

1973

## **Disclosure of Projected Financial Information in Corporate Annual Reports.**

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DISCLOSURE OF PROJECTED FINANCIAL INFORMATION IN  
CORPORATE ANNUAL REPORTS

A Dissertation

Submitted to the Graduate Faculty of the  
Louisiana State University and  
Agricultural and Mechanical College  
in partial fulfillment of the  
requirements for the degree of  
Doctor of Philosophy

in

The Department of Accounting

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TABLE OF CONTENTS

LIST OF TABLES.....v

ABSTRACT.....vi

Chapter

I. INTRODUCTION..... 1

    The Problem

    Purposes of the Study

    Background and Significance of the Study

    Hypotheses

    Operational Definitions

    Assumption of the Study

    Limitations of the Study

    Methodology of the Study

II. THEORETICAL AND LEGAL CONSIDERATIONS RELATING TO  
THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION  
IN CORPORATE ANNUAL REPORTS.....20

    Introduction

    Relevance

    Verifiability

    Freedom from Bias

    Quantifiability

    Professional Ethics

    Conservatism

    Role of the Securities and Exchange Commission

    Legal Cases Related to Projected Financial  
    Information

    Summary

III. SURVEY OF CORPORATE ANNUAL REPORTS REGARDING THE  
DISCLOSURE OF PROJECTED FINANCIAL INFORMATION.....50

    General

    Results of the Survey

    Summary

IV. SURVEY OF OPINIONS OF FINANCIAL ANALYSTS REGARDING  
THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION  
IN CORPORATE ANNUAL REPORTS.....64

    General

    Survey Returns

    Hypotheses

|   |     |
|---|-----|
| Other Data<br>Summary   |     |
| V.    SURVEY OF OPINIONS OF CERTIFIED PUBLIC ACCOUNTANTS<br>REGARDING THE DISCLOSURE OF PROJECTED FINANCIAL<br>INFORMATION IN CORPORATE ANNUAL REPORTS..... | 91  |
| General<br>Survey Returns<br>Hypotheses<br>Other Data<br>Summary  |     |
| VI.   SURVEY OF OPINIONS OF CHARTERED ACCOUNTANTS<br>REGARDING THE DISCLOSURE OF PROJECTED FINANCIAL<br>INFORMATION IN CORPORATE ANNUAL REPORTS.....        | 120 |
| General<br>Survey Returns<br>Hypotheses<br>Other Data<br>Summary  |     |
| VII.  SUMMARY AND RECOMMENDATIONS.....  | 148 |
| The Problem<br>Purposes of the Study<br>Methodology of the Study<br>Major Findings<br>Recommendations   |     |
| APPENDIX A.....   | 174 |
| APPENDIX B.....   | 181 |
| APPENDIX C.....   | 187 |
| APPENDIX D.....   | 197 |
| BIBLIOGRAPHY.....   | 199 |
| VITA.....   | 204 |

LIST OF TABLES

| Table   | Page |
|---|------|
| 4-1. Sources of Information for Financial Analysts....                        | 72   |
| 4-2. Projected Financial Statements-Financial Analysts.....                   | 73   |
| 4-3. Projected Financial Statements by Year-Financial Analysts.....           | 74   |
| 5-1. Projected Financial Statements-Certified Public Accountants.....         | 98   |
| 5-2. Projected Financial Statements by Year-Certified Public Accountants..... | 99   |
| 6-1. Projected Financial Statements-Chartered Accountants.....                | 127  |
| 6-2. Projected Financial Statements by Year-Chartered Accountants.....        | 128  |



## ABSTRACT

A primary objective of published corporate annual reports is to provide adequate disclosure of financial information to the users of the reports. Such information is necessary for the proper evaluation of management's performance and for the making of investment decisions. Some financial analysts and accountants believe that a major weakness of financial reporting in published corporate annual reports is due to its orientation to past economic activity. They feel that the changing needs of the external users of corporate reports are not being satisfied as these reports largely omit financial information relating to the future plans and goals of the firms which is relevant for investment decision making.

A review of the literature shows that several financial analysts and accountants have proposed including financial information relating to the future plans and goals of the firm (Projected Financial Information) in published corporate annual reports. This study dealt with such a proposal. More specifically, it's purposes were:

1. To determine the extent projected financial information is presented in corporate annual reports.
2. To examine the possible implications of adopting the practice of disclosing projected financial information in published corporate annual reports.
3. To determine if Financial Analysts desire the inclusion of projected financial information in these reports.
4. To survey the opinions of Certified Public Accountants toward the feasibility of reporting on projected financial information.
5. To survey the opinions of English Chartered Accountants concerning the inclusion of projected financial information in published corporate annual reports.

The methodology employed in the study included primary and secondary research. Secondary research dealt with the legal and theoretical examination of the topic and also aided in the development of two survey questionnaires used in the primary research. The questionnaires were used in surveys of Financial Analysts, Certified Public Accountants, and English Chartered Accountants. A fourth survey determined the extent of reporting of projected financial information in selected corporate annual reports. To determine if most Financial Analysts, Certified

Public Accountants and Chartered Accountants desired the future plans and goals of corporations to be disclosed in corporate annual reports, the Z test at the 95% confidence level was utilized. Also, the confidence interval was utilized to determine the range wherein the true characteristic of a larger population, i.e., the members of the Financial Analysts Federation, the members of the AICPA, and the members of the Institute of Chartered Accountants in England and Wales, lies.

The characteristics measured were:

1. The attitudes of members of the three groups toward the inclusion of projected financial information in published corporate annual reports.

2. The attitudes of members of the three groups toward the "attesting to" projected financial information.

Recommendations suggested by the study were:

1. Revision of the Code of Ethics of the American Institute of Certified Public Accountants so that the role of accountants in dealing with forecasted information be clearly understood.

2. Definition of the rights, duties, and liabilities of those associated with forecasted information.

3. Continued research into the needs of investors for corporate information.

## CHAPTER I

### INTRODUCTION

#### The Problem

A primary objective of published corporate annual reports is to provide adequate disclosure of financial information to the users of the reports. Such information is necessary for the proper evaluation of management's performance and for the making of investment decisions. Some financial analysts and accountants believe that a major weakness of financial reporting in published corporate annual reports is its orientation to past economic activity. They feel that the changing needs of the external users of corporate reports are not being satisfied as these reports largely omit financial information relating to the future plans and goals of the firms. In their view, published corporate annual reports should disclose that financial information relating to the future plans and goals of the firms which is relevant for investment decision making.

In the following, one can note that several financial analysts and accountants have proposed including financial information relating to the future plans and goals of the firms (projected financial information) in published corporate annual reports. If this proposal is adopted, a problem might arise as to the role of the auditor in attesting to the fairness of the

presentation of estimated information. Some writers propose that the attest function be extended to include estimated data, while others believe that the attest function should be restricted to historical financial information.

Adopting the proposal to include projected financial information in published corporate annual reports might have a substantial impact on legal, accounting and auditing theory. This topic is examined in Chapter II.

In summary, one can state that it is important that the needs of financial analysts relating to the disclosure of projected financial information be determined. Also, the roles of the auditor need to be examined if the proposals were to be adopted. Finally, the adopting of these proposals might cause a need for revising and extending legal, accounting, and auditing theory. This study deals with these considerations.

#### Purposes of the Study

The primary objective of the study is to make a contribution to the growing body of knowledge relating to disclosure of financial information in published corporate annual reports. More specifically, the study attempts to:

1. Determine the extent projected financial information is presented in corporate annual reports.
2. Examine the possible implications of adopting the practice of disclosing projected financial information in published corporate annual reports.

3. Determine if Financial Analysts desire the inclusion of projected financial information in these reports. This examination also includes the types of data desired and its manner of presentation.
4. Survey the opinions of Certified Public Accountants toward the feasibility of reporting on projected financial information.
5. Survey the opinions of English Chartered Accountants concerning the inclusion of projected financial information in published corporate reports.

#### Background and Significance of the Study

In 1947 Dr. Stuart A. Rice proposed the disclosure of budgetary information in corporate annual reports at the Sixtieth Annual Meeting of the American Institute of Certified Public Accountants by stating:

In the government it is the custom to publish budgets but not the final results of operations. In private accounting the custom is the reverse. I should like to see business firms undertake to publish their budgets as well as financial statements because (1) it will give valuable information to stockholders and enable them to judge the planning ability of their managers and (2) provide valuable information on business plans and business operations. . . for economists and statisticians.<sup>1</sup>

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<sup>1</sup>W. W. Cooper, N. Dopuch, and T. F. Keller, "Budgetary Disclosure and Other Suggestions for Improving Accounting Reports," The Accounting Review, XLIII, (October 1968), p. 640.

In discussing what he regards as the current crisis in financial reporting, Howard I. Ross states:

What most people really want to know is not what happened in the past, but what is going to happen in the future. Therefore, we might assume that our objective should be to devise a financial statement projecting what is going to happen next . . . By our training (and particularly because of our celebrated caution), we should be able to provide future projections better than anyone else, and this is an increasingly important field in which I believe we should be prepared to assume responsibilities.<sup>2</sup>

He further supports the proposal for presenting projected financial information in annual reports with:

What really worries me is that we seem to be reaching a point where our financial statements are not so much criticized as ignored. More and more (or so it seems to me) people are going to other sources for financial information--to the president's report, or to the calculations of analysts--rather than to the conventional accounting statements we prepare for their guidance.<sup>3</sup>

Morton Backer, a supporter of incorporating a projected profit plan in the annual report, states:

Logic would seem to dictate that a company's stockholders are entitled to know, not only what has happened in the past, but also management's profit plan for the future, providing the information disclosed does not

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<sup>2</sup>Howard I. Ross, "The Current Crises in Financial Reporting," Journal of Accountancy, CXXIV, (August 1967), p. 68.

<sup>3</sup>Ibid., p. 66.

result in competitive reactions or other serious disadvantages to the company.<sup>4</sup>

Further,

Inclusive of forecast earnings in reports to stockholders would provide an additional basis for investment decisions and evaluation of management's performance.<sup>5</sup>

In recent years, other writers have suggested that the attest function be extended to cover future business plans.

Herman Bevis, in discussing the potential future of the attest function, suggests "certification to business planning (prospective accounting)."<sup>6</sup>

Agreeing with Bevis, Wilkinson and Doney observed:

In order that the audit by the independent accountant might better serve as an audit of management's performance, it is suggested that the examination be enlarged to include the following: (1) An analysis of management's expectations for the coming year . . . (2) A comparison of the audited financial statements for the current period with the anticipated statements prepared at the beginning of the period, indicating to some extent how well management has met its short run objectives.<sup>7</sup>

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<sup>4</sup>Morton Backer, "Financial Reporting and Security Investment Decisions," Financial Analysts Journal, XXVII, (March-April, 1971), p. 70.

<sup>5</sup>Ibid., p. 70.

<sup>6</sup>Herman Bevis, "The CPA's Attest Function in Modern Society," Journal of Accountancy, CXIII, (February 1962), p. 34.

<sup>7</sup>James R. Wilkinson and Lloyd D. Doney, "Extending Audit and Reporting Boundaries," Accounting Review, XL, (October 1968), p. 753.



Similarly, Yuji Ijiri suggests that "the usefulness of budget disclosure to stockholders and other investors is unquestionable, the implementation of budget disclosure must be supported by effective budget auditing in order to insure the reliability of the budgets."<sup>8</sup>

Willingham, Smith, and Taylor further conclude that "extending the CPA's opinion to forecasts is within the present competence of the profession. As the needs of society change, accounting and auditing must evolve to meet these changing needs: the question becomes one of the demand for audited forecasts."<sup>9</sup> They also note the lack of standards of disclosure of projected information in corporate annual reports.

One argument against the release of projected financial information is that it might give competitors the opportunity to make moves to offset the firm's plans. Wilkinson and Doney doubt this and suggest an advantage would be shared by all competitors. They believe that "some knowledge of the goals and realizations of its competitors would assist a firm in formulating its own plans as well as evaluating the performance of its own management."<sup>10</sup>

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<sup>8</sup>Yuji Ijiri, "On Budgeting Principles and Budget-Auditing Standards," Accounting Review, XLIII, (October 1968), p. 667.

<sup>9</sup>John J. Willingham, Charles H. Smith, and Martin E. Taylor, "Should the CPA's Opinion be Extended to Include Forecasts?" Financial Executive, XXXVIII, (September 1970), p. 89.

<sup>10</sup>James R. Wilkinson and Lloyd Doney, op. cit., p. 755.

Another criticism for the presentation of budgetary information in annual reports is the lack of objectivity in budgets. Willingham, Smith, and Taylor suggest that this criticism might be overcome by the inclusion of the budget as a part of the regular audit and an expression of an opinion on the fairness of its presentation.<sup>11</sup>

Included above are statements of major American writers who propose the inclusion of projected financial information in corporate annual reports. From England we find the Chartered Accountant, R. A. Rayman observing:

The only method, so far devised, of assessing the potential of the firm as a whole is to make an estimate of the expected future flows. . . . It is therefore suggested that the firm's potential should be indicated by the provision of a projected funds statement. It is then open to each individual to form his own opinion of the firm.<sup>12</sup>

In the July 27, 1968 issue of The Accountant, one finds that the City Code on Take-overs and Mergers has placed on the accountant the responsibility of auditing and reporting calculations based on estimates.

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<sup>11</sup>John J. Willingham, Charles H. Smith, and Martin E. Taylor, op. cit., p. 89.

<sup>12</sup>R. A. Rayman, "Is Conventional Accounting Obsolete," Accountancy, CXXXI, (June 1970), p. 426.

The author states:

They [the accountants] can undertake a critical and objective review of the assumptions on which profit forecasts are framed, and can verify that the forecasts have been properly computed.<sup>13</sup>

In summary, it has been observed that several American writers have proposed various alternatives for presenting projected financial information in corporate annual reports. Also, it may be noted that the practice of attesting to projected profit plans has been adopted in England.

Concluding, the current hearings before the United States Securities and Exchange Commission provide adequate evidence that this topic is a proper subject of investigation.

#### Hypotheses

1. Most Financial Analysts believe that financial information relating to the future plans and goals of the corporations should be included in published annual reports.
2. Most Financial Analysts believe that the attest function should be extended to include projected financial information in published annual reports.
3. Most American Certified Public Accountants believe that financial information relating to the future plans and goals of the corporations should be included in published annual reports.
4. Most American Certified Public Accountants believe that the attest function should be extended to include projected financial information in published annual reports.

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<sup>13</sup> "Reporting on Profit Forecasts," The Accountant, CLIX, p. 99.

5. Most English Chartered Accountants believe that financial information relating to the future plans and goals of corporations should be included in published annual reports.
6. Most English Chartered Accountants believe that the attest function should be extended to include projected financial information in published corporate annual reports.

The Z test and the confidence interval were employed in testing these hypotheses, as described in a following section of this chapter.

#### Operational Definitions

Corporate Annual Report--refers to the primary corporate financial report issued to stockholders and other interested parties on an annual basis. The report usually contains the audited financial statements, the president's message, and other financial data.

Projected Financial Information--refers to all mathematical information relating to the future plans and goals of corporations. This would include such items as budgets, profit forecasts, pro forma statements and schedules, and cash forecasts.

Financial Analysts--refers to American Members of the Financial Analysts Federation. This group of individuals consists of investors as well as advisors to investors.

Certified Public Accountants--refers to members of the American Institute of Certified Public Accountants.

Chartered Accountants--refers to members of the Institute of Chartered Accountants in England and Wales.

#### Assumption of the Study

A tacit assumption of the study is that American Certified Public Accountants, English Chartered Accountants, and Financial Analysts have opinions relating to the inclusion of projected financial information in published corporate annual reports.

#### Limitations of the Study

A major limitation of the study is that the population of Financial Analysts was restricted to those Financial Analysts listed in the 1971 Membership Directory of the Financial Analysts Federation. It was not feasible to include all external users of annual reports and, therefore, the study was limited to this group of individuals as they represent probably the most sophisticated and well informed users of financial statements. Also, this group offers advisory services based on the analysis of annual statements to investors, bankers, brokers, and others. Horngren states:

Professional security analysts represent, dollarwise, probably a very large percentage of existing investment capital. That is why reports should be oriented toward fairly sophisticated investors--

they are the real users of financial information.<sup>14</sup>

A second limitation imposed on the study is that the sample population of accountants was restricted to members of the American Institute of Certified Public Accountants. This restriction in the scope of the study was based upon two considerations:

1. It was not feasible to include all accountants in the population sample.
2. This group provides a relatively homogenous population which was necessary for statistical sampling. This reason can also be stated for restricting the populations of Financial Analysts and Chartered Accountants.

A third limitation of the study is that the population defined as Chartered Accountants was restricted to members of the Institute of Chartered Accountants in England and Wales.

A fourth limitation, one inherent to the process of statistical sampling, is the determination of the opinions of non-respondents in the sample population. An attempt to overcome this limitation was made through the use of a follow-up letter requesting the completion of unreturned questionnaires. The original questionnaires were pre-coded to identify the non-respondents.

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<sup>14</sup>Charles T. Horngren, "Disclosure: What Next?" The Accounting Review, XXXIII, (January 1958), p. 92.

A final limitation of the study is that the sample population of corporate reports was restricted to those reports furnished by corporations listed in the most recent directory of Forbes 872 largest U. S. companies. This limitation is deemed desirable as the annual reports of these corporations are most likely to be analyzed by Financial Analysts and audited by members of the American Institute of Certified Public Accountants.

#### Methodology of the Study

The methodology employed in this study included primary and secondary research. Primary research tested the hypotheses stated in the chapter. Secondary research dealt with the legal and theoretical examination of the topic. Also, the secondary research aided in developing two survey questionnaires. One questionnaire was sent to a representative sample of Financial Analysts while the other was sent to representative samples of Certified Public Accountants and Chartered Accountants.

Sample Populations. Four sample populations were utilized in the study. They were:

1. Sample Population of Corporate Annual Reports--  
the population of Corporate Annual Reports from which a sample was drawn consisted of those corporations listed by Forbes magazine with a

numerical ranking consisting of:

- (1) the 500 publicly owned United States companies largest by revenues.
- (2) the 500 publicly owned United States companies largest by market value.
- (3) the 500 publicly owned United States companies largest by capital expenditures.
- (4) the 500 publicly owned United States companies largest by assets.
- (5) the 500 publicly owned United States companies largest by net profits.<sup>15</sup>

An examination of these listings indicated that there were 872 corporations which appeared at least once on the list and, therefore, constituted the population of the sample.

2. Sample Population of Financial Analysts---the population of Financial Analysts constituted the approximate 13,000 Financial Analysts as listed in the Membership Directory of Financial Analysts Federation.

3. Sample Population of Certified Public Accountants--this population consisted of the approximate 88,000 members of the American Institute of Certified Public Accountants.

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<sup>15</sup>Dimensions of American Business--2nd Annual Directory, Forbes, (May 15, 1970), pp. 136-174.



4. Sample Population of Chartered Accountants--  
this consisted of the approximate 50,000  
members of the Institute of Chartered  
Accountants in England and Wales.

Sample Sizes. The procedure for the selection of each sample size involved the steps described by Arkin:

1. Establish the required sample reliability.
2. Establish the desired confidence level . . . .
3. Estimate the maximum rate of occurrence anticipated in a bad situation.
4. Determine the approximate field size.
5. Refer to the sample size table.<sup>16</sup>

Sample precision relates to the degree of adherence of the sample estimate to the true population value or parameter. Precision, like the selection of the confidence level, requires judgement. Arkin notes:

Judgement must be exercised to establish a required sample precision which will not create unnecessary test cost by over-sampling nor result in sampling sizes such that the broad sampling variability permissible results in indecision in most tests and therefore in their extension, again with high costs.<sup>17</sup>

Therefore, precision of ± 5% was established for this study.

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<sup>16</sup> Herbert Arkin, Handbook of Sampling for Auditing and Accounting, (New York: McGraw Hill Company, Inc., 1963), p. 103.

<sup>17</sup> Ibid., p. 88.

After the sampling precision was fixed, the decision regarding the setting of the confidence level had to be reached. This is the probability that the value obtained from the test sample will depart from the true value (population parameter) by no more than the amount of specified precision. A confidence level of 95% was set for the study.

The estimate of the maximum desired rate of occurrence in a bad situation was set at 50% for the following reasons:

1. Arkin<sup>18</sup> suggests that when it is not possible to estimate the maximum rate of occurrence, it should be set at 50%. Because a study regarding this topic had never been undertaken, there was no way one can estimate the proportion of Financial Analysts who desired projected financial information in corporate annual reports. Furthermore, there was no basis for an estimate of the proportion of Certified Public Accountants or Chartered Accountants who believed that this type of information should be included in the annual reports.
2. The decision criterion for the acceptance of the hypotheses implied "the majority" or greater than 50% accept these hypotheses. At this point, one can determine the estimated sample sizes required

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<sup>18</sup> Ibid., p. 103.

to achieve the specified precision at the 95% confidence level. In Arkin we find tables which indicate these minimum required samples. They are:

(a) Sample Size of Corporate Annual Reports--274.

(b) Sample Size of Financial Analysts--333.

(c) Sample Size of Certified Public

Accountants--383.

(d) Sample Size of Chartered Accountants--381.<sup>19</sup>

Since the above figures represent the minimum number of respondents required for a reliable sample, it was necessary to consider the problem of non-respondents in the survey groups. In the case of obtaining corporate annual reports, the non-response rate was expected to be small, therefore, the sample was increased to 300 items. However, it was expected that the non-response rate would be larger in the surveys of Financial Analysts, Certified Public Accountants, and Chartered Accountants. To allow for non-response and to insure greater reliability of the sample, each sample was increased to 1,200 items.

A table of random numbers was used to select the items included in each sample. After determining the items to be included in the samples, Financial Analysts, Certified Public Accountants, and Chartered Accountants were sent the survey

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<sup>19</sup> Ibid., pp. 370, 372.

questionnaires. Also, the corporations selected for sampling were requested to furnish the latest copies of their annual reports.

Measuring Techniques Employed in the Study. As stated previously, it was hypothesized that more than 50% of the items being measured had a particular attribute. For example, in hypothesis 1 it was assumed that more than 50% of the Financial Analysts believed that financial information relating to the future plans and goals of the corporation should be included in published corporate annual reports. In hypothesis 3, it was assumed that more than 50% of the Certified Public Accountants believed that financial information relating to the future plans and goals of the corporation should be included in published annual reports. Richmond<sup>20</sup> suggests that in order to test these hypotheses about a population percentage one uses the Z test after first finding the standard error of the percentage. This was done by using the following formulas:

$$S_p = \sqrt{\frac{P(100-P)}{n}} \cdot \sqrt{\frac{N-n}{N-1}}$$

where:  $S_p$  = the estimated standard error of a sample percentage

$P$  = the sample percentage observed

$n$  = the sample size

$N$  = the number of items in a population

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<sup>20</sup>Samuel B. Richmond, Statistical Analysis (New York: The Ronald Press Company, 1964), pp. 207-17.

The hypotheses were then tested with:

$$Z = \frac{P - P_h}{S_p}$$

Where: Z = the standard normal deviate

P = the sample percentage observed

$P_h$  = hypothetical population percentage

$S_p$  = standard error of a sample percentage

Operationally, the null hypothesis states that the proportion of items having a particular attribute would be 50%.

The alternative hypothesis indicates that the proportion of items having a particular attribute will be more or less than 50%.

$$H_0 : P = 50\%$$

$$H_1 : P \neq 50\%$$

If the Z score is larger than 1.96 on the "Yes" or "No" side of the normal curve, one can reject the null hypothesis and accept the alternative hypothesis that more or less than 50% of the population has a given characteristic. However, if the Z score is larger than 1.96 on the "Yes" side, one can be 95% confident that more than 50% of the population has a given characteristic and the stated hypotheses can be accepted.

The above Z test indicates whether or not a particular hypothesis should be accepted or rejected. In addition, the study determined the confidence interval within which one can be 95% confident that the true population percentage falls.

For this, the following formula was used:

$$\text{Confidence limits} = P \pm Z \times S_p$$

Where:

P = the sample percentage observed

Z = the standard value for the 95% confidence level

$S_p$  = standard error of the sample percentage

Interpreting the above formula, there is a 95% probability that the true population percentage of items having a certain attribute falls within the interval between these confidence limits.

The application of the methodology as it relates to the survey groups are found in the following chapters.

1. Chapter IV deals with the opinions of Financial Analysts regarding the disclosure of projected financial information in corporate annual reports.

2. Chapter V examines the views of Certified Public Accountants on this important subject.

3. Chapter VI concludes the testing of the hypotheses and reports the survey results of English Chartered Accountants on the inclusion of projected financial information in published corporate annual reports.

## CHAPTER II

### THEORETICAL AND LEGAL CONSIDERATIONS RELATING TO THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION IN CORPORATE ANNUAL REPORTS

#### Introduction

This chapter deals with the results of secondary research relating to the theoretical and legal considerations involved in the disclosure of projected financial information in corporate annual reports. The purpose is twofold: First, the theoretical implications of reporting on projected financial information are examined; and secondly, a discussion of the legal aspects of such reporting is presented. The approach used presents the theoretical discussion in relation to the standards of reporting developed by the American Accounting Association. These are as follows: Relevance, Verifiability, Freedom from Bias and Quantifiability. In addition, the Code of Professional Ethics and Conservatism is discussed. The approach to the legal discussion first examines the role of the United States Securities and Exchange Commission in corporate reporting, and secondly, presents court cases brought against management and accountants which involve prediction and forecasting. Finally, a summarization concludes the chapter.

## Relevance

The American Accounting Association regards relevance as the primary standard to be used in evaluating potential accounting information. Its statement on accounting theory holds:

Although not sufficient as a sole criterion, it [relevance] represents a necessary characteristic for all accounting information.

Continuing:

For information to meet the standard of relevance, it must bear upon or be usefully associated with the action it is designed to facilitate or the result it is desired to produce. This requires that either the information or the act of communicating it exert influence or have the potential for exerting influence on the designated actions.<sup>21</sup>

Hendriksen notes that "in order to make the concept of relevance operational, it is necessary to set forth the specific type of information required in the decision-making processes of users of financial reports."<sup>22</sup> But who are the users of financial reports? In discussing this, Frishkoff states:

Identification of what has been termed the "coalition" of interested parties is by no means simple. Even if we choose investors, present and future, as the true beneficiaries of accounting reports, there is still the awesome problem of identifying the level of sophistication of the "typical" investor.

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<sup>21</sup>The American Accounting Association, A Statement of Basic Accounting Theory (Evanston, Ill., 1966), p. 9.

<sup>22</sup>Eldon S. Hendriksen, Accounting Theory, (Homewood, Ill.: Richard D. Irwin, Inc., 1970), p. 105.



Our inability to identify the users of a particular firm's financial statements, or the level of knowledge among them to which we want to address reports are both serious weaknesses in determining materiality. Even more detrimental, however, is the lack of knowledge about decision-makers, be they investors or whoever. Behavioral specialists in accounting still understand little about the decision-making process, and practicing accountants are in no sense behavioral experts.<sup>23</sup>

Frishkoff's position, then, is that accountants do not know the relevant needs of the users of annual reports. If this is the case, one must question Ijuri, Dopuch and Keller as to their determination that budgets or other projected financial information will satisfy the needs of these unidentified users of accounting reports. Yet there are statements such as Gynther's:

For decision making purposes, past costs are irrelevant.. The directors' reports may properly include comments on the expected future trends in the company's business, and other valuable background information for shareholders. As the investor's needs are so clearly future orientated, the most important information for him would be found in the company's budgets for future periods.<sup>24</sup>

Alvin Martin comments on the relevancy of financial statements, posing an alternative perspective.

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<sup>23</sup> Paul Frishkoff, "An Empirical Investigation of the Concept of Materiality in Accounting," Empirical Research in Accounting-Selected Studies, 1970, Journal of Accounting Research, pp. 116-117.

<sup>24</sup> Merle M. Gynther, "Disclosure to Investors--For the Amateur or the Professional," The Australian Accountant, XXXVIII, (May 1968), p. 273.

Traditional accounting reports are not constructed explicitly to be useful but to satisfy fiduciary reporting responsibilities.<sup>25</sup>

Although it may not be difficult to accept the premise that current financial reports are inadequate, to accept the statement that the inclusion of budgets or other projected financial information will correct the situation requires greater effort. The weakness of relevance is its subjectivity. What one investor might consider relevant may be irrelevant to another. The suggestion that budgeted data included in annual reports is relevant for decision-making is a value judgement made by the one proposing its relevance. The data may or may not be relevant to those actually using the reports. A possible approach to determine the relevancy of projected financial information in annual reports might be Miller's suggested long run solution to the external reporting problem. He suggests the following:

1. Investigating the information needs of the users of company reports.
2. Hypotheses regarding what is relevant for their purposes regardless of the problems of measurement and communication.
3. Experimentation with quantification and verification on a sufficient scale to judge the practicability of supplying the information.

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<sup>25</sup> Alvin Martin, "An Empirical Test of the Relevance of Accounting Information for Investment Decisions," Selected Studies Graduate School of Business, University of Chicago, 1971, p. 2.

