ABNORMAL FLUCTUATION MEANS MORE THAN WHAT YOU THINK: A COMMENTARY ON FOSTER AND BLUM'S "MANUFACTURERS' REPORTING OF ABNORMAL EXCESS CAPACITY COSTS"

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Abstract

The purpose of this commentary is to present various perspectives on the contribution of Foster & Blum's recent article, "Manufacturers' Reporting of Abnormal Excess Capacity Costs: Evidence from COVID-19 Disruption and Suggestions for the Future" (2022). Foster & Blum's paper signifies that many manufacturers lack direct disclosures on "abnormal excess capacity costs (AECC hereafter)" indicating noncompliance with SFAS 151. The authors suggest that regulatory entities require more direct disclosure about AECC. This disclosure can improve information quality by enhancing information users' understanding of the impact of production fluctuations. The paper highlights a theoretical link between AECC and Real Earning Management (REM).

COMMENTARY

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The AECC captures the basic thought reflecting the business' real operations. However, the definition is "subjective" (Foster & Blum, 2022). No authorities gave a measurable definition to guide the enforcement of this regulation. One frequently used measurement for SFAS 151 is from the literature on REM. Most studies set the normal production cost as the estimated expected production costs by 2-digit SIC code industry-year. The abnormal production cost is the difference between the observed companies' product cost and the industrial average (Huang et al., 2020; Galdi & Johnson, 2021; Afrifa et al., 2021). Based on the discussion above, two future research pipelines could be expanded regarding the AECC.

First, SFAS 151 is tightly related to real earnings management regulation (Galdi & Johnson, 2021). Some recently published papers launched a new perspective to assess the REM and its impact. Correia et al. (2018) use the time series of abnormal assets (like PPE and inventory) fluctuation to capture the REM. The result demonstrates that REM leads to a future stock price collapse and fewer innovations (Bereskin et al., 2018). These results notify that the companies' time series abnormal assets fluctuation can act as another measurement for AECC. This research branch can be expanded in the future to boost how to define AECC regarding SFAS 151.

Second, an obvious lacking direct disclosure of AECC also highlights a potential auditing issue (Foster & Blum, 2022). However, there is extremely limited auditing research to notify this phenomenon. The potential reason is that it is challenging to find accountable evidence for this subjective concept. Foster & Blum (2022) hinted that alternative data from open public data could act as evidence, like the Federal Reserve data source. The alternative auditing evidence needs to be theoretically and practically welldesigned and structured, which could be another research stream regarding the regulation of SFAS 151.

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