



1-1-2009

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Recommended Citation

Eakin, C. F., Louwers, T., & Wheeler, S. (2009). The Role of the Auditor in Managing Public Disclosures: Audit Opinion Modifications for Potentially Misleading Information in Documents Containing Audited Financial Statements. *Journal of Forensic and Investigative Accounting*, 1(2), 1–22.
<https://scholarlycommons.pacific.edu/esob-facarticles/166>

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**The Role of the Auditor in Managing Public Disclosures: Potentially Misleading
Information in Documents Containing Audited Financial Statements**

**Cynthia Firey Eakin
Timothy Louwers
Stephen Wheeler***

In the wake of recent alleged audit failures such as Enron, WorldCom, Xerox and others, it is interesting to note the 1999 quote by then Securities and Exchange Commission (SEC) Chairman Arthur Levitt (Holdings and Carlsen, 1999, A1): “Too many corporate managers, auditors and analysts are participants in a game of nods and winks. Managing may be giving way to manipulation. Integrity may be losing out to illusion. Today, American markets enjoy the confidence of the world. How many half-truths, and how many accounting sleights of hand, will it take to tarnish that faith?” Crenshaw and Fromson (1998, H1) similarly noted, “As in most professions, the real problems aren’t the big things - the gross breaches of ethics - but the little things. What clients want isn’t an outright lie, but a shading that casts the client’s situation in the most favorable light.” And more recently, U.S. Representative John Dingell (2001) chastised the profession saying, “The best accounting standards in the world are meaningless if the accounting and auditing processes are so inept or corrupt that they produce unreliable numbers or untruthful reporting.”

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Audited financial statements are included as a part of companies' annual reports to shareholders and as a part of 10-K reports to the SEC. Often times, to avoid duplication of disclosures, the annual report is "incorporated by reference," as is, into the 10-K filing. Accompanying the financial statements in a typical annual report is a myriad of other information, including a discussion and interpretation by corporate officers of the financial performance of the company (e.g., the President's letter). Furthermore, management's discussion and analysis (MD&A) of financial information is a required section of the 10K filing for public companies.

Statement on Auditing Standards (SAS) No. 8, (AICPA, 1975) "Other Information in Documents Containing Audited Financial Statements," states that "The auditor's responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document." However, the auditor does have a responsibility to "read the other information and consider whether such information, or the manner of its presentation is **materially inconsistent** with information, or the manner of its presentation, appearing in the financial statements" (emphasis added). In cases where a material inconsistency is noted, the auditor is instructed to first request that the client revise the other inconsistent information. If the client refuses, the auditor should either add an explanatory paragraph to the audit report discussing the material inconsistency or, depending on severity, consider withdrawing from the engagement.

Auditor consideration of the non-financial-statement information contained in annual reports is an important topic due to the attention given this other information by financial statement users. For instance, prior regulatory documents (e.g., SEC, 1977) establish that financial statement users are much more prone to read the President's Letter than to read the

financial statements, footnotes, or auditor's report. More recently, Epstein and Palepu (1999) surveyed financial analysts to explore what financial information they tend to use. Their results show that analysts find the Management Discussion and Analysis and the President's Letter to be very useful. In contrast, other analysts often perceive the actual financial statements to be irrelevant because of their reliance on outdated historical cost information.

With the increased responsibilities of external auditors under the Sarbanes-Oxley Act (SOX) of 2002, one might question whether the issues addressed in this paper are currently relevant. Clearly the disincentives for auditors to fail to detect misleading disclosures have changed. However, there is evidence that post-SOX managers still manipulate the way financial information is disclosed in the non-audited sections of the annual report. One recent example is Ryerson, Inc. In the notes to its 2005 annual report, Ryerson disclosed a \$9.8 million charge to earnings from a change in the way the LIFO inventory method was applied, and at the same time recognized a \$13.1 million increase to earnings from the liquidation of the resulting LIFO layers. Although the financial highlights section of the annual report notes the charge to earnings from the change in LIFO application, it does not disclose the even larger increase in earnings from the LIFO liquidation. The CEO's letter refers to "record earnings for Ryerson" in 2005, but does not disclose that more than 24 percent of 2005 earnings was attributable to the LIFO liquidation.

