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The Proliferation of "Special" Accounting Items: A Threat to Corporate Credibility

Betty L. Brewer, Robert J. Angell, and R. David Mautz, Jr.

Allegations of earnings management have persisted in academic literature and the business press for many years. However, researchers' attempts to document management interference with the financial reporting process have yielded mixed results. The business community is also divided on the issue of earnings management. Some managers argue that researchers and regulators focus on isolated events and exaggerate the magnitude of the problem. Others acknowledge that earnings management is pervasive and offer the demands of the securities markets as justification for influencing the financial reporting process. Volatility in stock prices and increasing scrutiny from the Securities and Exchange Commission (SEC) have caused some public companies to reexamine financial reporting practices that have been linked to earnings management. Public concern about earnings management has also intensified since the collapse of Enron and the indictment of Arthur Andersen.

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The authors present evidence that one practice linked to earnings management, the classification of gains and losses as "special" or "non-operating" items, has reached epidemic proportions among publicly-traded companies. The remainder of the article is organized as follows. The first section outlines the broad issues in earnings management and focuses on allegations in the financial press, recent regulatory developments, and prior research efforts. Findings of the current research on the proliferation of special accounting items are then presented. The article's conclusion addresses the potential consequences of aggressive financial reporting practices.

Earnings Management Issues

Interest, Allegations, and Anecdotes

Earnings management is a hot topic in the financial press, and interest is growing. Searching the electronic *Wall Street Journal* index for "earnings management" yielded 14 articles published from 1999 to September 2001. The corresponding search over the preceding 13 years, 1986 to 1998, uncovered only eight articles and none prior to 1986. Results from the broader ABI Inform search engine were similar. One article mentioned "earnings management" prior to 1986. From 1986 to 1998, the total was 206. The most recent

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period, 1999 to September 2001, yielded 280 hits.

In a particularly damning review of corporate financial reporting practices, Loomis (1999) asserts that managing earnings is the fundamental motivation for many accounting frauds. Missing earnings estimates by even a penny, she notes, is interpreted as an important failure, in part because managers have so many earnings management tools at their disposal. Describing the SEC's "war on bad financial reporting," Loomis (1999, p. 76) enumerates the accounting problems targeted by SEC Chairman Arthur Levitt in a September 1998 speech. Levitt's concerns include five specific practices.

> ***"Big bath" restructuring charges*** occur when companies anticipate large expenses that will occur over a period of several years in connection with a major organizational change. Rather than recognize these expenses as they occur, management reduces income by the total anticipated expenses in a single year. The resulting "big bath" may dramatically reduce current earnings. However, subsequent years' incomes are boosted by the absence of these costs. The motivation for a "big bath" is a belief that investors will quickly forgive one bad earnings year if it is followed by a series of better years.

> ***Acquisition accounting*** under U. S. generally accepted accounting principles (GAAP) was amended in June 2001 to require that all business combinations be accounted for using a single accounting method, commonly referred to as the "purchase method." At the time of Levitt's speech, transactions could be structured to qualify for the "pooling of interests" treatment which produced dramatically different financial results.

> ***"Cookie jar reserves"*** refers to the practice of anticipating and recognizing large losses or expenses in highly profitable years and establishing liabilities or "reserves" against which future expenditures may be charged. Should future profits fall below expectations, management is able to revise its estimate of the loss or expense downward, reduce the amount of the reserve, and boost income. Thus, the reserves represent a "cookie jar" of earnings available to disguise poor performance.

> ***The abuse of materiality*** is a particularly difficult practice to define or identify. Under U. S. GAAP, an item is considered material if it has the potential to influence the judgment of a financial statement reader. Because the authoritative literature offers little in the way of specific, quantitative guidelines, Mr. Levitt and others are concerned that managers avoid disclosing unfavorable results by declaring them to be "immaterial."

> ***Revenue recognition*** practices also allow considerable management judgment. Deciding when revenue is earned is particularly difficult when the seller has continuing performance obligations or the buyer retains the right to return merchandise, for example. Many observers of the business community believe that the sustained economic growth of the past decade has led companies to adopt progressively more aggressive revenue recognition policies.

