFI = 1.000, RMSEA = 0.001, Chi-Square = 0.644 (p = 0.525)

Standardized regression weights are reported for paths.
*, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

[a] Rating of the degree to which participants felt as if they would have to justify non-GAAP disclosure choices to the audit committee (1 = Did not feel I would be asked to justify; Definitely felt I would be asked to justify).

[b] Total distinct factors listed by participants in response to the question: "Please list the factors that you considered when determining the disclosure and presentation of the non-GAAP adjusted earnings measures discussed above."

[c] The dichotomous choice to disclose non-GAAP Adjusted EPS in the Headline or Subtitle/Highlights in Crisp's earnings release for the current year (1 = Disclosed in Headline or Subtitle/Highlights).

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TABLE 1
Participants' Financial Reporting Experience
(n = 100)

	Mean (Standard Deviation)				
	Less Flexible Auditor / GAAP Only Questioning⁺ (n=25)	**Less Flexible Auditor / Both GAAP & Non-GAAP Questioning⁺ (n=25)**	**More Flexible Auditor / GAAP Only Questioning⁺ (n=26)**	**More Flexible Auditor / Both GAAP & Non-GAAP Questioning⁺ (n=24)**	**F-statistic (p-value)**
Financial Statement Preparation Experience[a]	7.60	7.84	7.77	7.96	**0.25**
	(1.50)	(0.85)	(1.99)	(1.33)	**(0.86)**
Auditor Discussion Experience[b]	7.48	7.68	7.69	7.92	**0.41**
	(1.64)	(1.14)	(1.32)	(1.35)	**(0.74)**
Earnings Release Preparation Experience[c]	7.36	6.88	7.54	7.75	**1.31**
	(1.60)	(1.83)	(1.70)	(1.22)	**(0.28)**
Audit Committee Interaction Experience[d]	7.44	7.32	7.77	7.92	**0.81**
	(1.85)	(1.22)	(1.73)	(1.21)	**(0.49)**
Non-GAAP Experience[e]	7.32	7.20	7.54	7.83	**0.94**
	(1.35)	(1.22)	(1.73)	(1.31)	**(0.42)**

Notes:
* Reported p-values are two-tailed from overall one-way ANOVA of experimental condition.
⁺ The independent variables are Auditor Flexibility and Audit Committee Questioning Focus. Auditor Flexibility was manipulated at two levels (more flexible or less flexible). Audit Committee Questioning Focus was manipulated at two levels (both GAAP & non-GAAP or GAAP only).

[a] Participants' self-rating of experience preparing financial statements (1 = No experience; 9 = Considerable experience).
[b] Participants' self-rating of experience discussing subjective accounting matters with auditors (1 = No experience; 9 = Considerable experience).
[c] Participants' self-rating of experience helping to prepare earnings releases (1 = No experience; 9 = Considerable experience).
[d] Participants' self-rating of experience interacting with audit committees (1 = No experience; 9 = Considerable experience).
[e] Participants' self-rating of experience preparing or examining non-GAAP financial measures (1 = No experience; 9 = Considerable experience).

TABLE 2
Manipulation Check and Post-Experimental Questions
(n = 100)

	Mean (Standard Deviation)			
	Less Flexible Auditor / GAAP Only Questioning[+] (n=25)	**Less Flexible Auditor / Both GAAP & Non-GAAP Questioning[+] (n=25)**	**More Flexible Auditor / GAAP Only Questioning[+] (n=26)**	**More Flexible Auditor / Both GAAP & Non-GAAP Questioning[+] (n=24)**
Manipulation Check Questions				
Perception of Past Audit Committee Questioning[a]	5.48 (2.24)	6.16 (2.66)	5.77 (2.61)	7.00 (2.54)
Perception of Auditor Openness[b]	5.52 (2.49)	5.56 (2.27)	6.54 (2.06)	7.33 (1.58)
Post-Experimental Questions				
Audit Committee Competency Rating[c]	6.72 (2.28)	6.88 (1.83)	7.50 (1.45)	7.33 (1.93)
Auditor Competency Rating[d]	6.36 (1.96)	6.72 (1.62)	7.12 (1.31)	7.08 (1.64)

Notes:

[+] The independent variables are described on Table 1.

[a] Rating of the degree to which the audit committee posed questions that directly asked management to justify decisions on the disclosure of GAAP financial measures, as opposed to both GAAP and non-GAAP financial measures (1 = GAAP Only; 9 = Both GAAP & Non-GAAP).

[b] Rating of how open participants felt the audit partner was in considering the participants' position regarding the goodwill impairment loss (1 = Not open at all; 9 = Very open).

[c] Rating of the participants' perception of the audit committee's competency (1 = Not competent at all; 9 = Very competent).

[d] Rating of the participants' belief that the auditors were competent in the performance of Crisp's audit (1 = Fully disagree; 9 = Fully agree).

TABLE 3
Descriptive Statistics, Overall ANOVA, and Contrast Results for Goodwill Impairment Exclusion Likelihood (n = 100)

Panel A: Cell Means (SD) for Goodwill Impairment Exclusion Likelihood[a]

	Audit Committee Questioning Focus[+]		
Auditor Flexibility[+]	**Both GAAP & Non-GAAP**	**GAAP**	**Overall**
Less	5.76 (2.71)	5.64 (2.50)	5.70 (2.58)
More	6.29 (2.49)	7.38 (1.65)	6.86 (2.15)
Overall	6.02 (2.59)	6.53 (2.27)	6.28 (2.43)

Panel B: ANOVA for Goodwill Impairment Exclusion Likelihood[a]

Source	**df**	**Sum of Squares**	**F-statistic**	**p-value**
AuditorFlexibility	1	32.36	5.78	< 0.01*
AC_Questioning	1	5.91	1.06	0.15
*AuditorFlexibility * AC_Questioning*	1	9.19	1.64	0.10
Error	96	537.43		

Panel C: Contrast Test: Less Flexible/Both Questioning + Less Flexible/GAAP Questioning + More Flexible/Both Questioning > More Flexible/GAAP Questioning

Source	**df**	**Sum of Squares**	**Test statistic**	**p-value**
Contrast[b]	1	42.56	7.60	< 0.01**
Residual between-cells variance	2	6.17	0.55	0.58

Notes:
[+] The independent variables are described on Table 1.

* Reported p-values are from a two-way full factorial ANOVA; p-values for directional tests are one-tailed.