4. Testing, empirically, the predictive power or effectiveness of the information in satisfying needs and the ability of recipients to assimilate the information.
5. Choosing the information to be disclosed and the manner in which its disclosure is to be policed.<sup>26</sup>

### Verifiability

The American Accounting Association describes verifiability as that "attribute of information which allows qualified individuals working independently of one another to develop essentially similar measures or conclusions from an examination of the same evidence, data, or records...It is primarily concerned with the availability and adequacy of evidence attesting to the validity of the data being considered." The American Accounting Association further states that "for internal purposes, subjective estimates, especially forecasts, may be useful because of their high degree of relevance even though they possess a very low degree of verifiability."<sup>27</sup>

Patton and Littleton define "to verify" as to establish the truth, to test the accuracy of a fact, to substantiate an assertion...Evidence is a means of ascertaining the truth or of

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<sup>26</sup>M. C. Miller, "True and Fair 'and Auditors' Reports," The Australian Accountant, XXXIX, (April 1969), p. 174.

<sup>27</sup>The American Accounting Association, op. cit., p. 11

furnishing proof...Verifiable evidence, then, is evidence of such a nature as to lend itself to establishing the truth."<sup>28</sup>

Later, Paton and Littleton refer to objective evidence as being "impersonal and external to the person most concerned, in contrast with that person's unsupported opinion or desire."<sup>29</sup> When a manager submits his budget, it is his testimony that must be accepted by the accountant. As evidential matter, Mautz and Sharaf refer to the testimony of others as authoritarianism. They note that "evidence of this kind can never be more than persuasive; it lacks the force of conviction supplied by rational reasoning or sensory perception." They continue:

It is necessary for an individual to trust other individuals in matters which he cannot investigate for himself; and unless there is reason to suppose that the witnesses are biased or incompetent, their testimony should be put on a par with his own.<sup>30</sup>

In light of the preceding discussion one can pose the following question:

Can an independent accountant obtain evidential matter necessary to "verify" the plans of management?

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<sup>28</sup>W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards, (Ann Arbor, Mi.: The American Accounting Association, 1960), pp. 18-19.

<sup>29</sup>Ibid., p. 19.

<sup>30</sup>R. K. Mautz and H. A. Sharaf, The Philosophy of Auditing, (Madison, Wi.: The American Accounting Association, 1961), p. 92.

To this writer, the answer appears to be negative. The plans of management exist in the mind(s) of management--they are unreachable to sensory perception. Wallace E. Olson, executive vice president of the American Institute of Certified Public Accountants, in testimony before the United States Securities and Exchange Commission, stated:

Neither can a third party express an objective opinion about the reasonableness of assumptions since many of the assumptions are simply predictions for which there are no available means of objective verifications.<sup>31</sup>

#### Freedom from Bias

The statement on basic accounting theory by the American Accounting Association notes that "it is possible for accounting information to possess high degrees of relevance and verifiability and yet be biased in favor of some parties and detrimental to others. This bias may result from use of inappropriate techniques or it may be of a personal nature."<sup>32</sup> Later, the use of bias for management control is recognized:

Another widely used instrument for management control is the budget. In budgeting, sales volume figures may be used that are based on optimistic estimates that are more in the nature of goals than expectations. When used for planning it is far less useful.<sup>33</sup>

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<sup>31</sup>Wallace E. Olson, "News Reports", The Journal of Accountancy, CXXXIV, (January 1973), p. 9.

<sup>32</sup>The American Accounting Association, op. cit., p. 11.

<sup>33</sup>Ibid., p. 54.

It is further acknowledged that "as more and more of the internal information, such as budgets, become a part of external reports, the need for elimination of such biased figures is required."<sup>34</sup>

Johnson provides an enumeration of a number of pressures on management to influence externally reported measurement [information]. He believes that managerial bias may be as a result of self-interest and as a result of conflicting pressures from outside interests which attempt in various ways to exercise control over managers. Several aspects of these pressures which relate to projected financial information merit note.

1. Financial statements are to a large degree a report on managerial performance. Managers would not be human if they did not wish the report card to be favorable.
2. Pressures from the stockholders and investors to report results that will favorably influence stock prices may reinforce management's own self-interest in this direction.
3. Published reports are often an element of the propaganda system through which management tries to make a case or to influence public opinion.<sup>35</sup>

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<sup>34</sup> Ibid., p. 54.

<sup>35</sup> Charles E. Johnson, "Management's Role in External Accounting Measurements," Research in Accounting Measurements, eds. R. Jaedicke, Yuji Ijiri, and O. Nielsen, The American Accounting Association, 1966, p. 91.

Recognizing managerial self-interest as a prime motivating factor influencing external reporting, it would not be in management's best interest to report information which is not biased in its favor.

Gibson's approach is to first differentiate between a forecast and a budget, noting that a budget is an expression of the plans of management while a forecast is merely an estimate of the future. The main difference is that a forecast does not embody objectives and plans. He concludes that budgets cannot be "audited" at present and asks:

Can we imagine an auditor's report stating that: 'We have examined with due audit care the data found in the budgets and find that they present fairly management plans.'<sup>36</sup>

Further,

To the extent that a budget incorporates management objectives and plans it is more than a mere forecast and the only source of such budget data is the management, or more specifically, the mind(s) of management.<sup>37</sup>

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<sup>36</sup>C. J. Gibson, "Can the Auditor's Opinion be Extended to include Budgets?" The Chartered Accountant in Australia, XLII, (September 1971), p. 18.

<sup>37</sup>Ibid., p. 18.

From this one can conclude that since the accountant cannot determine what is in the mind(s) of management, he cannot state that a budget is free from personal bias. This concept of freedom from bias is discussed later under the Code of Professional Ethics.

#### Quantifiability

Quantification refers to the "association of a number with a transaction or an activity where the numbers assigned obey prescribed arithmetic laws or procedures."<sup>38</sup> This definition specifies neither past, present or future transactions or activities. Although accountants are primarily concerned with past or present activities, quantification of information relating to the future is common in management's budgeting process. According to Chambers, however, quantification of future events should not be confused with measurement. He writes:

The treatment of measurement, however, gives no warrant for the application of the term to estimates of the future or predictions. We may measure a property of something that has occurred or something that is present, but not something which does not exist and has not existed.<sup>39</sup>

This statement precludes the "measurement" of Depreciation or Bad Debt Expenses. The so-called "measurement" of Depreciation

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<sup>38</sup> The American Accounting Association, op. cit., pp. 11-12.

<sup>39</sup> R. J. Chambers, "Accounting and Analytical Methods: A Review Article," Journal of Accounting Research, IV, (Spring 1966), p. 108.



is only a prediction of the useful life of a fixed asset. Likewise, the "measurement" of Bad Debt Expense is a prediction that certain unknown debtors will not pay their obligations to the firm. In both cases, the auditor expresses an opinion on the reasonableness of the prediction.

Yet what is important is not that accountants "measure" the future, but that they quantify it. And as quantification is being done in the budgetary process, the inclusion of projected financial information in corporate annual reports would not violate this standard.

#### Professional Ethics

Carey describes professional ethics as a "mixture of moral and practical concepts, with a sprinkling of exhortation to ideal conduct designed to evoke 'right action' on the part of members of the professional concerned--all reduced to rules which are intended to be enforceable, to some extent at least, by disciplinary action.<sup>40</sup> Until March 1, 1973, the rule which provided the guidelines for accountants with regard to forecasts was found in the Code of Professional Conduct as 2.04:

A member or associate shall not permit his name to be used in conjunction with any forecast of the

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<sup>40</sup> John L. Carey and W. O. Doherty, Ethical Standards of the Accounting Profession, (New York: The American Institute of Certified Public Accountants, Inc. 1966), p. 6.

results of future transactions in a manner which may lead to the belief that the member or associate vouches for the accuracy of the forecast.<sup>41</sup>

An elaboration on this rule was provided in Opinion No. 10 which states:

The committee is of the opinion that Rule 2.04 does not prohibit a member from preparing, or from assisting a client in the preparation of, such statements and analyses. However, when a member associates his name with such statements and analyses, or permits his name to be associated therewith, there shall be the presumption that such data may be used by parties other than the client. In such cases, full disclosure must be made of the source of the information or the major assumptions made, in the preparation of the statements and analyses, the character of the work performed by the member, and the degree of responsibility he is taking...It is the opinion of the committee that full and adequate disclosure would put any reader of such statements on notice, and restrict the statement to their intended use.<sup>42</sup>

This statement indicates that the relationship of the accountant to forecasts is one of aiding the client in the conduct of his business. It is noted that cost analyses, budgets and other similar special purpose financial data, which set forth anticipated results of future operations, are important tools of management and furnish valuable guides for determining the future conduct of business. Further, when a member associates his name with such statements and analyses, or permits his name to be associated therewith, there shall be the presumption that

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<sup>41</sup>Summaries of Ethics Rulings, The American Institute of Certified Public Accountants, 1970, p. 152.

<sup>42</sup>Ibid., p. 163.

such data may be used by parties other than the client. These statements indicate that budgets and forecasts are prepared for internal use by management, and are not intended for external parties. It thus appears that they would preclude an opinion by an auditor on the "fairness" of budgetary data.

On March 1, 1973, a new Code of Professional Ethics was adopted by the American Institute of Certified Public Accountants.

Rule 2.04 was revised to read:

A member shall not permit his name to be used in conjunction with any forecast of future operations or financial conditions in a manner which may lead to the belief that the member vouches for the achieveability of the forecast.<sup>43</sup>

The interpretation under Rule 2.04 states:

Rule 2.04 does not prohibit a member from preparing, or assisting a client in the preparation of, forecasts of the result of future transactions. When a member's name is associated with such forecasts, there shall be the presumption that such data may be used by parties other than the client. Therefore, full disclosure must be made of the source of the information used and the major assumptions made in the preparation of the statements and analyses, the character of the work performed by the member, and the degree of the responsibility he is taking.<sup>44</sup>

A major difference in the revised statement is that the accountant does not vouch for the "achievability" of the forecast, whereas in the previous code he did not vouch for the

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<sup>43</sup> Restatement of the Code of Professional Ethics, The American Institute of Certified Public Accountants, March 1, 1973, p. 22.

<sup>44</sup> Ibid., p. 36.

"accuracy" of the forecast. Perhaps this change may permit the accountant to offer an opinion as to the "accuracy" of the preparation of forecasts as is being done by English Chartered Accountants in bids and takeovers. But again, in this new code it is found that the accountant is in the role of aiding management and not as an auditor who expresses an opinion on the "fairness" of forecasts. Therefore, one can conclude that the new wording does not substantially change the role of the accountant as regards forecasts. Others, of course, may provide different interpretations of this rule. Further, to speculate on future interpretations would be difficult, if not presumptive.

As found in the Accountant:

Prediction is always difficult, especially when it has to do with the future.<sup>45</sup>

A second area of the Code of Professional Ethics which would be concerned with the accountant's role in the preparation of forecasts or the expression of an opinion on forecasts is independence. Rule 101 reads:

A member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise.<sup>46</sup>

<sup>45</sup>"Reporting on Profit Forecasts," The Accountant, CLIX, (July 27, 1968), p. 99.

<sup>46</sup>Restatement of the Code of Professional Ethics, op. cit., p. 20.

Thomas G. Higgins, former chairman of the American Institute of Certified Public Accountants, states:

There are actually two kinds of independence which a CPA must have-independence in fact and independence in appearance. The former refers to a CPA's objectivity, to the quality of not being influenced by regard to personal advantage. The latter means his freedom from potential conflicts of interest which might tend to shake public confidence in his independence in fact.<sup>47</sup>

Harvey E. Kapnick, Chairman of the Board and Chief Executive of Arthur Andersen & Company, draws another distinction:

An obvious conflict of interest exists between the functions of attesting to financial statements and attesting to the assumptions used in forecasts. Therefore, if an independent accountant gives an opinion endorsing the reasonableness of the assumption underlying a financial forecast, he should thereby be disqualified from giving an opinion on the financial statements for the period covered by the forecasts.<sup>48</sup>

Further, if the accountant aids management in the preparation of the financial forecast and later expresses an opinion as to their "fairness", his independence could be questioned. Possibly he would be placing himself in the role of auditing his own work. Walter E. Hanson, senior partner at Peat, Marwick,

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<sup>47</sup> John L. Carey and William O. Doherty, op. cit., p. 20.

<sup>48</sup> Harvey E. Kapnick, "Will financial forecasts really help investors," Financial Executive, XL, (August 1972), p. 53.

Mitchell & Company, believes that the accounting profession should move into forecasting. It is his opinion that the question of independence can be overcome by having one CPA firm do the forecast and another make the audit.<sup>49</sup> The "rightness" of either position taken above will depend on definition of the role of the accountant in the preparation of projected financial statements.

#### Conservatism

The requirement that management disclose its plans or anticipated results of operations in corporate annual reports might probably be the greatest impetus to conservatism in accounting since the stock market crash of 1929. This impetus to the growth of conservatism would not occur because of a theoretical justification of the concept but because of the legal environment within which managers and accountants exist. First, the extension of the jurisdiction of the United States Securities and Exchange Commission to corporate annual reports appears imminent. At present, the SEC is holding hearings on corporate publicity involving forecasted information. Second, it shall be shown in a later discussion that there are legal consequences

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<sup>49</sup> "Accounting: A crisis over full disclosure," Business Week, (April 22, 1972), p. 59.

to an erroneous forecast. These would involve civil and criminal prosecution of managers and others associated with misleading forecasts.

Historically, the growth of conservatism has been fostered by an almost unrestricted optimism on the part of managers. Hendriksen states:

The entrepreneur is naturally optimistic about his enterprise and it is assumed that this optimism tends to be reflected in both the selection and emphasis in accounting reports. Through the pressure of creditors and other users of financial reports, the accountants of the 19th century were continually under pressure to refrain from reflecting this optimism in their reports.<sup>50</sup>

Sterling holds:

Faced with the universal tendency to overstate, the accountant conceived his role to be one of temperance.<sup>51</sup>

But if the Securities and Exchange Commission requires profit forecasts or the projection of financial information, the risk of civil and criminal prosecution will encourage pessimism instead of the unrestricted optimism that currently exists. Management, in its self-interest, is likely to avoid risk rather than present a "true picture" of its plans and expectations. Avoiding risk would probably involve the

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<sup>50</sup>Eldon S. Hendriksen, op. cit., p. 118.

<sup>51</sup>Robert R. Sterling, "Conservatism: The Fundamental Principle of Valuation in Traditional Accounting," Abacus, III, (December 1967), p. 109.

understating of anticipated profits and the overstating of anticipated losses. The reason for this is that except where the information was materially misleading, higher profits or smaller losses would be less likely to draw a stockholder suit than overstating profits or understating losses. Schmalenbach's chance-risk assumption best describes the probable position of management. He points out the inequality of the chance of success and the risk of failure of business. He states:

When a businessman undertakes a hazardous enterprise which will make him a wealthy man if he succeeds, and a bankrupt if he does not, then there, too, we cannot speak of equal chance and risk; even when the chance of success is a little greater than the risk of failure...an overstated profit is far more dangerous for the business and its proprietors than one which is understated...Chance and risk should therefore not be considered equal if the facts present only an arithmetical equivalence.<sup>52</sup>

Devine notes that his argument for conservatism is based "on the more serious consequence of being optimistic--the added danger he believes to be inherent in risk and not associated with chance...from a given set of initial conditions the risk from a decision is greater than the chance of gain from such a decision."<sup>53</sup>

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<sup>52</sup>Carl T. Devine, "The Rule of Conservatism Reexamined," Journal of Accounting Research, I, (Autumn 1963), p. 132.

<sup>53</sup>Ibid., p. 133.



Adopting Schmalenbach's argument to the reporting on projected financial information, we find that the chance of success of management's forecasts means "keeping his job" while the risk of failure of his expectations means "loss of his job" and possible civil and criminal prosecution. The inequality of chance and risk as a result of the American legal system will, no doubt, encourage pessimism, and therefore conservatism.

#### Role of the Securities and Exchange Commission

In 1934, the United States Congress created the Securities and Exchange Commission as an independent, bipartisan, quasi-judicial governmental agency. This agency administers the securities laws and protects the investor by providing for:

1. Disclosure of material financial and other facts about securities offered for public sale so that investors may make informed investment decisions.
2. Current reporting of similar data about securities of many companies, including securities traded on stock exchanges, so that investors may make an informed analysis and evaluation thereof.
3. Disclosure of information about corporate matters on which stockholders are asked to vote, so they may vote intelligently.
4. Current reporting by management officials of stock holdings in their company, and recovery of their short-term trading profits.

5. Penalties against fraudulent practices in the purchase and sale of securities and against market manipulations, and investor recovery rights if defrauded.<sup>54</sup>

The primary securities laws administered by the SEC which relate to this study are the Securities Act of 1933 and the Securities Exchange Act of 1934.

1. Securities Act of 1933. The Securities and Exchange Commission describes the basic objectives of this act as: (a) to provide investors with material financial and other information concerning securities offered for public sale; and (b) to prohibit misrepresentation, deceit and other fraudulent acts and practices in the sale of securities generally (whether or not required to be registered).<sup>55</sup>

Robbins describes the 1933 Act with:

The Securities Act is concerned generally with the initial distribution of securities. Its primary purpose is to make available to the public financial and related information concerning such securities. A second purpose is to prohibit misrepresentation and other fraudulent acts in the sale of securities, whether or not registration is required.<sup>56</sup>

<sup>54</sup>The Work of the Securities and Exchange Commission, Washington: U. S. Government Printing Office, 1971, cover.

<sup>55</sup>Ibid., p. 1.

<sup>56</sup>Sidney Robbins, The Securities Markets, (New York: The Free Press, 1966), p. 86.

2. Securities and Exchange Act of 1934. The Securities and Exchange Act of 1934 extended the disclosure doctrine of investor protection to securities listed and registered for public trading on national securities exchanges; and the enactment in August 1964 of the Securities Acts Amendments of 1964 applied the disclosure and reporting provisions to equity securities of hundreds of companies traded over-the-counter (if assets exceed \$1 million and the shareholders number 500 or more).

If, after investigation, the SEC concludes that the facts of a situation show possible fraud or other law violation, the SEC may pursue the following:

- a. Civil injunction. The Commission may apply to an appropriate United States District Court for an order enjoining those acts or practices alleged to violate the law or Commission rules.
- b. Criminal prosecution. If fraud or other willful law violation is indicated, the Commission may refer the facts to the Department of Justice with a recommendation for criminal prosecution of the offending persons. That Department, through its local United States Attorneys (who occasionally are assisted by Commission attorneys), may present the evidence to a Federal grand jury and seek an indictment.
- c. Administrative remedy. The Commission may, after hearing, issue orders suspending or expelling members from exchanges or the over-the-counter dealers association; denying, suspending or revoking the registration of broker-dealers; or censuring individuals for misconduct or

barring them (temporarily or permanently) from employment with a registered firm.<sup>57</sup>

Actions due to misrepresentations and fraud involving estimates, forecasts or predictions have been brought under Rule 10B-5 of the Security Exchange Act of 1934 which states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.

- (1) to employ any device, scheme, or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.<sup>58</sup>

Although this rule, as well as the Securities Act, does not apply to corporate annual reports sent to stockholders, it is found in the Atlantic Research case,<sup>59</sup> where the SEC provided that any material differences in the financial statements sent to securities holders from those filed with the Commission must be noted and the effects reconciled in the report. One must

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<sup>57</sup> The Work of the Securities and Exchange Commission, op. cit., p. 11.

<sup>58</sup> Rulings Under the Securities and Exchange Act of 1934, United States Securities and Exchange Commission, pp. 1005-1006.

<sup>59</sup> Securities Exchange Act release no. 6911 (October 10, 1962).

assume that the current hearings before the SEC on projected financial information will result in a law or ruling which will cover the entire area of forecasting without regard to the means of dissemination of information.

#### Legal Cases Related to Projected Financial Information

An extensive review of legal history reveals that there are four legal cases which relate to the subject under study.

They are:

1. The Ward La France Truck Corporation (13 SEC 373 - 1943).
2. Cady Roberts (40 SEC 907 - 1961).
3. SEC vs. Texas Gulf Sulphur Company (258 Fed. Supp. 262 - 1966).
4. Sprayregan vs. Livingston Oil Company (295 Fed. Supp. 1376 - 1968).

1. Ward La France Truck Corporation.<sup>60</sup> The case of Ward La France Truck Corporation is a situation in which the lack of full disclosure constituted a violation of Rule X-10B-5. In this particular case, stockholders were not informed of a phenomenal increase in earnings that were taking place as a result of war orders received from the U. S. Government. Also, the president and the treasurer of the Truck Corporation, who together owned 80 percent of voting power of the stock, failed to inform the

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<sup>60</sup>Ward La France Truck Corporation (13 SEC 373 - 1943).

stockholders of their intent to liquidate the firm. The SEC concluded that the president and treasurer violated Rule X-10B-5.

Earnings per share after taxes amounted to \$2.73 for the year ended December 31, 1971 as contrasted with \$15.75 for the 11 months ended November 30, 1972. Salta, the purchaser of the firm, did have significant knowledge of the growth in earnings through the negotiations for liquidation. The president and treasurer received \$45.86 per share of stock while the uninformed stockholders received an average price of \$9.71. As a result of the investigation by the SEC, payments of \$164,814.91 were made for injury to the uninformed stockholders.

2. Cady Roberts.<sup>61</sup> The Cady Roberts case involves the dissemination of corporate information. In this instance the failure to communicate a reduction in the quarterly dividend to stockholders, while insiders were disposing of their holdings of the securities, constituted a violation of X-10B-5.

In November, 1959, the President of Curtiss-Wright Corporation invited 2000 members of the financial press and business community to view a new type of internal combustion engine developed by the corporation. Press releases disclosing the development also appeared in newspapers. This announcement encouraged speculation and through November 25, the price rose to 40-3/4, the highest for the year. On November 25, the

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<sup>61</sup> Cady Roberts (40 SEC 907 - 1961).

Curtiss-Wright Directors decided to reduce the quarterly dividend. After the dividend decision, one of the directors notified his broker to sell his stock and take a profit. The sell orders were executed at 11:15 and 11:18 a.m. However, the information concerning the dividend reduction was not given to the Wall Street Journal until approximately 11:45 a.m. and it appeared on the Dow Jones ticker tape at 11:48 a.m. When it did appear on the tape, trading was suspended because of the large volume of sell orders.

The circumstances above indicated that the notification of the broker by the director of the dividend reduction placed the public investor at a disadvantage. As a result of the investigation a settlement was offered and the broker was suspended for 20 days from the New York Stock Exchange. The importance of this case relating to this study is that management speculated or encouraged speculation by providing misleading information about a "breakthrough" in engine technology.

3. SEC vs. Texas Gulf Sulphur Co.<sup>62</sup> In this case the SEC instituted action against Texas Gulf Sulphur for violation of the Securities and Exchange Act of 1934. The District Court held that two defendants violated the Act under Rule X-10B-5. The two individuals appealed the verdict. Eleven of the thirteen original defendants and the corporation were parties

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<sup>62</sup>SEC vs. Texas Gulf Sulphur (258 Fed. Supp. 262 - 1966).

in the proceedings before the Court of Appeals. The court held that the insiders must disclose material information to the investing public or abstain from trading while such information remains undisclosed. The Court of Appeals substantially reversed the trial court decision and remanded the case to trial court for appropriate remedy. Numerous private actions are now pending against Texas Gulf Sulphur and the individual defendants.

The SEC brought action against TGS and its officers and employers as a result of their issuing an overcautious press release regarding a mineral discovery on TGS properties while purchasing stock for their advantage.

The importance of the case relating to this study is the release of speculative information to the public by directors and employees of the corporation. The court held, however, that while the press release did appear gloomy or incomplete, it was not necessarily misleading or deceptive on the basis of known facts. If the press release said too much about the discovery, the defendants would have been open to possible liability if TGS had not discovered a commercial mine.

In dissenting with the majority opinion, Judge Moore wrote:

...The most disturbing aspect of the majority opinion is its utterly unrealistic approach to the problem of the corporate press release. If corporations were literally to follow its implications, every press release would have to have the same SEC clearance as a prospectus. Even this procedure would not suffice if future events should prove the facts to have been over or understated--or too gloomy or optimistic--because the courts will always be ready and available



to substitute their judgment for that of the business executives responsible therefor. But vulnerable as the news release may be, what of the many daily developments in the Research and Development departments of giant corporations. When and how are promising results to be disclosed. If they are not disclosed, the corporation is concealing information, if disclosed and hoped-for results do not materialize, there will always be those with the advantages of hindsight to brand them as misleading. Nor is it consonant with reality to suggest, as does the majority, that corporate executives may be motivated in accepting employment by the opportunity to make "secret corporate compensation\*\*\*derived at the expense of the uninformed public." Such thoughts can only arise from unfounded speculative imagination. And finally there is the sardonic anomaly that the very members of society which Congress has charged the SEC with protecting, i.e., the stockholders, will be the real victims of its misdirected zeal. May the Future, the Congress or possibly the SEC itself be able to bring some semblance of order by means of workable rules and regulations in this field so that the corporation and their stockholders may not be subjected to countless lawsuits at the whim of every purchaser, seller or potential purchaser who may claim he would have acted or refrained from acting had a news release been more comprehensive, less comprehensive or had it been adequately published in the news media of the 50 states.<sup>63</sup>

4. Sprayregan vs. Livingston Oil Co.<sup>64</sup> This final case involves a situation in which the shareholders claimed that the three directors overstated the corporation's net profit and cash flow by underestimating the provision for depletion and depreciation. Also, action was taken against the accounting firm of Peat, Marwick, Mitchell & Co. and the DeWitt Conklin

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<sup>63</sup>Texas Gulf Sulphur Co. (401 Fed. 2d 833 -196).

<sup>64</sup>Sprayregan vs. Livingston Oil Co. (295 Fed. Supp. 1376 - 1968).

Organization, Inc., a public relations firm. Bromberg<sup>65</sup> points out that a \$1 million suit has been filed against Livingston Oil Company and the above, alleging misleading income and cash flow projections made by company officers before a meeting of security analysts. The projections were for increases of 25% in income and 30% in cash flow over the previous year. Actual results were 30% decrease and 12% increase respectively. As yet, the case has not reached the trial court.

#### Summary

From the foregoing discussion, one can conclude the following:

1. Two of the four standards that provide criteria in evaluating potential accounting information would suggest the inclusion of projected financial information in corporate annual reports. These would be relevance and quantifiability. The other two standards, freedom from bias and verifiability would be more difficult to meet by forecasted information. As was discussed, it would be difficult to determine personal bias of management in presenting projected data. Also, it can be noted that forecasts or budgets cannot be verified at the time of the forecast. Freedom from bias and verifiability would,

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<sup>65</sup> Alan Bromberg, Securities Law--Fraud, SEC Rule 10-b-5, Vol. 1, Sec. 7.2(1), p. 148

therefore, suggest the exclusion of projected financial information in published corporate annual reports.

2. Regarding the professional ethics of accountants, it appears that the "auditing" of projected financial statements would be in violation of Rule 204. As noted, Kapnick suggests that an association with such information might give the appearance of a lack of independence by the accountant although he may be, in fact, independent.

3. The current legal environment of management and accountants would probably contribute to the growth of pessimism and conservatism in financial reporting.

4. With its primary purpose of protecting the investor, the United States Securities and Exchange Commission will become involved in the disclosure of projected financial information in corporate annual reports. This is indicated by its current hearings on the subject.

5. Cases brought against individuals for erroneous forecasts probably will be under Rule X-10B-5 of the Securities and Exchange Act of 1934. Precedent has been set in the four cases previously cited.

6. The law of corporate information governing forecasts must be clearly defined. As the disclosure of projected financial information in corporate annual reports involves

substantial risk to management, accountants and others associated with the forecasts; the rights, duties and obligations must be stated for the protection of these parties as well as the users of such statements.

## CHAPTER III

### SURVEY OF CORPORATE ANNUAL REPORTS REGARDING THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION

#### General

In 1963, the United States Securities and Exchange Commission made an extensive study of the securities market. As a result of their investigation into corporate publicity, they concluded:

The corporate publicity examined in the course of this study ran the gamut from straight forward reporting of corporate affairs to what can only be described as deliberate attempts to falsify a company's financial condition or prospect. Only rarely, however, was information disseminated which was a complete fabrication. Misleading publicity usually consists of optimistic sales and earnings projections which seem to be based primarily on wishful thinking, glowing descriptions of new products which are still in the experimental stage, and announcements of mergers or acquisitions which are only vague possibilities.<sup>66</sup>

The present survey, nine years later, is similar in that it too examines corporate publicity. It, however, is limited to the disclosure of projected financial information in corporate annual reports. This survey includes a randomly

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<sup>66</sup> Special Study, United States Securities and Exchange Commission, 1962, p. 88.

selected sample population of 350 items drawn from those corporations listed by Forbes Magazine with a numerical ranking consisting of:

1. the 500 publicly owned United States companies largest by revenues.
2. the 500 publicly owned United States companies largest by market value.
3. the 500 publicly owned United States companies largest by capital expenditures.
4. the 500 publicly owned United States companies largest by assets.
5. the 500 publicly owned United States companies largest by net profits.<sup>67</sup>

Of the 350 published corporate annual reports requested, 337 or 96.3% were made available for the study.

#### Results of the Survey

An examination of the reports revealed serious difficulties in placing information relating to the future into narrow categories. To obtain any meaningful discussion, it was necessary to develop broad classifications and, where possible, narrow the discussion. Four classifications were developed. They are as follows:

1. Financial Statements and Schedules. Accounts found in the financial statements and schedules often describe

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<sup>67</sup>"Dimensions of American Business--2nd Annual Directory," Forbes, May 15, 1970, pp. 136-174.

events which will occur in the future. Liabilities, reserves and commitments were found in each corporate annual report and were covered by the expression of the opinion of the auditor.

