

Full Length Research Paper

The impact of non-accrued contingent liability on the equity market value of Brazilian companies

Amaury José Rezende^{1*}, Flávia Zóboli Dalmácio² and Frederico Nilsen¹

¹University of São Paulo, Ribeirão Preto, Av. Bandeirantes, 3900 – Monte Alegre – Ribeirão Preto, SP, Brazil – 14040-900.

²University of São Paulo – São Paulo, Av. Prof. Luciano Gualberto, 908, FEA-3 – Cidade Universitária – São Paulo, SP, Brazil – 05508-010.

Accepted 16 April 2012

This study investigates the relation between equity market value and nonaccrued contingent liability that is disclosed in the footnotes but it is not recognized in net income. The analyses focus on whether the prices of shares in the stock market and the return's expectation of market react by the disclosure of non-accrued contingent liability in footnotes. 3.180 footnotes were analyzed from periods 2006 to 2010 of 159 companies of different sectors, in twenty quarterlies. These companies are listed in different corporate governance's levels of the São Paulo Stock Exchange. This study shows that the disclosure of non-accrued contingent liability in the footnotes is perceived by share price. In particular, the findings were consistent with the results of previous research that found that stock options are viewed as expenses and they are negatively associated with share price. The findings indicate that investors view the disclosure of non-accrued contingent liability as expense of the firms that reflect in their valuation assessments. This suggests that managers believe that even though nonaccrued contingent liability to be disclosed in the footnotes and not recognized as expense, it is relevant to financial statement users.

Keywords: Non-accrued Contingent Liability, Deliberation N° 489/05 of the Brazilian Securities and Exchange Commission (CVM), Timeliness of Share Price.

INTRODUCTION

The objective of this study is to understand to relation between equity market value and non-accrued contingent liability that is disclosed in footnotes but not recognized in net income, under Deliberation N° 489/05 of the Brazilian Securities and Exchange Commission (CVM) and Statement NPC N° 22 of the Brazilian Institute of Auditors (IBRACON, 2005). Accounting for contingent liability, specifically the provision contingent liability, has been controversial financial reports issues, because debate among accounting, managers, auditors, lawyers, regulators and accounting standard setters. The focus of discussion on issues whether the estimation of the value

of provision of contingent liabilities represent the level of risk of the transactions realized by enterprises. The lawyers and auditors have discusses whether it can be measured reliably enough as an expense of the firm, same than disclosed in off balance sheet (in the footnotes).

Specifically, the analyses focus on whether the prices of shares in the stock market and the return's expectation of market react by the disclosure of non-accrued contingent liability in footnotes. It is based on estimates of realization, which depend on expectations about the future.

The findings indicate that investors view the disclosure of non-accrued contingent liability as expense of the firm that reflected in their valuation assessments. It was found a significant negative relation between (Panel 1, 2, and 3) non-accrued contingent liability variable and share price. These results can to indicate that the investors view and understand this type information as a risk potential that can be realized in the future. These results are adherents as prior researches which analyze the effects of disclosed expenses in the footnotes, for example Gopalakrishnan (1994), Rees and Stott (1998), Li (2002); Bell et al (2002) and Belzile et al (2006).

The criteria adopted by firms to estimate the provision represents a recommendation of International Accounting Standards Boards (IASB). It argues that "a provision shall be recognized when: (a) An entity has a present obligation (legal or constructive) as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognized. If these conditions are not met, no provision shall be recognized" (IAS 37, par. 14).

Further, Brazilian accounting law requires firms that participate in the capital market to adopt the recommendations of the CVM and IASB.

IASB defines a contingent liability as " (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognized because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability" (IAS 37, par. 10).

This paper proceeds as follows. The next section summarizes discussion about disclosure of accounts off balance Sheet and it discusses the possible effects of understate CVM's Deliberation N° 489/05 to classify a contingent liability and related research. The section 3 outlines the research design. The section 4 describes the data and descriptive statistics. The sections 5 and 6 present the findings and the section 6 concludes.

LITERATURE REVIEW

Disclosure Accounts off Balance Sheet

In some cases, companies should disclose information that is up the net income, but that in the future will impact on their results. This obligation imposed by law is a way to reduce information asymmetry, which, according to Hendriksen and Breda (1999), occurs when one of the

parties of a transaction has more information than another.

As an example of this situation, can cite the treatment of contingent liabilities in Brazil and the stock option-based compensation in the USA. According to Aboody et al. (2006), accounting for stock option-based compensation is specified in Accounting Principles Board Opinion (APB) No. 25 (APB, 1973)¹ and SFAS 123². If a firm measures the expense under APB 25, SFAS 123 requires disclosure of pro forma net income, which is what net income would have been had SFAS 123 expense been recognized.

In this context, the Brazilian case, depending on the probability of occurrence of contingent liabilities, they are accrued or only disclosed in footnotes (non-accrued). The effect of non-accrued contingent liabilities, in relation to the Brazilian capital market, needs study. The Brazilian Accounting' rules recommend that determined transactions those envelopment high levels of risk should be recognized and disclosed in the off balance sheet, since that there are high levels probability's realization.

The enterprises in the Brazil should to follow the rules of CVM's Deliberation N° 489/05 to classify a liability contingent. The CVM's Deliberation N° 489/05 divides the contingent liabilities in three groups:

Probable – the companies need to disclose the provision account in the balance sheet and the results of periods.

Possible – the companies do not need to disclose the provision account neither balance sheet or results of periods. However, the companies are required to report an estimate of possible loss in footnotes.

Remote - the companies are not required to provision neither report it.

