

Earnings Quality: Eikon Measure vs Academic Measure

Financial statements are the most important source of information in the decision-making process. Within financial statements, earnings present itself as one of the most valuable accounting number used by stakeholders (e-g., investors, regulators, and executives). Therefore, the primary aim of earnings reporting is to produce reliable information for individuals with interest in financial reports (Francis et al. 2004).

Knowing that, it is easily perceivable that earnings need to be calculated accurately, in order to be reliable and provide assurance to the financial statement users and help investors to better assess firm value and performance and to make improved investment decisions (Gaio & Raposo, 2011).

Earnings quality (EQ), as a concept, is a significant topic and has been gathering a lot of attention in the last couple of decades. That is explained by various factors such as the development of the Jones Model (1991), the accounting scandals in the beginning of the millennium and the extensive adoption of IFRS in different countries. Another important factor is the emergence of computer accessed databases, which provide a more efficient way for academics and analysts to gather data, including a wide variety statistical models, including models that measure the quality of the earnings reported by companies. How one thinks about earnings quality is to some degree in the eye of the beholder (Nelson & Skinner 2013). In fact, in Dechow et al. (2010) states that earnings quality is context specific.

The growth in EQ research, and the big amount of measures created, can also be explained by the wide array of EQ uses. For investor to optimize the success of investments and to avoid the bad allocation of resources; for contracting purposes, influencing lender decisions; compensation committees, who can decide on executives compensations; standard setters who can investigate the effectiveness of their policies.

Despite these facts, does not exist a clear, generally accepted definition and model to measure EQ. Different studies provide their own metric, focusing on one or more aspect of earnings like predictability, persistence and sustainability, although in this great variety of a models there is no clear evidence of the superiority of any of them. (Licerán-Gutiérrez & Cano-Rodríguez, 2019). In Francis et al. (2004) the authors divide earnings properties between accounting-based and market-based. Also, in Dechow et al. (2010) the authors separate the proxies for EQ in three categories: Properties of earnings, investor responsiveness to earnings and external indicators of earnings misstatement.

The accounting-based measures are the most used in the literatures, taking cash or earnings itself as the reference construct and, consequently, are computed using accounting information only. This study uses the accruals component of earnings, since accruals are an accounting number, require estimation and are prone to be managed, meaning that they can be a sign of underlying volatility in the company's operations and low-quality earnings (Guay et al., 1996; Dechow & Schrand, 2004).

Despite the various uses of EQ, it is important to acknowledge that most of the potential users will not proceed to calculate one of the many EQ statistical model when time comes to decide. In a fast-moving world, that we live today, immediate access to information and high availability is extremely valuable. Financial information databases provide exactly the capability to access a variety of information on many industries and companies, making them essential. The connection between this world and EQ is made in Thomson Reuters Eikon database, where is provided a model consisting on a 0-100 score that takes into consideration various earnings components, generating daily updated EQ score.

The objective of this study to understand the correlation between Eikon EQ measure and the earnings quality measure created by DD, adjusted in Francis et al. (2005), bringing two different worlds together, database provided professional analysts models and academic models. Scarso (2019) tests the possible correlation between the Eikon score and seven other scholar measures. All seven are proxies based on properties of earnings, provided by models such as accruals quality. Out of all the models tested, the only model that had a positive, significant correlation was the abnormal accruals created by Dechow & Dichev adjusted in Francis et al. (2005).

By testing the correlation, it is possible to further investigate and deepen the research on these financial database quantitative models, and how are they related to academic research. Also, this study has as objective to understand and amplify the knowledge on the components of the Eikon EQ score. Since there is a big gap in current earnings quality literature, in respect to the use of models developed by databases, and overall investigation to these scores, it serves as motivation. Moreover, this study differs in respect to the sample used. While in Scarso (2019) the authors use US-based companies only, the investigation will be applied to European-based companies.

The reminder of the study is divided into different sections: section 2, the literature review, where subjects such as the concept of EQ are approached more in-depth. Section 3 presents the hypothesis, sample used and the research methodology. Section 4 is where

the results obtained are discussed and analyzed and, finally, section 5 presents the main conclusions of the study, along with the study limitations and future investigation suggestions.