Income Statement Format and Information Asymmetry: International Evidence

Abstract: This study examines how income statement format affects investors' information processing. Although many jurisdictions worldwide allow firms to classify expenses either by function or by nature, the capital market consequences of income statement format remain unclear. Using an international panel of firms from thirty countries, I find that reporting expenses by nature rather than by function is associated with lower information asymmetry among investors. Specifically, firms using the nature-of-expenses format exhibit narrower bid-ask spreads and lower idiosyncratic risk than those using the function-of-expenses format. Additional analyses also reveal lower short interest and stronger earnings response coefficients under the nature-of-expenses format. Overall, the findings suggest that, despite obscuring certain aggregates such as cost of sales, the nature-of-expenses format appears to offer a more informative disaggregation of operating costs, thereby facilitating the processing of firm-specific information by investors.