Despite the issue's potential importance, the topic of auditor scrutiny of other information contained in U.S. corporate annual reports has received little attention in the U.S. accounting literature.¹ Taylor and Anderson (1986) provide a tutorial on how an auditor should evaluate the "consistency" of graphical information presented in annual reports. Specifically, they provide examples of reporting "tricks" that may be considered misleading. These include: 1) creatively setting "zero lines" in graphical presentations, 2) using rates of change graphs rather than raw data graphs, 3) using "multiple amount" scales for graphs, 4) placing the most

irregular stratum near the top of graphs that show multiple data sets, 5) carefully selecting the years to be presented to create more favorable impressions, 6) not using the same order of time values as the financial statements to show trends, and 7) extending the scale range beyond the highest or lowest points to distort the perceptions of data variability.

Despite this early guidance, other research provides considerable evidence that improperly designed graphs are commonplace in annual reports (Beattie and Jones, 1992; Courtis, 1997; Steinbart, 1989; Johnson *et al.*, 1980). Steinbart (1989), in particular, called for more guidance in defining the auditor's responsibility in this area over a decade ago. Most recently, Arunachalam, Pei, and Steinbart (2000) find that the likelihood to invest in companies was significantly affected by graphical formats that made financial performance appear more favorable than it really was. Furthermore, two other papers (Eakin and Wendell, 1998; Louwers, Pitman, and Radtke, 1999) identified instances (both graphical and other) where disclosures in President's Letters, MD&A and other information accompanying the financial statements might be considered misleading.

In the Eakin and Wendell (1998) study, management's discussions of earnings surrounding the adoption of Statement of Financial Accounting Standards (SFAS) No. 96 on accounting for income taxes was at issue. Results showed numerous cases in which the effect of adopting SFAS No. 96 materially increased a company's income, yet management neglected to mention this fact in discussing the increase in earnings as compared to the prior year. Conversely, in cases where adoption caused a substantial decrease in net income, the adoption effects were dutifully mentioned in the year of change, but were *not* mentioned in the following year when discussing why net income was higher than the previous year. The conclusion reached was that adoption of SFAS No. 96 was used by some companies to "manage" public disclosure of their earnings. In fact, the authors note that some of the literature distributed by accounting

firms regarding SFAS No. 96 actually *suggested* that companies consider using the earnings effects for that purpose.

In the Louwers, Pitman, and Radtke (1999) study, an examination of 100 randomly-selected annual reports during the period 1991-1993 showed that 42 percent exhibited "less-than-completely straightforward presentation of operating results." These presentations ranged from a simple omission of net income information from the "Financial Highlights" section to the use of truncation and creative presentation techniques in graphs to make the information appear more positive than warranted. For example, one of the "creative" techniques involved tilting an entire graph containing declining earnings per share data over time to create the impression of an upward trend. A second example involved comparisons of current year data to prior year data with a corresponding column for "% increase." If the amounts increased, the percentage was dutifully reported. However, if the amounts decreased from the prior year, the column was left blank since it was not technically an *increase*. Similarly, another firm labeled any percentage decreases as not meaningful.

In a somewhat related study, Hodge (2001) points out the potential for the SAS No. 8 issue to apply when looking at audited financial statements that are hyperlinked to unaudited information in a web-based environment. He showed that web subjects misclassified hyperlinked unaudited information as audited more often than subjects viewing hard copy materials. Web subjects also rated the credibility of accompanying hyperlinked unaudited information as higher than subjects viewing hard copies of the unaudited information.

