Transitory Earnings Components, Earnings Thresholds, and Non-GAAP EPS

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Abstract

Financial Reporting Standard No. 3: Reporting Financial Performance allows UK firms the option of reporting customized earnings per share (EPS) constructs alongside GAAP EPS on the face of their profit and loss statement. Over 70 percent of UK non-financial firms currently report at least one such number. Consistent with expectations, we find the probability of adjusted EPS disclosure is higher when GAAP EPS provides a relatively poor indicator of underlying sustainable performance. We also find that the incidence of negative earnings changes and negative earnings surprises is significantly associated with firms’ decision on adjusted EPS disclosure. These findings are evidence that UK firms report non-GAAP EPS information when value irrelevant items drive a wedge between GAAP EPS and sustainable earnings, and when GAAP EPS fall short of key earnings benchmarks.