Similarly as research of Aboody et al (2004), the objective of this study is to determine whether the measuring reliability problems are sufficient to render non-accrued contingent liability as expense valuation relevant to disclose it. In this context, Williams and Gonçalves (2007) argue that there is a criteria's lack to define and to analyze of contingent expenses. They affirm that this facts have been classified of away equivocated concern to of risks judgment to companies and are resultant in estimative higher than that the prior.

Related Research

This study examines the value relevance of the disclosed

¹ Under APB 25, stock option-based compensation expense is based on the difference at the measurement date between the stock price and option exercise price. Because for most fixed option grants the exercise price equals the stock price at the date of grant, the expense under APB 25 typically equals zero.

² Under SFAS 123, the expense is calculated based on the option's fair value at grant date, and is not adjusted for subsequent changes in value. SFAS 123 expense is grant-date option value multiplied by the number of granted options, amortized over the vesting period.

pro forma expense, more specifically, the potential non-accrued contingent liability. The evidence from prior studies generally suggests that the disclosures in the footnotes are perceived as expenses and they are value relevant and incorporated into share prices.

Gopalakrishnan (1994) investigate if investors, in determining security prices, differentiate between information recognized in the balance sheet and that disclosed in the footnotes. The findings indicate that investors appear to consider pension information disclosed in the footnotes as value-relevant, given that an accrued (prepaid) pension liability (asset) is also recognized in the balance sheet. Second, investors attach equal importance to both sorts of pension information.

Rees and Stott (1998) employ pro-forma company footnote disclosures to assess the value-relevance of employee stock option compensation expense using the fair value method as stipulated by Statement of Financial Accounting Standard No. 123. They find a significant association between the disclosed compensation expense using the fair value method and firm value. This result implies that the disclosed employee stock option expense is a value-relevant measure and the incentives derived from employee stock option plans provide value-increasing benefits to the firm.

Li (2002) provides a theoretical analysis and empirical investigation of the valuation implications of employee stock options. The empirical results indicate the existence of a cross-sectional negative association between share prices and both outstanding employee stock options and expected stock option expense. Li (2002) find that SFAS 123 footnote disclosures at 10-K filings communicate useful information about employee stock options to investors.

Bell et al. (2002) investigate the relation between share price and SFAS No. 123³ expense and they find an insignificant relation between share price and their stock-based compensation expense variable for a sample of profitable computer software firms. But, according to Aboody et al. (2004) these results for computer software firms could not be extend to other industries.

Aboody et al. (2004) investigate the relation between share price and stock-based compensation expense that is disclosed but not recognized under Statement of Financial Accounting Standards (SFAS) No. 123, controlling for net income, equity book value and expected earnings growth. They find stock options are viewed as an expense and are negatively associated with share price. They find that investors view SFAS No. 123 (stock-based compensation) expense as an expense of the firm,

and as sufficiently reliable to be reflected in their valuation assessments.

Belzile et al. (2006) examine whether changes in the way stock option compensation is reported (recognition as an expense in the income statement or note disclosure of pro forma net income and earnings per share) affect financial statement users' judgments and investment decisions. The results indicate that the reporting method does indeed significantly influence subjects' judgment of the expected stock price direction, but has no material influence on their investment decisions.

Laux and N'Dir (2007) investigate market reaction to SFAS 123 Revised, which requires companies to recognize the fair value of employee stock options as expense on the income statement. Using a sample of 128 firms for the 2004 and 2005 periods, they find that markets have efficiently incorporated information formerly disclosed only in footnotes to the financial statements, effectively nullifying the argument that formally recognizing the expense would have a deleterious effect on stock prices of firms offering this type of compensation. The results indicate that the market values stock-based compensation expense efficiently whether disclosed or recognized formally in the financial statements.

Niu and Xu (2009) examine the market valuation of employee stock option expenses recognized by using the fair value approach under the Canadian Institute of Chartered Accounts Handbook section (CICA HB) 3870. Based on a sample of Canadian public firms traded on the Toronto Stock Exchange (TSX), they find that investors value employee stock option expenses differently prior to and after the implementation of the new standard. Specifically, pro forma compensation expenses disclosed prior to the new accounting regulation are negatively associated with annual stock returns, suggesting that the market interprets these expenses to have negative valuation consequences. In contrast, recognized stock option expenses from using the fair value approach mandated by the CICA HB 3870 are positively associated with stock returns, indicating that the market now interprets these expenses as a type of "asset" that contributes positively to firm valuation.

Hitz (2009) investigates the incidence and motives for disclosure of so-called 'pro forma earnings' – voluntarily disclosed earnings metrics that modify the bottom-line number of the income statement to arrive at a (more) representative income presentation. The results indicate that firms make extensive use of so-called earnings before-metrics and, more importantly, of pure non-GAAP performance measures, both in terms of frequency and reporting emphasis. This is accompanied by a low average level of transparency for non-GAAP adjustments. Multivariate analysis of determinants yields that both informative and strategic motives drive pro forma earnings disclosure decisions, and that recent regulatory recommendations have had no discernible impact.

³ SFAS No. 123 requires firms to disclose (in footnotes to the financial statements) the pro forma effects on earnings of employee compensation expense attributable to amortizing the fair value of employee stock options at the grant date. However, SFAS No. 123 does not generally require firms to recognize this employee stock options related compensation expense in the income statement, although it encourages firms to do so (Bell et al, 2002).

