

Disclosure of Disaggregated SG&A Information Under the Deregulation

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Abstract

The current accounting system classifies many parts of expenditures for intangible investments into selling, general, and administrative (SG&A) expenses; thus, information on its disaggregated expenses considered to be important. However, the number of Japanese firms disclosing disaggregated SG&A information in *Kessantanshin* (financial information summary) has decreased since deregulation. For example, only 36% of firms disclosed such information in 2023 compared with 83% in 2009. This study examines the management incentives to disclose disaggregated SG&A information in *Kessantanshin*. Using Japanese data, it obtains three key findings: First, firms with a higher future asset value created by SG&A expenses are more likely to disclose such information. Second, firms with more management intervention in accounting are less likely to disclose information. Finally, the burden of disclosure prevents firms from disclosing this information. The findings suggest a benefit of the regulation.

The Online Appendix is available at https://www.aea-j.org/journals_and_books/journal_al/.

Keywords: disaggregated disclosure; SG&A; earnings announcement; earnings management; disclosure

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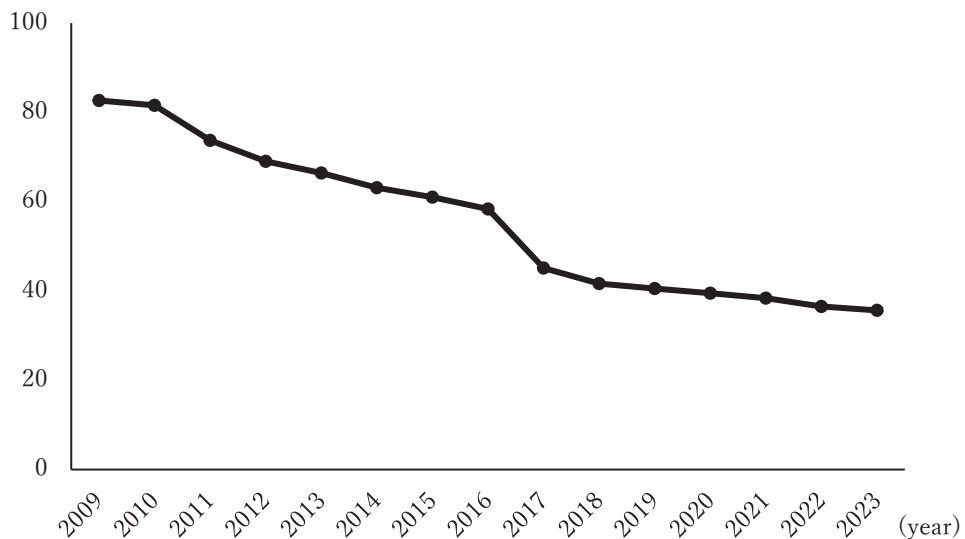
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1 Introduction

Although selling, general, and administrative (SG&A) expenses are some of the major costs that firms must bear, recent studies have revealed that current SG&A expenses generate future revenue because they include expenditures for intangible investments, such as research and development (R&D), advertising, and employee training. To estimate the amount of investment included in SG&A items linked to future revenue, investors' demand for a cost breakdown analysis of such expenses has increased. For example, feedback from investors on the 2021 Financial Accounting Standards Board (FASB) Invitation to Comment indicates that granular information about SG&A assists investors in better understanding an entity's cost structure and forecasting future cash flows (FASB, 2023). However, the number of firms disclosing disaggregated SG&A information in *Kessantanshin* (financial information summary) is decreasing yearly; compared with 83% in 2009, only 36% of firms disclosed such information in 2023 (Figure 1).

Figure 1. Percentage of firms disclosing disaggregated SG&A information in *Kessantanshin* (%)



Note: The figure indicates the percentage of firms that disclose disaggregated SG&A information in *Kessantanshin* (32,263 firm-years).

This study investigates the incentives for managers to disclose disaggregated SG&A information in *Kessantanshin* and analyzes the reasons for this downward trend. Understanding disclosure incentives is essential because it guides the necessity of regulations. This study contributes to the

existing literature by identifying incentives for the disclosure of disaggregated SG&A information, a topic that is largely unexplored. It shows that management discloses disaggregated SG&A information in *Kessantanshin* considering investors' information demand. However, other factors (earnings management incentives and administrative burden) also influence disclosure.

