1978

Forecasts Of Earnings: Empirical Studies Of Effects On Investment Analysts And Incidence In Canadian Annual Reports

Carson Michael Duncan

FORECASTS OF EARNINGS: EMPIRICAL STUDIES OF EFFECTS ON INVESTMENT ANALYSTS AND INCIDENCE IN CANADIAN ANNUAL REPORTS

by
Carson Michael Duncan

School of Business Administration

Submitted in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy

Faculty of Graduate Studies
The University of Western Ontario
London, Ontario
April, 1978

ABSTRACT

The accounting literature of the nineteen seventies has contained many views on whether public companies should be permitted or required to disclose forecasts of financial information. This thesis reports on two studies undertaken to shed light on two different aspects of the issue.

In the first study an experiment was conducted to test the effect of earnings forecasts in an annual report on investment analysts' predictions of earnings per share and stock price. The results indicated that the earnings forecasts did have an effect on the general level of analysts' forecasts. There was no strong evidence, however, that the forecasts had an effect on the confidence of analysts, or on the concensus among analysts. The conclusion was reached that the earnings forecasts were useful to the analysts.

In the second study 240 annual reports were examined to ascertain the incidence and nature of forecasts of company results. References to future results were categorized using a taxonomy specially developed for this purpose. It was found that forecasts were widespread in the sample, varied as to their form, and normally not very specific. The dominant pattern in the forecasts was one of strong predictions of increases, growth, or improvement. Of several company characteristics, only size and industry appeared to be related to the incidence of predictions of earnings increase. Predictions concerning next year's earnings were usually accurate, but no more accurate than predictions generated by simplistic rules.

ACKNOWLEDGEMENTS

A large number of persons and organizations have contributed directly or indirectly to the successful completion of this project.

Most important has been the assistance of the faculty and administration at the School of Business Administration, The University of Western Ontario. Special thanks to my thesis advisor, Professor T. Ross Archibald, whose assistance was instrumental in conducting the experiment and whose comments and suggestions improved the manuscript greatly.

The School's financial assistance, in the form of Richard Ivey Doctoral Fellowships and a Plan for Excellence Doctoral Fellowship, was invaluable. Financial support was also received from a Rio Algom Mines Doctoral Fellowship, a Canada Council Doctoral Fellowship, and from the governments of Nova Scotia and Canada.

The research could not have been undertaken without the cooperation of research directors and investment analysts at seven Canadian brokerage firms which will remain anonymous.

Eleanor Smith typed the later drafts and final copy of the thesis. Her cheerful competence is greatfully acknowledged.

Finally, I would like to thank several persons whose advice and encouragement have been instrumental in shaping my academic career or in completing this particular project.

John T. Sears, colleague at St. Francis Xavier University, was the first to encourage me towards an academic career. His support over the years has been most helpful.

Jacques Grisé and Brian Owen, fellow doctoral candidates at Western, were particularly helpful during the early stages of the thesis.

My father and late mother, George and Mary Duncan, made many sacrifices in the interest of my earlier university education. They have had an indirect but enormous influence in the completion of the present project.

My most grateful thanks go to Margaret, Jennifer, and Stephen, my wife and children. They could easily have been forgiven had they withdrawn their support for this project long ago. They have been entirely supportive throughout.

TABLE OF CONTENTS

TABLE OF CONTENTS--continued

LIST OF TABLES

LIST OF TABLES--continued

LIST OF TABLES--continued

LIST OF TABLES--continued

LIST OF TABLES--continued

LIST OF TABLES--continued

LIST OF FIGURES

LIST OF APPENDICES

CHAPTER I

BACKGROUND AND LITERATURE SURVEY

1. Introduction

It is generally accepted that Canadian society allows corporations to exist and operate in order to fulfill certain needs of society. Essentially, corporations are permitted to gain control of certain scarce resources and expected to efficiently convert these resources into goods and services of value to society. Corporations are able to gain control over scarce resources only because investors, i.e., shareholders and creditors, are willing to invest in the corporation in the hope of reasonable returns on their investments. To provide protection against loss for present and potential investors and to encourage efficient allocation of the country's resources, society insists that corporations periodically issue reports including certain information. The specifics of the reports vary depending upon whether the firm is public or private, and whether the firm is about to issue securities, but the general motive is the same. The motive is to provide actual and potential investors with information relevant for an appraisal of the firm and for an appraisal of the value of an investment in the firm.

For some time now, the basic reporting requirements have included an annual income statement and balance sheet based upon historical data. Although some have seriously questioned the usefulness of these traditional statements

(Ross, 1967), they are evidently thought by many to be at least somewhat useful for appraising the past operations of a firm and its financial position at a point in time (Backer, 1970; Financial Analysts Federation, 1972). Several suggestions for improving corporate disclosure have been put forward in recent years. Noticeable among these have been the concepts of current value accounting, general price level adjustments, segment reporting, accounting for human assets, and the disclosure of forecasts. It is the last-mentioned suggestion, i.e., that firms disclose forecasts, that is the subject of this thesis.

Various terms have been used in writing about the general topic of forecasts, e.g., earnings forecasts, budget disclosure, disclosure of future-oriented information, financial forecasts. Standardized terminology is not yet apparent in the discussion of the topic. The possible distinctions among the various terms is not important in this chapter, however, and the terms will be used interchangeably to refer to suggestions for more systematic public disclosure of corporate plans and results.

North American interest in the topic, as evidenced by writings in the financial literature, became widespread during the early nineteen seventies. Interest in Canada led to the major study by Kidd (1976) for the Canadian Institute of Chartered Accountants. That the interest remains high today is evident from the continuing research effort of the CICA (Thomas, 1977).

The reminder of this chapter provides a review of the literature on disclosure of forecasts and indicates the nature of the studies reported in this thesis.

2. Early Non-Empirical Literature

Cooper, Dopuch, and Keller (1968) credited Rice (1947) with being the first to suggest the value of firms' disclosing budget information. Cooper, Dopuch, and Keller concluded that there was no extensive support in 1968 for budgetary disclosure but that interest was growing. Their perception was correct. In the ensuing four years there appeared a number of articles dealing with the possibilities and problems of reporting budgets.

The context in which early authors suggested the disclosure of forecasts varied. So also did the specific suggestions as to type and format of information, and the role of the public accountant. The variety of concerns and suggestions of early writers was considerable.

Coughlan (1959) advocated the calculation of income by individual projects rather than by period of time. He argued that project assets should be valued at the present value of net receipts and that project income should be recognized as earned according to the rate of return for the individual project.

Birnberg and Dopuch (1963) developed a conceptual framework for disclosure which is at least implicitly accepted by all advocates of budget disclosure. Birnberg and Dopuch advocated that management articulate their goals and expectations and that results be reported in terms of these goals.

Green (1964) suggested disclosure of the year's expected fixed costs and contribution goal along with quarterly contribution targets and actual performance.

Wilkinson and Doney (1965) wrote from the perspective of enlarging the audit function so as to better serve as an audit of managerial performance. They suggested that the auditor should express an opinion on the reasonableness of management's forecast financial statements and that the auditor should evaluate management's past performance by analyzing the differences between expectations and realization.

For Cooper, Dopuch, and Keller (1968) the main interest in budget disclosure was in the perspective it provided regarding some alternatives for modifying existing accounting practice. They agreed with Wilkinson and Doney (1965) that pro forma financial statements should be disclosed. They suggested that the auditor should attest to management's explanation of the variances between actual and budget. They also suggested that perhaps capital budgets and other supplementary data should be included, and that interim reports and comparisons might be desirable if conditions changed significantly.

Pincus (1968) also argued for the updating of forecasts and suggested that forecasts be expressed as ranges to indicate a margin for error. Similarly, Morrison (1970) suggested the directors' probability distribution be published.

Mitchell (1969) and Solomon (1969) advocated the disclosure of budget financial statements, but Solomon urged the forecasts be restricted to prospectuses for the time being. Solomon also added that management's underlying assumptions and forecasting methods should also be disclosed.

The majority of early articles argued that budget financial statements, cast in the format of traditional historical statements, were the logical candidates for forecast disclosure. Edey, however, was cited by Tompkins (1969) as having urged in 1963 that management publish forecasted cash flows. Norr (1970) and Backer (1970) suggested planned capital expenditures should be disclosed. Norr claimed that investment analysts want this information and Backer indicated that bankers making long-term loans want it.

Several early authors commented on the possibility of public accountants' attesting to managements' forecasts, but few explored the problems in depth or made concrete suggestions for executing such an attestation (Mautz and Sharif, 1961; Roth, 1969; Stettler, 1968; Gibson, 1971; Wilkinson and Doney, 1965; Linowes, 1965; Nurnberg, 1971). Exceptions in this regard were Ijiri (1968), and Tompkins (1969). Ijiri took a conceptual approach, pointing out the need for budgeting principles and procedures and budget-auditing standards and procedures. Tompkins extended Ijiri's concepts somewhat.

The early literature generally suggested that the public accountants' role should be to attest that the projected financial statements follow logically from the underlying assumptions and that generally accepted accounting principles have been applied in a manner consistent with the previous year's historical statements. Morrison (1970) and Grenside (1970), however, commenting upon English accountants' attestation of profit forecasts, argued that English accountants should also pass judgement on the reasonableness of the assumptions. Nurnberg (1971) said the same from a North American perspective.

Many authors other than those cited above contributed to the early discussion by analyzing the pros and cons of forecast disclosure[1] or the possible extension of the public accountant's attest function.[2]

North American interest in forecast disclosure was heightened in the late sixties and early seventies by regulations and recommendations developed in the United Kingdom. The London Stock Exchange required forecasts in the prospectuses of firms listed or seeking listing; The City Working Party, a voluntary group of United Kingdom financial organizations, allowed forecasts in takeover bid circulars; and the Institute of Chartered Accountants of England and Wales issued recommendations to guide members in their involvement with corporate forecasts.

North American observers were kept informed by several authors who described the situation as it developed in the United Kingdom: Pacter (1969), Hicks and Johnson (1969), Graham (1969), Grenside (1970), Fraser (1971), and Gibson (1971).

3. More Recent Non-Empirical Literature

According to the Financial Analysts Federation's Special Committee on Corporate Forecasts (1973, p. 12) opinion in the United States favoring the broader dissemination of corporate forecasts was crystallized at the November 1971 Symposium on Ethics in Corporate Reporting (Burton, 1972). The broad concensus emerged that corporate forecasts was the most significant current issue in corporate disclosure to the investor and, coincident with the symposium, Securities and Exchange Commission Chairman Casey announced the SEC would undertake a review of its policy which prohibited forecasts in filings with the Commission.[3]

When it became obvious that the SEC might permit or require some kind of corporate forecasts various interest groups and academics stepped up their research of the issues. Presentations of the different points of view were made at the SEC Public Hearings in the Matter of Estimates, Forecasts or Projections of Economic Performance and Related Subjects, November 20 to December 12, 1972, and at a major conference on April 2 - 3, 1973 (Prakash and Rappaport, 1974).

The Financial Executives Research Foundation (1972) and the Financial Analysts Federation (1973) commissioned and published research studies which formed the foundations of their positions.

A number of articles discussed the question of legal liability arising from forecasts (Basi, 1976; Gillis, 1973; Herwitz, 1974; Mandel and Altschul, 1977; Sidley and

Austin, 1972).

Other authors continued the discussion of extending the public accountant's attest function (Carmichael, 1973, 1974; Committee on Basic Auditing Concepts, 1972, p. 30; Fess and Martin, 1973; Gormican, 1973; Kripke, 1972). Notable among this group was Guy (1972), who built upon the work of Ijiri (1968) to develop an auditing methodology for projected financial statements.

Numerous writers analyzed the advantages and disadvantages of forecast disclosure: Accountants International Study Group (1974), Anton (1976), Bissell (1972), Brown (1972), Burton (1976), Cook (1973), Corn (1974), Henry (1975), Kapnick (1972), Kripke (1972), Markwalder (1974), Nickerson, Pointer, and Strawser (1974), Shank and Calfee (1973), Sycamore (1974). Hipgrave (1976) reviewed the situation in Canada and discussed the opportunities for operations researchers in forecast preparation and third party review.

The issue was also discussed by authors whose topics were much larger in scope: Bedford (1973, p. 36), Committee on External Measurement and Reporting (1973, p. 246), Hendriksen (1977, p. 545), Skinner (1972, p. 360), Study Group on the Objectives of Financial Statements (1973, p. 46), Select Committee on Company Law (1973, Ch. 19). The last-mentioned study was of particular interest to Canadians because the committee of the Ontario Legislature concluded that the advantages of some formal type of financial forecasting out-weigh the disadvantages and that earnings forecasts should be independently reviewed, probably by public accountants.

The situation in the United Kingdom was further examined by Carmichael (1973) and Davison (1973).

Since 1972 there have appeared several more rigorous analyses of the possible usefulness and the impact of forecast disclosures, and more detailed suggestions as to appropriate forecast procedures, reporting principles, and formats. Stewart (1973, Ch. 8) did an economic analysis to assess possible benefits to the individual investor and the impact on the resource allocation function of the capital markets. Stewart's conclusion was that public disclosure of forecasts would likely result in only marginal economic benefits and costs, and that perhaps the most important single benefit would be the appearance of equity which would be created by public distribution.

Gonedes, Dopuch, and Penman (1976) did an information economics analysis to assess whether a rule requiring forecast disclosure is consistent with Pareto optimal allocations of resources. The analysis reached no unambiguous conclusion, but did suggest that many widely accepted justifications for disclosure have, as yet, little theoretical support.

A third economic analysis of forecast disclosure was presented by Hakansson (1977). He concluded that even though full disclosure may lead to some economic inefficiencies, it is difficult to argue against overdisclosure in view of the fact that the majority of investors are likely to benefit, at least in the short run.

Ronen (1974 a) developed a hierarchy of objectives that showed the relationship of management forecasts to overall objectives for external reporting. The same author examined the theory of discounted cash flow accounting (Ronen, 1974 b) and used one firm to test the feasibility of preparing discounted cash flow accounting statements (Ronen, 1974 c).

Clark and Elgers (1973) worked from investment portfolio theory to conclude that financial reports would be more useful to investors if they included expected data and the sources of variability in these expectations. The authors developed a tentative format for budget reports incorporating probabilistic information. Clark and Elgers based their conclusions in part on the empirical evidence gained from eight case studies.

Ijiri (1975, Ch. 9) examined ways in which the reliability of management forecasts may be improved by standardizing forecasting processes. He argued the need for forecasting principles to standardize forecasting processes, and outlined the areas to be covered by such principles.

Cramer and Sorter (1974, p. 343f) presented illustrative financial statements including earnings forecasts.

The American Institute of Certified Public Accountants issued two important releases: Guidelines for Systems for the Preparation of Financial Forecasts (1975 a) and Presentation and Disclosure of Financial Forecasts (1975 b).

These did not advocate nor discourage the publication of forecasts. They did, however, provide advice on preparation, presentation, and disclosure for members and firms that are involved in forecast disclosure. The AICPA is still studying the matter of third party review of forecasts.

Writing on the topic of forecasts has not been nearly so prolific in Canada as in the United States. The study by Kidd (1976), however, was a major contribution to the discussion in Canada and remains the definitive work. The study was commissioned by the Research Department of the Canadian Institute of Chartered Accountants. The concerns and aims of the Research Department were expressed in the foreward to Kidd's study:

> Because relatively little has been written in Canada about publishing earnings forecasts, and because of doubts about the "transferability" of UK or US experience and thinking, this Research Study was initiated with the following terms of reference:
>
> 1. To provide a comprehensive discussion of the problems and issues relating to the publication of earnings forecasts in Canada, and thus to facilitate informed discussion by all interested parties.
>
> 2. Assuming that earnings forecasts are in future to be included in annual reports of public companies, in prospectuses, in take-over circulars, or in interim reports, to study and reach conclusions on the following questions:
>
>   (a) what information should earnings forecasts include in each of these four circumstances?

(b) should the company's auditors be associated with them in any or all of these four circumstances, and if so:

(i) what should their report state; and

(ii) what procedures should they perform in support of their report?

(c) if the auditors are not to be associated in any area, how can association be avoided?

The terms of reference deliberately precluded the author from reaching a conclusion as to the desirability of publishing earnings forecasts. The aim was that all the pros and cons of publishing earnings forecasts should be set out so as to facilitate discussion of this vital issue by interested parties. The terms of reference also excluded the study of forecasts prepared for internal purposes and detailed consideration of forecasting techniques. The focus was intended to be on the publication of earnings forecasts.

The Kidd study was divided into three main parts. Part I began with a brief chapter on terminology and the effort required to prepare an earnings forecast. This was followed by chapters tracing the experience, opinions, regulations, and literature concerning earnings forecasts for each of Canada, the United Kingdom, and the United States. A chapter written by V. P. Alboini summarized the Canadian legal environment for public forecasting. The final chapter of Part I summarized the arguments for and against the disclosure of earnings forecasts. In light of the availability of Kidd's historical survey of developments in various countries and of the pros and cons of disclosure, these are not developed in any detail in the present study.

Part II of the Kidd study was based upon the major assumption that earnings forecasts will be disclosed. The first chapter was devoted to developing a statement of objectives for earnings forecasts, identifying characteristics which earnings forecasts should possess, and defining an earnings forecast. Subsequent chapters presented specific standards to be followed in the preparation, presentation and disclosure of earnings forecasts. Special attention was given to updating forecasts, forecasts during active corporate solicitations, and alternatives to regular and comprehensive disclosure.

Part III of the Kidd study was based upon a further major assumption: that some earnings forecasts will be subject to third party review. While recognizing that other groups might become involved, Kidd considered third party review only from the point of view of public accountants. An objective and appropriate scope for the review were suggested, as were general review standards and specific standards for field work and for writing the reviewer's comments.

Though his terms of reference precluded Kidd from reaching a conclusion on the desirability of publishing earnings forecasts, he did make some personal observations in a postscript. The major points may be summarized as follows:

- Public disclosure of earnings forecasts is not a panacea, but it can go a long way towards filling current perceived information needs and can be an effective vehicle for the communication of useful corporate information to the public.

- Any system for disclosure of earnings forecasts should be introduced slowly, and should be allowed to evolve gradually as experience is gained.
- Disclosure of earnings forecasts should perhaps be precluded in periods of high inflation.
- Not all companies will be able to disclose earnings forecasts within the suggested standards.
- It will not be possible to have third party review under the suggested standards for all earnings forecasts and therefore third party review should not be required of all earnings forecasts.
- Adoption of either the UK or US systems would not be reasonable in Canada. The standards suggested by Kidd call for fuller disclosure.
- A system of voluntary disclosure, rather than mandatory disclosure, and informal sanctions, rather than formal regulation, is best for Canada.

Kidd reports briefly on an empirical study of annual reports of Canadian companies. This will be discussed in a later section of this chapter.

The Kidd study having been received, the CICA Accounting Research Committee is now studying the question of earnings forecasts (Thomas, 1977). The CICA Auditing Standards Committee has approved earnings forecasts as a topic for study but has not as yet begun such a study (Thomas, 1977).

The Society of Management Accountants has also launched a study (Casey, 1977). The Accounting Principles and Practices Committee has approved the study, which will discuss the preparation of financial forecasts and be directed principally at management accountants in Canada.

Throughout the debate over publication of corporate forecasts attention has focused upon the following issues:

- The usefulness of management forecasts, especially to analysts and investors.
- The reliability or accuracy of management forecasts.
- The effect on company relationships with competitors, employees, suppliers, and customers.
- The effect on the behavior of management and corporate effectiveness and efficiency.
- The effect on analysts and investors and the operations of the securities markets.
- The effect on the behavior of auditors and the credibility of the accounting and auditing processes.
- The costs of preparing and auditing public forecasts.

Mitchell (1969) and the Special Committee on Corporate Forecasts (1973) are representative of the majority of authors, those who discussed the pros and cons and came out in favor of more systematic disclosure of forecasts. Kapnick (1972) and the Financial Executives Research Foundation (1972) are representative of authors who arrived at the opposite conclusion. Kidd (1976) presented the advantages and disadvantages of forecast disclosure without promoting one view or the other.

4. Empirical Literature

Empirical investigations of the issues were not common during the early years of discussion of earnings forecasts. Such studies have become more numerous in recent years. This section is devoted to a review of the empirical research which bears most directly on the issue of financial forecasts. It concludes with a description of research most closely related to the present studies. Unless otherwise indicated the studies were conducted using United States data.

a. Studies of Forecast Accuracy

A large number of empirical studies were concerned with the accuracy of forecasts made by management or investment analysts. Except as noted the accuracy studies were done with management forecasts taken from the *Wall Street Journal* and analyst forecasts from investment reports or Standard & Poor's *Earnings Forecaster*.

Daily (1971) and Clark and Elgers (1973) studied unpublished management forecasts. McDonald (1973), Dev and Webb (1972), and Fraser (1971) examined published management forecasts, the latter two in the United Kingdom.

Analysts' forecasts were the focus for studies by Richards (1976) and Stewart (1973). The accuracy of management and analyst forecasts were compared in a study by Basi, Carey, and Twark (1976).

Management forecasts were compared for accuracy with forecasts of various mechanical models in studies by Copeland and Marioni (1972) and Lorek, MacDonald and Patz (1976), and as a tangent in studies by Green and Segall (1967, 1966).

Analyst forecasts were compared to those of mechanical models for accuracy in studies by Cragg and Malkiel (1968), Elton and Gruber (1972), and Smith and Murphy (1976).

The last-mentioned study, using forecasts made by a prominent Canadian investment house, was the only accuracy study done with Canadian data. In this study it was concluded that the analysts outperformed the mechanical models, that analysts' first forecasts were better for some industries than for others, and that analysts' second forecasts were better than their first forecasts.

Results of the accuracy studies in general were mixed. Some studies concluded that forecasts by management and/or analysts were reasonably accurate while other studies concluded that these forecasts were quite unimpressive.

The interest in forecast accuracy among accountants has brought to the accounting literature three empirical works concerned with the improvement of forecast accuracy. Elliott and Uphoff (1972) used an econometric model, Mabert and Radcliffe (1974) used the Box-Jenkins forecasting technique, and Chiang and Liao (1977) used Monte Carlo simulation. All three studies indicated promise for their respective methodologies in improving forecast accuracy.

b. Opinion Surveys

Another large group of empirical studies bearing on forecast disclosure were survey or interview studies conducted to ascertain the perceptions and/or opinions of various interested groups, e.g., investment analysts, public accountants, corporate executives, bankers, and management accountants.

Of these studies only three were done with the earnings forecast issue solely in mind. The study by A. T. Kearney, Inc. (1972) for the Financial Executives Research Foundation documented the essentially negative attitude of United States executives towards public disclosure of financial forecasts. Among other issues the survey dealt with management's views of existing disclosure behavior, the accuracy of management forecasts, their usefulness, and the problem of legal liability.

The second major survey was undertaken by Stewart (1973) for the Financial Analysts Federation. It recorded the views of analysts which, though mixed, could be characterized as favoring more systematic disclosure of financial forecasts. The study examined the existing use of management forecast information and the perceived usefulness of managements' forecasts to analysts.

The third study, by Skousen, Sharp, and Tolman (1972), sought the views of analysts, public accountants, and corporate executives. Although executives were quite confident of the accuracy of their budgets, they were not in favor of public disclosure. The authors felt that analysts gave less thoughtful responses than the other two groups and showed a lack of agreement on the question of usefulness. Analysts indicated that management budgets would be useful to them but questioned the usefulness to less skilled users of financial reports. Public accountants felt that they could establish procedures and standards for reporting on budget data, but identified several potential problems with budget disclosure. On the whole, the study did not support budget disclosure.

Other surveys gathered opinions on forecast disclosure not as a primary objective but as part of a broader study of corporate disclosure: Backer (1970, 1971), Buzby (1975), Chandra (1974, 1975), Carpenter, Francia, and Strawser (1971), Rice et al. (1973), Stanga (1976).

Asebrook and Carmichael (1973) gathered opinions on the extension of the attest function to cover forecasts. In a broader study of the attest function Imke (1967) also got opinions on this issue. Corless and Norgaard (1974) surveyed financial analysts for their reaction to different possible types of attest reports.

Three survey studies gathered Canadian opinion on aspects of forecast disclosure, though none had this topic as its primary focus. Belkaoui and Kahl (1977) asked fifteen professors to rank and value thirty items of potential disclosure by Canadian chartered banks. The item "Pro forma EPS" was ranked twenty-third with an importance score of 2.7 out of four.

Benjamin, Francia, and Strawser (1973) surveyed different groups of accountants on their perceptions of selected accounting issues and financial reporting practices. The item "Inclusion of forecasts in annual reports" was one of eight items in the "proposals" category, one of four categories. Canadian management accountants rated this item second out of twenty-seven in deficiency, i.e., the difference between what should be and what is. They ranked it only sixteenth in importance, however, indicating they were not very concerned about the issue.

Dirksen and Scheibelhut (1976) surveyed members of the Toronto Society of Financial Analysts to determine their preferences for annual report disclosure. Opinions were sought on fifty-three items in ten categories. One category was "Forecast Data" consisting of seven items. Of the seven items the only item which respondents said was of great and more-than-average importance was estimated capital expenditures. Two items were said to be of average importance: prospects for industries and economies in which the firm operates, and possibilities and amounts of future cash flows due to contingent liabilities. The four remaining items were all considered to be of less-than-average importance: planned marketing expenditures, expected future sales levels, forecasted earnings per share, and expected future company employment levels. The general conclusion was that analysts thought it was of less-than-average importance to have forecast data included in annual reports. The absolute level of importance attached to various items was not reported.

Results of the opinion surveys in general were mixed. Analysts did not show a high degree of concensus, especially in earlier studies, but were consistently more enthusiastic about forecast disclosure than public accountants or corporate executives. The executives were quite solidly opposed to formal forecast disclosure, fearing legal liability, extra cost, and loss of competitive advantage. Public accountants were generally of the opinion that some form of attestation could be done but that considerable effort would be required in the development of principles and standards.

c. Efficient Market Studies

A third identifiable group of empirical studies investigated the effect of earnings forecasts on aggregate stock market behavior: Foster (1973), Gonedes, Dopuch and Penman (1976), Patell (1976). Following the tradition of efficient market research (Gonedes and Dopuch, 1974), these studies sought to ascertain whether management earnings forecasts, as published in the Wall Street Journal or as transmitted through investment analysts and Standard and Poor's Earnings Forecaster, had information content, i.e., whether significant new information was conveyed and reflected in changes of stock prices or volumes. The results in general indicated the earnings forecasts did have information content.

d. Experiments Concerning Effects of Forecasts on Users

The fourth group of empirical studies were laboratory experiments designed to test the effect of different accounting alternatives on users of accounting information. These are of particular interest because one of the studies reported in the present thesis was a laboratory experiment testing the effect of management forecasts in annual reports on the predictions of Canadian investment analysts.

Chevalier (1977) was interested primarily in whether different culture groups require the same type of information in financial statements. During an experiment in which Canadian graduate students were making investment decisions subjects were asked to evaluate thirty information items typically published in financial statements and ten items not typically published. Participants in general indicated that unpublished items were of higher importance than published items in making their investment decisions. Both French and English subjects indicated they gave much weight in their decision to the three forecast items which were included among the ten unpublished items: capital investment budget, budgeted earnings per share, and budgeted revenues. French subjects indicated a significantly higher need for the capital investment and earnings per share budgets than did the English subjects. Chevalier concluded that the results appeared to favor the inclusion of budgeted figures in financial statements.

Hofstedt (1972) conducted an experiment with MBA candidates and executives in which the subject assumed the role of an investor, read and analyzed excerpts from an annual report, and answered certain questions and made certain predictions about the firm represented in the report. The principal prediction made by the subject was next year's earnings per share.

Different subjects were given different sets of annual report information, and one of the factors which was manipulated was the consistency between the tone of the president's letter (optimistic or pessimistic) and the historical trend of earnings per share (increasing or decreasing). The research report did not indicate the exact contents of the president's letters. It appears that at least some future-oriented information was included, but that specific sales and earnings forecasts were not included.

The results indicated that the president's letter had a strong influence on the readers' feelings about the future profit performance of the firm. There were also indications that the effect of the letter may have varied with other factors, including the earnings per share trend and investor sophistication.

Each subject was also asked to list any additional information he would like in his role as an investor. On average subjects mentioned about three items they would like. Of all items mentioned by the executives seven percent were in the category of forecasts by management: sales, profits, capital spending, R. & D. Of all items mentioned by MBA candidates ten percent were in this category. Hence, subjects indicated some desire for management forecasts for the task of investment analysis.

In an unpublished study Cianciolo (1975) reported an attempt to determine what significance the small investor places on forecasted financial statements and the inclusion of an auditor's report. Subjects were given different data packets of financial information about two hypothetical firms. Data were in the form of broker advice and a simulated annual report. Data which were varied for different groups of subjects included broker advice, one-year financial forecasts, and auditor's reports. Subjects were asked to indicate in which of the two firms they would prefer to invest, and the strength of this preference.

The results indicated that broker advice dominated the decisions, but that the forecasts and auditor's reports had some influence, depending on the company, type of forecast and type of auditor's report.

In an unpublished study Deakin (1972) attempted to determine whether qualitative managerial representations in the annual report or the audited financial statements would enable an investor to make a better investment decision, or whether the items complimented each other. Bank trust investment officers were subjects. They were asked to allocate an investment fund between four American Stock Exchange Firms so as to maximize their return relative to the market for the coming twelve months. A model was developed to evaluate the relative value of a portfolio at any point in time, and hence the return.

In part one of the study, one of four different information packages was given to each subject. Two of the sets contained qualitative managerial representations in the form of a president's letter and product descriptions. The president's letter made general predictions about the company's future prospects, but did not contain a specific dollar estimate of earnings. Results of part one showed no significant differences in returns or in proportional allocation of investment funds among the four treatments.

Part two of the study used managerial representations that had been modified from the originals. They gave either a more favorable or less favorable outlook for the future. They did not contain specific dollar estimates of earnings. Significant shifts in proportional investment were found only when the two groups receiving the modified managerial representations, but no financial statements, were compared. This indicated an effect for managerial representations under some conditions, and the possibility of an indifference range in investor awareness.

Incidentally, subjects were asked, "If you were preparing such a study, what information would you include?" Of fifty-six subjects, six suggested an industry forecast, five suggested an economic forecast, and three suggested a company forecast.

