Information Risk and Fair Values: Further Evidence

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Abstract

This paper investigates whether less verifiable fair values are associated with longer earnings announcement and audit report lags, respectively. The results reveal that less verifiable fair value assets are positively related to earnings announcement delays and audit report delays, respectively, since the reliability of some unobservable inputs employed in measuring fair values may create uncertainty in the market and increases information risk between management and investors. In the robustness tests, the results show a positive relation between the change in level 3 fair value asset and reporting lags. A clear picture of how the change in fair value magnitude influences reporting lags may be obtained through a longer period examination. In practice, our results provide evidence that a firm cannot release information in time if a firm adopts previously unclear accounting treatment before ASU 2011-04 issued by FASB, since the previous accounting treatment gave managers a chance to increase the amount of level 3 fair value assets. Thus, it should be helpful for firms or auditors to follow the clear measurement procedure, ASU 2011-04. Audit firms should be aware of the risk and influence of level 3 fair value assets on audit reporting lags and develop better audit technology or carefully evaluate the risk from these assets in client screening. We provide new evidence to regulators that SFAS 157 fair value hierarchy disclosures are differently associated with earnings announcement and audit report lags. Regulators should consider the impact of less verifiable fair values on timely financial reporting in future policy setting, such as ASU 2011-04.

Keywords: Fair values, Reporting timeliness, Information risk, Earnings announcement lag, Audit report lag