

CREATIVE DISCLOSURE: AN EXPERIMENTAL STUDY

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This empirical study extends the study conducted by Vladu, Grosanu and Cuzdriorean (2012) and reached similar conclusions. This particular research was conducted with the scope of assessing the impact of: positive bias, persuasive language, creative visual manipulation and performance comparisons over the unsophisticated users of accounting opinion. We have chosen this particular category since retail investors have been identified as relying on the information provided in corporate annual reports for decision making (Wills, 2008). Based on their relative inexperience and limited knowledge of these investors it is plausible that they can be misled easily comparing to more sophisticated users of accounting information, as financial analysts.

The main argument for conducting such a research is the fact that little research was conducted so far and the effects of creative disclosure on investment decision cannot be assessed so far. Based on this, we conducted a laboratory experiment where participants were provided with an informational set of financial data and required to make an investment decision. Our results document that the users' perceptions are strongly affected by creative disclosure, contradictory with previous results documented in the literature, that their opinion cannot be influenced since they rely mostly on numerical information and less on the narrative segments of the financial statements. Even if our sample comprised few participants, we consider the results conclusive. A further research can extend the sample and test if our research hypothesis can be validated. Another possible spring of research can deal with the assessing of the opinion of the users of accounting information that are not considered unsophisticated, as financial analysts.

Keywords: Creative disclosure, Positive bias, Persuasive language, Creative visual manipulation, Performance comparisons

JEL Classification: M41

1. Introduction

Creative disclosure can be regarded as a complex mechanism that comprises: motives for engaging in manipulation of accounts, types of information disclosed and types of manipulations strictly connected to presentation of information. Further, both verbal and numerical information can be comprised in the area of creative disclosure. Each of these strategies are not part of an objective disclosure choice moreover are based on subjectivity and bias. The scope of creative presentation is to present the financial information in the best light possible (or sometimes in a very negative light, depending on the management objectives) by comprising only certain items that flatter the final results. The items that don't portray the desired image are omitted from presentation and if there is mandatory to disclose them, will be presented in a very subtle way. In this respect the so-called in the literature "Pollyanna principle" (Hildebrandt and Snyder, 1988) can be the ultimate foundation for this demarche.

Courtis (2004) referring to a creative manner used to make the text of financial presentation difficult to read and interpret, asserted that this particular manner is designed to obscure the intended message, to distract or confuse the readers and further empirical studies proved that its arguments were correct (Wills, 2008). On the other hand, there were studies that rejected any connection between creative disclosure and user's perceptions. Since we found contradictory

views in the literature, our study was design to bring new insights regarding this spring of research. In this respect, our study documents the results of an laboratory experiment designed to isolate the effects of positive bias manipulation, persuasive language, creative visual manipulation and performance comparisons and assess their effect upon the user's perceptions that further are transformed in investment decisions. By determining the effects of creative disclosure features and its power regarding the users perceptions we can conclude regarding the decision making process and further about the risk of making unwise investment by unsophisticated users of accounting information (Smith, 2004).

2. State of the art

Courtis (1995) approaching the difficulty to read some corporate reports concluded that only two possibilities can be invoked in such cases by the following: "whether writing which is difficult to read is executed deliberately to mask some unfavorable aspect of corporate behavior, or is performed unwittingly out of ignorance". On the other hand Clatworthy and Jones (2001) attribute exclusively the reading difficulty to managerial manipulation since they consider that the lack of skill cannot be invoked in this context since corporate reports are written by professionals. Rutherford (2003) asserted that preparers that are willing to manipulate the user's opinion have the possibility to manage the transparency of financial information by minimizing the clarity of certain items that are disclosed. Another root for creative disclosure appearance is identified by Llewellyn and Milne (2007), as the codification of the accounting language, that "turns out to be a less than perfect solution". "Positive bias" (Lang and Lundholm, 2000) is not only related to the manner in which disclosures are presented but also in the frequency of the positive or optimistic segments comprised in the annual reports. The study conducted by Lang and Lundholm (2000) found that the frequency of positive disclosure increased substantially before equity public offerings in order to increase the firm's share prices. One study that was focused on the language used by firms to transmit positive and negative earnings was the study conducted by Yuthas et al. (2002). The authors suggested that firms with earnings surprises use preponderantly items like "sincerity" and "clarity" to emphasize their honesty and trustworthiness, their tone being persuasive in respect of the financial strong performance of the firms. Enron engaged in this kind of manipulation and used persuasive language based on our understanding. In the Enron's Letter to Shareholders, Annual Report 2000 the language can be easily categorized as persuasive language as we can notice from the following:

- "Enron's performance in 2000 was a success by any measure, as we continued to outdistance the competition and solidify our leadership in each of our major businesses. In our largest business, wholesale services, we experienced an enormous increase of 59 percent in physical energy deliveries. Our retail energy business achieved its highest level ever of total contract value" (2000:4);

- "During our 15-year history, we have stretched ourselves beyond our own expectations. We have metamorphosed from an asset-based pipeline and power generating company to a marketing and logistics company whose biggest assets are its well-established business approach and its innovative people" (2000: 6-7);

- "Our results put us in the top tier of the world's corporations" (2000:7);

- "We plan to leverage all of these competitive advantages to create significant value for our shareholders" (2000:7).

