IR WEB REPORT

U.S. large-caps have shoddy reporting practices, study finds

June 18, 2004
By Staff Reporter

Almost one-third of the leading publicly-traded companies file financial statements that do not accurately represent their true financial condition, according to a study conducted by **RateFinancials Inc.**, an independent research firm specializing in rating financial reporting.

An analysis of financial filings of more than 120 companies in the S&P 500, representing close to 40 percent of the Index's market capitalization, showed that obfuscating financial reporting remains pervasive in America.

RateFinancials said 32% of the companies it examined had a “below average” or “poor” rating in the subcategory of “Areas of Financial Concern & Quality of Earnings,” signaling an “inordinately high risk of existing or future financial problems and low overall quality of reported earnings.” Only 4 percent of the companies were rated outstanding, the firm said.

“Despite the provisions of Sarbanes-Oxley, investors cannot accurately evaluate the securities of a significant portion of companies in the S&P, based on their reported financial statements,” said Victor Germack, founder and president of RateFinancials. “It's abundantly clear that companies continue to concoct creative - and not so creative - measures to make it difficult, if not impossible, to get a clear sense of their financial condition.”

Among the findings:

- 75% of companies used complex financing devices to shift long-term financial obligations off their balance sheet. When these obligations are added to balance sheet debt it substantially increases leverage and leads to dramatic swings in a firm's debt-to-equity ratio.
- 64% made unreasonable assumptions and forecasts when calculating future pension liabilities. Although many companies run large long-term funding deficits within their pension plans, GAAP accounting allows companies to post net positive pension assets. This happens despite the obvious economic liabilities reflected by the plans' underfunded status.
- 28% used aggressive revenue recognition techniques. These methods often allow companies to post revenue from transactions well before goods and services have been provided or cash payment is expected.
- 47 % of the financial statements were rated as being average or “acceptable.”
- 14 % were rated “below average”
- 1% were rated “poor.”
- 35% were rated “superior.”
- 3% were rated as “outstanding.”

Among the largest market capitalization companies whose filings were rated overall “below average” were: Archer Daniels Midland, Halliburton, Best Buy, Bristol Myers Squibb, Corning, Eastman Kodak, EDS, Gap, Janus Capital, Motorola, and the Walt Disney Company.

Companies rated “average or acceptable” included: Lowe's Companies, Boeing, Polo Ralph Lauren, Du Pont, Intel, EMC, Medtronic, Merrill Lynch and Alcoa.

Major companies whose financial statements were rated “outstanding” included: BMC Software, Family Dollar Stores and Microsoft.

In evaluating companies' financial reporting, New York-based RateFinancials uniformly examines a variety of critical measures including: quality of earnings, overall accounting polices, corporate governance, clarity and completeness of both footnotes and the management's discussion and analysis.