2 Japanese Disclosure System

All Japanese listed firms are required to release financial statements in two steps. First, they summarize the key financial items in *Kessantanshin* required by the Tokyo Stock Exchange (TSE). Second, they disclose detailed financial information in *Yukashoken-Houkokusho* required by the Financial Instruments and Exchange Law. Although *Kessantanshin's* objective is to convey *key* financial and nonfinancial information in a timely manner, the TSE has increased the amount of information required to be disclosed since the late 1990s. This requirement of increased information disclosure is a serious problem because it increases the administrative burden. In response to these concerns, the TSE strived to simplify *Kessantanshin* since the mid-2000s by reducing the number of items required to be disclosed.

Japanese generally accepted accounting (JAAP) requires firms to classify SG&A into appropriate categories and disclose major expenses and their amounts; however, it does not require to disclose this information in *Kessantanshin*. Therefore, the number of firms disclosing disaggregated expenses has decreased since the acceptance of the simplification of *Kessantanshin* (Figure 1). This study investigates managers' incentives to disclose disaggregated SG&A information under the simplification of *Kessantanshin*.

3 Hypotheses

Research reveals that investors' demand is a factor incentivizing firms to disclose financial items (Chen et al., 2002; Levi, 2008). Accordingly, this paper predicts that firms are more likely to disclose disaggregated SG&A information in *Kessantanshin* when investors' demand is high.

However, measuring investors' demand for SG&A information directly is difficult. Therefore, following Chen et al. (2002), this study focuses on situations where disaggregated SG&A information is important for estimating firms' value. It assumes that investors' demand for disaggregated SG&A information is high when these expenses generate more future revenue. SG&A expenses include two types of expenditures: those corresponding to the current period's revenues and those generating future revenues. Sales commissions and packing, freight, and storage expenses are included in the current-period revenues, whereas R&D, advertising, and some part of personnel expenses can be a source of future revenues. Disaggregated SG&A information is useful in evaluat-

ing the extent to which current SG&A expenses include future revenue-generating expenditures because it provides detailed information on the cost breakdown included in SG&A expenses.

Hypothesis 1: Firms with a high future asset value of SG&A expenses are more likely to disclose disaggregated SG&A information in Kessantanshin.

Despite the benefits of disclosure, prior literature identifies an incentive that limits disclosure. D'Souza et al. (2010) predict that firms whose managers routinely intervene in accounting limit the disclosure of supplementary financial items emphasizing instead on summarized financial information such as bottom-line earnings. Accordingly, this study predicts that managers who routinely manage earnings by adjusting the expenses included in SG&A are less likely to disclose disaggregated SG&A information on *Kessantanshin*.¹ This is because disclosing the summarized information on the total SG&A expenses without disclosing the disaggregated information can obscure the reported earnings.

Hypothesis 2: Firms routinely managing earnings through SG&A expenses are less likely to disclose disaggregated SG&A information in Kessantanshin.

Although disclosures reduce the information asymmetry between management and investors, it is expensive and management does not disclose information unless its benefits outweigh the costs (Verrecchia, 1983, 1990). The cost of preparing financial statements has long been a serious concern in Japan. Owing to criticism regarding the industry's burdens, the TSE has been accepting simplified information disclosure in *Kessantanshin* since the mid-2000s. Based on *Kessantanshin*'s history, the cost of preparation is considered a significant driver preventing corporate disclosure.

Hypothesis 3: Firms with high costs for preparing Kessantanshin are less likely to disclose disaggregated SG&A information in Kessantanshin.

¹ Research reveals that management adjusts earnings through discretionary expenses such as SG&A and R&D and advertising included in SG&A (Roychowdhury, 2006). These expenditure do not generate revenue in the current period but are expensed in the period in which they are expensed. Reducing these expenses can increase current period earnings, although long-term corporate value may decrease. Such earnings management behavior is observed not only in U.S. firms but also in Japanese firms (Pan, 2009).