In an unpublished study (Brandon, 1972) an attempt was made to determine whether certain methods of forecast disclosure provide useful information. The subjects, intermediate accounting students, were asked to estimate future earnings per share on the basis of information contained in financial statements. Some of the financial statements contained point or interval estimates of future earnings per share. Some also included an historical record of management's forecasting accuracy. All financial data, historical and forecasted, were generated by a computer simulation model. The model also generated "actual" results which were used to gauge the accuracy of subjects' predictions and hence the usefulness of forecast data.

The first time the experiment was run no single method of disclosure proved to be superior as a basis for predicting earnings per share. It was suspected that this may have been due to the subjects' unfamiliarity with forecast disclosure. The experiment was run again with prior education being given to subjects on the nature of the information contained in the forecast disclosure. The results of the second test indicated that forecast disclosure was useful information to subjects when preceded by prior education.

In general the experimental studies described above suggested that management representations in annual reports were found to be useful by subjects attempting to analyze companies in order to make predictions or decisions. This was found to be true for management forecasts where they were presented.

The experimental study of the present thesis, described in Chapters II and III, is similar to the previous studies in general intent, but is different in several important respects. First, the subjects of the present study were investment analysts at Canadian brokerage houses. None of the previous studies dealt with brokerage house analysts. The reaction of brokerage house analysts to management forecasts is of interest because these analysts play an important role in the investment decision process. Their recommendations, through investor decisions, have an impact on resource allocation in the country. In the only related experiment in the Canadian context (Chevalier, 1977) the subjects were students rather than analysts and forecast information was presented as "unpublished financial information" rather than as part of an annual report. Second, the treatments for the present study included annual reports which contained complete pro forma financial statements for the following year. Some previous studies utilized earnings forecasts, but none presented subjects with forecast financial statements. Third, special efforts were made in the present study to make the experiment as realistic as possible. Analysts were contacted in person, and they participated while at their place of work during normal business hours. In addition the annual reports were printed and bound so as to appear similar to those issued by many actual companies.

Thus, by examining the effect of a different type of forecast disclosure, on a different group of annual report users, the present study contributes to a greater understanding of the effects of various forecast disclosures on various users.

e. Studies of Incidence of Forecasts

The last group of empirical studies to be reviewed is that which deals with the incidence of disclosure of management forecasts. This group is of particular interest because the second study reported in the present thesis examined in a detailed manner the incidence in Canadian annual reports of management forecasts of overall company results.

The wide-ranging survey on financial reporting by Backer (1970) touched briefly on the incidence of earnings forecasts. On the basis of interviews it was determined that firms vary in the extent to which they disclose profit forecasts and in the manner they disclose them, and that annual reports often contain generalized and fragmentary forecasts, but that they rarely contain an explicit earnings forecast (p. 199). About one-third of firms were said to disclose profit expectations publicly, while another forty percent were said to comment on the reasonableness of analysts' profit expectations (p. 206).

The study by Rice et al. (1973) also involved interviews with management which provided insight into forecast disclosure practices. It was found that many companies attempt to prevent irresponsible analyst forecasts by questioning erroneous assumptions and demonstrating faulty logic. About one-third of the sample indicated that, as the year progressed, they tacitly confirmed earnings per share forecasts of analysts when forecasts were stated as a range (p. 28).

Several studies have examined the overall quality of disclosure in annual reports and have in the process produced some data on the extent of disclosure of forecast items. Buzby (1974) constructed an index of disclosure consisting of thirty-eight items and examined the annual reports of eighty-eight small and medium size companies to determine the extent of disclosure. "Forecast of next year's earnings per share" was one of the items. Of the eighty-eight annual reports, one contained a specific dollar estimate or range for EPS, sixteen gave an indication of the expected direction of change in EPS, and the remaining seventy-one contained no such disclosure (p. 431).

"Capital expenditures--coming year" was another item in the Buzby study. Twelve annual reports made some disclosure of this item while seventy-six did not. "Factors which will affect next year's performance" was another item. Sixty-three annual reports contained some disclosure of this item while twenty-five did not.

Barrett (1976) constructed an index of disclosure consisting of seventeen items and examined the annual reports of 103 large publicly held firms in seven countries, of which Canada was not one. One of the seventeen items was "Capital Expenditure: Planned". Barrett found that British firms disclosed more about the planned level of capital expenditure than did United States firms (p. 13). For the other five countries, it was found that twenty of sixty-nine firms made some disclosure of this item, with the incidence being much higher in reports containing fully consolidated financial statements (p. 23).

Stanga (1976) asked financial analysts to assess the importance of seventy-nine information items and he then examined the annual reports of eighty large industrial firms to determine the extent of disclosure of these items. The six forecast items and the percentage of firms disclosing same, as reported by Stanga (p. 45-46), were as follows: projected sales for the next fiscal year (0.0), projected earnings for the next fiscal year (1.2), planned research and development expenditures for the next fiscal year (6.5), planned capital expenditures for the next fiscal year (20.0), amount and expected sources of financing planned for the next fiscal year (6.2), planned advertising expenditures for the next fiscal year (2.0).

Belkaoui and Kahl (1977) asked professors of business administration at a Canadian university to assess the importance of thirty information items and they then examined the annual reports of the ten Canadian chartered banks to determine the extent of disclosure of these items. The only forecast item was "disclosure of pro-forma earnings per share". None of the annual reports examined contained this information item.

Dirksen and Scheibelhut (1976) asked Canadian financial analysts to assess the importance of fifty-three information items divided into ten basic types. They then examined the annual reports of thirty-four large Canadian non-utility companies and an equal number of United States firms matched with the Canadian firms for size.

One of the basic types of information was "forecast data"; it contained the following seven items: forecasted earnings per share, planned marketing expenditures, planned capital expenditures, expected future sales levels, expected future company employment levels, prospects for industries and economies in which the firm operates, possibilities and amounts of future cash flows due to contingent liabilities.

Detailed statistical results were not reported, but the authors indicated that about eighty percent of the reports contained data on industry prospects (p. 46). Excluding data on contingent liabilities, which must be reported, the only other forecast information presented with any degree of frequency was information on committed capital expenditures.

The studies on incidence of forecasts reviewed to this point did not have as their central concern the disclosure of financial forecasts. They were concerned with disclosure in a broader sense. The five studies reviewed below did, however, focus directly on disclosure of management forecasts.

A. T. Kearny, Inc. (1972) surveyed executives to ascertain attitudes towards public disclosure of business forecasts. One section of the report (pp. 31-38) was devoted to the topic of current disclosure practices. The authors concluded (p. 33): "The release of forecasts is not widespread among companies. Only 12 percent of the respondents release any of the forecasts included in the study and even fewer release assumptions in any form. The release practice relative to each type of forecast is shown in Table X." Table X is reproduced as Table 1 in this study. The authors qualified this conclusion, however, when they said (p. 35): "The actual release practice is greater than that indicated by Table X. For example, two companies interviewed stated that although it is not company policy to routinely release forecasts, they do release forecast data on occasion. The special circumstances surrounding the release were the desire to reduce security price fluctuations in the market and to obtain increased exposure in the fin cial press."

TABLE 1

TABLE X FROM A. T. KEARNEY, INC. (1972)

RELEASE PRACTICE

Types of Forecast	Number Which Release	Per Cent of Total Responding
Corporate Sales	29	9
Corporate Earnings	24	7
Changes in Capital Structure	22	8
Sales by Division	8	3
Corporate Expenses	8	2
Earnings by Division	5	2
Expenses by Corporate Chart of Accounts	4	2
Expenses by Division	4	1
Changes in Productivity	2	2
Total Companies Releasing Forecasts(1)	42	12

(1) The total release is less than the total by type of forecast due to some companies releasing more than one forecast.

Concerning the means by which companies release forecasts, the authors stated (p. 36): "Companies employ a variety of communications media in releasing the forecasts, as shown in Table XI." Table XI is reproduced as Table 2 in this study.

TABLE 2

TABLE XI FROM A. T. KEARNEY, INC. (1972)

COMMUNICATION MEDIA USED FOR RELEASING FORECASTS

Media	Number[(1)] of Companies	Per Cent of Total Responding
Individual Analyst Interviews	19	66
Annual Meeting	16	55
Analyst Society Meetings	16	55
Small Group Meetings	11	38
Quarterly or Interim Reports	9	31
Press Release	9	31
Special Mailings	5	17
Annual Report	4	14
Other	2	7

(1) Only 29 of the 42 companies who release forecasts responded to this question. The total exceeds 29 because several media were used by companies.

Three parts of the study by Stewart (1973) bear on the issue of incidence of forecast disclosure. The first is a nonrigorous survey of corporate forecasts published in the Wall Street Journal between October 1971 and September 1972 (Ch. 9). The survey was not intended to be exhaustive and no detailed analysis of the data was attempted. The purpose was simply to belie the impression, sometimes given, that corporations are extremely reluctant to make public forecasts and that there is very little, if any, public forecasting. The author's conclusions were that some firms do disclose forecasts to the public, that the forecasts are being made by a broad variety of firms, that forecasts are disclosed through analysts' meetings, interviews and press releases, that forecasts cover a variety of projection periods, and that sales, earnings, and a variety of substantiating material are included in the forecasts (p. 103).

The second relevant part of the Stewart study was contained in an opinion survey of analysts and portfolio managers. From Exhibit 11-11 of the study (reproduced here as Table 3), the author concluded: "Apparently corporate forecasts of some sort are available from a large number of companies" (p. 145). From Exhibit 11-8 (Table 4 here) the conclusion was drawn that "the most commonly forecast items were sales and earnings per share for the coming year" (p. 142). Exhibit 11-4 (Table 5 here) indicated analysts' opinions on the incidence of various forecasting formats. Exhibit 11-6 (Table 6 here) indicated opinions on the media through which forecasts were received by analysts.

The third relevant part of the Stewart study was contained in a report of interviews with senior investment executives. In summary, this group believed that most corporate financial projection information rarely gets out to analysts, stockholders, or the general public; that managers very seldom make detailed forecasts available to anyone outside the corporation; that any public announcements are usually very general and lack detail; that companies do provide external implicit forecasts by adjusting analysts' own forecasts; and that the flow of information to analysts and the public is very uneven.

TABLE 3

EXHIBIT 11-11 FROM STEWART (1973)

AVAILABILITY OF FORECASTS

Forecast Information Received From Companies Followed by Analysts

% of Companies From Which Some Type of Forecast is Received	% of All Analysts
0% - 25%	31%
26% - 50%	27%
51% - 75%	28%
76% - 100%	14%

TABLE 4

EXHIBIT 11-8 FROM STEWART (1973)

CONTENT AND FUTURITY OF COMPANY FORECASTS

For companies making forecasts, which of these items are being forecasted and what time period do they usually cover?

	3 Months	12 Months	18 Months or more
Sales	10%	67%	7%
Profit Margins	10	48	4
Earnings Per Share	11	66	2
Cash Flow	4	41	7

TABLE 5

EXHIBIT 11-4 FROM STEWART (1973)

FORMAT OF CORPORATE FORECASTS

Presently some companies make certain types of forecasts available. For the companies you follow, do analysts receive forecasts in the form of:

	Frequently	Sometimes	Rarely
General Statement of Trends	65%	24%	4%
Confirmation of Analysts' Forecasts	23	49	20
Range of Dollar Figures	12	54	25
Specific Dollar Figures	2	11	74

TABLE 6

EXHIBIT 11-6 FROM STEWART (1973)

DISCLOSURE MEDIA FOR CORPORATE FORECASTS RECEIVED BY ANALYSTS

	Frequently	Sometimes	Rarely
Published Financial Reports	21%	38%	31%
Shareholder Meetings	16	46	27
Press Conferences	9	48	31
Analyst Society Meetings-on the Record	19	60	12
Analyst Meetings-Private	29	43	16
Management Interviews	47	36	8

In an unpublished study Brandon (1972, pp. 29-31) described briefly a survey conducted to determine the extent of financial forecasts in the annual reports of United States corporations. A total of 588 reports for the calendar or fiscal year 1969 were examined for any disclosure concerning the future, including expectations, plans, objectives, budgets, anticipated profits, losses, or growth, and economic outlook. Table II of the study (Table 7 here) showed the classification of annual reports according to three major groupings and several secondary classifications. Brandon concluded that very few firms made specific forecasts, e.g., "Management anticipates that earnings will increase 10 percent in 1970", but that a much larger number disclosed general forecasts, e.g., "We expect that 1970 will show improved profits for our firm" (p. 30).

TABLE 7

TABLE II FROM BRANDON (1972)

CLASSIFICATION OF THE NUMBER AND PERCENT OF FORECASTS IN A SAMPLE OF ANNUAL REPORTS

	Number	Total	Percent
1) Specific estimates of 1970		21	3.59
2) General estimates of 1970		324	55.09
a) the profits/earnings/sales are expected to be good/improve	170		
b) reference to the general economy--management expects profits to be good/increase	138		
c) reference to division or product break down of growth	7		
d) difficult/cannot predict 1970 due to uncertainty	9		
3) No specific reference to 1970		243	41.32
a) earnings are expected to continue to grow/improve in the future	136		
b) management is optimistic and expects to meet the challenges/objectives in the future	47		
c) no direct reference is made to the future	60		
Totals		588	100.00

In another unpublished study Keller (1973, pp. 50-63) described an analysis of the 1971 annual reports of 337 of the largest publicly owned United States companies. Due to difficulties in placing information into narrow categories, Keller reported the results under four broad classifications, presented several examples for each classification, and reported few detailed statistics. The results, by classification, may be summarized as follows: (1) Financial statements and schedules. Liabilities, reserves, and commitments were found in each report and were covered by the auditor's opinion. (2) Speculation and prediction. Judgements about the future were common in the reports. Optimistic speculation was found in 99.1 percent of the reports, largely in the form of statements relating to the growth of demand, sales, earnings, revenues, or profits. Terms such as "bright future or outlook" were also common. (3) Implications concerning the future. A discussion of the various activities of the corporation, implying that these activities will continue into the future, was usually presented in the annual reports. (4) Plans for the future. Plans, distinguished from speculation by an indication of intention to do something, were either referred to or provided in each of the annual reports. The incidence of disclosure of plans of different kinds was varied.

Finally, Kidd (1976, p. 18) states, "The public disclosure of information which would likely constitute an earnings forecast has been common in Canada in annual reports, press releases and public announcements." Support for this statement is presented by Kidd (p. 253) in the following sentence, "A random sample of 150 annual reports of Canadian publicly listed companies was examined and approximately 30 percent contained comments which disclosed either future sales or earnings expectations." No further description of the research design or statistical results were reported, but excerpts from several annual reports, dated 1972-75, were provided to illustrate the diversity of future-oriented comments being made.

In summary, the literature contains several studies which dealt to some extent with the incidence of forecast disclosure. None of these studies, however, presented a detailed examination of annual report forecasts of corporate results. Particularly, none presented such an examination for the annual reports of Canadian firms. Thus the discussion to date of forecast disclosure has proceeded with an incomplete understanding of actual practice. The annual report study of the present thesis, described in Chapters IV and V, helps to remedy this situation by providing a detailed analysis of management forecasts of overall company results as found in 240 Canadian annual reports.

5. The Present Studies

This chapter has described the literature on disclosure of forecasts and has explained how the present studies contribute to the literature. The early literature tended to be largely opinion, with little empirical support. More recently various empirical studies have shed light on certain aspects of the topic. The next four chapters of this thesis present the results of two additional empirical studies concerning the issue of forecast disclosure.

The first of the present studies was a laboratory experiment which dealt with the effect of earnings forecasts in annual reports on the predictions of security analysts. The experiment differed from earlier ones in that it concentrated directly on management forecasts in annual reports, utilized complete pro forma financial statements, and employed brokerage house investment analysts as subjects. The main finding drawn from the experiment was that the forecasts in the annual reports did influence the analysts in their predictions of earnings per share and stock price. The research method for this study is described in Chapter II and the results are presented in Chapter III.

The second of the present studies was an analysis of the contents of 240 annual reports to determine the extent of disclosure of predictions of company results. The study differed from earlier ones in that it examined Canadian annual reports in detail, utilizing a new taxonomy developed to categorize management forecasts. The main findings were that forecasts of corporate results were widespread among the sample companies, varied as to their form, almost always optimistic, and normally not very specific. The research method for this study is described in Chapter IV and the results are presented in Chapter V.

Chapter VI summarizes the purposes of the two studies, their methods, and their findings. It relates the findings to the literature, draws general conclusions, and makes suggestions for further research.

FOOTNOTES

1. For comments on the various pros and cons of forecast disclosure see Alexander (1969), Archibald (1971), Bodenhorn (1961), Burton (1968, 1969), Committee on External Reporting (1969, pp. 85, 88, 118), Committee on Foundations of Accounting Measurement (1971, p. 30), Committee to Prepare A Statement of Basic Accounting Theory (1966, p. 27), Coughlan (1960, 1962), Davidson (1969), Edwards (1971), Heller (1961), Hicks and Johnson (1969), Nielson (1960), Ross (1967), Wanger (1970).

2. For comments on the extension of the attest function see Bevis (1962), Clarke (1968, 1970), Task Force 2000 (1970), Willingham, Smith, and Taylor (1970).

3. Since 1971 the SEC has made several statements and proposals on financial forecasts (Kidd, 1976, Ch. 5). It has not as yet established a final position on the matter, but has elicited views from all concerned and is about to receive recommendations from its Advisory Committee on Corporate Disclosure (Beresford and Neary, 1977).

CHAPTER II

EFFECT ON ANALYSTS: RESEARCH METHOD

1. Introduction

This chapter describes a laboratory experiment undertaken to test the effect of earnings forecasts on analysts' predictions of earnings per share (EPS) and stock price.

Briefly, each of forty-nine brokerage firm analysts examined one of four different versions of a corporate annual report. Each then predicted the company's earnings per share for the following year and the market price of the company's common stock at the end of the year. Each analyst then listed the most important factors he had considered in making his predictions. The analysts' predictions and lists of factors were analyzed to determine the effect of earnings forecasts on their analyses and predictions.

The basic objective of the experiment was to improve our understanding of accounting users' needs for forecast information or, in other words, to improve our understanding of the relevance or usefulness of forecast information. The necessity of understanding user needs was emphasized by the Committee to Prepare a Statement of Basic Accounting Theory (1966, p. 7) in presenting relevance as the primary standard for evaluating accounting information and in suggesting areas future research (p. 69). The Study Group on the Objectives of Financial Statements (1973) stressed the importance of usefulness to users as the primary criterion for evaluating financial statements.

The present study, utilizing a laboratory experiment, contributes to our understanding of the usefulness of forecast accounting data in a particular situation. It was a study of individual investor behavior, the type of study advocated by Sterling and Harrison (1974, p. 155) and Wilcox (1972, p. 193), rather than of aggregate investor behavior.

Several research approaches appear to have potential for improving our understanding of user needs, but each has its inherent shortcomings. Large scale surveys of users can ask users which data they find useful. The difficulty with this approach is that users may not be aware of and/or may not be willing to disclose their data preferences and decision processes. Intensive studies of the decision making processes of one or two users can be undertaken. The difficulty here is one of drawing conclusions about the preferences and decision processes of a large group of users from the observation of a very small sample. Studies of stock market data can shed light on the eventual aggregate effects of accounting disclosures. The strength of this method is at the same time its weakness, since conclusions cannot be drawn concerning the possibly varying reactions of different individuals and groups influencing the market.

Thus each of the above-mentioned research approaches has its contribution to make and its limitations. This is true also of the laboratory experiment method chosen for the present study. By its nature an experiment is limited in what it can reveal about real world behavior and results. An experiment presents subjects with certain information, under certain conditions. To the extent that actual investment analyses are conducted using different information inputs, under different conditions, the experimental results are only imperfect indicators of the real world effects of the experimental treatment. In addition, an experiment tests the effect of only some of the many possibilities for accounting disclosure.

Its shortcomings notwithstanding, an experiment does have distinct advantages for studying user reactions to disclosure alternatives. Most importantly, the researcher is able to control the conditions of an experiment and is thus more confident that any observed differences in subject behavior are caused by differences in treatment rather than by some unknown variable. In addition, an experiment allows the testing of accounting disclosures which are different from those currently in practice.

The present experiment then sought to add to our understanding of the effect of earnings forecasts on investment analysts. Although it dealt with only certain disclosure alternatives, under certain conditions, it does contribute to our understanding of this complex issue.

Every experimenter seeks a balance between external validity and internal validity, through the design and the administration of the experiment. The experimenter strives for a measure of realism so that the experimental results have meaning for real life situations, while managing the subjects' environment so that the results can confidently be attributed to the treatments. At the same time, the experimenter must design the experiment so that the time and effort required of subjects is such that they are willing to participate. The remainder of the chapter describes the research plan in detail, indicating the steps that were taken to simultaneously satisfy these crucial, but sometimes conflicting, objectives.

2. Subjects

Subjects for this experiment were investment analysts at seven Canadian stock brokerage firms. A specific group of larger firms was selected so that a large number of analysts could take part in the study in a short period of time. At each firm, all analysts who were willing and available to participate were accepted as subjects.

Strictly speaking, the subjects chosen were not a random sample of any larger population, and the results of the experiment cannot be used to draw conclusions about any larger group. It would have been interesting to use a random sample of all analysts in Canada, but quite infeasible to do so. A random sample would have been spread all over the country, making it impossible to administer the experiment to all subjects within a short period of time except through mail contact. It was considered vital to complete the administration of the experiment quickly so as to minimize the possible effect on analysts' attitudes of changing economic and market conditions. It was also considered important to avoid the low response rate which could be expected with a mail questionnaire (Stallman, 1969).

Although the subjects were not a random sample of any larger group it is not clear that they reacted differently in the experiment than would any other group of professional analysts, including a group chosen at random from all Canadian analysts. The reader may therefore be inclined to draw conclusions about analysts in general from the results of this study. Such inference is not necessary, however, to view the results as useful. The subject group itself is an interesting population - several analysts from some of Canada's leading securities firms. The subject group itself, through recommendations to clients, likely has an important influence on investment decisions in this country. Whether they represent any larger group or not is irrelevant; they are a group of interest just in themselves.

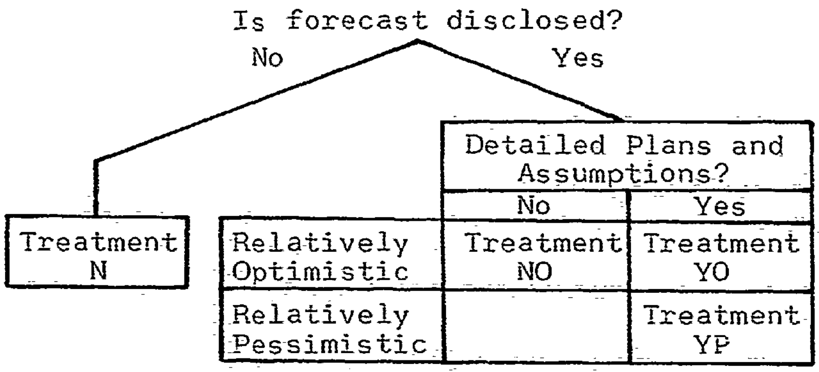
3. Treatments

The treatments, or independent variables, in this experiment were the annual reports which the subjects analyzed before answering the questionnaires. Four different annual reports were used, hence there were four experimental treatments. All annual reports were for the same company and the same year, and they contained exactly the same historical information. They differed in only one respect: the extent of the disclosure of forecasts. Reduced photocopies of the four annual reports are presented in Appendices 1 to 4, and the differences among them are explained below.

Figure 1 summarizes the differences among the treatments and indicates how the designations N, NO, YO and YP were derived.

FIGURE 1

EXPERIMENTAL TREATMENTS



The first treatment, called treatment N, contained no forecast, i.e., it contained no explicit predictions or plans for the future. This treatment is presented in Appendix 1.

The second treatment, called treatment NO, contained relatively optimistic management forecasts of EPS and sales, but very little detail as to the plans and assumptions underlying the forecasts. This treatment is presented in Appendix 2. The forecast consisted of a single paragraph, the last one of the president's report.

The third treatment, called treatment YO, contained relatively optimistic management forecasts of EPS and sales, considerable detail as to the plans and assumptions underlying the forecasts, and forecast financial statements. This treatment is presented in Appendix 3. The forecast in the president's report began in paragraph eleven, "You will notice that...," and continued to the end of the report. The forecast financial statements were located adjacant to the historical statements, and a forecast column accompanied the seven year review.

The fourth treatment, called treatment YP, was identical to treatment YO except that the management forecast was relatively pessimistic. This treatment is presented in Appendix 4. The president's report was exactly the same as for treatment YO except for the forecasts of: sales, EPS, number of new stores, and amount of new floor space. Forecasts in treatment YP were considerably lower than those in treatment YO. The forecast financial statements and the forecast column accompanying the seven year review reflected the lower forecasts.

The forecasts given in treatment NO were exactly the same as some of those given in treatment YO. Treatment YO was constructed first (as described below), and then certain sentences were selected for inclusion in treatment NO.

The four treatments therefore varied on two dimensions: the amount of forecast data disclosed by management and the degree of optimism implicit in the forecast. Concerning the amount of forecast data, treatment N contained none, NO contained some, and treatments YO and YP contained more. As for degree of optimism, it was higher for treatments NO and YO (forecast EPS = $1.79) than for treatment YP (forecast EPS = $1.48).

Development of the four annual reports was a major undertaking, and was completed only after several drafts, a pilot test, and critical evaluation by academic and security industry experts. Following is a brief description of the process by which the reports were developed.

A Canadian public company was identified which met the following criteria:

- It would not be affected by the proposed tax rate change for profits earned on manufacturing and processing. (Otherwise analysts' responses might have unnecessarily varied because of vastly different assumptions about the 1973 tax rate.)
- It was not in an industry which, because of technology, markets, or financing, required a very specialized expertise on the part of analysts. (Otherwise only a few analysts would have been able to do a reasonable job of analyzing the statements. The merchandising industry met the first two criteria, and a firm from this industry was eventually selected.)
- It had been in existence for at least five years. (Otherwise the additional difficulty of evaluating a new firm would have complicated the analyst's task.)
- It had, over the previous five years, shown a consistent year-to-year increase in earnings per share. (This was considered desirable to set up the "optimistic" and "pessimistic" forecasts so that both would be believable.

The optimistic forecast would say, in effect, "continued growth of EPS, and at an accelerated rate," while the pessimistic forecast would say, in effect, "continued growth in EPS, but at a slower rate." In actual fact EPS for the year turned out to be $1.62, approximately mid-way between the optimistic and pessimistic treatment forecasts.)

- Actual company annual reports for several years were available. (This was necessary in order to allow the researcher to develop an understanding of the company as a basis for constructing realistic forecasts for the experimental annual reports.)
- The company was Canadian and was public. (It was considered important to be able to tell the subjects that the annual report they were analyzing was based on a real Canadian public company. This would increase the realism of the situation for the analyst and increase the probability of a typical analysis by the analyst.)

Once a suitable company had been identified, a study of company annual and quarterly reports and published analyses of the company and the industry were undertaken. This was done to better acquaint the researcher with the economics of the industry and the particular company.

The actual construction of forecast statements began with an extrapolation of past EPS figures to arrive at an "optimistic" EPS for 1973, and a "pessimistic" EPS. The optimistic EPS was based on an assumption of EPS percentage growth slightly higher than any year-to-year increase over the preceding five years. The pessimistic EPS was based on an assumption of EPS percentage growth slightly lower than any year-to-year increase over the preceding five years. Detailed assumptions were then laid out for both the optimistic and pessimistic cases, so that the resulting EPS figures would be plausible. Basic assumptions were required in such areas as: number, size and type of new stores to be opened, sales per square foot in different store types, sales growth in old stores, margins on sales in new and old stores, growth in earnings of subsidiaries, sales of the major new subsidiary and margin on sales, stock options to be exercised, effective tax rate for current and deferred taxes, sale of fixed assets. From the basic assumptions and an analysis of past financial statement ratios, complete financial statements were developed for the optimistic and pessimistic cases.

The non-financial parts of the annual reports were constructed from previous company annual reports (from which all forecasts had been eliminated) and from the basic assumptions referred to above.

It was felt that the above method of developing undisguised experimental annual reports, though time-consuming, was necessary to ensure reports which appeared realistic and which would inspire an analyst to do an analysis somewhat similar to that which he might do with a real report.

Finally, several changes were made in the financial and non-financial sections to disguise the identity of the company. All numbers describing the company operations and results were multiplied by a constant. Names of people and places were deleted. Extraordinary items and adjustments to retained earnings were removed from the financial statements. The names of the company and its subsidiaries were changed. The disguise could not be expected to be 100 percent effective, but it was intended to minimize the possibility that a subject would simply refer to a recent brokerage firm forecast for the company and use that as his best estimate.

The annual reports were typeset and printed by offset process on 11" x 17" book and cover stocks similar to those used in financial statements. Reports were folded, saddle stitched, and edges trimmed. The result was a set of annual reports which were based on a series of realistic and mutually consistent assumptions, and which looked like real annual reports. It was hoped that the result would be a conscientious effort by subjects to use the reports in a way approaching realism.

The process of developing the final annual reports was not, of course, as straightforward as the above description would imply. For example, criteria for selection of the company were developed gradually as many companies were considered and problems with some of them became obvious. Several attempts were necessary before a set of assumptions was found which was both plausible and which produced the desired EPS. A pilot study was conducted with forty MBA graduates, using a set of five different annual reports (Duncan, 1973). Major modifications were made as a result. Academic and investment industry experts suggested improvements as well.

4. Dependent Variables

The dependent variables for the experiment were the answers which subjects gave to questions 1 to 4 on a questionnaire headed "Questions to be Answered After Analyzing the Annual Report", and questions 1 and 2 on a second questionnaire, headed "Questions to be Answered After Making Forecasts."

In essence, these questions asked subjects to make single point predictions of next year's EPS and the year-end common stock price and to indicate a range within which the actual results would likely fall. The questions also asked subjects to list and rate the importance of factors which had been considered when making the predictions. Photocopies of the two questionnaires are presented in Appendices 5 and 6 respectively.

5. Administration Procedure

Contact with the subjects was made through the research director at each brokerage firm. In gaining the cooperation of the research directors two conflicting objectives had to be kept in mind. On the one hand, the information given to the director had to be kept to a minimum. Were he to know the details of the experiment he could inadvertently bias the outcome by explaining beforehand to subjects the nature of their participation. At the same time he had to be convinced to cooperate: to arrange a meeting of as many of his analysts as possible within a specific one-week period, and to allow the analysts to devote an hour or so of working time to participation in the study.

