# ON THE ASSOCIATION BETWEEN VOLUNTARY DISCLOSURE AND EARNINGS MANAGEMENT


## Abstract

This paper investigates the extent to which managers use their accounting discretion to reduce the costs associated with voluntary disclosure in general, and with management forecast errors in particular. The empirical findings are consistent with the prediction that managers, fearing costly legal actions by shareholders and loss of reputation for credibility, use positive discretionary accruals to manage reported earnings upward when realized earnings fall below their publicly disclosed earnings projections. Results also suggest that the magnitude of discretionary accruals for these firms is associated with proxies for expected litigation costs, i.e., the likelihood of a 10b-5 lawsuit and/or the amount of damages potentially awarded to plaintiffs. Further analysis indicates that the positive discretionary accruals identified for the firms whose managers have overestimated earnings do not seem to reflect the effect of competing earnings management incentives, nor the effect of the potential simultaneity between management's decisions to issue an earnings forecast and to manage reported earnings. Contrary to the findings for the firms whose managers have overestimated earnings, there is no evidence that managers who have underestimated earnings manage reported earnings downward. In fact, managers who have underestimated earnings are twice as likely to revise their earnings forecasts than managers who have overestimated earnings, suggesting these managers prefer forecast revision as a way to mitigate their forecasting errors.