Clearly, the magnitudes and severities of the instances noted in prior studies vary substantially. However, they provide a useful starting point to examine the bigger issue of what types of disclosures, if any, have been considered by auditors to meet the "materially inconsistent" criterion of SAS No. 8 since its release in 1975.

Research Questions

To date, no empirical study of how often materially inconsistent information in annual reports has been encountered in practice or what types of issues give rise to a need to address them. Therefore two research questions are addressed in this study as follows:

Research Question #1: What is the frequency of audit report modifications for other information in annual reports considered to be materially inconsistent with audited financial statements?

Research Question #2: What types of other information contained in annual reports are considered to be materially inconsistent with audited financial statements?

3. Archival Search Methodology and Results

Using the NAARS database of full text annual reports and the SEC's EDGAR database, we searched for key-words associated with the issue. Specifically, we looked for the words "*materially inconsistent,*" or various forms of the two words in audit reports for all companies for the period 1975 through 2007, (the latest date available on NAARS is 1995, and EDGAR was used for subsequent years). We also looked for other possible words such as "*other information*" or "*documents containing audited financial statements,*" or various forms of these phrases.

As a result of exhaustive key-word search procedures, we could not locate *any* instances where an audit report was modified for the issue at hand. Clearly implicit is that none of the disclosures in the previously discussed studies resulted in *modifications* of auditors' reports.² The logical conclusion is that, to the best of our knowledge, during the thirty-year period following the issuance of SAS No. 8 in 1975, there was not a single unresolved disagreement between an auditor and a public-company client concerning annual report disclosures considered materially inconsistent with the financial statement information.³ Therefore, Research Question #1 regarding the incidence of audit report modifications is answered with the empty set.

Consequently, Research Question #2, which addressed the types of disclosures considered materially inconsistent, is rendered moot.

Interpretation of the findings is somewhat perplexing. On the one hand, the results could indicate that no problem exists since all disputes regarding materially inconsistent information have been rectified prior to issuing audit reports. On the other hand, given the disclosure examples brought up in cited recent research, the failure to note any audit report modifications for materially inconsistent “other information” may indicate that a problem does exist and more clarification of the issue is needed.

To help clarify the argument, we first discussed the issue with three practicing Big-4 audit managers to determine whether a sample of the issues brought up in prior research would be considered materially inconsistent with the financial statements that they accompany. We also asked how often they had encountered disagreements with clients over potentially-misleading other information in annual reports. All three stated that such an issue had come up at least once during their careers. In every instance, these auditors stated that the issue was resolved to their satisfaction by having the client change the information considered potentially inconsistent. Interestingly though, when presented with the two examples of the “tilted graph” and the “non-reporting of the % decreases,” all three said that they would have insisted on having the item changed by the client.

Given this anecdotal evidence, we decided that obtaining the perceptions of more practicing accountants using examples of potentially misleading disclosure would help to clarify the issue. Also, given that the accounting profession often suffers from “expectation gaps” between the perceptions of financial statement users and professional accountants, we opted to obtain feedback from non-CPAs as well.

Survey Methodology

Five cases were developed from excerpted actual reports of a sample of companies noted in the aforementioned studies, as follows (see Appendix):

Case 1: Omission of Net Loss from *operating highlights* presented.

Case 2: *Creative graph tilting* to give an impression of a positive trend

Case 3: Omission of mention of the *income-increasing effect of a change in accounting principle* when discussing the increase of current year's income over prior year's income (cumulative effect disclosed in financial statements).

Case 4: *Selective presentation of % increase* data, omitting any decreases.

Case 5: *Non-mention of LIFO liquidation* effects when discussing current operating results and improvement from prior year.

Case materials contained a detailed discussion of the issue, including the requirements of SAS No. 8. Also, sufficient excerpts from the annual reports and other information were included to adequately explicate the disclosure issue.