MATERIALS AND METHODS

The first set of tests focuses on determining whether expenses disclosed in footnotes under CVM's Deliberation N° 489/05 and IBRACON's Statement NPC N° 22 explain disclosed option value estimates of the firms. In particular, the inferences were based on the following equation:

$$P_{it} = \alpha_1 BV_{it} + \alpha_2 NI_{it} + \alpha_3 ACL_{it} + \alpha_4 NACL_{it} + \alpha_5 ASSET_{it} + \sum_{a=2}^{11} \delta_a Q_{it} + \sum_{s=2}^{19} \gamma_s S_{it} + \sum_{cg=2}^2 \xi_{cg} CG_{it} + e_{i,t} \quad (A)$$

P_{it} is share price, BV_{it} is equity book value, NI_{it} is net income, ACL_{it} is accrued contingent liability, $NACL_{it}$ is non-accrued contingent liability⁴, $ASSET_{it}$ is the assets value. All variables were measured at quarterly-end and fiscal year-end i and t denote firm and period.

Three control's variables were imputed: periods (Q); industry or sector (S); and corporate governance's level (CG). Q is period dummy variable; S is sector or industry dummy variable; and CG is corporate governance's level dummy variable which equals 1 (one) if firm i is in the Level 1, Level 2 or New Market of corporate governance's levels of the BOVESPA and zero otherwise. Subscripts i and t denote firms and period.

Thus, the estimate (Equation A) permits to test whether the effects of $NACL_{it}$ (non-accrued contingent liability) are associated with the variation of the P_{it} (share price) of firms. Besides three vectors of control variables were included, which also are described.

The first analyses were based on a model deflated by number of shares outstanding and at the end of the year which comprises following variables BV, NI, ACL, NACL and ASSETS. All equation was estimated using robust regression.

The model (A) is consistent with Ohlson (1995), because Liu and Ohlson (2000) and Ohlson (2001) show that the expected future abnormal earnings are reflected in equity price before they are reflected in equity book value and net income.

The operational earning of firm does not include the expense of NACL. Thus, it is expected which ACL can capture the impacts associated disclosed NACL in the footnotes (off balance sheet) not reflected in net income.

It is believed that expense as NACL can be likely related with expectative of growth operational income. Based on prior research, it was also predicted α_1 , α_2 , and α_3 are positive. Thus, if investors view NACL as a future expense of the firms, and to the extent that any effect associated or reflected on net income, equity book value, and expected earnings grow, thus it was predicted α_4 with signal negative.

To investigate whether disclosed NACL in the footnotes (off balance sheet) on a timely base change in investor-perceive costs-perceptive cost associate with expense NACL, it was estimated:

$$RET_{it} = \alpha_1 NI_{it} + \alpha_2 \Delta NI_{it} + \alpha_3 ACL_{it} + \alpha_4 NACL_{it} + \alpha_5 Assets_{it} + \sum_{a=2}^{11} \delta_a Q_{it} + \sum_{s=2}^{19} \gamma_s S_{it} + \sum_{cg=2}^2 \xi_{cg} CG_{it} + e_{i,t} \quad (B)$$

RET_{it} is annual share return and/or quarterly, and Δ denotes annual

4 The liabilities analyzed in this study represent just the liability estimate and disclosed in the footnotes, because the CVM's Deliberation N° 489 and the IBRACON's Statement NPC N° 22 recommend which to account the contingent liabilities only whether the levels of risk is considered possible.

change, ΔNI_{it} is net income, ACL_{it} is accrued contingent liability, and $NACL_{it}$ is non-accrued contingent liability⁵. All variables were deflated by share price at the beginning of quarterly or year i and t denote firm and period.

Data and descriptive statistics

The data for firms were collected in the Economática® Database and the firms listed in the Securities and Exchange Commission of Brazil (CVM, 2008) and in the São Paulo Stock Exchange (BOVESPA, 2008). The firms were ranked by BOVESPA's corporate governance levels. According to these levels of the corporate governance, the firms are divided into three categories: Level 1, Level 2 and New Market.

To identify firms that published non-accrued contingent liability (NACL), were analyzed 3.180 footnotes published off balance sheet. It was selected a sample between 96 to 159 firms with a total of 1.908 observations, during the periods from 2006 to 2010, that comprised 20 quarterly. It was identified that in average 67,15% of firms disclosed non-accrued contingent liability in the footnotes and 91,24% of firms had accrued contingent liability.

The data were collected from financial statements footnotes of firms. It was identified the nature of contingent liabilities, for example: 27,07% civil, 29,45% fiscal, 23,70% and 19,77% other types⁶.

It was used panel data, according to Pindyck and Rubinfeld (2004), Gujarati (2006) e Fávero et al (2009), allows, among other features: increase considerably the sample size; increased number of observations, increasing the degrees of freedom and efficiency of the data; reduction of problems of multicollinearity of explanatory variables; intertemporal dynamic, represented by the mix between the cross-sections and time series; data more informative, and study more complex behavioral models. The sample of work can be considered an unbalanced panel because it has different numbers of observations of court for each year.

RESULTS

Tables 1 and 2 show the summary statistics from the equation 1 and the equation 2.

$$P_{it} = \alpha_1 BV_{it} + \alpha_2 NI_{it} + \alpha_3 NACL_{it} + \alpha_5 ASSET_{it} + \sum_{a=2}^{11} \delta_a Q_{it} + \sum_{s=2}^{19} \gamma_s S_{it} + \sum_{cg=2}^2 \xi_{cg} CG_{it} + e_{i,t}$$

The results of the Equations 1 and 2 (Panel 1 and Panel 2) showed that the model based in the data deflated by number of share outstanding is able to capture the effect that the market give to non-accrued contingent liability in the footnotes. Thus, it seems that the market has absorbed this potential risk (information) and it has

⁵ The liabilities analyzed in this study represent just the liability estimate and disclosed in the footnotes, because the CVM's Deliberation N° 489/05 and the IBRACON's Statement NPC n° 22, recommended to account the contingent liabilities only whether the levels of risk is considered possible.