** The reported p-value is one-tailed due to the directional prediction of the contrast.

[a] The dependent variable is the managers' likelihood of recommending that Crisp **exclude** the goodwill impairment loss in the calculation of non-GAAP Adjusted Net Earnings in Crisp's earnings release for the current year (1 = Extremely unlikely; 9 = Extremely likely).

[b] The contrast coding is -1 (Less Flexible Auditor / Both GAAP & Non-GAAP Audit Committee Questioning), -1 (Less Flexible Auditor / GAAP Only Audit Committee Questioning), -1 (More Flexible Auditor / Both GAAP & Non-GAAP Audit Committee Questioning), 3 (More Flexible Auditor / GAAP Only Audit Committee Questioning) to align with my hypothesis.

TABLE 4
Descriptive Statistics and Overall ANOVA for Non-GAAP EPS Disclosure Likelihood
(n = 100)

Panel A: Cell Means (SD) for Non-GAAP EPS Disclosure Likelihood[a]

	Audit Committee Questioning Focus[+]		
Auditor Flexibility[+]	**Both GAAP & Non-GAAP**	**GAAP**	**Overall**
Less	6.44	6.72	6.58
	(2.31)	(1.81)	(2.06)
More	7.25	7.27	7.26
	(1.67)	(1.97)	(1.82)
Overall	6.84	7.00	6.92
	(2.04)	(1.90)	(1.96)

Panel B: ANOVA for Non-GAAP EPS Disclosure Likelihood[a]

Source	**df**	**Sum of Squares**	**F-statistic**	**p-value**
AuditorFlexibility	1	11.54	3.00	0.04*
AC_Questioning	1	0.56	0.15	0.35
*AuditorFlexibility * AC_Questioning*	1	0.42	0.11	0.37
Error	96	368.82		

Notes:
[+] The independent variables are described on Table 1.

* Reported p-values are from a two-way full factorial ANOVA; p-values for directional tests are one-tailed.

[a] The dependent variable is the managers' likelihood of recommending that Crisp **disclose non-GAAP Adjusted EPS** in Crisp's earnings release for the current year (1 = Extremely unlikely; 9 = Extremely likely).

TABLE 5

Descriptive Statistics, Chi-Square Analysis, and Binary Logistic for Non-GAAP EPS Presentation in Headlines/Highlights

(n = 100)

Panel A: Cell Counts (Percentage) for Non-GAAP EPS Disclosure in Headlines/Highlights[a]

	Audit Committee Questioning Focus[+]	
Auditor Flexibility[+]	**Both GAAP & Non-GAAP**	**GAAP**
Less	13 52.0%	14 56.0%
More	6 25.0%	15 57.7%

Chi-Square Tests:	**df**	**Value**	**p-value**
Overall	3	6.87	0.08
Effect of Audit Committee Questioning within Auditor Flexibility:			
Less	1	0.08	0.50
More	1	5.48	0.02*

Panel B: Binary Logistic Regression for Non-GAAP EPS Disclosure in Headlines/Highlights[a]

IV	**Beta Coeff.**	**Std. Error**	**Wald**	**p-value**
AuditorFlexibility	-0.07	0.57	0.01	0.45
AC_Questioning	-1.41	0.62	5.23	0.01*
*AuditorFlexibility * AC_Questioning*	1.25	0.84	2.22	0.07*
Constant	0.31	0.40	0.61	0.43

Notes:

[+] The independent variables are described on Table 1.

* Reported p-values for directional tests are one-tailed.

[a] The dependent variable is the dichotomous choice to disclose **non-GAAP Adjusted EPS** in the Headline or Subtitle/Highlights in Crisp's earnings release for the current year (1 = Disclosed in Headline or Subtitle/Highlights).

TABLE 6
Selected Results from Post-Experimental Survey Regarding Non-GAAP Disclosures
(n = 100)

Panel A: Non-GAAP Disclosure Experiences

Question	Mean	Median	Std. Deviation
How often do you use non-GAAP disclosures to provide information to investors when there are limitations in GAAP reporting?[a]	6.88	7	2.11
In your opinion, how important are non-GAAP disclosures in earnings press releases to investors?[b]	7.31	8	1.85
In your experience, how much consideration does your company typically give to the placement of disclosures made in earnings press releases (i.e., how early or late they are disclosed in the document)?[c]	7.36	7	1.53

Panel B: Perception of Investor Attention to Earnings Release Sections

When preparing earnings press releases, how much attention do you think a typical investor will pay to the different sections of the release?[d]	Mean Percentage
Headline	25.56%
Highlights/Subtitle	19.54%
First or second paragraph	18.77%
Later in body of release	15.42%
Financial Tables	20.71%

Notes:

[a] Response provided on a 9-point scale (1 = Not often at all; 9 = Very often).

[b] Response provided on a 9-point scale (1 = Not important at all; 9 = Very important).

[c] Response provided on a 9-point scale (1 = No consideration at all; 9 = Significant consideration).

[d] Participants were asked to allocate a percentage of expected investor attention (totaling 100%) to each section. They were given a template of an earnings release that provided labels and descriptions of each section, which could be accessed during the survey.

APPENDIX A: EXPERIMENTAL INSTRUMENT

INSTRUCTIONS

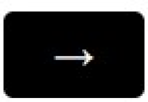
[Provided in all conditions]

Thank you for taking the time to participate in this study. The purpose of this study is to better understand managerial judgment. Your participation is voluntary. Refusal to participate in this study will involve no penalty or loss of benefits to which you would otherwise be entitled. You may discontinue participation in this study at any time.

The following case study examines how financial managers disclose financial information in earnings press releases. As you read the following study for Crisp Electronics, Inc. (Crisp), please take the role of the Chief Financial Officer (CFO) for this public company. You will be given background information on Crisp, along with prior-year financial data and information related to the current year's financial statement preparation. You need no specific expertise in Crisp's industry to complete the study.

This study should take approximately 30 minutes to complete. All data are being collected in a manner that ensures your complete anonymity. All individual responses will only be analyzed in the aggregate. If you have any questions or concerns about the study, please contact me, Kevin Hale (kevinh89@vt.edu) or my doctoral advisor, Professor Sudip Bhattacharjee (sudipb@vt.edu).

By agreeing to participate in this study, you are indicating that you understand the above information and voluntarily consent to participate in this study. You are also affirming that you are at least 18 years of age. Thank you again for your participation.



[Provided in all conditions- experience screening]

Before you begin the case study, please respond to the following questions to ensure you are eligible to participate.

Do you have experience as a financial manager/executive with a U.S. publicly-traded company?

- Yes
- No

Do you have experience discussing accounting issues with external auditors?

- Yes
- No

Are you familiar with non-GAAP financial measures?

