REUTERS
KNOW. NOW.

REUTERS NEWS SERVICE

Accounting Still Vague 2 Years after Reforms – Study

June 17, 2004
By Arindam Nag

Nearly two years after U.S. authorities stepped in to clean up corporate reporting following a series of scandals, many companies' financial statements still fail to paint a clear picture of their condition, a study released on Thursday said.

In fact, an "alarming" 75 percent of the 120 companies studied by independent research firm RateFinancials persist in using off-balance sheet financing. The disintegration of energy trader Enron Corp. in 2001 owed a lot to complex off-balance sheet transactions that were hidden from investors.

The study, which looked at about one-quarter of the members of the Standard & Poor's 500 index, estimates that about a third of big public companies still practice "obfuscating financial reporting." Sixty-four percent made unreasonable assumptions of pension fund liabilities and 28 percent used "aggressive" revenue-recognition techniques, the study said.

The New York firm, which specializes in rating financial reporting, rated 32 percent of the companies in the study as "below average" or "poor" for quality of earnings.

Only 4 percent earned an "outstanding" rating -- including BMC Software Inc., Family Dollar Stores Inc. and Microsoft Corp. RateFinancials credited them for strong corporate governance, clarity and thoroughness in detailing accounting policies, footnotes, and management discussion and analysis of operations.

"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.

"We can predict with a high degree of certainty that the ominous trend of earnings surprises and restatements will continue for the foreseeable future and that investors should be wary when purchasing securities," Germack said.

U.S. authorities introduced reforms requiring greater disclosure and stricter audit controls two years ago after investors lost billions, including from such scandals as the bankruptcies of telecommunications companies WorldCom (now MCI) and Global Crossing Ltd.

The reforms, unveiled under the Sarbanes-Oxley Act, were an attempt to curb aggressive accounting and mismanagement and force directors to be more accountable to shareholders.

But RateFinancials researchers, all former investors or researchers on Wall St., say serious flaws remain. Its analysts do not consult the management of companies they review, relying instead solely upon public information.

"We look for accounting policies, we define quality of earnings as whether the reported earnings should be taken at face value," said Allan Young, a managing director at the firm. "Is it a clear indicator of future economic value?"

Among recent analyses, RateFinancials concluded that radio company Clear Channel Communications Inc.'s use of operating leases had the effect of understating liabilities. Clear Channel also was criticized for keeping $7.3 billion of goodwill on its balance sheet, inflating assets and making it appear less leveraged with debt.

A Clear Channel spokesman was not immediately available to comment.

In another case, RateFinancials noted that at retailer Costco Wholesale Corp. accounts receivable -- or the balance owed it by customers -- had risen 47.2 percent over the last three years while its reserves for bad receivables have fallen 23.1 percent.

Costco spokesman Richard Galanti said most of its receivables were linked to rebates from big suppliers. The company has not detailed that in its filings on this but would review its disclosure policy if this became an issue with investors, he said.