It was recognized before approaching the research directors that there was really no significant direct payoff for them in participating, and that some might feel nervous about having the performance of their analysts publically compared with those of other firms. It was decided therefore to emphasize that results of the study would not identify individual participants or firms and that results would be made available to participating firms about a month after completion of the study.

The plan then was to telephone each research director in late August, 1973, and to acquire his cooperation by telling him no more than the following:

- The researcher's name is Carson Duncan.
- He is a Ph.D. candidate at the University of Western Ontario.
- Professor Ross Archibald suggested the researcher call him for help in conducting a research study.
- The research project involves a study of investment analysis techniques - forecasting techniques.
- The research can be done only with the cooperation of several research directors and analysts.
- What will be required is the participation of all full-time stock analysts for approximately one hour some working day.
- The task of the analysts will be to analyze a company annual report and answer a few questions.

- Results of the study will be made available to participating firms.
- Results of the study will not single out individual participants or firms.

In some cases the research director put the researcher in contact with a subordinate, implicitly agreeing to cooperate but appointing someone else to arrange the details. In six of the seven cases full cooperation was assured in the first telephone conversation, and a time was agreed upon for the researcher to visit and conduct the study. In one case, a preliminary meeting was held with the research director and a time then agreed upon for the researcher to return and conduct the study. In all but one or two cases, cooperation was achieved without divulging details of the study beyond those in the list above. In the few instances where the firm contact insisted on more detail, it was provided, but the contact was strongly urged to keep these details secret until participation of his analysts was complete.

So that all subjects in all firms would be analyzing the annual reports in roughly the same economic and market environment, it was desirable to conduct the whole experiment as quickly as possible once it was underway. The researcher was able to schedule meetings with the various firms so that the time elapsed between the first and last was only eight days - August 27 to September 4, 1973.

The procedure followed in conducting the experiment was much the same at each firm. The researcher arrived at the offices of the firm and was greeted by the research director or his delegate. A few minutes were spent in small talk or in discussion of the study while the analysts were being gathered together. The research director then introduced the researcher to the assembled group and the researcher gave a short talk.

> "I am a Ph.D. candidate at The University of Western Ontario, doing research on forecasting by financial analysts. It is vital to my research that I get the cooperation of research directors and analysts like you. I am grateful to Mr. ______ for agreeing to help and I will be very grateful for your participation today.
>
> "What I want you to do is take one of the envelopes from this pile, go to your office, open the envelope and follow the instructions. When you are finished, return everything to me.
>
> "Basically, you will find an annual report to analyze, and some questions to answer. I realize that you may find the data somewhat inadequate for a complete analysis, but if you do the best you can that will be fine.
>
> "Take as much time as you need. Previous participants have generally taken less than an hour. When you return the first questionnaire, a second one will be given to you. It should take only a few extra minutes to complete.
>
> "Do not communicate with other participants during the study, and please do not discuss this study with analysts in other firms for at least two weeks after today.
>
> "This is not a test of your competence and your answers will be anonymous. Results will not be disclosed by individual, or even by firm. A copy of the results combining all analysts

> at all firms will, however, be sent to the research director for your information.
>
> "Thank you once again for participating, I would rather not go into any more detail now; you should find the instructions clear. But if there are questions I will try to answer them, and I will be glad to discuss the study in detail after you have finished your task."

In most cases analysts did exactly what they were asked to do. In a few firms, one or two participants were unable to complete the task immediately due to prior commitments. Their responses were picked up later by the researcher or were mailed to him. In one firm it was deemed impractical for the participants to complete the task while the researcher waited. In this firm the contact person agreed to hand out the second questionnaire upon completion of the first, and to mail the completed responses to the researcher. Since these responses were mailed on September 11, 1973 it is probable that some of the analyses from this firm were done as late as that date, meaning the total elapsed time for the experiment may have been as much as fifteen days.

Random assignment of subjects to treatments was an important feature of the design. This was accomplished by arranging the pile of envelopes from which subjects drew. Each group of four envelopes contained one of each of the treatments; within the group of four they were randomly distributed. This ensured that there would be no bias induced at the individual firm by certain personality types always choosing first and hence always receiving the same treatment. It also ensured that over the whole experiment approximately the same number of observations would be obtained for each treatment.

Each envelope contained one annual report representing one treatment (see Appendices 1 to 4), and one sheet of green paper. On one side of the green paper were instructions to be followed (see Appendix 7); on the other side was the first questionnaire (see Appendix 5). The questionnaire was designed to gather the study's dependent variables. The instruction sheet was designed to do two things: (1) reiterate the important points made verbally to subjects in the meeting, and (2) establish a common set of assumptions concerning the economic environment facing the firm to be analyzed. These assumptions were provided so that analysts would concentrate on analyzing the annual reports, and so that their responses would tend to differ largely as a result of different reactions to the annual reports rather than as a result of different economic assumptions they might have held.

The selection of economic assumptions was based upon a study of analyses of the merchandising industry and merchandising companies. Assumptions were provided for factors which seemed to be popular inputs to merchandising analyses (gross national product, consumer spending, retail sales), or which seemed to be particularly volatile for 1973 (inflation, unemployment).

The first questionnaire was coded so the answers could be identified with the appropriate treatment. The code was contained in the "date" printed at the bottom of the page. To allow matching of the two questionnaires by subject, both questionnaires for a particular subject were given a common number at the time the first was being collected and the second distributed.

6. Hypotheses

The general question addressed in the experiment was what difference if any would management disclosure of earnings forecasts make. It was suspected that the forecasts would influence the subjects who received them and that the subjects would therefore respond differently to the questionnaires. It was expected that the forecasts might influence subjects' responses along three dimensions: first, the general level of estimates for earnings per share and stock price; second, the degree of confidence felt by subjects in making these estimates; third, the degree of concensus among analysts concerning these estimates.

a. General Level of Estimates

The first dimension, general level of estimates, was of interest because if it could be established that analysts' predictions differed between treatments it would indicate that the forecast information was useful. Useful in this context meant that the information was used by analysts in formulating their forecasts or expectations about the firm and its stock. This was one of the concepts of usefulness presented by Pankoff and Virgil (1970, p. 2) and supported by Greenball (1970, p. 49). The concept said nothing about whether better investment decisions would be made by individual analysts using the forecast data, or whether the economy's resources would be better allocated by the collective investment decisions of all analysts and investors. Experimental differences would simply indicate that the forecast data had been used, because subjects believed, consciously or unconsciously, that the information was useful to them in their task of prediction.

Questions 1 and 3 on the first questionnaire elicited a general level of estimates for EPS and stock price from each treatment group. There was no way of knowing, before the experiment was conducted, what general level of estimates would be made by the subject group N. It was possible that, on the basis of purely historical company information and analyst assumptions about the future of the economy and the company, treatment N would produce estimates at any level. Estimates for EPS might generally have been higher than the $1.79 forecast in treatments NO and YO; they might have been equal to $1.79; they might have been between $1.79 and the $1.48 of treatment YP; or they might have been lower than $1.48. Estimates of stock price likewise might have taken any level for treatment N, because the price-earnings ratio as well as the EPS estimate could have taken any value.

Thus it was impossible, before the experiment, to hypothesize whether treatments NO, YO, and YP would elicit generally higher or lower earnings estimates than N. It was hypothesized, however, that the forecasts would make a difference in general levels of earnings estimates. It was expected that, no matter what the estimate of treatment N subjects, forecasts would tend to move NO, YO, and YP subject estimates in the direction of management's forecasts. It was felt that management's "optimistic" and "pessimistic" forecasts, $1.79 and $1.48, were sufficiently far apart that significant differences would appear even if treatment N produced an estimate exactly equal to one of them. It was predicted that the general level of earnings estimates for YO would be higher than that for YP. This hypothesis implied that the general level for YO would be higher than that for N if the level for N were lower than that for YP.

It was similarly impossible to hypothesize whether treatments NO, YO, and YP would elicit generally higher or lower stock price estimates than N. It was predicted, however, that the general level of stock price estimates for YO would be higher than that for YP. This prediction was based on the prediction concerning earnings estimates, plus the hypothesis that treatment YO would elicit a price-earnings ratio at least as large as that for YP. With the above exception, no strong hypotheses were held concerning price-earnings ratios.

It was suspected, though not strongly held, that treatment YO would evoke generally higher EPS and stock price estimates than NO. It was expected that subjects would regard the $1.79 management forecast as rather high, and that they would tend to discount this forecast less when more detail was provided.

b. Confidence in Estimates

The second dimension, degree of confidence, was of interest for basically the same reason as the first. Stallman (1969) specifically emphasized the importance of user confidence as a measure of the usefulness of accounting information.

Questions 2 and 4 on the first questionnaire were designed to measure the degree of confidence which subjects had in their own estimates of earnings and stock price. Strong hypotheses were not held in this area, but it was suspected that treatment YO would result in greater subject confidence than NO because of the greater detail provided.

c. Concensus on Estimates

The third dimension, concensus among analysts, was of interest because of the possible bearing on stock market efficiency. If investor concensus on the value of the firm is increased by additional disclosure, price fluctuations could be reduced and market efficiency increased (Singhvi and Desai, 1971). Conclusions in this area based on experimental results must be very tentative, however, since experiments focus on individual behavior rather than aggregrate market behavior (Gonedes and Dopuch, 1974, p. 106).

For any treatment group, the dispersion around the central tendency was defined as the measure of the concensus of the group with respect to that estimate. These measures were derived, therefore, from answers to questions 1 and 3 on the first questionnaire.

The only strongly held prior in this area was that the concensus generated by treatment YO would be greater than that generated by NO. It was expected that the greater detail provided in YO would tend to bring analysts into greater agreement in their estimates of the company's earnings and stock price.

To summarize, the following hypotheses were tested using the results of the experiment. Hypotheses 1, 2, 3, 8, and 9 were held with more conviction than the others.

H1. The general level of EPS predictions is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving detailed pessimistic forecasts.

H2. The general level of stock price predictions is higher for analysts receiving detailed optimistic earnings forecasts than for analvsts receiving detailed pessimistic forecasts.

H3. The general level of price-earnings ratios for analysts receiving detailed optimistic earnings forecasts is at least as high as that for analysts receiving detailed pessimistic forecasts.

H4. The general level of EPS predictions is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving optimistic forecasts without detail.

H5. The general level of stock price predictions is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving optimistic forecasts without detail.

H6. Confidence in predictions of EPS is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving optimistic forecasts without detail.

H7. Confidence in predictions of stock price is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving optimistic forecasts without detail.

H8. Concensus among analysts in predicting EPS is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving optimistic forecasts without detail.

H9. Concensus among analysts in predicting stock price is higher for analysts receiving detailed optimistic earnings forecasts than for analysts receiving optimistic forecasts without detail.

d. The Second Questionnaire

The intention in administering the second questionnaire was to see whether subjects receiving treatments NO, YO, and YP would explicitly mention the management forecast as one of the factors going into their own estimates. It was expected that subjects would notice the forecasts, use them in formulating their estimates, recognize that they had done so, and mention the forecasts as one of the factors they had considered.

It was expected that subjects receiving more detail, in YO or YP, would be more inclined to mention it than those receiving less detail, in NO.

This concludes the description of the method by which an experiment was conducted to ascertain the effect of management forecasts on analysts' predictions. The next chapter presents the results of this study. Chapter VI relates the findings to the literature and draws general conclusions.

CHAPTER III

EFFECT ON ANALYSTS: RESEARCH RESULTS

This chapter presents the results of the experiment described in the previous chapter. It describes briefly the subjects who participated in the study and the effort they devoted to the task, and then discusses the results of the study in terms of the hypotheses described in chapter two. The detailed raw data upon which this discussion is based are presented in Appendix 8.

1. Subjects: Characteristics and Effort

Table 8 shows the distribution of subjects by firm.

TABLE 8

NUMBER OF SUBJECTS
BY TREATMENT AND BY FIRM

	Firm							
Treatment	A	B	C	D	E	F	G	Total
N	2	2	3	1	1	2	1	12
NO	2	3	2	1	2	0	2	12
YO	1	1	3	1	3	1	2	12
YP	2	3	3	1	2	1	1	13
Total	7	9	11	4	8	4	6	49

A total of forty-nine subjects were drawn from seven brokerage firms. Two firms contributed the low of four subjects; one firm contributed the high of eleven. The median contribution was seven subjects. Distribution of treatments within firms was not perfectly even (note firms B, E, and F), but the important objective of even overall distribution of subjects to treatments was accomplished, as all treatments had twelve subjects except YP which had thirteen.

Table 9 shows the distribution of subjects by years of experience. Subjects had as little as three months experience as a professional analyst, and as much as thirty-three years. The median for all subjects was 3.5 years, ranging from 2.0 years for treatment YO to 4.0 years for treatments N and YP.

TABLE 9

NUMBER OF SUBJECTS
BY TREATMENT AND BY YEARS OF EXPERIENCE

Years of Experience	Treatment N	NO	YO	YP	Total
Less than 1.0			2	1	3
1.0 - 1.9		4	3	1	8
2.0 - 2.9	2	3	2	2	9
3.0 - 3.9	1	1	1	2	5
4.0 - 4.9	4		1	3	8
5.0 - 5.9	2	1	2		5
6.0 - 6.9	2	2			4
7.0 - 7.9				1	1
8.0 - 8.9			1	1	2
More than 8.9	1	1		2	4
Total	12	12	12	13	49
Median in Years	4.0	2.5	2.0	4.0	3.5

Table 10 shows the distribution of subjects by time spent on analysis of the annual report. The median time spent by all subjects was 45 minutes, ranging from 37 minutes for treatment NO to 50 minutes for treatments YO and YP.

Subjects receiving the detailed management forecasts took slightly longer on average to complete their analyses and make their estimates. This might have been due in part to the fact that treatments YO and YP contained more material to read and analyze. The time difference could also be partly explained by the fact that subjects receiving treatments YO and YP had, on the average, less experience than N and NO subjects - a median of 3.5 years of experience versus 4.0. The Kendall rank correlation coefficient[1] for experience and time spent was about .2 with a significance level between .05 and .10 (one-tailed test).

TABLE 10

NUMBER OF SUBJECTS
BY TIME SPENT ON ANALYSIS

Time Spent (Minutes)	Treatment				
	N	NO	YO	YP	Total
Less than 26	1	2		2	5
26 - 35	4	4	2	1	11
36 - 45	2	2	3	3	10
46 - 55	2	1	4	3	10
56 - 65	3	3	2	2	10
More than 65			1	2	3
Total	12	12	12	13	49
Median in Minutes	40	37	50	50	45

2. General Level of Estimates: Earnings

Table 11 gives the general level of subjects' estimates of earnings per share and stock price, by treatment. Table 12 presents significance levels[2] pertaining to the data in Table 11.

TABLE 11

MEDIAN ESTIMATES (IN DOLLARS) FOR EARNINGS PER SHARE AND STOCK PRICE

Treatment and Management Forecast of EPS		EPS Estimates			Stock Price Estimates		
		Best Estimate	Upper Bound	Lower Bound	Best Estimate	Upper Bound	Lower Bound
N	N/A	1.41	1.525	1.375	20.775	23.75	17.00
NO	1.79	1.705	1.895	1.555	25.50	29.56	20.00
YO	1.79	1.645	1.70	1.475	25.30	28.45	22.50
YP	1.48	1.45	1.50	1.35	21.00	27.00	17.00

TABLE 12

SIGNIFICANCE LEVELS FOR SELECTED COMPARISONS IN TABLE 11 (ONE-TAILED TESTS)

Treatments Compared	Best Estimate of Earnings Per Share		Best Estimate of Stock Price	
	U test[a]	t test[b]	U test	t test
N and NO	<.001	<.001	<.05	.026
N and YO	<.001	<.001	<.01	.009
N and YP	>.05	.135	>.05	.287
NO and YO	>.05[c]	.281	>.05	.489
NO and YP	<.001	<.001	>.05	.074
YO and YP	<.01	.001	>.05[c]	.036

[a]The Mann-Whitney U test is described in Siegel (1956, p. 116f).

[b]The t test is described in Dixon and Massey (1969, p. 116f).

[c]Value of U exceeded only slightly the critical value for .05.

The first thing to note in Table 11 is the response of subjects who received treatment N. Prior to the experiment, it was not known what general level of estimates treatment N would evoke. The data show that, on the average, subjects receiving treatment N made best estimates of 1973 earnings per share of $1.41. On average, they were reasonably confident that earnings per share would not rise above $1.525, nor fall below $1.375. Their corresponding best estimate, upper bound, and lower bound for market price were $20.775, $23.75 and $17.00 respectively.

The data for treatment N provide a benchmark with which to compare the results of other treatments. Since treatment N contained no forecast, the effect of providing some forecast versus none can be seen by comparing the results from other treatments with those from treatment N.

The expectation was that providing forecasts would make a difference in the general level of earnings per share estimates; that estimates would tend to move towards the forecast provided by management. This clearly happened. Whereas subject group N estimated earnings per share of $1.41, subject group NO (who were given a management forecast of $1.79) estimated $1.705, subject group YO (who were also given a management forecast of $1.79) estimated $1.645, and subject group YP (who were given a management forecast of $1.48) estimated $1.45. It appears that subjects in each of the groups receiving a management forecast discounted this information somewhat in forming their own estimates, but they did, in general, use it in forming these estimates.

The shift in best estimates of earnings caused by treatments NO and YO are both substantial and statistically significant. Treatment NO raised the estimate by $.295 (21 per cent) over the level for N. Treatment YO raised the estimate by $.235 (17 per cent) over the level for N. In each case the probability that the forecast really had no effect, in spite of the results, is less than .001.

Treatments NO and YO caused not only best estimates of earnings to rise but also upper bounds and lower bounds. Upper bounds tended to rise even more than did best estimates, while lower bounds tended to rise less than did best estimates.

Treatment YP provided subjects with a management forecast for earnings ($1.48) which was quite close to that which subjects with no forecast were to estimate on their own ($1.41). Thus it would not be expected that estimates of earnings by YP subjects would differ greatly from those by N subjects. They did not. The median best estimate for YP was $1.45, only $.04 (3 per cent) higher than that for N. In fact there is a probability greater than .05 that the apparent difference was not attributable to treatment YP, but rather to chance. The upper bounds and lower bounds of YP subjects were in fact slightly lower than those of N subjects.

In summary, treatments containing forecasts did cause best estimates of earnings to differ from those of the benchmark treatment N. In the cases of NO and YO, where the management forecast was considerably higher than $1.41, the difference was sizeable and very significant. In the case of YP, where the management forecast was only slightly higher than $1.41, the difference was minor and not very significant.

Hypothesis 1 predicted that the best estimates of earnings for treatment YO would be higher than those for YP.

The difference was both large ($.195 or 13 per cent) and statistically significant (probability less than .01). Upper and lower bounds for earnings estimates were also higher for YO than for YP.

Treatment NO also produced earnings estimates (best, upper bound, and lower bound) which were higher than those for YP. In fact, the estimates for NO were higher than those for YO, though the statistical significance of the difference was not high. This result was contrary to Hypothesis 4. It had been reasoned that subjects who received more detail would be encouraged to put greater reliance on management's forecasts and thus move their own estimate closer to management's. There are at least three possible explanations for the opposite result. First, perhaps the difference is the result of chance. In replication YO estimates may turn out to be higher than NO estimates. Second, perhaps treatment NO contained the key item(s) of detail for subject acceptance of management forecasts, and the additional detail in YO added nothing to the impact on subjects of management's forecast. Third, perhaps treatment YO contained in its additional detail some item(s) which had the effect of reducing subject acceptance of management forecasts, so that the overall effect of management's forecast and explanation was less than in the NO case. Of course, more than one of these explanations may have been operating simultaneously.

3. General Level of Estimates: Stock Price

Tables 11 and 12 show that results for the general level of stock price estimates parallel those for earnings per share as to direction of difference, but significance levels are not as high.

Treatments NO and YO produced stock price estimates considerably higher than did N, with high significance. Treatment YP produced estimates only slightly higher than did N, with lower significance.

Hypothesis 2 was supported when treatment YO produced estimates higher than YP with a significance level of approximately .05. Treatment NO also produced stock price estimates which were higher than those for YP.

Unlike the EPS situation, stock price estimates for NO were not consistently higher than those for YO. Best estimates were practically the same, while upper bounds were higher for NO, and lower bounds were higher for YO. This result did not support Hypothesis 5; the possible explanations suggested above for the non-support of Hypothesis 4 apply here as well.

4. Price-Earnings Ratios

By dividing each subject's best estimate of earnings per share into his best estimate of stock price a price-earnings (P/E) ratio was calculated for each subject. This ratio is the explicit or implicit multiplier used by subjects in going from an earnings estimate to a stock price estimate. Responses to the second questionnaire indicated that most subjects did explicitly use a P/E approach in estimating stock price. Of forty-seven completed questionnaires, forty-three contained some reference to "P/E" or "multiple" among the factors considered in making the stock price estimate. Two of the other four questionnaires made reference to earnings.

Table 13 shows the median price-earnings ratios by treatment. Hypothesis 3 was supported in that the P/E for YO was not lower than that for YP. The overall differences among P/E ratios by treatment was not great, and the Kruskal-Wallis test[3] indicated a probability of approximately .8 that the observed differences could have occurred by chance. The differences therefore were not significant. This indicated that while subjects took notice of the earning forecasts in estimating earnings, they did not give the forecasts double effect in estimating stock price by applying a significantly larger P/E ratio to their larger earnings estimate.

TABLE 13

MEDIAN PRICE/EARNINGS RATIOS INDICATED BY BEST ESTIMATES OF EPS AND STOCK PRICE

Treatment	P/E Ratio
N	14.05
NO	14.8
YO	15.5
YP	14.25

5. Confidence in Estimates

Table 14 summarizes the measures of subject confidence calculated from answers to questions 2 and 4 on the first questionnaire. Two measures of a subject's confidence were calculated. The first was the difference between the amount given for the upper bound of his estimate and the amount given for the lower bound. This measure was calculated for each subject for earnings per share and for stock price, and the median measures for each treatment are presented in columns 2 and 3 of Table 14. Thus, the average subject who received treatment N placed a \$.20 confidence band around his best estimate of earnings per share, and a \$7.13 confidence band around his best estimate of stock price.

TABLE 14

MEDIAN DIFFERENCES BETWEEN UPPER AND LOWER BOUNDS;
MEDIANS OF THESE DIFFERENCES DIVIDED BY BEST ESTIMATES

	Median Difference Between Upper & Lower Bounds ($)		Median of Differences Divided by Best Estimates	
Treatment (1)	Earnings Per Share (2)	Stock Price (3)	Earnings Per Share (4)	Stock Price (5)
N	.20	7.13	.155	.334
NO	.30	8.00	.177	.450
YO	.25	8.05	.156	.293
YP	.20	9.25	.143	.405
All Subjects	.20	8.00	.146	.366

The second measure of a subject's confidence was the fraction resulting from the division of the confidence band, as described above, by his best estimate. This measure was calculated for each subject for earnings per share and for stock price, and the median measures are presented in columns 4 and 5 of Table 14. Thus when the confidence band to best estimate ratios were calculated for subjects who received treatment N, the median ratio for earnings per share was .155 and the median ratio for stock price was .334.

The advantage of the second measure over the first was that it adjusted for the general level of estimate. It might be expected that as best estimates increased so would the absolute values of the confidence bands. By expressing each confidence band as a fraction of its best estimate, the second measure eliminated any such bias which might exist.

No strong hypotheses were held concerning differences in confidence which various treatments would inspire, and the data indicate that no significant differences in confidence appeared as a result of the treatments. When the Kruskal-Wallis test[3] was applied to the four measures of confidence in Table 14 nothing approaching statistical significance was discovered.[4]

Hypotheses 6 and 7 did suggest that treatment YO would produce greater confidence than treatment NO. Columns 4 and 5 in Table 14 indicate that this was the tendency, but even a t test on the data for these two treatments would not allow rejection of the null hypothesis of no difference at the .10 level.

The overall conclusion from Table 14 is that the treatments had no systematic effect on subjects' confidence.

It is interesting however to note the degree of confidence felt by subjects as a whole. At the median, the confidence band for the EPS estimate was .146 of best estimate. This means that on the average subjects were reasonably confident that actual EPS would be within approximately seven percent, plus or minus, of their best estimate. Some subjects were, of course, more confident that this; others were less confident. It does seem that subjects were quite confident of their earnings predictions.

As might be expected, subjects as a whole were less confident of their stock price estimates than they were of their earnings estimates; the ratio of confidence band to best estimate was .366 at the median, compared to .146 for EPS. This may be explained by the fact that stock price estimates were based not only on earnings estimates but also on estimates of other stochastic variables. Notable among these other variables were the state of the stock market in general and the market opinion of merchandising stocks in general. At least one reference to one of these variables was made by seventy-two per cent of the subjects responding to the stock price portion of the second questionnaire.

6. Concensus on Estimates

Table 15 summarizes the measures of concensus calculated from answers to questions 1 and 3 on the first questionnaire. The first measure of concensus was the standard deviation of best estimates made by any treatment group. The group which received treatment N made best estimates of earnings per share which had a standard deviation of \$.130. The standard deviation for best estimates of stock price was \$4.17 for the same group. The second measure of concensus was the coefficient of variation of best estimates, that is, the standard deviation divided by the mean. Thus for treatment N, the standard deviation of \$.130 divided by the mean of \$1.414 produced a coefficient of variation of 9.2 percent for best estimates of EPS. The coefficient of variation for best estimates of stock price was 19.9 percent for treatment N.

TABLE 15

STANDARD DEVIATIONS AND COEFFICIENTS OF VARIATION FOR BEST ESTIMATES OF EARNINGS PER SHARE AND STOCK PRICE

	Standard Deviation (Dollars)		Coefficient of Variation (Percentage)	
Treatment	Earnings Per Share	Stock Price	Earnings Per Share	Stock Price
N	.130	4.17	9.2	19.9
NO	.173	7.67	10.2	29.3
YO	.123	5.79	7.4	22.0
YP	.132	4.27	9.0	19.1

The advantage of the second measure was that it adjusted for the general level of estimate. It might be expected that as the general level of best estimates increased so would the absolute value of the standard deviation. The coefficient of variation removed any such bias by expressing the standard deviation as a percentage of the group mean.

The pattern emerging from Table 15 is that the group receiving treatment YP developed about the same degree of concensus as did the group receiving treatment N. Group YO developed more concensus on earnings per share estimates but less on stock price estimates. Group NO developed less concensus than any other group on both earnings and stock price estimates.

Significance levels for comparisons of the data in Table 15 are presented in Table 16. They indicate that most of the differences in variances are not highly significant. The highest probabilities of real difference are associated with treatment NO. It seems that treatment NO did in fact lead to a lessening of concensus among the subjects who received it versus the other treatments. This may indicate that such disclosure could tend to have the effect of increasing stock market velocity and hence decreasing market efficiency.

Hypotheses 8 and 9 had predicted that treatment YO would result in more concensus than would treatment NO. This was the case for both EPS and stock price estimates, although the significance levels for differences between the variances were only in the .10 to .25 range.

TABLE 16

SIGNIFICANCE LEVELS FOR COMPARISONS OF BEST ESTIMATE VARIANCES[a]

Treatments Compared	Earnings Per Share	Stock Price
N and NO	.10-.25	.025-.05
N and YO	>.25	.10 -.25
N and YP	>.25	>.25
NO and YO	.10-.25	.10 -.25
NO and YP	.10-.25	.025-.05
YO and YP	>.25	.10 -.25

[a]F ratio test is explained in Dixon and Massey (1969, p. 111).

There was no strong indication that detailed forecasts produced degrees of concensus different from those of treatment N.

As was the case with measures of subject confidence, measures of concensus for stock price estimates differed greatly from those for EPS estimates. The coefficients of variation for stock price estimates are more than double those for EPS estimates. Again this would imply that in going from earnings estimates to stock price estimates subjects considered a number of other factors, and that they differed rather substantially over the importance, magnitude, and effect of these factors.

7. References to Forecasts in Second Questionnaire

Previous sections of this chapter have indicated clearly that the management forecasts made a difference, that is, the forecasts were noticed and used by subjects in estimating earnings per share and stock price. It might have been expected then that subjects receiving forecasts would, in answering the second questionnaire, explicitly mention the forecast as one of the factors influencing their estimate. Table 17 shows that some of these subjects did just that. Of thirty-six subjects receiving forecasts, fifteen, or 41.7 percent, made reference to the forecast as one of the factors used in making their estimates of earnings per share, and five, or 13.9 percent, said the forecast was a factor in their stock price estimate. Every subject who listed the forecast as a factor influencing stock price estimate also listed it as a factor influencing earnings per share estimate.

TABLE 17

SUBJECTS MAKING REFERENCE TO MANAGEMENT FORECAST AS A FACTOR INFLUENCING THEIR ESTIMATES OF EARNINGS PER SHARE OR STOCK PRICE

Treatment	Number of Subjects Completing Second Questionnaire	Subjects Making Reference to Forecast: Earnings Per Share		Subjects Making Reference to Forecast: Stock Price	
		Number	Percent	Number	Percent
NO	12	3	25.0	1	8.3
YO	11	4	36.4	2	18.2
YP	13	8	61.5	2	15.4
Total	36	15	41.7	5	13.9

As expected, subjects who received the more detailed forecasts in treatments YO and YP mentioned forecasts more often than those who received less detail in treatment NO. Of those who received detailed forecasts, 50 percent, twelve out of twenty-four, mentioned the forecast as a factor. Of those who received forecasts without detail, only 25 percent, three out of twelve, mentioned the forecast as a factor. A one-tailed Chi-square test[5] indicates a .10 to .15 probability that such a difference could have arisen due to chance alone. The fact that many subjects mentioned the forecast as a factor influencing their estimates strengthens the conclusions drawn from analysis of the first questionnaire, that is, that the forecasts were noticed and did have an effect.

One might wonder why the number of subjects mentioning the forecasts was not greater. Could it be that only a certain proportion of subjects receiving forecasts were affected by them, and that these subjects were the ones to cause differences among groups to appear, and that these subjects were the ones to mention the forecast as a factor influencing their estimates? The evidence does not support such an explanation. Table 18 shows that subjects mentioning the forecast as a factor influencing their estimates were no more likely to have made a high estimate (or a low estimate) than subjects who did not mention the forecast as a factor. Thus it was not just the estimates of the subjects who mentioned the forecasts that caused results to differ among treatments. Subjects in general were influenced by the forecasts, but only some of the subjects explicitly mentioned forecasts in the second questionnaire.