- Yes
- No

Do you have experience in helping to prepare earnings press releases?

- Yes
- No

[Provided in all conditions- knowledge screening]

Before you begin the case study, please respond to the following questions to ensure you are eligible to participate.

Assume Flexico, Inc. acquired 100% of Pops, Inc. for $480,000 in cash. At the time of acquisition, Pops, Inc. had noncash assets with a fair value of $280,000 and liabilities with a fair value of $80,000. Assume Flexico, Inc. uses US GAAP in recording financial transactions.

What effect would the acquisition of Pops, Inc. (described above) have on the accounts Flexico, Inc.? Please select the best option from the choices below.

A. [X]

- INCREASE IN NONCASH ASSETS OTHER THAN GOODWILL $280,000
- INCREASE IN GOODWILL $280,000
- INCREASE IN LIABILITIES $80,000
- DECREASE IN CASH $480,000

B.

- INCREASE IN NONCASH ASSETS OTHER THAN GOODWILL $280,000
- INCREASE IN GOODWILL $80,000
- DECREASE IN LIABILITIES $80,000
- DECREASE IN CASH $280,000

C.

- INCREASE IN NONCASH ASSETS OTHER THAN GOODWILL $200,000
- INCREASE IN GOODWILL $280,000
- DECREASE IN LIABILITIES $80,000
- DECREASE IN CASH $480,000

[Knowledge screening continued]

Suppose that after 3 years, Flexico, Inc. determines that the goodwill created from the acquisition of Pops, Inc. has been impaired by $50,000. What effect would this impairment have on the accounts of Flexico, Inc.? Please select the best option from the choices below.

A.

- DECREASE IN GOODWILL LIABILITIY $50,000
- DECREASE IN GOODWILL IMPAIRMENT LOSS $50,000

B. [X]

- INCREASE IN GOODWILL IMPAIRMENT LOSS $50,000
- DECREASE IN GOODWILL $50,000

C.

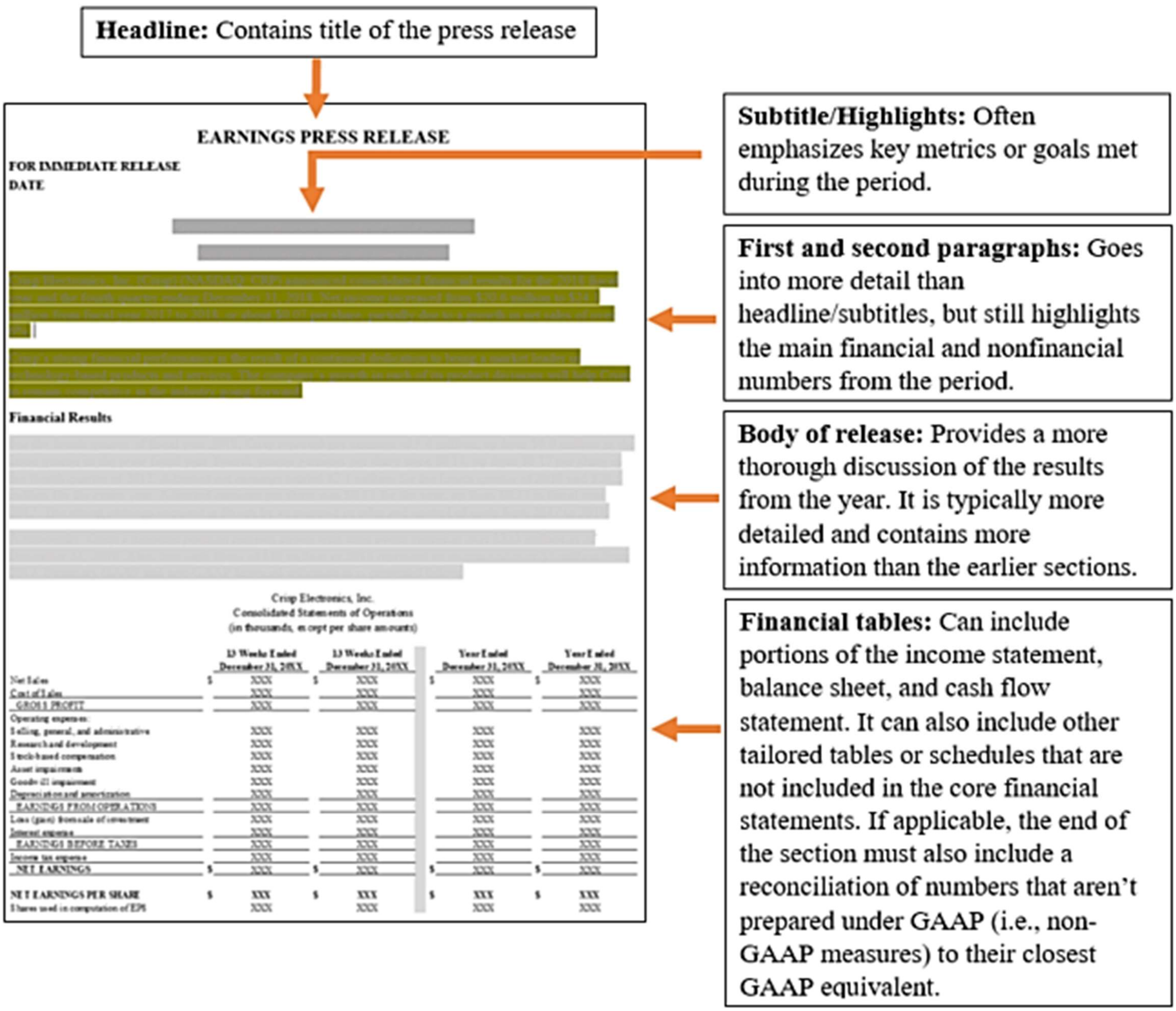
- INCREASE IN GOODWILL IMPAIRMENT LOSS $50,000
- DECREASE IN CASH $50,000

What effect would the above impairment loss have on the net income of Flexico, Inc. (assuming all else equal)?

- Increase net income
- Decrease net income [X]
- No effect on net income

GAINING AN UNDERSTANDING OF EARNINGS RELEASES

In this study, you will be asked to make judgments about items in the earnings press release ("earnings release") for Crisp. An earnings release is a public announcement by a company of material non-public information regarding a company's results of operations or financial condition for a completed quarterly or annual financial period (per SEC Release No. 33-10588; 34-84842). While there is variation in the way earnings releases can be prepared, a typical release can look as follows. You will be able to refer back to this page at any point.