2. Speculation and Prediction. Judgments about the future were also common throughout the annual reports. The frequency with which optimistic speculation is found might indicate that management is attempting to mislead those reading the reports. Alternatively, such optimism might reflect the hopes and desires of management rather than judgments based on sound economic reasoning. In either case, optimistic speculation was found in 334, or 99.1%, of the reports.

Such speculation largely takes the form of statements relating to the growth of demand, sales, earnings, revenues, or profits. Terms such as "bright future or outlook" are commonly found in the President's letter. Speculation is also found to a lesser degree in the discussion of price changes, the introduction of new products, production costs, prospective cash dividends and the future financing of the firm. Where a corporation was engaged in litigation, a statement to the effect that the litigation was expected to have no adverse impact upon corporate earnings generally appeared.

The point should be made that speculation takes on added importance if it is believed by the users of the reports. Inaccurate speculation increases the risk of loss to the investor

or other users. As was shown in the preceding chapter, it also increases the risk of liability to management and other parties associated with the speculation.

3. Implications Concerning the Future. A discussion of the various activities of the corporation is usually presented in the body of the corporate annual report. Although this discussion often refers to the past or present, there is the implication that these activities will continue into the future. Research, training, and community action programs are typical examples of corporate activities described in the reports, their discussion implying extension into future periods. Examples are:

Example 1  
Dupont  
Extract from Body of Report.

"Dupont actively recruits members of minority groups for employment. It participates in a number of programs to make jobs available to disadvantaged youths and the hard-core unemployed, and provides special instruction and training to prepare them for employment and advancement."

Example 2  
Rohm and Haas Company  
Extract from Body of Report.

"The company's Affirmative Action Program continues to give major emphasis to improving employment and advancement opportunities for minority groups and women."

Example 3  
Dominion Bankshares Corporation  
Extract from Body of Report.

"Financial responsibility has always been synonymous with sound banking. But, at Dominion Bankshares, we believe bankers must also have a sense of community



responsibility. Many of our officers are outstanding civic leaders. They do everything from working with youth to serving in the city government."

4. Plans for the Future. Reference to plans or the details of plans were provided in each of the 337 corporate annual reports. Inasmuch as the wording generally makes it extremely difficult to distinguish between speculation and plans, a criterion of intention was established to differentiate between the two categories. If a statement indicating an intention to do something was made by the corporation, the statement was regarded as falling into the category of plans. If "intent" was absent from the statement, it was considered speculation. Omitted from category 4 is the discussion of past or present activities which, by implication, refer to the future. Examples were provided in category 3. All of the reports examined made reference to various programs undertaken by the corporations. As stated previously, there must be an indication of "intent" for any statement to fall into this category; otherwise, it is mere speculation.

Plans for the future fall into several classifications:

- (a) Planned Capital Expenditures.
- (b) Planned Mergers, Acquisitions, and Divestitures.
- (c) Research, Exploration and the Creation and Promotion of New Products.
- (d) Planned Price or Rate Changes.
- (e) Financing Plans.
- (f) Cost Control Programs.
- (g) Accounting Changes.

(a) Planned Capital Expenditures. Information on planned capital expenditures was offered in 292, or 86.6%, of the corporate annual reports. Included in such expenditures were expansions of facilities, investments in real estate developments, and acquisitions of other fixed assets. This information was most often provided in the president's letter, the body of the report, or the notes to the financial statements. Examples 4-8 illustrate the manner in which references to planned capital expenditures were presented in the statements.

Example 4  
Roadway Express, Inc.  
Extract from President's Letter.

"Capital Expenditures for carrier operating property amounted to \$10,897,344, of which \$8,054,590 was for tractors, trailers and trucks and \$2,842,754 was for land, terminal facilities and freight handling equipment. Capital expenditures of \$20,000,000 are planned for 1972, of which \$15,000,000 will be for tractors, trailers and trucks and \$5,000,000 for terminal facilities and equipment."

Example 5  
Central Illinois Light Company  
Extract from President's Letter.

"Construction expenditures for 1972 will be approximately \$38 million, down \$18 million from 1971. The company also proposes to purchase certain electric distribution properties from Commonwealth Edison Company for approximately \$22 million."

Example 6  
The Southern Company  
Extract from Body of Report.

"The system's construction program is expected to require some \$843 million during 1972. For the three years 1972-74 inclusive, construction expenditures totaling approximately \$2.7 billion are anticipated."

Example 7  
Nevada Power Company  
Extract from Notes to the Financial Statements.

"The 1972 construction budget of approximately \$33,600,000 includes \$21,600,000 relating to the Navajo Project."

Example 8  
Belco Petroleum Company  
Extract from Notes to the Financial Statements.

"The planned capital investment program of the Company for 1972 is estimated to be approximately \$21,000,000 of which approximately \$7,000,000 was committed as of December 31, 1971."

(b) Planned Mergers, Acquisitions, and Divestitures.

Information given by companies as to the treatment of mergers, acquisitions, the creation of subsidiaries, and the divestitures of plants, companies and product lines were given in 108, or 32.0%, of the 337 annual reports. This type of information was usually found in the president's letter and the body of the report. Examples 9-13 provide illustrations:

Example 9  
Crown Zellerbach Company  
Extract from President's Letter.

"In international operations, our subsidiary, Crown Zellerbach International, Inc., has reached an understanding on a proposal for acquisition of a 50 percent interest in Van Gelder Papier of Amsterdam, the Netherlands. Approval of the proposal by Van Gelder shareowners will expand our interest in these ventures to a 50 percent equity position in the parent Dutch Company."

Example 10  
Arcata National Corporation  
Extract from the Body of the Report.

"Continued emphasis will be placed on development and implementation of strategies to return the companies remaining to a growing profit position. These steps include the planned acquisition of Knight, Gladioux & Smith, a well-known management consulting firm with particular expertise in computer-based information systems and environmental controls."

Example 11  
Hart, Schaffner & Marx  
Extract from President's Letter.

"The consent order entered June 1, 1970 settling the anti-trust suit requires the company to select and divest 30 stores by October 31, 1973. Five of these stores are to be sold by the April 30, 1972 date approved by the U. S. Department of Justice and the Federal District Court."

Example 12  
Mohawk Data Sciences Corporation  
Extract from President's Letter.

"Shareholders of Colorado Instruments, Inc., will shortly be called upon to approve the proposed merger of that company into a subsidiary of MDS at an exchange basis of one MDS share for nine shares of Colorado."

Example 13  
Southwest Bancshares, Inc.  
Extract from President's Letter.

"Southwest Bancshares has entered into an agreement to acquire control of Denton County National Bank in Denton through a cash purchase of not less than 51 percent of the bank's stock, subject to the approval of the regulatory authorities. Bancshares intends to offer to buy all the remaining stock of the bank following approval of regulatory bodies."

(c) Research, Exploration and the Creation and Promotion  
of New Products. This broad classification embodies research,

exploration, and the promotion and marketing of products. This category is necessarily broad to avoid duplicate reporting of similar items. Included in this classification are product testing, market research, sales promotion, and the development of new products. Of the 337 corporate annual reports, 190, or 56.4%, made reference to the promotion of products and the entrance into new markets. Specific research was referred to in 148, or 43.9%, of the reports. Illustrations of wording used by companies in giving information of this nature are shown in examples 14-19.

Example 14  
United Utilities, Inc.  
Extract from Body of Report.

"During 1971, UBC's direct sales coverage for voice products was expanded from 5 to 11 major cities, and distributors for voice products were expanded from 13 to 24. Plans for 1972 call for expansion of direct sales coverage to three more major cities and 12 additional distributors, and the introduction of five voice switchboard products."

Example 15  
Havatampa Cigar Corporation  
Extract from Body of Report.

"Our advertising budget and program was presented to the Board of Directors at its meeting in November as is the usual custom and same was approved. Full color page ads in sports magazines will be placed, as well as spot announcements on television in selected areas and in selected events. No increase in the budget was made although outdoor billboards were added this year."

Example 16  
 Zenith Radio Corporation  
 Extract from Body of Report.

"Looking to the future, Zenith is conducting substantial research directed toward the development of new types of color TV picture displays...research areas in advanced displays include laser light projection, liquid crystals, gas discharges and light-emitting diodes."

Example 17  
 Brooklyn Union Gas  
 Extract from Body of Report.

"Exploration will continue during 1972. Some gas may reach us from the successful wells drilled in Texas, and more drilling there is planned."

Example 18  
 Houston Natural Gas Corporation  
 Extract from Body of Report.

"HNG Oil's planned drilling expenditures during fiscal 1973 will amount to at least \$12 million, and again will be concentrated for the most part on prospects in West Texas."

Example 19  
 Archer Daniels Midland Company  
 Extract from President's Letter.

"In the coming year, an additional line of convenience dishes combining pasta, TVP textured vegetable proteins and dry seasonings will be test-marketed. We also plan to market a high-protein type macaroni product that qualifies for school lunch programs."

(d) Planned Price or Rate Changes. Planned price or rate changes were discussed in 77, or 22.8%, of the 337 reports. Frequently it was indicated that the price or rate increases were subject to the approval of the Price Commission. The examples below are typical of the wording used in annual reports to describe planned price or rate changes.

Example 20  
Dayton Power and Light Company  
Extract from President's Letter.

"In November, 1971, the Company filed applications with the Public Utilities Commission of Ohio to increase electric rates by 15% and steam rates by 23.8%. If approved, the proposed increases would yield a total additional revenue of \$20.1 million."

Example 21  
Columbia Gas System  
Extract from Body of Report.

"During 1971, System retail rate increase granted amounted to approximately \$9.8 million in revenue annually. An additional \$ .6 million annually has been filed for but was not being collected at year-end."

Example 22  
Wilmington Trust Company  
Extract from Body of Report.

"Following a thorough review, the Chancellor announced the Court's approval of a new higher rate schedule to take effect January 1, 1972...We intend to put the new fee schedule into effect as soon as a determination is made that it is not in conflict with current price regulations."

(e) Financing Plans. References to corporate financing plans were discussed in 117, or 34.7%, of the annual reports. Typically, a discussion of a pending debt or equity issue included the purpose or intended use of funds. Examples are:

Example 23  
Florida Power Corporation  
Extract from Body of Report.

"To finance the 1972 construction expenditures, which are expected to amount to \$186.2 million, we tentatively plan to issue \$50 million of first mortgage bonds and \$30 million of preferred stock in the spring, and an additional \$50 million of first mortgage bonds in the fall."

Example 24  
Southern California Edison Company  
Extract from Body of Report.

"Current plans for 1972, subject to change as market conditions warrant, include the sale of an equity issue followed by a bond offering later in the year."

Example 25  
Central Maine Power Company  
Extract from Body of Report.

"It is expected that in 1972, the Company will issue \$25,000,000 of bonds to refund \$10,655,000 of Series M 3½% bonds due September 1, 1972, to repay loans and to meet other obligations."

(f) Cost Control Programs. Cost control programs were frequently discussed in the body of the annual reports. Of the 337 corporate reports examined, 95, or 28.2%, made some reference to a cost savings plan. Included in this category are relocations, reorganizations, and the computerization of operations. Examples 26-28 show extracts from corporate annual reports relating to plans which might effect cost reductions.

Example 26  
American Investment Company  
Extract from President's Letter.

"During 1972, a computerized inventory control system which connects each merchandising warehouse with a central computer will be installed. This system, which is unique in the furniture industry, will give management tools to control inventory, costs, and margins on a basis more immediate and factual than is presently available on a manual basis."



Example 27  
Universal Oil Products Company  
Extract from President's Letter.

"The Instruments Division is being consolidated and some of its product lines will be relocated to the Bantam, Conn. plant of the Aerospace Division. The Aerospace Division's plant in Melville, N. Y. and the Wolverine Tube Mill in Detroit, Mich. are both scheduled for closing during the year. The properties will be offered for sale."

Example 28  
Detroit Edison  
Extract from Body of Report.

"The impact of financial, regulatory and environmental factors resulted in substantially reduced marketing expenditures during 1971. Further reductions have been implemented for 1972. Another move toward greater efficiency during 1971 was the initiation of a planned three to five year program to streamline customer office operations. We have closed 16 of the original 72 offices during 1971 and plan to close a similar number during 1972."

(g) Accounting Changes. Planned accounting changes were infrequently discussed. Of the 337 reports examined, only 7, or 2.1%, contained references to changes in accounting policy or systems. It should be pointed out that to avoid duplication the computerization of accounting systems was included in the previous discussion of cost control programs. Examples of planned accounting changes are:

Example 29  
Coastal States Gas Producing Company  
Extract from Body of Report.

"In order to simplify corporate reporting procedures and eliminate the need for dual financial presentations, the company plans to change its fiscal year-end from June 30 to December 31, which is the date required in most reports to governmental and administrative agencies."

Example 30  
Arden-Mayfair Corporation  
Extract from Body of Report.

"Many very basic systems procedures, and controls have been nonexistent, inefficient, or below standard. To help correct this condition, we are currently developing and are in the first stage of implementing a new accounting system."

#### Summary

In summary, one can state that the results of this study were similar to the 1963 investigation of corporate publicity by the United States Securities and Exchange Commission. As in 1963, earnings projections, the introduction of new products, and the announcements of prospective mergers or acquisitions were prominent in discussions of the future. However, because this study deals with the future, only time will ascertain whether the publicity analyzed actually represents concrete plans, speculation or deliberately misleading statements.

## CHAPTER IV

### SURVEY OF OPINIONS OF FINANCIAL ANALYSTS REGARDING THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION IN CORPORATE ANNUAL REPORTS

#### General

This chapter is concerned with the reporting of the results of the survey of opinions of Financial Analysts regarding the disclosure of projected financial information in corporate annual reports. The purpose is twofold: First, hypotheses 1 and 2 are tested; and second, the opinions of financial analysts regarding this subject are presented. Finally, a summarization concludes the chapter.

#### Survey Returns

| Questionnaires<br>Mailed | Required<br>Returns | Useable<br>Returns | Percentage<br>Returned |
|--------------------------|---------------------|--------------------|------------------------|
| 1200                     | 333                 | 460                | 38.3                   |

#### Hypotheses

Hypothesis 1: Most Financial Analysts believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

This hypothesis was tested by posing the following question to the Financial Analysts:

In your opinion, should financial information relating to the future plans and goals of the corporation be disclosed in published corporate annual reports?

Of the 460 replies, 391, or 85.0%, stated "Yes"; they do believe that projected financial information should be included in published corporate annual reports.

Testing the hypothesis using the Z test, one finds the standard error of the percentage with:

$$\begin{aligned}
 S_p &= \sqrt{\frac{P(100 - P)}{n}} \cdot \sqrt{\frac{N - n}{N - 1}} \\
 &= \sqrt{\frac{(85.0)(15.0)}{460}} \cdot \sqrt{\frac{13,000 - 460}{13,000 - 1}} \\
 &= 1.655 \cdot .982 = 1.64
 \end{aligned}$$

The Z test is then used where:

$$Z = \frac{P - P_h}{S_p} = \frac{85.0 - 50.0}{1.64} = \frac{35.0}{1.64} = 21.34$$

Since 21.34 is greater than 1.96, the hypothesis that most Financial Analysts do believe that projected financial information should be included in published corporate annual reports can be accepted.

To determine the confidence interval within which one can be 95% confident that the true population percentage falls, one finds:

$$\begin{aligned}
 \text{Confidence limits} &= P \pm Z \cdot S_p \\
 &= 85.0 \pm 1.96 \cdot 1.64 \\
 &= 85.0 \pm 3.2 = 88.2 \\
 &= 85.0 - 3.2 = 81.8
 \end{aligned}$$

Interpreting, one can be 95% confident that the true percentage of Financial Analysts who believe that projected financial information should be included in published corporate annual reports falls between 81.8% and 88.2% of the 13,000 members of the Financial Analysts Federation.

Hypothesis 2: Most Financial Analysts believe that the attest function should be extended to include projected financial information in published corporate annual reports.

This hypothesis was tested by posing the following question:

If projected financial information, such as budget, profit plans, or cash forecasts were disclosed in published corporate annual reports, do you feel that a CPA should examine this data and offer some form of an opinion based upon his examination?

Using the tests as above, there is:

$$\begin{aligned}
 S_p &= \sqrt{\frac{P(100 - P)}{n}} \cdot \sqrt{\frac{N - n}{N - 1}} \\
 &= \sqrt{\frac{(50.4)(49.6)}{460}} \cdot \sqrt{\frac{13,000 - 460}{13,000 - 1}} \\
 &= 2.331 \cdot .982 = 2.289 \\
 Z &= \frac{P - P_h}{S_p} = \frac{50.4 - 50.0}{2.289} \\
 &= \frac{.4}{2.289} = .17
 \end{aligned}$$

Since .17 is lower than 1.96, one can reject the hypothesis that most Financial Analysts believe that a CPA should examine projected financial information and offer some form of an opinion based upon his examination.

Again, one finds the confidence interval within which he can be 95% confident that the true population percentage falls with:

$$\text{Confidence limits} = P \pm Z \cdot S_p$$

$$50.4 + 1.96 \cdot 2.29 = 54.9$$

$$50.4 - 1.96 \cdot 2.29 = 45.9$$

One can be confident that the true percentage of Financial Analysts who believe that projected financial information should be "attested to" falls between 45.9% and 54.9% of the 13,000 members of the Financial Analysts Federation.

#### Other Data

In addition to the questions relating to the preceding hypotheses, the views of Financial Analysts were requested on the below topics:

1. General Evaluation of Corporate Annual Reports.
2. Attitudes of Financial Analysts on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.
3. Attitudes of Financial Analysts Regarding the Nature of Projected Financial Information to be included in Published Corporate Annual Reports.

4. Attitudes of Financial Analysts Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports.

The views of the Financial Analysts on the four topics follow.

1. General Evaluation of Corporate Annual Reports.

To evaluate the current status of corporate reporting, the following question was posed:

In your opinion, do you feel that published annual reports generally disclose adequate financial information to investors?

Of the 460 analysts who replied to the questionnaire, the great majority, 445, or 96.7%, chose to answer this question. Their views were fairly evenly distributed. Their replies were 217, or 48.8% "Yes" while 228, or 51.2%, replied that published annual reports generally do not disclose adequate financial information to investors.

Along with the preceding question on the general evaluation of corporate annual reports, the analysts were asked to offer an opinion on the usefulness of the various sections usually found in the reports. The degrees of usefulness were "Very Useful", "Useful", "Of Little Use" and "Of No Use". The sections of the annual report delineated were the President's Letter, the Highlights Section, the Balance Sheet, the Income Statement, the Statement of Source and Use of Funds, the Footnotes to the Financial Statements, the Historical Operating and Financial Statistics, and Organization Charts.

Regarding the usefulness of the President's Letter, 244, or 53.6% felt that it was "Useful". Only 80, or 17.6%, considered it "Very Useful". One hundred and twenty-five, or 27.5%, considered it "Of Little Use" while only six, or 1.3%, believed that the President's Letter was "Of No Use".

Overall, the degree of usefulness of the Highlights Section was considered slightly lower than the President's Letter. "Very Useful" fell to 58, or 12.8%, while "Useful" increased by 17 to 261, or 57.4%. "Of Little Use" received 122 replies, or 26.8%, and "Of No Use" received 14, or 3.0% of the 455 replies.

A substantial increase in the degree of usefulness was indicated for the Balance Sheet. "Very Useful" received 329, or 72.3% of the 455 replies. "Useful" received 119, or 26.2%, of the replies while "Of Little Use" received 6, or 1.3%. One of the financial analysts considered the Balance Sheet to be "Of No Use".

The Financial Analysts felt that the Income Statement was even more useful than the Balance Sheet. Three hundred and fifty-nine, or 78.9%, considered the Income Statement to be "Very Useful". Ninety-four, or 20.7%, viewed the Income Statement as "Useful" while only 2, or 0.4%, felt that it was "Of Little Use" or "Of No Use".

Although not rated as useful as the Balance Sheet or Income Statement, the Statement of Source and Use of Funds was judged to be "Very Useful" by most of the financial analysts (60.9%). The "Useful" category received 150 designations, some



33.0%. Twenty-seven, or 5.9%, of the analysts believed that the Statement of Source and Use of Funds was "Of Little Use", while only one, or 0.2%, considered it "Of No Use".

Of the various sections of the annual report, the Footnotes to the Financial Statements received the largest number of "Very Useful" replies. This category received 375, or 82.4%, of the replies while 71, or 15.6%, designated the footnotes "Useful". Only 9, or 2.0%, stated that footnotes were "Of Little Use".

Financial Analysts attitudes toward Historical Operating and Financial Statistics were distributed between "Very Useful" and "Useful", with "Useful" receiving the majority of the replies. These categories received 179, or 39.3%, and 251, or 55.2%, respectively. "Of Little Use" received 23, or 5.1%, and "Of No Use" received only two, or 0.4%, of the 455 replies.

Organization Charts were not considered to be "Very Useful" with "Of Little Use" and "Useful" receiving the majority of the replies. Only 12, or 2.6%, of the analysts believed that Organization Charts were "Very Useful", while 172, or 37.9%, considered the charts "Useful". Two hundred and twenty-four, or 49.2%, of the analysts viewed Organization Charts to be "Of Little Use" with 47, or 10.3%, indicating they were "Of No Use".

In conclusion, one can see that considerable usefulness was placed on the Footnotes to the Financial Statements, the Balance Sheet and Income Statement, and the Statement of Source and Use of Funds. Some degree of usefulness was believed for the President's Letter, the Highlights Section, and the Historical Operating and Financial Statistics, while the Organization Charts section was viewed as the least useful section of the annual reports.

A final question in this section related to the ranking of sources of information important to financial analysts. The following was posed:

Listed below alphabetically are sources of financial information for financial analysts. A space is also provided should you desire to specify a source other than those in the listing. Please rank the importance of each source by assigning the number 1 to the most important source, 2 to the second most important source, etc.

- \_\_\_\_\_ Corporate Annual Report. (CAR)
- \_\_\_\_\_ Direct Contact with Management (letter, phone, or meetings). (DCWM)
- \_\_\_\_\_ Interim Reports. (IR)
- \_\_\_\_\_ Prospectus and Registration Statements. (P&RS)
- \_\_\_\_\_ Statistical Investment Advisory Services. (SIAS)
- \_\_\_\_\_ Trade Publications. (TP)
- \_\_\_\_\_ Other (Please state). (O)

The results, from 1 to 7 in declining importance, were:

Table 4-1

| <u>Source</u> | <u>Ranking</u> |          |          |          |          |          |          |
|---------------|----------------|----------|----------|----------|----------|----------|----------|
|               | <u>1</u>       | <u>2</u> | <u>3</u> | <u>4</u> | <u>5</u> | <u>6</u> | <u>7</u> |
| P&RS          | 167            | 132      | 67       | 43       | 20       | 7        | 3        |
| DCWM          | 167            | 93       | 78       | 49       | 27       | 13       | 2        |
| CAR           | 85             | 121      | 132      | 74       | 22       | 10       | 1        |
| O             | 28             | 34       | 15       | 11       | 11       | 12       | 13       |
| SIAS          | 18             | 32       | 46       | 59       | 128      | 89       | 34       |
| IR            | 9              | 33       | 72       | 148      | 112      | 46       | 6        |
| TP            | 1              | 13       | 30       | 46       | 86       | 173      | 31       |

As indicated above, "Corporate Annual Report" was ranked third behind "Direct Contact with Management" and "Prospectus and Registration Statements" as a source of financial information. These were followed by "Statistical Investment Advisory Service", "Other", "Interim Reports", and "Trade Publications".

2. Attitudes of Financial Analysts on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.

The attitudes of Financial Analysts on the inclusion of forecasted statements in published corporate annual reports were also requested. They were asked to check the appropriate box relating to forecasted statements which might appear in published corporate annual reports. Table 4-2 provides a summary of the 435-441 replies in the form of percentages of the total.

Table 4-2

|  | <u>Definitely<br/>Should be<br/>Included</u> | <u>Possibly<br/>Should be<br/>Included</u> | <u>Should Not<br/>be<br/>Included</u> |
|--|--|--|---------------------------------------|
| Statement of Source and<br>Use of Funds  | 49.2%  | 32.9%                                      | 17.9%                                 |
| Statement of Anticipated<br>Growth of the Firm<br>(sales, human and<br>physical resources) | 42.0%  | 40.8%                                      | 17.2%                                 |
| Projected Income<br>Statement  | 32.6%  | 35.5%                                      | 31.9%                                 |
| Projected Balance Sheet  | 27.4%  | 40.8%                                      | 31.8%                                 |
| Statement of Use of<br>Natural Resources   | 25.8%  | 52.0%                                      | 22.2%                                 |

As indicated above, the forecasted Statement of Source and Use of Funds and the Statement of Anticipated Growth of the Firm received the most support for inclusion in corporate annual reports.

In conjunction with Table 4-2, those Financial Analysts who checked "Definitely Should Be Included" and "Possibly Should Be Included" were asked to indicate the period of time to which these forecasted statements should be extended. Table 4-3 categorizes the replies:

Table 4-3

|   | <u>1 Year</u> | <u>2 Years</u> | <u>3 or More<br/>Years</u> |
|---|---------------|----------------|----------------------------|
| Statement of Source and<br>Use of Funds<br>(Total Replies-331)        | 55.6%         | 25.7%          | 18.7%                      |
| Statement of Anticipated<br>Growth of the Firm<br>(Total Replies-336) | 30.1%         | 19.6%          | 50.3%                      |
| Projected Income<br>Statement<br>(Total Replies-294)                  | 55.5%         | 25.5%          | 19.0%                      |
| Projected Balance Sheet<br>(Total Replies-291)                        | 62.9%         | 22.0%          | 15.1%                      |
| Statement of Use of<br>Natural Resources<br>(Total Replies-308)       | 29.2%         | 17.5%          | 53.3%                      |

From Table 4-3, one can note that the largest percentage of replies for those statements normally dealt with by Financial Analysts fell in the one year category. Also, these statements received fewer replies than those not typically found in corporate reports. However, the majority of the respondents believed that the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources should be forecasted for three or more years.

3. Attitudes of Financial Analysts on the Degree of Importance They Place on Projected Financial Information.

Unfortunately, this particular section of the questionnaire was fairly complex, involving 10 categories; four relating to importance and six relating to disclosure policy. The

respondents were asked to check "Very Important", "Moderately Important", "Fairly Unimportant" or "Unimportant" for selected items of projected financial information. Also, they were asked to select the disclosure policy of each item. These included "No Disclosure", "Disclose in President's Letter", "Disclose in Projected Statement", "Disclose in Supplemental Schedule Associated with the Primary Financial Statement", "Disclose in Primary Financial Statement's Footnotes", and "Other", with a request that they write in proper disclosure method. Regarding the major items of information requested, they fell into the following classifications:

- a. Sales and Earnings.
- b. Human Resources.
- c. Future Research and Development.
- d. Advertising.
- e. Natural Resources.
- f. Capital Expenditures.
- g. Corporate Acquisitions.
- h. Inventories.
- i. Dividend Policy.
- j. Future Financing.

To facilitate the understanding of this complex question, a summary is provided. The complete results may be found in Appendix A. Relating to this question, there were between 428 and 446 replies to each of these items.

a. Sales and Earnings. Under this topic, several items were covered where the analysts were requested to indicate the degree of importance they would place on each item. As with the following topics, the items covered are listed in the order of importance to the analysts.

"Expected Contribution Margins by Product, Territory, or Division" was considered "Very Important" by 74.9% of the respondents. Also, 19.6% indicated "Mildly Important", while only 5.5% believed that "Expected Contribution Margins by Product, Territory or Division" were "Unimportant" or "Fairly Unimportant". As for disclosure of such information, 36.0% of the analysts indicated a separate "Projected Statement". "No Disclosure" and "Supplemental Schedule" received 21.3% and 22.2% respectively. The "President's Letter" was noted by 10.6% of the respondents, "Statement Footnotes" received 7.0%, while "Other" was designated by 2.9% of the analysts.

A second item considered important to analysts was "Expected Sales Breakdowns by Product, Territory, or Division". Seventy-four and six-tenths percent of the respondents believed that this item was "Very Important", while 20.8% noted "Mildly Important". "Fairly Unimportant" and "Unimportant" received 4.6% of the replies. The "Projected Statement" received the most replies for disclosure with 35.2%. Following were the "Supplemental Schedule" (24.9%), "No Disclosure" (17.6%), "President's Letter" (13.9%), "Statement Footnotes" (4.8%) and "Other" (3.6%).

The third item of importance to financial analysts was "Backlog of Orders to be Filled". Of the 446 respondents to this item, 65.2% noted "Very Important", while 29.2% checked "Mildly Important". Few (5.6%) considered this item "Unimportant" or

"Fairly Unimportant". Thirty-eight and one-tenth percent of the analysts believed that this information should be presented in the "President's Letter". That this information should be disclosed in a "Supplemental Statement" was indicated by 23.6% of the analysts. Twenty-two and two-tenths percent specified "Projected Statement", while 11.6% checked "No Disclosure".

A slight decline in relative importance to the analysts was noted for "Forecasted Volume of Future Sales". "Very Important" declined to 62.6%, while the replies to "Mildly Important" (29.3%), "Fairly Unimportant" (5.6%) and "Unimportant" (2.5%) remained similar to the preceding item. As for disclosure, if at all, "Projected Statement" received the most replies with 39.2%. This was followed by "President's Letter" (26.3%), "No Disclosure" (16.0%), "Supplemental Schedule" (11.3%), "Statement Footnotes" (5.2%), and "Other" (2.0%).

