



**CGA Accounting Research Centre and The AFI Section
DISTINGUISHED SPEAKER SERIES**

Professor Desmond Tsang
McGill University



Profile:

Professor Tsang was appointed as Assistant Professor of Accounting since 2006. He began his career in the auditing department at Deloitte and Touche in Hong Kong and later worked as an economist at the Ontario Ministry of Finance in Canada. His research interests include: Earnings Management; Corporate Governance; Analyst Forecast; International Financial Reporting Standards; Real Estate Investment Trusts; and International Real Estate Issues. Professor Tsang has published in journals such as Real Estate Economics and Journal of Real Estate Finance and Economics and has presented his research findings at conferences in the US, Europe and Asia. Professor Tsang is also a Certified Public Accountant (CPA) and has completed all levels of the Certified Financial Analyst (CFA) exams.

Topic: «SEC Intervention and Industry Guidance: The Effect on Non-GAAP Financial Disclosures »

Abstract:

This paper examines how the U.S. Securities and Exchange Commission (SEC) intervention in 2003 regarding non-GAAP disclosures affects the reporting of Funds from Operations (FFO), an industry-guided non-GAAP performance measure commonly reported by Real Estate Investment Trusts (REIT). We find that, contrary to the results of prior studies of pro forma earnings, the SEC intervention does not deter the reporting of FFO. Nonetheless, we show that the quality of FFO disclosures improves significantly subsequent to additional disclosure requirements and increased scrutiny by the SEC in 2003. In particular, we find that (1) companies are more likely to follow the industry guidance in defining FFO; (2) all exclusions from FFO have become more transitory following the SEC intervention; and (3) companies are less likely to manage the FFO measure to beat or meet analysts' forecasts. Lastly, we examine investors' perceptions regarding the usefulness of the FFO measure and find that the market perceives FFO as being more value relevant following the intervention of the SEC. Collectively, our findings suggest that, with sufficient industry guidance, the SEC can best achieve its objectives of improving the quality of non-GAAP reporting without the unintended consequences of deterring firms from reporting value relevant non-GAAP information.

TIME: 2:00 -3.30 p.m. Friday, October 23, 2009

PLACE: Desmarais, Room 7136

**For more information, please, contact Ludmila Pauk at CGA-ARC room 7102 or
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Details:

As part of the CGA Accounting Research Centre series of distinguished speakers , Professor Desmond Tsang, of Mc Gill University , presented a discussion of his research paper on ” SEC Intervention and Industry Guidance: The Effect on Non-GAAP Financial Disclosure”. Specifically the paper examines how the US Securities and Exchange Commissions (SEC) intervention in 2003 regarding of Funds From Operation (FFO), an industry guided non-GAAP performance measure commonly reported by Real Estate Investment Trusts (REIT).

The SEC intervened with Regulation G in 2003 with a requirement for full disclosure if earnings were reported without full employment OF GAAP. Some 82 % of firms in the REIT group reported some form of FFO without full adherence to GAAP. Opponents to this approach referred to FFO as “earnings before bad staff “hence the need for SEC intervention.

Firms in the REIT group in order to qualify for the title must invest 75% in real estate assets and a dividend payout is required at 90%.The FFO concept that they use , based on industry evidence, measures earnings but in doing so eliminates depreciation in calculations as well as losses/gains from extraordinary items and some other measures. At times the differences between normally computed net income and FFO can be significant.

The objectives of the study were to examine none the US SEC intervention affected the reporting of FFO from firms in the REIT group.

To support the conclusion of the paper a series of three hypotheses was analyzed and confirmed through the use of mathematical model. The hypotheses were:

- The frequency of firms reporting FFO declined subsequent to the SEC intervention.
- The adoption of SEC disclosure requirements reduced the incidence of opportunistic behavior in the measurement of FFO
- The FFO measure is more value-relevant following the SEC intervention.

While the study concludes that the quality of disclosure improved significantly subsequent to the promulgation of the SEC disclosure requirement, a number of specific findings were also possible:

1. Companies are more likely to follow the industry guidance in defining FFO.
2. All exclusions from FFO have become more transitory.
3. Companies are less likely to manage the FFO measure to beat or meet analysts’ forecasts
4. The market perceives the FFO measure as now being more value- relevant.

Generally, the findings of the study suggest that, with sufficient industry guidance, the SEC can best achieve its objective of improving the quality of non - GAAP reporting without the unintended consequences of deterring from reporting value-relevant non - GAAP information.