COMPANY BACKGROUND

[Provided in all conditions]

Crisp Electronics, Inc. (Crisp) is a public company that manufactures and sells computer peripherals to businesses and individual consumers. The company specializes in producing printers, monitors, external storage devices, and associated software. All divisions of the company have remained profitable over the last several years. Additionally, Crisp has acquired several small companies in the last few years to grow the company. Crisp's stock is traded on the NASDAQ.

Crisp's annual financial statements are nearly completed, so the company is ready to prepare the fourth quarter and full year earnings press release to its investors, which is done by your company's disclosure committee. You, as CFO, oversee the committee, which also includes members of the accounting staff, internal legal counsel, an investor relations officer, and a member of the risk management team. The CEO typically reviews the earnings releases before they are issued, but relies on your expertise in disseminating financial information to outside parties.

After you have prepared the preliminary draft of the release and the CEO has provided his approval, it will be reviewed by your company's audit committee. The audit committee is comprised of three independent members who all have financial or accounting expertise. The committee meets frequently (normally around 12 times per year), and they usually meet in person to discuss all press releases before they are issued by the company. Additionally, the committee has always seemed to be proactive in identifying issues and addressing them as they arise.

[GAAP only audit committee questioning condition only]

Based on your past experiences, you have noticed that the audit committee is often active in posing questions that directly ask management to justify decisions related to the disclosure of GAAP financial measures in earnings releases. For example, they check for consistency and comparability in the presentation and calculation of GAAP measures that are to be disclosed in the earnings release. They have also previously asked questions to ensure that all GAAP information chosen for disclosure in the release is useful to investors. Overall, it seems as if the audit committee's questions are intended to challenge management's process of disclosing and presenting the GAAP financial information.

[GAAP and non-GAAP audit committee questioning condition only]

Based on your past experiences, you have noticed that the audit committee is often active in posing questions that directly ask management to justify decisions related to the disclosure of **both** GAAP and non-GAAP financial measures in earnings releases. For example, they check for consistency and comparability in the presentation and calculation of both GAAP and non-GAAP measures that are to be disclosed in the earnings release. They have also previously asked questions to ensure that all GAAP information, in addition to non-GAAP information, chosen for disclosure in the release is useful to investors. Overall, it seems as if the audit committee's questions are intended to challenge management's process of disclosing and presenting **both** the GAAP and non-GAAP financial information.

[Provided in all conditions]

As CFO, you also have a significant role in overseeing the preparation of the financial statements. You supervise the accounting staff, and you also serve as a liaison to the external auditors. Crisp's financial statements have been audited by the same large international public accounting firm for several years and you have developed a good working relationship with the firm, including the lead audit engagement partner, Tom Rogers. The firm has a reputation for conducting high quality audits that help produce reliable financial statements. You believe that the audit team assigned to Crisp and the engagement partner, Tom Rogers, are competent, well-trained, and have the right expertise to perform the audit. Crisp has received unqualified audit opinions every year from the auditors and no major accounting issues have arisen in prior years.

Additionally, Crisp has been successful the past several years. The company's products have been well-received, and its financially strong performance has allowed for steady growth. To help sustain the company's growth, Crisp intends to raise additional capital at the beginning of the next fiscal year through the issuance of both common stock and the sale of bonds.

A copy of last year's earnings release (fiscal year 2018), which includes full year and fourth quarter information for the previous year, is presented below. You will have the option to view this earnings release again later in the case materials, where you will be asked questions on earnings releases.

[LAST YEAR'S EARNINGS RELEASE]

Crisp Electronics Announces Fourth Quarter and Fiscal Year 2017 Financial Results

FOR IMMEDIATE RELEASE

02/21/2019

Reported Fourth Quarter GAAP Earnings of $0.18 per share

Net Sales Increase by over 6% from FY 2017

Crisp Electronics, Inc. (Crisp) (NASDAQ: CRP) announced consolidated financial results for the 2018 fiscal year and the fourth quarter ending December 31, 2018. GAAP net earnings increased from $20.6 million to $24.1 million from fiscal year 2017 to 2018, or about $0.07 per share, partially due to a growth in net sales of over 6%.

Crisp's strong financial performance is the result of a continued dedication to being a market leader in technology-based products and services. The company's growth in each of its product divisions will help Crisp to remain competitive in the industry going forward.

Financial Results

For the fourth quarter of fiscal year 2018, Crisp reported GAAP net earnings of $5.6 million, up from $5.0 million in the same quarter in the prior fiscal year. Fourth quarter GAAP earnings per share were $0.18, up from $0.17 per share in the fourth quarter of 2017. GAAP earnings per share was $0.78 for the fiscal year. Non-GAAP adjusted net earnings totaled $7.1 million for the fourth quarter of 2018 and $26.5 million for the entire year. The strong earnings increase is driven by an increase in sales and control of costs from 2017 to 2018.

Additionally, Crisp's financial position remains strong with total assets valued at over $233 million as of December 31, 2018. The free cash flow of $19 million in 2018 represents an increase of over $1 million from 2017. Summary GAAP and non-GAAP financial information is presented below.

Crisp Electronics, Inc.
Consolidated Statements of Operations
(in thousands, except per share amounts)

	13 Weeks Ended December 31, 2018	13 Weeks Ended December 31, 2017	Year Ended December 31, 2018	Year Ended December 31, 2017
Net Sales	$ 106,335	$ 99,530	$ 429,062	$ 403,747
Cost of Sales	64,900	61,006	262,196	249,060
GROSS PROFIT	41,435	38,524	166,866	154,687
Operating expenses:				
Selling, general, and administrative	17,479	16,518	70,178	68,053
Research and development	8,653	8,220	34,525	32,059
Depreciation and amortization	5,350	5,136	21,400	20,544
Stock-based compensation	327	317	1,226	1,129
Other operating items	403	75	403	75
EARNINGS FROM OPERATIONS	9,223	8,257	39,133	32,827
Loss (gain) from sale of investment	-	-	-	(950)
Interest expense	2,200	1,992	8,888	7,988
EARNINGS BEFORE TAXES	7,023	6,265	30,245	25,789
Income tax expense	1,405	1,253	6,049	5,158
NET EARNINGS	$ 5,618	$ 5,012	$ 24,196	$ 20,631
NET EARNINGS PER SHARE	**$ 0.18**	**$ 0.17**	**$ 0.78**	**$ 0.71**
Shares used in computation of EPS	31,200	29,000	31,200	29,000

[LAST YEAR’S EARNINGS RELEASE]

Crisp Electronics, Inc.
Consolidated Balance Sheets
(in thousands)