⁶ Others type represents the contingent liabilities as: environment, customers and suppliers.

Table 1. Summary Statistics from Regression Equation 1 (Panel 1)

PRICE(10)	Coef.	Std. Err.	t-statistic	P> t
BV	0.022477	0.032237	0.70	0.486
NI	0.017093	0.100673	0.17	0.865
ACL	0.010682	0.113726	0.09	0.925
NACL	-0.04793	0.02302	-2.08	0.037**
ASSET	0.056181	0.009425	5.96	0.00*
Constant	4.62449	1.163949	3.97	0.00*
n. Obs.	1678			
Statistic-F	32.78			
(Prob.)	0.000			
R-squared	0.4586			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

PRICE is share price, BV is equity book value, NI is net income, ACL is accrued contingent liability, and NACL non-accrued contingent liability.

In equation 1, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 2, it was considered the average price for 20 days before and after the publication of financial statements.

Table 2. Summary Statistics from Regression Equation 2 (Panel 2)

PRICE(20)	Coef.	Std. Err.	t-statistic	P> t
BV	0.0249479	0.03264	0.76	0.445
NI	0.0115341	0.099698	0.12	0.908
ACL	-0.015192	0.110519	-0.14	0.891
NACL	-0.053768	0.022607	-2.38	0.018**
ASSET	0.0574696	0.009245	6.22	0.00*
Constant	4.442215	1.165904	3.81	0.00*
n. Obs.	1696			
Statistic-F	32.23			
(Prob.)	0			
R-squared	0.4592			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

PRICE is share price, BV is equity book value, NI is net income, ACL is accrued contingent liability, and NACL non-accrued contingent liability.

In equation 1, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 2, it was considered the average price for 20 days before and after the publication of financial statements.

demanded a premium for disclosed risk by the company.

In the Equations 1 and 2, were inserted more three dummies variables as control variables: periods (Q); corporate governance's levels (CG); and sector or industry (S). Therefore, when were added others variable of control the results present better performance. However, just the coefficient of sector or industry dummy variable or sector was not significant.

Tables 3 and 4 show the summary statistics from the equation 3 and equation 4. It was analyzed if NACL has

significant impact for a sample of companies that presented a loss in the periods analyzed.

The results of the Equation 3 and 4 (Panel 3 and 4) indicated that the model deflated¹⁰ too was able to capture the effect that the market gives to non-accrued contingent liability in the footnotes. However, just the coefficient of

¹⁰ All variables were deflated by share price at the beginning of quarterly or year.

Table 3. Summary Statistics from Regression equation (Panel 3)

PRICE(10)	Coef.	Std. Err.	t-statistic	P> t
BV	0.129487	0.057357	2.26	0.026**
NI	0.269126	0.433268	0.62	0.536
ACL	-0.47765	0.242798	-1.97	0.051***
NACL	-0.12381	0.026716	-4.63	0.00*
ASSET	0.088991	0.021689	4.1	0.00*
Constant	-9.46386	3.714809	-2.55	0.012*
n. Obs.	173			
Statistic-F	6.01			
(Prob.)	0			
R-squared	0.8011			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

PRICE is share price, BV is equity book value, NI is net income, ACL is accrued contingent liability, and NACL non-accrued contingent liability.

In equation 3, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 4, it was considered the average price for 20 days before and after the publication of financial statements.

Table 4. Summary Statistics from Regression Equation 2 (Panel 4)

PRICE(20)	Coef.	Std. Err.	t-statistic	P> t
BV	0.1229806	0.054582	2.25	0.026**
NI	0.2129522	0.419676	0.51	0.613
ACL	-0.462843	0.242044	-1.91	0.058***
NACL	-0.121223	0.025101	-4.83	0.00*
ASSET	0.0876447	0.021801	4.02	0.00*
Constant	-9.422475	3.769644	-2.5	0.014**
n. Obs.	174			0.026**
Statistic-F	6.0071			0.613
(Prob.)	0			0.058***
R-squared	0.7998			0.00*

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

PRICE is share price, BV is equity book value, NI is net income, ACL is accrued contingent liability, and NACL non-accrued contingent liability.

In equation 3, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 4, it was considered the average price for 20 days before and after the publication of financial statements.

sector or industry dummy variable or sector was not significant.

It was found that the effects of non-accrued contingent liability on the stock prices have more impacts for companies that have losses. Therefore, in addition, the signal of the coefficient of the variable NACL was as expected and significant.

To investigate whether non-accrued contingent liability reflects on a timely basis in investor perceived associated with this risk. It was used the proposed model by Bushman et al. (2004). Additionally, three control variables

were included: industries, periods, and corporate governance's levels. Thus, the following equation was estimated:

$$RET_{it} = \alpha_1 NI_{it} + \alpha_2 \Delta NI_{it} + \alpha_3 ACL_{it} + \alpha_4 NACL_{it} + \alpha_5 ASSET_{it} + \sum_{a=2}^{11} \delta_a Q_{it} + \sum_{s=2}^{19} \gamma_s S_{it} + \sum_{cg=2}^2 \xi_{cg} CG_{it} + e_{i,t}$$

Where RET is quarterly return of share price, and Δ denotes quarterly change.

Table 5. Summary Statistics from Regression Equation 5 (Panel 5)

RET (10)	Coef.	Std. Err.	t-statistic	P> t
NI	0.001758	0.000803	2.19	0.029**
Δ NI	0.00165	0.000835	1.98	0.048**
ASSET	-2.05E-05	0.000053	-0.39	0.699
ACL	0.000273	0.000689	0.4	0.69
NACL	1.69E-06	0.000178	0.01	0.99
Constant	-0.02382	0.012887	-1.85	0.065***
n. Obs.	1648			
Statistic-F	3.25			
(Prob.)	0			
R-squared	0.0511			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, ACL is accrued contingent liability, and NACL is non-accrued contingent liability.