A further decline in importance was indicated by the analysts for the item "Estimated Earnings Per Share of Common Stock". Sixty-one and five-tenths percent of the analysts believed that this item was "Very Important". "Mildly Important" (28.8%) and "Fairly Unimportant" (4.5%) showed decreases, while "Unimportant" increased to 5.2%. As for disclosure, the "President's Letter", "No Disclosure", and "Projected Statement" received 25.6%, 29.0%, and 27.5% respectively, of the replies; while a "Supplemental Schedule", "Statement Footnotes", and "Other" received 9.8%, 5.4%, and 2.7% respectively. The final



item, "Anticipated Price Increase of Products", showed a substantial decline over the preceding item. "Very Important" fell to 52.9%, while "Mildly Important" rose to 36.0%. "Fairly Unimportant" rose to 8.5%, while "Unimportant" fell to 2.6%. Regarding disclosure, the replies were: "President's Letter" (31.4%), "Projected Statement" (26.0%), "No Disclosure" (22.4%), "Supplemental Schedule" (14.1%), "Statement Footnotes" (3.6%), and "Other" (2.5%).

b. Human Resources. Of the items included under Human Resources, "Future Effect of Wages Increases Due to Pending Union Agreement" was viewed by the analysts to be of greatest importance to the investor. Fifty-seven and six-tenths percent checked "Very Important", while 37.7% noted "Mildly Important". Slightly under four percent believed this item to be considered "Fairly Unimportant" with only 1.1% believing it to be "Unimportant" to the investor. Disclosure policy centered on the "President's Letter" (32.3%) and the "Projected Statement" (23.7%), followed by the "Supplemental Schedule" (18.3%), "No Disclosure" (13.1%), "Statement Footnotes" (9.7%), and "Other" (2.9%).

"Common Shares Owned by Officers and Directors" ranked second in importance to analysts. "Very Important" and "Mildly Important" received the majority of the replies--33.4% and 43.3%, respectively. The location for expected disclosure, however, shifted to the "Statement Footnotes" (34.5%) and the "Supplemental

Schedule" (28.9%). Categories remaining were: "No Disclosure" (9.9%), "Projected Statement" (8.0%), "President's Letter" (7.9%), and "Other" (10.8%).

A slight decline in relative importance can be noted for the item "Estimated Pension Fund Costs". Contrasting this item with the preceding one, the responses fell from 33.4% to 30.5% for "Very Important" and rose from 43.3% to 45.1% for "Mildly Important". "Fairly Unimportant" remained at 20.3%. "Unimportant" increased from 2.9% to 4.1%. As with the preceding item, the "Statement Footnotes" (27.8%) and "Supplemental Schedule" (29.8%) received the largest percentage of replies, while "Projected Statement" rose from 8.0% to 19.6%. The remaining replies were distributed between the categories: "President's Letter (11.3%), "No Disclosure" (8.8%), and "Other" (2.7%).

A substantial decrease in importance was accorded the remaining four items under Human Resources--"Anticipated Change in Company's Policies Regarding Employees", "Estimated Employee Turnover Data", "Anticipated Change in Employment Contracts of Directors and Officers", and "Programmed Future Cost for the Training and Recruiting of Employees". Analysts noted "Very Important" 8.4% to 14.5% for these items. "Mildly Important" rose to between 33.6% and 43.4%. The category most often indicated by the analysts was "Fairly Unimportant", with between 34.6% and 43.3% of the responses. Seven and five-tenths percent to 14.7% of the analysts considered these items "Unimportant".

The decline in importance of these items was accompanied by an increase in the "No Disclosure" policy--22.9% to 36.2% of the replies. Disclosure in the "President's Letter" was indicated in 11.6% to 28.8% of the replies. "Supplemental Schedule" received between 17.2% and 26.5%, while "Statement Footnotes" was noted in 5.4% to 14.0% of the responses.

c. Future Research and Development. The nature of information relating to future research and the development of new products were:

- (1) Expected Research and Development Expenditures.
- (2) Anticipated New Products or Patents.
- (3) Estimated Increase in Sales Due to New Products.

The response to these items were substantially similar. Analysts viewed them as fairly important. Between 51.6% and 60.5% of the replies were "Very Important". "Mildly Important" received 34.0% to 42.9%, while "Fairly Unimportant" and "Unimportant" never received more than 5.0% for each item. Another similarity between these items was the expected disclosure policy of investors. For each item, the "President's Letter" and "Projected Statement" was indicated more than any of the other categories. Between 29.7% and 43.4% checked "President's Letter", while 22.1% to 37.4% indicated "Projected Statement". Following was "Supplemental Schedule" with between 12.8% and 18.5%. "No Disclosure" received between 10.0% and 19.9% and the other categories received less than three percent.

d. Budgeted Advertising Expenditures. Analysts were asked to provide their views on how important "Budgeted Advertising Expenditures" and "Projected Growth in Sales as a Result of Advertising" would be to them. Only 17.3% believed that "Budgeted Advertising Expenditures" to be "Very Important". "Mildly Important" received 46.2% of the responses, while "Fairly Unimportant" and "Unimportant" received 28.9% and 7.6%, respectively. "Projected Growth in Sales as a Result of Advertising" was rated similarly. Fifteen and nine-tenths percent of the responses were "Very Important", 42.2%--"Mildly Important", 31.0%--"Fairly Unimportant", and 10.9%--"Unimportant". As a low degree of importance was placed on these items, "No Disclosure" was often indicated as expected disclosure policy, (26.9% and 35.8%). The "Projected Statement" ranked second in replies (27.8% and 27.3%). Third was the "Supplemental Schedule" with 24.6% and 16.2% of the responses. Fourth was the "President's Letter" with 12.0% and 14.8%, and less than six percent of the replies were noted in the other categories.

e. Natural Resources. Generally, analysts viewed "Projected Exploration Expenditures" as "Very Important" (45.8%). Forty-two percent indicated "Mildly Important" with 10.1% and 2.2% being regarded as "Fairly Unimportant" or "Unimportant". Similarly, "Forecast Changes in Natural Resources" were viewed as "Very Important" (44.5%) to investors. Thirty-eight and

eight-tenths percent of the analysts indicated "Mildly Important". Accordingly, "Fairly Unimportant" and "Unimportant" received 13.0% and 3.7% of the responses. Expected disclosure policy for "Projected Exploration Expenditures" fell mainly into four categories: (1) "President's Letter" (25.6%), (2) "Projected Statement" (35.0%), (3) "No Disclosure" (15.1%), and (4) "Supplemental Schedule" (18.6%). With the same trend in responses, expected disclosure policy for "Forecasted Changes in Natural Resources" was (1) "President's Letter" (29.1%), (2) "No Disclosure" (17.2%), (3) "Projected Statement" (31.5%), and (4) "Supplemental Schedule" (15.8%).

f. Capital Expenditures. Items covered in this classification were:

- (1) Planned Capital Expenditures.
- (2) Increase in Plant Capacity Due to Capital Expenditures.
- (3) Proposed Method of Financing Capital Expenditures.

The results for these three items were substantially alike. Between 65.3% and 73.1% of the respondents viewed these items as being "Very Important". Also, between 23.3% and 31.6% noted "Mildly Important". "Fairly Unimportant" and "Unimportant" each received less than four percent of the replies. Concerning expected disclosure policy, approximately one-third (35.6% to 38.9%) of the respondents regarded the "President's Letter" as the location in the annual report in which these items should

appear. Ranking second was the "Projected Statement" (22.6% to 28.7%). Declining slightly was "Supplemental Schedule" with between 19.1% and 20.5%. "No Disclosure" received 8.0% to 11.2% of the replies and less than 5% was noted in the other categories.

g. Corporate Acquisitions. Substantial importance was accorded items related to corporate acquisitions. The majority of the analysts (63.4% to 66.3%) felt that the following items were "Very Important":

- (1) Cost of Prospective Acquisitions.
- (2) Effect of Acquisitions on Future Costs and Sales.
- (3) Proposed Method of Financing Acquisitions.

Between 27.3% and 27.8% of the responses to these items were "Mildly Important". Less than 6% was noted in the categories "Fairly Unimportant" or "Unimportant". As with Capital Expenditures, disclosure in the "President's Letter" received the largest percentage of replies (25.5% to 30.7%). Disclosure in the "Projected Statement" ranked second with 21.3% to 26.4%. "No Disclosure" response rate for these items was 20.2% to 25.8%, while "Statement Footnotes" and "Other" received less than six percent of the replies for each item.

h. Inventories. Two items relating to projected financial information desired by analysts are "Forecasted Change in Physical Inventories" and "Anticipated Price Changes of

Materials". Twenty-eight and thirty-eight percent believed these items "Very Important". "Mildly Important" replies were 45.6% and 40.8%. "Fairly Unimportant" received 23.2% and 17.9%, while "Unimportant" received less than 4% for the items. As noted for other items, where the degree of importance declined, "No Disclosure" replies increased. Twenty-six and eight-tenths percent and 23.8% of the analysts indicated "No Disclosure" for the items. However, 33.5% and 31.9% of the respondents indicated the "Projected Statement". The remaining were: "Supplemental Schedule" (21.1% and 19.0%), "President's Letter" (12.4% and 18.4%), "Statement Footnotes" (4.1%), and "Other" (2.1% and 2.8%).

i. Dividend Policy. The degree of importance placed on future cash or stock dividends by analysts was fairly substantial. It was not surprising that 36.6% of the analysts viewed a cash dividend as "Very Important". Likewise, 34.0% of the replies relating to a proposed stock dividend noted "Very Important". "Mildly Important" received 37.4% and 37.0%, respectively, for the proposed cash and stock dividends. "Fairly Unimportant" received 20.1% and 21.7%, while "Unimportant" received less than eight percent for each item. Expected disclosure policy was similar for both items. Forty-four and six-tenths percent and 42.5% of the responses indicated the "President's Letter". "No Disclosure" received 19.6% and 20.5% for proposed cash and stock dividends. Fourteen and eight-tenths percent and 14.4% of the replies indicated "Projected Statement", while 13.0% and 14.2% indicated "Supplemental Schedule". The "Other" category and "Statement Footnotes" received less than six percent of the total replies.

j. Future Financing. Although no less in importance than the items listed above, this final classification includes the following:

- (1) Details of Proposed Stock Issues.
- (2) Future Effects of Conversion Features of Debt or Preferred Stock.
- (3) Anticipated Pledging of Assets for Long-term Debt.
- (4) Schedule of Future Debt Payments.
- (5) Rental Payments and Other Details of Anticipated Long-term Leases.

The majority of analysts viewed the "Details of Proposed Stock Issues" and "Future Effects of Conversion Features of Debt or Preferred Stock" as being "Very Important" to investors--53.9% indicated for "Proposed Stock Issues" and 50.2% for the "Conversion Features of Debt or Preferred Stock". Over one-third of the respondents indicated "Mildly Important" for both items, while less than ten percent was noted in each of the categories, "Fairly Unimportant" and "Unimportant". Expected disclosure policy for "Proposed Stock Issues" was: 29.6%--"President's Letter", and between 11.7% and 19.6% in each category, "Supplemental Schedule", "Statement Footnotes", "Projected Statement", and "No Disclosure". In the case of "Future Effects of Conversion Features of Debt or Preferred Stock", there was a shift in expected disclosure policy away from the "President's Letter" toward the "Statement Footnotes". The "President's Letter" decreased to 7.2%, while "Statement Footnotes" rose to 32.9% of



the replies. "Projected Statement" and "Supplemental Schedule" received 22.8% and 25.9% respectively.

A lower level of importance was indicated for items 4 and 5 above. "Schedule of Future Debt Payments" was considered "Very Important" by 42.4% of the analysts. Forty-three and four-tenths percent indicated "Mildly Important". Other responses were 12.4% to "Fairly Unimportant" and 1.8% to "Unimportant". As for item 5, "Rental Payments and Other Details of Anticipated Long-term Leases", 39.2% of the analysts noted "Very Important", with 45.5% marking "Mildly Important". Other responses were 12.8% and 2.5% for "Fairly Unimportant" and "Unimportant" respectively. Expected disclosure for "Schedule of Future Debt Payments" was: "Supplemental Schedule"--31.7%, "Statement Footnotes"--32.8%, "Projected Statement"--20.0%, "No Disclosure"--9.6%, "President's Letter"--4.1%, and "Other"--1.8%. With regard to "Rental Payments and Other Details of Anticipated Long-term Leases" expected disclosure was: "Statement Footnotes"--29.8%, "Supplemental Schedule"--27.3%, "Projected Statement"--20.4%, "No Disclosure"--14.7%, "President's Letter"--6.8%, and "Other"--1.0%.

A further decline in importance was noted for the final item, "Anticipated Pledging of Assets for Long-term Debt". "Very Important" was indicated in 34.1% of the replies, while "Mildly Important" increased to 42.1%. "Fairly Unimportant" and "Unimportant" received 19.9% and 3.9% respectively. In

conclusion, expected disclosure policy for this item was:

"Statement Footnotes"--21.5%, "No Disclosure"--21.3%, Projected Statement"--19.2%, "Supplemental Schedule"--22.6%, "President's Letter"--12.4% and "Other"--3.0%.

4. Attitudes of Financial Analysts Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports. Relating to Hypothesis 2 on the views of analysts on the extension of the "attest" function to projected financial information, the following statement was posed:

Assuming a CPA would be required to express an opinion on projected financial information included in published corporate annual reports, the contents of such an opinion should: (Check as many as desired).

\_\_\_\_\_ Include a statement as to the accuracy of the calculations in preparing the forecasts.

\_\_\_\_\_ Include a statement as to the fairness of the assumptions on which the forecasts are based.

\_\_\_\_\_ Include a statement that he (the CPA) is in no way guaranteeing the realization of the forecasts.

\_\_\_\_\_ Include a statement that he (the CPA) does share responsibility with management for the preparation of the forecasts.

Concerning the accuracy of the calculations in preparing the forecasts, 218 of the 460 respondents, or 47.4%, believed that an opinion should require such a statement. As to the fairness of the assumptions on which the forecasts were based, 263, or 57.2%, believed that this statement should be included in a required opinion. Fifty-six percent of the analysts indicated that an opinion should

require a statement that the CPA is in no way guaranteeing the realization of the forecasts. Only 106, or 23.0%, of the analysts suggested that CPAs should share responsibility with management for the preparation of forecasts.

### Summary

Regarding the hypotheses posed in this chapter, one can conclude the following:

1. Between 81.8% and 88.2% of the members of the Financial Analysts Federation believe that financial information relating to the future plans and goals of the corporation should be disclosed in published corporate annual reports.

2. Between 45.9% and 54.9% of the members of the Financial Analysts Federation believe that a CPA should examine projected financial information and offer some form of an opinion based upon an examination.

Other attitudes examined revealed the following:

1. General Evaluation of Corporate Annual Reports.

A slight majority (51.2%) of the analysts believed that published annual reports generally disclosed adequate financial information to investors. Analysts generally believed that the Balance Sheet, Income Statement, Footnotes to the Financial Statements, and the Statement of Source and Use of Funds were of major importance to them. Of less importance were the Historical Operating and Financial Statistics, the Highlights

Section, the President's Letter, and Organization Charts.

Finally, the "Corporate Annual Report" was ranked third behind "Direct Contact with Management" and "Prospectus and Registration Statements" as a source of financial information.

2. Attitudes of Financial Analysts on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.

Forecasted statements, such as the Projected Balance Sheet, the Projected Income Statement, and the Statement of Use of Natural Resources received the least support for inclusion in published corporate annual reports. The Statement of Source and Use of Funds received the largest support for inclusion in published annual reports followed by the Statement of Anticipated Growth of the Firm. For those analysts who indicated that forecasted statements should be included in published corporate annual reports, most felt that the Projected Balance Sheet, the Projected Income Statement, and the Statement of Source and Use of Funds should be for one year in the future, while the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources should be prepared for three or more years.

3. Attitudes of Financial Analysts on the Degree of Importance They Would Place on Projected Financial Information.

Generally, analysts believed that forecasted items related to Future Research and Development, Corporate Acquisitions, Capital Expenditures, Projected Exploration Expenditures, Future Financing and Sales and Earnings would be of considerable

importance to investors. Declining in importance were items related to Dividend Policy, Human Resources, Inventories, and Advertising. Concerning expected disclosure, the following general conclusions can be stated:

a. Where items were rated low in importance, "No Disclosure" received a significant percentage of replies.

b. The "President's Letter", the "Projected Statement", and the "Supplemental Schedule" were named most as the areas of disclosure for all major topics.

c. The "Statement Footnotes" received large percentages of replies for "Estimated Pension Fund Costs" and "Common Shares Owned by Officers and Directors".

4. Attitudes of Financial Analysts Regarding the Contents of an Opinion on Projected Financial Information in Published Corporate Annual Reports. If a CPA were required to offer an opinion on projected financial information included in corporate annual reports, the majority of the analysts believed that the opinion should include statements that the CPA is in no way guaranteeing the realization of the forecasts or on the fairness of the assumption of the forecasts. Only 23.0% indicated that CPAs should share responsibility with management for the preparation of the forecasts. Concluding, 47.4% of the analysts believed that the opinion should include a statement as to the accuracy of the calculations in preparing the forecasts.

## CHAPTER V

### SURVEY OF OPINIONS OF CERTIFIED PUBLIC ACCOUNTANTS REGARDING THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION IN CORPORATE ANNUAL REPORTS

#### General

This chapter is concerned with the reporting of the results of the survey of opinions of Certified Public Accountants regarding the disclosure of projected financial information in corporate annual reports. The purpose is twofold: First, hypotheses 3 and 4 are tested; and second, the opinions of Certified Public Accountants regarding this subject are presented. Finally, a summarization concludes the chapter.

#### Survey Returns

| Questionnaires<br>Mailed | Required<br>Returns | Usable<br>Returns | Percentage<br>Returned |
|--------------------------|---------------------|-------------------|------------------------|
| 1200                     | 383                 | 478               | 39.8                   |

#### Hypotheses

Hypothesis 3: Most American Certified Public Accountants believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

This hypothesis was tested by posing the following

question to the Certified Public Accountants:

In your opinion, should financial information relating to the future plans and goals of the corporation be disclosed in published corporate annual reports?

Of the 478 replies, 352, or 73.6%, stated "Yes"; they do believe that projected financial information should be included in published corporate annual reports.

Testing the hypothesis using the Z test one finds the standard error of the percentage with:

$$\begin{aligned} S_p &= \sqrt{\frac{P(100 - P)}{n}} \cdot \sqrt{\frac{N - n}{N - 1}} \\ &= \sqrt{\frac{(73.6)(26.4)}{478}} \cdot \sqrt{\frac{88,000 - 478}{88,000 - 1}} \\ &= 2.016 \cdot .997 = 2.01 \end{aligned}$$

The Z test is then used where:

$$Z = \frac{P - P_h}{S_p} = \frac{73.6 - 50.0}{2.01} = \frac{23.6}{2.01} = 11.7$$

Since 11.7 is greater than 1.96 one can accept the hypothesis that most Certified Public Accountants do believe that projected financial information should be included in published corporate annual reports.

To determine the confidence interval within which one can be 95% confident that the true population percentage falls one finds:

$$\begin{aligned} \text{Confidence limits} &= P \pm Z \alpha S_p \\ &= 73.6 \pm 1.96 \alpha 2.01 \\ &= 73.6 \pm 3.9 = 77.5 \\ &= 73.6 - 3.9 = 69.7 \end{aligned}$$

Interpreting, one can be 95% confident that the true percentage of Certified Public Accountants who believe that projected financial information should be included in published corporate annual reports falls between 69.7% and 77.5% of the 88,000 members of the American Institute of Certified Public Accountants.

Hypothesis 4: Most American Certified Public Accountants believe that the attest function should be extended to include projected financial information in published corporate annual reports.

This hypothesis was tested by posing the following question:

If projected financial information such as budgets, profit plans, or cash forecasts were disclosed in published corporate annual reports, do you feel that a CPA should examine this data and offer some form of an opinion based upon his examination?

Using the test as above, there is:

$$\begin{aligned}
 S_p &= \sqrt{\frac{P(100 - P)}{n}} \cdot \sqrt{\frac{N - n}{N - 1}} \\
 &= \sqrt{\frac{(33.7)(66.3)}{478}} \cdot \sqrt{\frac{88,000 - 478}{88,000 - 1}} \\
 &= 2.16 \cdot .997 = 2.155
 \end{aligned}$$

$$Z = \frac{P - P_h}{S_p} = \frac{33.7 - 50.0}{2.155} = \frac{-16.3}{2.155} = -7.56$$

Since -7.56 is lower than 1.96 the hypothesis that most Certified Public Accountants believe that a CPA should examine projected financial information and offer some form



of an opinion based upon his examination can be rejected.

Again one finds the confidence interval within which he can be 95% confident that the true population percentage falls with:

$$\begin{aligned} \text{Confidence Limits} &= P \pm Z \times S_p \\ &= 33.7 + 4.2 = 37.9 \\ &= 33.7 - 4.2 = 29.5 \end{aligned}$$

Interpreting, one can be 95% confident that the true percentage of Certified Public Accountants who believe that projected financial information should be "attested to" falls between 29.5% and 37.9% of the 88,000 members of the American Institute of Certified Public Accountants.

#### Other Data

In addition to the questions relating to the preceding hypotheses, the views of Certified Public Accountants were requested on the following topics:

1. General Evaluation of Corporate Annual Reports.
  2. Attitudes of Certified Public Accountants on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.
  3. Attitudes of Certified Public Accountants on the Beliefs of Investors Regarding the Nature of Projected Financial Information to be Included in Published Corporate Annual Reports.
  4. Attitudes of Certified Public Accountants Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports.
1. General Evaluation of Corporate Annual Reports.

To evaluate the current status of corporate reporting, the following question was posed:

In your opinion, do you feel that published annual reports generally disclose adequate financial information to investors?

Of the 478 accountants who replied to the questionnaire, the great majority, 449, or 93.9%, chose to answer this question. Their views were evenly distributed on this question. Two hundred and forty-seven, or 55.0%, stated "Yes" while 202, or 45.0%, believed that published annual reports generally do not disclose adequate financial information to investors.

Along with the preceding question on the general evaluation of corporate annual reports the accountants were asked to offer an opinion on the usefulness of the various sections usually found in annual reports. The degrees of usefulness were "Very Useful", "Useful", "Of Little Use" and "Of No Use". The sections of the annual report delineated were the President's Letter, the Highlights Section, the Balance Sheet, the Income Statement, the Statement of Source and Use of Funds, the Footnotes to the Financial Statements, the Historical Operating and Financial Statistics, and Organization Charts.

Regarding the usefulness of the President's Letter, 240, or 50.2%, believed that it was "Useful". Only 86, or 18.0%, considered it "Very Useful". One hundred and thirty-six, or 28.5%, considered it "Of Little Use" while 16, or 3.3% noted

that the President's Letter was "Of No Use".

Overall the degree of usefulness of the Highlights Section was considered somewhat higher than the President's Letter. "Very Useful" increased to 135, or 28.2%, while "Useful" increased by 13 to 253, or 52.9%. "Of Little Use" received 78 replies, or 16.4%, and "Of No Use" 12, or 2.5%, of the 478 replies.

A substantial increase in the degree of usefulness was indicated for the Balance Sheet. "Very Useful" received 305, or 63.8%, of the 478 replies. "Useful" received 159, or 33.3%, of the replies while "Of Little Use" received 14, or 2.9%. None of the accountants considered the Balance Sheet to be "Of No Use".

The accountants indicated that the Income Statement was even more useful than the Balance Sheet. Three hundred and fifty-three, or 73.8%, considered the Income Statement to be "Very Useful". One hundred and sixteen, or 24.3%, viewed the Income Statement as "Useful" while only 9, or 1.9%, believed that it was "Of Little Use" or "Of No Use".

Although not rated as useful as the Balance Sheet or Income Statement, the Statement of Source and Use of Funds was judged to be "Very Useful" by most of the accountants (59.6%). The "Useful" category received 148 designations, some 31.0%.

Forty-Five, or 9.4%, of the accountants believed that the Statement of Source and Use of Funds was "Of Little Use".

Of the various sections of the annual report, the Footnotes to the Financial Statements received the largest number of "Very Useful" replies. This category received 372, or 77.8%, of the replies while 91, or 19.0%, designated the footnotes "Useful". Only 15, or 3.2%, stated that footnotes were "Of Little Use" or "Of No Use".

Accountants' attitudes toward Historical Operating and Financial Statistics were fairly evenly distributed between "Very Useful" and "Useful". These categories received 215, or 45.0%, and 231, or 48.3%, respectively. "Of Little Use" received 30, or 6.3%, and "Of No Use" received 2, or 0.4%, of the 478 replies.

Organization Charts were not considered to be very useful with "Of Little Use" and "Of No Use" receiving the majority of replies. Only 24, or 5.0%, of the accountants noted that they were "Very Useful" while 116, or 24.3%, considered the charts "Useful". The majority of the accountants, 269, or 56.3% viewed organization Charts to be "Of Little Use" with 69, or 14.4%, indicating they were "Of No Use".

Concluding, one can see that considerable usefulness was placed on the Footnotes to the Financial Statements, the

Balance Sheet and Income Statement, and the Statement of Source and Use of Funds. Some degree of usefulness was believed for the President's Letter, the Highlights Section and the Historical Operating and Financial Statistics while Organization Charts was viewed as the least useful of the sections of the annual reports.

2. Attitudes of Certified Public Accountants on the Inclusion of Forecasted Statements in Published Corporate Annual Reports. The attitudes of Certified Public Accountants on the inclusion of forecasted statements in published corporate annual reports were also requested. They were asked to check the appropriate box relating to forecasted statements which might appear in published corporate annual reports. Table 5-1 provides a summary of the 478 replies in the form of percentages of the total.

|  | Table 5-1                                    |  |                                       |
|--|--|--|---------------------------------------|
|  | <u>Definitely<br/>Should Be<br/>Included</u> | <u>Possibly<br/>Should Be<br/>Included</u> | <u>Should Not<br/>Be<br/>Included</u> |
| Statement of Anticipated<br>Growth of the Firm | 38.5%  | 40.4%                                      | 21.1%                                 |
| Statement of Source and<br>Use of Funds        | 32.6%  | 27.8%                                      | 39.6%                                 |
| Projected Income Statement                     | 28.5%  | 26.5%                                      | 45.0%                                 |
| Statement of Use of<br>Natural Resources       | 16.8%  | 48.3%                                      | 34.9%                                 |
| Projected Balance Sheet                        | 14.4%  | 31.4%                                      | 54.2%                                 |

As indicated above, forecasts relating to those statements

typically audited by accountants received the least support for inclusion in corporate annual reports. Possibly, there is a fear that the "attest" function may be extended to such statements. It was noted in testing our hypothesis that a large majority of accountants did believe that the auditing and the expression of an "opinion" on forecasted data were undesirable.

In conjunction with Table 5-1, those accountants who checked "Definitely Should Be included" and "Possibly Should Be Included" were asked to indicate the period of time to which these forecasted statements should be extended. Table 5-2 categorizes the replies:

Table 5-2

|   | <u>1 Year</u> | <u>2 Years</u> | <u>3 or More<br/>Years</u> |
|---|---------------|----------------|----------------------------|
| Statement of Anticipated<br>Growth of the Firm<br>(Total Replies=357) | 24.4%         | 22.7%          | 52.9%                      |
| Statement of Source and Use<br>of Funds<br>(Total Replies=289)        | 44.6%         | 30.1%          | 25.3%                      |
| Projected Income Statement<br>(Total Replies=255)                     | 42.7%         | 26.7%          | 30.6%                      |
| Statement of Use of Natural<br>Resources<br>(Total Replies=285)       | 28.1%         | 20.0%          | 51.9%                      |
| Projected Balance Sheet<br>(Total Replies=210)                        | 52.4%         | 21.9%          | 25.7%                      |

From Table 5-2 one can note that the largest percentage of replies for those statements normally dealt with by accountants fell in the one year category. Also, these statements received

substantially fewer replies than those not "audited" by accountants. The majority of the respondents believed that the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources should be forecasted for 3 or more years. To be presumptive, one might suggest that these replies collaborate our hypotheses that accountants believe that the plans and goals of the firm should be included in published corporate annual reports, but that they should not be "attested to" by Certified Public Accountants.

3. Attitudes of Certified Public Accountants on the Degree of Importance They Would Expect an Investor to Place on Projected Financial Information. Unfortunately, this particular section of the questionnaire was fairly complex, involving 10 categories; four relating to importance and six relating to disclosure policy. The respondents were asked to check "Very Important", "Moderately Important", "Fairly Unimportant" or "Unimportant" for selected items of projected financial information. Also, they were asked to select the disclosure policy of each item. These included "No Disclosure"\* , "Disclose in President's Letter", "Disclose in Projected Statement", "Disclose in Supplemental Schedule Associated with the Primary Financial Statements", "Disclose in Primary Financial Statement's Footnotes",

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\*In the few cases where no disclosure was indicated, "No Disclosure" was used as the balancing item.

and "Other" with a request that they write in proper disclosure method. Regarding the major items of information requested, they fell into the following classifications:

- a. Sales and Earnings.
- b. Human Resources.
- c. Future Research and Development.
- d. Advertising.
- e. Natural Resources.
- f. Capital Expenditures.
- g. Corporate Acquisitions.
- h. Inventories.
- i. Dividend Policy.
- j. Future Financing.

To facilitate the understanding of this complex question, a summary is herewith provided. The complete results may be found in Appendix B. Relating to this question, there were between 442 and 474 replies to each of these items.

a. Sales and Earnings. Under this topic, several items were covered where the accountants were requested to indicate the degree of importance they would expect investors to place on each item. As with the following topics, the items covered are listed in the order of expected importance to the investor.