4.1 Subjects

We administered the cases to two groups. The first group consisted of a total of 107 CPAs at a continuing professional education seminar presented by the state CPA society of a western U.S. state. Participants averaged 17 years of professional experience (a range of 1 to 49 years).⁴ To surrogate for financial statement users,⁵ we also administered the survey to 51 MBA students at a western U.S. University. These students had recently completed a graduate seminar in Financial Accounting and Reporting and averaged professional experience of four years (a range of one to twenty) before entering the MBA program. MBA subjects are considered appropriate surrogates for nonprofessional investors, given that the accounting and auditing issues are clearly explicated and the task is not high in integrative complexity (Elliott *et al.*, 2007).

4.2 Survey Results

Table 1 presents the mean responses by example case and by subject group of the assessments of the degree to which disclosures were considered potentially misleading.⁶ As seen in Table 1, across all five cases and both subject groups, all means were significantly greater than zero (all at $p < 0.01$), with zero corresponding to “not at all materially inconsistent (not at all misleading)” and four corresponding to “extremely materially inconsistent (extremely misleading).” This result indicates that subjects perceived all five cases to be, at least to some degree, potentially misleading.

We also tested the significance of the responses as compared to the midpoints (2.0) of the Likert scales. When compared to the midpoints, only three of the five cases were significantly greater than 2.0 for the CPA group (i.e., the net loss not disclosed, selective presentation of % increases, and non-mention of LIFO liquidation). In contrast, four of the five cases were significantly greater than 2.0 for the MBA group. Comparing groups, the third case, involving non-mention of the effects of accounting principle changes when discussing year-to-year changes in profits in Presidents’ letters, was not considered materially misleading by the CPAs, but was by the MBAs ($t = -2.91$, $p < 0.004$). While neither subject group considered the second case using the “tilted graph” to be significantly misleading when compared to 2.0, MBAs saw the disclosure as significantly more misleading than the CPAs ($t = -3.60$, $p < 0.001$).

Discussion

In this paper, we investigate auditors' responsibilities concerning other information contained in documents containing audited financial statements. SAS No. 8 mandates that the auditor modify the audit report for annual report information considered to be materially inconsistent in content or in manner of disclosure with information contained in the financial statements. Exhaustive data base key-word searches for phrases that would be associated with such report modifications yielded no matches for the years 1975-2007. These results indicate that in a thirty-year period since the implementation of SAS No. 8 on this topic, not one annual report containing published information accompanying audited public financial statements was considered by the auditor to be misleading enough to warrant an report modification. Despite this finding, recent research points to examples of disclosures in annual reports that may be considered misleading.

We conducted a case survey of CPAs and MBA students using examples of potentially inconsistent disclosures in President's letters or in Management's Discussions and Analyses noted in recent studies. We find that for all five potentially misleading disclosure issues addressed in the survey, participants saw at least some potential for misleading disclosures. When compared to midpoints of the response scales, four (three) of the issues were considered significantly misleading by the MBA (CPA) subjects. These issues involved 1) omitting net loss information from the "Financial Highlights" section of the annual report, 2) not mentioning income-increasing accounting change effects when discussing income increases in the President's Letter, 3) creative selective presentation of % increase data, and 4) ignoring LIFO liquidation income-increasing effects when discussing operating results in the MD&A section of a 10K report.

For two of the example disclosures, MBAs rated disclosures as significantly more misleading than their CPA counterparts. These results and the cited studies identifying disclosures that apparently “push the envelope” of questionable disclosure practices, logically imply that future research providing more authoritative clarification of the term “materially inconsistent” may be needed. It would also be interesting to study how materiality is interpreted with respect to this issue.

Also, with the boom in web-based financial statement disclosures, the issue of information accompanying audited financial statements has become even more salient. Despite this, Interpretation No. 4 of SAS No. 8 (1997) states that auditors are not required to read and assess the consistency of information contained on electronic sites.