In equation 5, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 6, it was considered the average price for 20 days before and after the publication of financial statements.

Table 6. Summary Statistics from Regression Equation 6 (Panel 6)

RET (20)	Coef.	Std. Err.	t-statistic	P> t
NI	0.003353	0.0012343	2.72	0.007*
Δ NI	0.001866	0.0010184	1.83	0.067***
ASSET	-6.84E-05	0.0000631	-1.08	0.279
ACL	-0.00094	0.0009645	-0.98	0.33
NACL	0.000151	0.00018	0.84	0.402
_ Constant	-0.01309	0.0170043	-0.77	0.442
n. Obs.	1665			
Statistic-F	3.92			
(Prob.)	0			
R-squared	0.0726			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, ACL is accrued contingent liability, and NACL is non-accrued contingent liability.

In equation 5, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 6, it was considered the average price for 20 days before and after the publication of financial statement.

In the panel 5 and 6¹¹, it was estimated if return of share price has captured the effects that the market gives to non-accrued contingent liability disclosed in the footnotes. Tables 5 and the 6 show the summary statistics from the equation 5 and the equation 6.

For the results of both equations, considering all the

companies, it was not possible to identify whether stock returns have absorbed risks contingency not provided, but disclosed in the notes.

The results did not allow concluding that there is not significant evidences of the usefulness and timeliness of variation of NACL and ACL. Only the NI and Δ NI variables showed significant.

In the panel 7 and 8, it was estimated if return of share

¹¹ The model used was proposed by Bushman et al (2004).

Table 7. Summary Statistics from Regression Equation 7 (Panel 7)

RET(10)	Coef.	Std. Err.	t-statistic	P> t
NI	0.001233	0.000758	1.63	0.104
Δ NI	0.001379	0.000805	1.71	0.087***
ASSET	1.24E-05	5.76E-05	0.22	0.829
ACL	0.000649	0.000753	0.86	0.389
NACL	-0.00078	0.000302	-2.58	0.01*
Constant	-0.02121	0.013243	-1.6	0.109
n. Obs.	1426			
Statistic-F	3.49			
(Prob.)	0			
R-squared	0.0651			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, ACL is accrued contingent liability, and NACL is non-accrued contingent liability.

In equation 5, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 6, it was considered the average price for 20 days before and after the publication of financial statements

Table 8. Summary Statistics from Regression Equation 8 (Panel 8)

RET(20)	Coef.	Std. Err.	t-statistic	P> t
NI	0.00269	0.001253	2.15	0.032**
Δ NI	0.001981	0.001093	1.81	0.07***
ASSET	-7E-05	6.72E-05	-1.05	0.295
ACL	-0.0004	0.001012	-0.39	0.694
NACL	-0.00034	0.000632	-0.54	0.592
Constant	-0.01365	0.024941	-0.55	0.584
n. Obs.	1442			
Statistic-F	3.44			
(Prob.)	0			
R-squared	0.0835			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, ACL is accrued contingent liability, and NACL is non-accrued contingent liability.

In equation 5, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 6, it was considered the average price for 20 days before and after the publication of financial statements.

price has captured the effects that the market gives to non-accrued contingent liability disclosed in the footnotes. But, it was considered only companies that had earnings in the periods studied. Tables 7 and 8 show the summary statistics from the equation 7 and the equation 8.

The results of panel 7 show that when are analyzed the

companies that had earnings in the periods studied, a window of 10 days before and after, return of share price has captured the effects that the market gives to non-accrued contingent liability disclosed in the footnotes. But, considering a time window of 20 days, the coefficients were not statistically significant.

In the panel 9 and 10, it was estimated if return of

Table 9. Summary Statistics from Regression Equation 9 (Panel 9)

RET (10)	Coef.	Std. Err.	t-statistic	P> t
NI	0.017519	0.008756	2	0.047**
Δ NI	0.000215	0.00344	0.06	0.95
ASSET	6.57E-05	0.00036	0.18	0.855
ACL	-0.00025	0.001844	-0.13	0.894
NACL	0.000371	0.00028	1.32	0.188
Constant	0.000941	0.066482	0.01	0.989
n. Obs.	170			
Statistic-F	0.12			
(Prob.)	0			
R-squared	0.3015			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, ACL is accrued contingent liability, and NACL is non-accrued contingent liability.

In equation 9, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 10, it was considered the average price for 20 days before and after the publication of financial statements.

Table 10. Summary Statistics from Regression Equation 10 (Panel 10)

RET (20)	Coef.	Std. Err.	t-statistic	P> t
NI	0.0263522	0.012686	2.08	0.04
Δ NI	-0.0041445	0.00525	-0.79	0.431
ASSET	-0.0004386	0.000551	-0.8	0.427
ACL	-0.0006439	0.003188	-0.2	0.84
NACL	0.0008349	0.000471	1.77	0.079***
Constant	-0.2205799	0.076974	-2.87	0.005*
n. Obs.	170			
Statistic-F	0.21			
(Prob.)	0			
R-squared	0.2128			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, ACL is accrued contingent liability, and NACL is non-accrued contingent liability.

In equation 9, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 10, it was considered the average price for 20 days before and after the publication of financial statements.

share price has captured the effects that the market gives to non-accrued contingent liability disclosed in the footnotes. But, it was considered only companies that are making losses in the periods studied.

The Table 9 and the Table 10 show the summary statistics from the equation 9 and the equation 10. The results of panel 10 show that return of share price has

captured the effects that the market gives to non-accrued contingent liability disclosed in the footnotes.