TABLE 18

SUBJECTS LISTING AND NOT LISTING FORECAST AS A FACTOR BY GENERAL LEVEL OF EARNINGS PER SHARE ESTIMATE

	Earnings Per Share Estimate Lower Than Median for Subject's Group	Earnings Per Share Estimate Higher Than Median for Subject's Group
Forecast Listed as a Factor Influencing Estimates	7	7
Forecast Not Listed as a Factor Influencing Estimates	11	10

It must be concluded then that some subjects who received a forecast were influenced by it without realizing it and/or were influenced by it but did not acknowledge this. In either case, the implication is clear for research which seeks to discover user models through asking users what they do, and what factors influence their estimates. Research of that type must be carefully designed to elicit facts which the user may not wish to disclose or of which he may not be aware.

8. Summary

A laboratory experiment was undertaken to test the effect of earnings forecasts on analysts' predictions of earnings per share and stock price. Analysts examined one of four annual reports which differed only in their disclosure of forecasts. Analysts' responses to two questionnaires were then analyzed to ascertain the effect of the forecasts.

The results clearly supported the strongly held hypotheses (H1, H2, H3) concerning general level of estimates and price-earnings ratios. Less strongly held hypotheses in this area (H4, H5) were not supported, but on the whole it was clear that the forecasts had made a difference; analysts definitely used the forecasts. This main finding was strengthened by responses to the second questionnaire.

The results provided some support for hypotheses concerning confidence of analysts (H6, H7), but no strong pattern of effect was apparent in this area.

The results provided some support for hypotheses concerning concensus of analysts (H8, H9), but again no strong pattern of effect was apparent.

Within the context of this specific experiment, the above conclusions can be drawn with considerable confidence. Indications are that the experimental design and implementation were such that a high level of internal validity was achieved. Generalizing the results to a wide variety of real world situations is a different matter, however. This experiment addressed only a few specific questions in a very complex area. Even for these questions the experiment dealt only with a particular set of subjects, who examined a particular set of data, which pertained to one particular company. Strictly speaking, any relationships observed in the data cannot be said to exist beyond the specific conditions of this experiment. This limitation notwithstanding, the study does add to our understanding of the effects of earnings forecasts.

Chapter VI summarizes the purpose, method and findings of the experiment, relates the findings to the literature, and makes suggestions for further research.

FOOTNOTES

1. The Kendall rank correlation coefficient is explained in Siegel (1956, p. 213f).

2. The Kruskal-Wallis one-way analysis of variance test (Siegel, 1956, p. 184f) was performed to determine the overall significance of the differences in best estimates shown in Table 11. For best estimates of earnings per share the probability was less than .001 that the observed differences could have occurred by chance. For best estimates of stock price the probability was just over .05. Thus in both cases the overall differences were significant.

3. The Kruskal-Wallis one-way analysis of variance test is explained in Siegel (1956, p. 184f).

4. The probabilities of chance occurance were in the .3 to .9 range.

5. The Chi-square test is explained in Dixon and Massey (1969, p. 237f).

CHAPTER IV

INCIDENCE IN ANNUAL REPORTS: RESEARCH METHOD

Chapter I explained that although several studies have touched upon the issue of forecast disclosure in annual reports, the literature contains no report of a major study which had as its main focus a detailed examination of annual report forecasts of corporate results. Particularly, no such study has been reported for the annual reports of Canadian companies. Thus, the discussion to date of forecast disclosure has proceeded with an incomplete understanding of actual practice. The present study was undertaken to provide a greater understanding of actual forecast disclosure practices.

A study of 240 annual reports was done to determine the extent of di closure by managers of Canadian corporations of forecast corporate results, including earnings forecasts. The annual reports examined were those of sixty firms chosen at random from the Canadian corporations listed as Industrials in the March, 1973 issue of the Toronto Stock Exchange Review. A firm was included in the sample only if its common stock was listed and if it had been public sufficiently long to have published four annual reports. The sixty firms chosen are listed in Appendix 9. Annual reports for the years 1969, 1970, 1971, and 1972 were examined.[1] The total of 240 reports were those of the sixty firms for the same four consecutive years. In each case the entire annual report was examined, excluding the financial statements and related footnotes and auditor's opinion. These were excluded from consideration because a preliminary survey indicated that no forecasts of overall corporate results were contained in financial statements and because it seemed highly unlikely that auditors would permit such forecasts to appear in the financial statements.

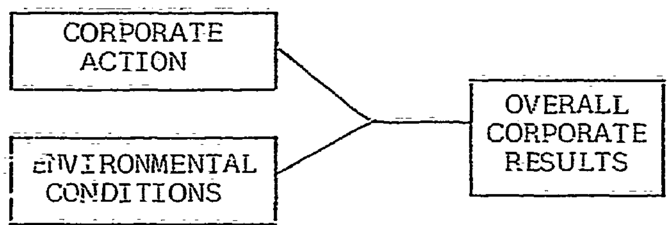
The primary objective was to describe the forecasts of corporate results disclosed by the sample firms. Secondary objectives were to examine relationships that might exist between such disclosure and various characteristics of the firms, and to evaluate the accuracy of management predictions.

1. Model for Forecast Information

The framework used to categorize forecast items was developed from the general model shown in Figure 2. The first category, corporate action, refers to assertions about company behavior in the future. For example, "We will introduce a new product in July." The second category, environmental conditions, refers to assertions about the future environment in which the company will operate. For example, "Interest rates will rise and consumer demand will fall during the coming year." The third category, corporate results, refers to assertions about the results that the company as a whole will experience in the future as a result of the interaction of company action and the company's environment. For example, "Earnings will increase next year" or "We look forward to a successful year." A fourth type of assertion can be identified, that which indicates a cause and effect relationship between elements in the three categories. For example, "Our introduction of a new product will likely prompt a price reduction by competitors."

FIGURE 2

GENERAL MODEL FOR FORECAST INFORMATION



Each part of this overall framework could be refined greatly. Tables 19, 20, and 21 illustrate possible subcategories for each of the main elements: corporate action, environmental conditions, and corporate results. Though considerably detailed, these tables are not all-inclusive. In fact the possible assertions could never be fully anticipated, since there is no limit to the assertions which firms could make about future company action, environmental conditions, overall company results, or the relationships among these elements.

The original research plan envisioned a classification and analysis of all forecast information in the annual reports, using the overall framework of Figure 2 and subcategories such as those in Tables 19, 20, and 21. It became obvious that this goal was unrealistic, and a decision was made to concentrate on one major category, corporate results.

This selection reflected the belief that readers of annual reports are, and should be, very much interested in management's prediction of overall corporate results, particularly future profitability. The selection was also closely related to the focus of the other major study reported here: that on analysts' reactions to earnings forecasts in annual reports.

TABLE 19

EXAMPLES OF CORPORATE ACTION

Marketing
- Target market
- Products
  - Differentiation
  - Performance
- Price
- Promotion
- Distribution
- Sales volume
- Competitive advantage
- Costs
- Distinctive competence
- Number of salesmen
- Number of stores

Research and Development
- Directions
- Costs
- Competitive advantage
- Distinctive competence
- Capacity

Organization
- Structure
- Leadership style
- Key people
- Training program
- Planning and control systems

Production
- Plants
- Equipment
- Capacity
- Efficiency
- Costs
- Capital expenditures
- Competitive advantage
- Distinctive competence

Financing
- Borrowing
- Share issues
- Leasing
- Earnings retention rate
- Financing needs

TABLE 20

EXAMPLES OF ENVIRONMENTAL CONDITIONS

General Economy
- Gross national product
- Disposable income
- Demand for consumer goods
- Demand for consumer durables
- Demand for non-durables
- Demand for industrial goods
- Interest rates
- Inflation
- Unemployment
- Consumer psychology

Government Policy
- Fiscal
- Monetary
- Trade
- Pollution control
- Foreign investment

Population and Demography
- Family formations

Availability of Factors of Production
- Materials
- Labor
- Capital

Industry Demand
- Market for a type of product or service
- Activity level in segment of economy
- Type of product required to satisfy demand
- Attitudes of consumers in an industry

Firm Demand
- Market for the specific product sold by the company
- Attitude of company customers

Competitive Conditions
- Competitors' strengths and weaknesses
- Competitors' strategies
- Key factor for successful competition
- Number/identification of competitors

Technology
- How devices will be built: components and processes

TABLE 21

EXAMPLES OF CORPORATE RESULTS

Income Statement
- Sales
- Cost of sales
- Gross margin
- Selling & administrative expenses
- Income before taxes
- Net income

Balance Sheet
- Current assets
- Fixed assets
- Total assets
- Current liabilities
- Non-current liabilities
- Capital
- Retained earnings

Sources and Uses Statements
- Various sources
- Various uses

Various financial statement ratios

Other
- Growth
- Success
- Performance
- Results

2. Model for Corporate Results

A framework was developed to describe the forecasts categorized as corporate results. It consisted of four elements: object, period, nature, modifier. The framework, its elements and subelements are summarized in Table 22.

TABLE 22

FRAMEWORK FOR DESCRIBING CORPORATE RESULTS

Object
- Earnings
- Sales
- Cash
- Performance
- General

Period
- Next year
- Other year
- Unspecified
- Annual

Nature
- Strong prediction
- Weak prediction
- Qualified strong prediction
- Qualified weak prediction
- Necessity
- Goal
- No prediction
- Year to date

Modifier

(Categories differ for various objects.)

For the object Earnings
- Positive
- Negative
- Profitable growth
- Increase
- Increase or decrease
- Decrease
- Compare well
- Good
- Outlook good
- Poor
- Maximum
- Optimum
- Not modified

For the object Sales
- Increase
- Decrease
- Equal
- Outlook good
- Good
- Exceed
- Not modified

For the object Cash
- Positive
- Increase

For the object Performance
- Increase
- Comparable
- Outlook good
- Good
- Fluctuate

For the object General
- Growth
- Progress
- Good
- Optimism
- Confidence
- Success
- Encouraging
- Meet challenge
- Other favorable
- Unfavorable
- Not modified

Object refers to that about which management is making the assertion. Consider, for example, the following assertion: "Earnings will increase next year." In this assertion "earnings" is the object, because management is making a prediction about earnings.

Period refers to the period of future time about which management is asserting. In the example above, "next year" is the period.

Nature refers to the nature of management's assertion about the future. In our example, the word "will" indicates a strong unqualified prediction.

Modifier refers to that which is said about the object. In the example, "increase" describes what is expected to happen to the object "earnings."

Each instance of a management assertion about future corporate results was classified according to its object, period, nature, and modifier.

3. Content Analysis

The research method by which the annual reports were examined is called content analysis, two definitions of which are, "a research technique for the objective, systematic, and quantitative description of the manifest content of communication," and "any procedure for assessing the relative extent to which specified references, attitudes, or themes permeate a given message or document" (Holsti, 1968, p. 597).

This section and the four which follow describe the content analysis performed on the annual reports. To derive the set of instructions necessary to replicate the study a reader need only convert the form of these sections --from the descriptive to the imperative.

In conducting a content analysis choices must be made among alternative recording units and context units (Holsti, 1968, pp. 647-48). The recording unit refers to the size of the units to be coded, i.e., the specific segment of content to be categorized. Alternatives include the word, the sentence, the paragraph, and the theme. The context unit is the largest body of content that may be searched to characterize a recording unit. Alternatives include the sentence, the paragraph, and the entire document.

The recording unit chosen for this content analysis was the theme, i.e., a single assertion about some subject. In cases where a sentence contained more than one theme, the sentence was reduced to its component themes before they were categorized. For example, the sentence -- "We expect increased sales and earnings" -- consists of two themes: (1) "we expect increased sales" and (2) "we expect increased earnings."

The context unit chosen consisted of three paragraphs: the paragraph containing the theme, the paragraph immediately preceding the one containing the theme, and the paragraph immediately following the one containing the theme. In other words, when it was not possible to classify a theme without some reference to the context in which it appeared, reference was made to any or all of the three specified paragraphs.

Holsti (1968) emphasizes the importance for objectivity and reliability of setting up appropriate categories for the classification of data (pp. 644, 646, 658). He also discusses the difficulties of category definition (pp. 646, 658) and identifies a dilemma: "as categories and units of analysis become more complex, they are likely to become both more useful and less reliable" (p. 660).

In this study the scheme for categorizing the themes was developed by trial and error, by testing the usefulness of tentative categories and then modifying them in the light of the data. Holsti (1968, p. 646) points out that this is a common approach in the absence of standard classification schemes.

Considerable trial and error was necessary before categories were established which met the criteria of being (1) related to the research elements of interest, (2) exhaustive, and (3) mutually exclusive, and before definitions of categories were developed that allowed consistency in the classification of themes.

The following four sections of this chapter describe the final classification scheme and specify the indicators that were used to determine which themes fell into each category.

4. Object

The objects about which managements made assertions were categorized as follows: earnings, sales, cash, performance, general. Each is explained below.

Earnings includes reference to the following: earnings, profits, earnings per share, return on investment, return on equity, return on shareholders' equity, rate of return, etc., where reference is undoubtedly being made to the dollar earnings of the firm.

Sales includes reference to the following: sales, revenue, billings, etc., where reference is undoubtedly being made to the dollar sales of the firm.

Cash includes reference to cash flow, net cash flow, net cash inflow, etc., where reference is undoubtedly being made to the net cash flow of the firm.

Performance includes reference to the following: performance, financial results, results, operating results, or annual reports.

General includes all other references to overall company results. Examples are as follows: the outlook is good, the future is bright, the company will succeed, prospects are grim.

5. Period

Future periods referred to in management assertions were categorized as follows: next year, other year, unspecified, annual. Each is explained below.

Next year reflects a clear reference to the fiscal year following that upon which the current annual report is reporting.

Other year reflects a clear reference to some specific period of time other than that of next year. For example: over the next three years, the year after next, nineteen eighty-four.

Unspecified reflects a reference to future period(s) not clearly identified. For example: future years, months ahead, in the short run, immediately, foreseeable future.

Annual reflects a specific reference to the annual occurrence of a particular phenomenon. For example: annually, yearly.

6. Nature

Management assertions were categorized by their nature, as follows: strong prediction, weak prediction, qualified strong prediction, qualified weak prediction, necessity, goal, no prediction, year to date.

Strong prediction reflects a clear, unambiguous prediction about future overall company results. For example: "Earnings will increase," or "Earnings are expected to increase." Numerous other expressions were also classified as strong predictions. The range is demonstrated in Table 23.

Weak prediction reflects a less strong prediction about future overall company results. For exampl : "Earnings might increase," or "Earnings could increase." The assertion raises the probability of a future overall company outcome without predicting it clearly. The range of such expressions is demonstrated in Table 24.

TABLE 23

EXPRESSIONS CONVEYING STRONG PREDICTION

Earnings will increase.
We expect an earnings increase.
We anticipate an earnings increase.
We predict an earnings increase.
We forecast an earnings increase.
We foresee an earnings increase.
We are certain of an earnings increase.
We are assured of an earnings increase.
We are confident of an earnings increase.
We are assuming an earnings increase.
Increased earnings is indicated.
The outlook is for increased earnings.
The prospect is for increased earnings.
There is a good probability of increased earnings.
The likelihood is for increased earnings.
Earnings are about to increase.
Increased earnings are just ahead.
Increased earnings are coming.
Earnings are going to increase.
Earnings should increase.
We look for an earnings increase.
Increased earnings are imminent.
Increased earnings are impossible.
Increased earnings are doubtful.
The expectation is for an earnings increase.
Increased earnings are expected.
Earnings are expected to increase.
We are soundly positioned for continued growth.
We are a growing company.
Our business is growing.
Our ever-growing company.

TABLE 24

EXPRESSIONS CONVEYING WEAK PREDICTION

Earnings might increase.
Earnings may increase.
Earnings could increase.
Earnings will perhaps increase.
We are hopeful that earnings will increase.
There is some probability that earnings will increase.
It is possible that earnings will increase.
The potential exists for increased earnings.
There is a chance of increased earnings.

Qualified strong prediction reflects a strong prediction qualified in the same sentence as to certain conditions which are required for the predicted outcome. For example: "Earnings will increase when the economy improves," or "Earnings will increase if the economy improves."

Qualified weak prediction reflects a weak prediction qualified in the same sentence as to certain conditions which are required for the predicted outcome. For example: "Earnings might increase when the economy improves."

Necessity reflects an assertion about the need for certain overall company outcomes. For example: "Earnings must increase if we are to continue to attract capital." Other examples are shown in Table 25.

TABLE 25

EXPRESSIONS CONVEYING NECESSITY

Earnings must increase.
Earnings have to increase.
An increase in earnings is necessary.
An increase in earnings is required.
An increase in earnings is essential.

Goal reflects the notion that certain overall company outcomes have been accepted as company objectives or goals, or that the company is exerting effort toward the accomplishment of certain overall company outcomes, or that the company has developed plans for the purpose of accomplishing certain overall company outcomes. For example: "Our objective is to increase earnings," or "We are making every effort to increase earnings," or "We have specific plans to increase earnings." Other examples are shown in Table 26.

TABLE 26

EXPRESSIONS CONVEYING GOAL

Our objective is to increase earnings.
Our goal is to increase earnings.
Our desire is to increase earnings.
Our hope is to increase earnings.
We are aiming to increase earnings.
We are hoping to increase earnings.
We are determined to increase earnings.
We are intending to increase earnings.
We are planning to increase earnings.
We strive for a return to earnings growth.
We are trying to increase earnings.
We are making every effort to increase earnings.
We are preparing to increase earnings.
We are interested in increasing earnings.
We are committed to increasing earnings.
We are scheduling an increase in earnings.
We have plans to increase earnings.
These become important factors in our profitability.
Earnings will be a reflection of our ability to control expenses.
The new structure is designed for growth.
An increase in earnings depends upon close attention to costs.

No prediction reflects a management assertion about its inability or unwillingness to predict overall company outcomes. For example: "It is difficult to predict earnings for next year."

Year to date reflects an assertion about overall company outcomes to date in the fiscal year underway at the time of the writing of the annual report, i.e., the year following that covered by the Income Statement included in the annual report. For example: "So far this year earnings are running ahead of last year's pace."

7. Modifier

Finally, management assertions were categorized according to the modifier used to describe the object. The categories were not the same for all objects, because the kinds of things said about various objects differed substantially, and not all modifiers could be logically related to all objects.

The categorization schemes for modifiers of the various objects were summarized in Table 22, and are explained below, beginning with those for the object earnings.

a. Earnings

Positive means earnings greater than zero. For example: "Next year will see a return to profitability," or "Past losses will be applied against next year's earnings."

Negative means earnings less than zero. For example: "It is unlikely that we will see a return to profitability next year," or "Losses are expected to increase."

Profitable growth means an optimistic management reference to future earnings by use of the specific wording "profitable growth," or wording very similar to it, e.g., "profitable expansion," "expand profitably."

Increase means earnings greater, or losses less, than those of the previous year. Many expressions convey the notion of increase. For example: advance, better, exceed, expand, grow, greater, higher, improve, larger, progress, rise, upward, upturn.

Increase or decrease means earnings or losses that could be greater or less than those of the previous year.

Decrease means earnings less, or losses greater, than those of the previous year.

Compare well means earnings that compare well or favorably with those of the previous year.

Good means that future earnings have been described in a way reflecting management satisfaction or optimism. For example, describing future earnings as good, satisfactory, reasonable, adequate, high, strong, or sufficient.

Outlook good means that the outlook for earnings has been described in a way reflecting management satisfaction or optimism. For example, describing the outlook for earnings as good, bright, favorable, optimistic, encouraging, or promising.

Poor means that future earnings have been described in a way reflecting management dissatisfaction or pessimism. For example, describing future earnings as poor, unsatisfactory, unreasonable, inadequate, low, weak, or insufficient.

Maximum means a reference to earnings maximization.

Optimum means a reference to an optimum level of earnings.

Not modified means the management reference to earnings was not modified by use of any of the modifiers listed above, nor by use of any other modifier that could be so listed. For example, "Clearing the way for a profit-oriented future!"

b. Sales

The categorization scheme for modifiers of the object sales included five modifiers identical in name and meaning to those used with the object earnings. Two additional modifiers were also used; they are explained below.

Increase.

Decrease.

Equal means sales equal to those of the previous year.

Outlook good.

Good.

Exceed means sales that will exceed a given dollar amount.

Not modified.

c. Cash

The categorization scheme for modifiers of the object cash was limited to two modifiers, both of which were identical in name and meaning to modifiers used with the object earnings.

Positive.

Increase.

d. Performance

The categorization scheme for modifiers of the object performance included three modifiers identical in name and meaning to those used with the object earnings. Two additional modifiers were also used; they are explained below.

Increase.

Comparable means that performance will be comparable to that of the previous year.

Outlook good.

Good.

Fluctuate means that there will be fluctuations or variability in performance.

e. General

The categorization scheme for modifiers of the object general is explained below.

Growth means that the company will grow. For example: "We are planning further growth," or "This is a firm foundation for future growth," or "We are a growing company," or "A new era of expansion is fast erupting."

Progress means that the company will progress. For example: "Next year should be another year of progress," or "This will assure our continuing progress," or "A loyal work-force is necessary for our continued progress." The word progress or some variation, e.g., progressive, must be used.

Good means that overall company results will be good. For example: "Next year will be a good year," or "We look forward to a reasonably good year." The word good must be used.

Optimism means that management describes its outlook for the future as being one of optimism. For example: "We look to the future with optimism," or "We cannot help but be optimistic." The word optimism or some variation, e.g., optimistic, must be used.

Confidence means that management describes its outlook for the future as being one of confidence. For example: "We look to the future with confidence," The word confidence or some variation, e.g., confident, must be used.

Success means that the company will enjoy success. For example: "We expect a successful year," or "This will contribute to our continuing success." The word success or some variation, e.g., succeed, successful, must be used.

Encouraging means that the future is described as being encouraging. For example: "The outlook for your company is encouraging," or "We enter the new decade very encouraged at our prospects." The word encouraging or some variation, e.g., encouraged, must be used.

Meet Challenge means that the company will meet the challenges which will face it. The word challenge or some variation must be used.

Other favorable means any general comment partaining to favorable corporate results other than those falling within the eight previous categories. This category covers the many modifiers of general corporate results which convey a feeling of optimism about the future but which appear less frequently than the eight previous modifiers. Some of the operative words are: accomplishment, favorable, bright, attractive, proper, exciting, attain goals, enthusiastic, development, prepared.

Unfavorable means any general comment pertaining to possible unfavorable corporate results. For example: "Proposals in the White Paper would damage the company," or "Inflation poses a threat to the sound growth of the company."

Not modified.

This completes the description of the framework which was developed to describe the forecasts categorized as corporate results. The framework, its elements and sub-elements are summarized in Table 22.

8. Company Characteristics

The previous section described the method by which forecasts of corporate results were categorized according to object, period, nature, and modifier. This section describes various company characteristics which were examined in an attempt to find relationships with forecast disclosure.

a. Following a Profit or Loss

Annual reports were put into one of two categories: those which were reporting a profit in the year just ended, and those reporting a loss in the year just ended. The data were obtained from the income statements of the actual annual reports. An annual report was considered to be reporting a loss if either earnings before extraordinary items or earnings after extraordinary items was negative. This characteristic was of interest because it might be hypothesized that management's propensity to forecast was conditioned by the current existence or absence of earnings, by whether it was reporting good news or bad news for the year just ended.

b. Following Increased or Decreased Earnings

Annual reports were put into one of two categories: those reporting earnings for the year just ended which were greater than earnings of the previous year, and those reporting earnings for the year just ended which were less than earnings of the previous year. The data used to classify a given annual report were obtained from the comparative income statements of that annual report.

This characteristic was of interest because it might be hypothesized that management's propensity to forecast was conditioned by whether it was reporting an improving situation or a declining situation.

To effect this classification it was necessary to develop rules to handle situations in which earnings before extraordinary items (EBEI) had increased while earnings after extraordinary items (EAEI) had decreased, and vice versa.

In cases where EBEI decreased while EAEI increased, the annual report was deemed to have reported a decrease in earnings. This was because EBEI is the generally-acknowledged measure of profitability from ordinary operations (Fischer and Jordon, 1975, p. 210). Managers and investors like to see EBEI increasing, not decreasing. The fact that, in a given year, an extraordinary gain can turn the decrease before extraordinary items into an increase after extraordinary items does not hide the fact that basic ongoing profitability has decreased. Managers and investors are concerned about a decrease in EBEI regardless of EAEI.

In cases where EBEI increased while EAEI decreased, the classification of the annual report depended upon the cause of the decrease in EAEI. If the decrease in EAEI arose because extraordinary gains in the current year were less than extraordinary gains in the previous year, the annual report was said to have reported an increase in earnings. In this situation, the important EBEI did increase; only the amount of extraordinary gain decreased. Management is reporting essentially good news about the year just ended.

If, however, the decrease in EAEI arose because extraordinary losses in the current year were greater than extraordinary losses in the previous year, the annual report was said to have reported a decrease in earnings. In this situation significant extraordinary losses are being reported - losses enough to nullify the advance in EBEI. Management is reporting some bad news about the year just ended.

c. Preceding a Profit or Loss

Annual reports were put into one of two categories: those which were followed a year later by annual reports showing a profit, and those which were followed a year later by annual reports showing a loss. The data were obtained from the income statements of the actual annual reports. An annual report was considered to be reporting a loss if either earnings before extraordinary items or earnings after extraordinary items was negative.

This characteristic was of interest because it might be hypothesized that management's propensity to forecast was conditioned by whether the coming year was likely to produce a profit or a loss.

d. Preceding Increased or Decreased Earnings

Annual reports were put into one of two categories: those which were followed a year later by annual reports showing an increase in earnings, and those which were followed a year later by annual reports showing a decrease in earnings. The data used to classify a given annual report were obtained from the comparative income statements of the annual report which followed a year later.

Again it was necessary to develop rules to handle situations in which EBEI and EAEI moved in opposite directions. The rules developed for item (b) above were used for this purpose.

This characteristic was of interest because it might be hypothesized that management's propensity to forecast was conditioned by the results which management would be able to report in the annual report of the following year.

e. Company Size

Annual reports were placed in one of four categories, corresponding to the quartile rank in terms of total assets for the specific year in question. For each of the four years involved, quartile ranks were developed using total assets as shown on the balance sheets of the annual reports.

Total assets was chosen over sales as the measure of size largely for convenience. Whereas the total asset figure was readily available, an unambiguous figure for sales was not always reported. For example, firms varied in their definitions and categorization of sales, revenue, and income. In at least one annual report no sales figure at all was reported.

Table 27 shows the composition of the four quartiles for each year examined.

TABLE 27

COMPOSITION OF ASSET SIZE QUARTILES

	Total Assets ($ Millions)			
Quartile	Year 1 (1969)	Year 2 (1970)	Year 3 (1971)	Year 4 (1972)
1	66 & over	71 & over	78 & over	87 & over
2	22 - 65.9	28 - 70.9	35 - 77.9	42 - 86.9
3	10 - 21.9	10 - 27.9	12 - 34.9	14 - 41.9
4	0 - 9.9	0 - 9.9	0 - 11.9	0 - 13.9

By way of comparison, The Financial Post ranking[2] for 1969 of Canada's largest manufacturing, resource, and utility companies listed eighty firms with assets of $66 million or more. In addition there were nine merchandising companies with assets this great, and all of the twenty-five largest financial companies had assets this great. Thus one might approximate that the sample firms in the largest quartile of the present study were all among the largest two hundred Canadian companies and that most of the others were not.

Company size was of interest because it might be hypothesized that management's propensity to forecast was conditioned by the size (maturity, power, visibility) of the company.

f. Company Industry

Annual reports were placed in one of twenty-one categories according to the classification assigned to the companies in the 1970 editions of *The Financial Post Survey of Industrials* and *The Financial Post Survey of Investment Funds*. Table 28 lists the industry categories and indicates the number of firms classified in each.

TABLE 28

DISTRIBUTION OF COMPANIES BY INDUSTRY

Industry	Number of Companies
Banking and finance	1
Beverages	3
Chemicals	1
Construction	1
Data processing	-
Electrical equipment	5
Foodstuff and allied products	1
Investment fund	1
Iron and steel	5
Management and holding	1
Merchandising	7
Non-ferrous metals	-
Oils and pipelines	3
Printing, publishing & broadcasting	2
Property development	10
Public utilities	4
Pulp, paper and lumber	5
Textiles	1
Transportation and storage	2
Trust and loan	3
Miscellaneous	4
Total	60

This characteristic is of interest because it might be hypothesized that management's propensity to forecast was conditioned by the nature (maturity, stability, riskiness) of the industry in which the firm operated.

g. Preceding a Securities Issue

Annual reports were put into one of three categories: those which were followed within one year by the public issue of equity securities, those followed within one year by an issue of debt securities only, and those not followed within a year by any public securities issue.

Identification of new issues was made with the 1970-74 editions of The Financial Post Corporation Service Record of New Issues.

The year following the annual report was measured from the date of the Letter to the Shareholders or the date of the Auditor's Report, whichever was later.

An issue was considered to be an equity issue if the unit issued consisted in whole or in part of any of the following: equity shares, warrants for equity shares, rights for equity shares, securities convertible into equity shares. An issue was considered to be debt only when the unit issued consisted entirely of debt securities. Annual reports followed by issues of both debt and equity were classified as preceding an equity issue.

This characteristic was of interest because it might be hypothesized that management's propensity to forecast was conditioned by management's plans for the issue of new securities.

h. Auditor

Annual reports were categorized according to the firm(s) of Chartered Accountants which rendered an opinion on the financial statements. Identification of the firm(s) was made from the annual reports.

This characteristic is of interest because it might be hypothesized that management's propensity to forecast in the annual report was conditioned by the auditor's attitude towards such disclosure in the annual report.

9. Accuracy

The study revealed no annual reports containing specific point estimates of earnings for future years. Thus it was not possible to measure accuracy in terms of dollar or percentage deviations from predicted values. An analysis was undertaken, however, to assess the accuracy of selected references to next year's earnings. Predictions were checked for accuracy by reference in each case to the annual report for the year following the prediction. Thus only predictions appearing in annual reports of the first three years were tested for accuracy.

The first accuracy test involved all explicit references to next year's earnings. For references which clearly predicted positive/negative earnings or an increase/decrease in earnings, accuracy was easily ascertained by reference to the annual report of the following year. For references with less specific modifiers a judgement on accuracy was made by referring to the sign of the following year's earnings and the direction of their change from the previous year.