	As of December 31, 2018	As of December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 70,487	$ 68,577
Receivables, net	32,199	31,555
Inventories, net	38,370	37,102
Prepaid expenses and other current assets	3,901	3,573
Total current assets	144,956	140,807
Propety and equipment:		
Land	15,657	15,365
Buildings and leasehold improvements, net	24,962	24,247
Total property and equipment	40,619	39,612
Goodwill	4,063	3,988
Other noncurrent assets	43,688	41,932
Total assets	**$ 233,326**	**$ 226,339**
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 38,092	$ 36,092
Accrued liabilities	17,561	16,885
Income taxes payable	1,948	1,701
Current portion of debt, net	4,750	4,566
Total current liabilities	62,351	59,244
Other long-term liabilites	46,780	44,134
Long-term debt, net	11,800	10,360
Total liabilities	120,931	113,738
Stockholders' equity	112,395	112,601
Total liabilities and stockholders' equity	**$ 233,326**	**$ 226,339**

Crisp Electronics, Inc.
Consolidated Statements of Cash Flows
(in thousands)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Cash flow activities		
Net cash provided by operating activities	$ 49,505	$ 47,641
Net cash used in investing activities	(15,997)	(18,475)
Net cash used in financing activities	(31,598)	(24,864)
Net increase in cash and cash equivalents	1,910	4,302
Cash and cash equivalents at beginning of period	68,577	64,275
Cash and cash equivalents at end of period	**$ 70,487**	**$ 68,577**

[LAST YEAR'S EARNINGS RELEASE]

Reconciliation of Non-GAAP Financial Measures

	13 Weeks Ended December 31, 2018	13 Weeks Ended December 31, 2017	Year Ended December 31, 2018	Year Ended December 31, 2017
NET EARNINGS	$ 5,618	$ 5,012	$ 24,196	$ 20,631
Stock-based compensation	327	317	1,226	1,129
Acquisition-related charges	1,600	-	1,600	-
Tax effect of adjustments	(385)	(63)	(565)	(226)
ADJUSTED NET EARNINGS	$ 7,160	$ 5,266	$ 26,457	$ 21,534
ADJUSTED NET EARNINGS PER SHARE	$ **0.23**	$ **0.18**	$ **0.85**	$ **0.74**
Shares used in computation of EPS	31,200	29,000	31,200	29,000

Net cash provided by operating activities	$ 49,505	$ 47,641
Less: Capital expenditures	30,015	29,219
Free cash flow	**$** 19,490	**$** 18,422

CURRENT FISCAL YEAR: POTENTIAL GOODWILL IMPAIRMENT

[Provided in all conditions]

Crisp experienced another successful year in the current year (fiscal year 2019). Sales and net earnings both increased during the year. Due to the strong performance, the company continues to plan to raise additional capital at the beginning of next year through the issuance of common stock and the sale of bonds.

However, during this year's audit, there was a difference of opinion between the audit team and Crisp's accounting staff related to a potential impairment loss. The potential impairment was related to goodwill created from an acquisition of a printing software company three years ago. The printing software company is now a reporting unit for Crisp. Per accounting standards, Crisp has tested for impairment of the reporting unit annually since the acquisition, and concluded that no impairment occurred due to the fact that the fair value of the reporting unit exceeded the carrying value of all identifiable assets. The auditors took no issue with this assessment in prior years.

In the fourth quarter of this year, Crisp's stock price decreased slightly after the announcement of a new product by a competitor in the printing software industry. The auditors suggested that this might be a qualitative factor that would need to be considered in the annual goodwill impairment testing. , consistent with Accounting Standards Codification (ASC) Topic 350, *Intangibles-Goodwill and Other*. You, the CFO, initially disagreed with the impact this new product would have on sales for Crisp, citing consistent sales growth during the year. Additionally, you noted that some external market reports project growth for the printing software industry overall, which you believe will allow Crisp to maintain strong sales despite increased competition. However, after a discussion with the audit partner, Tom Rogers, you agreed to perform a quantitative analysis to determine if any impairment related to the reporting unit had occurred.

Using a discounted cash flow analysis, you and your accounting staff determined that it might be necessary to recognize an impairment loss. The company's models indicated that the fair value had slightly decreased from prior years and using your most conservative estimates, an impairment loss of $1 million was possible. With this loss, net earnings would be lower than expected. The primary assumptions in this analysis are outlined below.

Key Assumptions:

Sales growth rate: Sales growth has historically been around 5-6% per year in the printing division. Crisp is budgeting for a 6% growth, as internal projections indicate this is attainable. The 6% growth rate for sales over the next five years is used as the assumption in the discounted cash flow model.

Operating costs: Operating costs have remained consistent over the past several years. Internal projections show gross margins of around 35%, and selling expenses of around 15%.

Capital expenditures: The typical capital expenditures budget has been 2% of sales, which has been adequate to support operations. This expectation is the assumption used in future cash flow projections.

Required rate of return: The company's weighted average cost of capital (WACC) has historically been around 14%, so this is the discount rate used in the discounted cash flow analysis.

Effective Tax Rate: Assumed to be 20% based on prior years.

Based on these assumptions in the discounted cash flow analysis, the $1 million impairment loss was recorded as a reduction to net earnings in the current year. Crisp's proposed draft of the current year's income statement, including the $1 million impairment loss, is included below.

DRAFT ONLY

Crisp Electronics, Inc.
Consolidated Statements of Operations
(in thousands, except per share amounts)

	13 Weeks Ended December 31, 2019	13 Weeks Ended December 31, 2018	Year Ended December 31, 2019	Year Ended December 31, 2018
Net Sales	$ 110,588	$ 106,335	$ 446,777	$ 429,062
Cost of Sales	67,172	64,900	272,716	262,196
GROSS PROFIT	43,417	41,435	174,061	166,866
Operating expenses:				
Selling, general, and administrative	17,916	17,479	71,843	70,178
Research and development	8,826	8,653	35,039	34,525
Depreciation and amortization	5,351	5,350	21,404	21,400
Stock-based compensation	330	327	1,318	1,226
Other operating items	-	403	-	403
Goodwill impairment	1,000	-	1,000	-
EARNINGS FROM OPERATIONS	9,994	9,223	43,456	39,133
Loss (gain) from sale of investment	-	-	-	-
Interest expense	2,376	2,200	9,409	8,888
EARNINGS BEFORE TAXES	7,618	7,023	34,047	30,245
Income tax expense	1,524	1,405	6,809	6,049
NET EARNINGS	**$ 6,094**	**$ 5,618**	**$ 27,238**	**$ 24,196**
NET EARNINGS PER SHARE	**$ 0.19**	**$ 0.18**	**$ 0.85**	**$ 0.78**
Shares used in computation of EPS	32,000	31,200	32,000	31,200

After reviewing your impairment analysis and the draft of the current year income statement, the audit team had some concerns related to your sales growth projections. Specifically, they thought that the increased market competition could damage sales growth and recommended a sales growth rate of 3-4% over the next five years based on industry data.