The way information is disclosed visually speaking has the potential to influence the decisions. Creative visual effects can be used to underlie a part of the corporate report or an item in order to make it more obvious to users (e.g. figures, font style, size of the letters or numbers, color, etc.) (Courtis, 2004). Where there is willingness to present an item as being very important the first parts of the corporate reports can be chosen for such a demarche. When the item is considered to minimize the favorable direction that must be created and interpreted under the best light

possible, the last parts the corporate reports can be chosen or inserted in the most narrative part of the reports. By choosing to explain or underlie the importance only for some earnings numbers and intentionally omitting the ones that are not flattering the final results involve subjectivity and further manipulation of corporate reports. This particular creative presentation is related to manipulation of numerical disclosures. The main idea is that firms can manipulate the information disclosed using performance comparisons that flatter their performance. This type of manipulation is developed using either inside numerical information or external numerical information. As regarding of inside numerical information the lowest prior-period comparative benchmark earnings number can be chosen to report in this respect the highest year-on-year increase in earnings (Schrand and Walther, 2000).

The main goal of this research is to refocus the previously research questions found in the literature, that comprises the identification of the mainly forms of creative disclosure assessing the effects not of a certain form of impression management, but almost all features of creative disclosure. Also, based on the fact that the positive bias is a persuasive construction, the figures conveyed in the annual reports might be overlooked or insufficient examined by the unsophisticated users of accounting information (Henderson et al., 2004). In order to overcome this shortcoming, we introduced in our laboratory experiment also numerical manipulations, in order to test all features of creative disclosure not only certain features previously tested like positive bias or persuasive language.

3. Hypothesis development

Since the goal of this particular study is to document the cumulative effect of creative disclosure, on corporate annual report users' perception regarding the company performance, below we have developed our research question to match such demarche. Based on the fact that creative disclosure is documented as occurring in the corporate annual reports (Jameson, 2000), the hypothesis tested is concerned with the effect that this particular manipulation over the unsophisticated users of accounting information. In this respect the research hypothesis developed is:

H: Investment decisions taken by unsophisticated users of accounting information can be influenced by creative disclosure features like: positive bias, persuasive language, creative visual manipulation and performance comparisons.

4. Research design

Based on the fact that our research is investigating a causal relationship, the laboratory experiment was chosen as proper research design to test our above hypothesis. In this respect our experiment was conducted using 26 last year university students, whom we provided a set of information commonly found in annual reports, comprising information of two fictional companies and the third one, developed partially on the financial statements provided by Enron, and request them to make an investment decision. All the participants received an information pack containing either no creative disclosure features (control group), and respectively no creative disclosure and creative disclosure features (treatment group). In this respect two groups were formed and further their investment choice analyzed in order to observe the effect of manipulation on the participants investment choice.

Like previously conducted studies in the literature (Schulz, 1999; Courtis, 2004) in order to increase the internal validity of the study and to assess the causal effect of the positive bias manipulation, we chosen a randomized two group design comprising one control group and one treatment group, with 13 students each, like in the following table:

Table 1.Experimental design – randomized two group design

(1) Control group – 13 last year students	(2) Treatment group – 13 last year students
<p>2 set of financial information containing neutral language for company 1 and company 2.</p> <p>No positive bias language in order to manipulate their perception regarding the performance of the company. No performance comparisons, no creative visual manipulation and no persuasive language.</p>	<p>2 set of financial information as following:</p> <ul style="list-style-type: none"> - first set contains neutral language, no positive bias or persuasive language comprised in company 1 from the control group, also no creative visual manipulation and no performance comparisons. - <i>second set of financial information contains positive bias and persuasive language (taken from Enron 2000 annual report, examples above) to whom we attached creative visual manipulation and performance comparisons. All those features of creative disclosure was selected in order to see if we can affect their investment choice.</i>
<p><i>Students were asked to make an investment choice and to choose the company that they consider the most suitable one.</i></p> <p><i>Observation: We included in this respect also numerical manipulation not only narrative one, in order to test for all features of creative disclosure not only some of them.</i></p>	