While these and other earnings management strategies may fall within the letter of GAAP, market participants and observers are expressing increasing concern about potentially misleading accounting practices. Kahn (2001), for example, draws parallels between financial reporting at General Electric and Alice's Adventures in Wonderland. Restructuring charges and "one-time" gains and losses are at the heart of the controversy over alleged earnings management at General Electric. Clifford (2001) also highlights the use of "one-time" charges at Kmart, Occidental Petroleum, and other brand-name companies. Citing a study commissioned by *Fortune* magazine, he emphasizes that companies taking multiple charges to income systematically underperform the Standard and Poor's index (Clifford, 2001). Brown (2001) warns that lengthy SEC filings, often filled with the details of restructurings and other special charges, are a harbinger of poor performance.

Companies that emphasize income before special charges in their press releases have also been criticized for misleading the investing public. Weil (2001) focuses on the widespread practice of reporting "operating," "core," or "pro forma" earnings. These terms, he explains, are code for income before the

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effects of special items. Weil's (2001) specific concern is that analysts and rating agencies accept these numbers at face value, incorporate them into analyses such as the price/earnings (P/E) ratio, and pass them on to the investing public. As a result, companies' actual net earnings are deemphasized, their P/E ratios are systematically understated, and investors are led to believe that stocks are better values.

Regulatory Response

Concerns expressed by top SEC officials have resulted in a series of enforcement initiatives and official releases. In January 1999, the SEC targeted 150 companies for review in response to news reports of significant charges taken in 1998 financial statements (MacDonald, 1999a). Three recent SEC pronouncements also take direct aim at potential earnings management tools.

Staff Accounting Bulletin (SAB) no. 99, *Materiality*, targets misuse of the accounting doctrine of materiality. SAB 99 makes clear that "Misstatements created for the purpose of managing earnings are unacceptable, regardless of materiality" (Grant et al., 2000, p. 43). SAB 100, *Restructuring and Impairment Charges*, details guidelines intended to limit companies' ability to manage earnings through the use of these special items. SAB 100, *Revenue Recognition in Financial Statements*, enumerates SEC staff views on revenue recognition in an attempt to reduce the latitude currently available to companies. Steinberg (2000) notes that, "While Staff Accounting Bulletins are not rules of the SEC and do not bear the Commission's official approval, they represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administrating the disclosure requirements of the Federal securities laws" (p. 24). The Enron collapse and alleged culpability of Arthur Andersen will, no doubt, lead to even greater scrutiny of financial reporting practices by publicly-traded companies.

Academic Research

Interest in earnings management predates the current surge of interest on the part of journalists and regulators. Researchers in accounting and finance have been persistent in their attempts to identify and quantify earnings management, but the pace of progress has been modest. Commenting on earnings management research, Schipper (1989) observed that "anecdotal evidence (from the financial press) does not provide a solid basis for thinking systematically and productively about earnings management" and "empirical evidence . . . is suggestive but not conclusive." Schipper (1989) defines earnings management as "a purposeful intervention in the external financial reporting process . . ." and urges researchers to systematically investigate the incentives, contractual situations, and communication settings that give rise to earnings management (pp. 100-101).

The body of literature scrutinizing financial reporting practices has grown considerably since Schipper's (1989) comments. Yet, Dechow and Skinner (2000) assert that "academic research has not demonstrated that earnings management has a large effect on average on reported earnings, or that whatever earnings management does should concern investors" (p. 236). They attribute the lack of conclusive results, in part, to academic researchers' desire to identify generalizable results through the application of statistical analyses to large populations. Practitioners and regulators, they point out, are more likely to encounter individual cases of earnings management. Another limitation faced by academic researchers is their inability to observe management intent, a key element in most definitions of earnings management.

Dechow and Skinner (2000) advocate a greater focus on capital market incentives for earnings management and discuss recent research that provides "*prima facie* evidence that earnings management is pervasive" (pp. 236-237). These studies suggest (1) that managers intervene in the financial reporting process to meet simple earnings benchmarks and to improve the terms on which their company's shares are sold to the public, and (2) that relatively simple earnings management practices may "fool" market participants.

Healy and Wahlen (1999) acknowledge that incentives exist to manage earnings to influence the stock market, affect management compensation, ensure compliance with lending agreements, and avoid regulatory

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intervention. While these findings corroborate anecdotal reports of earnings management, Healy and Wahlen (1999) assert that researchers have yet to address the questions of greatest interest to accounting standard setters. After reviewing more than 60 articles and papers in the accounting literature, they offer the following definition of earnings management.

> Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers (Healy & Wahlen, 1999, p. 368).

Healy and Wahlen (1999) suggest a series of questions that must be answered in order for accounting standard setters to effectively respond to concerns about earnings management. The list includes two questions that bear directly on the current research effort.

- Which accounting standards are used to manage earnings?
- What is the frequency of managers' use of reporting judgment to manage earnings rather than to communicate firm performance to investors (1999, p. 380)?

Existing research provides one response to the first question. Kinney and Trezevant (1997) examine a large sample of COMPUSTAT data spanning the ten-year period 1981 through 1991 and find that the recognition and placement of "special items" in financial reports is consistent with earnings management. Specifically, they report that firms with large changes in reported earnings recognize significantly negative income from special items. Kinney and Trezevant's (1997) findings are consistent with dampening large increases to produce a smooth, upward trend and engaging in "big baths" when earnings decline. Moreover, negative special items are more likely to be highlighted in the financial statements (presumably to emphasize their transitory nature) while positive special items are deemphasized. In short, Kinney and Trezevant's (1997) results clearly point to special items as an earnings management tool.

Practical Aspects of Identifying Earnings Management

Schipper (1989) discusses earnings management in terms of "purposeful intervention" in the financial reporting process while Healy and Wahlen (1999) focus on the use of judgment in structuring and/or reporting transactions. In practice, managers face a wide variety of financial reporting situations and a correspondingly wide variety of opportunities and methods to manage earnings.

At one end of this spectrum are events and transactions that allow management virtually no discretion in terms of accounting and reporting. Natural disasters and accounting rule changes mandated by the Financial Accounting Standards Board (FASB) or SEC fall into this category. When management discretion is a possibility, it may take many forms.

- Companies may elect to enter into or delay a transaction that will influence income. Research and development spending is a commonly cited example of this earnings management strategy.
- Estimates of useful lives and residual values on depreciable assets represent another earnings management opportunity, as do the amounts and timing of inventory write-downs and goodwill impairments. Uncollectible receivables, product returns, and warranty obligations are all examples of estimates supplied by management.
- In some cases, GAAP allows management to freely select one of several possible accounting practices. FIFO versus LIFO inventory accounting and straight line versus accelerated depreciation are examples. Changes from one method to another are also possible in some situations.
- When GAAP specifies accounting treatments based on specific circumstances, management may structure a transaction to achieve the desired result. Leases, for example, can easily be designed to meet the "operating" definition, which avoids recording a liability for future lease payments.
- Similarly, management is often charged with evaluating whether a transaction meets

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the criteria for a particular accounting treatment. In order for an item to be presented as "extraordinary," it must be deemed both unusual and infrequent. Revenue may be recognized on partially completed construction projects if the contract meets certain requirements and progress can be reliably estimated.

- Finally, management has considerable flexibility to determine which items are disclosed as separate line items on the financial statements and how those items are described in captions and footnotes. These so-called "special items" are the primary focus of the current research.

Research Method and Results

Sample Selection and Data Collection

The variety of earnings management strategies available has led researchers to focus on specific issues, such as changes in accounting principle or discretionary accruals. However, the COMPUSTAT database includes a data item identified as "special items" that captures a variety of possible earnings management opportunities. Special items represent "unusual or nonrecurring items presented above taxes by the company." This item *excludes* the three major items for which separate, net-of-tax disclosure is mandated by GAAP: discontinued operations, extraordinary items, and the effects of changes in accounting principle. The term "special items" includes as many as fifteen items that management chooses to present as a separate line item, before income tax expense. Some categories, such as flood, fire, or other natural disasters, are clearly beyond management control. Others are subject to varying degrees of management intervention. Table 1 displays a complete listing of the items included in the COMPUSTAT definition of "special items."

Items 9 and 14 in this listing correspond directly to two of the practices identified by SEC Chairman Arthur Levitt as problems—restructuring charges, and cookie jar reserves (transfers from reserves provided for in prior years). Items 10, 11, and 15 are all write-downs for which management provided estimates of the amount and potentially influenced timing. Items 2, 3, 6, 7, and 13 are transactions that result from management decisions, and item 5 is the direct result of management's assertion that an item is unlikely

TABLE 1
COMPUSTAT DEFINITION OF SPECIAL ITEMS

This item . . . includes . . .