"Estimated Earnings Per Share of Common Stock" was considered "Very Important" to the investor by 52.5% of the respondents. Of the replies, 30.3% indicated "Mildly Important" while only ten percent believed that "Earnings Per Share" to be "Unimportant" to the investor. As to where disclosure of such information would be desired by an investor, 38.7% of the accountants indicated a separate "Projected Statement".



"No Disclosure" and "President's Letter" each received approximately 23.0% of the replies.

The "Backlog of Orders to be Filled" was considered "Very Important" and "Mildly Important" to the investor by 48.9% and 34.9% of the accountants, respectively. Unlike "Earnings Per Share of Common Stock", 36.7% of the accountants believed that investors would prefer this information to be disclosed in the "President's Letter". The "Projected Statement" was noted by 22.1% of the respondents and "No Disclosure" fell to 15.3%. "Supplemental Schedule" and "Primary Financial Statement's Footnotes" received 13.7% and 9.9% of the responses, respectively.

The third item considered important to investors was "Forecasted Volume of Future Sales". Of the 450 respondents to this item, 47.8% noted "Very Important" while 38.2% checked "Mildly Important". A few (5.8%) believed that investors would consider this item "Unimportant". Of the accountants, 43.8% felt that investors would desire this information to be presented in a "Projected Statement". That this information would be preferred by investors to be disclosed in the "President's Letter" was indicated by 26.0% of the accountants. Sixteen percent specified "No Disclosure" while 10.4% checked "Supplemental Schedule".

A decline in expected importance to the investor was

evidenced by accountants' responses with regard to "Expected Sales Breakdowns" and "Expected Contribution Margins by Product, Territory, or Division". For "Expected Sales Breakdowns", "Very Important" declined to 32.3% while the replies "Fairly Unimportant" (16.9%) and "Unimportant" (13.8%) increased. "Mildly Important" remained approximately the same as the preceding item at 37.0%. Similar to "Expected Sales Breakdowns", "Expected Contribution Margins" declined to 32.6% for "Very Important". "Fairly Unimportant" and "Unimportant" each increased to over seventeen percent, with "Mildly Important" noting a slight decline to 32.8%. As to the expected disclosure, if at all, "No Disclosure" received the most replies with 30.3% for "Expected Sales Breakdowns" and 34.6% for "Expected Contribution Margins by Product, Territory, or Division". Slightly under twenty-nine percent of the replies indicated disclosure in a "Projected Statement" for both of these items. Similarly, disclosure in the "President's Letter" and Supplemental Schedule" ran between 15.2% and 18.1% for each item.

A substantial decline in importance was indicated by the accountants for the item, "Anticipated Price Increases of Products". Only 19.6% of the accountants believed that this item was "Very Important" to investors. "Mildly Important" (40.0%) and "Fairly Unimportant" (23.3%) showed increases while "Unimportant"

remained at 17.1%. Along with this decline in importance, "No Disclosure" of this information increased to 40.7%. The "President's Letter" and a "Projected Statement" received 23.5% and 20.7% of the replies while a "Supplemental Schedule", "Statement Footnotes", and "Other" received 9.4%, 2.2%, and 3.5%, respectively.

b. Human Resources. Of the items included under Human Resources, "Common Shares Owned by Officers and Directors" was viewed by the accountants to be of greatest importance to the investor. Forty-five percent checked "Very Important" while 36.6% noted "Mildly Important". Slightly under thirteen percent believed that this item to be considered "Fairly Unimportant" with only 5.7% believing it to be "Unimportant" to the investor. Unlike the preceding items related to sales and earnings, expected disclosure policy shifted to "Supplemental Schedule" and "Statement Footnotes". These two categories received 30.1% and 26.5% while the remaining replies were evenly distributed over the other categories.

The "Future Effect of Wage Increases Due to Pending Union Agreement" ranked second in investors' minds in the view of the accountants surveyed. "Very Important" and "Mildly Important" received the majority of the replies--39.1% and 46.7%, respectively. The location for expected disclosure, however, shifted to the "President's Letter" (31.1%) and the "Projected Statement"

(24.0%). Categories remaining were: "No Disclosure" (16.2%), "Supplemental Schedule" (13.6%), "Statement Footnotes" (11.5%), and "Other" (3.6%).

A decline in expected importance can be noted for the item, "Anticipated Change in Employment Contracts of Directors and Officers". Contrasting this item with the preceding one, the responses fell from 39.1% to 27.3% for "Very Important" and from 46.7% to 41.4% for "Mildly Important". "Fairly Unimportant" increased from 8.9% to 20.3% and "Unimportant" increased from 5.3% to 11.0%. As with the preceding item, the "President's Letter" received the largest percentage of replies (31.7%) while "No Disclosure" increased from 16.2% to 28.6%. Again, the remaining replies were relatively equally distributed between the categories: "Projected Statement", "Supplemental Schedule", and "Statement Footnotes" (10.6% to 13.7%).

Accountants believed that "Estimated Pension Fund Costs" were of some importance to the investor. Twenty-four percent of the replies were "Very Important" and 48.9% were "Mildly Important". Only 8.5% considered this item "Unimportant" to the investor. The views of the accountants toward the investor's disclosure desires fell between 21.1% and 25.2% for "Statement Footnotes", "Projected Statement", and "No Disclosure". "Supplemental Schedule" drew 16.3% with the "President's Letter" receiving only 10.9% of the replies.

A substantial decrease in importance was accorded the

remaining three items under Human Resources--"Anticipated Change in Company's Policies Regarding Employees", "Programmed Future Cost for the Training and Recruiting of Employees", and "Estimated Employee Turnover Data". Accountants noted "Very Important" 5.6% to 7.9% for these items. "Mildly Important" increased to between 17.2% and 26.5%. The category most often indicated by the accountants was "Fairly Unimportant", with between 37.5% and 42.2% of the responses. Twenty-eight and three-tenths percent to 32.7% of the accountants believed that investors consider these items "Unimportant". The decline in importance of these was accompanied by an increase in the "No Disclosure" policy--51.7% to 63.4% of the replies. Disclosure in the "President's Letter" was indicated in 14.8% to 29.6% of the replies with the other categories receiving less than fourteen percent.

c. Future Research and Development. The nature of information relating to future research and the development of new products were:

- (1) Expected Research and Development Expenditures.
- (2) Anticipated New Products or Patents.
- (3) Estimated Increase in Sales Due to New Products.

The response to these items were substantially similar. Accountants believed that investors viewed them as fairly important. Between 31.4% and 38.4% of the replies were "Very

Important". "Mildly Important" received 47.9% to 53.1% while "Fairly Unimportant" and "Unimportant" never received more than nine percent for each item. Another similarity between these items was expected disclosure policy of investors. For each item the "President's Letter" was indicated more than any of the other categories. Fifty percent of the replies to "Anticipated New Products or Patents" indicated the "President's Letter". For this category, "Expected Research and Development Expenditures" and "Estimated Increase in Sales Due to New Products" noted 31.4% and 36.1%, respectively. It appears that the difference between the low of 31.4% and the high of 50.2% was a shift from the "President's Letter" to a "Projected Statement". "Expected Research and Development Expenditures" and "Estimated Increase in Sales Due to New Products" increased to 27.3% and 27.9% while "Anticipated New Products or Patents" stood at 13.9% for the "Projected Statement". One interpretation of this is that accountants believe that investors would prefer a separate statement or schedule for expenditures whereas a description of new products or patents might be included in the "President's Letter".

d. Budgeted Advertising Expenditures. Accountants were asked to provide their views on how important "Budgeted Advertising Expenditures" and "Projected Growth in Sales as a Result of Advertising" would be to investors. Only 10.3%

indicated that "Budgeted Advertising Expenditures" to be "Very Important". "Mildly Important" received 38.6% of the responses while "Fairly Unimportant" and "Unimportant" received 29.6% and 21.5%, respectively. "Projected Growth in Sales as a Result of Advertising" was rated similarly. Twelve percent of the responses were "Very Important", 35.2%--"Mildly Important", 29.0%--"Fairly Unimportant", and 23.9%--"Unimportant". As a low degree of importance was placed on these items, "No Disclosure" was more often indicated as expected disclosure policy (38.6% and 41.8%). The "Projected Statement" ranked second in replies (22.2% and 25.7%). Third was the "President's Letter" with approximately 20.0% and less than ten percent of the replies were noted in the other categories.

e. Natural Resources. Generally, accountants believed that investors viewed "Projected Exploration Expenditures" as "Mildly Important" (51.8%). Twenty-one percent indicated "Very Important" with 16.1% and 10.6% being regarded as "Fairly Unimportant" and "Unimportant", respectively. Similarly, "Forecast Changes in Natural Resources" were viewed as "Mildly Important" (43.7%) to investors. Twenty-three and six-tenths percent of the accountants indicated "Very Important". Accordingly, "Fairly Unimportant" and "Unimportant" received

18.2% and 14.5% of the responses. Expected Disclosure policy for "Projected Exploration Expenditures" fell into four categories: (1) "President's Letter" (31.8%), (2) "Projected Statement" (26.5%), (3) "No Disclosure" (20.7%), and (4) "Supplemental Schedule" (12.7%). With the same trend in responses, expected disclosure policy for "Forecasted Changes in Natural Resources" was: (1) "President's Letter" (35.3%), (2) "No Disclosure" (23.8%), (3) "Projected Statement" (18.0%), and (4) "Supplemental Schedule" (13.6%).

f. Capital Expenditures. Items covered in this classification were:

- (1) Planned Capital Expenditures.
- (2) Increase in Plant Capacity Due to Capital Expenditures.
- (3) Proposed Method of Financing Capital Expenditures.

The results for these three items were substantially alike. Between 40.2% and 46.1% of the respondents believed that investors would view these items as being "Very Important". Also, between 42.3% and 48.0% noted "Mildly Important". "Fairly Unimportant" and "Unimportant" received less than nine percent of the replies. Concerning expected disclosure policy, approximately one-third (33.5% to 37.2%) of the respondents regarded the "President's Letter" as the location of the annual



report where investors would expect to find these items. Ranking second was the "Projected Statement" (22.4% to 28.8%). Declining slightly was "Supplemental Schedule" with between 16.7% and 18.5%. "No Disclosure" received 9.2% to 12.2% of the replies and less than ten percent was noted in the other categories.

g. Corporate Acquisitions. Substantial importance was accorded items related to corporate acquisitions. The majority of the accountants (50.1% to 51.8%) believed that the following items would be "Very Important" to investors.

- (1) Cost of Prospective Acquisitions.
- (2) Effect of Acquisitions on Future Costs and Sales.
- (3) Proposed Method of Financing Acquisitions.

Between 31.3% and 34.8% of the responses to these items were "Mildly Important". Less than ten percent was noted in each category, "Fairly Unimportant" or "Unimportant". As with Capital Expenditures, disclosure in the "President's Letter" received the largest percentage of replies (27.9% to 34.5%). Disclosure in the "Projected Statement" ranked second with 19.3% to 24.7%. "No Disclosure" response rate for these items was 17.5% to 21.0% while "Statement Footnotes" and "Other" received less than eight percent of the replies for each item.

h. Inventories. Two items relating to projected financial information desired by investors are "Forecasted Change in Physical Inventories" and "Anticipated Price Changes of Materials". Thirteen and nine-tenths percent and 17.4% of the accountants believed these items to be "Very Important". "Mildly Important" had responses of 38.2% for "Forecasted Change in Physical Inventories" and 42.5% for "Anticipated Price Changes of Materials". Slightly over forty percent of the accountants believed that investors viewed these items as "Fairly Unimportant or "Unimportant". As noted for other items, where the degree of importance declined, "No Disclosure" replies increased. Over one-third, or 33.3%, of the accountants indicated "No Disclosure" for both items. For "Forecasted Change in Physical Inventories" the remaining replies were 14.3%--"President's Letter", 25.6%--"Projected Statement", 14.7%--"Supplemental Schedule", and less than five percent for each category, "Statement Footnotes" and "Other". For "Anticipated Price Changes of Materials" the results were 20.2%--"President's Letter", 21.9%--"Projected Statement", 12.0%--"Supplemental Schedule", and less than six percent for "Statement Footnotes" or "Other".

i. Dividend Policy. The degree of importance placed on future cash or stock dividends by investors should be substantial. It was not surprising that 50.9% of the accountants believed

investors viewed a cash dividend as "Very Important". Likewise, 49.5% of the replies relating to a proposed stock dividend was "Very Important". "Mildly Important" received 33.8% and 32.5%, respectively, for the proposed cash and stock dividends. "Fairly Unimportant" and "Unimportant" received less than eleven percent on each item. Expected disclosure policy was similar for both items. Forty-six and one-tenth percent and 45.9% of the responses indicated the "President's Letter". "No Disclosure" received 17.3% and 18.2% for proposed cash and stock dividends, respectively. Between 10.5% and 12.2% of the replies indicated "Projected Statement", "Supplemental Schedule" and "Statement Footnotes". The "Other" category received 3.0% of the total replies.

j. Future Financing. Although no less in importance than the items listed above, this final classification includes the following:

- (1) Details of Proposed Stock Issues.
- (2) Future Effects of Conversion Features of Debt or Preferred Stock.
- (3) Anticipated Pledging of Assets for Long-term Debt.
- (4) Schedule of Future Debt Payments.
- (5) Rental Payments and Other Details of Anticipated Long-term Leases.

The majority of accountants viewed the "Details of Proposed Stock Issues" and "Future Effects of Conversion Features of Debt or Preferred Stock" as being "Very Important" to

investors--54.2% indicated for "Proposed Stock Issues" and 52.1% for the "Conversion Features of Debt or Preferred Stock". Over one-third of the respondents indicated "Mildly Important" for both items, while less than seven percent was noted in each category, "Fairly Unimportant" and "Unimportant". Expected disclosure policy for "Proposed Stock Issues" was: 37.7%--"President's Letter", and between 13.7% and 15.8% in each category, "Supplemental Schedules", "Statement Footnotes", "Projected Statement" and "No Disclosure". In the case of "Future Effects of Conversion Features of Debt or Preferred Stock", there was a shift in expected disclosure policy away from the "President's Letter" toward the "Statement Footnotes". The "President's Letter" decreased to 17.8% while "Statement Footnotes" increased to 28.0% of the replies.

A decline in importance was indicated for items 3 and 4 above. "Anticipated Pledging of Assets for Long-term Debt" was considered "Very Important" to investors by 42.2% of the accountants. Thirty-four and three-tenths percent of the accountants indicated "Mildly Important". Other responses were 13.8% to "Fairly Unimportant" and 9.7% to "Unimportant". As for item 4, the "Schedule of Future Debt Payments", 38.7% of the accountants noted "Very Important" with 41.7% marking "Mildly Important". Other responses were 12.6% and 7.0% for "Fairly Unimportant" and "Unimportant", respectively. Expected disclosure

for "Anticipated Pledging of Assets for Long-term Debt" was:  
 "President's Letter"--26.2%, "No Disclosure"--21.5%, "Projected  
 Statement"--17.9%, "Supplemental Schedule"--13.9%, "Statement  
 Footnotes"--17.1%, and "Other"--3.4%. With regard to a  
 "Schedule of Future Debt Payments", expected disclosure was:  
 "Statement Footnotes"--26.9%, "Supplemental Schedule"--22.2%,  
 "Projected Statement"--21.4%, "No Disclosure"--13.7%, and  
 "Other"--3.8%.

A further decline in expected importance was noted for  
 the final item, "Rental Payments and Other Details of Anticipated  
 Long-term Leases". "Very Important" was indicated in 27.0%  
 of the replies while "Mildly Important" increased to 45.8%.  
 "Fairly Important" and "Unimportant" received 17.4% and 9.8%.  
 In conclusion, expected disclosure policy for this item was:  
 "Statement Footnotes"--22.0%, "No Disclosure"--21.1%, "Projected  
 Statement"--19.9%, "Supplemental Schedule"--17.6%, "President's  
 Letter"--15.9%, and "Other"--3.5%.

4. Attitudes of Certified Public Accountants Regarding  
 the Contents of an "Opinion" on Projected Financial Information  
 in Published Corporate Annual Reports. Relating to Hypothesis  
 4 on the views of accountants to the extension of the "attest"  
 function to projected financial information the following  
 statement was posed:

Assuming a CPA would be required to express an opinion on projected financial information included in published corporate annual reports, the content of such an opinion should: (Check as many as desired).

- \_\_\_\_\_ Include a statement as to the accuracy of the calculations in preparing the forecasts.
- \_\_\_\_\_ Include a statement as to the fairness of the assumptions on which the forecasts were based.
- \_\_\_\_\_ Include a statement that he (the CPA) is in no way guaranteeing the realization of the forecasts.
- \_\_\_\_\_ Include a statement that he (the CPA) does share responsibility with management for the preparation of the forecasts.

Concerning the accuracy of the calculations in preparing the forecasts, 196, or 41.0%, of the 478 respondents believed that an opinion should require such a statement. As to the fairness of the assumptions on which the forecasts were based, 216, or 45.2%, believed that this statement should be included in a required opinion. Overwhelmingly, (84.5%), the accountants indicated that an opinion should require a statement that the CPA is in no way guaranteeing the realization of the forecasts. Only 89, or 18.6%, of the accountants suggested that CPAs should share responsibility with management for the preparation of the forecasts.

### Summary

Regarding the hypotheses posed in this chapter, one can conclude the following:

1. Between 69.7% and 77.5% of the members of the American Institute of Certified Public Accountants believe that financial information relating to the future plans and goals of the corporation should be disclosed in published corporate annual reports.

2. Only 29.5% to 37.9% of the members of the American Institute of Certified Public Accountants believe that a CPA should examine projected financial information and offer some form of an opinion based upon an examination.

Other attitudes examined revealed the following:

1. General Evaluation of Corporate Annual Reports.

A slight Majority (55.0%) of the accountants believed that published annual reports generally disclose adequate financial information to investors. Accountants generally believed that the Balance Sheet, Income Statement, Footnotes to the Financial Statements, and the Statement of Source and Use of Funds were of major importance to investors. Declining in importance were the Historical Operating and Financial Statistics, the Highlights Section, the President's Letter and Organization Charts.

2. Attitudes of Certified Public Accountants on the Inclusion of Forecasted Statements in Published Corporate Annual Reports. Forecasted Statements, such as the Projected Balance Sheet, the Projected Income Statement and the Projected

Statement of Source and Use of Funds received the least support for inclusion in published corporate annual reports. Forecasted statements not related to the statements audited by CPAs received considerable support for inclusion in corporate annual reports. These would be the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources. For those accountants who indicated that forecasted statements should be included in published corporate annual reports, most noted that the Projected Balance Sheet, the Projected Income Statement, and the Statement of Source and Use of Funds should be for one year in the future while the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources should be prepared for three or more years.

3. Attitudes of Certified Public Accountants on the Degree of Importance They Would Expect an Investor to Place on Projected Financial Information. Generally, accountants believed that forecasted items related to Dividend Policy, Corporate Acquisitions, Capital Expenditures, Future Financing and Sales and Earnings would be of considerable importance to investors. Declining in expected importance were items related to Future Research and Development and Natural Resources. Little importance was attributed to Inventories, Advertising and Human Resources, with two exceptions in the latter case. "Common Shares Owned by Officers and Directors" and "Future Effect of



Wage Increases Due to Pending Union Agreement", were designated as having substantial importance to investors. Concerning expected disclosure, the following general conclusions can be stated:

a. Where items were rated low in importance, "No Disclosure" received a significant percentage of replies.

b. The "President's Letter" and the "Projected Statement" were named most as the areas of disclosure for all major topics.

c. The "Supplemental Schedule" and "Statement Footnotes" received large percentages of replies in the area of Future Financing and the item "Common Shares Owned by Officers and Directors".

4. Attitudes of Certified Public Accountants Regarding the Contents of an Opinion on Projected Financial Information in Published Corporate Annual Reports. If a CPA were required to offer an opinion on projected financial information included in corporate annual reports the accountants overwhelmingly believed that the opinion should include a statement that he (the CPA) is in no way guaranteeing the realization of the forecasts. Only 18.6% felt that CPAs should share responsibility with management for the preparation of the forecasts. Forty-one percent of the accountants believed that the opinion should

include a statement as to the accuracy of the calculations in preparing the forecasts while 45.2% believed that the opinion should include a statement as to the fairness of the assumptions on which the forecasts were based.

## CHAPTER VI

### SURVEY OF OPINIONS OF CHARTERED ACCOUNTANTS REGARDING THE DISCLOSURE OF PROJECTED FINANCIAL INFORMATION IN CORPORATE ANNUAL REPORTS

#### General

This chapter is concerned with the reporting of the results of the survey of opinions of Chartered Accountants regarding the disclosure of projected financial information in corporate annual reports. The purpose is twofold: First, hypotheses 5 and 6 are tested; and second, the opinions of Chartered Accountants regarding this subject are presented. Finally, a summarization concludes the chapter.

#### Survey Returns

| Questionnaires<br>Mailed | Required<br>Returns | Usable<br>Returns | Percentage<br>Returned |
|--------------------------|---------------------|-------------------|------------------------|
| 1200                     | 381                 | 390               | 32.5                   |

#### Hypotheses

Hypothesis 5: Most English Chartered Accountants believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

This hypothesis was tested by posing the following

question to the Chartered Accountants:

In your opinion, should financial information relating to the future plans and goals of the corporation be disclosed in published corporate annual reports?

Of the 390 replies, 264, or 67.7%, stated "Yes"; they do believe that projected financial information should be included in published corporate annual reports.

Testing the hypothesis using the Z test one finds the standard error of the percentage with:

$$\begin{aligned} S_p &= \sqrt{\frac{P(100 - P)}{n}} \cdot \sqrt{\frac{N - n}{N - 1}} \\ &= \sqrt{\frac{(67.7)(32.3)}{390}} \cdot \sqrt{\frac{50,000 - 390}{50,000 - 1}} \\ &= 2.367 \cdot .996 = 2.36 \end{aligned}$$

The Z test is then used where:

$$Z = \frac{P - P_h}{S_p} = \frac{67.7 - 50.0}{2.36} = \frac{17.7}{2.36} = 7.5$$

Since 7.5 is greater than 1.96 one can accept the hypothesis that most Chartered Accountants do believe that projected financial information should be included in published corporate annual reports.

To determine the confidence interval within which one can be 95% confident that the true population percentage falls one finds:

$$\begin{aligned} \text{Confidence limits} &= P \pm Z \cdot S_p \\ &= 67.7 \pm 1.96 \cdot 2.36 \\ &= 67.7 \pm 4.6 = 72.3 \\ &= 67.7 - 4.6 = 63.1 \end{aligned}$$

Interpreting, one can be 95% confident that the true percentage of Chartered Accountants who believe that projected financial information should be included in published corporate annual reports falls between 63.1% and 72.3% of the 50,000 members of the Institute of Chartered Accountants in England and Wales.

Hypothesis 6: Most English Chartered Accountants believe that the attest function should be extended to include projected financial information in published corporate annual reports.

This hypothesis was tested by posing the following question:

If projected financial information, such as budgets, profit plans, or cash forecasts were disclosed in published corporate annual reports, do you feel that a CA should examine this data and offer some form of an opinion based upon his examination?

Using the test as above, there is:

$$\begin{aligned}
 S_p &= \sqrt{\frac{P(100 - P)}{n}} \cdot \sqrt{\frac{N - n}{N - 1}} \\
 &= \sqrt{\frac{(60.8)(39.2)}{390}} \cdot \sqrt{\frac{50,000 - 390}{50,000 - 1}} \\
 &= 2.472 \cdot .996 = 2.46 \\
 z &= \frac{P - P_h}{S_p} = \frac{60.8 - 50.0}{2.46} = \frac{10.8}{2.46} = 4.39
 \end{aligned}$$

Since 4.39 is greater than 1.96 the hypothesis that most Chartered Accountants believe that a CA should examine projected financial information and offer some form of an opinion based upon his examination can be accepted.

Again, one finds the confidence interval within which he can be 95% confident that the true population percentage

falls with:

$$\begin{aligned}\text{Confidence limits} &= P \pm Z \sigma_{S_p} \\ &= 60.8 + 4.8 = 65.6 \\ &= 60.8 - 4.8 = 56.0\end{aligned}$$

Interpreting, one can be confident that the true percentage of Chartered Accountants who believe that projected financial information should be "attested to" falls between 56.0% and 65.6% of the 50,000 members of the Institute of Chartered Accountants in England and Wales.

#### Other Data

In addition to the questions relating to the preceding hypotheses, the views of Chartered Accountants were requested on the following topics:

1. General Evaluation of Corporate Annual Reports.
  2. Attitudes of Chartered Accountants on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.
  3. Attitudes of Chartered Accountants on the Beliefs of Investors Regarding the Nature of Projected Financial Information to be Included in Published Corporate Annual Reports.
  4. Attitudes of Chartered Accountants Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports.
1. General Evaluation of Corporate Annual Reports.

To evaluate the current status of corporate reporting, the following question was posed:

In your opinion, do you feel that published annual reports generally disclose adequate financial information to investors?

Of the 390 accountants who replied to the questionnaire, the great majority, 377, or 96.6%, chose to answer this question. Their views were mostly negative. Two hundred and forty-six, or 65.2%, stated "No" while 131, or 34.8%, believed that published annual reports generally do disclose adequate financial information to investors.

Along with the preceding question on the general evaluation of corporate annual reports the accountants were asked to offer an opinion on the usefulness of the various sections usually found in annual reports. The degrees of usefulness were "Very Useful", "Useful", "Of Little Use", and "Of No Use". The sections of the annual report delineated were the President's Letter, the Highlights Section, the Balance Sheet, the Income Statement, the Statement of Source and Use of Funds, the Footnotes to the Financial Statements, the Historical Operating and Financial Statistics, and Organization Charts.

Regarding the usefulness of the President's Letter, 177, or 45.7%, believed that it was "Useful". Only 89, or 23.0%, considered it "Very Useful". One hundred and three, or 26.6%, considered it "Of Little Use" while 18, or 4.7%, indicated that the President's Letter" was "Of No Use".

Overall, the degree of usefulness of the Highlights Section was considered slightly higher than the President's Letter. "Very Useful" increased to 90, or 23.9%, while "Useful" increased by 13 to 190, or 50.6%. "Of Little Use" received 85 replies, or 22.6%, and "Of No Use" 11, or 2.9%, of the 376 replies to this item.

A substantial increase in the degree of usefulness was indicated for the Balance Sheet. "Very Useful" received 255, or 65.9%, of the 387 replies. "Useful" received 114, or 29.5% of the replies while "Of Little Use" received 18, or 4.6%. None of the accountants considered the Balance Sheet to be "Of No Use" to the investor.

The accountants believed that the Income Statement was slightly more useful than the Balance Sheet. Two hundred and fifty-seven, or 66.4%, considered the Income Statement to be "Very Useful". Of the respondents, 108, or 27.9%, viewed the Income Statement as "Useful" while 22, or 5.7%, indicated that it was "Of Little Use" or "Of No Use".

Although not rated as useful as the Balance Sheet or Income Statement, the Statement of Source and Use of Funds was judged to be "Very Useful" by most of the accountants (58.9%). The "Useful" category received 125 designations, some 32.3%. Thirty-two, or 8.3%, of the accountants indicated that the



Statement of Source and Use of Funds was "Of Little Use" while 3, or 0.8%, designated "Of No Use".

A slight decline in usefulness was indicated for the Footnotes to the Financial Statements. "Very Useful" received 191, or 49.9%, of the replies while 162, or 42.3%, designated the footnotes "Useful". Only 30, or 7.8%, stated that footnotes were "Of Little Use" or "Of No Use".

Accountants' attitudes toward Historical Operating and Financial Statistics showed a sharp decline in usefulness over the preceding item. "Very Useful" declined to 86, or 22.4%, of the replies. "Useful" increased by 45 to 207 (53.9%). "Of Little Use" received 82, or 21.4%, and "Of No Use" received nine, or 2.3%, of the 384 replies.

Organization Charts were not considered very useful with "Of Little Use" and "Of No Use" receiving the majority of the replies. Only 26, or 6.7%, of the accountants believed that they were "Very Useful" while 118, or 30.5%, considered the charts "Useful". Almost a majority of the accountants, 191, or 49.4%, viewed Organization Charts to be "Of Little Use" with 52, or 13.4%, believing they were "Of No Use".

Concluding, one can see that considerable usefulness was placed on the Balance Sheet and Income Statement, the Statement of Source and Use of Funds, and the Footnotes to the Financial Statements. Some degree of usefulness was indicated for the President's Letter, the Highlights Section, and the

Historical Operating and Financial Statistics while Organization Charts was viewed to be the least useful section of the annual report.

2. Attitudes of Chartered Accountants on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.

The attitudes of Chartered Accountants on the inclusion of forecasted statements in published annual reports were also requested. They were asked to check the appropriate box relating to forecasted statements which might appear in published corporate annual reports. Table 6-1 provides a summary of the 378-385 replies in the form of percentages of the total.

Table 6-1

|  | <u>Definitely<br/>Should Be<br/>Included</u> | <u>Possibly<br/>Should Be<br/>Included</u> | <u>Should Not<br/>Be<br/>Included</u> |
|--|--|--|---------------------------------------|
| Statement of Source and<br>Use of Funds        | 44.7%  | 30.4%                                      | 24.9%                                 |
| Statement of Anticipated<br>Growth of the Firm | 34.8%  | 39.5%                                      | 25.7%                                 |
| Projected Income Statement                     | 34.9%  | 35.5%                                      | 29.6%                                 |
| Projected Balance Sheet                        | 20.5%  | 39.4%                                      | 40.1%                                 |
| Statement of Use of<br>Natural Resources       | 19.8%  | 44.8%                                      | 35.4%                                 |

As indicated above, the Statement of Source and Use of Funds received the most support for inclusion in published corporate annual reports. This was followed by the Projected

Income Statement and the Statement of Anticipated Growth of the Firm. Less Support was noted for the Projected Balance Sheet and the Statement of Use of Natural Resources.

