

## Worried About Corporate Numbers? How About the Charts?

Donna Rosato, *The New York Times*, September 15, 2002.

Add charts in annual reports to the list of corporate financial information that investors should view with skepticism.

At least 1 in 10 graphics in annual reports shows a more positive picture than the underlying financial information warrants, a study of American corporate reports by Florida Gulf Coast University indicates.

While other academic research over the last decade has established that financial charts are often designed to paint a rosier corporate picture than the numbers warrant, a study by Deanna Oxender Burgess, an accounting professor at Florida Gulf Coast University, goes a step further. It examined the effect of the chart design on readers of annual reports, who are mainly investors, stock analysts and shareholders.

Dr. Burgess found that even slight distortions in a chart changed readers' perceptions of the information. "The danger is that people believe there's more growth than there really is or that performance isn't as poor, which could influence investment decisions," said Dr. Burgess, who conducted focus groups with 80 stockbrokers, bankers, accountants and business students.

In showing examples of bar charts to the groups, Dr. Burgess found that even the slightest change in a chart led people to think that there was more growth in the numbers than there really was.

The most common technique is to start the baseline of a chart at a number other than zero, which at first glance can indicate stronger growth or a smaller decline than actually occurred.

For example, a quick look at the sales growth chart in the 2001 annual report of the Zales Corporation, the jewelry retailer, might make a reader think that sales more than tripled in the last five years when they did not even double, Dr. Burgess said.

Zales says the chart was not intended to mislead. "You're not losing the validity of the information by the way it is presented," said David Sternblitz, a spokesman for Zales. "This was the most condensed way of doing it with the numbers clearly stated."

Mr. Sternblitz added, "If you were truly trying to mislead someone, you would just leave out charts that might be negative."

In some cases, Dr. Burgess says distortions are "egregious." Some companies omit numbers from the scale altogether, making it even tougher for investors to see the true picture.

The Dial Corporation, the maker of soaps and other consumer products, posted a sharp drop in earnings per share from continuing operations from 1999 to 2000. In its 2001 annual report, the scale of a chart showing those numbers began at less than zero, which made the decline appear less severe, she said. Dial did not include a scale on the chart.

The company said it did not regard the chart as confusing.

"The visual representation of the financial highlights is just that: a representation," said Conrad Conrad, Dial's chief financial officer. "Since the visual contains all the actual numbers, we find it hard to believe that anybody can be confused about the results." Mr. Conrad said the chart appeared on a page in the report that also displayed five years of financial data, providing more context for readers.

Dr. Burgess's study was based on 70 annual reports from American companies. Other research supports her findings of a pattern of distorted graphics. An analysis of 270 annual reports of 74 companies from 1984 through 1994 found that nearly half of the graphics did not include a scale and 17 percent did not begin with a zero baseline. The study was published last year by Cynthia Frownfelter-Lohrke of Samford University in Birmingham, Ala., and Cheryl Linthicum Fulkerson of the University of Texas at San Antonio.

The findings add weight to investor cynicism about the honesty of corporate financial reporting.

"In today's environment, it's more important than ever for companies to communicate information to investors that is clear and understandable," said Louis M. Thompson, the chief executive of the National Investor Relations Institute, an association of investor relations and corporate communications officers. "Any presentation that in any way distorts the message is a mistake."

About 75 percent of corporate annual reports contain charts and graphics, according to a survey of American annual reports that was released in August by the institute. The most common varieties depict trends in revenue, net income, earnings per share and dividends. A distorted chart in an annual report is not a small issue, Mr. Thompson said.

"The corporate annual report is the most-used written document that a corporation produces," he said. "There are some very sophisticated individual investors today, but they don't have the same kind of resources that an analyst or big institutional investor would have, like talking to a company's suppliers or taking a plant tour. The annual is an important tool for them."

Even experienced investors say they are influenced by the charts they see in annual reports.

"A chart or graphic will help me understand things more clearly," said Ron Riley, 52, a Prudential Securities investment adviser in Fort Myers, Fla., who participated in Dr. Burgess's study. "I realize now that even the slightest twist or nuance can really distort the bottom line."

He study did not delve into why companies distort charts, but some financial industry experts say the practice is more about spinning information positively than intentionally misleading readers.

"It's pretty common but not necessarily done with malice," said Lee Seidler, managing director emeritus of Bear Stearns. Still, he said, the practice is not acceptable. "In some ways, this is a symptom of a bigger issue, which is corporations and management stepping over the line in terms of how they present their performance," Mr. Seidler said.

Others blame a trend toward loading glossy reports with charts.

"The complex process of creating annual reports allows for errors and distortions of various kinds to creep in, many of which are probably not intentional," said Alan J. Davis, director of tax communications for PricewaterhouseCoopers in Canada.

Dr. Burgess said the study raised questions about the responsibility of corporate auditors, who express opinions about the financial statements in annual reports. But auditors, who are not involved in constructing the charts, are required to review them for material inconsistency with the financial statements, according to the Auditing Standards Board of the American Institute of Certified Public Accountants.

That leaves a lot to judgment, said Dr. Burgess, who contended that auditors should take an active role in pointing out distortions in annual-report charts and helping clients avoid potential "earnings management" problems.

That proposal does not sit well with some auditors.

"Even in this blame-the-auditor frenzy, it is one step too far," said Patrick Dorton, a spokesman for Arthur Andersen, the now defunct auditor of the 2001 Zales annual report. Deloitte & Touche, the auditor for Dial, declined to comment.

Mr. Thompson of the investor relations institute said it would not be appropriate for auditors to take on the duty for graphics.

"We're heaping a lot of responsibility on auditors these days," he said. "It's a bit of a stretch to say that auditors are responsible for an annual report's graphics. But it's clearly the responsibility of the company."