4 Data and Research Design

4.1 Future Asset Value of SG&A Expense

This study measures the future asset value of SG&A expenses in two ways: the sum of current personnel, advertising, and R&D expenses included in SG&A expenses (*SGAINT*) and the estimated level of future value of SG&A expenses (*SGAFV*) using a regression model (Banker et al., 2011, 2019). *SGAFV* indicates how much SG&A expenses spent in the current year generate future earnings. Online appendix provides the detailed estimation methodology.

4.2 Earnings Management through SG&A Expenses

This study uses abnormal discretionary expenditure as the proxy for the measure of real earnings management through SG&A expenses following Roychowdhury (2006). It calculates the discretionary expenditure in two ways: using total SG&A expenses (*ABDE_all*) following Roychowdhury (2006), and sum of five SG&A expenses (*ABDE_five*) following Yamaguchi (2021). Online appendix provides the detailed estimation methodology; larger values indicate greater earnings management.

4.3 Costs of Preparing Kessantanshi

This study uses the number of consolidated subsidiaries (*SUBSIDIARY*) as a variable to capture the administrative burden of preparing financial statements. This is because firms with more subsidiaries face more difficulty in checking and combining the financial statements prepared by their subsidiaries; consequently, the costs of preparing financial statements are expected to be higher.

4.4 Sample

This study uses Japanese listed firms that adapt JGAAP from 2009 to 2023, excluding financial firms. It obtains the financial data used in the analysis from *Nikkei NEEDS-FinancialQUEST*. Online appendix provides the sample selection process, descriptive statistics and correlation matrix.

Table 1. Definition of variables

Variables	Definition
$DISCLOSURE_{i,t}$	= Dummy variable that takes a value of 1 if disaggregated SG&A information is disclosed on <i>Kessantanshin</i> and 0 otherwise. When 18 items (K01067-K01084) included in the <i>Nikkei NEEDS-FinancialQUEST</i> are missing, those observations are defined as non-disclosure of disaggregated SG&A information in <i>Kessantanshin</i> .
$SGAINT_{i,t}$	= Total personnel, advertising, and R&D expenses for period t divided by total assets at the end of period t . Missing data are replaced by 0.
$Personal\ Expenses_{i,t}$	= Personnel expenses for period t divided by total assets at the end of period t . Missing data are replaced by 0.
$Advertising\ Expenses_{i,t}$	= Advertising expenses for period t divided by total assets at the end of period t . Missing data are replaced by 0.
$R\&D\ Expenses_{i,t}$	= R&D expenses for period t divided by total assets at the end of period t . Missing data are replaced by 0.
$SGAFV_{i,t}$	= Future value of SG&A expenses spent in period t estimated following Banker et al. (2019). For more details, see online appendix.
$ABDE_all_{i,t}$	= Average amount of abnormal discretionary expenditures of SG&A in period t over the past 5 years measured according to Roychowdhury (2006). For more details, see online appendix.
$ABDE_five_{i,t}$	= Average amount of abnormal discretionary expenditures of five items included in SG&A in period t over the past 5 years measured according to Roychowdhury (2006). For more details, see online appendix..
$SUBSIDIARY_{i,t-1}$	= Number of consolidated subsidiaries in period t standardized by sales in period t (billions of yen).
$SALES_SD_{i,t}$	= Standard deviation of sales standardized by total assets from period $t-4$ to period t .
$SGA_SD_{i,t}$	= Standard deviation of SG&A expenses standardized by total assets from period $t-4$ to period t .
$RET_SD_{i,t}$	= Standard deviation of daily stock returns in period t . If a return of at least 100 is unavailable, it is excluded from the sample.
$LOSS_{i,t}$	= Dummy variable that takes a value of 1 if net income in period t is less than 0 and 0 otherwise.
$fe_{i,t}$	= The absolute value of the forecast error of net income for the fiscal year t divided by the market capitalization of the stock. The forecast error is the most recent forecast value published by management.
$AGE_{i,t}$	= Natural logarithm of firm age in period t .
$SPEED_{i,t}$	= Natural logarithm of the number of days from the end of the fiscal year t to the earnings announcement date multiplied by -1.
$FRGN_{i,t}$	= Percentage of foreign investors' holdings at the end of period t .
$\%PEERS_{i,t}$	= Percentage of firms included in the same <i>Nikkei medium classification</i> in period t that disclose disaggregated SG&A information on <i>Kessantanshin</i> .
$MV_{i,t}$	= Natural logarithm of market capitalization at the end of period t .
$BM_{i,t}$	= Ratio of shareholders' market capitalization to shareholders' equity in period t .
$SGA_{i,t}$	= SG&A expenses standardized by total assets in period t .

5 Empirical Results

To identify the incentives for disaggregated SG&A information disclosure in *Kessantanshin*, the study estimates logit model following Chen et al. (2002) and Levi (2008). Columns (1)-(5) of Table 2 show the results of Hypothesis 1. Column (1) shows the results using $SGAINT$ as the explained variable, columns (2)-(4) show the results of decomposing $SGAINT$ into *Personal Ex-*

penses, *Advertising Expenses*, and *R&D Expenses* and Column (5) presents the result of *SGAFV*. All coefficients of interest are positive and statistically significant, consistent with the hypothesis. Columns (6)–(8) show the results of Hypotheses 2 and 3. The coefficients of *ABDE_all* in column (6), *ABDE_five* in column (7), and *SUBSIDIARY* in column (8) are negative at the 1% significance level, supporting the hypotheses.

Overall, the results indicate that management decides to disclose disaggregated SG&A information in *Kessantanshin* when the future asset value of SG&A is higher, but withholds it if they engage in earnings management or have a higher administrative burden.

Table 2. Results of the logit analysis

Dependent variable = $DISCLOSURE_{i,t}$								
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
$SGAINT_{i,t}$	2.986*** (0.301)							
$Personal\ Expenses_{i,t}$		2.232*** (0.319)						
$Advertising\ Expenses_{i,t}$			9.757*** (1.187)					
$R\&D\ Expenses_{i,t}$				4.558*** (1.170)				
$SGAFV_{i,t}$					0.236*** (0.110)			
$ABDE_all_{i,t}$						-0.807*** (0.286)		
$ABDE_five_{i,t}$							-7.379*** (0.423)	
$SUBSIDIARY_{i,t}$								-3.864*** (0.585)
<i>Constant</i>	-1.325*** (0.550)	-1.248*** (0.548)	-0.895*** (0.541)	-0.976*** (0.541)	0.733*** (1.397)	-0.713*** (0.553)	0.194*** (0.558)	-0.921*** (0.542)
<i>Control</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>Industry</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	24,357	24,357	24,357	24,357	5,370	24,357	24,357	24,357
pseudo R-sq	0.121	0.119	0.120	0.118	0.120	0.118	0.128	0.119
Log-likelihood	-14586	-14613	-14597	-14630	-3202	-14633	-14474	-14616

Note: The explained variable *DISCLOSURE* is a dummy variable that takes a value of 1 if firms disclose disaggregated SG&A information on *Kessantanshin* and 0 otherwise. Control variables include *SALES_SD*, *SGA_SD*, *RET_SD*, *LOSS*, *FE*, *AGE*, *SPEED*, *FRGN*, *%PEERS*, *MV*, *BM*, *SGA*, industry dummy, and year dummy. To avoid multicollinearity problems *SGA* is excluded from the control variables in the analysis of $SGAINT_{i,t}$ and $SGAFV_{i,t}$. Table 1 presents the definitions of variables. The numbers in parentheses are the heteroskedasticity-consistent standard errors. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Yet, certain firms with specific characteristics may be more likely to provide disaggregated SG&A information, raising concerns about endogeneity. To address this concern, the supplemental analysis in the online appendix adds firm fixed effects in the main regression model. Almost all the results are similar to those in Table 2, suggesting that the results of this study are robust even when endogeneity is considered.

6 Discussion and Conclusions

This study determines management's incentives to disclose disaggregated information in SG&A expenses in *Kessantanshin* finding that management decides to disclose disaggregated SG&A information considering not only investors' information demand, but also other factors such as earnings management and administrative burden. Now the FASB proposes disaggregated disclosure of operating expenses on the income statement. The study's results imply that without regulation, useful information may remain undisclosed in some cases, suggesting the benefits of regulation.

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