1. Adjustments applicable to prior years . . .
2. After-tax adjustment to net income for the purchase portion of net income of partly-pooled companies when the adjustment is carried over to retained earnings.
3. Current years' results of discontinued operations and to be discontinued.
4. Flood, fire, and other natural disaster losses.
5. Any significant nonrecurring items.
6. Nonrecurring profit or loss on the sale of assets, investments, securities, among others.
7. Profit or loss on the repurchase of debentures.
8. Special allowance for facilities under construction.
9. Transfers from reserves provided for in prior years.
10. Write-downs or write-offs of receivables, intangibles among others.
11. Write-offs of capitalized computer software costs.
12. Interest on tax settlements . . .
13. Relocation and moving expenses
14. Restructuring charges
15. Write-down of assets

Note: The above items are all reported before income tax expense, discontinued operations, extraordinary items, or the effects of changes in accounting principle. In other words, these are items identified by management for separate, line-item disclosure.

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to recur. While no single data item isolates opportunities for management intervention in the financial statements, the term special items clearly incorporates many transactions that are potential tools for earnings management.

The current research examines special items for three portfolios of companies: S&P Industrials, S&P Mid-Caps, and S&P Small-Caps. Data were divided among these three groups in order to identify differences due to size and growth prospects. In addition, companies in these categories are likely to comprise the majority of investments by many mutual funds and direct investors. Therefore, the extent to which these companies may be managing earnings through the use of special items should be of interest to large segments of the investing public.

Data were collected for firms in all three indices (Industrials, Mid-Caps, and Small-Caps) for the period from 1989 through 1998. Income before extraordinary items was also extracted for all firms. Only those firms with complete data for the entire study period were retained in the sample. Eliminating companies with incomplete data reduced the Industrials sample from 376 firms to 173. The Mid-Caps set included 169 of 400 firms with complete data. Of 600 firms in the Small-Caps data set, 229 had complete data for the study period.

Frequency of Special Items

Table 2 summarizes the frequency of special items reporting in all three Index sets from 1989 to 1998. Positive and negative special items are reported separately, as are the percentages of firms reporting special items in each year. Inspection of Table 2 suggests three general observations. First, companies in all three Index sets report large numbers of special items. Second, the number of special items reported is increasing over time, and third, negative special items are much more common than positive special items.

The 173 Industrial companies studied report a total of 944 special items in the ten-year study period. In other words, the average sample firm reported 5.5 special items in ten years. The totals and averages among Mid-Caps and Small-Caps were smaller, but noteworthy. The 169 Mid-Cap companies reported a total of 642 special items (3.8 per company) over ten years. Among Small-Caps, the figures were 764 special items reported by 229 companies (3.3 per company).

While the incidence of special accounting items increased over the study period in all three Index sets, the increase was largest among Industrial companies. The percentage of Industrial companies reporting special items climbed from 48% in 1989 to 71% in 1998. The trends among Mid-Caps and Small-Caps were less pronounced, but still positive. Reports of special items among Mid-Caps and Small-Caps moved from 31% to 53% and from 32% to 42%, respectively.

Negative special items dominated all categories of companies and all time periods. The most recent data in all three Index sets indicated that approximately 80% of special items reported were negative. In only one of the 30 set/years reported in Table 2 did the number of positive special items outweigh the negative total. Mid-Cap companies reported 27 positive and 26 negative special items in 1989. The predominance of negative reports was consistent with the use of special items to manage reported earnings (Kinney and Trezevant, 1997).

Table 3 partitions Industrial companies according to their earnings before special items. In every year, the vast majority of study companies reported positive earnings before special items.[1] Despite this imbalance, the data reported in Table 3 suggest that

(1) negative special items were more common among both profitable and unprofitable companies; and

(2) the tendency to report negative special items was greater among unprofitable companies than among those that were otherwise profitable.

On average, among companies with positive earnings before special items, 68.4% of special items reported were negative. The corresponding statistic for companies with negative earnings before special items was 82.8%.

