



Voluntary disclosures in corporate annual reports — More than meets the eye

Companies have increased latitude in what to disclose. It is important not to overlook voluntary disclosures when preparing, reviewing, or reading an annual report.



By Merridee Bujaki and Bruce McConomy

As professional accountants, most of us have some involvement with annual reports issued by publicly-traded corporations. Accountants in industry may help prepare annual reports; auditors read annual reports to ensure consistency with the audited financial statements; and management accountants read annual reports issued by companies whose shares they own. While many of the disclosures included in annual reports are mandatory — according to provincial securities legislation, including the management's discussion and analysis (MD&A) and audited financial statements — most of the other information included falls under the definition of voluntary disclosure.

Even within the MD&A, management need to make decisions about what to disclose and how to disclose it. For example, the Ontario Securities Commission (OSC) encourages companies to provide a balanced discussion of their results as part of the MD&A, including discussion of items such as liquidity, off balance sheet financing, and trends

and risks that may affect the current (and future) results of the company. Similarly, MD&A disclosures should help financial statement users assess the quality of the company's earnings and cash flows. Companies need to make choices about what is required to be disclosed under the MD&A, versus what is desirable. In a recent "unofficial consolidation" of amendments to its continuous disclosure requirements, the OSC suggests companies focus their MD&A on material information. For example, managers should consider whether a reasonable investor's decision to buy, sell or hold your company's securities would be influenced if the information being considered for disclosure was omitted or misstated. If so, the information is likely material.

If we look beyond the required disclosures in a company's financial statements and MD&A, companies have increased latitude in what to disclose. It is important not to overlook these voluntary disclosures when preparing, reviewing, or reading an annual report. In fact, some researchers have suggested that these disclosures may be particularly



informative because management has an opportunity to choose what to include.

Voluntary disclosures in corporate annual reports include everything from the letter to shareholders to photographs. There is considerable research that suggests the letter to shareholders is the most widely read section of annual reports.

Management accountants need to read voluntary disclosures in corporate annual reports with a critical eye.

Letters to shareholders

Prior research suggests letters to shareholders help reveal a corporation's values, priorities, and even expectations for the future. A number of authors — including accounting researchers and researchers of business communications — have looked at the language used in the letter to shareholders to evaluate whether the author's choice of language differs

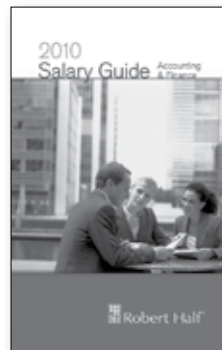
when performance changes, from reporting a net income to a net loss; whether the level and complexity of language increases when the corporation has bad news to report; and whether a CEO's choice of metaphors reveal his or her priorities for the corporation or, in some cases, avoid accountability.

In 2006, Joel Amernic, of the Rotman School of Management at the University of Toronto and Russell Craig, professor at the National Graduate School of Management at the Australian National University published *CEO-Speak: The Language of Corporate Leadership* which explores the unspoken messages in many speeches, letters, and communiqués. We used their research to examine the use of metaphors found in letters to shareholders issued by Nortel Networks Corporation from 1997 to 2006.

Nortel is an interesting corporation to study because it's both one of Canada's greatest corporate successes and one of its greatest failures. Four very different CEOs headed Nortel: John Roth (1997-2000), Frank Dunn (2001-2002), Bill Owens (2003-2004), and Mike Zafirovski (2005-2006).



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After reading Nortel's letters to shareholders and examining the metaphors used by each CEO to describe Nortel's relationships, successes, challenges, plans, and priorities, we found common metaphors: business as a journey, business as movement or change, business as a vision, business as relationships; and business "under construction." We also found some variability year by year and between each CEO. In 1999, John Roth wrote about the new millennium and opportunities emerging with the Internet. He used a number of metaphors dealing with time, science, change, and revolution. Roth made comparatively few references to health and the law — they were just not relevant at that time. In 2001 and 2002, just after the tech bubble burst and Nortel's share price plummeted, Frank Dunn discussed the need for Nortel to have a vision and to continue on its journey. Dunn, however, made few references to relationships — an area he was reputed to be less comfortable with. Bill Owens, Dunn's successor, was faced with numerous shareholder lawsuits — and his use of a legal metaphor in 2004 reflects this. Owens' background as an admiral in the U.S. military is also revealed by his use of terminology that invokes a war metaphor. Mike Zafirovski's letters to shareholders build upon his own reputation for team building, as reflected in his use of metaphors addressing relationships and sports. Zafirovski's letters to shareholders are also remarkable for their comparatively limited use of construction metaphors. Given Zafirovski subsequently presided over Nortel's break up; it is perhaps not surprising that he rarely invoked building metaphors.

In the case of metaphors, the CEO's choices frequently reveal something about his or her personality and may suggest the future direction for the corporation.

Photographs in annual reports

In a separate research project, we examined photographs included in the 2003 annual reports for all TSX100 corporations. We evaluated the number of photographs in each annual report and looked in detail at the information conveyed by each picture. We found 92 per cent of annual reports included pictures, with an average of 29 pictures in each, though this varies considerably by industry. Almost 60 per cent of all annual report photographs were of people. Consistent with prior research, women are significantly

underrepresented in annual report photographs relative to their workforce participation rates. We also examined whether the inclusion of women on the board of directors and women in annual report photographs are associated with corporate financial performance. Corporations with a higher percentage of women in their photographs tend to have a higher percentage of women on their boards of directors and higher rates of return on equity.

Implications

These disclosures — either the choice of metaphors or the choice of photographs — say something, sometimes explicitly, and sometimes implicitly, about the values and priorities of the corporation. In the case of metaphors, the CEO's choices frequently reveal something about his or her personality and may suggest the future direction for the corporation. The choice of photographs may telegraph to women and men expectations about the roles they are expected to play in the corporation, and indeed, in society more generally. This may discourage some individuals from seeking employment or advancement in the corporation, limiting the talent pool available to the company and restricting its competitiveness.

Management accountants need to read voluntary disclosures in corporate annual reports with a critical eye. The voluntary disclosure literature asserts that disclosure choices are made to ensure the benefits derived from the disclosures exceed the costs. When we read, review, or advise on the preparation of corporate annual reports, we should be asking ourselves why management might choose a particular turn of phrase or metaphor and why particular photographs were selected or commissioned for inclusion in the annual report. Advisors should be on the lookout for unspoken, and possibly unintended, meanings in the CEO's use of metaphors or pictures — they can ensure the annual report conveys a clear and consistent message.

Lastly, readers of annual reports should assess whether the values depicted in the letter to shareholders and choice of photographs are consistent with other information included about the corporation, and carefully consider how the information collected from voluntary disclosures may be used to influence their investment, lending, and employment decisions. ■

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