In conjunction with Table 6-1, those accountants who checked "Definitely Should Be Included" and "Possibly Should Be Included" were asked to indicate the period of time to which these forecasted statements should be extended. Table 6-2 categories the replies:

|  | <u>1 Year</u> | <u>2 Years</u> | <u>3 or More<br/>Years</u> |
|--|---------------|----------------|----------------------------|
| Statement of Source and Use of Funds<br>(Total Replies=286)        | 48.2%         | 30.8%          | 21.0%                      |
| Statement of Anticipated Growth of the Firm<br>(Total Replies=276) | 31.5%         | 24.3%          | 42.2%                      |
| Projected Income Statement<br>(Total Replies=276)                  | 55.1%         | 29.7%          | 15.2%                      |
| Projected Balance Sheet<br>(Total Replies=226)                     | 68.6%         | 17.7%          | 13.7%                      |
| Statement of Use of Natural Resources<br>(Total Replies=248)       | 32.7%         | 23.4%          | 43.9%                      |

From Table 6-2 it can be noted that the largest percentage of replies for those statements normally dealt with by accountants fell in the one year category. A large number of the respondents believed that the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources

should be forecasted for three or more years.

3. Attitudes of Chartered Accountants on the Degree of Importance They Would Expect an Investor to Place on Projected Financial Information. Unfortunately, this particular section of the questionnaire was fairly complex, involving 10 categories; four relating to importance and six relating to disclosure policy. The respondents were asked to check "Very Important", "Moderately Important", "Fairly Unimportant", or "Unimportant" for selected items of projected financial information. Also, they were asked to select the disclosure policy of each item. These included "No Disclosure", "Disclose in President's Letter", "Disclose in Projected Statement", "Disclose in Supplemental Schedule Associated with the Primary Financial Statement", "Disclose in Primary Financial Statement's Footnotes", and "Other" with a request that they write in proper disclosure method. Regarding the major items of information requested, they fell into the following classifications:

- a. Sales and Earnings.
- b. Human Resources.
- c. Future Research and Development.
- d. Advertising.
- e. Natural Resources.
- f. Capital Expenditures.
- g. Corporate Acquisitions.
- h. Inventories.
- i. Dividend Policy.
- j. Future Financing.

To facilitate the understanding of this complex question, a summary is herewith provided. The complete results may be found in Appendix C. Relating to this question, there were between 347 and 384 replies to each of these items.

a. Sales and Earnings. Under this topic, several items were covered where the accountants were asked to indicate the degree of importance they expect investors to place on each item. As with the following topics, the items covered are listed in the order of expected importance to the investor.

"Estimated Earnings Per Share of Common Stock" was considered "Very Important" to the investor by 74.5% of the respondents. Eighteen percent of the respondents indicated "Mildly Important" while only eight percent believed that "Earnings Per Share" was "Fairly Unimportant" or "Unimportant" to the investor. As to where disclosure of such information would be desired by an investor, 32.1% of the accountants indicated a separate "Projected Statement". The "President's Letter" was noted by 24.1%, followed by the "Supplemental Schedule" (17.8%), "Statement Footnotes" (13.3%), "No Disclosure" (11.7%), and "Other" (1.0%).

A second item considered important to Chartered Accountants was "Forecasted Volume of Future Sales". Fifty-six percent of the respondents indicated that this item was "Very Important" while 34.2% noted "Mildly Important". "Fairly Unimportant" and

"Unimportant" received 9.8% of the replies. The "Projected Statement" received the most replies for disclosure with 47.3%. Following were the "President's Letter (19.3%), the "Supplemental Schedule" (15.5%), "No Disclosure" (15.4%), "Statement Footnotes"(1.4%), and "Other" (1.1%).

The third item considered important to investors was "Expected Contribution Margins by Product, Territory, or Division". Of the 367 replies to this item 37.3% noted "Very Important" while 32.2% checked "Mildly Important". Eighteen percent noted "Fairly Unimportant" while 12.2% designated "Unimportant". Of the accountants, 37.6% believed that investors would desire this information to be presented in a "Projected Statement". That this information would be preferred by investors to be disclosed in a "Supplemental Schedule" was indicated by 20.7% of the accountants. Thirty-three percent specified "No Disclosure" while 5.2% checked "President's Letter".

A slight decline in expected importance to the investor was evidenced by accountants' responses with regard to "Expected Sales Breakdowns" and "Backlog of Orders to be Filled". For "Expected Sales Breakdowns", "Very Important" fell to 36.7%. "Mildly Important", "Fairly Unimportant", and "Unimportant" remained approximately the same as the preceding item. Similar

to "Expected Sales Breakdowns", "Backlog of Orders to be Filled" declined to 33.5%. This was followed by "Mildly Important" (38.6%), "Fairly Unimportant" (18.9%) and "Unimportant" (9.0%). As to the expected disclosure, if at all, a "Projected Statement" received replies of 36.7% for "Expected Sales Breakdowns" and 21.7% for "Backlog of Orders to be Filled". Approximately one-third of the replies indicated "No Disclosure" for both of these items. Disclosure in the "President's Letter" was only 5.9% for "Expected Sales Breakdowns" and 24.8% for "Backlog of Orders to be Filled". The "Supplemental Schedule" was noted in 20.7% and 16.6% of the replies to each item, respectively.

A further decline in importance was indicated by the accountants for the item, "Anticipated Price Increase of Products". Only 29.8% of the accountants believed that this item was "Very Important" to investors. "Fairly Unimportant" (19.1%) and "Unimportant" (15.3%) showed increases while "Mildly Important" declined to 35.8%. Along with this decline in importance, "No Disclosure" increased to 45.4%. The Projected Statement" and the President's Letter" received 23.1% and 15.6% of the replies while a "Supplemental Schedule", "Statement Footnotes" and "Other" received 12.1%, 2.7%, and 1.1%, respectively.

b. Human Resources. Of the items included under

Human Resources "Common Shares Owned by Officers and Directors" was viewed by the accountants to be of greatest importance to investors. Fifty-seven percent checked "Very Important" while 31.4% noted "Mildly Important". Slightly over 9% checked "Fairly Unimportant" with only 2.5% indicating "Unimportant". Expected disclosure policy was mainly for the "Supplemental Schedule" (36.6%) and the "Statement Footnotes" (30.6%).

The "Future Effect of Wage Increase Due to Pending Union Agreement" was second in expected importance to investors. The replies were: "Very Important" (45.7%), "Mildly Important" (35.7%), "Fairly Unimportant" (12.6%) and "Unimportant" (6.0%). Disclosure policy was mainly "Projected Statement" (28.6%), "President's Letter" (32.0%) and "No Disclosure" (20.3%).

A decline in expected importance can be noted for the item, "Anticipated Change in Employment Contracts of Directors and Officers". Contrasting this item with the preceding one, the responses declined from 45.7% to 34.6% for "Very Important" and from 35.7% to 35.4% for "Mildly Important". "Fairly Unimportant" increased from 12.6% to 21.9% and "Unimportant" increased from 6.0% to 8.1%. As with the preceding item, the "President's Letter" received the largest percentage of replies (33.7%) while "No Disclosure" increased from 20.3% to 22.8%. The remaining replies were distributed between the categories: "Projected Statement" (14.1%), "Supplemental Schedule" (19.6%), and



"Statement Footnotes" (8.4%).

Accountants believed that "Anticipated Change in Company's Policies Regarding Employees" were of some importance to the investor. Fourteen percent of the replies were "Very Important" and 30.9% were "Mildly Important". Thirty-four percent considered this item "Fairly Unimportant" while 21.2% noted "Unimportant" to the investor. The views of the accountants toward the investor's disclosure desires were: "No Disclosure" (41.2%), "President's Letter" (31.8%), "Projected Statement" (11.0%), and "Supplemental Schedule" (11.3%).

A substantial decrease in expected importance was accorded the remaining three items under Human Resources--"Estimated Pension Fund Costs", "Programmed Future Costs for the Training and Recruiting of Employees", and "Estimated Employee Turnover Data". Accountants noted "Very Important" 7.9% to 12.5% for these items. "Mildly Important" increased to between 26.6% and 27.6%. The category most often indicated by the accountants was "Fairly Unimportant", with between 32.4% and 42.8% of the responses. Twenty-one and seven-tenths percent to 28.7% of the accountants believed that investors consider these items "Unimportant". The decline in importance of these items was accompanied by an increase in the "No Disclosure" policy--39.7% to 48.8% of the replies. Disclosure in the "President's

Letter" was indicated in 5.3% to 10.9% while "Projected Statement" and Supplemental Schedule" was noted in between 14.1% and 21.9% of the responses to each item.

c. Future Research and Development. The nature of information relating to future research and the development of new products were:

- (1) Expected Research and Development Expenditures.
- (2) Anticipated New Products or Patents.
- (3) Estimated Increase in Sales Due to New Products.

The response to these items were substantially similar. Accountants believed that investors viewed them as fairly important. Between 41.4% and 44.4% of the replies were "Very Important". "Mildly Important" received 41.4% to 46.7% while "Fairly Unimportant" and "Unimportant" never received more than 10% for each item. Disclosure policy, however, differed between the three items. Disclosure for "Expected Research and Development Expenditures" was noted for the "Projected Statement" (39.7%), followed by "Supplemental Schedule" (20.6%), "President's Letter" (19.6%), and "No Disclosure" (15.7%). Disclosure for "Anticipated New Products or Patents" shifted to "No Disclosure" (31.6%), the "President's Letter" (30.5%) and then the "Projected Statement" (23.0%). Finally, expected disclosure policy for

"Estimated Increase in Sales Due to New Products" was:

"Projected Statement" (35.5%), "No Disclosure" (23.9%), and

"President's Letter" (22.0%).

d. Budgeted Advertising Expenditures. Accountants were asked to provide their views on how important "Budgeted Advertising Expenditures" and "Projected Growth in Sales as a Result of Advertising" would be to investors. Only 12.1% felt that "Budgeted Advertising Expenditures" to be "Very Important". "Mildly Important" received 30.8% of the responses while "Fairly Unimportant" and "Unimportant" received 31.3% and 25.8%. "Projected Growth in Sales as a result of Advertising" was rated similarly. Sixteen percent of the responses were "Very Important", 38.8%--"Mildly Important", 23.4%--"Fairly Unimportant", and 22.7%--"Unimportant". As a low degree of importance was placed on these items, "No Disclosure" was more often indicated as expected disclosure policy (47.6% and 42.4%). The "Projected Statement" ranked second in replies (28.1% and 28.6%). Third in rank was the "Supplemental Schedule" (14.8% and 15.7%) and less than ten percent of the replies were noted in the other categories.

e. Natural Resources. Generally, accountants believed that investors viewed "Projected Exploration Expenditures" as "Mildly Important" (36.5%). Thirty-one percent indicated

"Very Important" with 19.8% and 12.2% being regarded as "Fairly Unimportant" and "Unimportant". Similarly, "Forecast Changes in Natural Resources" were viewed as "Mildly Important" (35.8%) to investors. Thirty and eight-tenths percent of the accountants indicated "Very Important". Accordingly, "Fairly Unimportant" and "Unimportant" received 21.2% and 12.2% of the responses. Expected disclosure policy for "Projected Exploration Expenditures" fell mainly into four categories: (1) "President's Letter" (18.5%), (2) "Projected Statement" (33.1%), (3) "No Disclosure" (27.9%), and (4) "Supplemental Schedule" (16.4%). Expected disclosure policy for "Forecasted Changes in Natural Resources" was" (1) "President's Letter" (25.2%), (2) "No Disclosure" (29.2%), (3) "Projected Statement" (23.6%), and (4) "Supplemental Schedule" (16.7%).

f. Capital Expenditures. Items covered in this classification were:

- (1) Planned Capital Expenditures.
- (2) Increase in Plant Capacity Due to Capital Expenditures.
- (3) Proposed Method of Financing Capital Expenditures.

The results for these three items were substantially alike. Between 53.7% and 70.1% of the respondents indicated that investors would view these items as being "Very Important". Also, between 26.9% and 33.0% noted "Mildly Important". "Fairly

"Unimportant" and "Unimportant" each received less than seven percent of the replies. Concerning expected disclosure policy, approximately one-third (31.9% to 39.1%) of the respondents regarded the "Projected Statement" as the location in the annual report where investors would expect to find these items. Ranking second was the "President's Letter" (17.3% to 25.1%). Declining slightly was "Supplemental Schedule" with between 18.4% and 23.4%. "No Disclosure" received 8.6% to 20.2% of the replies and less than twelve percent was noted in the other categories.

g. Corporate Acquisitions. Substantial importance was accorded items related to corporate acquisitions. The majority of the accountants (64.6% to 68.2%) believed that the following items would be "Very Important" to investors.

- (1) Cost of Prospective Acquisitions.
- (2) Effect of Acquisitions on Future Cost and Sales.
- (3) Proposed Method of Financing Acquisitions.

Between 23.1% and 28.0% of the responses to these items were "Mildly Important". Less than seven percent was noted in each category, "Fairly Unimportant" or "Unimportant". Unlike "Capital Expenditures", disclosure was noted in between 22.4% and 30.1% of the replies for "President's Letter", "Projected Statement" and "No Disclosure". "Supplemental Schedule" received 14.6% to 15.4% for these three items.

h. Inventories. Two items relating to projected financial information desired by investors are "Forecasted Change in Physical Inventories" and "Anticipated Price Changes of Materials". Fourteen and eight-tenths percent and 17.8% of the accountants believed these items to be "Very Important". "Mildly Important" had responses of 41.9% for "Forecasted Change in Physical Inventories" and 39.0% for "Anticipated Price Changes of Materials". Slightly over forty-three percent of the accountants believed that investors viewed these items as "Fairly Unimportant" or "Unimportant". As noted for other items, where the degree of importance declined, "No Disclosure" replies increased. Over thirty-eight percent of the accountants indicated "No Disclosure" for both items. For "Forecasted Change in Physical Inventories" the remaining replies were 5.1%--"President's Letter", 27.4%--"Projected Statement", 19.4%--"Supplemental Schedule", and less than seven percent for each category, "Statement Footnotes" and "Other". For "Anticipated Price Changes of Materials" the results were 11.7%--"President's Letter", 24.9%--"Projected Statement", 18.6%--"Supplemental Schedule", and less than six percent for "Statement Footnotes" and "Other".

i. Dividend Policy. The degree of importance placed on future cash or stock dividends by investors should be substantial. It was not surprising that 74.4% of the accountants believed

that investors viewed a cash dividend as "Very Important". Likewise, 73.4% of the replies relating to a proposed stock dividend noted "Very Important". "Mildly Important" received 19.7% and 20.0%, respectively, for the proposed cash and stock dividends. "Fairly Unimportant" and "Unimportant" received less than five percent on each item. Expected disclosure policy was similar for both items. Forty-two and nine-tenths percent and 43.7% of the responses indicated the "President's Letter". "No Disclosure" received 10.4% and 8.9% for proposed cash and stock dividends. Between 14.7% and 18.4% of the replies indicated "Projected Statement", "Supplemental Schedule" and "Statement Footnotes". The "Other" category received less than two percent of the total replies.

j. Future Financing. Although no less in importance than the items listed above, this final classification includes the following:

- (1) Details of Proposed Stock Issues.
- (2) Future Effects of Conversion Features of Debt or Preferred Stock.
- (3) Anticipated Pledging of Assets for Long-term Debt.
- (4) Schedule of Future Debt Payments.
- (5) Rental Payments and Other Details of Anticipated Long-term Leases.

The majority of accountants viewed the "Anticipated Pledging of Assets for Long-term Debt" and "Future Effects of Conversion Features of Debt or Preferred Stock" as being "Very

Important" to investors--64.4% indicated for "Anticipated Pledging of Assets for Long-term Debt" and 64.2% for the "Conversion Features of Debt or Preferred Stock". Almost one-third of the respondents indicated "Mildly Important" for both items, while less than eight percent was noted in each category, "Fairly Unimportant" and "Unimportant".

Expected disclosure policy for "Pledging of Assets" was: 40.4%--"Projected Statement", and between 10.2% and 21.9% in each category, "Supplemental Schedule", "Statement Footnotes", "President's Letter" and "No Disclosure". In the case of "Future Effects of Conversion Features of Debt or Preferred Stock", there was a small shift in expected disclosure away from the "Projected Statement" (35.5%) toward the "President's Letter" (23.6%) and "No Disclosure" (19.4%). "Supplemental Schedule" (17.0%) and "Statement Footnotes" (4.5%) also showed a slight decline in percentage of replies.

A decline in importance was indicated for items 4 and 5 above. "Schedule of Future Debt Payments" was considered "Very Important" to investors by 47.0% of the accountants. Thirty-eight and three-tenths percent of the accountants indicated "Mildly Important". Other responses were "Fairly Unimportant" (9.5%) and "Unimportant" (5.2%). As for item 5, the "Rental Payments and Other Details of Anticipated Long-term Leases", 34.0% of the accountants noted "Very



Important" with 40.2% marking "Mildly Important". Other responses were 13.7% and 12.1% for "Fairly Unimportant" and "Unimportant", respectively. Expected disclosure for "Schedule of Future Debt Payments" was: "Projected Statement"--36.7%, "President's Letter"--22.2%, "No Disclosure"--21.0%, "Supplemental Schedule"--16.4%, and "Statement Footnotes"--3.7%. With regards to "Rental Payments and Other Details of Anticipated Long-term Leases" expected disclosure was: "President's Letter"--35.0%, "No Disclosure"--25.9%, "Projected Statement"--16.7%, "Supplemental Schedule"--11.7%, "Statement Footnotes"--10.8%, and "Other"--0.5%.

A further decline in expected importance was noted for the final item, "Details of Proposed Stock Issues". "Very Important" was indicated in 29.9% of the replies while "Mildly Important" increased to 32.0%. "Fairly Unimportant" and "Unimportant" received 20.4% and 17.7%, respectively. In conclusion, expected disclosure policy for this item was: "Projected Statement"--42.1%, "President's Letter"--22.7%, "Supplemental Schedule"--15.6%, "No Disclosure"--14.8%, and "Statement Footnotes"--4.8%.

4. Attitudes of Chartered Accountants Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports. Relating to hypothesis 6 on the views of accountants to the extension of the "attest"

function to projected financial information the following was posed:

Assuming a CA would be required to express an opinion on projected financial information included in published corporate annual reports, the content of such an opinion should: (Check as many as desired).

- \_\_\_\_\_ Include a statement as to the accuracy of the calculations in preparing the forecasts.
- \_\_\_\_\_ Include a statement as to the fairness of the assumptions on which the forecasts were based.
- \_\_\_\_\_ Include a statement that he (the CA) is in no way guaranteeing the realization of the forecasts.
- \_\_\_\_\_ Include a statement that he (the CA) does share responsibility with management for the preparation of the forecasts.

Concerning the accuracy of the calculations in preparing the forecasts, 216 of the 390 respondents, or 55.3%, noted that an opinion should require such a statement. As to the fairness of the assumptions on which the forecasts were based, 262, or 67.1%, believed that this statement should be included in a required opinion. Overwhelmingly, (80.2%), the accountants indicated that an opinion should require a statement that the CA is in no way guaranteeing the realization of the forecasts. Only 85, or 21.7% of the accountants suggested that CAs share responsibility with management for the preparation of the forecasts.

#### Summary

Regarding the hypotheses posed in this chapter, one can conclude the following:

1. Between 63.1% and 72.3% of the members of the Institute of Chartered Accountants in England and Wales believe that financial information relating to the future plans and goals of the corporation should be disclosed in published annual reports.

2. Between 56.0% and 65.6% of the members of the Institute of Chartered Accountants in England and Wales believe that a CA should examine projected financial information and offer some form of an opinion based upon an examination.

Other attitudes examined revealed the following:

1. General Evaluation of Corporate Annual Reports.

A majority (65.2%) of the accountants believed that published annual reports generally did not disclose adequate financial information to investors. Accountants generally believed that the Balance Sheet, Income Statement, Footnotes to the Financial Statements, and the Statement of Source and Use of Funds were of major importance to investors. Declining in importance were the Historical Operating and Financial Statistics, the Highlights Section, the President's Letter, and Organization Charts.

2. Attitudes of Chartered Accountants on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.

Forecasted statements, such as the Statement of Source and Use of Funds, the Projected Income Statement and the Projected Statement of Anticipated Growth of the Firm received the most support for inclusion in published annual reports. The Projected Balance Sheet and Statement of Use of Natural Resources received a lesser degree of support for inclusion in the annual reports. For those accountants who indicated that forecasted statements should be included in published corporate annual reports, most believed that the Projected Balance Sheet, the Projected Income Statement, and the Statement of Source and Use of Funds should be for one year in the future while the three year category was most noted for Anticipated Growth of the Firm and the Statement of Use of Natural Resources.

3. Attitudes of Chartered Accountants on the Degree of Importance They Would Expect an Investor to Place on Projected Financial Information. Generally, accountants believed that forecasted items related to Dividend Policy, Corporate Acquisitions, Capital Expenditures, Future Financing, and Sales and Earnings would be of considerable importance to investors. Declining in importance were items related to Future Research and Development and Natural Resources. Little importance was attributed

to Inventories, Advertising and Human Resources, with three exceptions in the latter case. "Common Shares Owned by Officers and Directors", "Future Effects of Wage Increases Due to Pending Union Agreement", and "Anticipated Change in Employment Contracts of Directors and Officers" were designated as having substantial importance to investors. Concerning expected disclosure, the following general conclusions can be stated:

a. Where items were rated low in importance, "No Disclosure" received a significant percentage of replies.

b. The "President's Letter" and the "Projected Statement" were named most as the areas of disclosure for all major topics.

c. The "Supplemental Schedule" and "Statement Footnotes" received fairly large percentages of replies in the area of Future Financing and the item "Common Shares Owned by Officers and Directors".

4. Attitudes of Chartered Accountants Regarding the Contents of an Opinion on Projected Financial Information in Published Corporate Annual Reports. If a CA were required to offer an opinion on projected financial information included in corporate annual reports the accountants overwhelmingly believed that the opinion should include a statement that he (the CA)

is in no way guaranteeing the realization of the forecasts. Only 21.7% of the respondents noted that CAs should share responsibility with management for the preparation of the forecasts. Fifty-five percent of the accountants indicated that the opinion should include a statement as to the accuracy of the calculations in preparing the forecasts while 67.1% believed that the opinion should include a statement as to the fairness of the assumptions on which the forecasts were based.

## CHAPTER VII

### SUMMARY AND RECOMMENDATIONS

#### The Problem

A primary objective of published corporate annual reports is to provide adequate disclosure of financial information to the users of the reports. Some accountants and financial analysts believe that the changing needs of the external users of corporate annual reports are not being satisfied because these reports largely omit financial information relating to the future plans and goals of the firms. As a result, several of these writers have proposed including financial information relating to the future plans and goals of the firms in the corporate annual reports furnished to investors.

Adopting this proposal to include projected financial information in published corporate annual reports might have a substantial impact on the legal environment of accounting as well as on accounting and auditing theory. This study has dealt with these considerations.

#### Purposes of the Study

In the effort to contribute to the growing body of

knowledge relating to disclosure of financial information in published corporate annual reports, the study attempted to:

1. Determine the extent projected financial information is presented in corporate annual reports.
2. Examine the possible implications of adopting the practice of disclosing projected financial information in published corporate annual reports.
3. Determine if Financial Analysts desire the inclusion of projected financial information in these reports. This examination also included the types of data desired and its manner of presentation.
4. Survey the opinions of Certified Public Accountants toward the feasibility of reporting on projected financial information.
5. Survey the opinions of English Chartered Accountants concerning the inclusion of projected financial information in published corporate annual reports.

#### Methodology of the Study

The methodology employed in this study utilized primary and secondary research. Primary research, using a survey questionnaire, tested the hypotheses of the study. Also, it determined the extent projected financial information was included in corporate annual reports. Secondary research was employed to examine the legal, accounting and auditing aspects



of including projected financial information in corporate annual reports. The sample populations used in this study were:

1. The largest United States corporations listed in Forbes magazine by:
  - (a) the 500 publicly owned United States companies largest by revenues;
  - (b) the 500 publicly owned United States companies largest by market value;
  - (c) the 500 publicly owned United States companies largest by capital expenditures;
  - (d) the 500 publicly owned United States companies largest by assets;
  - (e) the 500 publicly owned United States companies largest by net profits.<sup>69</sup>

From this list of 872 reports, 350 randomly selected reports were requested.

2. Financial Analysts as listed in the Membership Directory of the Financial Analysts Federation.
3. American accountants as listed in the Membership Directory of the American Institute of Certified Public Accountants.
4. English accountants as listed in the Membership Directory of the Institute of Chartered Accountants in England and Wales.

From the above three groups, 1200 members were randomly selected

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<sup>69</sup>Forbes, op. cit., pp. 136-174.

for sampling. The measuring techniques employed in the study for testing the hypotheses included the Z test, which allowed one to make a decision regarding the hypotheses; the confidence interval provided the range within the true population had a particular characteristic.

### Major Findings

#### Secondary Research-Theoretical Aspects

Using the standards for information developed by the American Accounting Association it was found that projected financial information met the two standards of relevance and quantifiability. However, the standards of freedom from bias and verifiability would be more difficult to meet by forecasted information. It would be difficult, if not impossible, to determine the personal bias of management in presenting projected financial data. Furthermore, one could not verify the forecasts or budgets at the time they were created.

An examination of the newly adopted Code of Professional Ethics of the American Institute of Certified Public Accountants reveals that the "attesting to" projected financial statements by an auditor would more likely be in violation of Rule 204 which states:

A member shall not permit his name to be used in conjunction with any forecast of future operations or financial conditions in a manner which may lead to the belief that the

member vouches for the achievability of the forecast.<sup>70</sup>

Finally, it was found that the requiring of forecasted information in corporate annual reports would probably be the greatest impetus to conservatism in accounting since the stock market crash of 1929. This would result from the legal environment within which managers and accountants exist. The legal consequences of an erroneous forecast might involve civil and criminal prosecution of managers and accountants.

#### Secondary Research-Legal Aspects

The role of the United States Securities and Exchange Commission in the administration of the securities laws of the United States has also been noted. Any action by this semi-judicial agency of the government involving forecasts would probably be brought under Rule X-10B-5 of the Securities and Exchange Act of 1934 which states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any national securities exchange.

- (1) to employ any device, scheme, or artifice, to defraud;
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or;

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<sup>70</sup>American Institute of Certified Public Accountants, op. cit., p. 22.

- (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.<sup>71</sup>

Actions under this rule might involve civil injunction, criminal prosecution or administrative remedy.

The examination of four legal cases relating to the study revealed that the law of corporate information is not clearly defined. These cases related to the dissemination of corporate information. One involved the release of speculative information and the providing of misleading income and cash flow projections. A conclusion can be reached that if a manager is aware of a possible future event which might effect the investor's judgement, he should provide the investor with such information. However, if the event does not occur he may be sued for failing to provide accurate information to the investor. This dilemma shall face the manager if he is forced to disclose projected financial information.

#### Primary Research

The first survey was concerned with the extent of disclosure of projected financial information in corporate annual reports. An examination of 337 reports revealed that judgements about the future were common throughout the annual reports. Optimistic speculation was found in 334, or 99.1%, of the reports. Such

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<sup>71</sup>Securities and Exchange Commission, op. cit., pp. 1005-1006.

speculation took the form of statements relating to the growth of demand, sales, revenues, or profits. Terms such as "bright outlook" were found in the president's letter. Speculation was also found in the discussion of price changes, the introduction of new products, production costs, prospective cash dividends, and the future financing of the firm. Where a corporation was engaged in litigation a statement to the effect that the litigation was expected to have no adverse impact upon corporate earnings generally appeared.

A discussion of past or present programs of the corporations was usually presented in the body of the annual report. However, there was the implication that these programs will continue into the future. Examples of such programs were concerned with research, training, and community action activities.

Reference to the future plans of corporations were provided in each of the 337 annual reports. These plans fell into the following classifications:

- (a) Planned Capital Expenditures.
- (b) Planned Mergers, Acquisitions, and Divestitures.
- (c) Research, Exploration, and the Creation and Promotion of New Products.
- (d) Planned Price or Rate Changes.
- (e) Financing Plans.
- (f) Cost Control Programs.
- (g) Accounting Changes.

Information on planned capital expenditures was offered in 292, or 86.6%, of the annual reports. Such information was

related to expansions of facilities, investments in real estate developments, and acquisitions of other fixed assets. This information was most often provided in the president's letter, the body of the report, or the notes to the financial statements.

Information related to planned mergers, acquisitions, and divestitures was given in 108, or 32.0%, of the annual reports. Such information was usually found in the president's letter and the body of the report.

Planned research, exploration and the creation and promotion of new products was mentioned in 190, or 56.4%, of the 337 corporate annual reports. This classification included product testing, market research, sales promotion and the development of new products. Specific research was referred to in 148, or 43.9%, of the reports.

Planned price or rate changes were discussed in 77, or 22.8%, of the 337 annual reports. Often, the price or rate changes were subject to the approval of the Price Commission.

Reference to corporate financing plans were frequently embodied in the annual reports. Typically, a discussion of a pending debt or equity issue included the purpose or intended use of the funds.