The second accuracy test involved both explicit and implicit strong predictions of either positive or increased earnings for next year. An implicit prediction was one which, although not made explicitly, could be deduced from an explicit prediction. For example, if a report contained an explicit prediction that earnings would increase and if the firm was currently enjoying earnings greater than zero, there was an implicit prediction that next year's earnings would also be positive. Similarly, an explicit prediction of positive earnings, made by a firm currently in a loss position, was an implicit prediction of increased earnings for the coming year.

This chapter has described the method by which annual reports were analyzed for forecasts of corporate results. The study was exploratory in nature, aimed at discovering the real world situation with respect to forecast disclosure in Canadian annual reports. The purpose was not to test any firmly held specific hypotheses. The general hypotheses were that some firms disclose forecasts of corporate results, and that firms differ in the nature of their disclosure. The next chapter presents the results of this study. Chapter VI relates the findings to the literature and draws general conclusions.

FOOTNOTES

1. An annual report was classified as belonging to 1969 if the balance sheet date was between July 1, 1969 and June 30, 1970. This is referred to as year one in the discussion of results in Chapter V.

2. <u>The Financial Post</u>, July 11, 1970, p. 11.

CHAPTER V

INCIDENCE IN ANNUAL REPORTS: RESEARCH RESULTS

This chapter presents the results of the study of annual reports described in the previous chapter. The first section provides a general picture of the disclosure of corporate results. Sections two through six focus on references to each of the five objects in the categorization model. Sections seven through nine concentrate on predictions of next year's earnings, including an analysis of relationships to company characteristics and an analysis of forecasting accuracy.

1. References to Some Object

Of the 240 annual reports, 182 (75.8 percent) made at least one reference to the future with respect to one of the objects under examination: earnings, sales, cash, performance, or general. Table 29 shows the number of annual reports making reference to each of the five objects in each of the four years. For example, twenty-five annual reports from year 1 contained at least one reference to the object earnings; twelve contained a reference to sales; three contained a reference to performance; and thirty-   en contained a reference to the object general. In total, forty-four of the sixty annual reports from year 1 contained at least one reference to one of the objects. The sum of 25, 12, 3, and 37 exceeds forty-four because some annual reports contained reference to more than one object. The table shows that 113 of the sample of 240 annual reports (47.1 percent) contained a reference to earnings and 182 (75.8 percent) contained a reference to at least one of the objects.

Table 30 shows the total number of references made in these 182 annual reports to each of the five objects. The numbers in Table 30 are larger than those in Table 29 because many annual reports contained more than one reference to a given object. For example, the twenty-five annual reports of year 1 which made reference to earnings (Table 29) contained a total of thirty-seven such references (Table 30). For all four years, the 113 annual reports making reference to earnings (Table 29) contained 165 such references (Table 30), and the 182 annual reports which contained at least one reference to any object contained 523 references in total.

TABLE 29

NUMBER OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO VARIOUS OBJECTS BY YEAR OF ANNUAL REPORT

Year of Annual Report	Object					Any Object
	Earnings	Sales	Cash	Performance	General	
Year 1	25	12	0	3	37	44
Year 2	27	14	0	6	35	46
Year 3	28	10	1	7	36	46
Year 4	33	16	2	4	35	46
Total	113	52	3	20	143	182
Total as Percentage of 240 Reports	47.1	21.7	1.2	8.3	59.6	75.8

TABLE 30

NUMBER OF REFERENCES, BY OBJECT AND BY YEAR OF ANNUAL REPORT

Year of Annual Report	Object					Total
	Earnings	Sales	Cash	Performance	General	
Year 1	37	20	0	3	71	131
Year 2	35	18	0	7	64	124
Year 3	44	14	2	7	66	133
Year 4	49	20	3	4	59	135
Total	165	72	5	21	260	523
Total as Percentage of All References	31.5	13.8	1.0	4.0	49.7	100.0

The overall pattern disclosed in Tables 29 and 30 is that references to the object general and the object earnings were the most prevalent, followed by references to sales, performance, and cash, in that order.

In terms of numbers of annual reports, Table 29 shows that 143 annual reports (59.6 percent of all reports) made reference to the object general; 113 (47.1 percent) made reference to the object earnings; 52 made reference to the object sales; 20 made reference to the object performance; and only 3 made reference to the object cash.

Table 30 shows a similar pattern in terms of numbers of references. Of the 523 references, 260 (49.7 percent) were to the object general; 165 (31.5 percent) were to the object earnings; 72 were to the object sales; 21 were to the object performance; and only 5 were to the object cash.

The last columns in Tables 29 and 30 indicate little year to year variation in the overall incidence of forecasts for the four years examined. Table 29 shows that forty-four annual reports of year 1 contained a forecast reference and that there were forty-six such reports in each of the other three years. Table 30 shows that 131 forecast references were made in the annual reports of year 1 and that the reports of succeeding years contained 124, 133, and 135 respectively.

Tables 29 and 30 do, however, show more year to year fluctuation for individual objects. There is some suggestion of an increasing trend to refer to earnings, as the number of annual reports with such references rose steadily from twenty-five in year one to thirty-three in year four. The number of references to earnings went from thirty-seven in year one to forty-nine in year four. At the same time, there is some suggestion of a decreasing trend to general references. Although the number of annual reports containing such references remained about the same, the number of such references fell from seventy-one in year one to fifty-nine in year four. Throughout this study, however, any suggestions of possible trends must be interpreted very cautiously, since they may be a function of unspecified third factors rather than of time.

Table 31 shows the distribution among the sixty sample companies of the 182 annual reports which contained a reference to the future with respect to one of the objects. Thirty-one companies made some reference to some object for all four years examined. Eleven companies made some reference in three of the four years. Ten companies made some reference in two years, five companies made some reference in one year, and only three made no reference in any of the four years. Thus, approximately one-half of the firms made some reference to future company results in each of the four years examined and 95 percent made some such reference in at least one of the four years.

TABLE 31

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO ANY OBJECT

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	31	51.7	51.7
3	11	18.3	70.0
2	10	16.7	86.7
1	5	8.3	95.0
0	3	5.0	100.0
	60	100.0	

. Table 32 analyzes the 523 references to all objects according to the future time period to which references were made. Most references were made to unspecified future periods. There were 287 such references, these being 54.9 percent of all references. Next most common were references to next year. There were 216 references to next year, these comprising 41.3 percent of all references. Together, references to unspecified future periods and to next year comprised 96.2 percent of all references. Only 14 references were to specific periods other than next year, and only 6 references were to an annual future result. Some year to year fluctuation is seen in Table 32 for each of the periods referred to. No trend over time is apparent.

TABLE 32

NUMBER OF REFERENCES, BY PERIOD REFERRED TO AND BY YEAR OF ANNUAL REPORT

Year of Annual Report	Period Referred to: Next Year	Other Year	Unspecified	Annual	Total
Year 1	48	3	77	3	131
Year 2	50	5	67	2	124
Year 3	64	2	67	0	133
Year 4	54	4	76	1	135
Total	216	14	287	6	523
Percent of Total	41.3	2.7	54.9	1.1	100.0

In summary, 75.8 percent of the annual reports in the sample contained some reference to future results. References most often concerned the objects general and earnings and the future periods unspecified and next year. The next five sections of this chapter describe in more detail the references made to each of the five objects.

2. References to Future Earnings

Of the 240 annual reports, 113 (47.1 percent) contained at least one reference to future earnings. Table 33 shows the incidence of such annual reports by year. Twenty-five of the annual reports were from the first year examined; twenty-seven were from the second year; twenty-eight were from the third year; and thirty-three were from the fourth year.

The distribution among years was about even, but a steady increase over time did exist.

TABLE 33

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO FUTURE EARNINGS, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	25	41.7
Year 2	27	45.0
Year 3	28	46.7
Year 4	33	55.0
All Years	113	47.1

Table 34 shows the distribution of these 113 annual reports among the sixty sample companies. Eight companies made reference to future earnings for all four years examined. Ten companies made such a reference in three of the four years. Sixteen companies made such a reference in two years, nineteen made such a reference in one year, and only seven made no such reference in any of the four years. Thus, 30 percent of the firms made such a reference in at least three years, and 88.3 percent of firms made such a reference in at least one of the four years.

TABLE 34

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO FUTURE EARNINGS

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	8	13.3	13.3
3	10	16.7	30.0
2	16	26.7	56.7
1	19	31.7	88.3
0	7	11.7	100.0
	60	100.0	

a. Next Year's Earnings

Of the 240 annual reports, sixty-nine (28.8 percent) contained at least one reference to next year's earnings. Table 35 shows the incidence of such annual reports by year. Seventeen of the sixty-nine annual reports were from the first year examined; sixteen were from the second year; nineteen were from the third year; and seventeen were from the fourth year. The distribution among years was about even.

TABLE 35

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S EARNINGS, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	17	28.3
Year 2	16	26.7
Year 3	19	31.7
Year 4	17	28.3
All Years	69	28.8

Table 36 shows the distribution of these sixty-nine annual reports among the sixty sample companies. Three companies made reference to next year's earnings for all four years examined. Four companies made such a reference in three of the four years. Ten companies made such a reference in two years, twenty-five made such a reference in one year, and eighteen made no such reference in any of the four years. Thus, 70 percent of the firms made such a reference in at least one year, but only 11.7 percent made one in at least three years.

TABLE 36

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S EARNINGS

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	3	5.0	5.0
3	4	6.7	11.7
2	10	16.7	28.3
1	25	41.7	70.0
0	18	30.0	100.0
	60	100.0	

Table 37 shows the number and type of references to next year's earnings which were found in the sixty-nine annual reports containing any such reference. The total number of references (seventy-seven) is greater than the number of annual reports (sixty-nine) because some annual reports contained more than one reference.[1]

TABLE 37

NUMBER OF EXPLICIT REFERENCES TO NEXT YEAR'S EARNINGS BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature						
Modifier	Strong Prediction	Weak Prediction	Qualified Strong Prediction	Goal	No Prediction	Year to Date	Total
Positive	7						7
Negative			1			1	2
Increase	42		3	6		5	56
Decrease	1						1
Compare well	1		1				2
Good	1			1			2
Poor						1	1
Outlook good	1						1
Profitable growth				1			1
Increase or decrease		1					1
Not modified	—	—	—	2	1	—	3
Total	53	1	5	10	1	7	77

In terms of the nature of the references, Table 37 shows that references to next year's earnings were most often in the nature of a strong prediction (fifty-three references, or 68.8 percent of all references). For example, "1970-71 should be another year of expanded sales and increased profits." Next most prevalent were references to goals (ten references, or 13.0 percent of all references). For example, ". . . an increase in both sales and earnings is planned . . ." There were seven references to year to date (9.1 percent of all references). For example, "Our volume and profit this year continues at an improved pace . . ." There were five qualified strong predictions (6.5 percent of all references). For example, ". . . economic factors . . . have improved and if this trend continues, we can look forward to higher earnings in 1971." One reference was in the nature of a weak prediction -- ". . . we will do well to maintain earnings equal to last year." Finally, there was one reference of the nature of no prediction -- "The economy is too uncertain to forecast sales, cost and profit trends in the second half of 1970."

In terms of the modifier of the reference, Table 37 shows that in fifty-six instances (72.7 percent of all references) the explicit reference was to an increase in next year's earnings. The previous paragraph contains several examples. In seven references (9.1 percent) the modifier explicitly indicated positive earnings for next year. For example, "It is reasonable to expect that 1972 will be a profitable year." The nine other modifiers discovered appeared no more than three times each. In no instance was a specific dollar figure or range of dollars given as a forecast.

Considering the nature of the references and their modifiers together, the outstanding feature is the high incidence of strong predictions that next year's earnings will increase. Forty-two references (54.5 percent of all references) were of this type. No other type of reference was nearly so prevalent. In addition to the forty-two strong predictions explicitly predicting an increase in earnings, three more strong predictions predicted an increase implicitly, by explicitly predicting positive earnings after a year of negative earnings.

On the whole, references to next year's earnings delivered good news rather than bad news to readers of the annual reports. Only five references (6.5 percent of all references) were of a nature that could be classified as indicating bad news (negative, decrease, poor, increase or decrease).

Section 7 of this chapter examines more closely the fifty annual reports containing the fifty-three strong unqualified predictions about next year's earnings.

b. <u>Earnings of a Period Not Specified as Next Year</u>

Of the 240 annual reports, only four (1.7 percent) contained at least one reference to earnings of a specific period other than that of the next year.

Of the 240 annual reports, only two (0.8 percent) contained at least one reference to earnings in terms of an annual occurance.

Of the 240 annual reports, sixty-seven (27.9 percent) contained at least one reference to earnings of an unspecified future period. Table 38 shows the incidence of such annual reports by year. Fourteen of the annual reports were from the first year examined; fourteen were from the second year; sixteen were from the third year; and twenty-three were from the fourth year. The distribution among years is about even for the first three years, but considerably higher in the fourth year. Except for this concentration in year four, the distribution is similar to that for references to next year's earnings (Table 35).

TABLE 38

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO EARNINGS OF AN UNSPECIFIED FUTURE PERIOD, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	14	23.3
Year 2	14	23.3
Year 3	16	26.7
Year 4	23	38.3
All Years	67	27.9

Table 39 shows the distribution of the sixty-seven annual reports among the sixty sample companies. Only one company made reference to the earnings of some unspecified future period for all four years examined. Five companies made such a reference in three of the four years. Twelve companies made such a reference in two years, twenty-four made such a reference in one year, and eighteen made no such reference in any of the four years. Thus, 70 percent of the firms made such a reference in at least one year, but only 10 percent made one in at least three years. This concentration among the companies is very similar to that for references to next year's earnings (Table 36).

TABLE 39

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO EARNINGS OF AN UNSPECIFIED FUTURE PERIOD

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	1	1.7	1.7
3	5	8.3	10.0
2	12	20.0	30.0
1	24	40.0	70.0
0	18	30.0	100.0
	60	100.0	

Table 40 shows the number and type of references to earnings of an unspecified future period which were found in the sixty-seven annual reports containing any such reference. The total number of references (eighty) is greater than the number of annual reports (sixty-seven) because some annual reports contained more than one reference.[1]

TABLE 40

NUMBER OF REFERENCES TO EARNINGS OF AN UNSPECIFIED FUTURE PERIOD BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature						
Modifier	Strong Prediction	Weak Prediction	Qualified Strong Prediction	Necessity	Goal	No Prediction	Total
Positive	8						8
Increase	25	1		3	11		40
Good	1			2	3		6
Outlook good	2						2
Profitable growth	4		1		7		12
Maximum	1				2		3
Optimum					1		1
Not modified					7	1	8
Total	41	1	1	5	31	1	80

In terms of the nature of the references, Table 40 shows that references to earnings of an unspecified future period were most often in the nature of a strong prediction (forty-one references; 51.3 percent of all references) or a goal statement (thirty-one references; 38.8 percent of all references). There were five references to the necessity of earnings and one each in the nature of a weak prediction, a qualified strong prediction, and no prediction. Comparing these results with those of Table 37 (references to next year's earnings), it is seen that strong predictions are clearly the most prevalent in both. Statements of goals are the next most common, being especially prevalent in the unspecified period situation.

In terms of the modifiers, Table 40 shows that forty of the eighty references were to increases in earnings in some unspecified future period. Twelve references (15 percent) were to profitable growth in the future. Eight references (10 percent) were to positive earnings and six (7.5 percent) were to good earnings. The concentration in the increase category is not so heavy here as it is in Table 37 for next year's earnings, but when the increase and profitable growth categories are combined the pattern is very similar.

Considering the nature of the references and their modifiers together, the most common reference was a strong prediction of an increase in earnings (twenty-five instances, 31.3 percent of all references). For example, ". . . gives us confidence in projecting also a continued and healthy profit growth . . ." Next most common was a reference to a goal of increasing earnings (eleven references, 13.8 percent of all references). For example, ". . . is an example of the company's constant desire to . . . add to its profitability . . ."

Table 40 indicates that little bad news was delivered to readers by the references to earnings of unspecified future periods. No references were made to negative earnings or decreases in earnings. Thus whether referring to earnings of next year or some unspecified future period, annual reports tended to communicate good news rather than bad.

3. References to Future Sales

Of the 240 annual reports, fifty-two (21.7 percent) contained at least one reference to future sales. Table 41 shows the incidence of such annual reports by year. Twelve of the annual reports were from the first year examined; fourteen were from the second year; ten were from the third year; and sixteen were from the fourth year. The distribution among years fluctuated considerably.

Table 42 shows the distribution of these annual reports among the sixty sample companies. Only one company made reference to future sales for all four years examined.

Four companies made such a reference in three of the four years. Ten companies made such a reference in two years, sixteen made such a reference in one year, and twenty-nine made no such reference in any of the four years. Thus, about one-half of the companies made no reference to future sales in any of the four years, and only 8.3 percent of the companies made such a reference in three or more of the four years.

TABLE 41

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO FUTURE SALES, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	12	20.0
Year 2	14	23.3
Year 3	10	16.7
Year 4	16	26.7
All Years	52	21.7

TABLE 42

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO FUTURE SALES

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	1	1.7	1.7
3	4	6.7	8.3
2	10	16.7	25.0
1	16	26.7	51.7
0	29	48.3	100.0
	60	100.0	

a. Next Year's Sales

Of the 240 annual reports, forty-two (17.5 percent) contained at least one reference to next year's sales. Table 43 shows the incidence of such annual reports by year. Nine of the annual reports were from the first year examined; eleven were from the second year; ten were from the third year; and twelve were from the fourth year. The distribution among years was about even.

TABLE 43

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S SALES, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	9	15.0
Year 2	11	18.3
Year 3	10	16.7
Year 4	12	20.0
All Years	42	17.5

Table 44 shows the distribution of these annual reports among the sixty sample companies. No company made reference to next year's sales for all four years examined. Two companies made such a reference in three of the four years. Nine companies made such a reference in two years, eighteen made such a reference in one year, and thirty-one made no such reference in any of the four years. Thus, about one-half of the companies made no reference to next year's sales in any of the four years, and only 3.3 percent of the companies made such a reference in three of the four years.

TABLE 44

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S SALES

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	0	0.0	0.0
3	2	3.3	3.3
2	9	15.0	18.3
1	18	30.0	48.3
0	31	51.7	100.0
	60	100.0	

Table 45 shows the number and type of references to next year's sales which were found in the forty-two annual reports containing any such reference. The total number of references (forty-eight) is greater than the number of annual reports (forty-two) because some annual reports contained more than one reference.[1]

In terms of the nature of the references, Table 45 shows that references to next year's sales were most often in the nature of a strong prediction (thirty references, or 62.5 percent of all references).

Next most prevalent were references to goals (eight references, or 16.7 percent of all references) and year to date (seven references, or 14.6 percent of all references). Two references were in the nature of a qualified strong prediction and there was one reference in the nature of no prediction.

TABLE 45

NUMBER OF REFERENCES TO NEXT YEAR'S SALES BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature					
Modifier	Strong Prediction	Qualified Strong Prediction	Goal	No Prediction	Year to date	Total
Increase	26	1	8		6	41
Equal	1					1
Outlook good	1					1
Good	2				1	3
Exceed		1				1
Not modified	—	—	—	1	—	1
Total	30	2	8	1	7	48

In terms of the modifier of the references, Table 45 shows that in forty-one instances (85.4 percent of all references) the reference was to an increase in next year's sales. No other modifier appeared more than three times. In no instance was a specific dollar figure or range of dollars given as a forecast.

Considering the nature of the references and their modifiers together, the outstanding feature is the high incidence of strong predictions that next year's sales will increase. Twenty-six references (54.2 percent of all references) were of this type. No other type of reference was nearly so prevalent.

On the whole, references to next year's sales delivered good news rather than bad news to readers of the annual reports. Only the single reference predicting next year's sales equal to those of the previous year might be viewed as bad news. No reference indicated a decrease in sales, or that sales would be poor or unsatisfactory.

b. Sales of a Period Not Specified as Next Year

Of the 240 annual reports, only one (0.4 percent) contained at least one reference to sales of a specific period other than next year.

Of the 240 annual reports, only two (0.8 percent) contained at least one reference to sales in terms of an annual occurance.

Of the 240 annual reports, eighteen (7.5 percent) contained at least one reference to sales of an unspecified future period. Table 46 shows the incidence of such annual reports by year. Six of the annual reports were from the first year examined; four were from the second year; one was from the third year; and seven were from the fourth year. The distribution among years was about even except for the low incidence in year three.

Table 47 shows the distribution of these annual reports among the sixty sample companies. No company made reference to sales of an unspecified future period for all four years examined. No company made such a reference in three of the four years. Only four companies made such a reference in two years, ten made such a reference in one year, and forty-six made no such reference in any of the four years. Thus, the incidence of references to sales of an unspecified future period was low, with about three-quarters of the companies making no such reference in any of the four years.

TABLE 46

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO SALES OF AN UNSPECIFIED FUTURE PERIOD, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	6	10.0
Year 2	4	6.7
Year 3	1	1.7
Year 4	7	11.7
All Years	18	7.5

TABLE 47

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO SALES OF AN UNSPECIFIED FUTURE PERIOD

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	0	0.0	0.0
3	0	0.0	0.0
2	4	6.7	6.7
1	10	16.7	23.3
0	46	76.7	100.0
	60	100.0	

Table 48 shows the number and type of references to sales of an unspecified future period which were found in the eighteen annual reports containing any such reference. The total number of references (twenty-one) is greater than the number of annual reports (eighteen) because some annual reports contained more than one reference.[1]

TABLE 48

NUMBER OF REFERENCES TO SALES OF AN UNSPECIFIED FUTURE PERIOD BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature				
Modifier	Strong Prediction	Qualified Strong Prediction	Necessity	Goal	Total
Increase	14	1		3	18
Decrease	1				1
Good	1	_	1	_	2
Total	16	1	1	3	21

In terms of the nature of the references, Table 48 shows that references to sales of an unspecified future period were most often in the nature of a strong prediction (sixteen references, or 76.2 percent of all references). Three references were in the nature of a goal; one was in the nature of a qualified strong prediction; and one was in the nature of a necessity.

In terms of the modifier of the references, Table 48 shows that in eighteen instances (85.7 percent of all references) the reference was to an increase in sales in an unspecified future period. No other modifier appeared more than twice. In no instance was a specific dollar figure or range of dollars given as a forecast.

Considering the nature of the references and their modifiers together, the outstanding feature is the high incidence of strong predictions that sales in an unspecified future period will increase. Fourteen references (66.7 percent of all references) were of this type. No other type of reference was nearly so prevalent.

On the whole, references to sales of an unspecified future period delivered good news rather than bad news to readers of the annual reports. Only one reference predicted decreased sales, and this decline was said to be temporary. The prediction of the temporary decrease was accompanied by a prediction of a longer term increase. The one reference to the necessity of good sales was made in the context of a public utility's explaining how rising costs might require increased selling prices.

4. References to Future Cash Flows

Of the 240 annual reports, only three (1.3 percent) contained at least one reference to future cash flows. One of the annual reports was from the third year examined; two were from the fourth year. The three annual reports came from three different companies.

Table 49 shows the number and type of references to future cash flows which were found in the three annual reports containing any such reference. The total number of references (five) is greater than the number of annual reports (three) because some annual reports contained more than one reference.

TABLE 49

NUMBER OF REFERENCES TO FUTURE CASH FLOWS BY NATURE, BY MODIFIER AND BY PERIOD REFERRED TO, ALL FOUR YEARS

		Nature		
Modifier:	Period	Strong Prediction	Goal	Total
Positive:	Unspecified	1		1
Increase:	Next year	1		1
	Other Year	1		1
	Unspecified	1	1	2
Total		4	1	5

In terms of the nature of the references, Table 49 shows that references to future cash flows were most often in the nature of a strong prediction (four references, or 80.0 percent of all references). The remaining reference was to a goal.

In terms of the modifier of the references, Table 49 shows that in four instances (80.0 percent of all references) the reference was to an increase in cash flow. The remaining reference was to net cash flows that would be positive.

Thus, references to future cash flows were very few in number. Those that did exist tended to be strong predictions and to deliver good news rather than bad news.

5. References to Future Performance

Of the 240 annual reports, twenty (8.3 percent) contained at least one reference to future performance. Table 50 shows the incidence of such annual reports by year. Three of the annual reports were from the first year examined; six were from the second year; seven were from the third year; and four were from the fourth year. The distribution among years fluctuated somewhat, but in no year was the incidence greater than twelve percent.

TABLE 50

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO FUTURE PERFORMANCE, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	3	5.0
Year 2	6	10.0
Year 3	7	11.7
Year 4	4	6.7
All Years	20	8.3

Table 51 shows the distribution of these annual reports among the sixty sample companies. No company made reference to future performance for all four years examined. One company made such a reference in three of the four years. One company made such a reference in two years, fifteen made such a reference in one year, and forty-three made no such reference in any of the four years. Thus, 71.7 percent of companies made no reference to future performance in any of the four years, and only 3.3 percent made such a reference in two or more years.

TABLE 51

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO FUTURE PERFORMANCE

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	0	0.0	0.0
3	1	1.7	1.7
2	1	1.7	3.3
1	15	25.0	28.3
0	43	71.7	100.0
	60	100.0	

a. Next Year's Performance

Of the 240 annual reports, sixteen (6.7 percent) contained at least one reference to next year's performance. Table 52 shows the incidence of such annual reports by year. Three of the annual reports were from the first year examined; five were from the second year; five were from the third year; and three were from the fourth year. The distribution among years was about even.

Table 53 shows the distribution of these annual reports among the sixty sample companies. No company made reference to next year's performance for all four years examined. One company made such a reference in three of the four years. No company made such a reference in two years, thirteen made such a reference in one year, and forty-six made no such reference in any of the four years. Thus, about three-quarters of the companies made no reference to next year's performance in any of the four years, and only one company made such a reference in more than one year.

TABLE 52

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S PERFORMANCE, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	3	5.0
Year 2	5	8.3
Year 3	5	8.3
Year 4	3	5.0
All Years	16	6.7

TABLE 53

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S PERFORMANCE

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	0	0.0	0.0
3	1	1.7	1.7
2	0	0.0	1.7
1	13	21.7	23.3
0	46	76.7	100.0
	60	100.0	

Table 54 shows the number and type of references to next year's performance which were found in the sixteen annual reports containing any such reference. The total number of references (seventeen) is greater than the number of annual reports (sixteen) because one annual report contained two references.[1]

TABLE 54

NUMBER OF REFERENCES TO NEXT YEAR'S PERFORMANCE, BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature			
Modifier	Strong Prediction	Qualified Strong Prediction	Year to Date	Total
Increase	8	2		10
Comparable	1			1
Outlook good			1	1
Good	4	—	1	5
Total	13	2	2	17

In terms of the nature of the references, Table 54 shows that references to next year's performance were most often in the nature of a strong prediction (thirteen references, or 76.5 percent of all references). Two of the references (11.8 percent) were in the nature of a qualified strong prediction, and two were in the nature of a statement about the year to date.

In terms of the modifier of the references, Table 54 shows that in ten instances (58.8 percent of all references) the reference was to an increase, u,ually expressed as an improvement in performance. In five instances (29.4 percent of all references) the reference was to good performance. The other two modifiers which appeared were used only once each.

Considering the nature of the references and their modifiers together, the most common reference was a strong prediction of an increase (improvement) in performance. Eight references (47.1 percent of all references) were of this type. For example, ". . . improved financial results are expected to be achieved in 1973." Next most common were strong predictions of good performance, with four references (23.5 percent of all references). For example, "We believe that a strong performance can reasonably be expected in 1971 . . ."

On the whole, references to next year's performance delivered good news rather than bad news to readers of the annual reports. None of the references was to future poor performance or even to weakening performance.

b. Performance of a Period Not Specified as Next Year

None of the 240 annual reports contained a reference to performance of a specific period other than next year, and none contained a reference to performance in terms of an annual occurance.

Of the 240 annual reports, only four (1.7 percent) contained at least one reference to performance of an unspecified future period. One of the annual reports was from the second year examined; two were from the third year; and one was from the fourth year. Two of the four annual reports were from one company.

Table 55 shows the number and type of references to performance of an unspecified future period which were found in the four annual reports containing any such reference.[1]

TABLE 55

NUMBER OF REFERENCES TO PERFORMANCE OF AN UNSPECIFIED FUTURE PERIOD, BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature		
Modifier	Strong Prediction	Goal	Total
Increase	1	1	2
Good	1		1
Fluctuate	1	–	1
Total	3	1	4

In terms of the nature of the references, Table 55 shows that three of the four references to performance of an unspecified future period were in the nature of a strong prediction. The remaining one was in the nature of a goal.

In terms of the modifier of the references, Table 55 shows that in two instances the reference was to an increase (improvement) in performance; in one instance the reference was to good performance; and in one instance the reference was to fluctuation in performance.

The last-mentioned reference might be viewed as bad news, but it was accompanied by a statement that the overall trend for the company would be one of growth.

Thus references to performance of an unspecified future period were very few in number. Those that did exist tended to deliver good news rather than bad news.

6. References to Future General Results

Of the 240 annual reports, 143 (59.6 percent) contained at least one reference to future general results. Table 56 shows the incidence of such annual reports by year. Thirty-seven of the annual reports were from the first year examined; thirty-five were from the second year; thirty-six were from the third year; and thirty-five were from the fourth year. The distribution among years was about even.

TABLE 56

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO GENERAL RESULTS, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	37	61.7
Year 2	35	58.3
Year 3	36	60.0
Year 4	35	58.3
All Years	143	59.6

Table 57 shows the distribution of these annual reports among the sixty sample companies. Eighteen companies made reference to general results for all four years examined. Fifteen companies made such a reference in three of the four years. Eight companies made such a reference in two years, ten made such a reference in one year, and only nine made no such reference in any of the four years. Thus, 85 percent of the companies made reference to future general results in at least one of the four years, and 55 percent made such a reference in at least three of the four years.

TABLE 57

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO GENERAL RESULTS

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	18	30.0	30.0
3	15	25.0	55.0
2	8	13.3	68.3
1	10	16.7	85.0
0	9	15.0	100.0
	60	100.0	

a. Next Year's General Results

Of the 240 annual reports, sixty-two (25.8 percent) contained at least one reference to next year's general results. Table 58 shows the incidence of such annual reports by year. Thirteen of the annual reports were from the first year examined; ten were from the second year; twenty-two were from the third year; and seventeen were from the fourth year. The distribution among years suggests somewhat greater incidence in the latter two years.