It is important to note that the SEC cannot be expected to take action against firms for many of the inconsistencies we examine. This is because most of the information we examined in our survey is not included in SEC filings. For example, CEO letters, graphical and other representations of earnings growth are part of the annual report sent to shareholders, but are not necessarily part of the 10K filings. The only item included in our survey that is certainly reported to the SEC in the Management’s Discussion and Analysis (MD&A) section is the failure to disclose the effects of a LIFO liquidation in the MD&A section. Interestingly, in August of 2007, the SEC filed civil charges against three executives of Nicor, Inc. for failing to make disclosures required by generally accepted accounting principles about the effects of LIFO inventory liquidations on Nicor’s reported income. Given this, perhaps the entire annual report should be required to be submitted with the 10K to the SEC and reviewed by the auditors.

The major disincentive auditors have to modify the opinion for material inconsistencies noted (if they are in fact noted) is the clients’ aversion to receiving a report modification. As noted in the paper, when we discussed this with practicing Big 4 accountants, they all said that

when found, the client always changed the items in question. What this paper is pointing out is that, apparently, some items that are considered misleading slip through the auditors' procedures. We believe this is because, at least historically, either 1) auditors have not looked at these other disclosures as carefully as desired, or 2) the auditing standards in this area are not clear enough or stringent enough to prompt the detection of these potentially misleading disclosures.

The findings of this study are limited by certain factors. For example, by explicating the accounting and auditing issues prominently in the instrument, the possibility of biasing responses upward exists. However, the issues addressed here would appear to be *clear* examples of inappropriate disclosures (as pointed out in prior papers and verified by our pre-testing of the instrument). Therefore, starting from this premise, we asked informed subjects to determine just how misleading they were. To the extent that responses are biased upward limits our conclusions. Also, since the instrument included the original dates of the disclosures (i.e., 19XX), rather than, say, 20X6 and 20X7, subjects may have overstated their perceptions about how misleading the disclosures were. In retrospect, it would have been interesting to include a case with a correct disclosure to see if subjects still rated the issue as misleading, and hence, to measure this potential bias. Finally, auditor experience levels, which were not measured, may have affected the results.

¹ Johnstone (1986) discusses Canadian Auditing Standards Section 7500 "The Auditors Involvement with Annual Reports." Ironically, Canadian rules do not provide for modification of the auditor's report in cases where the auditor feels other information is materially inconsistent with the financial statements. Instead, the Canadian rulemaking body, AuSc, concluded that, "given that auditors were reporting only on the financial statements, it was doubtful whether they had any legal right to add such remarks" (p. 59).

² As a test of the search procedures used, we specifically looked at reports for all of the companies cited in the Eakin and Wendell (1999) and the Louwers, Pittman and Radtke (1999) studies. None of the audit reports for these companies were modified to mention material inconsistencies in the information accompanying the audited financial statements.

³ Because of our finding (no instances noted), we undertook a search of the *Journal of Accountancy* in the 1970's leading up to SAS No. 8's passage to determine why the standard was issued in the first place (i.e., did widespread inconsistencies drive the passage of the standard?);

we found the authoritative literature and dissenting opinions (because of litigation concerns), but no justification for the promulgation of SAS No. 8.

⁴ Given the wide range of experience within the CPA group, we also tested whether the experience level significantly influenced subject responses. Regression results for the experience variable proved insignificant in explaining the variation in CPA subjects' responses to all five cases.

⁵ Of the MBAs, 14 of 51 indicated measurable prior experience in investing activities. Analysis of these subjects showed that their responses were not significantly different than the other MBA subjects. Thus, the MBA group was considered a reasonable surrogate for financial statement users.

⁶ The instrument also asked subjects about whether the audit report should be modified. These results are not presented since they exactly parallel the results of the other question.