Additional analyses

It was done some additional analyzes that has as

Table 11. Summary Statistics from Regression Equation 11(Panel 11).

RET (10)	Coef.	Std. Err.	t-statistic	P> t
NI	0.0013766	0.00063	2.18	0.029**
ΔNI	0.0010981	0.000691	1.59	0.112
ΔACL	0.0015311	0.00088	1.74	0.082***
ΔNACL	-0.000337	8.31E-05	-4.06	0.00*
ASSET	0.0000303	5.28E-05	0.57	0.566
Constant	-0.025052	0.013459	-1.86	0.063***
n. Obs.	1364			
Statistic-F	4.33			
(Prob.)	0			
R-squared	0.0786			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, Δ ACL is accrued contingent liability, and Δ NACL is non-accrued contingent liability.

In equation 11, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 12, it was considered the average price for 20 days before and after the publication of financial statements.

objective to measure the effects of potential risks of contingent liability disclosed in the footnotes about return of share price has captured the effects that the market.

$$RET_{it} = \alpha_1 NI_{it} + \alpha_2 \Delta NI_{it} + \alpha_3 \Delta NACL_{it} + \alpha_4 \Delta ACL_{it} + \alpha_5 ASSET_{it} + \sum_{a=2}^{11} \delta_a Q_{it} + \sum_{s=2}^{19} \gamma_s S_{it} + \sum_{cg=2}^2 \xi_{cg} CG_{it} + e_{i,t}$$

Considering only companies that had earnings in the periods studied, the results presented in the panel 11 and 12 show that return of share price has captured the effects that the market gives to variation of non-accrued contingent liability, disclosed in the footnotes. The coefficients were statistically significant and the sign of the coefficient ΔNACL was as expected. Tables 13 and 14 show the summary statistics from the equation 13 and the equation 14.

In the panel 13 and 14, it was estimated if return of share price has captured the effects that the market gives to non-accrued contingent liability disclosed in the footnotes. But, it was considered only companies that are making losses in the periods studied. The coefficients, in both panels (13 and 14), were statistically significant and the signal of the coefficient of the ΔNACL was as expected.

Summary and concluding remarks

This study investigated the relation between share price

and non-accrued contingent liability not recognizes in net income under CVM's Deliberation N° 489/05, but disclosed in the footnotes. Two models¹² were used to evaluate the impact of the NACL (non-accrued contingent liability) on share price and on return of share price. It was used with asset, industry, period of published and corporate governance's levels with control variables.

3.180 footnotes were analyzed from periods 2006 to 2010 of 159 companies of different sectors, in twenty quarterlies. These companies are listed in different Exchange. Fourteen models were estimated, where: (i) four estimative relate share price to the NACL variable; and (ii) ten estimative examine the relationship between return of share price with the NACL variable. Additionally, the companies were divided into two groups: profitable¹³ (Table 7 and 8; Table 11 and 12) and unprofitable¹⁴ (Table 3 and 4; Table 9 and 10; Table 13 and 14; Appendix 1.

The expectations were that there was a negative relation between the non-accrued contingent liability (NACL) variable and share price. It was found a significant statistically relationship to the share price. The relation between the non-accrued contingent liability (NACL) variable and return of share price was negative and

¹² (i) The model share price is based on model proposed by Ohlson (1995); Liu and Ohlson (2000); Ohlson (2001); and (ii) The model share return was proposed by Bushman et al. (2004). These models were used by Aboody, Barth and Kasznik (2004).

corporate governance's levels of the São Paulo Stock

¹³ Companies that have obtained net profit in the period analyzed.

¹⁴ Companies that have obtained loss in the period analyzed.

Table 12. Summary Statistics from Regression Equation 12 (Panel 12)

RET (20)	Coef.	Std. Err.	t-statistic	P> t
NI	0.0021985	0.0009395	2.34	0.019**
Δ NI	0.0019148	0.0009805	1.95	0.051***
Δ ACL	0.0008188	0.0011304	0.72	0.469
Δ NACL	-0.0001944	0.0001199	-1.62	0.10***
ASSET	-0.0000461	0.0000618	-0.75	0.455
Constant	-0.0250515	0.0134593	-1.86	0.063
n. Obs.	1380			
Statistic-F	3.38			
(Prob.)	0			
R-squared	0.091			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, Δ ACL is accrued contingent liability, and Δ NACL is non-accrued contingent liability.

In equation 11, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 12, it was considered the average price for 20 days before and after the publication of financial statements.

Table 13. Summary Statistics from Regression Equation 13 (Panel 13)

RET (10)	Coef.	Std. Err.	t-statistic	P> t
NI	0.023584	0.009816	2.4	0.018**
Δ NI	-0.00041	0.00526	-0.08	0.938
Δ ACL	-0.00167	0.00184	-0.91	0.365
Δ NACL	0.000526	0.000246	2.14	0.04**
ASSET	-0.00034	0.000161	-2.12	0.036**
Constant	-0.02658	0.061505	-0.43	0.666
n. Obs.	169			
Statistic-F	0.12			
(Prob.)	0			
R-squared	0.343			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, Δ ACL is accrued contingent liability, and Δ NACL is non-accrued contingent liability.

In equation 9, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 10, it was considered the average price for 20 days before and after the publication of financial statements.

significant in the panel 7.

In the panel 10, it was found a significant statistically relationship between the RET¹⁶ and the NACL variables. But, the effects find were not of according to expect. The coefficient was significant statistically, but the signal was contrary to expectations. Additionally, in panel 11 and

panel 12, the relationship between the RET and the Δ NACL was negative and significant statistically.

The primary results of this study found that the non-accrued contingent liability disclosed in the footnotes understates CVM's Deliberation N° 489/05 is perceived by share price. In particular, the findings were consistent with the results of Aboody et al (2004) that found that stock options are viewed as an expense and they are negatively associated with share price. Aboody et al

¹⁶ In this analyze all variables accounts were deflated just by number of shares outstanding and at the end-year.

Table 14. Summary Statistics from Regression Equation 14 (Panel 14)

RET (20)	Coef.	Std. Err.	t-statistic	P> t
NI	0.030213	0.016821	1.8	0.075**
Δ NI	0.000102	0.011477	0.01	0.993
Δ ACL	-0.00518	0.00344	-1.51	0.135
Δ NACL	0.000896	0.000371	2.42	0.017**
ASSET	-0.00097	0.000325	-2.98	0.003*
Constant	0.039526	0.094222	0.42	0.676
n. Obs.	169			
Statistic-F	0.17			
(Prob.)	0			
R-squared	0.363			

Notes: *Significance level 1%; **Significance level 5%; ***Significance level 10%.

RET is quarterly return of share price, and Δ denotes quarterly change, NI is net income, ASSET is the asses value, Δ ACL is accrued contingent liability, and Δ NACL is non-accrued contingent liability.

In equation 9, it was considered the average price for 10 days before and after the publication of financial statements.

In equation 10, it was considered the average price for 20 days before and after the publication of financial statements.

(2004) found that investors view SFAS N^o 123 (stock-based compensation) expense as an expense of the firm, and as sufficiently reliable to be reflected in their valuation assessments.

This suggests that managers believe that even though non-accrued contingent liability to be disclosed in the footnotes and not recognized as expense, it is relevant to financial statement users. More importantly, the findings suggest that some concerns about the overall reliability of non-accrued contingent liability disclosed in the footnotes are not warranted. It was left it to standard setters to determine whether the effects of discretion on reliability are sufficient to cause them concern and, if so, how such effects can be mitigated.

The study was silent on the potential implications of changing the accounting treatment of non-accrued contingent liability instituted by the CVM's Deliberation N^o 489/05 and the IBRACON's Statement NPC N^o 22. Although expense did not have seen recognition would likely provide managers with greater incentives to understate the expense, it would also likely increase costs related to audit, regulatory enforcement, and scrutiny by investor groups associated with doing so.

Three limitations were identified: (i) the composition of the sample because include only companies listed in one of three corporate governance's levels of the São Paulo Stock Exchange (BOVESPA) – Level 1, Level 2 and New Market; (ii) The number of companies surveyed, and (iii) Many companies do not report the values of contingency liabilities in their footnotes, even being required to publish.

For future research, it is suggested examining the type

of provision represents an important information for the market or if the relationship is restricted only to aggregate information. Besides the increase time analyzed and number of companies.

REFERENCES

- Aboody D, Barth ME, Kasznik R (2004). SFAS No. 123 Stock-Based Compensation Expense and Equity Market Values. *Acc. Rev.* 79(2):251-275.
- Aboody D, Barth ME, Kasznik R (2006). Do Firms Understate Stock Option-Based Compensation Expense Disclosed under SFAS 123? *Forthcoming, Review of Accounting Studies.*
- Balera W, Raeffray APO (2007). Os Advogados e as provisões contábeis. *Jornal Valor Econômico*, São Paulo, 03/05/2007. Available at: <<http://www.valoronline.com.br/>>.
- Belzile R, Fortin A, Viger C (2006). Recognition versus Disclosure of Stock Option Compensation: An Analysis of Judgements and Decisions of Nonprofessional Investors. *Can. Acc. Perspect.* 5(2):147-179.
- BOVESPA. Bolsa de Valores de São Paulo (2008). Available at: <<http://www.bovespa.com.br/>>.
- Bushman R, Chen Q, Engel E, Smith A (2004). Financial accounting information, organizational complexity and corporate governance systems. *J. Account. Econ.* 37:167-201.
- CVM – Comissão de Valores Mobiliários. (2008) Estudo sobre as práticas contábeis brasileiras e as normas internacionais de contabilidade (IFRS). Available at: <<http://www.cvm.gov.br/>>. Accessed on: 01/10/2008.
- CVM – Comissão de Valores Mobiliários. (2005). Deliberação CVM N^o 489/05. Available at: <<http://www.cvm.gov.br/>>. Accessed on: 01/10/2008.
- CVM – Comissão de Valores Mobiliários (1993). Instrução CVM N^o 202/93. Available at: <<http://www.cvm.gov.br/>>.
- Fávero LPL, Belfiore P, Silva FL, Chan BL (2009). *Análise de Dados: Modelagem Multivariada para Tomada de Decisões*. Rio de Janeiro: Campus Elsevier, 646p.
- Gopalakrishnan V (1994). The effect of recognition vs. disclosure on