TABLE 58

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S GENERAL RESULTS, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	13	21.7
Year 2	10	16.7
Year 3	22	36.7
Year 4	17	28.3
All Years	62	25.8

Table 59 shows the distribution of these annual reports among the sixty sample companies. Only one company made reference to next year's general results for all four years examined. Four companies made such a reference in three of the four years. Seventeen companies made such a reference in two years, twelve made such a reference in one year, and twenty-six made no such reference in any of the four years. Thus, 56.7 percent of the companies made reference to next year's general results in at least one year, but only 8.3 percent made such a reference in three or more years.

Table 60 shows the number and type of references to next year's general results which were found in the sixty-two annual reports containing any such reference. The total number of references (seventy-three) is greater than the number of annual reports (sixty-two) because some annual reports contained more than one reference.[1]

TABLE 59

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO NEXT YEAR'S GENERAL RESULTS

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	1	1.7	1.7
3	4	6.7	8.3
2	17	28.3	36.7
1	12	20.0	56.7
0	2[illegible]	43.3	100.0
	60	100.0	

In terms of the nature of the references, Table 60 shows that references to next year's general results were most often in the nature of a strong prediction (fifty-seven references, or 78.1 percent of all references). For example, ". . . combine to make further growth . . . a reasonable prospect for the year 1970." Next most prevalent were references to goals (six references, or 8.2 percent of all references). For example, "Our plans for 1972 provide for continuing growth." There were five qualified strong predictions (6.8 percent of all references). For example, "If that condition is maintained, . . . has every reason to look forward to a good business year." Two references were in the nature of a weak prediction, two in the nature of no

TABLE 60

NUMBER OF REFERENCES TO NEXT YEAR'S GENERAL RESULTS, BY NATURE AND MODIFIER, ALL FOUR YEARS

Modifier	Nature						Total
	Strong Prediction	Weak Prediction	Qualified Strong Prediction	Goal	No Prediction	Year to Date	
Growth	9			3		1	13
Progress	4		1	1			6
Good	10		2				12
Optimism	6						6
Confidence	1						1
Success	2						2
Encouraging	2						2
Meet Challenge	1						1
Other favorable	21		2	2			25
Unfavorable	1	2					3
Not modified	—	—	—	—	2	—	2
Total	57	2	5	6	2	1	73

prediction, and one in the nature of a statement about the year to date.

In terms of the modifier of the references, Table 60 shows that a great variety of modifiers was used. The single most common modifier was growth (thirteen instances, or 17.8 percent of all references), and second most common was the modifier good (twelve instances, or 16.4 percent of all references). No other specific modifier was used more than six times. The category other favorable accounted for twenty-five references, but this was composed of a great number of specific modifiers each used less than five times in all references to general results.

Considering the nature of the references and their modifiers together, the impression is one of considerable diversity. The main tendencies apparent are for references that are strong predictions and that deliver good news. Only three of the references (4.1 percent) were in the category of an unfavorable reference to next year's general results; and two of these were weak predictions which just raised the possibility that certain environmental conditions could affect the company adversely. In the third case it was predicted that economic conditions would restrain the company's growth in the coming year but that this was a short-term condition only. In short, references to next year's general results tended to deliver good news.

b. General Results of a Period Not Specified as Next Year

Of the 240 annual reports, only six (2.5 percent) contained at least one reference to general results of a specific period other than next year. Only one of the 240 annual reports (0.4 percent) contained at least one reference to general results in terms of an annual occurance.

Of the 240 annual reports, 113 (47.1 percent) contained at least one reference to general results of an unspecified future period. Table 61 shows the incidence of such annual reports by year. Thirty-two of the annual reports were from the first year examined; twenty-eight were from the second year; twenty-seven were from the third year; and twenty-six were from the fourth year. The distribution among years was about even though it showed a slight steady decrease from year one to year four.

TABLE 61

ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO GENERAL RESULTS OF AN UNSPECIFIED FUTURE PERIOD, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	32	53.3
Year 2	28	46.7
Year 3	27	45.0
Year 4	26	43.3
All Years	113	47.1

Table 62 shows the distribution of these annual reports among the sixty sample companies. Nine companies made reference to general results of an unspecified future period for all four years examined. Fifteen companies made such a reference in three of the four years. Eight companies made such a reference in two years, sixteen made such a reference in one year, and twelve made no such reference in any of the four years. Thus, 80 percent of the companies made reference to general results of an unspecified future period for at least one year, and 40 percent made such a refe_ence in at least three of the four years.

TABLE 62

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING AT LEAST ONE REFERENCE TO GENERAL RESULTS OF AN UNSPECIFIED FUTURE PERIOD

Number of Annual Reports in Which Reference is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	9	15.0	15.0
3	15	25.0	40.0
2	8	13.3	53.3
1	16	26.7	80.0
0	12	20.0	100.0
	60	100.0	

Table 63 shows the number and type of references to general results of an unspecified future period which were found in the 113 annual reports containing any such reference. The total number of references (179) is greater than the number of annual reports (113) because some annual repc ts contained more than one reference.[1]

TABLE 63

NUMBER OF REFERENCES TO GENERAL RESULTS OF AN UNSPECIFIED FUTURE PERIOD, BY NATURE AND MODIFIER, ALL FOUR YEARS

	Nature					
Modifier	Strong Prediction	Weak Prediction	Qualified Strong Prediction	Necessity	Goal	Total
Growth	29	2		1	52	84
Progress	5				2	7
Optimism	12					12
Confidence	10					10
Success	3				5	8
Encouraging	4					4
Meet Challenge	4					4
Other favorable	38	2	1		5	46
Unfavorable	2	2	—	—	—	4
Total	107	6	1	1	64	179

In terms of the nature of the references, Table 63 shows that references to general results of an unspecified future period were most often in the nature of a strong prediction (107 references, or 59.8 percent of all references). Next most common were references to goals (sixty-four references, or 35.8 percent of all references). Six references were in the nature of a weak prediction, one reference was a qualified strong prediction, and one was in the nature of a necessity.

In terms of the modifier of the references, Table 63 shows that in eighty-four instances (46.9 percent of all references) the reference was to growth. No other specific modifier was used more than twelve times. A great variety of modifiers was used. Aside from references to growth, the more common references were to optimism, confidence, success and progress. The category other favorable accounted for forty-six references, but this was composed of a great number of specific modifiers each used less than five times in all references to general results.

Considering the nature of the references and their modifiers together, the impression is one of considerable attention to the notion of growth, and great diversity in presenting other good news about the future. Only four of the references (2.2 percent) were in the category of an unfavorable reference to general results of an unspecified future period, and two of these were weak predictions which just raised the possibility that certain environmental conditions could affect the company adversely. The third unfavorable reference came from a utility company which explained that it faced a problem resulting from inflation and that it might have to apply for an increase in prices. The fourth unfavorable reference said that inflation posed a serious threat to the sound growth of the company. This statement was accompanied, however, by several statements of a positive nature about the future of the firm. In short, references to general results of unspecified future periods tended to deliver good news.

7. Strong Unqualified Predictions About Next Year's Earnings

Of the 240 annual reports, fifty (20.8 percent) contained at least one strong unqualified prediction about next year's earnings. These fifty reports contained a total of fifty-three such predictions (Table 37). Table 64 shows the incidence of the fifty annual reports by year. Eleven of the fifty annual reports were from the first year examined; eleven were from the second year; sixteen were from the third year; and twelve were from the fourth year. With the exception of year three, the distribution among years is about even.

Table 65 shows the distribution of the annual reports among the sixty sample companies. No company made such a prediction for all four years examined. Five companies made such a prediction in three of the four years. Seven made such a prediction in two years, twenty-one made such a prediction in one year only, and twenty-seven made no such prediction in any of the four years. Thus, more than half th. firms made such a prediction in at least one year, but only 8.3 percent made one in at least three years.

TABLE 64

ANNUAL REPORTS CONTAINING STRONG PREDICTION ABOUT NEXT YEAR'S EARNINGS, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	11	18.3
Year 2	11	18.3
Year 3	16	26.7
Year 4	12	20.0
All Years	50	20.8

TABLE 65

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING STRONG PREDICTIONS ABOUT NEXT YEAR'S EARNINGS

Number of Annual Reports in Which Prediction is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	0	0.0	0.0
3	5	8.3	8.3
2	7	11.7	20.0
1	21	35.0	55.0
0	27	45.0	100.0
	60	100.0	

Of the fifty annual reports, forty-nine predicted, either explicitly or implicitly[2], that earnings next year would be positive. The remaining annual report was that of a company reporting a loss. The company predicted "profit improvement for the coming year," but did not state whether the improvement would be substantial enough to change earnings from negative to positive. None of the fifty annual reports predicted negative earnings for the following year.

Of the fifty annual reports, forty-five predicted, either explicitly or implicitly[3], that earnings next year would be higher than those of the year just ended. Four annual reports did not clearly predict an increase or decrease in earnings; they did, however, give the impression of optimism, with no hint of a decrease in earnings. Only one of the fifty annual reports predicted that earnings would decrease in the year to follow.

Thus, the fifty annual reports conveyed very little bad news in their strong unqualified predictions about next year's earnings.

8. Predictions of Earnings Increase and Company Characteristics

This section examines more closely the above-mentioned forty-five annual reports which contained a strong unqualified prediction that next year's earnings would be higher than those of the year just ended.

Table 66 shows the incidence of . ch predictions by year. There were nine in the first year, nine in the second, fifteen in the third and twelve in the fourth. The later two years examined saw a greater incidence than did the earlier two years.

TABLE 66

ANNUAL REPORTS CONTAINING STRONG PREDICTION
OF EARNINGS INCREASE, BY YEAR

	Number of Reports	Percent of All Reports That Year
Year 1	9	15.0
Year 2	9	15.0
Year 3	15	25.0
Year 4	12	20.0
All Years	45	18.8

Table 67 shows the concentration of such predictions among the sixty companies. No company made such a prediction in all four years. Three companies made such a prediction in three of the four years. Eight did in two of the years, twenty did in one year only, and twenty-nine firms made no such prediction in any year. Thus, over half of the firms made such a prediction in at least one year, but only five percent did in at least three years.

TABLE 67

CONCENTRATION BY COMPANY OF ANNUAL REPORTS CONTAINING
STRONG PREDICTION OF EARNINGS INCREASE

Number of Annual Reports in Which Prediction is Made	Number of Companies	Percent of Companies	Cumulative Percent of Companies
4	0	0.0	0.0
3	3	5.0	5.0
2	8	13.3	18.3
1	20	33.3	51.7
0	29	48.3	100.0
	60	100.0	

Tables 68 through 76 present evidence concerning relationships between strong predictions of earnings increase and the various company characteristics described in Section 8 of Chapter IV.

Table 68 indicates that annual reports prepared after a loss year were slightly more likely to contain a strong prediction of earnings increase than were annual reports prepared after a profit year. Of the twenty-one reports following losses, five (or 23.8 percent) contained a strong prediction of increased earnings. Of the 219 reports following gains, forty (or 18.3 percent) contained such a prediction. The statistical significance was not great, as the null hypothesis of no dependence could not be rejected at the .10 level.[4]

TABLE 68

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND PROFIT OR LOSS IN YEAR JUST ENDED

Number (Percentage) of Annual Reports

Profit or Loss in Year Just Ended	Prediction	No Prediction	Total
Profit	40 (18.3)	179 (81.7)	219 (100.0)
Loss	5 (23.8)	16 (76.2)	21 (100.0)
	45 (18.8)	195 (81.3)	240 (100.0)

Table 69 indicates that annual reports prepared after a year of increasing profit, and annual reports prepared after a year of decreasing profit were about equally likely to contain a strong prediction of earnings increase. Of the 174 reports prepared following an increase in earnings, thirty-two (or 18.4 percent) contained a prediction of increased earnings. Of the sixty-two reports prepared following a decrease in earnings, twelve (or 19.4 percent) contained such a prediction. The difference was not at all statistically significant.[4]

TABLE 69

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND INCREASED OR DECREASED EARNINGS IN YEAR JUST ENDED

Increased or Decreased Earnings in Year Just Ended	Number (Percentage) of Annual Reports		
	Prediction	No Prediction	Total
Increased	32 (18.4)	142 (81.6)	174 (100.0)
Decreased	12 (19.4)	50 (80.6)	62 (100.0)
Not Classified[a]	1	3	4
	45 (18.8)	195 (81.3)	240 (100.0)

[a]Four annual reports were not classified because the comparative income statements covered significantly different lengths of time, e.g., twelve months versus seven months.

Table 70 indicates that annual reports prepared before a profit year were slightly more likely to contain a strong prediction of increased earnings than were annual reports prepared before a loss year. Of the 161 reports prepared prior to a profit year, thirty (or 18.6 percent) contained a prediction of increased earnings. Of the nineteen reports prepared prior to a loss year, three (or 15.8 percent) contained a prediction of an earnings increase. The difference was not at all statistically significant.[4]

TABLE 70

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND PROFIT OR LOSS IN YEAR JUST AHEAD

Number (Percentage) of Annual Reports

Profit or Loss in Year Just Ahead	Prediction	No Prediction	Total
Profit	30 (18.6)	131 (81.4)	161 (100.0)
Loss	3 (15.8)	16 (84.2)	19 (100.0)
	33 (18.3)	147 (81.7)	180 (100.0)

Table 71 indicates that annual reports prepared before a year of increased earnings were slightly more likely to contain a strong prediction of increased earnings than were annual reports prepared before a year of decreased earnings. Of the 131 annual reports prepared prior to increased earnings, twenty-five (or 19.1 percent) contained a strong prediction of increased earnings. Of the forty-seven annual reports prepared prior to decreased earnings, eight (or 17.0 percent) contained a prediction of an earnings increase. The difference was not at all statistically significant.[4]

Table 72 indicates that annual reports of the largest companies were least likely to contain a strong prediction of increased earnings. Of the sixty reports of the group of largest firms, two (or 3.3 percent) contained such a prediction. Of the sixty reports in the second quartile, thirteen (or 21.7 percent) contained such a prediction. The sixty reports in the third quartile had the highest incidence of such predictions, sixteen (or 26.7 percent). Of the sixty reports of the group of smallest companies, fourteen (or 23.3 percent) contained a strong prediction of increased earnings. These differences were significant at the .005 level.[4]

TABLE 71

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND INCREASED OR DECREASED EARNINGS IN YEAR JUST AHEAD

Number (Percentage) of Annual Reports

Increased or Decreased Earnings in Year Just Ahead	Prediction	No Prediction	Total
Increased	25 (19.1)	106 (80.9)	131 (100.0)
Decreased	8 (17.0)	39 (83.0)	47 (100.0)
Not Classified[a]	0	2	2
	33 (18.3)	147 (81.7)	180 (100.0)

[a]Two annual reports were not classified because the comparative income statements covered significantly different lengths of time, e.g., twelve months versus seven months.

There is no obvious explanation for the fact that the largest companies made fewer strong predictions of an earnings increase than did other companies. Table 73 dismisses the possibility that the largest firms were less likely to be facing an earnings increase, and hence less likely to predict one. The table shows that the largest firms were virtually identical to the other firms in terms of the likelihood that the year following their annual report would show increased earnings.

TABLE 72

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND COMPANY SIZE (ASSETS)

Number (Percentage) of Annual Reports

Size Quartile (1 = largest)	Prediction	No Prediction	Total
1	2 (3.3)	58 (96.7)	60 (100.0)
2	13 (21.7)	47 (78.3)	60 (100.0)
3	16 (26.7)	44 (73.3)	60 (100.0)
4	14 (23.3)	46 (76.7)	60 (100.0)
	45 (18.8)	195 (81.3)	240 (100.0)

TABLE 73

RELATIONSHIP BETWEEN COMPANY SIZE (ASSETS) AND INCREASED OR DECREASED EARNINGS IN YEAR JUST AHEAD

Number (Percentage) of Annual Reports

Increased or Decreased Earnings in Year Just Ahead	Largest Companies (Quartile 1)	Other Companies (Quartiles 2,3,4)	Total
Increased	33 (73.3)	98 (73.7)	131 (73.6)
Decreased	12 (26.7)	35 (26.3)	47 (26.4)
	45 (100.0)	133[a] (100.0)	178 (100.0)

[a]Two annual reports were not classified because the comparative income statements covered significantly different lengths of time, e.g., twelve months versus seven months.

Some possibilities can be offered for the relatively low incidence among largest firms of predictions of increased earnings. Perhaps managers of larger and hence more visible companies would have found an inaccurate prediction far more embarrassing than would managers of a smaller firm, and were therefore more reluctant to make strong optimistic forecasts. Perhaps the largest firms prefered to rely on other media for getting predictions of this sort to the public. For example, they may have made predictions which ended up in newspaper stories or investment analyst reports. These possibilities are purely speculative and only further research will establish whether they have any validity.

Table 74 shows the incidence of strong predictions of increased earnings by industry. Data are shown separately for the five industries with five or more companies in the sample. The data indicate that reports of firms in the property development industry were the most likely to contain a strong prediction of increased earnings. Of the forty reports of such companies, fourteen (or 35.0 percent) contained such a prediction. Next most inclined were firms from the merchandising industry. Of twenty-eight reports, seven (or 25.0 percent) contained the prediction. The industries of iron and steel (15.0 percent), electrical equipment (10.0 percent), and pulp, paper, and lumber (10.0 percent) were all below the overall average for all companies (18.8 percent). The statistical significance[4] of these differences was between .05 and .10.

TABLE 74

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND COMPANY INDUSTRY

Number (Percentage) of Annual Reports

Company Industry	Prediction	No Prediction	Total
Electrical equipment	2 (10.0)	18 (90.0)	20 (100.0)
Iron and steel	3 (15.0)	17 (85.0)	20 (100.0)
Merchandising	7 (25.0)	21 (75.0)	28 (100.0)
Property development	14 (35.0)	26 (65.0)	40 (100.0)
Pulp, paper and lumber	2 (10.0)	18 (90.0)	20 (100.0)
All others	17 (15.2)	95 (84.8)	112 (100.0)
	45 (18.8)	195 (81.3)	240 (100.0)

Property development firms and merchandising firms tended not to be among the largest firms in the sample. Therefore there is a connection between the pattern indicated by Table 74 and that indicated earlier by Table 72.

Table 75 indicates that annual reports preceding a public issue of equity securities were more likely than other reports to contain a strong prediction of increased earnings. Of fifteen reports followed by an equity issue, five (or 33.3 percent) contained the prediction. Of sixteen reports preceding an issue of debt only, two (or 12.5 percent) contained the prediction. Of 209 reports with no securities issue in the following year, thirty-eight (or 18.2 percent) contained the prediction. The statistical significance was not great, as the null hypothesis of no dependence could not be rejected at the .10 level.[4]

TABLE 75

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND SECURITIES ISSUE IN YEAR JUST AHEAD

Number (Percentage) of Annual Reports

Public Securities Issue Within One Year of Annual Report	Prediction	No Prediction	Total
Equity issue	5 (33.3)	10 (66.7)	15 (100.0)
Debt issue only	2 (12.5)	14 (87.5)	16 (100.0)
Sub-total	7 (22.6	24 (77.4)	31 (100.0)
No issue	38 (18.2)	171 (81.8)	209 (100.0)
	45 (18.8)	195 (81.3)	240 (100.0)

Table 76 shows the relationship between strong predictions of increased earnings and the auditor(s) who rendered an opinion on the financial statements. Data are shown separately for the six auditing firms most prevalent in the sample. These six firms each signed at least twenty-four opinions. None of the remaining firms signed more than ten.

The reports accompanied by an opinion of one of the more prevalent auditors were less likely than other reports to contain a strong prediction of increased earnings. Of 173 such reports, twenty-eight (or 16.2 percent) contained the prediction. For less prevalent auditors, eighteen out of seventy-nine reports (or 22.8 percent) contained the prediction. The statistical significance was not great, as the null hypothesis of no dependence could not be rejected at the .10 level.[4]

TABLE 76

RELATIONSHIP BETWEEN STRONG PREDICTION OF EARNINGS INCREASE AND AUDITOR

Number (Percentage) of Annual Reports

Auditor	Prediction	No Prediction	Total
Price Waterhouse & Co.	8 (20.0)	32 (80.0)	40 (100.0)
Clarkson, Gordon & Co.	3 (9.7)	28 (90.3)	31 (100.0)
Peat, Marwick, Mitchell & Co.	5 (17.9)	23 (82.1)	28 (100.0)
McDonald, Currie & Co.	4 (15.4)	22 (84.6)	26 (100.0)
Thorne, Gunn & Co.	4 (16.7)	20 (83.3)	24 (100.0)
Touche Ross & Co.	4 (16.7)	20 (83.3)	24 (100.0)
Sub-total	28 (16.2)	145 (83.8)	173 (100.0)
All others	18 (22.8)	61 (77.2)	79 (100.0)
	46 (18.3)	206 (81.7)	252[a] (100.0)

[a]Total number of reports is greater than 240 because twelve reports were signed by two auditors.

The more prevalent auditors tended to be the larger ones, and there was a disproportionately high tendency for these auditors to be associated with the largest companies in the sample. Hence, there is a connection between the pattern indicated by Table 76 and that indicated earlier in Table 72.

In summary, there were only two company characteristics which seemed related to strong predictions of an increase in next year's earnings. These were size and industry. The largest companies in the sample were least likely to make a strong prediction of earnings increase, and companies in the property development and merchandising industries were more likely than others to make such a prediction.

9. Accuracy of Predictions of Next Year's Earnings

Predictions concerning next year's earnings were checked for accuracy by reference in each case to the annual report for the year following the prediction. Thus only predictions appearing in annual reports of the first three years under study were tested for accuracy. The results are summarized in Tables 77 and 78 and are explained below.

a. Explicit Predictions

Table 77 shows the number of accurate explicit predictions of various sorts which were made and, for comparison, the total number of explicit predictions, accurate and inaccurate. Overall, forty-three out of fifty-four explicit predictions (79.6 percent) were completely accurate.

Forty strong unqualified explicit predictions were made. Of these, thirty predicted an increase in earnings. Twenty-two of the thirty proved to be completely accurate in that there did occur an increase in earnings, both before and after extraordinary items. Six of the thirty were completely inaccurate. In the remaining two cases, earnings before extraordinary items decreased while earnings after extraordinary items increased. These were counted as inaccurate predictions, although it could be argued that they are at least partially accurate.

TABLE 77

NUMBER OF ACCURATE EXPLICIT PREDICTIONS CONCERNING NEXT YEAR'S EARNINGS, BY NATURE AND MODIFIER, FIRST THREE YEARS

(Number of Explicit Predictions in Parentheses)

Modifier	Nature: Strong Prediction	Nature: Qualified Strong Prediction	Nature: Goal	Nature: Year to Date	Total
Positive	6 (6)				6 (6)
Negative		1 (1)		1 (1)	2 (2)
Increase	22 (30)	2 (3)	3 (4)	3 (3)	30 (40)
Decrease	1 (1)				1 (1)
Compare well	1 (1)				1 (1)
Good	1 (1)		1 (1)		2 (2)
Outlook good	1 (1)				1 (1)
Profitable growth			0 (1)		0 (1)
Total	32 (40)	3 (4)	4 (6)	4 (4)	43 (54)
Percent accurate	80.0	75.0	66.7	100.0	79.6

The six strong predictions of positive earnings were accurate, as was the lone prediction of an earnings decrease.

The one strong prediction that earnings would compare well was considered accurate because earnings did increase. The one strong prediction of good earnings was considered accurate because earnings were positive and did increase. The one strong prediction of outlook good for earnings was considered accurate because earnings were about the same as in the previous year. An exact comparison was impossible in this case because of a change in the fiscal year.

Thus, in total, thirty-two of the forty unqualified strong explicit predictions were completely accurate. Of the eight inaccurate predictions, two might be classified as at least partially accurate.

Four predictions were of the qualified strong nature. Of these, one predicted negative earnings and was accurate; three predicted an increase in earnings; two were accurate and one was inaccurate. In total, three of the four qualified strong predictions were accurate.

Six predictions were in the nature of a statement of a company goal. In four cases the stated goal was to increase earnings; in three of these earnings did increase. In one case the goal was good earnings. This was considered accurate because earnings were positive and did increase. In one case the goal was profitable growth. This was considered to be inaccurate because earnings decreased in the following year. In total, four of the six predictions in the nature of a goal statement were considered to be accurate.

Four predictions were in the nature of a statement about earnings in the current year to date. In one case, earnings in the year to date were said to be negative. Earnings for the year in question did turn out to be negative, so the statement about the year to date was considered to be an accurate prediction of the eventual result. In three other cases, earnings in the year to date were said to show an increase over those of the previous year. In all three cases, the earnings for the year in question did turn out to be higher than those of the previous year, so the statements about the year to date were considered to be accurate predictions of eventual results. In total, all four of the predictions in the nature of a statement about earnings in the current year to date were considered to be accurate.

As stated above, thirty-two out of forty strong predictions were completely accurate. This ratio of 80 percent compares with 75.0 percent for qualified strong predictions, 66.7 percent for statements of goals, and 100.0 percent for statement of year to date. The small number of predictions in the latter three categories, however, limits the value of the comparison.

Of the fifty-four explicit earnings predictions that could be checked for accuracy only three were communicating news which was clearly bad. Two of these were predicting negative earnings while one was predicting a decrease in earnings. All three bad news predictions turned out to be accurate.

Inaccurate explicit predictions then were not a result of undue pessimism, but rather undue optimism. All eleven inaccuracies involved an indication of earnings growth which failed to materialize.

b. Explicit and Implicit Predictions

Table 78 focuses on strong predictions that earnings would be positive and strong predictions that earnings would increase. It differs from Table 77 in that it includes implicit[2,3] as well as explicit predictions.

TABLE 78

NUMBER OF ACCURATE STRONG PREDICTIONS, EXPLICIT AND IMPLICIT, FOR POSITIVE EARNINGS AND INCREASED EARNINGS, FIRST THREE YEARS

(Number of Predictions in Parentheses)

	Nature			
Modifier	Explicit Strong Prediction	Implicit Strong Prediction	Total	Total Percent Accurate
Positive	6 (6)	29 (31)	35 (37)	94.6
Increase	22 (30)	3 (3)	25 (33)	75.8
Total	28 (36)	32 (34)	60 (70)	
Percent accurate	77.8	94.1	85.7	

It was possible to test the accuracy of thirty-seven cases in which there was an explicit or implicit strong prediction of positive earnings. Table 78 shows that in thirty-five of these cases (94.6 percent) actual earnings, both before and after extraordinary items, turned out to be positive and the prediction was completely accurate. In one case actual earnings, both before and after extraordinary items, turned out to be negative, and the prediction was completely inaccurate. In the one remaining case earnings before extraordinary items turned out to be negative while earnings after extraordinary items turned out to be positive. This has been recorded as an inaccurate prediction but could be defended as at least partially accurate.

Thirty-three instances of explicit or implicit strong predictions of earnings increase were available for accuracy tests. Of these, twenty-five (or 75.8 percent) were found to be completely accurate, since earnings both before and after extraordinary items did increase. Six predictions were found to be completely inaccurate. The remaining two predictions were followed by decreases in earnings before extraordinary items and increases in earnings after extraordinary items, these two predictions were classified as inaccurate, although it could be argued that they were at least partially accurate.

In summary, strong predictions, explicit and implicit, of positive earnings, turned out to be accurate more than 94 percent of the time. Strong predictions of increased earnings were accurate more than 75 percent of the time.

10. Summary

The analysis of 240 annual reports indicated widespread disclosure of forecasts of future corporate results. Approximately 76 percent of the annual reports contained at least one reference of this type. One-half of the sample companies made such a forecast in all four years examined while only three companies made no such reference in any of the four years.

Most of the references were to the objects general and earnings, and pertained to the next year or to an unspecified future period.

A common pattern was evident in the references to the five objects examined: earnings, sales, cash, performance, and general. The pattern was one of strong predictions of increases, or growth, or improvement, for both the next year and unspecified future periods. No specific point estimates of earnings were found. Good news rather than bad news was conveyed by the forecasts.

An attempt was made to discover relationships between strong predictions of an increase in next year's earnings and various company characteristics. The only statistically significant results were for the characteristics of size and industry.

Predictions of next year's earnings were examined for accuracy. Approximately 80 percent of all explicit predictions were found to be accurate. All of the inaccurate explicit predictions involved earnings growth which failed to materialize. Explicit and implicit strong predictions of positive earnings were accurate more than 94 percent of the time; those for increased earnings were accurate more than 75 percent of the time.

Chapter VI summarizes the purpose, method and findings of this study, relates the findings to the literature, and makes suggestions for further research.

FOOTNOTES

1. In cases where a particular reference appeared more than once in the same annual report it was counted as one reference. That is, repetitions were not counted as separate references.

2. Examples of implicit predictions of positive earnings are as follows:

   - "Earnings will increase."
   - "Earnings will compare favorably with those of last year."
   - "The outlook for earnings is good."

   Where the statement was made after a profitable year.

   - A statement after a year of high profits that a predicted decline in earnings should be of no concern.

3. An example of an implicit prediction of earnings increase is as follows:

   - "Earnings will be positive," where the statement was made after a year in which earnings were negative.

4. Statistical significance was tested using the Chi-square test, described in Dixon and Massey (1969, p. 237f).

CHAPTER VI

SUMMARY AND CONCLUSIONS

Recent years have seen increased interest in the issue of management disclosure of forecasts. Accounting bodies, securities regulating bodies, and others have launched studies to help determine whether and how companies should formally disclose plans and predictions for the future.

Early literature on the topic tended to be largely opinion, with little empirical support. More recently, various empirical studies have shed light on aspects of the debate. This thesis reviewed the literature to date and reported two new empirical studies.

Chapter I reviewed the literature on forecast disclosure and explained how the two present studies relate to the literature. Chapter II described the method by which a laboratory experiment was undertaken to test for the effect of management forecasts on investment analysts. Chapter III presented the results of the experiment. Chapter IV described the method by which an analysis of annual reports was undertaken to ascertain the extent of management forecasts of overall company results. Chapter V presented the results of the annual reports analysis. The present chapter summarizes the purposes of the two studies, their methods, and findings. It also relates the findings to the previously-described literature in the field, draws general conclusions, and makes suggestions for further research.

