

Internet Appendix A123: Insider Selling
A123.1 Illustrative Reverse Engineered Pitch Template Example

Pitcher's Name	Bao Hoang Nguyen	FoR category	Insider Selling	Date Completed	25/07/2016
(A) Working Title	Dechow, P. M., Lawrence, A., & Ryans, J. P. (2015). SEC comment letters and insider sales. <i>The Accounting Review</i> , 91(2), 401-439. [reverse engineered]				
(B) Basic Research Question	Whether insiders benefit from trading before the release of comment letters? How do investors respond to the disclosure of SEC Comment Letters given high pre-disclosure insider sales?				
(C) Key paper(s)	Cassell, C. A., Dreher, L. M., & Myers, L. A. (2013). Reviewing the SEC's review process: 10-K comment letters and the cost of remediation. <i>The Accounting Review</i> , 88(6), 1875-1908. Cohen, L., Malloy, C., & Pomorski, L. (2012). Decoding inside information. <i>The Journal of Finance</i> , 67(3), 1009-1043. Huddart, S., Ke, B., & Shi, C. (2007). Jeopardy, non-public information, and insider trading around SEC 10-K and 10-Q filings. <i>Journal of Accounting and Economics</i> , 43(1), 3-36.				
(D) Motivation/Puzzle	Comment letter correspondence between the Securities and Exchange Commission's (SEC) Division of Corporation and companies has raised a concern about opportunistic insider trading because of the delay in making it publicly disclosed and the different perceptions of its importance. The SEC views most issues in comment letters as unlikely to move prices and, hence, as not material under the legal definition, whereas corporate executives are deeply concerned with investor perception of comment letters and willing to change their reporting practices to reduce the probability of receiving a comment letter. Therefore, the motivation of this study is to investigate whether opportunistic insiders take advantage of the SEC's policy to benefit themselves.				
THREE	Three core aspects of any empirical research project i.e. the "IDioTs" guide				
(E) Idea?	To examine whether the degree of insider sales is abnormal, firm's insider sales are compared to their expected level in different time intervals during the correspondence period, pre-disclosure period and post-disclosure period. Given the hypothesis about the importance of Revenue Recognition Comment Letter, the sample is divided into two groups (Revenue Recognition Comment Letters and Other 10-K Comment Letters). In the former group, firms in the highest quintile of short interest are also analysed to test whether insider selling is more pronounced in the presence of high short interest. Moreover, this paper uses full sample data to run the regression of pre-disclosure insider sales on Revenue Recognition Comment Letter, high short interest and their interaction term with controls for other determinants to study their separate and moderating effects on the dependent variable. CAR (calculated by the cumulative daily stock returns less CRSP capitalization weighted market return) in different time windows of pre-disclosure insider sale firms and no pre-disclosure insider sale firms are compared to study investor response to the release of comment letters in each group. The paper also tries to explain why there is no immediate stock price response at the release time, i.e., there is a drift after the release.				
(F) Data?	Country: US Unit of Analysis: Firms. Sample period: 7 years (2006-2012). Data Type: Firm-specific. Sample Size: 6728 observations. Data Sources: Audit Analytics Comment Letter database, Thomson Reuters Insider database, Compustat Fundamentals Annual database, CRSP (for return data). Data Issue: <ul style="list-style-type: none"> - Define a "conversation" as a series of comments and responses and identify the number of unique conversations in the sample period. - Excluding comment letter observations in which (a) firm's data on the variables used to analyse is not available or/and (b) the actual disclosure date is not within five business day of the anticipated date. - For insider sales variable, the main results use total insider sales (daily fraction of shares outstanding sold by insiders). The results are robust if using insider sales net of buys. The non-zero insider sales data are winsorized at the 1 percent level to avoid effects of outlier observations, consistent with prior literature. 				
(G) Tools?	Research Method: <ul style="list-style-type: none"> - Use revenue recognition comment letters to proxy for price-sensitive comment letters. 				

	<ul style="list-style-type: none"> - Using Lie's (2005) methodology to control for the expected level of insider sales. - Using statistical inference to compare insider sales, CAR. - Using OLS regression. - Two additional approaches to identify price-sensitive comment letters
TWO	Two key questions
(H) What's New?	This study suggests that comment letters vary in their informativeness to the market and the variation in usefulness depends on the topics covered, while prior studies generally assume all comment letters contain useful information. Moreover, it is the first time the variation in the usefulness of different comment letter categories is examined.
(I) So What?	The finding of this study provides regulators and corporate boards empirical evidence to reassess their policy on comment letter disclosure to reduce the appearance of executive opportunism.
ONE	One bottom line
(J) Contribution?	This study adds novelty to research about comment letters by providing a proxy (insider sales around release date) to evaluate which comment letters are likely to be more informative to market participants. Furthermore, it contributes to the literature on the strategic use of insider information by designing a tighter test in which the window where insiders are expected to trade is measured in days rather than months or years as in previous studies.
(K) Three Key Findings	<ol style="list-style-type: none"> 1. Insider trading is significantly higher than normal levels prior to the public disclosure of SEC comment letters relating to revenue recognition, especially for firms with high short positions. 2. Negative drift in return is small at the comment letter release date, 1 to 5 percent over the next 50 days following the release and stronger with greater pre-disclosure sales 3. The delayed price reaction to comment letter releases is due to investor inattention.

Mickey Mouse Diagram:

