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How Was That Again?

Convoluting language in financial reports reduces the accuracy of analysts' forecasts while boosting their influence on investors.

A study in the ***American Accounting Association's Accounting Review*** found "less readable 10-Ks [regulatory financial statements] are associated with ... lower accuracy and greater overall uncertainty in analyst earnings forecasts."

Ironically, overly complex reports create greater investor demand for analysts to weigh in, so more analysts follow these firms and they have a greater influence on investors, said Feng Li of the University of Michigan.

Prof. Li and two colleagues applied the fog index, which measures linguistic and syntactic complexity, to 33,000 corporate 10-Ks. The mean fog score of the samples was 19.53, well above the level considered to be plain English. The Wall Street Journal, for example, has a Fog score of about 12.

The professors found that while less-readable reports attract more analysts, the increase in coverage slows at high levels of complexity that "the analysts give up."

It took the analysts about 10 to 15 per cent longer to issue reports on the more complex filings, which is "likely to be economically important given the rapid pace at which markets impound new information," said Prof. Li.

"In sum," he said, "corporate reports that are difficult to read stymie not just average investors, but analysts as well."