Using the auditor’s preferred growth rate of 3% in the cash flow model, a goodwill impairment loss of $2.5 million would result due to the decrease in fair value of the reporting unit. Since this amount was considerably higher than your company’s projections for the impairment, you thought the matter needed to be discussed with the auditors. As the CFO, you decided to discuss the issue with Tom Rogers, the audit engagement partner.

DISCUSSION WITH AUDITOR

[Provided in the less flexible auditor conditions only]

You called Tom to discuss the potential impairment and defend your assumptions on the fair value estimate. Based on discussions with Tom in prior years, you felt that it was unlikely he would consider a change to the financial statements that had been drafted. Tom said that circumstances had changed from prior years and that you needed to update the assumptions in your fair value model. You described how the sales growth rate of 5-6% was in line with how the printing division has performed in recent years. Tom quickly countered your argument and said, in this case, the past sales growth is not a dependable estimate of future performance. He forcefully cited external market reports and guidance from the firm's valuation specialist projecting increased competition in the industry in the coming years and stated that the company's sales growth rate projection was too aggressive. You noted that some of the market reports also project growth in the printing software industry overall, which will allow Crisp's printing software to continue to sell well, even with a new competitor. You informed him that despite the information in the market reports, the 5% growth rate was reasonable, which would result in the $1 million impairment you were proposing to recognize. Tom said this estimate was still too aggressive and recommended a lower growth rate, which would result in the larger suggested impairment loss. You told Tom you believed the recognition of a $1 million loss best reflected economic reality, but Tom disagreed and didn't seem to see a need to continue the discussion.

You offered to sit down with Tom and go over your cash flow projections so he could better understand your rationale. He agreed to the meeting but did not appear to see much value in putting all the information on the table and sharing concerns with one another. During the meeting, you discussed your projections, but it seemed as if Tom's mind was already made up. He heard you out, but stated the uncertainty around the projections was too high and that a higher impairment figure was necessary. You sensed that he did not fully acknowledge your concerns, but he did eventually agree to accept a slightly higher sales growth assumption. Using the new assumption, an impairment loss of $2 million would result. Ultimately, after what you thought was a difficult discussion process with Tom, you agreed to recognize the loss of $2 million in the financial statements.

After recognizing the $2 million loss, Crisp's earnings per share is $0.83 for the year and $0.17 for the fourth quarter. If a $1 million loss had been recognized instead, the earnings per share would have been $0.85 for the year and $0.19 for the fourth quarter. If no loss had been recognized, the earnings per share would have been $0.88 for the year and $0.22 for the fourth quarter.

[Provided in the more flexible auditor conditions only]

You called Tom to discuss the potential impairment and defend your assumptions on the fair value estimate. Based on discussions with Tom in prior years, you felt that it was likely he would consider a change to the financial statements that had been drafted. Tom said that circumstances had changed from prior years and that you both needed to consider how to best update the assumptions in your fair value model. You described how the sales growth rate of 5-6% was in line with how the printing division has performed in recent years. Tom acknowledged your argument, but said, in this case, past sales growth is likely not a dependable estimate of future performance. He cited external market reports and guidance from the firm's valuation specialist projecting increased competition in the industry in the coming years and stated that the company's sales growth rate projection might be too aggressive. You noted that some of the market reports also project growth in the printing software industry overall, which will allow Crisp's printing software to continue to sell well, even with a new competitor. You informed him that despite the information in the market reports, the 5% growth rate was reasonable, which would result in the $1 million impairment you were proposing to recognize. Tom said this estimate was probably still too aggressive and recommended that you consider a lower growth rate, which would result in the larger suggested impairment loss. You told Tom you believed the recognition of a $1 million loss best reflected economic reality, and while Tom disagreed, he was open to continuing the discussion.

You offered to sit down with Tom and go over your cash flow projections so he could better understand your rationale. He readily agreed to the meeting and appeared to see the value in putting all the information on the table and sharing concerns with one another. During the meeting, you discussed your projections, and Tom seemed open to your position. He heard you out, but stated the uncertainty around the projections appeared to be too high and still proposed that a higher impairment figure was necessary. You sensed that he fully acknowledged your concerns and, as such, did eventually agree to accept a slightly higher sales growth assumption. Using the new assumption, an impairment loss of $2 million would result. Ultimately, after what you thought was an amicable discussion process with Tom, you agreed to recognize the loss of $2 million in the financial statements.

After recognizing the $2 million loss, Crisp's earnings per share is $0.83 for the year and $0.17 for the fourth quarter. If a $1 million loss had been recognized instead, the earnings per share would have been $0.85 for the year and $0.19 for the fourth quarter. If no loss had been recognized, the earnings per share would have been $0.88 for the year and $0.22 for the fourth quarter.

[Provided in all conditions]

The final income statement with the $2 million impairment loss is provided below.

FINAL GAAP INCOME STATEMENT (CURRENT FISCAL YEAR)

Crisp Electronics, Inc.
Consolidated Statements of Operations
(in thousands, except per share amounts)

	13 Weeks Ended December 31, 2019	13 Weeks Ended December 31, 2018	Year Ended December 31, 2019	Year Ended December 31, 2018
Net Sales	$ 110,588	$ 106,335	$ 446,777	$ 429,062
Cost of Sales	67,172	64,900	272,716	262,196
GROSS PROFIT	43,417	41,435	174,061	166,866
Operating expenses:				
Selling, general, and administrative	17,916	17,479	71,843	70,178
Research and development	8,826	8,653	35,039	34,525
Depreciation and amortization	5,351	5,350	21,404	21,400
Stock-based compensation	330	327	1,318	1,226
Other operating items	-	403	-	403
Goodwill impairment	2,000	-	2,000	-
EARNINGS FROM OPERATIONS	8,994	9,223	42,456	39,133
Loss (gain) from sale of investment	-	-	-	-
Interest expense	2,376	2,200	9,409	8,888
EARNINGS BEFORE TAXES	6,618	7,023	33,047	30,245
Income tax expense	1,324	1,405	6,609	6,049
NET EARNINGS	$ 5,294	$ 5,618	$ 26,438	$ 24,196
NET EARNINGS PER SHARE	**$ 0.17**	**$ 0.18**	**$ 0.83**	**$ 0.78**
Shares used in computation of EPS	32,000	31,200	32,000	31,200

TASK: EARNINGS RELEASE DISCLOSURES

[Provided in all conditions]

As the CFO of Crisp, please provide your input on the following questions regarding how to disclose certain financial measures in the earnings press release. When answering these questions, assume that you are having discussions with the rest of the disclosure committee on how to formulate the release. As the head of the disclosure committee, your judgments on these decisions will be important to the rest of this committee and to the CEO.

