ARTICLE IN PRESS

China Journal of Accounting Research xxx (2017) xxx–xxx

HOSTED BY

ELSEVIER

Contents lists available at ScienceDirect

China Journal of Accounting Research

journal homepage: www.elsevier.com/locate/cjar

The effect of non-recurring items on analysts' earnings forecasts

Nan Li[a,*], Hongtong Su[b], Wanqing Dong[c], Kai Zhu[b]

[a] School of Accountancy, Shanghai University of Finance Business and Economics, China
[b] School of Accountancy, Shanghai University of Finance and Economics, China
[c] China Securities Regulatory Commission Shanghai Commissioner's Office, China

ARTICLE INFO

Article history:
Received 21 January 2016
Accepted 26 October 2017
Available online xxxx

Keywords:
Non-recurring items
Earnings forecasts
Revisions

ABSTRACT

This article discusses the effects of non-recurring profits and losses on statement users' decision-making processes from the perspective of securities analysts. We examine the relationship between analysts' forecast revisions and firms' non-recurring earnings. We find that 1) non-recurring gains and losses can influence analysts' earnings forecast revision; 2) compared with non-recurring items resulting from policy changes, analysts are more concerned about those attributed to changes in business scope; 3) if listed companies use non-recurring items to turn losses into gains during earnings management, it will weaken the effects of non-recurring items on analysts' earnings forecast revision. The results suggest that non-recurring items that result from changes in business scope incorporate information that users need for the future operation of the business. This article verifies the information relevance of non-recurring items and provides evidence for the necessity of non-recurring item disclosure.

1. Introduction

This paper examines the effect of the disclosure of non-recurring items and their characteristics on analysts' forecast revisions. Unlike earnings generated from continuous operation, non-recurring items are one-time and contingent. The CSRC announcement "Explanatory Announcement No. 1 of Corporate Information Disclosure on Public Issuance of Securities - Non-recurring items (2008)" defines non-recurring items as

* Corresponding author at: No 1900, Wenxiang Road, Songjiang District, Shanghai, China.
E-mail addresses: nanmv1@163.com (N. Li), 840440692@qq.com (H. Su), innereden@163.com (W. Dong), aczhuk@mail.shufe.edu.cn (K. Zhu).

https://doi.org/10.1016/j.cjar.2017.10.001
1755-3091/

Please cite this article in press as: Li, N., et al. The effect of non-recurring items on analysts' earnings forecasts. China Journal of Accounting Research (2017), https://doi.org/10.1016/j.cjar.2017.10.001

"earnings from transactions and events which are not directly related to normal business, or related to normal business but influence statement users' decisions in the corporation's business performance and profitability due to its special nature and contingency." Questions arise from this: do the non-recurring items influence statement users' value judgments, and if so, how?

The literature has mainly focused on whether non-recurring items can be used to manipulate corporate earnings (Jaggi and Baydoun, 2001; McVay, 2006). In terms of the role non-recurring items played in statement users' decisions, research has mainly focused on the correlation between non-recurring items and stock price. Some researchers hold the view that the information involved lacks consistency. In that case, non-recurring items have no incremental information for the capital market (Nichols, 1973; Ramakrishnan and Thomas, l998; Castagna and Matolcsy, 1989). Yang (2008) and Cready (2010) discovered that various non-recurring items differed in consistency, which brought differences in value relevance.

Using analysts' forecast revisions as proxy for the information process outcome, this paper investigates the effect of non-recurring items on statement users' decision-making processes. As a group of statement users who possess professional knowledge, securities analysts predict the corporation's future earnings level and provide investment advice. If non-recurring items are one-time, contingent and have no influence on the corporation's future profitability, analysts will not revise future earnings forecasts. However, if non-recurring items contain information about the corporation's future earnings changes, the analyst will revise earnings forecasts accordingly.

This paper uses Chinese A-stock companies in the Shenzhen and Shanghai security markets from 2009 to 2013 as a research sample to investigate the relationship between non-recurring items and analysts' forecast revisions. The empirical results suggest the following. (1) Analysts revise earnings forecast upwards when non-recurring gains occur, and do not revise earnings forecasts when non-recurring losses occur. The revision is asymmetric. (2) Due to changes in business scope, non-recurring items incorporate more information for analysts to revise earnings forecasts than other items. (3) When listed companies use non-recurring items to turn losses into gains for earnings management, analysts can see through this manipulation and revise the forecasts downward.

We conclude that non-recurring items incorporate information about corporate future earnings, but non-recurring items of different types and from different sources have different effects on analysts' earnings forecast revision. Therefore, disclosure of non-recurring items is consistent with the requirements of statement users. This paper also provides empirical evidence for the further improvement of methods for disclosing non-recurring items.

The remainder of the paper is organized as follows. Section 2 provides the institutional background, literature review and development of hypotheses. Section 3 describes our data and empirical methodology. Section 4 reports the empirical results and analyses. Section 5 concludes the paper.

2. Institutional background and theoretical analysis

2.1. Institutional background

Accounting theory holds that there are differences between recurring items and non-recurring items, and countries disagree on how to disclose non-recurring items. The U.S. Financial Accounting Standards Board (FASB) requires companies to recognize non-recurring items based on their business scope. In contrast, the accounting standard for non-recurring items in China is more standardized and consistent. In 1999, the CSRC clarified the concept and disclosure requirements of non-recurring items for the first time, and it has subsequently adjusted the definition of non-recurring items and disclosure requirements for several items.

In terms of items included, the CSRC first defined specific items of non-recurring gains and losses in 2001, which were divided into identified items and presumed items. In 2004, the CSRC canceled the classification and adjusted the specific items of non-recurring gains and losses. In 2007, the CSRC removed three obsolete items and added certain items such as net profit of subsidiaries under common control for the current period from the beginning to the merger date, restructuring costs such as employee resettlement expenses and integration costs, and gains and losses arising from estimated liabilities unrelated to the company's main business. Meanwhile, the CSRC adjusted the scope of items such as asset disposal income, government subsidies, asset

Please cite this article in press as: Li, N., et al. The effect of non-recurring items on analysts' earnings forecasts. China Journal of Accounting Research (2017), https://doi.org/10.1016/j.cjar.2017.10.001