Cost control programs were often mentioned in the body of the reports. This classification included relocations,

reorganizations, and the computerization of operations. Of the 337 annual reports, 95, or 28.2%, made some reference to a cost savings plan.

Planned accounting changes were discussed in only 7, or 2.1%, of the reports. This classification, however, did preclude the computerization of accounting systems which was included in the prior section.

In summary, the first survey determined that there was substantial disclosure of projected financial information in corporate annual reports. Optimistic speculation and plans for the future were mentioned in the majority of the reports. However, because this study deals with the future, it cannot be determined whether these statements are concrete plans, speculation, or deliberately misleading representations.

After determining the extent of the inclusion of projected financial information in corporate annual reports, the opinions of Financial Analysts, Certified Public Accountants, and English Chartered Accountants on this important topic were surveyed. The findings, which included the testing of the hypotheses, were:

**Hypothesis 1:** Most Financial Analysts believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

This hypothesis was accepted. One can be 95% confident that between 81.8% and 88.2% of the 13,000 members of the Financial

Analysts Federation do believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

Hypothesis 2: Most Financial Analysts believe that the attest function should be extended to include projected financial information in published corporate annual reports.

This hypothesis was rejected. It cannot be concluded that the majority of Financial Analysts desire that a CPA examine budgets, profit plans, or other projected financial information and offer some form of an opinion based upon his examination. Two possibilities which might explain the rejection of this hypothesis present themselves. First, the Financial Analysts, in all likelihood, recognize the extreme difficulties in auditing such projections, whether by CPAs or others. Second, the Financial Analysts, perhaps identifying with the problems of management, might believe that the cost of an audit of projected financial information would be prohibitive.

Hypothesis 3: Most American Certified Public Accountants believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

This hypothesis was accepted. Between 69.7% and 77.5% of the members of the American Institute of Certified Public Accountants believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.



**Hypothesis 4:** Most American Certified Public Accountants believe that the attest function should be extended to include projected financial information in published corporate annual reports.

This hypothesis was rejected. Only between 29.5% and 37.9% of the members of the AICPA believe that the attest function should be extended to projected financial information. One explanation of the rejection of this hypothesis is the vagueness in the law of corporate information. Such vagueness has given rise to numerous lawsuits against management, accountants and others associated with financial reporting. Accordingly, CPAs would naturally avoid such legal complications.

**Hypothesis 5:** Most English Chartered Accountants believe that financial information relating to the future plans and goals of the corporation should be included in published annual reports.

This hypothesis was accepted. Between 63.1% and 72.3% of the members of the Institute of Chartered Accountants in England and Wales believe that the future plans and goals of the corporation should be disclosed in published corporate annual reports.

**Hypothesis 6:** Most English Chartered Accountants believe that the attest function should be extended to include projected financial information in published corporate annual reports.

This hypothesis was accepted. Between 56.0% and 65.6% of the members of the Institute of Chartered Accountants in England and Wales believe that the attest function should be extended to include projected financial information in published corporate annual reports. The acceptance of this hypothesis by

the English Chartered Accountants is in sharp contrast with the response of American Certified Public Accountants. This might be explained by the following reasons. First, in England, Chartered Accountants are currently offering opinions on profit forecasts in cases of bids and takeovers. Having more experience in this area, they are more willing to offer such opinions dealing with the future. Second, either due to a greater clarity in their laws or to a less litigious society, English Chartered Accountants are involved in fewer court proceedings than their American counterparts. As a consequence, they should have fewer fears concerning liability for such opinions.

#### Other Data

In addition to the questions relating to the preceding hypotheses, the views of Certified Public Accountants, Chartered Accountants and Financial Analysts were requested on the following topics:

1. General Evaluation of Corporate Annual Reports.
2. Attitudes of the Three Groups on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.
3. Attitudes of the Three Groups on the Beliefs of Investors Regarding the Nature of Projected Financial Information to be Included in Published Corporate Annual Reports.
4. Attitudes of the Three Groups Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports.

1. General Evaluation of Corporate Annual Reports. To evaluate the current status of corporate reporting, the following question was posed:

In your opinion, do you feel that published corporate annual reports generally disclose adequate financial information to investors?

Of the three groups, the Chartered Accountants were most dissatisfied with current disclosure practices--65.2% indicating "No". Then followed the Financial Analysts, with 51.2% noting "No" to the question. However, 55.0% of the Certified Public Accountants did believe that published corporate annual reports generally disclose adequate financial information to investors.

In addition to the preceding question on the general evaluation of corporate annual reports the three groups were asked to offer opinions on the usefulness of the various sections usually found in annual reports.

The Footnotes to the Financial Statements, the Balance Sheet, and the Income Statement were considered very useful to investors by Certified Public Accountants and Financial Analysts. Although Chartered Accountants did regard the Income Statement and Balance Sheet as being useful to investors, there was a substantial decline in expected usefulness for the Footnotes to the Financial Statements.

A substantial decrease in the expected usefulness was indicated by the three groups for the Statement of Source and Use of Funds. Between 58.0% and 61.0% of the replies were "Very Useful" for this item.

The President's Letter and the Highlights Section further declined in expected usefulness by the three groups.

Historical Operating and Financial Statistics was considered fairly useful to investors by Certified Public Accountants and Financial Analysts. "Very Useful" received 45.0% and 39.9% of the replies, respectively. A decline in expected usefulness was noted by the Chartered Accountants--"Very Useful" (22.4%).

Organization Charts were regarded the least useful to investors by the three groups with only between 2.6% and 6.7% indicating "Very Useful".

Representing investors and advisors to investors, the Financial Analysts were asked to rank various sources of financial information. The "Corporate Annual Report" was ranked third behind "Direct Contact with Management" and "Prospectus and Registration Statement" as a source of financial information. One explanation for this third ranking of the "Corporate Annual Report" might be the need for timely information by investors. Unfortunately, annual reports are published several months after the close of the accounting year. "Direct Contact with Management" can occur at times more relevant to the needs of investors. Ranked after the "Corporate Annual Report" was the "Statistical Investment

Advisory Service", "Other", "Interim Reports", and "Trade Publications".

2. Attitudes of the Three Groups on the Inclusion of Forecasted Statements in Published Corporate Annual Reports.

After determining the views of the three groups on the current status of corporate reporting, they were then asked for their views on the inclusion of forecasted statements in the reports.

Table 7-1 provides a summary of the responses:

|  | <u>Table 7-1</u><br><u>Definitely</u><br><u>Should Be</u><br><u>Included</u> | <u>Possibly</u><br><u>Should Be</u><br><u>Included</u> | <u>Should Not</u><br><u>Be</u><br><u>Included</u> |
|--|--|--|---|
| <b>Projected Balance Sheet</b>                     |  |  |   |
| CAs  | 20.5%  | 39.4%  | 40.1%   |
| CPAs   | 14.4%  | 31.4%  | 54.2%   |
| FAs  | 27.4%  | 40.8%  | 31.8%   |
| <b>Projected Income Statement</b>                  |  |  |   |
| CAs  | 34.9%  | 35.5%  | 29.6%   |
| CPAs   | 28.5%  | 26.5%  | 45.0%   |
| FAs  | 32.6%  | 35.5%  | 31.9%   |
| <b>Statement of Source and Use of Funds</b>        |  |  |   |
| CAs  | 44.7%  | 30.4%  | 24.9%   |
| CPAs   | 32.6%  | 27.8%  | 39.6%   |
| FAs  | 49.2%  | 32.9%  | 17.9%   |
| <b>Statement of Anticipated Growth of the Firm</b> |  |  |   |
| CAs  | 34.8%  | 39.5%  | 25.7%   |
| CPAs   | 38.5%  | 40.4%  | 21.1%   |
| FAs  | 42.0%  | 40.8%  | 17.2%   |
| <b>Statement of Use of Natural Resources</b>       |  |  |   |
| CAs  | 19.8%  | 44.8%  | 35.1%   |
| CPAs   | 16.8%  | 48.3%  | 34.9%   |
| FAs  | 25.8%  | 52.0%  | 22.2%   |

From the above it can be concluded that some support was given by Financial Analysts and Chartered Accountants for the inclusion of a Projected Balance Sheet in the corporate annual report. However, the majority of Certified Public Accountants were opposed to such inclusion. Again, this might be as a result of conservatism on the part of the American CPAs. They do not want their names associated with the "typically" audited statements.

An increase in support for inclusion of a Projected Income Statement in the annual reports was given by all three groups. However, 45.0% of the Certified Public Accountants still believed that this statement should not be included in the annual report.

The Projected Statement of Source and Use of Funds received substantial support for inclusion in the annual report by Chartered Accountants and Financial Analysts. Again, Certified Public Accountants indicated less support for this statement.

The inclusion of a Statement of Anticipated Growth of the Firm in the annual report received similar support for the three groups. Financial Analysts provided the most support with 42.0% noting this statement should definitely be included in the reports. This was followed by Certified Public Accountants (38.5%) and Chartered Accountants (34.8%).

Finally, the Projected Statement of Use of Natural

Resources received little support for definite inclusion in the annual report. Only 16.8% to 25.8% of the responses of the three groups indicated that this statement definitely should be included in the published corporate annual reports.

In conjunction with Table 7-1 those respondents who checked "Definitely Should Be Included" and "Possibly Should Be Included" were asked to indicate the period of time to which these forecasted statements should be extended. The results were similar for the three groups. That the Projected Balance Sheet, the Projected Income Statement, and the Statement of Source and Use of Funds be extended for one year received the most designations. The 3 or more years category was noted most for the Statement of Anticipated Growth of the Firm and the Statement of Use of Natural Resources.

3. Attitudes of the Three Groups on the Degree of Importance They Would Expect an Investor to Place on Projected Financial Information. In this complex question the Certified Public Accountants and Chartered Accountants were asked to indicate the degree of importance they would expect an investor to place on selected items of information. The Financial Analysts, representing investors, were asked to indicate the degree of importance they would place on these items. In addition, they were requested to note the section of the annual report in which each item should be disclosed. The summary by

"Anticipated Price Increases of Products". With Chartered Accountants, the "President's Letter", the "Projected Statement" and the "Supplemental Schedule" was most often noted with the "Projected Statement" receiving the most support. "No Disclosure" was often designated for "Backlog of Orders to be Filled", "Anticipated Price Increases of Products", "Expected Sales Breakdowns" and "Expected Contribution Margins by Product, Territory, or Division".

b. Human Resources. The three groups placed considerable importance on "Common Shares Owned by Officers and Directors" and "Future Effect of Wage Increases Due to Pending Union Agreement". However, Financial Analysts placed somewhat more importance on "Estimated Pension Fund Costs" than the accountants. But the accountants placed more importance on "Anticipated Change in Employment Contracts of Directors and Officers" than did the Financial Analysts. "Estimated Employee Turnover Data", "Anticipated Change in Company's Policies Regarding Employees" and "Programmed Future Cost for the Training and Recruiting of Employees" were regarded as being not very important to investors by the three groups.

"No Disclosure" was most prominent for the three items regarded of little importance. The "President's Letter", "Projected Statement", and "Supplemental Schedule" was also noted for these items. The "Supplemental Schedule" and



"Statement Footnotes" were checked most by the three groups for the items "Common Shares Owned by Officers and Directors". For "Estimated Pension Fund Costs" the Certified Public Accountants designated "No Disclosure", the "Projected Statement", "Statement Footnotes" and the "Supplemental Schedule" in descending order. Chartered Accountants noted "No Disclosure", the "Projected Statement", the "Supplemental Schedule", and "Statement Footnotes". The Financial Analysts, however, placed more emphasis on the "Supplemental Schedule", "Statement Footnotes", and the "Projected Statement". The three groups most often checked the "President's Letter" and the "Projected Statement" for the item, "Future Effect of Wage Increase Due to Pending Union Agreement". Also, the three groups were similar in their views on disclosure of the final item, "Anticipated Change in Employment Contracts of Directors and Officers". Most replies were for the "President's Letter", "No Disclosure" and the "Supplemental Schedule".

c. Future Research and Development. For the three items in this classification, "Expected Research and Development Expenditures", "Anticipated New Products or Patents", and "Estimated Increase in Sales Due to New Products", the Financial Analysts placed considerably more importance on the than did the accountants. Also, the Chartered Accountants regarded these items as slightly more important to the investor than did the

Certified Public Accountants.

Most replies by the Financial Analysts and Certified Public Accountants were for the "President's Letter" and the "Projected Statement". While the "President's Letter" and the "Projected Statement" were often noted by the Chartered Accountants, "No Disclosure" was also frequently checked.

d. Budgeted Advertising Expenditures. Little importance was placed on the items in this category. The Financial Analysts did, however, place more importance on this category than the accountants.

As little importance was noted for this category, "No Disclosure" was more often designated by the three groups of respondents. After "No Disclosure", the "Projected Statement" was most often checked.

e. Natural Resources. As with many of the preceding items, the Financial Analysts placed somewhat more importance on this classification of items than did the accountants. Although not regarding items in this classification as importantly as did the Financial Analysts, the Chartered Accountants did expect investors to consider them more important than did the Certified Public Accountants.

For disclosure policy, Financial Analysts more often noted the "President's Letter" and the "Projected Statement". The accountants regarded expected disclosure to be in the

"Projected Statement", "No Disclosure" and the "President's Letter".

f. Capital Expenditures. Items in this classification were regarded as being very important to investors by Financial Analysts and Chartered Accountants. Although Certified Public Accountants did believe that items related to Capital Expenditures were important to investors, it was not the degree of importance expected by the preceding groups.

Certified Public Accountants and Financial Analysts were generally in agreement as to disclosure policy. The "President's Letter" received the most designations followed by the "Projected Statement". Differing, the Chartered Accountants first checked the "Projected Statement", followed by the "President's Letter" and the "Supplemental Schedule".

g. Corporate Acquisitions. As with items related to Capital Expenditures, Financial Analysts and Chartered Accountants considered items related to Corporate Acquisitions to be very important to investors. A slight decrease in expected importance to investors was noted by Certified Public Accountants.

Disclosure policy for items in this classification was similar for the three groups of respondents. The categories receiving the most designations were the "President's Letter", the "Projected Statement" and "No Disclosure".

h. Inventories. Items related to inventories were

not considered very important to the respondents. Financial Analysts did place, however, more importance on these items than did the accountants.

Accountants placing little importance on these items noted "No Disclosure" more than any other category. This was followed by the "Projected Statement". With Financial Analysts considering items related to Inventories slightly more important than accountants, the "Projected Statement" was more often designated than "No Disclosure".

i. Dividend Policy. Chartered Accountants regarded details of proposed stock and cash dividends as being extremely important to investors. Certified Public Accountants regarded these items as important but not as much as did the Chartered Accountants. Also, a further decline in importance was noted by the Financial Analysts.

As this category was regarded important by the three groups, most replies by the respondents indicated the "President's Letter" as the location for disclosure in the annual report.

j. Future Financing. The divergence of views on the importance of items in this final category was substantial. Both the "Details of Proposed Stock Issues" and the "Future Effects of Conversion Features of Debt or Preferred Stock" were regarded fairly important to investors by Financial Analysts and Certified Public Accountants. While the "Future Effects of

Conversion Features of Debt or Preferred Stock" was regarded very important to investors by Chartered Accountants, "Details of Proposed Stock Issues" was not. Also, the Chartered Accountants considered "Anticipated Pledging of Assets for Long-term Debt" substantially more important to investors than did the Certified Public Accountants and the Financial Analysts. The "Schedule of Future Debt Payments" and "Rental Payments and Other Details of Anticipated Long-term Leases" were regarded of moderate importance by the three groups of respondents.

The disclosure categories receiving the most replies for the item "Details of Proposed Stock Issues" were: Certified Public Accounts--"President's Letter", Financial Analysts--"President's Letter", Chartered Accountants--"Projected Statement". Certified Public Accountants and Financial Analysts placed strong emphasis on the "Statement Footnotes" for the item, "Future Effects of Conversion Features of Debt or Preferred Stock". Chartered Accountants, however, noted the "Projected Statement" in most instances. The three groups did not agree on the disclosure policy for "Anticipated Pledging of Assets for Long-term Debt". The results were: Certified Public Accountants--"President's Letter", Chartered Accountants--"Projected Statement", Financial Analysts--"Supplemental Schedule". The Certified Public Accountants and Financial Analysts indicated strong support for the "Statement Footnotes"

and the "Supplemental Schedule" for the items, "Schedule of Future Debt Payments" and "Rental Payments and Other Details of Anticipated Long-term Leases". Chartered Accountants emphasized the "Projected Statement" for "Schedule of Future Debt Payments" and the "President's Letter" for "Rental Payments and Other Details of Anticipated Long-term Leases".

The following generalizations can summarize this section:

1. Financial Analysts placed more importance on the items than did the accountants.
2. Chartered Accountants placed more importance on the items than did the Certified Public Accountants.
3. Where items were not considered very important to investors, "No Disclosure" was most often designated.
4. Attitudes of the Three Groups Regarding the Contents of an "Opinion" on Projected Financial Information in Published Corporate Annual Reports. Relating to the hypotheses concerning the extension of the "attest" function to projected financial information, the results were:
  - a. Slightly more than half of the Chartered Accountants believed that an "Opinion" should include a statement as to the accuracy of the calculations in preparing the forecasts. Fewer (47.4%) Financial Analysts desired this statement and yet fewer (41.0%) Certified Public Accountants believed that

this statement should be included in an "Opinion".

b. An increase in support for the inclusion of a statement as to the fairness of the assumptions on which the forecasts were based was indicated by the three groups. The results were: Chartered Accountants--67.1%, Financial Analysts--57.2%, and Certified Public Accountants--45.2%.

c. Strong support for a statement that the accountant is in no way guaranteeing the realization of the forecasts was shown by the accountants--Chartered Accountants (80.2%), Certified Public Accountants (84.5%). Only 55.7% of the Financial Analysts believed that this statement should be included in an "Opinion".

d. Finally, none of the groups gave much support for a statement in the "Opinion" that the accountant does share responsibility with management for the preparation of the forecasts.

One explanation for Chartered Accountants believing that an "Opinion" should include statements as to the accuracy of the calculations in preparing a forecast and as to the fairness of the assumptions on which they are prepared might be that they are currently offering such an "Opinion" in cases of bids and takeovers. Certified Public Accountants, on the other hand, do not offer such opinions and have fears of the legal consequences if they were required to do so.

### Recommendations

The research in this study has provided additional knowledge on the theoretical and legal aspects of reporting projected financial information. In addition, it has presented the opinions of Certified Public Accountants, Chartered Accountants, and Financial Analysts on this important topic. Finally, it has examined the current practices of reporting projected financial information in the corporate annual reports of major corporations.

Recommendations suggested by the study might be:

1. To revise the Code of Professional Ethics of the American Institute of Certified Public Accountants so that the accountants' role in dealing with projected financial information might be clearly understood.
2. To define the legal rights, duties, and liabilities of those associated with projected financial information.
3. To further research the needs of investors for corporate information.



APPENDIX A

COVER LETTER AND SURVEY RESULTS OF QUESTIONNAIRES  
TO FINANCIAL ANALYSTS

Although there are numerous demands on your time, will you please take a few minutes for a task which might result in the improvement of reporting practices in corporate annual reports?

I am conducting an investigation into the opinions of Financial Analysts regarding the adequacy of disclosure of projected financial information in annual reports. The study is being made under the direction of the accounting faculty of Louisiana State University at Baton Rouge and is in partial fulfillment of the doctoral requirements of the university.

Answers to the attached questionnaire will provide valuable information in determining the viewpoints of members of the Financial Analysts Federation on this important subject.

It will be greatly appreciated if you would complete the questionnaire and return it at your earliest convenience in the enclosed envelope provided for your use.

If you desire the results of the study, please sign the questionnaire; however, omitting your signature will retain your anonymity. In either case, all information will be kept in strict confidence.

Thank you very much.

Sincerely,

Robert J. Keller, CPA

## QUESTIONNAIRE TO FINANCIAL ANALYSTS

1. In your opinion, do you feel that published corporate annual reports generally disclose adequate financial information to investors? YES 217 NO 228
2. Listed below alphabetically are sources of financial information for financial analysts. A space is also provided should you desire to specify a source other than those in the listing. Please rank the importance of each source by assigning the number 1 to the most important source, 2 to the second most important source, etc. (See text of study)

\_\_\_\_\_ Corporate Annual Report.  
 \_\_\_\_\_ Direct contact with Management (letter, phone, or meetings).  
 \_\_\_\_\_ Interim Reports.  
 \_\_\_\_\_ Statistical Investment Advisory Services.  
 \_\_\_\_\_ Prospectus and Registration Statements.  
 \_\_\_\_\_ Trade Publications.  
 \_\_\_\_\_ Other (Please state) \_\_\_\_\_

3. Below are the various sections usually found in published corporate annual reports. Please indicate the degree of usefulness of each section to you as an analyst by checking the appropriate box.

|  | Very<br>Useful | Useful     | Of Little<br>Use | Of No<br>Use |
|--|----------------|------------|------------------|--------------|
| President's Letter                               | <u>80</u>      | <u>244</u> | <u>125</u>       | <u>6</u>     |
| Highlights Section                               | <u>58</u>      | <u>261</u> | <u>122</u>       | <u>14</u>    |
| Balance Sheet                                    | <u>329</u>     | <u>119</u> | <u>6</u>         | <u>1</u>     |
| Income Statement                                 | <u>359</u>     | <u>94</u>  | <u>1</u>         | <u>1</u>     |
| Statement of Source and Use of Funds             | <u>277</u>     | <u>150</u> | <u>27</u>        | <u>1</u>     |
| Footnotes to the Financial Statements            | <u>375</u>     | <u>71</u>  | <u>9</u>         | <u>  </u>    |
| Historical Operating and<br>Financial Statistics | <u>179</u>     | <u>251</u> | <u>23</u>        | <u>2</u>     |
| Organization Charts                              | <u>12</u>      | <u>172</u> | <u>224</u>       | <u>47</u>    |

4. In your opinion, should financial information relating the future plans and goals of the corporation be disclosed in published corporate annual reports? YES 391 NO 69

5. Listed below are items of information relating to the future of a firm which you might find important to you as a financial analyst. Please indicate the degree of importance each item is to you in your activities as an analyst by checking the appropriate box (1-4). Also, please indicate where you believe the item should be disclosed in the annual report, if at all, by checking the appropriate box under columns 5 thru 10.

Degree of Importance

Columns 1 - VI - Very Important  
 Columns 2 - MI - Moderately Important  
 Columns 3 - FU - Fairly Unimportant  
 Columns 4 - U - Unimportant

Disclosure Policy

5 - ND - No Disclosure  
 6 - PL - Disclose in President's Letter.  
 7 - PS - Disclose in Projected Statement.  
 8 - SS - Disclose in Supplemental Schedule associated with the Primary Financial Statement.  
 9 - SF - Disclose in Primary Financial Statement's Footnote.  
 10 - O - Other (please write in proper disclosure method).

|   | VI  | MI  | FU  | U  | ND  | PL  | PS  | SS  | SF  | O  |
|---|-----|-----|-----|----|-----|-----|-----|-----|-----|----|
| <u>Sales and Earnings</u>   |     |     |     |    |     |     |     |     |     |    |
| Expected sales breakdowns by product, territory, or division.         | 327 | 91  | 10  | 10 | 77  | 61  | 154 | 109 | 21  | 16 |
| Expected contribution margins by product, territory, or division.     | 333 | 87  | 15  | 10 | 95  | 47  | 160 | 99  | 31  | 13 |
| Anticipated price increase of products.                               | 236 | 161 | 38  | 11 | 85  | 140 | 116 | 63  | 16  | 11 |
| Forecasted volume of future sales.                                    | 278 | 130 | 25  | 11 | 56  | 117 | 174 | 50  | 23  | 9  |
| Backlog of orders to be filled.                                       | 291 | 130 | 16  | 9  | 52  | 170 | 99  | 105 | 11  | 9  |
| Estimated earnings per share of common stock.                         | 271 | 127 | 20  | 23 | 128 | 113 | 121 | 43  | 24  | 12 |
| <u>Human Resources</u>  |     |     |     |    |     |     |     |     |     |    |
| Estimated employee turnover data.                                     | 49  | 175 | 169 | 49 | 143 | 66  | 45  | 117 | 24  | 30 |
| Anticipated change in company's policies regarding employees.         | 47  | 164 | 180 | 51 | 143 | 77  | 40  | 76  | 36  | 18 |
| Estimated pension fund costs.   | 135 | 200 | 90  | 18 | 39  | 50  | 87  | 132 | 122 | 12 |
| Future effect of wage increases due to pending union agreement.       | 253 | 167 | 16  | 5  | 52  | 143 | 105 | 81  | 43  | 13 |
| Anticipated change in employment contracts of directors and officers. | 164 | 140 | 153 | 33 | 101 | 77  | 53  | 65  | 60  | 24 |
| Programmed future costs for the training and recruiting of employees. | 37  | 145 | 191 | 53 | 131 | 57  | 72  | 5   | 37  | 31 |
| Common shares owned by officers and directors.                        | 179 | 163 | 31  | 12 | 77  | 33  | 32  | 109 | 15  | 21 |

| VI                     | MI  | RU  | U  | ND  | PL  | PS  | SS  | SF  | 0  |
|------------------------|-----|-----|----|-----|-----|-----|-----|-----|----|
| 226                    | 188 | 19  | 5  | 74  | 130 | 164 | 21  | 10  | 9  |
| 265                    | 156 | 13  | 5  | 76  | 190 | 97  | 56  | 6   | 13 |
| 259                    | 149 | 21  | 9  | 87  | 124 | 145 | 65  | 5   | 12 |
| 76                     | 203 | 122 | 33 | 118 | 53  | 122 | 108 | 24  | 17 |
| 70                     | 185 | 136 | 48 | 157 | 65  | 120 | 71  | 10  | 16 |
| Natural Resources      |     |     |    |     |     |     |     |     |    |
| 200                    | 183 | 44  | 10 | 62  | 117 | 153 | 81  | 12  | 13 |
| 194                    | 169 | 57  | 16 | 75  | 127 | 137 | 69  | 15  | 13 |
| Capital Expenditures   |     |     |    |     |     |     |     |     |    |
| 311                    | 117 | 10  |    | 35  | 166 | 126 | 88  | 15  | 9  |
| 284                    | 138 | 13  | 3  | 139 | 155 | 125 | 63  | 18  | 15 |
| 320                    | 102 | 14  | 2  | 69  | 170 | 99  | 90  | 18  | 12 |
| Corporate Acquisitions |     |     |    |     |     |     |     |     |    |
| 277                    | 121 | 25  | 14 | 113 | 116 | 93  | 80  | 23  | 12 |
| 291                    | 120 | 16  | 12 | 98  | 117 | 116 | 85  | 13  | 15 |
| 284                    | 121 | 19  | 12 | 88  | 134 | 98  | 83  | 19  | 14 |
| Inventories            |     |     |    |     |     |     |     |     |    |
| 120                    | 199 | 107 | 16 | 117 | 54  | 146 | 92  | 118 | 9  |
| 165                    | 178 | 78  | 15 | 104 | 80  | 139 | 63  | 18  | 12 |
| Dividend Policy        |     |     |    |     |     |     |     |     |    |
| 160                    | 164 | 88  | 26 | 62  | 193 | 65  | 57  | 24  | 11 |
| 149                    | 162 | 95  | 32 | 90  | 186 | 63  | 62  | 26  | 11 |
| Future Financing       |     |     |    |     |     |     |     |     |    |
| 171                    | 198 | 56  | 11 | 38  | 29  | 89  | 119 | 130 | 3  |
| 233                    | 153 | 38  | 10 | 75  | 129 | 86  | 61  | 51  | 14 |
| 149                    | 184 | 87  | 17 | 93  | 54  | 84  | 99  | 94  | 13 |
| 218                    | 165 | 67  | 8  | 38  | 31  | 57  | 111 | 163 | 13 |
| 153                    | 159 | 54  | 2  | 72  | 137 | 131 | 77  | 131 | 1  |

Future Research and Development  
 Expected research and development expenditures.  
 Anticipated new products or patents.  
 Estimated increase in sales due to new products.  
 Advertising  
 Budgeted advertising expenditures.  
 Projected growth in sales as a result of advertising.  
 Natural Resources  
 Projected exploration expenditures.  
 Forecasted change in natural resources.  
 Capital Expenditures  
 Planned capital expenditures.  
 Increase in plant capacity due to capital expenditures.  
 Proposed method of financing capital expenditures.  
 Corporate Acquisitions  
 Costs of prospective acquisitions.  
 Effect of acquisitions on future costs and sales.  
 Proposed method of financing acquisitions.  
 Inventories  
 Forecasted change in physical inventories.  
 Anticipated price changes of materials.  
 Dividend Policy  
 Details of proposed cash dividend.  
 Details of proposed stock dividend.  
 Future Financing  
 Rental payments and other details of anticipated long-term leases.  
 Details of proposed stock issues.  
 Anticipated pledging of assets for long-term debt.  
 Anticipated effects of conversion features of debt or preferred stock.  
 Schedule of future debt payments.