Repeated Reports of Accounting Special Items

The statistics in Table 4 highlight one of the most striking findings

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TABLE 2
FREQUENCY OF REPORTED SPECIAL ITEMS PER YEAR: 1989 - 1998

Industrials: 173

Year	Positive	%	Negative	%	Annual Total	% (of 173)
1989	41	49.4	42	50.6	83	48.0
1990	20	25.3	59	74.7	79	45.7
1991	20	25.3	59	74.7	79	45.7
1992	27	31.4	59	68.6	86	49.7
1993	25	27.2	67	72.8	92	53.2
1994	25	28.4	63	71.6	88	50.9
1995	30	31.6	65	68.4	95	54.9
1996	31	30.1	72	69.9	103	59.5
1997	32	27.6	84	72.4	116	67.1
1998	22	17.9	101	82.1	123	71.1
Total	273	28.9	671	71.1	944	

Mid Caps: 169

Year	Positive	%	Negative	%	Annual Total	% (of 169)
1989	27	50.9	26	49.1	53	31.4
1990	20	31.3	44	68.8	64	37.9
1991	10	18.5	44	81.5	54	32.0
1992	16	34.0	31	66.0	47	27.8
1993	16	27.1	43	72.9	59	34.9
1994	15	26.3	42	73.7	57	33.7
1995	15	23.4	49	76.6	64	37.9
1996	26	35.6	47	64.4	73	43.2
1997	31	37.8	51	62.2	82	48.5
1998	20	22.5	69	77.5	89	52.7
Total	196	30.5	446	69.5	642	

Small Caps: 229

Year	Positive	%	Negative	%	Annual Total	% (of 229)
1989	24	32.9	49	67.1	73	31.9
1990	27	35.5	49	64.5	76	33.2
1991	20	29.4	48	70.6	68	29.7
1992	24	36.4	42	63.6	66	28.8
1993	20	27.4	53	72.6	73	31.9
1994	16	25.4	47	74.6	63	27.5
1995	20	25.3	59	74.7	79	34.5
1996	22	25.3	65	74.7	87	38.0
1997	19	23.2	63	76.8	82	35.8
1998	17	17.5	80	82.5	97	42.4
Total	209	27.4	555	72.6	764	

of this research—the widespread practice of reporting multiple special items over relatively short time periods. Again, the largest firms were most visible in the analysis. Over the course of the ten-year period under study, nearly 65% of the companies in the S&P Industrial set reported five or more special items. The corresponding percentages among Mid-Caps and Small-Caps were 28.4% and 29.1%, respectively. Nearly one-fourth of the Industrial companies reported eight special items in ten years, and eleven of the 173 companies reported a special accounting item in every year of the study period!

Results were similar when the data were partitioned into five-year periods. Approximately half the companies in the Industrial set reported special accounting items in three or more of the five years from 1989 to 1993. In the more recent five-year period (1994-1998), the total jumped to 66.5%. The trend was similar among companies in the Mid-Caps set. Between 1989 and 1993, 26% of the companies studied reported three or more special items. From 1994 to 1998, 36.7% had three or more special items. Among the Small-Caps, the data were mixed. The number of companies reporting three or more special items remained relatively constant, moving from 26.3% in the early period to 27.9% in the later period. However, the number of Small-Caps reporting *no* special items dropped dramatically from 73 (31.9%) to only 45 (19.7%).

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TABLE 3
SPECIAL ITEMS PARTITIONED BY EARNINGS BEFORE EXTRAORDINARY ITEMS (INDUSTRIALS)

Firms With Positive Earnings Before Extraordinary Items

Year	Number of Firms	Total Special Items	Positive Special Items	%	Negative Special Items	%
1989	165	77	39	50.6	38	49.4
1990	163	70	20	28.6	50	71.4
1991	162	70	19	27.1	51	72.9
1992	161	77	27	35.1	50	64.9
1993	166	89	24	27.0	65	73.0
1994	167	83	24	28.9	59	71.1
1995	168	91	29	31.9	62	68.1
1996	169	100	31	31.0	69	69.0
1997	167	111	30	27.0	81	73.0
1998	160	112	22	19.6	90	80.4

Firms With Negative Earnings Before Extraordinary Items

Year	Number of Firms	Total Special Items	Positive Special Items	%	Negative Special Items	%
1989	8	6	2	33.3	4	66.7
1990	10	10	1	10.0	9	90.0
1991	11	9	1	11.1	8	88.9
1992	12	9	0	0.0	9	100.0
1993	7	3	1	33.3	2	66.7
1994	6	5	1	20.0	4	80.0
1995	5	4	1	25.0	3	75.0
1996	4	3	0	0.0	3	100.0
1997	6	5	2	40.0	3	60.0
1998	12	11	0	0.0	11	100.0

Conclusions

The results reported in this article demonstrate that publicly-traded companies are reporting unprecedented numbers of special items in their financial statements. The trend is toward more special items over the period from 1989 to 1998, and the largest companies are the most likely to report special items. Negative special items are the most common among both profitable and unprofitable companies, regardless of size. This imbalance is even more pronounced among companies that report losses before special items. Finally, the number of companies reporting multiple special items in relatively short periods of time suggests that special items are neither unusual nor infrequent. Not all of the items reported in this category are discretionary. However, these findings, along with prior research, provide strong evidence that many companies use special items to manage reported earnings. While some managers argue that the current scrutiny of reporting practices is an over-reaction, SEC officials maintain that earnings management has reached unacceptable levels and must be reduced for the protection of the investing public (MacDonald, 1999b). Preliminary reports suggest that the crackdown may be having an effect. MacDonald (1999c) reports that volume of restructuring charges (a special item under current accounting rules) dropped by nearly one-fourth in the wake of the SEC's campaign to curb earnings management.

In addition to provoking unwelcome regulatory scrutiny, managers who interfere with the financial reporting process run the risk of unfavorable reactions in the capital markets. Dechow and Skinner (2000) associate earnings management with disappointing earnings in subsequent periods, systematic underperformance in the equity markets, increases in bid-ask spreads, declines in analyst following, increases in short interest, and increased dispersion in analyst forecast errors. Investors may be fooled in the short run by relatively simple manipulations, but the evidence suggests that market participants punish companies for managing earnings when the practice is discovered (Dechow and Skinner, 2000).

The bottom line is management credibility. Earnings management is a fact of life in corporate

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TABLE 4
FIRMS REPORTING MULTIPLE SPECIAL ITEMS

Ten year period: 1989-1998

Special Items Reported	Industrials	%	Mid Caps	%	Small Caps	%
0	7	4.0	16	9.5	24	10.5
1	8	4.6	17	10.1	28	12.2
2	12	6.9	25	14.8	37	16.2
3	15	8.7	27	16.0	41	17.9
4	19	11.0	27	16.0	32	14.0
5	21	12.1	15	8.9	23	10.0
6	27	15.6	13	7.7	25	10.9
7	22	12.7	10	5.9	12	5.2
8	19	11.0	9	5.3	1	0.4
9	12	6.9	9	5.3	6	2.6
10	11	6.4	1	0.6	0	0.0
	173	100%	169	100%	229	100%
Total Special Items		**944**		**642**		**764**

Five year period: 1989-1993

Special Items Reported	Industrials	%	Mid Caps	%	Small Caps	%
0	26	15.0	48	28.4	73	31.9
1	33	19.1	40	23.7	51	22.3
2	28	16.2	37	21.9	45	19.7
3	35	20.2	20	11.8	32	14.0
4	30	17.3	17	10.1	21	9.2
5	21	12.1	7	4.1	7	3.1
	173	100%	169	100%	229	100%
Total Special Items		**419**		**277**		**356**

Five year period: 1989-1993

Special Items Reported	Industrials	%	Mid Caps	%	Small Caps	%
0	13	7.5	28	16.6	45	19.7
1	18	10.4	35	20.7	56	24.5
2	27	15.6	44	26.0	64	27.9
3	43	24.9	20	11.8	36	15.7
4	36	20.8	28	16.6	24	10.5
5	36	20.8	14	8.3	4	1.7
	173	100%	169	100%	229	100%
Total Special Items		**525**		**365**		**408**

America, special items are a popular earnings management tool, and participants in the capital markets are waking up to the fact. Managers must weigh the possible short-term benefits of abusing special item reporting against the almost certain long-term erosion of credibility with the investing public. Financial analysts want better disclosure in both good and bad times and make a strong connection between the rationale for accounting choices and the credibility of financial reports (Epstein and Palepu, 1999). Miller (2001) urges companies to adopt "quality financial reporting" as a strategy for lowering the cost of capital, increasing real income, and generating higher security prices. Careful consideration of policies for reporting restructuring charges and other accounting special items is a must for companies that seek the benefits of a quality financial reporting strategy.

Endnote

1. The ratio of profitable versus unprofitable companies most likely reflects a survivor bias. Companies reporting positive earnings would more likely survive the entire study period than those reporting losses.

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