Source: Authors projection

We have chosen this particular research design in order to allow all participants to be tested in the same time and location, reducing potential threats to internal validity of the experiment. The students were asked to choose between the informational sets provided, where each of them were developed in the Romanian language with the exception of the 2000 Enron annual report that was translated in the Romanian language and used as an example of persuasive language. The participants were last year students from accounting and finance unit and their were told that they have a limited amount of money (unspecified) and that they have the possibility to invest in one of the companies presented or to split the money and invest in both, case in which they will have to specify the proportion of the investment (e.g. 30% investment in company 1 and 70% investment in company 2). We provided two sets of data for each group, comprising Chairman's statement, four year summary of corporate annual reports. Both companies 1 and 2 from the control group and respectively company 1 from the treatment group have strong performance indicators, but to make the scenario more realistic we designed those companies as being proportionally 1.5 larger than company 2 from the treatment group in order to examine if only the creative disclosure has the potential to influence mainly their investment decision. Company 1 is similar in both groups, company 2 from the second group (e.g. the treatment group) is developed based on Enron, but the participants haven't been informed about it.

5. Results and discussions

As we asserted above, the goal of the study was to assess if creative disclosure features has the power to influence investment choices. The results obtained are presented below in table 2 as following:

Table 2. Results of the investment choices taken by the participants

Companies / Results obtained per each group	Control group (%) – single investment choice	Control group (%) – split investment choice	Treatment group (%) – single investment choice	Treatment group (%) – split investment choice
Company 1 – No creative disclosure features	42	12 (50%/50% investment in each company)	7	22 (30% in company 1 and 70% in company 3)
Company 2 – No creative disclosure features	46		Not tested in the treatment group	Not tested in the treatment group
Company 3 – Positive bias, persuasive language (Enron), creative visual manipulation and performance comparisons	Not tested in the control group	Not tested in the control group	71	22 (30% in company 1 and 70% in company 3)

Source: Authors projection

As can be observed based on the above results presented in Table 2, 42% of our participants from the control group decided to invest in company 1 while 46% of them decided to invest in company 2. The proportions are not significantly different. Only 12% of the participants from the control group decided to invest both companies, but equally as proportion. When it comes to the investment choices made by the participants from the treatment group, significant differences can be observed compared with the results obtained by the control group. Only 7% of our participants decided to invest in company 1 (where there is no influence of creative disclosure) based on the fact that company 1 is 1.5 larger compared with company 3 (e.g. based on Enron financial statements). A significant proportion (71%) decided to invest in company 3 (e.g. Enron), where creative disclosure features were comprised. More than that, a larger proportion compared with the participants from the control group decided to split their investment in both companies, but the proportions are significantly in favor of company 3. Based on the fact that company 1 and 2 present a neutral and non-persuasive utterance, and similar financial figures, the investment choices between them are equally split. In the treatment group, in order to make a distinction between the two companies and to offer a fair chance to each of them, we decided that since company 3 could have a competitive advantage based on the creative disclosure features, we designed company 1 to be larger as size (1.5 larger based on the financial information provided to participants). The significant proportion of the participants from the treatment group chosen company 3 as an investment choice. The only feature that could conduct to this choice in this respect is the presence of creative disclosure introduced under the manifestation of: positive bias, persuasive language, creative visual manipulation and performance comparisons that convinced them that the company is worth investing in.

6. Conclusions

The results of the experimental design conducted documented that significant difference between the investments choices of the participants occurred. Based on the results presented above, the participants exposed to creative disclosure features appear to be affected in their investment decisions in a significant manner, contradictory to Stanton et al. (2004) opinion. Personal traits of the participants did not differ across the groups and based on that should not be responsible for the results obtained. Since neutral and persuasive language, positive bias and creative visual

manipulation was presented equally, and the participants chosen the informational set that comprised the latter, it can be concluded that they can be misled by individual segments of the package, by the language used and by the creative visual manipulation. However since we haven't tested the same research path on other more sophisticated users of the accounting information the results must be treated with caution.

7. Limitations and scope for future research

One important limitation of the study can be related to the use of students as proxy for the unsophisticated or ordinary investors. Taking into accounting the opinion of Hoyle et al. (2002), this can threaten our internal validity experimental design since our participants could have been more vulnerable to effects of creative disclosure. On the other hand, previous studies conducted in the literature documented that students can be used as proxy since ordinary investors are young to middle age adults with limited knowledge of investment and business practices (Wills, 2008). This research can open a new path by focusing on the cumulative effects of creative disclosure used in the annual reports and their power to distort the decision making process. A future spring of research can test our research hypothesis on sophisticated users of accounting information as financial analysts.

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