6. In the following are forecasted statements which might appear in published corporate annual reports. Please indicate if you believe these statements should be included as a part of the reports by checking the appropriate box.

|  | Definitely<br>Should Be<br>Included | Possibly<br>Should Be<br>Included | Should Not<br>Be Included |
|--|-------------------------------------|-----------------------------------|---------------------------|
| Projected Balance Sheet  | 121                                 | 180                               | 140                       |
| Projected Income Statement   | 144                                 | 157                               | 141                       |
| Statement of Source and Use of Funds   | 214                                 | 143                               | 78                        |
| Statement of Anticipated Growth of the Firm (sales, human, and physical resources) | 185                                 | 180                               | 76                        |
| Statement of Use of Natural Resources  | 114                                 | 230                               | 98                        |

7. If you believe the above statements should be included in published corporate annual reports, please indicate the length of period that should be covered by the statements by checking the appropriate box.

|  | 1 Year | 2 Years | 3 Or More<br>Years |
|--|--------|---------|--------------------|
| Projected Balance Sheet  | 183    | 64      | 44                 |
| Projected Income Statement   | 163    | 75      | 56                 |
| Statement of Source and Use of Funds   | 184    | 85      | 62                 |
| Statement of Anticipated Growth of the Firm (sales, human, and physical resources) | 101    | 66      | 169                |
| Statement of Use of Natural Resources  | 90     | 54      | 164                |

8. If projected financial information such as budgets, profit plans, or cash forecasts were disclosed in published corporate annual reports, do you feel that independent external auditors should examine this data and offer some form of an opinion based upon this examination? YES 232 NO 228
9. Assuming a CPA would be required to express an opinion on projected financial information included in corporate annual reports, the content of such an opinion should: (Check as many as desired)

218 include a statement as to the accuracy of the calculations in preparing the forecasts.

263 include a statement as to the fairness of the assumptions on which the forecasts were based.

256 include a statement that he (the CPA) is in no way guaranteeing the realization of the forecasts.

106 include a statement that he (the CPA) does share responsibility with management for the preparation of the forecasts.

In the above you were asked to offer your opinion on questions which could involve substantial discussion. If you desire to comment further on these questions, please use the back side of the questionnaire. An elaboration would be helpful.

The replies to the "Other" category in question 2 were  
as follows:

Mansfield Charts, 10-K, 8-K, analysts reports, financial  
press, long form audit report, opinions of competitors,  
Investment Bankers, Treasurer of the company, brokerage  
houses, comparison with other industries.

APPENDIX B

COVER LETTER AND SURVEY RESULTS OF QUESTIONNAIRES  
TO CERTIFIED PUBLIC ACCOUNTANTS



Although there are numerous demands on your time, will you please take a few minutes for a task which might result in the improvement of reporting practices in corporate annual reports?

I am conducting an investigation into the opinions of Certified Public Accountants regarding the adequacy of disclosure of projected financial information in annual reports. The study is being made under the direction of the accounting faculty of Louisiana State University at Baton Rouge and is in partial fulfillment of the doctoral requirements of the university.

Answers to the attached questionnaire will provide valuable information in determining the viewpoints of members of the American Institute of Certified Public Accountants on this important subject.

It will be greatly appreciated if you would complete the questionnaire and return it at your earliest convenience in the enclosed envelope provided for your use.

If you desire the results of the study, please sign the questionnaire; however, omitting your signature will retain your anonymity. In either case, all information will be kept in strict confidence.

Thank you very much.

Sincerely,

Robert J. Keller, CPA

## QUESTIONNAIRE TO ACCOUNTANTS

1. In your opinion, do you feel that published corporate annual reports generally disclose adequate financial information to investors? Yes 247 No 202 No Answer 29

2. Below are the various sections usually found in corporate annual reports. Please indicate the degree of usefulness you believe each section would be to an informed investor by checking the appropriate box.

|   | Very Useful | Useful | Of Little Use | Of No Use |
|---|-------------|--------|---------------|-----------|
| President's Letter                            | 86          | 240    | 136           | 16        |
| Highlights Section                            | 135         | 251    | 78            | 12        |
| Balance Sheet                                 | 105         | 159    | 14            | 0         |
| Income Statement                              | 151         | 116    | 7             | 2         |
| Statement of Source and Use of Funds          | 285         | 148    | 45            | 0         |
| Footnotes to the Financial Statements         | 372         | 01     | 14            | 1         |
| Historical Operating and Financial Statistics | 215         | 231    | 30            | 2         |
| Organization Charts                           | 24          | 116    | 260           | 69        |

3. In your opinion, should financial information relating to the future plans and goals of the corporation be disclosed in published corporate annual reports? Yes 352 No 126

4. In the following are forecasted statements which might appear in published corporate annual reports. Please indicate if you believe these statements should be included as a part of the reports by checking the appropriate box.

|   | Definitely Should Be Included | Possibly Should Be Included | Should Not Be Included |
|---|-------------------------------|-----------------------------|------------------------|
| Projected Balance Sheet   | 69                            | 150                         | 259                    |
| Projected Income Statement  | 136                           | 127                         | 215                    |
| Statement of Source and Use of Funds  | 156                           | 133                         | 189                    |
| Statement of Anticipated Growth of the Firm (sales, human and physical resources) | 184                           | 193                         | 101                    |
| Statement of Use of Natural Resources   | 80                            | 231                         | 167                    |

5. If you believe the above statements should be included in published corporate annual reports, please indicate the length of period that should be covered by the statements by checking the appropriate box.

|   | 1 Year | 2 Years | 3 Or More Years |
|---|--------|---------|-----------------|
| Projected Balance Sheet   | 110    | 46      | 34              |
| Projected Income Statement  | 109    | 68      | 78              |
| Statement of Source and Use of Funds  | 129    | 87      | 73              |
| Statement of Anticipated Growth of the Firm (sales, human and physical resources) | 87     | 81      | 189             |
| Statement of Use of Natural Resources   | 80     | 57      | 148             |

6. Listed below are items of information relating to the future of a firm which, in importance to an informed investor, please indicate the degree of importance you wish expect an investor to place on each item by checking the appropriate box under columns 1 through 5. Also, please indicate where you believe the item should be disclosed in the annual report, if at all, by checking the appropriate box under columns 6 through 10.

|   | Degree of Importance |     |     |     |     | Disclosure Policy |     |     |     |    |
|---|----------------------|-----|-----|-----|-----|-------------------|-----|-----|-----|----|
|   | VI                   | MI  | FU  | U   | ND  | PL                | PS  | SS  | SF  | O  |
| <u>Sales and Earnings</u>   |                      |     |     |     |     |                   |     |     |     |    |
| Expected sales breakdowns by product, territory, or division.       | 143                  | 168 | 76  | 62  | 133 | 81                | 123 | 81  | 3   | 19 |
| Expected contribution margins by product, territory, or division.   | 143                  | 143 | 79  | 78  | 157 | 69                | 131 | 76  | 5   | 16 |
| Anticipated price increases of products.                            | 83                   | 182 | 106 | 78  | 183 | 107               | 94  | 43  | 10  | 16 |
| Forecasted volume of future sales.                                  | 213                  | 172 | 37  | 26  | 74  | 117               | 197 | 47  | 3   | 12 |
| Backlog of orders to be filled.                                     | 217                  | 153 | 43  | 27  | 68  | 163               | 98  | 61  | 44  | 10 |
| Estimated earnings per share of common stock.                       | 232                  | 134 | 31  | 43  | 100 | 101               | 171 | 40  | 22  | 8  |
| <u>Human Resources</u>  |                      |     |     |     |     |                   |     |     |     |    |
| Estimated employee turnover data.                                   | 36                   | 78  | 19  | 14  | 287 | 67                | 29  | 42  | 9   | 19 |
| Anticipated change in company's policies regarding employees.       | 35                   | 117 | 167 | 123 | 233 | 132               | 23  | 31  | 8   | 16 |
| Estimated pension fund costs.                                       | 198                  | 233 | 83  | 39  | 116 | 50                | 109 | 73  | 97  | 13 |
| Future effect of wage increases due to existing union contracts.    | 176                  | 210 | 40  | 24  | 73  | 142               | 103 | 61  | 52  | 16 |
| Indicated to use in employment contracts of directors and officers. | 122                  | 188 | 92  | 59  | 139 | 111               | 31  | 62  | 48  | 19 |
| Estimated future rate of rate including and regarding the future.   | 23                   | 119 | 132 | 123 | 232 | 73                | 63  | 56  | 14  | 21 |
| Company should disclose officers and directors.                     | 263                  | 167 | 33  | 26  | 70  | 3                 | 35  | 137 | 121 | 42 |

5 - ND - No Disclosure  
 6 - PL - Disclose in President's Letter  
 7 - PS - Disclose in Footnote Statement  
 8 - SS - Disclose in Supplemental Schedule Associated With the Primary Financial Statement  
 9 - SF - Disclose in Primary Financial Statement's Footnote  
 10 - O - Other (Please write in proper disclosure method).

|  | VI  | HI  | FU  | U   | ND  | PL  | PS  | SS  | SI  | C   |
|--|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| <u>Future Research and Development</u>                             |     |     |     |     |     |     |     |     |     |     |
| Expected research and development expenditures.                    | 146 | 124 | 142 | 130 | 129 | 146 | 127 | 171 | 14  | 23  |
| Anticipated new products or patents.                               | 183 | 227 | 39  | 26  | 70  | 238 | 66  | 60  | 13  | 25  |
| Estimated increase in sales due to new products.                   | 173 | 223 | 39  | 24  | 67  | 168 | 130 | 63  | 11  | 23  |
| <u>Advertising</u>   |     |     |     |     |     |     |     |     |     |     |
| Budgeted advertising expenditures.                                 | 48  | 180 | 138 | 100 | 180 | 90  | 120 | 46  | 11  | 19  |
| Projected growth in sales as a result of advertising.              | 56  | 165 | 136 | 112 | 196 | 96  | 104 | 43  | 11  | 19  |
| <u>Natural Resources</u>   |     |     |     |     |     |     |     |     |     |     |
| Projected exploration expenditures.                                | 100 | 74  | 75  | 49  | 96  | 138 | 123 | 57  | 177 | 22  |
| Forecasted change in natural resources.                            | 109 | 202 | 74  | 67  | 110 | 163 | 83  | 63  | 19  | 24  |
| <u>Capital Expenditures</u>  |     |     |     |     |     |     |     |     |     |     |
| Planned capital expenditures.                                      | 706 | 218 | 28  | 14  | 43  | 158 | 134 | 78  | 26  | 27  |
| Increase in plant capacity due to capital expenditures.            | 187 | 223 | 88  | 17  | 52  | 173 | 104 | 86  | 22  | 28  |
| Proposed method of financing capital expenditures.                 | 215 | 197 | 134 | 20  | 57  | 156 | 111 | 81  | 33  | 26  |
| <u>Corporate Acquisitions</u>                                      |     |     |     |     |     |     |     |     |     |     |
| Costs of prospective acquisitions.                                 | 233 | 157 | 44  | 31  | 192 | 151 | 97  | 74  | 26  | 25  |
| Effect of acquisitions on future costs and sales.                  | 74  | 162 | 32  | 31  | 98  | 130 | 115 | 72  | 25  | 26  |
| Proposed method of financing acquisitions.                         | 242 | 146 | 45  | 34  | 82  | 161 | 90  | 76  | 31  | 25  |
| <u>Inventories</u>   |     |     |     |     |     |     |     |     |     |     |
| Forecasted change in physical inventories.                         | 65  | 173 | 125 | 100 | 176 | 67  | 120 | 63  | 19  | 18  |
| Anticipated price changes of materials.                            | 81  | 198 | 102 | 85  | 167 | 97  | 102 | 50  | 28  | 19  |
| <u>Dividend Policy</u>   |     |     |     |     |     |     |     |     |     |     |
| Details of proposed cash dividend.                                 | 238 | 158 | 39  | 33  | 81  | 216 | 51  | 49  | 57  | 14  |
| Details of proposed stock dividend.                                | 232 | 152 | 48  | 36  | 85  | 215 | 49  | 49  | 56  | 14  |
| <u>Future Financing</u>  |     |     |     |     |     |     |     |     |     |     |
| Rental payments and other details of anticipated long-term leases. | 123 | 27  | 83  | 47  | 131 | 76  | 53  | 34  | 105 | 77  |
| Details of proposed stock issues.                                  | 254 | 159 | 78  | 28  | 122 | 177 | 66  | 74  | 71  | 113 |
| Anticipated pledging of assets for long-term debt.                 | 158 | 161 | 55  | 51  | 123 | 123 | 32  | 33  | 32  | 32  |
| Future effects of conversion features of debt or preferred stock.  | 244 | 173 | 32  | 18  | 57  | 31  | 90  | 36  | 111 | 113 |
| Schedule of future debt payments.                                  | 187 | 135 | 37  | 32  | 121 | 137 | 122 | 121 | 127 | 123 |

7. If projected financial information, such as budgets, profit plans, or cash forecasts were disclosed in published corporate annual reports, do you feel that a CPA should examine this data and offer some form of an opinion based upon his examination?

Yes 161 No 317

8. Assuming a CPA would be required to express an opinion on projected financial information included in published corporate annual reports, the content of such an opinion should: (Check as many as desired)

196 Include a statement as to the accuracy of the calculations  
216 in preparing the forecasts.  
404 Include a statement as to the fairness of the assumptions  
on which the forecasts were based.  
89 Include a statement that he (the CPA) is in no way guaranteeing the  
realization of the forecasts.  
       Include a statement that he (the CPA) does share responsibility  
with management for the preparation of the forecasts.

In the above you were asked to offer your opinion on questions which could involve substantial discussion. If you desire to comment further on these questions, please use the back side of the questionnaire. An elaboration would be helpful.



APPENDIX C

COVER LETTER AND SURVEY RESULTS OF QUESTIONNAIRES  
TO CHARTERED ACCOUNTANTS

Although there are numerous demands on your time will you please take a few minutes for a task which might result in the improvement of reporting practices in corporate annual reports?

I am conducting an investigation into the opinions of Chartered Accountants regarding the adequacy of disclosure of projected financial information in published annual reports. The study is being made under the direction of the accounting faculty of Louisiana State University at Baton Rouge (U. S.) and is in partial fulfillment of the doctoral requirements of the university.

Answers to the attached questionnaire will provide valuable information in determining the viewpoints of members of the Institute of Chartered Accountants in England and Wales on this important subject.

It will be greatly appreciated if you would complete the questionnaire and return it at your earliest convenience in the enclosed envelope provided for your use.

If you desire the results of the study, please sign the questionnaire; however, omitting your signature will retain your anonymity. In either case, all information will be kept in strict confidence.

Thank you very much.

Sincerely,

Robert J. Keller, CPA

## QUESTIONNAIRE TO ACCOUNTANTS

1. In your opinion, do you feel that published corporate annual reports generally disclose adequate financial information to investors? Yes 131 No 246

2. Below are the various sections usually found in corporate annual reports. Please indicate the degree of usefulness you believe each section would be to an informed investor by checking the appropriate box.

|   | Very Useful | Useful | Of Little Use | Of No Use |
|---|-------------|--------|---------------|-----------|
| President's Letter                            | 89          | 177    | 103           | 18        |
| Highlights Section                            | 90          | 190    | 85            | 11        |
| Balance Sheet                                 | 255         | 174    | 18            |           |
| Income Statement                              | 257         | 108    | 21            | 1         |
| Statement of Source and Use of Funds          | 227         | 125    | 32            | 3         |
| Footnotes to the Financial Statements         | 191         | 162    | 30            |           |
| Historical Operating and Financial Statistics | 86          | 207    | 82            | 9         |
| Organization Charts                           | 26          | 118    | 191           | 52        |

3. In your opinion, should financial information relating to the future plans and goals of the corporation be disclosed in published corporate annual reports? Yes 264 No 126

4. In the following are forecasted statements which might appear in published corporate annual reports. Please indicate if you believe these statements should be included as a part of the reports by checking the appropriate box.

|   | Definitely Should Be Included | Possibly Should Be Included | Should Not Be Included |
|---|-------------------------------|-----------------------------|------------------------|
| Projected Balance Sheet   | 78                            | 150                         | 153                    |
| Projected Income Statement  | 132                           | 134                         | 112                    |
| Statement of Source and Use of Funds  | 172                           | 117                         | 96                     |
| Statement of Anticipated Growth of the Firm (sales, human and physical resources) | 134                           | 152                         | 99                     |
| Statement of Use of Natural Resources   | 76                            | 172                         | 136                    |

5. If you believe the above statements should be included in published corporate annual reports, please indicate the length of period that should be covered by the statements by checking the appropriate box.

|   | 1 Year | 2 Years | 3 Or More Years |
|---|--------|---------|-----------------|
| Projected Balance Sheet   | 155    | 70      | 31              |
| Projected Income Statement  | 152    | 82      | 42              |
| Statement of Source and Use of Funds  | 138    | 88      | 60              |
| Statement of Anticipated Growth of the Firm (sales, human and physical resources) | 87     | 67      | 122             |
| Statement of Use of Natural Resources   | 81     | 58      | 106             |



Listed below are items of information relating to the future of a firm which might be important to an informed investor. Please indicate the degree of importance you would expect an investor to place on each item by checking the appropriate box under columns 1 through 4. Also, please indicate where you believe the item should be disclosed in the annual report, if at all, by checking the appropriate box under columns 5 through 10.

|   | Degree of Importance |     |     |     | Disclosure Policy |     |     |     |    |    |
|---|----------------------|-----|-----|-----|-------------------|-----|-----|-----|----|----|
|   | VI                   | MI  | FU  | U   | ND                | PL  | PS  | SS  | SF | O  |
| <b>Sales and Earnings</b>   |                      |     |     |     |                   |     |     |     |    |    |
| Expected sales breakdowns by product, territory, or division.         | 140                  | 128 | 68  | 47  | 123               | 22  | 140 | 79  | 12 | 2  |
| Expected contribution margins by product, territory, or division.     | 137                  | 118 | 67  | 45  | 123               | 19  | 138 | 76  | 9  | 2  |
| Anticipated price increase of products.                               | 111                  | 133 | 71  | 57  | 169               | 58  | 86  | 45  | 10 | 14 |
| Forecasted volume of future sales.                                    | 206                  | 126 | 22  | 14  | 57                | 71  | 174 | 57  | 5  | 14 |
| Backlog of orders to be filled.                                       | 118                  | 137 | 67  | 32  | 103               | 88  | 77  | 59  | 26 | 2  |
| Estimated earnings per share of common stock.                         | 281                  | 66  | 21  | 9   | 44                | 91  | 121 | 67  | 50 | 14 |
| <b>Human Resources</b>  |                      |     |     |     |                   |     |     |     |    |    |
| Estimated employee turnover data.                                     | 45                   | 95  | 117 | 103 | 176               | 32  | 51  | 69  | 23 | 3  |
| Anticipated change in company's policies regarding employees.         | 51                   | 113 | 123 | 76  | 124               | 113 | 40  | 41  | 11 | 5  |
| Estimated pension fund costs.   | 30                   | 98  | 154 | 75  | 143               | 19  | 77  | 79  | 36 | 14 |
| Future effect of wage increases due to pending union agreement.       | 160                  | 123 | 24  | 21  | 71                | 113 | 103 | 45  | 16 | 5  |
| Anticipated change in employment contracts of directors and officers. | 120                  | 123 | 75  | 28  | 79                | 117 | 49  | 65  | 29 | 5  |
| Programmed future cost for the training and retraining of employees.  | 29                   | 101 | 15  | 103 | 127               | 50  | 33  | 154 | 22 | 10 |
| Common shares owned by officers and directors.                        | 203                  | 113 | 34  | 7   | 127               | 37  | 55  | 154 | 11 | 10 |

|  | V   | WT  | F   | T  | N   | PL  | PS  | SS  | SF | O  |
|--|-----|-----|-----|----|-----|-----|-----|-----|----|----|
| <b>Future Acquisitions and Development</b>                         |     |     |     |    |     |     |     |     |    |    |
| Included to match and supplement expenditures.                     | 170 | 173 | 20  | 14 | 60  | 75  | 132 | 179 | 13 | 4  |
| Anticipated new products or patents.                               | 132 | 153 | 35  | 23 | 115 | 114 | 96  | 44  | 6  | 6  |
| Estimated increase in sales due to new products.                   | 166 | 162 | 26  | 23 | 90  | 83  | 134 | 56  | 9  | 5  |
| <b>Advertising</b>   |     |     |     |    |     |     |     |     |    |    |
| Budgeted advertising expenditures.                                 | 46  | 117 | 119 | 98 | 181 | 21  | 107 | 56  | 9  | 6  |
| Projected growth in sales as a result of advertising.              | 60  | 147 | 90  | 87 | 163 | 36  | 110 | 60  | 5  | 10 |
| <b>Natural Resources</b>   |     |     |     |    |     |     |     |     |    |    |
| Projected exploration expenditures.                                | 123 | 140 | 76  | 47 | 107 | 71  | 127 | 63  | 13 | 3  |
| Forecasted change in natural resources.                            | 116 | 133 | 80  | 46 | 110 | 95  | 89  | 63  | 14 | 6  |
| <b>Capital Expenditures</b>  |     |     |     |    |     |     |     |     |    |    |
| Purchased capital expenditures.                                    | 260 | 100 | 6   | 5  | 32  | 64  | 145 | 87  | 42 | 1  |
| Increase in plant capacity due to capital expenditures.            | 202 | 124 | 26  | 24 | 76  | 84  | 120 | 69  | 26 | 1  |
| Proposed method of financing capital expenditures.                 | 243 | 103 | 23  | 10 | 153 | 96  | 123 | 71  | 17 | 5  |
| <b>Corporate Acquisitions</b>                                      |     |     |     |    |     |     |     |     |    |    |
| Costs of prospective acquisitions.                                 | 258 | 87  | 11  | 22 | 114 | 97  | 97  | 55  | 11 | 4  |
| Effect of acquisitions on future costs and sales.                  | 247 | 103 | 9   | 23 | 104 | 97  | 106 | 57  | 14 | 4  |
| Proposed method of financing acquisitions.                         | 242 | 104 | 17  | 8  | 83  | 116 | 95  | 57  | 15 | 4  |
| <b>Inventories</b>   |     |     |     |    |     |     |     |     |    |    |
| Forecasted change in physical inventories.                         | 55  | 156 | 95  | 66 | 152 | 19  | 102 | 72  | 25 | 2  |
| Anticipated price changes of materials.                            | 67  | 147 | 101 | 62 | 145 | 44  | 94  | 70  | 22 | 2  |
| <b>Dividend Policy</b>   |     |     |     |    |     |     |     |     |    |    |
| Details of proposed cash dividend.                                 | 79  | 74  | 16  | 6  | 39  | 141 | 65  | 55  | 48 | 5  |
| Details of proposed stock dividend.                                | 273 | 74  | 17  | 7  | 33  | 151 | 68  | 57  | 45 | 5  |
| <b>Future Financing</b>  |     |     |     |    |     |     |     |     |    |    |
| Rental payments and other details of anticipated long-term leases. | 126 | 149 | 51  | 43 | 124 | 136 | 62  | 51  | 20 | 2  |
| Details of proposed stock issues.                                  | 113 | 121 | 77  | 67 | 134 | 68  | 158 | 39  | 18 | 1  |
| Anticipated pledging of assets for long-term debt.                 | 24  | 113 | 15  | 11 | 35  | 37  | 153 | 32  | 13 | 1  |
| Future earnings of corporation less as of date of proposed stock.  | 242 | 112 | 24  | 11 | 13  | 23  | 122 | 32  | 11 | 1  |
| Schedule of future debt payments.                                  | 178 | 143 | 17  | 11 | 71  | 114 | 123 | 57  | 43 | 1  |

7. If projected financial information, such as budgets, profit plans, or cash forecasts were disclosed in published corporate annual reports, do you feel that a CA should examine this data and offer some form of an opinion based upon his examination?  
Yes 237 No 153

8. Assuming a CA would be required to express an opinion on projected financial information included in published corporate annual reports, the content of such an opinion should: (Check as many as desired)

216 Include a statement as to the accuracy of the calculations in preparing the forecasts.

262 Include a statement as to the fairness of the assumptions on which the forecasts were based.

313 Include a statement that he (the CA) is in no way guaranteeing the realization of the forecasts.

85 Include a statement that he (the CA) does share responsibility with management for the preparation of the forecasts.

In the above you were asked to offer your opinion on questions which could involve substantial discussion. If you desire to comment further on these questions, please use the back side of the questionnaire. An elaboration would be helpful.

## REPLIES TO "OTHER" FOR THE THREE QUESTIONNAIRES

Expected sales breakdowns by product, territory, or division.

Highlights section, separate narrative section, director's report, discussion with management, background report.

Expected contribution margins by product, territory, or division.

Highlights section, news releases, directors report, prospectus.

Anticipated price increase of products.

Footnote to projected statement, news letter, footnote to supplemental schedule or projected statement.

Forecasted volume of future sales.

Prospectus, highlights section, news letter.

Backlog of orders to be filled.

Highlights section, prospectus.

Estimated earnings per share of common stock.

News releases, prospectus, income statement.

Estimated employee turnover data.

Highlights section, statistical section, future operations section, special report, general company section, forecast schedule.

Anticipated change in company's policies regarding employees.

Separate statement, highlights section, financial highlights, forecast schedule, statement of labor relations, special section.

Estimated pension funds costs.

Forecast schedule, highlights section, footnote to SS or PS, general company section.

Future effect of wage increases due to pending union agreement.

Section on employee trends, footnote to PS or SS, highlights section, future operations, forecast schedule, director's report.

Anticipated change in employment contracts of directors and officers.

Forecast schedule, director's report, financial highlights, newsletter, footnote on PS, general company section, supplemental statistics, proxy statement.

Programmed future cost for the training and recruiting of employees.

Separate statement, highlights section, statistical section, footnote to PS or SS, general discussion, proxy statement.

Common shares owned by officers and directors.

Footnote to financial statement and proxy, separate section, SEC report, forecast schedule director's report, notice of annual meeting, footnote to projected statement, highlights section.

Expected research and development expenditures.

News release, schedule to PS, general narrative, special section.

Anticipated new products or patents.

Special section, PS comments, footnote to PS, narrative section.

Estimated increase in sales due to new products.

News release, schedule to PS, highlights section, footnote to PS, prospectus.

Budgeted advertising expenditures.

Funds statement, financial highlights, footnote to PS or SS, budget section, public relations section.

Projected growth in sales as a result of advertising.

Budget section, public relation section, footnote to PS, highlights section, narrative section.

Projected exploration expenditures.

Directors report, highlights section, budget section, narrative, supplemental to projected statement, quarterly reports.

Forecasted change in natural resources.

Footnote to PS, highlights section, narrative reports, quarterly reports.

Planned capital expenditures.

Schedule to PS, general narrative, special section, footnote to PS, financial section.

Increase in plant capacity due to capital expenditures.

Footnote to PS, finance section, special section, narrative section, highlights section.

Proposed Method of financing capital expenditures.

Schedule to PS, highlights section, footnote to PS, finance section, budget section.

Costs of prospective acquisitions.

Footnote to PS, financial highlights, general narrative, budget section.

Effect of acquisitions on future costs and sales.

Financial highlights, schedule to PS, narrative, footnote to PS, budget section.

Proposed method of financing acquisitions.

Footnote to PS, proxy statement, verbally, highlights, budget section, footnotes to SS.

Forecasted change in physical inventories.

Financial highlights, schedule to PS, highlights, narrative, funds statement.

Anticipated price changes of materials.

Financial highlights, budget section, narrative report.

Details of proposed cash dividends.

Letter, public relations, prospectus, highlights section, income statement, directors report.

Details of proposed stock dividend.

Financial statement, income statement, directors report, highlights, narrative report, letter, SS.

Rental payments and other details of anticipated long-term leases.

Footnote to SS, company commentary, highlights, separate section, PS, narrative report.

Details of proposed stock issues.

Source and use of funds, highlights, comments, SEC, budget section, narrative report, financial section, S-1, footnote to PS, prospectus, public relations.

Anticipated pledging of assets for long-term debt.

Letter, footnote to PS or SS, highlights, separate section, finance schedule.

Future effects of conversion features of debt or preferred stock.

Statistical section, highlights, separate section on future operations, finance section, SS to PS, letter, income statement.

Schedule of future debt payments.

Funds statement statistical section, highlights section, budget section.

APPENDIX D

LETTER REQUESTING CORPORATE ANNUAL REPORT



Dear Sir:

Please consider this a request for a copy of your 1971 annual report.

I am writing a dissertation for the Ph.D. at Louisiana State University at Baton Rouge and a part of my research involves statistical analysis of randomly selected annual reports of major corporations throughout the nation.

If you could furnish me with your latest report, it would be greatly appreciated. Please send the report to:

Robert J. Keller, CPA  
Associate Professor of Accounting  
F. T. Nicholls State University  
Thibodaux, Louisiana 70301

Sincerely,

Robert J. Keller, CPA

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## VITA

Robert John Keller was born January 16, 1936, in New Orleans, Louisiana. He was graduated from the College of Business Administration of Tulane University in 1957. In 1965, he received the Masters of Business Administration degree from Loyola University in New Orleans.

After ten years of practicing accounting in industry and as a Certified Public Accountant, he entered the doctoral program in accounting at Louisiana State University. He spent two years at that institution and received an assistantship during that time.

The following four years were spent teaching accounting at Nicholls State University in Thibodaux, Louisiana, and at Loyola University in New Orleans, a position he currently holds.

**EXAMINATION AND THESIS REPORT**

Candidate: Robert John Keller

Major Field: Accounting

Title of Thesis: Disclosure of Projected Financial Information in Corporate Annual Reports

Approved:

Daniel T. Kyle  
Major Professor and Chairman

James G. Traynham  
Dean of the Graduate School

EXAMINING COMMITTEE:

W. E. Sykes

Don L. Woodland

Edmund R. Gray

Leslie J. Morris

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Date of Examination:

July 5, 1973