Table 1
Mean Responses to Potentially Misleading Disclosures Cases

Case	CPAs (n=107)	MBAs (n=51)
	Mean (std error)	Mean (std error)
1. Net Loss Not Disclosed in Financial Highlights	2.40*# (.11)	2.67*# (.15)
2. “Tilted” EPS Graph	1.39* (.10)	1.93* (.16)
3. Effect of Change in Accounting Principle Not Mentioned when Discussing Current vs. Prior Year Operations	2.17* (.10)	2.78*# (.11)
4. % Increases, but Not % Decreases Disclosed	2.20*# (.11)	2.40*# (.17)
5. LIFO Liquidation Effects Not Mentioned in MD&A Discussion of Operating Results	2.52*# (.10)	2.56*# (.15)

* - significantly greater than zero at $p < 0.01$ using t-test. Responses ranged from zero, which represented the “not at all inconsistent (not misleading)” response on the provided Likert scales, to 4.0, representing, respectively, the “extremely materially inconsistent (extremely misleading).” See Appendix for a copy of the instrument.

- significantly greater than 2.0 midpoint of Likert scale range at $p < 0.05$ using t-test.

APPENDIX

Survey Instrument

Thank you for participating in this case survey. **It should only require about 10 minutes of your time.** The materials you will be looking at contain **actual disclosures** in annual reports and 10-K reports of audited public companies. The company names have been changed.

THE ISSUE: Statement on Auditing Standards (SAS) No. 8, issued in 1975, covers the auditor's responsibilities regarding "**Other Information in Documents Containing Audited Financial Statements.**" These documents include President's Letters" in annual reports and the Management's Discussion and Analysis section of a 10K filing with the SEC. SAS No. 8 states that, "The auditor's responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document." However, the auditor does have a responsibility to "read the other information and consider *whether such information, or the manner of its presentation is materially inconsistent* with information, or the manner of its presentation, appearing in the financial statements." In cases where a material inconsistency is noted, the auditor is instructed to first request that the client revise the other inconsistent information. If the client refuses, the auditor should either add an explanatory paragraph to the audit report discussing the material inconsistency or, depending on severity, consider withdrawing from the engagement.

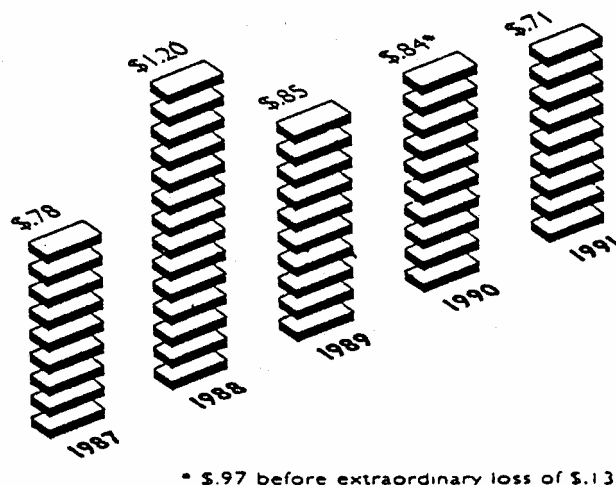
Instructions: For each of the following example disclosures, please indicate on the provided scale to what degree you believe the information or the manner of its disclosure is materially inconsistent with the audited financial statements (i.e., misleading). In cases where numbers are used, you may assume that you have successfully traced them to the financial statements and that the disclosure amounts are considered material. Also, the requirements of SAS No. 8 have remained unchanged since its issuance in 1975. Therefore, the actual year of any post-1975 annual report should not be an issue.

**Inconsistent
(not misleading)**

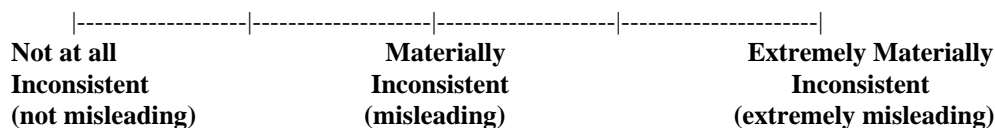
**Inconsistent
(misleading)**

**Inconsistent
(extremely misleading)**

Example 2: In this case, the company's annual report contained the following graph of fully-diluted earnings per share data for the five-year period ending in 19X1. While the data generally show a decreasing trend across the period, the entire graph has been tilted in an upward, left-to-right manner, which is normally associated with the presentation of increasing-trend data.