1. The Experiment

Each of forty-nine investment analysts examined one of four different versions of a corporate annual report. One version (designated N) contained no management forecast. The second version (NO) contained a specific prediction of earnings per share ($1.79) but little detail as to underlying plans and assumptions. The third version (YO) contained a specific prediction of EPS ($1.79), considerable detail as to underlying plans and assumptions, and complete forecast financial statements. The forth version (YP) was identical to the third except that the EPS prediction was $1.48 and other data were modified to fit this prediction.

After analyzing one of the annual reports each analyst recorded his own prediction of EPS for the following year and of the market price of the company's common stock at the end of the year. For both predictions the analyst indicated a best estimate, an upper bound, and a lower bound. Later each analyst listed the most important factors which he had considered in making his predictions.

The analysts' predictions and their lists of factors were analyzed to determine what effect if any the inclusion of management forecasts in the annual reports had on analysts' analyses and predictions.

This was not the first experiment to test the effect of management forecasts on readers of annual reports. The present study was unique however in that it included detailed pro forma financial statements in its treatments and it used investment analysts from Canadian brokerage houses as subjects.

The basic objective of the experiment was to contribute to our understanding of accounting users' needs for forecast information or, in other words, to improve our understanding of the relevance or usefulness of forecast information. The overall conclusion from the experimental results was that the management forecasts did affect the predictions of analysts, and that the forecasts therefore met one test of usefulness, i.e., they were used.

The findings of the experiment can be summarized according to the four types of dependent variables calculated from the analysts' predictions. The first was the general level of EPS and stock price predictions made by analysts. The second was the general level of price-earnings ratios, calculated from the EPS and stock price predictions. The third was the analysts' confidence in their EPS and stock price predictions, calculated from the upper and lower bounds placed on their predictions. The fourth was the concensus among analysts, represented by the variance of predictions within groups of analysts.

a. General Level of Predictions

It was in the first area, that of the general level of predictions, that the strong evidence of an experimental effect was observed. While analysts who received no management forecast (treatment N) made a median EPS best estimate of $1.41, analysts receiving management forecasts (treatments NO, YO, YP) made median EPS best estimates of $1.705, $1.645, and $1.45 respectively (Table 11). The differences were sizeable and statistically very significant. Similar differences in the general level of stock price estimates were also observed, though the statistical significance was not as high. These results led to the main finding of the experiment: that the forecasts had made a difference, i.e., that the analysts did use the forecasts.

This finding is consistent with several previous studies which, through opinion questionnaires or laboratory experiments, have concluded that external parties do, or would, find management forecasts in annual reports to be useful information.

Stewart's opinion survey (1973, p. 146) found that 88 percent of analysts used management forecasts as information in developing their own forecasts.

Skousen, Sharp and Tolman (1972) also surveyed professional analysts. Without reporting in statistical terms, the researchers stated that analysts would use budgetary data if it were disclosed publically, and that analysts thought that the disclosure of operating budget figures would be useful to them (p. 54). The same analysts indicated that budgetary data would be used as just one more piece of data in their analyses. The results of the present study are consistent with this opinion in that management forecasts appeared to shift analyst predictions in the direction of the forecast but not all the way to the forecast. Analysts did not, in other words, use the newly-available budgetary data as the only input into their own forecasts.

One opinion survey was not so positive in its assessment of the usefulness of forecasts in annual reports. Dirksen and Sheibelhut (1976) surveyed financial analysts in Toronto, seeking their opinions on several items for possible inclusion in annual reports. The researchers did not present a detailed statistical report of their findings but they stated that analysts thought forecasted earnings per share was not of great importance for disclosure and that the only forecast item of more-than-average importance was estimated capital expenditures (p. 46). This reported opinion of analysts with respect to the absolute level of importance of management forecasts must be questioned in light of the results of the present experiment. In the experiment management forecasts were important enough to effect a significant change in analysts' predictions. The experiment did not, however, permit a comparison of the relative usefulness to analysts of the various items in the Dirksen and Sheibelhut survey, and can neither support nor contest the opinion study's findings on comparative usefulness.

The present experiment differed from previous experiments in important respects, and hence was not testing exactly the same thing. Its main finding, however, that the forecasts were used, is consistent with results reported in related experiments.

Hofstedt (1972) and Deakin (1972) presented subjects with management forecasts which were general in nature. Specific predictions of EPS were not included. Hofstedt found that the tone of the president's letter had a strong influence on MBA candidates and executives who were predicting EPS. Deakin found that under some conditions managerial representations in the president's letter had an effect on the investment decisions of bank trust investment officers. In the present experiment management's forecast did contain a specific prediction of EPS. In one of the treatments however (NO) this forecast was presented only in the president's letter. This treatment resulted in significantly different analyst predictions, compared to treatment N which contained no management forecast. Thus the present study supported the findings of Hofstedt (1972) and Deakin (1972) that managerial representations in the president's letter do have an influence on readers of annual reports.

Brandon (1972), Cianciolo (1975) and Chevalier (1977) presented subjects with specific management predictions of EPS. Brandon found that after intermediate accounting students were educated in the area of forecast disclosure, management forecasts were useful to the students in arriving at their own estimates of EPS. Cianciolo found that although broker advice was the dominant influence in the investment decisions of small investors management forecasts did have some influence. Chevalier found that the Canadian graduate students in his study gave much weight to the forecast data in making investment decisions. Three treatments in the present experiment provided analysts with specific management EPS forecasts. The results provided strong evidence that this type of management forecast does have an influence on readers of annual reports.

In summary, the present experiment indicated clearly that the management forecasts had an effect on the general level of analysts' predictions of EPS and stock price. This main finding, that readers of annual reports are influenced by management earnings forecasts, is consistent with the results of most previous opinion surveys and experiments.

The present study examined not only the general level of analysts' predictions but also the implicit price-earnings ratios, the confidence of analysts in their estimates, and the degree of concensus among analysts.

b. Price-Earnings Ratios

The price-earnings ratios implicit in the analysts' predictions were not significantly different for the four experimental treatments (Table 13). This indicated that while subjects took notice of the management forecasts in estimating earnings, they did not give the forecasts double effect in estimating stock price by applying a significantly larger P/E ratio to their larger earnings estimates. The effect of the management forecast on stock price estimates was therefore delivered through the earnings prediction alone, and not through the P/E multiple.

c. Confidence of Analysts

Analysis of the upper and lower bounds which analysts attached to their best estimates indicated that the subjects were quite confident of their earnings predictions (Table 14). The average analyst was reasonably confident that the actual EPS would be within approximately seven percent, plus or minus, of his best estimate. Analysts were of course less confident of their stock price estimates. where the median confidence band was approximately eighteen percent, plus or minus. The level of confidence expressed by the analysts is an indication that the experimental treatments provided them with sufficient information of the right kind to do a reasonable job of analysis and prediction.

There had been some expectation that the greater detail provided by treatment YO would produce more analyst confidence than would treatment NO, but no significant differences in confidence were found among all four treatments.

d. Concensus Among Analysts

The four treatments did differ somewhat in the concensus among analysts as to best estimates of EPS and stock price (Table 15). It had been expected treatment YO would generate more concensus than NO. This occured, but the statistical significance of the difference was not great. Treatment NO produced the least concensus among analysts of all treatments, but for most comparisons with other treatments the differences were not statistically very significant.

As explained in Chapter II, significant differences in concensus among treatments might cautiously be interpreted as having implications for stock market velocity and market efficiency. The results of the experiment do not provide the basis for any strong conclusion in this regard. At best, there is a slight indication that the annual reports containing no forecast, and those containing a detailed forecast, promoted greater concensus among analysts than reports containing a forecast with little detail, and thus might promote greater market efficiency.

e. Detailed Management Forecasts

One of the innovations of the present experiment was the use of complete pro forma financial statements in two of the treatments (YO and YP). In both of these treatments management's EPS forecast was supported by detailed forecast financial statements as well as greater explanation in the president's letter. To allow a test of the effect of the detailed disclosure, treatment NO was given the same dollar EPS forecast as YO but no forecast financial statements and little detail in the letter. It had been expected that the analysts would find the detailed disclosure of treatment YO more convincing and would thus (a) make best estimates more in line with those of management, (b) be more confident of their own forecast, and (c) achieve a greater degree of concensus among analysts. The results did not conform to these expectations in any consistent and strong pattern (Tables 11, 14, and 15). In fact the general level of EPS best estimates for treatment NO was slightly higher than it was for YO (Table 11). Although no reason was apparent for this result some possibilities were suggested in Chapter III. The conclusion arising from the results is that a specific EPS forecast appearing with little explanation in the president's letter had an impact on analysts which was very significant and not very different from that of a detailed forecast.

f. Conclusion and Suggestions for Further Research

In drawing final conclusions from the present experiment the basic inherent limitation of the research method should be reiterated. The experiment addressed only certain specific questions in a complex area. It dealt with only a particular set of subjects, who examined a particular set of data, which pertained to one particular company. Strictly speaking, any relationships observed in the data cannot be said to exist beyond the specific conditions of the present experiment.

This limitation notwithstanding, the study does add to our understanding of the effects of financial forecasts on readers of annual reports. The results indicated clearly that EPS forecasts, with or without supporting detail, influenced analysts' assessments of the firm. The study also explored the possibility that forecasts differing in degree of detail would cause different reader reactions, but no clear pattern of effect was found.

The study demonstrated that field laboratory experiments in the Canadian investment community are feasible. The experience of setting up the experiment and administering it confirmed the importance of pretesting experimental instruments, of keeping subjects' involvement time to a reasonable level, and of providing participants with a timely preliminary report on the results of the study.

Although the present experiment has added to our understanding of user reactions to management forecasts, many questions can be answered only through further research. Numerous extensions of the present study might be suggested for developing a more complete understanding of how forecasts are used.

The issue of the effect of detailed disclosure is a particularly interesting one in light of the common suggestion that earnings forecasts should be accompanied by underlying assumptions. The fact that the present study did not demonstrate an effect for different levels of detail could be a function of the particular conditions. It would be interesting to see whether the same results held when the company's historical earnings pattern was different or when management's forecast indicated a change in the direction of the earnings trend or when the company was in a different industry.

Other suggestions for forecast disclosure could also be tested for their effect on users. For example, comparisons of actual with forecast and the explanation of variances;

external reviews or audits of management forecasts; use of a range or other means of expressing management uncertainty about the forecasts.

In short, research into the reactions and needs of accounting's users is a continual process. The present experiment has contributed to our knowledge in this area, but there is much opportunity for additional study.

2. The Analysis of Annual Reports

The annual reports of sixty companies for four consecutive years were examined to determine the extent and nature of forecasts of overall company results. The study was unique in that it involved a detailed examination of Canadian annual reports, utilizing a new taxonomy developed to categorize management forecasts of overall company results.

The study was undertaken because the literature contained no report of a major study which had as its main focus a detailed examination of annual reports of corporate results. Particularly, no such study had been reported for the annual reports of Canadian companies.

The annual reports were those of sixty companies chosen at random from among Toronto Stock Exchange industrials. The reports were for the years 1969 to 1972 inclusive. In each case the entire report was examined, excluding the financial statements.

The recording unit chosen for this content analysis was the theme, i.e., a single assertion about some object.

Where a sentence contained more than one theme each theme was categorized separately.

The only themes recorded and analyzed in the present study were those concerning the overall future results of the company. These themes constitute only a subset of all forecasts that could be made by management (Figure 2). This is an important subset, however, because it deals with the net result of corporate action and environmental conditions on the overall profitability, health and progress of the firm.

The taxonomy developed to categorize references to overall future results was summarized in Table 22. It consisted of four main elements: (1) object--that about which management is making the assertion, (2) period--the period of future time about which management is asserting, (3) nature--the nature of management's assertion about the future, (4) modifier--that which is said about the object.

In addition to presenting a detailed description of the references to overall company results, the present study reported preliminary explorations of two related issues: company characteristics which may be related to the propensity to forecast, and the accuracy of forecasts. Eight company characteristics were checked for a correlation with strong predictions of an earnings increase next year. The accuracy assessment was made using explicit and implicit predictions about next year's earnings.

The results of the analysis of the 240 annual reports can be summarized briefly as follows. The disclosure of forecasts of overall company results was widespread among the firms in the sample. The type of forecast varied greatly. The most common forecast was that of a strong prediction of an increase, growth, or improvement. Forecasts almost always contained good news, not bad. Most forecasts referred to the object general or the object earnings. Most forecasts pertained to some unspecified future period or to next year. Forecasts of company results were generally not very specific. Of several company characteristics tested, only company size and industry were related to the propensity to make a strong prediction that next year's earnings will increase. Predictions concerning next year's earnings were usually accurate, but the percentage was not remarkably high. Inaccurate predictions were the result of overestimation of earnings. The subsections below elaborate on each of these findings, relate the findings to other studies where possible, and suggest opportunities for further research.

a. Forecasts of Overall Results Were Widespread

Of the 240 annual reports, 75.8 percent contained at least one reference to the future overall results of the company (Table 29). Only three of the sixty companies made no such reference in any of the four years examined, while thirty-one of the sixty made at least one reference in each of the four years (Table 31). In short, a large proportion of the annual reports did contain forecasts of company results and almost all of the sample firms made this type of forecast during the four year period.

This finding lends support to assertions made by several writers. Backer (1970, p. 199) stated that generalized and fragmentary forecast data often appears in annual reports. Kidd (1976, p. 18) said, "The public disclosure of information which would likely constitute an earnings forecast has been common in Canada in annual reports, . . ." Also, the Select Committee on Company Law stated, "The annual reports of most corporations usually contain some statement with respect to the future of the corporation" (Kidd, 1976, p. 17).

The finding of widespread forecast disclosure is also consistent with the statistical results presented by Brandon (1972) and Keller (1973) for their analyses of United States annual reports. An interpretation of Table II in Brandon (reproduced as Table 7 in the present study) indicates that between 65 and 96 percent[1] of annual reports in that study contained references to the future that would have met the test for inclusion in the present study. The data presented by Keller (p. 52) are less amenable to quantitative comparison with the present study[2], but the notion of widespread forecast disclosure is clear: "Judgements about the future were also common in the annual reports. . . . , optimistic speculation was found in 334, or 99.1% of the reports."

b. Type of Forecast Varied

Although some types of forecasts were more prevalent than others, there did exist a wide variety of forecasts. This variety was observed in terms of the objects referred to (Table 30), the time period referred to (Table 32), the nature of the references (Tables 37 and 60), and the modifiers used (Tables 37 and 60).

Kidd (1976, p. 255) also indicated that considerable "diversity of future-oriented comments" had been found in a sample of 150 annual reports of Canadian companies. This was illustrated by excerpts from several annual reports (pp. 255-60).

c. Common Pattern: Nature/Modifier

From the great variety of management forecasts there did emerge a predominant pattern. Most references to the future were in the nature of a strong prediction and almost all references promised good overall company results rather than bad. This common pattern is evident in the tables which classified references as to nature and modifier for each of the five objects: earnings (Tables 37, 40), sales (45, 48), cash (49), performance (54, 55), and general (60, 63). Of the 504 references[3] categorized in these nine tables, 324 (64.3 percent) were strong predictions. Only twelve of the 504 references (2.4 percent) had modifiers delivering bad news to readers of the annual report. In almost all cases the reference forecast an increase, or an improvement, or growth, or some other favorable result.

Because previous studies have not differentiated among forecasts according to their nature, it is not possible to compare the high incidence of strong predictions in the present study. Other studies have, however, indicated a tendency for annual reports to forecast good news. As mentioned earlier, Keller (1973, p. 52) noted that virtually all of the annual reports in his sample contained "optimistic speculation." Likewise Table 7 of the present study indicated that little bad news was discovered by Brandon (1972) in his sample of annual reports. Similarly, the excerpts from annual reports presented by Kidd (1976, pp. 255-60) conveyed mostly good news to readers.

d. Common Pattern: Object/Period

A pattern also emerged in terms of the object and time period to which references were made. The object general and the object earnings dominated, with 49.7 percent and 31.5 percent, respectively, of all references (Table 30).

References to an unspecified future period, 54.9 percent, and to next year, 41.3 percent, dominated in terms of the time period covered by the forecasts (Table 32).

e. Forecasts Not Very Specific

Although the annual reports contained numerous references to future company results these references were not very specific. This lack of specificity is evident upon examination of any of the four main categories: object, period, nature, or modifier.

With respect to object, less than half of all references were to the specific items: earnings, sales, or cash. More than half were to the non-specific objects: performance, or general (Table 30). Only 31.5 percent of references were specifically to earnings.

With respect to period, less than half of all references were to specific time periods: next year, another year, or annual. More than half were to an unspecified future time period (Table 32).

With respect to their nature, approximately 64 percent of references were strong predictions (section c above). The remaining 36 percent of references were classified as weak predictions, qualified predictions, statements of necessity, statements of goals, statements about the year to date, or statements indicating inability or unwillingness to predict. This 36 percent clearly did not present any forecast as forcefully and clearly as did the references which were strong predictions.

With respect to modifiers, the most significant finding does not appear in any table. It is a non-finding. Of the 523 references to future overall company results not one was a specific dollar estimate of earnings. There was only one specific dollar estimate of sales--a company stated that total revenue for the present year should be approximately the same as for the past year. The vast majority of modifiers for references to earnings and sales reflected a prediction of increase or growth (Tables 37, 40, 45, 48). That is, the references tended to put a lower limit on sales and earnings, but no upper limit and no most likely estimate.

Considering object, nature, period, and modifier together, perhaps the ultimate in specificity would be a prediction such as: "we expect earnings after taxes to be $4.50 per share next year." This would be a strong prediction about the object earnings, pertaining to the next year, and having as modifier a specific dollar amount. No such reference appeared. Although there were a number of strong predictions concerning earnings, none was a point estimate. In most cases the predictions indicated only a direction of change--upward.

Other studies have also noted the lack of specificity in annual report forecasts. In an analysis of eighty-eight annual reports, Buzby (1974, p. 431) found only one instance of a specific dollar estimate or range for next year's EPS. Of eighty reports examined by Stanga (1976, p. 29) only 1.2 percent contained a specific estimate of earnings for the next fiscal year. Keller (1973) made no statement about the specificity of forecasts in 337 annual reports examined; he gave no indication that specific dollar estimates were found. Brandon (1972) reported that of 588 annual reports, 3.59 percent contained "specific estimates of 1970" (Table 7 of the present study). An examination of Brandon's Appendix C, however, reveals that "specific estimates" included references to unspecified future periods, references to sales alone, and references giving only a lower limit and not a most likely estimate. Thus the proportion of reports containing a point estimate of earnings for the coming year appears to have been much less than 3.59 percent.

Studies of Canadian annual reports indicated a similar lack of specificity. Belkaoui and Kahl (1977, p. 34) found that none of ten annual reports from chartered banks contained a forecast of EPS. Dirksen and Scheibelhut (1976) examined thirty-four annual reports. They reported that EPS and sales were not forecast with any degree of frequency (p. 46); they made no mention of any point estimates having been found. Kidd (1976) did not report on the specificity of forecasts in the 150 annual reports examined. Appendix A of that study did, however, provide examples of the forecasts; one of the thirty-five excerpts contained specific dollar estimates of next year's EPS and sales.

Thus a variety of studies in the United States and Canada has failed to discover any significant number of point estimates of earnings in annual reports.

f. Predictions and Company Characteristics

Eight company characteristics were tested for correlations with the strong prediction that next year's earnings will increase. Of the eight only two, company size and industry, appeared to be related to the propensity to forecast the increase. The largest firms in the sample were least likely to make the prediction, and firms in property development and merchandising were most likely. These characteristics were themselves related in that firms in the high disclosure industries were not among the largest firms in the sample.

No previous studies have reported on the relationship between forecast disclosure and company characteristics. The examination in the present study was very much exploratory, being confined to one particular type of forecast and using simple one-at-a-time tests for association.

9. Accuracy of Predictions

The exploration of the accuracy issue was limited by the fact that point estimates of future results did not appear in the annual reports. Nonetheless, references to next year's earnings were examined and assessed as to their accuracy. Forty-three out of fifty-four explicit predictions, or 79.6 percent, were found to be accurate (Table 77). Forty of the fifty-four predictions were of the strong unqualified variety; of these, 80.0 percent were accurate. The three forecasts relating bad news were accurate; all eleven inaccurate predictions pertained to earnings growth which failed to materialize.

A second test of accuracy was conducted by checking explicit and implicit strong predictions of positive or increased earnings next year (Table 78). Of seventy such predictions, sixty (85.7 percent) were accurate. Predictions of positive earnings were accurate in 94.6 percent of instances, while predictions of increased earnings were accurate 75.8 percent of the time. Since all of the predictions checked here related good news, i.e., positive earnings or increased earnings, all of the inaccuracies were once again a result of overpredictions of earnings.

In order to make a judgement on whether the observed accuracy levels reflect "good" forecasting by management it is necessary to identify a standard or benchmark. Forecasts of earnings can never be certain, of course, and one could hardly expect 100 percent accuracy for any group of firms, even when the predictions are of the relatively simple positive/negative and increase/decrease variety. But if 100 percent accuracy is too high to expect, what is reasonable--90 percent? 80 percent? 70 percent? 51 percent?

One approach to this question is to examine the proportion of firms which had positive earnings or had an increase in earnings in the last three years of the study[4], regardless of whether they forecast the same or not. Of the 180 annual reports of the last three years, 171 (95.0 percent) reported positive earnings, before and after extraordinary items, for the current year. This means that if every annual report of the first three years had predicted positive earnings for the next year the accuracy rate would have been 95.0 percent. The actual accuracy rate for the thirty-seven reports that made an explicit or implicit strong prediction of positive earnings was 94.6 percent (Table 78). Thus the predictions which did appear were, as a group, no more accurate than a blanket prediction that earnings for all firms would be positive each year. Therefore although 94.6 is a very high percentage it is no better than one could have obtained with a simple prediction rule that all firms will have positive earnings every year.

A similar comparison can be done for predictions of an increase in earnings. Of the 180 annual reports, 73.6 percent[5] reported an increase in earnings for the current year. This means that if every annual report of the first three years had predicted an earnings increase, the accuracy rate would have been 73.6 percent. The actual accuracy rate for the thirty-three reports that made an explicit or implicit strong prediction of an earnings increase was 75.8 percent (Table 78). Thus the predictions which did appear were, as a group, only slightly more accurate than a blanket prediction that earnings for all firms would increase each year.

The conclusion from these comparisons is that the strong predictions of positive earnings and increased earnings did not possess a remarkably high level of accuracy.

Another approach to evaluating the accuracy of the predictions in the present study would be a comparison with predictions examined in previous studies. Opportunities for such comparison are extremely limited because previous studies did not examine the accuracy of annual report predictions and they concerned themselves largely with a type of prediction not encountered in the present study, i.e., the point estimate of EPS.

Nonetheless, it is interesting to note the percentage of management forecasts appearing in the Wall Street Journal which correctly predicted the direction of change in EPS, as reported in three previous studies. Green and Segall (1967, p. 54) found that seven out of twelve predictions (58.3 percent) correctly predicted the direction. In a replication, the same authors (1966, pp. 34-35) found that ten of twelve firms (83.3 percent) were correct in predicting the direction. In a similar study Copeland and Marioni (1972, p. 499) reported that forty-three out of fifty firms (86.0 percent) correctly predicted the direction. Aggregating the data from the three studies, one finds that 81.1 percent of companies correctly predicted the direction of the change in EPS. In the present study, 75.8 percent of explicit and implicit strong predictions of an earnings increase were accurate (Table 78), i.e., they correctly predicted the direction of change. Thus the annual report predictions examined for accuracy in the present study were only somewhat less accurate than the Wall Street Journal predictions examined in the three previous studies. The comparison becomes more favorable for the annual report predictions when the Wall Street Journal predictions are restricted to those which appeared during the first quarter of the year. For this group, only 73.1 percent of predictions were correct as to direction.

Thus while the management predictions of the present study do not appear to be remarkably accurate, there is some indication that they were no less accurate than newspaper predictions of other groups of companies in another country.

As a final comment on the accuracy of predictions, it was found in the present study that almost all forecasts involved good news and that every instance of inaccuracy involved an earnings increase that failed to materialize, i.e., there was a tendency to err on the side of over-estimation of earnings. This tendency to overestimation has been reported in three studies of management forecasts found in the Wall Street Journal: McDonald (1973), Copeland and Marioni (1972), Basi, Carey, and Twark (1976). Two studies discovered underprediction of earnings, rather than over-prediction, to be more common. Daily (1971) was examining internal, not public, forecasts of management, however, and Hull (1974) was referring to predictions made in prospectuses for new stock issues in the United Kingdom.

h. Conclusions and Suggestions for Further Research

The present study has taken the most detailed look to date at annual report forecasts of overall company results. For the years examined it was concluded that a wide variety of forecasts were disclosed by a wide variety of companies, but that the forecasts tended to be not very specific.

This description of reporting practice during the period 1969 to 1972 provides baseline data for the ongoing discussion of forecast disclosure alternatives and for further research. With a clearer understanding of the kinds of forecasts made by management we are in a better position to discuss suggestions for change. As time passes it will be possible to conduct similar studies on annual reports of later years. For example, it will be interesting to see whether forecast disclosure practices change, perhaps as a result of the increased discussion and public debate of the issue.

Still in the realm of descriptive studies, further research could usefully explore the extent to which earnings forecasts are supported by underlying assumptions and company plans. Such disclosure has been widely advocated in the literature. A logical place to begin such a study would be with the most specific predictions of next year's earnings.

The present study found some indication that the propensity to forecast company results might be related to the size of the firm and/or its industry. Further research will be required to clarify the nature of these relationships. A purposive sample should be selected so as to give adequate representation to various size and industry variations.

In the absence of point estimates of future earnings, the present analysis of forecast accuracy focused on whether earnings were positive or negative, and increased or decreased, in the year following the forecast. The conclusion was reached that management forecasts were no better indicators of future results than the simple rule that all firms will have positive and increased earnings next year. Only further research will indicate whether forecast accuracy is related to certain company characteristics, whether it has improved since the years of the present study, and whether for individual firms past accuracy has an influence on current propensity to forecast.

FOOTNOTES

1. From the description in Brandon (1972, pp. 29-31) it is not possible to calculate the exact percentage. It appears that the minimum would include items 1, 2a, 2d, 3a, and 3b, for a total of 383 annual reports (65.1 percent of 588). The maximum would include the 383 plus the 138 of item 2b, giving a total of 566 (96.3 percent of 588). It is likely that the actual percentage is neither the minimum nor maximum just calculated, because item 2b would appear to consist of some annual reports which would be included in the present study and some which would not.

2. From the description in Keller (1973, p. 52) it appears certain that "speculation and prediction" encompassed more types of references than did the present study. For example, it appears that the discussion of future price changes, new products, production costs, dividends, future financing and litigation were counted in the Keller study whereas the present study was restricted to references to future overall company results.

3. As indicated in Table 30, the annual reports in the present study contained a total of 523 references to future overall company results. Subsequent tables in Chapter V, cited here, described only 504 of these as to nature and modifier because the remaining nineteen references were distributed in very small numbers among various object/period categories.

4. The last three years are of interest here because it was in the annual reports of these years that accuracy was ascertained for predictions made in annual reports of the first three years.

5. From Table 71: 131 divided by the sum of 131 and 47.

APPENDIX 1

ANNUAL REPORT FOR TREATMENT N

CANADIAN RETAIL LIMITED

Annual Report 1972

APPENDIX 1--continued

PRESIDENT'S REPORT

The past year was an outstanding one for Canadian Retail Limited. New records were set in both sales and earnings and at the same time the largest expansion program in the company's history took place.

Sales in the year ended December 31, 1972 rose to $43,150,847 compared to $32,912,385 in 1971, an increase of 31 percent. Net earnings increased by 34 percent to $2,794,012 or $1.24 per share, compared with $2,079,776 or $.93 per share in the previous year.

It should be pointed out that although the Consolidated Balance Sheet as at December 31, 1972 includes the assets of Consumer Durables Limited, the Consolidated Statements of Earnings and Retained Earnings for 1972 do not include the sales and earnings of Consumer Durables Limited.

During the past year 14 retail stores were added, bringing the total to 61. Retail selling space now amounts to 617,000 square feet.

Towards the end of the year, your company acquired Consumer Durables Limited. This acquisition broadens our corporate market area considerably. Your company is now integrating the two firms' lines of merchandise to provide a greater diversity of products for both Canadian Retail and Consumer Durables operations.

This new subsidiary supplies consumer durable goods and hardware to a chain of 229 dealer franchised stores and in addition carries on a wholesale industrial account business to the building trades. Fifteen Canadian Retail stores are now benefitting from Consumer Durables expertise in durable consumer goods while rubber and canvas footwear items have been made available to Consumer Durables dealers.

In the latter part of 1972 Canadian Retail purchased an additional 17 percent interest in Clothing Importers Limited, one of our importing subsidiaries.

Larger warehousing and head office facilities, purchased early in 1972, have now been renovated and redecorated and the move to the new location is underway. The building provides Canadian Retail with 180,000 square feet for the distribution centre and executive offices and 45,000 square feet for importing operations.

A dividend policy was introduced in 1972 commencing with a semi-annual dividend of six cents per share paid in August. A similar dividend was paid in February 1973.

Along with the physical expansion has gone a strengthening of management personnel at both the executive and senior management levels. The expertise of our key people has been invaluable in the past year and we express our appreciation to these and our many other loyal employees.

On behalf of the Board

President

APPENDIX 1--continued

Retail Division

The retail division continues to be the largest and most important, while other divisions provide the company with depth and stability. The retail division is now 19 years old and has grown from a single store to a chain of outlets. The table below sets out the growth in number of stores operated from 1967 to 1972.

Number of Stores

	1967	68	69	70	71	72
Clothing stores	10	11	12	17	32	44
Junior department stores	–	1	4	6	10	12
Department stores	–	1	5	5	5	5
	10	13	21	28	47	61

Originally Canadian Retail marketed only family clothing, but as it grew, so did its lines of merchandise. Each new location is studied carefully and depending on the results of area surveys, a new store may be one of several different types. In some communities, Canadian Retail is the major department store.

The table below provides an analysis of retail sales by type of store for the years 1967 to 1972.

Percent of Retail Sales

	1967	68	69	70	71	72
Clothing stores	100	96	46	46	52	52
Junior department stores	—	—	20	24	25	29
Department stores	–	4	34	30	23	19
	100	100	100	100	100	100

The company has been developed to take full advantage of the economic benefits of volume purchasing and central distribution which have increased as the company expanded. Mass merchandising, primarily on a cash and carry basis, is a concept which has proven successful for Canadian Retail and continues to be encouraged in most locations. Credit departments are, however, incorporated into full line department stores where customers purchase major appliances and furniture.

