Investors Use of Accounting Estimates during Macroeconomic Uncertainty

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Economic Uncertainty and Financial Reporting

A User’s Perspective – Sell-Side Equity Research

- Economic uncertainty leads to lower confidence in outlook
  - Management teams are more reluctant to provide guidance
  - Negatively impacts investor sentiment
  - Raises corporate’s cost of capital

- From a financial reporting perspective, uncertainty reduces the utility of historical financial statements
  - Prior period not an accurate reflection of the anticipated future economic conditions

- An Example – Impact of inflation on outlook:
  - More difficult to forecast
  - Wider dispersion of estimates
  - Less certainty
  - Lower multiples: Empirical evidence of a negative correlation between P/E’s and (expected) inflation
Economic Uncertainty and Financial Reporting

What Can Professional Accountants Do to Alleviate Banking Scandals?

• **Capital Markets/Banking Sector Has Been Rife with Scandals**
  - The Financial Crisis was not the end of scandals in the world of banking
  - Current predicament of Credit Suisse highlights the ongoing issues
    - I fully admit that Barclays has hardly been a paragon of virtue

• **Accountants Need to Retain a High Degree of Skepticism**
  - Accountants and Auditors need to use judgement
  - Users of financial statements must put reporting in context
    - Be aware of underlying motives and incentives