Please indicate (by placing an X on the scale below) the degree to which you believe the above disclosure is Materially Inconsistent with the information in the financial statements or the manner of its presentation



Example 3: In this case, the company's income statements (excerpted) show that 19X8 net income was materially affected by two non-recurring items (loss from discontinued operations and a gain from the cumulative effect of adopting SFAS No. 96 on Accounting for Income Taxes). Also shown below are the first two paragraphs of the company's shareholder letter written the year the company adopted SFAS 96. Although adoption of SFAS 96 increased net income by 114%, no mention of its effect is made in the shareholder letter in the year of adoption. Note also that the items that decreased net income (including discontinued operations) were discussed in the letter.

INCOME STATEMENT (Excerpted)
(IN THOUSANDS, EXCEPT FOR PER SHARE DATA)

	Year Ended June 30,		
	19X8	19X7	19X6
Net rental income(loss)	\$710	\$ (431)	\$48
General and administrative			

expenses	1,368	1,489	2,977
Loss from operations	(658)	(1,920)	(2,929)
Non-operating income (expense)	(69)	1,058	2,921
Loss from continuing operations	(479)	(487)	(5)
Loss from discontinued operations, net	(917)	(3,781)	(1,940)
Extraordinary item, net	-	-	2,173
Cumulative effect of change in accounting principle	743	-	-
Net income (loss)	(653)	(4,268)	228
Net income (loss) per share	(.20)	(1.64)	.09

SHAREHOLDERS' LETTER (Excerpted)

FELLOW SHAREHOLDERS:

This is my first report to shareholders and it is a pleasure to furnish you the results for the year ended June 30, 19X8. We believe this was a year of significant accomplishment for (company name) that is reflected more on the balance sheet than the operating statement and more for the future than the present. The focus during the year was on settling outstanding lawsuits, selling assets that have no relevance to our future plans, improving the rental operations of our 381 San Diego rental units, and raising additional capital to enable the Company to embark on a meaningful long-term strategy. Although operations were improved, there was a loss for the year.

IMPROVED OPERATIONS

For the year ended June 30, 19X8 consolidated results were a loss of \$653,000 (\$0.20 per share) compared to a loss of \$4,268,000 (\$1.64 per share) for the previous year. However, we call to your attention certain unusual and non-recurring charges that are included in 1988 results. In G&A expenses is a charge of \$240,000 resulting from the termination and settlement of retirement benefits due to a former officer of the Company. Included in non-operating expense is a charge of \$1,110,000 to write down the realizable value of the (certain assets) and in expenses of discontinued operations are litigation-related costs of \$1,180,000. Although we will continue to have litigation expenses until all pending lawsuits are resolved, we believe the heaviest burden of these expenses is behind us. For fiscal year 19X9, we expect that lower G&A expenses and additional interest income resulting from the increase in capital will make the Company profitable.

Please indicate (by placing an X on the scale below) the degree to which you believe the above disclosure is *Materially Inconsistent* with the information in the financial statements or the manner of its presentation

|-----|-----|-----|-----|

Not at all Inconsistent (not misleading)	Materially Inconsistent (misleading)	Extremely Materially Inconsistent (extremely misleading)	
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Example 4: In this case, the company's Financial Highlights section includes comparative data for 19X3 and 19X2, including a column to indicate the year-to-year change titled "% increase." Note that for items that increased, the percentage is reported (but not in all cases). However, if an item decreased, the % increase column was left blank in all cases.