[GAAP only questioning audit committee condition only]

In addition, after the preliminary draft has been completed, it will be reviewed by the Board's audit committee. Recall that you have noticed in the past that the audit committee often poses questions that directly ask management to justify decisions related to the disclosure of GAAP financial measures.

[GAAP and non-GAAP questioning audit committee condition only]

In addition, after the preliminary draft has been completed, it will be reviewed by the Board's audit committee. Recall that you have noticed in the past that the audit committee often poses questions that directly ask management to justify decisions related to the disclosure of **both** GAAP and non-GAAP financial measures.

[Provided in all conditions]

Your discussions with the disclosure committee are focused on how to handle the reporting of the goodwill impairment loss and the company's earnings. The company will continue to calculate "Adjusted Net Earnings," a non-GAAP disclosure, in the earnings release with the same exclusions as in previous years (you may refer to last year's release for reference). However, given that the printing division reporting unit has not previously recognized goodwill impairment in prior years, the disclosure committee is evaluating how to treat this item in the calculation of "Adjusted Net Earnings." Below are two options for calculating "Adjusted Net Earnings" starting from GAAP Net Earnings. The first option **excludes** the $2 million impairment loss in calculating the earnings figure (i.e., adds the loss back to GAAP Net Earnings). The second option **does not exclude** the $2 million impairment loss in calculating the earnings figure (i.e., does not add the loss back to GAAP Net Earnings).

OPTION 1

	13 Weeks Ended December 31, 2019	13 Weeks Ended December 31, 2018	Year Ended December 31, 2019	Year Ended December 31, 2018
NET EARNINGS	$ 5,294	$ 5,618	$ 26,438	$ 24,196
Stock-based compensation	330	327	1,318	1,226
Acquisition-related charges	-	1,200	-	1,200
Goodwill impairment	2,000	-	2,000	-
Tax effect of adjustements	(466)	(305)	(664)	(485)
ADJUSTED NET EARNINGS	$ 7,158	$ 6,840	$ 29,092	$ 26,137
ADJUSTED NET EARNINGS PER SHARE	**$ 0.22**	**$ 0.22**	**$ 0.91**	**$ 0.84**
Shares used in computation of EPS	32,000	31,200	32,000	31,200

OPTION 2

	13 Weeks Ended December 31, 2019	13 Weeks Ended December 31, 2018	Year Ended December 31, 2019	Year Ended December 31, 2018
NET EARNINGS	$ 5,294	$ 5,618	$ 26,438	$ 24,196
Stock-based compensation	330	327	1,318	1,226
Acquisition-related charges	-	1,200	-	1,200
Tax effect of adjustements	(66)	(305)	(264)	(485)
ADJUSTED NET EARNINGS	$ 5,558	$ 6,840	$ 27,492	$ 26,137
ADJUSTED NET EARNINGS PER SHARE	**$ 0.17**	**$ 0.22**	**$ 0.86**	**$ 0.84**
Shares used in computation of EPS	32,000	31,200	32,000	31,200

You can review any previously provided information at any time as you answer the questions that follow.

[Dependent variable measurements]

Based on this information, how likely are you to recommend that Crisp **exclude** the goodwill impairment loss in the calculation of "Adjusted Net Earnings" (i.e., add the loss back to GAAP Net Earnings) in Crisp's earnings release for the current year, consistent with Option 1 above?

Extremely Unlikely								Extremely Likely
○	○	○	○	○	○	○	○	○

The disclosure committee has a choice in the amount of goodwill impairment loss to exclude in the calculation of "Adjusted Net Earnings." How much of the goodwill impairment loss will you recommend to exclude in the calculation of "Adjusted Net Earnings" (i.e., add the loss back to GAAP Net Earnings) in Crisp's earnings release for the current year? Recall that you originally proposed to recognize a $1 million loss, but ultimately booked a $2 million loss after discussions with auditors.

How likely are you to recommend that Crisp **disclose** "Adjusted Net Earnings **Per Share**" (a non-GAAP financial measure) in the company's earnings release for the current year?

Extremely Unlikely								Extremely Likely
○	○	○	○	○	○	○	○	○

The following four questions are about the presentation of information in the earnings release. Please recall that you were earlier provided with a sample of a typical earnings release that contained descriptions of the different sections presented in the release. You may wish to refer to back to this information as you answer the next four questions.

Where within Crisp's earnings release are you likely to discuss/display "Adjusted Net Earnings" (a non-GAAP financial measure) in Crisp's earnings release for the current year? You may select multiple options. You may reference the earnings release example template provided earlier for descriptions of these sections.

- Headline/Title
- Subtitle/Highlights
- First or second paragraph
- Further down in body of release
- In the financial tables at the end of the release
- No disclosure at all

[Dependent variable measurements continued]

Where within Crisp's earnings release are you likely to discuss/display "Adjusted Net Earnings **Per Share**" (a non-GAAP financial measure) in Crisp's earnings release for the current year? You may select multiple options. You may reference the earnings release example template provided earlier for descriptions of these sections.

- Headline/Title
- Subtitle/Highlights
- First or second paragraph
- Further down in body of release
- In the financial tables at the end of the release
- No disclosure at all

Where within Crisp's earnings release are you likely to discuss/display GAAP "Net Earnings" from the income statement in Crisp's earnings release for the current year? You may select multiple options. You may reference the earnings release example template provided earlier for descriptions of these sections.

- Headline/Title
- Subtitle/Highlights
- First or second paragraph
- Further down in body of release
- In the financial tables at the end of the release
- No disclosure at all

Where within Crisp's earnings release are you likely to discuss/display GAAP "Net Earnings **Per Share**" from the income statement in Crisp's earnings release for the current year? You may select multiple options. You may reference the earnings release example template provided earlier for descriptions of these sections.

- Headline/Title
- Subtitle/Highlights
- First or second paragraph
- Further down in body of release
- In the financial tables at the end of the release
- No disclosure at all

Please list the factors that you considered when determining the disclosure and presentation of the non-GAAP adjusted earnings measures discussed above.