- investor valuation: The case of pension accounting. *Rev. Quantitat. Financ. Account.* 4(4):383-396.
- Gujarati D (2006). *Econometria básica*. Rio de Janeiro, Campus, 812 p.
- Hendriksen ES, Van Breda MF (1999). *Teoria da Contabilidade*. São Paulo: Atlas.
- Hitz J (2009). Information Versus Strategic Reporting: Disclosure of Pro Forma Earnings by Large German Corporations. In European Accounting Association Annual Meeting, Tampere, Finland.
- IAS 37. International Accounting Standards 37. (2002). In: International Accounting Standards. IASB: Londres.
- IBRACON (2005). Instituto Brasileiro dos Auditores Independentes. Norma e Procedimento de Contabilidade nº 22. Available at: <<http://www.ibracon.com.br>>. Accessed on: 01/10/2008.
- Laux JA, N'Dir A (2007). Employee Stock Options And Market Efficiency. *J. Appl. Bus. Res.* 23(2):1-6.
- Li H (2002). Employee Stock Options, Residual Income Valuation and Stock Price Reaction to SFAS 123 Footnote Disclosures. Available at SSRN: <http://ssrn.com/abstract=376580> or doi:10.2139/ssrn.376580.
- Liu J, Ohlson JA (2000). "The Feltham–Ohlson (1995) Model: Empirical Implications". *J. Account. Audit. Financ.* 15:321–331.
- Niu F, Xu B (2009). Does Recognition Versus Disclosure Really Matter? Evidence from the Market Valuation of Recognition of Employee Stock Option Expenses. *Asia-Pacific J. Account. Econ.* 16:215-234.
- Ohlson JA (2001). "Earnings, Book Values, and Dividends in Security Valuation: An Empirical Perspective". *Contemp. Account. Res.* 18:107–121.
- Ohlson JA (1995). "Earnings, Book Values, and Dividends in Security Valuation". *Contemp. Account. Res.* 11:661–687.
- Pindyck R, Rubinfeld DL (2002). *Microeconomia*. 5. ed. São Paulo: Prentice Hall.
- Rees LL, Stott DM (1998). The Value-Relevance of Stock-Based Employee Compensation Disclosures. Available at: SSRN: <http://ssrn.com/abstract=145929> or doi:10.2139/ssrn.145929.
- Williams RE, Gonçalves LGB (2007). Classificação contábil X classificação jurídica. *Jornal Valor Econômico*, São Paulo, 16/08/2007. Available at: <<http://www.valoronline.com.br/>>.

APPENDIX

Table 15. Descriptive analysis.

Variable	Obs	Mean	Std. Dev.	Min	Max
Price 10	2762	15.27267	11.45781	0.24	73.59
Price 20	2793	15.16689	11.46699	0.26	73.5
RET 10	2718	0.001185	0.117826	-0.75	0.82
Reto 20	2753	0.006317	0.161678	-1.42	0.8
ACL	2420	1.587979	4.926686	0	132.61
Δ ACL	2427	0.314343	13.47868	-131.53	613.5
NACL	1946	2.168099	10.94377	0	322.95
ΔNACL	1907	0.14688	14.21017	-322.95	322.95
BV	2602	17.96759	55.02461	-17.8	988.67
BV-ACL	2721	15.78032	53.46281	-131.61	988.67
NI	2597	1.643092	15.5832	-26.48	759.95
ΔNI	2610	0.411169	15.42658	-57.52	759.95
ASSET	2592	46.70926	79.48971	0	983.48

Table 16. Pearson correlation analysis.

	Price10	Price20	Ret10	Ret20	ACL	ΔACL	NACL	ΔNACL	BV	BV-CL	NI	ΔNI	Asset
Price10	1.00												
Price20	1.00	1.00											
Sig	0.00												
Ret10	0.02	0.01	1.00										
Sig	0.41	0.44											
Ret20	-0.02	-0.02	0.71	1.00									
Sig	0.32	0.34	0.00										
ACL	0.19	0.19	0.03	0.01	1.00								
Sig	0.00	0.00	0.15	0.66									
ΔACL	-0.03	-0.03	0.01	-0.01	0.54	1.00							
Sig	0.18	0.22	0.66	0.80	0.00								
NACL	0.11	0.11	0.02	0.01	0.29	0.09	1.00						
Sig	0.00	0.00	0.34	0.61	0.00	0.00							
ΔNACL	0.00	0.00	0.00	0.00	0.09	0.17	0.86	1.00					
sig	0.90	0.97	0.86	0.98	0.00	0.00	0.00						
BV-liq	0.12	0.12	0.04	0.02	0.34	0.05	0.20	0.00	1.00				
sig	0.00	0.00	0.08	0.30	0.00	0.02	0.00	0.90	0.90				
BV-ACL	0.10	0.10	0.03	0.02	0.17	-0.05	0.22	0.00	1.00	1.00			
Sig	0.00	0.00	0.08	0.25	0.00	0.01	0.00	0.97	0.00				
NI	0.04	0.04	0.03	0.01	0.35	0.07	0.21	-0.01	0.45	0.44	1.00		
Sig	0.04	0.03	0.22	0.67	0.00	0.00	0.00	0.68	0.00	0.00			
ΔNI	-0.02	-0.02	0.02	0.01	0.19	0.24	0.13	0.08	0.05	0.04	0.96	1.00	
Sig	0.37	0.36	0.27	0.53	0.00	0.00	0.00	0.00	0.01	0.05	0.00		
Asset	0.32	0.32	0.05	0.03	0.42	0.04	0.19	0.00	0.71	0.68	0.46	0.08	1.00
Sig	0.00	0.00	0.03	0.14	0.00	0.04	0.00	0.85	0.00	0.00	0.00	0.00	

Table 17. Sectors of Companies.

Sectors	Number	%
Agriculture	3	1.89
Food and beverages	9	5.66
Trade	7	4.40
Construction	22	13.84
Electronics	2	1.26
Electricity	14	8.81
Finance and Insurance	19	11.95
Industrial Machinery	3	1.89
Mining	2	1.26
Minerals Metallurgy	2	1.26
Other	31	19.50
Paper	3	1.89
Oil and Gas	1	0.63
Chemistry	5	3.14
Steel & Metallurgy	9	5.66
Software and Data	2	1.26
Communications	3	1.89
Textiles	6	3.77
Transport and Services	11	6.92
Vehicles and parts	5	3.14
TOTAL	159	100.00