Financial Highlights

	<u>Fiscal 19X3</u>	<u>Fiscal 19X2</u>	<u>% Increase</u>
Net sales and revenue	\$1,269,484	\$1,268,143	0.1
Earnings before cumulative effect of accounting changes	132,845	127,569	4.1
Cumulative effect of accounting changes	(90,390)		
Net earnings	42,455	127,569	
Earnings per share:			
Before cumulative effect of accounting changes	1.80	1.71	5.3
Cumulative effect of accounting changes	(1.22)		
Net earnings per share	.58	1.71	
Cash flow from operations as a percent of revenue	19.6%	19.5%	0.5
Return on shareholders' equity	32.3%	30.0%	7.6
Number of shareholders of record	15,279	10,121	
Average number of associates	9,280	12,871	

Please indicate (by placing an X on the scale below) the degree to which you believe the above disclosure is *Materially Inconsistent* with the information in the financial statements or the manner of its presentation

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Not at all Inconsistent (not misleading)	Materially Inconsistent (misleading)	Extremely Materially Inconsistent (extremely misleading)

Example 5: In this case, the notes to the company's financial statements (see below) disclose the effects of a significant LIFO inventory liquidation (reduction in inventory quantities resulting in presumed sale of older, low-priced inventory) during 19XX which caused net income to rise by \$ 33 million or 30%. In management's discussion (see below) of the increase in income from last year to the current year, no mention of the LIFO liquidation is made, although reference *is* made to the decreases caused by adopting SFAS No. 106 on Post-retirement benefits.

Inventory Footnote

Under the LIFO inventory method, cost of goods sold ordinarily reflects current production costs thus providing a matching of current costs and current revenues in the income statement. However, when LIFO-valued inventories decline, as they did in 19X3, lower costs that prevailed in prior years are matched against current year revenues, resulting in higher reported net income. Benefits from the reduction of LIFO inventories totaled \$51 million (\$33 million or \$.43 per share after income taxes) in 19X3.

Management's Discussion and Analysis

The Company's consolidated income for the fiscal year ended October 31, 19X3, before the cumulative effect of adopting new accounting standards related to postretirement and postemployment benefits, was \$111.0 million compared with 19X2 net income of \$95.0 million.

The ratio of earnings before fixed charges to fixed charges was 1.99 to 1 (excluding the effects of accounting changes) for 19X3 compared with 1.74 to 1 in 1992. The improvement in net income resulted primarily from higher securitization and servicing fee income from retail notes previously sold, lower credit losses, higher financing margins, and increased gains from the sale of retail notes, which more than offset the effects of a lower balance of Receivables and Leases financed. Net income totaled \$107.2 million in 19X3, including the cumulative effect of adopting Financial Accounting Standards Board (FASB) Statement No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, and FASB Statement No. 112, Employers' Accounting for Postemployment Benefits.

Please indicate (by placing an X on the scale below) the degree to which you believe the above disclosure is *Materially Inconsistent* with the information in the financial statements or the manner of its presentation

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<table border="0" style="width: 100%;"> <tr> <td style="width: 33%; text-align: center;">Not at all</td> <td style="width: 33%; text-align: center;">Materially</td> <td style="width: 33%; text-align: center;">Extremely Materially</td> </tr> <tr> <td style="text-align: center;">Inconsistent</td> <td style="text-align: center;">Inconsistent</td> <td style="text-align: center;">Inconsistent</td> </tr> <tr> <td style="text-align: center;">(not misleading)</td> <td style="text-align: center;">(misleading)</td> <td style="text-align: center;">(extremely misleading)</td> </tr> </table>	Not at all	Materially	Extremely Materially	Inconsistent	Inconsistent	Inconsistent	(not misleading)	(misleading)	(extremely misleading)
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(not misleading)	(misleading)	(extremely misleading)							

THANK YOU VERY MUCH FOR PARTICIPATING! If you would be interested in knowing more about the results, just send me an e-mail at

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