[Manipulation check questions]

Please respond to the following questions.

Based on the information in this case:

In the past, to what degree did the audit committee pose questions that directly asked management to justify decisions on the disclosure of GAAP financial measures, as opposed to both GAAP and non-GAAP financial measures??

Active questioning GAAP only								Active questioning both GAAP and non-GAAP
○	○	○	○	○	○	○	○	○

How open did you feel the audit partner, Tom Rogers, was in considering your position regarding the goodwill impairment loss?

Not Open at All								Very Open
○	○	○	○	○	○	○	○	○

To what degree did it seem as if the audit partner, Tom Rogers, already had his mind made up about booking a higher goodwill impairment loss, as opposed to acknowledging your arguments for the lower amount during your discussions?

Mind Not Made Up								Mind Definitely Made Up
○	○	○	○	○	○	○	○	○

[Non-GAAP knowledge check]

Will excluding the goodwill impairment loss in the calculation of "Adjusted Net Earnings" increase or decrease "Adjusted Net Earnings" (a non-GAAP measure)?

- Increase
- Decrease

[Comprehension check]

Did the case materials indicate Crisp did or did not plan to raise additional capital at the next fiscal year (through the issuance of common stock and the sale of bonds)?

- Crisp **DID** plan on raising additional capital next year.
- Crisp **DID NOT** plan on raising additional capital next year.
- The case materials did not indicate if Crisp planned to raise additional capital next year.

[Post-experimental questions]

I believe the auditors were competent in their performance of Crisp's audit.

Fully Disagree								Fully Agree
○	○	○	○	○	○	○	○	○

I felt the auditor was attempting to dictate my reporting behavior.

Completely Disagree								Completely Agree
○	○	○	○	○	○	○	○	○

I felt pressured to take a certain action given the auditor's behavior during discussions on the accounting issue.

Completely Disagree								Completely Agree
○	○	○	○	○	○	○	○	○

I felt the auditor's behavior during the discussions on the accounting issue restricted my autonomy to choose.

Completely Disagree								Completely Agree
○	○	○	○	○	○	○	○	○

I felt the auditor tried to make a decision for me in regard to the amount of goodwill impairment to recognize.

Completely Disagree								Completely Agree
○	○	○	○	○	○	○	○	○

[Post-experimental questions continued]

How would you rate the audit committee's competency in this case?

Not Competent								Very Competent
○	○	○	○	○	○	○	○	○

I anticipated that the audit committee would ask specific questions about my decisions regarding the disclosure, calculation, and/or presentation of non-GAAP financial measures (i.e. "Adjusted Net Earnings" and/or "Adjusted Earnings Per Share").

Did not anticipate non-GAAP questions								Definitely anticipated non-GAAP questions
○	○	○	○	○	○	○	○	○

When making decisions about the disclosure, calculation, and presentation of non-GAAP financial measures (i.e. "Adjusted Net Earnings" and/or "Adjusted Earnings Per Share"), I felt it was likely that I would be asked to justify these decisions by the audit committee.

Did not feel I would be asked to justify								Definitely felt I would be asked to justify
○	○	○	○	○	○	○	○	○

[Demographic questions]

Current Position in your company:

Number of years of experience:

In what industry does your company operate?

[Demographic questions continued]

How much experience do you have preparing financial statements?

No Experience								Considerable Experience
○	○	○	○	○	○	○	○	○

How much experience do you have discussing subjective accounting matters with auditors?

No Experience								Considerable Experience
○	○	○	○	○	○	○	○	○

How much experience do you have preparing earnings press releases?

No Experience								Considerable Experience
○	○	○	○	○	○	○	○	○

How much experience do you have interacting with audit committees?

No Experience								Considerable Experience
○	○	○	○	○	○	○	○	○

How much experience do you have in preparing or examining non-GAAP financial measures?

No Experience								Considerable Experience
○	○	○	○	○	○	○	○	○

[Follow-Up Survey]

Please respond to the following questions about your experiences and opinions related to financial disclosures.

1) How often do you use non-GAAP disclosures to provide information to investors when there are limitations in GAAP reporting?

Not often at all								Very often
○	○	○	○	○	○	○	○	○

2) What do you think are the most important reasons to provide non-GAAP disclosures to investors?

3) In your opinion, how important are non-GAAP disclosures in **earnings press releases** to investors?

Not important at all								Very important
○	○	○	○	○	○	○	○	○

4) In your experience, how much consideration does your company typically give to the placement of disclosures made in **earnings press releases** (i.e., how early or late they are disclosed in the document)?

No consideration at all								Significant consideration
○	○	○	○	○	○	○	○	○

5) When preparing **earnings press releases**, how much attention do you think a typical investor will pay to the different sections of the release, as described earlier in the case and available here (link provided)? Please allocate a percentage of expected investor attention (totaling 100%) to each section.
   - Headline
   - Subtitle/Highlights
   - First and second paragraph
   - Body of the release
   - Financial tables

6) In your opinion, how important are non-GAAP disclosures in communication mediums **other than earnings press releases** to investors (such as conference calls)?

Not important at all								Very important
○	○	○	○	○	○	○	○	○

7) As part of the quarterly and annual financial reporting process, rate the amount effort you typically spend in deciding the type of disclosures to make in **earnings press releases**?

Moderate effort								Very significant effort
○	○	○	○	○	○	○	○	○

8) When preparing **earnings press releases**, how likely do you think it is that your disclosure choices will be reviewed or scrutinized by regulators (e.g., the SEC)?

Not likely at all								Very likely
○	○	○	○	○	○	○	○	○

9) When preparing **earnings press releases**, how important is it to disclose the same measures consistently from one period to the next?

Not important at all								Very important
○	○	○	○	○	○	○	○	○

10) In your experience, how often do external auditors typically review **earnings press releases**?

Not often at all								Very often
○	○	○	○	○	○	○	○	○

11) In your experience, how often do external auditors typically review non-GAAP disclosures?

Not often at all								Very often
○	○	○	○	○	○	○	○	○

12) In your experience, how often do audit committees review financial statement disclosures?

Not often at all								Very often
○	○	○	○	○	○	○	○	○

13) In your experience, how often do audit committees review **earnings press releases**?

Not often at all								Very often
○	○	○	○	○	○	○	○	○

14) In your experience, how often do audit committees question non-GAAP disclosures?

Not often at all								Very often
○	○	○	○	○	○	○	○	○

Thank you for your time. Your assistance with this project is greatly appreciated.