Retail sales volume from the older established outlets has increased at the same time that expansion into new market areas was taking place.

Consumer Durables Limited

Through the years Consumer Durables has developed a successful marketing concept using the dealer franchise system and today distributes a variety of brand name consumer durable goods to 229 dealer owned stores. The company supplies goods for retail, along with advertising material, merchandising and promotional programs and any other business assistance the independent operator may require. Three distribution centres are operated. The two major centres supply franchise dealers and industrial accounts. The third serves only industrial accounts.

Consumer Durables is now providing an expanded range of durable goods to 15 of the larger Canadian Retail outlets and the infusion of clothing carried by Canadian Retail into the Consumer Durables program provides dealers with the opportunity to expand into general merchandising.

The management of Consumer Durables has many years experience with the firm and has been retained to continue operation of this division.

Importing, Wholesaling, and Manufacturing

Your company has two importing subsidiaries, one wholesaling subsidiary and one manufacturing subsidiary.

Clothing Importers Limited imports ladies' sportswear and some children's and men's wear from the Far East. The company's sales force operates from centres across Canada, selling to leading department stores, chain stores, wholesalers, and distributors. Less than ten percent of the company's volume is sold to Canadian Retail.

The other importing subsidiary also brings in merchandise from the Far East, primarily canvas and rubber footwear. In addition, the company is a distributor for a line of stereo components and radios.

The wholesaling subsidiary distributes domestic and imported shoes, mainly European, to leading stores.

The manufacturing subsidiary is a producer of men's tailored and semi-tailored clothing. Both double-knit and woven garments are sold to national department stores and leading men's wear shops. Less than ten percent of the company's production is sold to Canadian Retail.

APPENDIX 1--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS
for the year ended December 31, 1972 (with comparative figures for 1971)

	1972	1971
Sales	$43,150,847	$32,912,385
Cost of goods sold and operating expenses before the following	36,484,947	27,828,110
Depreciation and amortization	393,365	277,613
Interest – current	260,053	187,070
– long-term	221,568	79,394
	37,359,933	28,372,187
Earnings from operations before income taxes and minority interests	5,790,914	4,540,198
Income taxes – current	2,657,735	2,150,892
– deferred	112,288	109,989
	2,770,023	2,260,881
Minority interests	226,879	199,541
Net Earnings for the year	2,794,012	2,079,776
Retained earnings, beginning of year	6,733,741	4,653,965
	9,527,753	6,733,741
Dividends	135,114	
Retained earnings, end of year	$ 9,392,639	$ 6,733,741
Net earnings per share	$1.24	$.93

Notes to consolidated financial statements are an integral part of this statement.

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

as at December 31, 1972 (with comparative figures for 1971)

Assets	1972	1971
Current Assets		
Cash and term deposits (note 1)	$ 6,370,584	$ 1,184,981
Accounts receivable	5,909,523	2,018,056
Inventories (note 2)	17,662,300	10,236,133
Prepaid expenses	92,892	79,090
	30,035,299	13,518,260
Non Current Receivables		
Notes receivable in instalments to 1981	368,990	
Mortgages	148,624	6,983
	517,614	6,983
Fixed Assets (note 3)	9,993,961	5,302,806
Unamortized Debt Discount and Expense (note 4)	343,338	
Other Assets	66,652	66,652
Goodwill (notes 1 and 5)	1,818,467	1,496,578
	$42,775,331	$20,391,279

Notes to consolidated financial statements are an integral part of this statement.

AUDITORS' REPORT

To the Shareholders of Canadian Retail Limited:

We have examined the consolidated balance sheet of Canadian Retail Limited and its subsidiaries as at December 31, 1972 and the consolidated statements of earnings and retained earnings, and source and use of working capital for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

APPENDIX 1--continued

Liabilities	1972	1971
Current Liabilities		
Bank loans payable (note 6)	$ 7,675,818	$ 2,216,310
Accounts payable and accrued liabilities	6,206,800	3,055,833
Income and other taxes payable	988,347	814,737
Long-term debt due within one year	769,560	12,826
	15,640,525	6,099,706
Long-Term Debt (notes 6 and 7)	10,516,725	444,942
Deferred Income Taxes	821,238	341,483
Minority Interests (notes 1 and 10)	365,716	829,644
Shareholders' Equity		
Share Capital (note 8)	6,038,488	5,941,763
Retained Earnings	9,392,639	6,733,741
	15,431,127	12,675,504
	$42,775,331	$20,391,279

Approved by the board:
J. Smith, Director
K. Brown, Director

In our opinion, these consolidated financial statements present fairly the financial position of the companies as at December 31, 1972 and the results of their operations and the source and use of their working capital for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

February 28, 1973 — Chartered Accountants

APPENDIX 1--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SOURCE AND USE OF WORKING CAPITAL
for the year ended December 31, 1972 (with comparative figures for 1971)

	1972	1971
Source of Working Capital		
Net earnings for the year	$ 2,794,012	$ 2,079,776
Depreciation and amortization	393,365	277,613
Deferred income taxes	112,288	109,989
Earnings of minority interests	226,879	199,541
Provided from operations	3,526,544	2,666,919
Bank loans (note 7)	6,718,170	
Debentures and deferred income taxes of newly acquired subsidiary (note 1)	4,239,467	
Issue of shares (note 8)	96,725	133,903
Proceeds from disposal of fixed assets		280,588
Decrease (increase) in other assets	838	(6,983)
	14,581,744	3,074,427
Use of Working Capital		
Purchase of fixed assets of subsidiary (note 1)	2,001,717	
Purchase of other assets of subsidiary (note 1)	854,806	
Purchase of other fixed assets	3,082,803	2,033,077
Purchase of additional share in partially owned subsidiary (note 1)	1,012,696	
Dividends paid	135,114	
Current portion of new bank loans and reduction in other long-term debt	518,388	14,326
	7,605,524	2,047,403
Increase in Working Capital	6,976,220	1,027,024
Working Capital, beginning of year	7,418,554	6,391,530
Working Capital, end of year	$14,394,774	$ 7,418,554

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 1--continued

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of consolidation. The consolidated financial statements include the accounts of all subsidiaries. The results of the operations of subsidiary companies have been included only from the dates of acquisition (except as noted below) and provision has been made for minority interests. The purchase method has been used in accounting for the acquisition of all subsidiaries.

(a) Acquisition of Consumer Durables Limited:

As of December 1, 1972, Canadian Retail Limited purchased all of the issued and outstanding shares of Consumer Durables Limited for cash of $9,170,170. The excess of purchase price over net book value, an amount of $850,663, was applied to land. The assets and liabilities of Consumer Durables as at December 1, 1972 have been included in the company's consolidated balance sheet as at December 31, 1972.

The unaudited net earnings of Consumer Durables for the month of December, 1972 amounted to $19,400 with sales of $1,370,000. These earnings and sales have not been included in the company's consolidated statements of earnings and retained earnings and source and use of working capital.

(b) Acquisition of additional share interest in Clothing Importers Limited:

During the third quarter of 1972, the company purchased for cash of $1,012,694 an additional 17% share interest in this subsidiary, bringing the company's present share holdings to 92%. The excess of the purchase price for this additional interest over the proportionate value of the subsidiary's net assets at the date of acquisition was $321,889 which has been allocated to goodwill.

2. Inventories. Inventories are valued at the lower of cost or estimated net realizable value less normal profit margins.

3. Fixed assets

	Cost	Accumulated Depreciation	Net Book Value 1972	1971
Land	$ 3,065,591	–	$3,065,591	$1,120,968
Buildings	5,873,365	$1,305,185	4,568,180	2,440,572
Fixtures and equipment	3,548,410	1,564,855	1,983,555	1,444,604
Leasehold improvements	496,051	119,416	376,635	296,662
	$12,983,417	$2,989,456	$9,993,961	$5,302,806

4. Unamortized debt discount and expense. This will be amortized at the rate of $36,300 per annum over the term of the debentures.

5. Goodwill. This amount is made up of:

	1972	1971
Purchased	$ 260,150	$ 260,150
On consolidation	1,558,317	1,236,428
	$1,818,467	$1,496,578

The above amounts are carried in the accounts at cost without amortization.

6. Bank indebtedness. The company has assigned the loss proceeds of certain fire insurance policies and lodged with the bank certificates of title to certain real properties as security for short-term and long-term indebtedness to the bank. Accounts receivable of a subsidiary company are assigned from time to time to the bank as security for its bank indebtedness, of which none was outstanding as at December 31, 1972.

The company has provided a letter of undertaking to its bankers to provide them on request with a debenture incorporating both a specific charge over fixed assets and a floating charge over all assets of the company and certain of its wholly-owned subsidiaries.

In arranging for financing for the acquisition of Consumer Durables the company agreed to furnish the following to the bank as security for loans.

(i) Collateral mortgages on certain properties.
(ii) An additional assignment of loss proceeds of fire insurance policies on certain other properties.
(iii) Certificates of title to certain other real properties.
(iv) Pledge of all outstanding shares of Consumer Durables Limited.

APPENDIX 1--continued

7. Long-term debt

	1972	1971
6% Sinking Fund Debentures, Series "A" due May 15, 1982	$ 4,114,000	$
Bank Loans (Note 6)		
Payable with interest at rates not exceeding 2% over the prevailing prime bank rate and maturing at various dates to 1982	6,718,170	-
Mortgages		
Payable with interest at 9% per annum and maturing in 1984	395,259	400,725
Others at various interest rates and maturity dates	58,856	57,043
	11,286,285	457,768
Deduct amounts due within one year	769,560	12,826
	$10,516,725	$ 444,942

Sinking fund payment requirements on the 6% debentures are $363,000 annually. The sinking fund payment for 1973 is anticipated to be reduced by $121,000, which is the amount of debentures purchased and tendered to the Trustee as at December 31, 1972. The 6% debentures are secured by a first floating charge on all assets, business and undertakings of Consumer Durables Limited.

Payments required for retirement of debentures and other long-term debt over the next five years are:
1973 - $769,560 1974 - $948,640 1975 - $982,520 1976 - $1,029,710 1977 - $1,090,210

8. Share capital

		No. of shares	
Authorized:	Common shares of no par value	4,000,000	
Issued:	Balance, December 31, 1971	2,245,412	$ 5,941,763
	Shares issued on options exercised during the year for cash	10,866	96,725
	Balance December 31, 1972	2,256,278	$ 6,038,488

Certain employees have options to purchase 15,715 shares at $8.66 per share, 800 shares at $14.70 per share and 9,000 shares at $22.90 per share.

The total options for 25,515 shares expire in the following years:
1973 - 6,000 1974 - 12,015 1975 - 3,700 1976 - 2,000 1977 - 1,800
No material dilution of earnings per share results from these options.

9. Lease commitments. Minimum annual rentals for property leases in each of the next five years are:
1973 - $942,913 1974 - $914,563 1975 - $886,641 1976 - $763,598 1977 - $631,776
Certain of the leases provide for additional rentals based on sales, as well as other occupancy charges.

10. Contractual obligations. The company has an obligation under certain circumstances to purchase for cash the minority interests' share holdings of 8% in a subsidiary company. The company also has an option under certain circumstances to acquire these minority interests for a prescribed cash consideration. This option expires December 31, 1989.

11. Remuneration of directors and senior officers. The aggregate remuneration paid or payable by the company and its subsidiaries to the directors and senior officers of the company for 1972 and 1971 was $210,983 and $203,885 respectively.

12. Subsequent event. On January 3, 1973, the directors of the company declared a dividend of six cents per share payable February 15, 1973 to shareholders of record on February 1, 1973.

APPENDIX 1--continued

SEVEN YEAR REVIEW

	1966	1967	1968	1969	1970	1971	1972
Operating results ($000)							
Sales	4,417	5,256	7,382	14,809	25,347	32,912	43,151
Earnings from operations before the following:	540	910	1,339	2,093	3,709	4,819	6,184
Depreciation	62	77	96	122[1]	220	278	393
Income taxes	227	404	629	978[1]	1,819	2,261	2,770
Minority interests	–	–	–	–	167	200	227
Net earnings	250	428	615	993	1,503	2,080	2,794
Financial Position ($000)							
Working capital	365	680	1,091	5,299	6,392	7,419	14,395
Inventories	499	877	1,607	4,190	7,298	10,236	17,662
Fixed assets–net	768	845	1,068	3,181	3,828	5,303	9,994
Total assets	1,796	2,626	3,715	11,277	16,055	20,391	42,775
Long-term debt	22	12	44	450	460	445	10,517
Shareholders' equity	1,130	1,557	2,341	8,222	10,461	12,676	15,431
Per Common Share ($)							
Net earnings	.16	.27	.37	.52[2]	.67	.93	1.24
Dividends paid	–	–	–	–	–	–	.06
Cash flow[3] from operations	.19	.32	.43	.62[2]	.93	1.17	1.56
Net asset value	.70	.97	1.41	3.80	4.69	5.65	6.84
Stock market price: High	4.10	7.00	9.38	14.50	12.75	17.25	23.88
Low	2.35	4.55	4.05	8.38	6.00	9.50	16.00
Close	3.10	5.88	8.88	12.13	9.38	15.88	23.88
Ratios and Statistics							
Number of shares outstanding	1,604,906	1,605,101	1,664,874	2,165,141	2,229,890	2,245,412	2,256,278
Net earnings ÷ Sales	.06	.08	.08	.07	.06	.06	.06
Net earnings ÷ Shareholders' Equity	.22	.27	.26	.12	.14	.16	.18
Net earnings ÷ Total Assets	.14	.16	.17	.09	.09	.10	–[4]
Sales ÷ Shareholders' Equity	3.91	3.38	3.15	1.80	2.42	2.60	2.80
Sales ÷ Total Assets	2.46	2.00	1.99	1.31	1.58	1.61	–[4]
Shareholders' Equity ÷ Total Assets	.63	.59	.63	.73	.65	.62	.36
% Growth[5]							
Net Earnings per Share		69	37	41	29	39	33
Net Earnings		71	44	61	51	38	34
Sales		19	40	101	71	30	31
Cash Flow[3] per Share		68	34	44	50	28	31
Working capital ratio	1.6:1	1.6:1	1.8:1	3.0:1	2.5:1	2.2:1	1.9:1
Price-earnings ratio[6]	19.4	21.8	24.0	23.3	14.0	17.1	19.3

NOTES TO SEVEN YEAR REVIEW

1. During 1969, the rates of depreciation were changed to conform with revised estimates of the useful life of fixed assets and the company converted from the taxes payable to the tax allocation method of providing for income taxes. Prior years figures as shown above have not been restated.
2. Based on weighted average of 1,907,012 shares outstanding.
3. Net earnings + Depreciation and amortization + Deferred income taxes + Minority interests.
4. Not calculated because assets of subsidiary acquired in December are included but sales and earnings are not.
5. Increase during year divided by level at beginning of year.
6. Closing stock market price per share for the year divided by net earnings per share for the year.

APPENDIX 2

ANNUAL REPORT FOR TREATMENT NO

CANADIAN RETAIL LIMITED

Annual Report 1972

APPENDIX 2--continued

PRESIDENT'S REPORT

The past year was an outstanding one for Canadian Retail Limited. New records were set in both sales and earnings and at the same time the largest expansion program in the company's history took place.

Sales in the year ended December 31, 1972 rose to $43,150,847 compared to $32,912,385 in 1971, an increase of 31 percent. Net earnings increased by 34 percent to $2,794,012 or $1.24 per share, compared with $2,079,776 or $.93 per share in the previous year.

It should be pointed out that although the Consolidated Balance Sheet as at December 31, 1972 includes the assets of Consumer Durables Limited, the Consolidated Statements of Earnings and Retained Earnings for 1972 do not include the sales and earnings of Consumer Durables Limited.

During the past year 14 retail stores were added, bringing the total to 61. Retail selling space now amounts to 617,000 square feet.

Towards the end of the year, your company acquired Consumer Durables Limited. This acquisition broadens our corporate market area considerably. Your company is now integrating the two firms' lines of merchandise to provide a greater diversity of products for both Canadian Retail and Consumer Durables operations.

This new subsidiary supplies consumer durable goods and hardware to a chain of 229 dealer franchised stores and in addition carries on a wholesale industrial account business to the building trades. Fifteen Canadian Retail stores are now benefitting from Consumer Durables expertise in durable consumer goods while rubber and canvas footwear items have been made available to Consumer Durables dealers.

In the latter part of 1972 Canadian Retail purchased an additional 17 percent interest in Clothing Importers Limited, one of our importing subsidiaries.

Larger warehousing and head office facilities, purchased early in 1972, have now been renovated and redecorated and the move to the new location is underway. The building provides Canadian Retail with 180,000 square feet for the distribution centre and executive offices and 45,000 square feet for importing operations.

A dividend policy was introduced in 1972 commencing with a semi-annual dividend of six cents per share paid in August. A similar dividend was paid in February 1973.

Along with the physical expansion has gone a strengthening of management personnel at both the executive and senior management levels. The expertise of our key people has been invaluable in the past year and we express our appreciation to these and our many other loyal employees.

We foresee another good year ahead, with sales rising to $79,162,000 and earnings per share to $1.79. This includes the sales and earnings of Consumer Durables, to be consolidated for the first time in 1973. Consumer spending and retail sales are expected to expand in 1973 at rates close to their 1972 rates (which were 11.6% and 10.9%, respectively). The retail division will open 21 new stores with combined floor space of more than 190,000 square feet.

On behalf of the Board

President

APPENDIX 2--continued

Retail Division

The retail division continues to be the largest and most important, while other divisions provide the company with depth and stability. The retail division is now 19 years old and has grown from a single store to a chain of outlets. The table below sets out the growth in number of stores operated from 1967 to 1972.

Number of Stores

	1967	68	69	70	71	72
Clothing stores	10	11	12	17	32	44
Junior department stores	–	1	4	6	10	12
Department stores	—	1	5	5	5	5
	10	13	21	28	47	61

Originally Canadian Retail marketed only family clothing, but as it grew, so did its lines of merchandise. Each new location is studied carefully and depending on the results of area surveys, a new store may be one of several different types. In some communities, Canadian Retail is the major department store.

The table below provides an analysis of retail sales by type of store for the years 1967 to 1972.

Percent of Retail Sales

	1967	68	69	70	71	72
Clothing stores	100	96	46	46	52	52
Junior department stores	—	—	20	24	25	29
Department stores	—	4	34	30	23	19
	100	100	100	100	100	100

The company has been developed to take full advantage of the economic benefits of volume purchasing and central distribution which have increased as the company expanded. Mass merchandising, primarily on a cash and carry basis, is a concept which has proven successful for Canadian Retail and continues to be encouraged in most locations. Credit departments are, however, incorporated into full line department stores where customers purchase major appliances and furniture.

Retail sales volume from the older established outlets has increased at the same time that expansion into new market areas was taking place.

Consumer Durables Limited

Through the years Consumer Durables has developed a successful marketing concept using the dealer franchise system and today distributes a variety of brand name consumer durable goods to 229 dealer owned stores. The company supplies goods for retail, along with advertising material, merchandising and promotional programs and any other business assistance the independent operator may require. Three distribution centres are operated. The two major centres supply franchise dealers and industrial accounts. The third serves only industrial accounts.

Consumer Durables is now providing an expanded range of durable goods to 15 of the larger Canadian Retail outlets and the infusion of clothing carried by Canadian Retail into the Consumer Durables program provides dealers with the opportunity to expand into general merchandising.

The management of Consumer Durables has many years experience with the firm and has been retained to continue operation of this division.

Importing, Wholesaling, and Manufacturing

Your company has two importing subsidiaries, one wholesaling subsidiary and one manufacturing subsidiary.

Clothing Importers Limited imports ladies' sportswear and some children's and men's wear from the Far East. The company's sales force operates from centres across Canada, selling to leading department stores, chain stores, wholesalers, and distributors. Less than ten percent of the company's volume is sold to Canadian Retail.

The other importing subsidiary also brings in merchandise from the Far East, primarily canvas and rubber footwear. In addition, the company is a distributor for a line of stereo components and radios.

The wholesaling subsidiary distributes domestic and imported shoes, mainly European, to leading stores.

The manufacturing subsidiary is a producer of men's tailored and semi-tailored clothing. Both double-knit and woven garments are sold to national department stores and leading men's wear shops. Less than ten percent of the company's production is sold to Canadian Retail.

APPENDIX 2-continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS
for the year ended December 31, 1972 (with comparative figures for 1971)

	1972	1971
Sales	$43,150,847	$32,912,385
Cost of goods sold and operating expenses before the following	36,484,947	27,828,119
Depreciation and amortization	393,365	277,613
Interest — current	260,053	187,070
— long-term	221,568	79,394
	37,359,933	28,372,187
Earnings from operations before income taxes and minority interests	5,790,914	4,540,198
Income taxes — current	2,657,735	2,150,892
— deferred	112,288	109,989
	2,770,023	2,260,881
Minority interests	226,879	199,541
Net Earnings for the year	2,794,012	2,079,776
Retained earnings, beginning of year	6,733,741	4,653,965
	9,527,753	6,733,741
Dividends	135,114	
Retained earnings, end of year	$ 9,392,639	$ 6,733,741
Net earnings per share	$1.24	$.93

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 2--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
as at December 31, 1972 (with comparative figures for 1971)

Assets	1972	1971
Current Assets		
Cash and term deposits (note 1)	$ 6,370,584	$ 1,184,981
Accounts receivable	5,909,523	2,018,056
Inventories (note 2)	17,662,300	10,236,135
Prepaid expenses	92,892	79,090
	30,035,299	13,518,260
Non Current Receivables		
Notes receivable in installments to 1981	368,990	
Mortgages	148,624	6,983
	517,614	6,983
Fixed Assets (note 3)	9,993,961	5,302,806
Unamortized Debt Discount and Expense (note 4)	343,338	
Other Assets	66,652	66,652
Goodwill (notes 1 and 5)	1,818,467	1,496,578
	$42,775,331	$20,391,279

Notes to consolidated financial statements are an integral part of this statement.

AUDITORS' REPORT

To the Shareholders of Canadian Retail Limited:

We have examined the consolidated balance sheet of Canadian Retail Limited and its subsidiaries as at December 31, 1972 and the consolidated statements of earnings and retained earnings, and source and use of working capital for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

APPENDIX 2--continued

Liabilities	1972	1971
Current Liabilities		
Bank loans payable (note 6)	$ 7,675,818	$ 2,216,310
Accounts payable and accrued liabilities	6,206,800	3,055,833
Income and other taxes payable	988,347	814,737
Long-term debt due within one year	769,560	12,826
	15,640,525	6,099,706
Long-Term Debt (notes 6 and 7)	10,516,725	444,942
Deferred Income Taxes	821,238	341,483
Minority Interests (notes 1 and 10)	365,716	829,644
Shareholders' Equity		
Share Capital (note 8)	6,038,488	5,941,763
Retained Earnings	9,392,639	6,733,741
	15,431,127	12,675,504
	$42,775,331	$20,391,279

Approved by the board:
J. Smith, Director
K. Brown, Director

In our opinion, these consolidated financial statements present fairly the financial position of the companies as at December 31, 1972 and the results of their operations and the source and use of their working capital for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

February 28, 1973 — Chartered Accountants

APPENDIX 2--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SOURCE AND USE OF WORKING CAPITAL
for the year ended December 31, 1972 (with comparative figures for 1971)

	1972	1971
Source of Working Capital		
Net earnings for the year	$ 2,794,012	$ 2,079,776
Depreciation and amortization	393,365	277,613
Deferred income taxes	112,288	109,989
Earnings of minority interests	226,879	199,541
Provided from operations	3,526,544	2,666,919
Bank loans (note 7)	6,718,170	
Debentures and deferred income taxes of newly acquired subsidiary (note 1)	4,239,467	
Issue of shares (note 8)	96,725	133,903
Proceeds from disposal of fixed assets		280,588
Decrease (increase) in other assets	838	(6,983)
	14,581,744	3,074,427
Use of Working Capital		
Purchase of fixed assets of subsidiary (note 1)	2,001,717	
Purchase of other assets of subsidiary (note 1)	854,806	
Purchase of other fixed assets	3,082,803	2,033,077
Purchase of additional share in partially owned subsidiary (note 1)	1,012,696	
Dividends paid	135,114	
Current portion of new bank loans and reduction in other long-term debt	518,388	14,326
	7,605,524	2,047,403
Increase in Working Capital	6,976,220	1,027,024
Working Capital, beginning of year	7,418,554	6,391,530
Working Capital, end of year	$14,394,774	$ 7,418,554

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 2--continued

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of consolidation. The consolidated financial statements include the accounts of all subsidiaries. The results of the operations of subsidiary companies have been included only from the dates of acquisition (except as noted below) and provision has been made for minority interests. The purchase method has been used in accounting for the acquisition of all subsidiaries.

   (a) Acquisition of Consumer Durables Limited:

   As of December 1, 1972, Canadian Retail Limited purchased all of the issued and outstanding shares of Consumer Durables Limited for cash of $9,170,170. The excess of purchase price over net book value, an amount of $850,663, was applied to land. The assets and liabilities of Consumer Durables as at December 1, 1972 have been included in the company's consolidated balance sheet as at December 31, 1972.

   The unaudited net earnings of Consumer Durables for the month of December, 1972 amounted to $19,400 with sales of $1,370,000. These earnings and sales have not been included in the company's consolidated statements of earnings and retained earnings and source and use of working capital.

   (b) Acquisition of additional share interest in Clothing Importers Limited:

   During the third quarter of 1972, the company purchased for cash of $1,012,694 an additional 17% share interest in this subsidiary, bringing the company's present share holdings to 92%. The excess of the purchase price for this additional interest over the proportionate value of the subsidiary's net assets at the date of acquisition was $321,889 which has been allocated to goodwill.

2. Inventories. Inventories are valued at the lower of cost or estimated net realizable value less normal profit margins.

3. Fixed assets

	Cost	Accumulated Depreciation	Net Book Value 1972	Net Book Value 1971
Land	$ 3,065,591	—	$3,065,591	$1,120,968
Buildings	5,873,365	$1,305,185	4,568,180	2,440,572
Fixtures and equipment	3,548,410	1,564,855	1,983,555	1,444,604
Leasehold improvements	496,051	119,416	376,635	296,662
	$12,983,417	$2,989,456	$9,993,961	$5,302,806

4. Unamortized debt discount and expense. This will be amortized at the rate of $36,300 per annum over the term of the debentures.

5. Goodwill. This amount is made up of:

	1972	1971
Purchased	$ 260,150	$ 260,150
On consolidation	1,558,317	1,236,428
	$1,818,467	$1,496,578

   The above amounts are carried in the accounts at cost without amortization.

6. Bank indebtedness. The company has assigned the loss proceeds of certain fire insurance policies and lodged with the bank certificates of title to certain real properties as security for short-term and long-term indebtedness to the bank. Accounts receivable of a subsidiary company are assigned from time to time to the bank as security for its bank indebtedness, of which none was outstanding as at December 31, 1972.

   The company has provided a letter of undertaking to its bankers to provide them on request with a debenture incorporating both a specific charge over fixed assets and a floating charge over all assets of the company and certain of its wholly-owned subsidiaries.

   In arranging for financing for the acquisition of Consumer Durables the company agreed to furnish the following to the bank as security for loans:

   (i) Collateral mortgages on certain properties.
   (ii) An additional assignment of loss proceeds of fire insurance policies on certain other properties.
   (iii) Certificates of title to certain other real properties.
   (iv) Pledge of all outstanding shares of Consumer Durables Limited.

APPENDIX 2--continued

7. Long-term debt:

	1972	1971
6% Sinking Fund Debentures, Series "A" due May 15, 1982	$ 4,114,000	$ -
Bank Loans (Note 6)		
Payable with interest at rates not exceeding 2% over the prevailing prime bank rate and maturing at various dates to 1982	6,718,170	-
Mortgages		
Payable with interest at 9% per annum and maturing in 1984	395,259	400,725
Others at various interest rates and maturity dates	58,856	57,043
	11,286,285	457,768
Deduct amounts due within one year	769,560	12,826
	$10,516,725	$ 444,942

Sinking fund payment requirements on the 6% debentures are $363,000 annually. The sinking fund payment for 1973 is anticipated to be reduced by $121,000, which is the amount of debentures purchased and tendered to the Trustee as at December 31, 1972. The 6% debentures are secured by a first floating charge on all assets, business and undertakings of Consumer Durables Limited.

Payments required for retirement of debentures and other long-term debt over the next five years are:
1973 - $769,560 1974 - $948,640 1975 - $982,520 1976 - $1,029,710 1977 - $1,090,210

8. Share capital

		No. of shares	
Authorized:	Common shares of no par value	4,000,000	
Issued:	Balance, December 31, 1971	2,245,412	$ 5,941,763
	Shares issued on options exercised during the year for cash	10,866	96,725
	Balance December 31, 1972	2,256,278	$ 6,038,488

Certain employees have options to purchase 15,715 shares at $8.66 per share, 800 shares at $14.70 per share and 9,000 shares at $22.90 per share.

The total options for 25,515 shares expire in the following years:
1973 - 6,000 1974 - 12,015 1975 - 3,700 1976 - 2,000 1977 - 1,800
No material dilution of earnings per share results from these options.

9. Lease commitments. Minimum annual rentals for property leases in each of the next five years are:
1973 - $942,913 1974 - $914,563 1975 - $886,641 1976 - $763,598 1977 - $631,776
Certain of the leases provide for additional rentals based on sales, as well as other occupancy charges.

10. Contractual obligations. The company has an obligation under certain circumstances to purchase for cash the minority interests' share holdings of 8% in a subsidiary company. The company also has an option under certain circumstances to acquire these minority interests for a prescribed cash consideration. This option expires December 31, 1989.

11. Remuneration of directors and senior officers. The aggregate remuneration paid or payable by the company and its subsidiaries to the directors and senior officers of the company for 1972 and 1971 was $210,983 and $203,885 respectively.

12. Subsequent event. On January 3, 1973, the directors of the company declared a dividend of six cents per share payable February 15, 1973 to shareholders of record on February 1, 1973.

APPENDIX 2--continued

SEVEN YEAR REVIEW

	1966	1967	1968	1969	1970	1971	1972
Operating results ($000)							
Sales	4,417	5,256	7,382	14,809	25,347	32,912	43,151
Earnings from operations before the following	540	910	1,339	2,093	3,709	4,819	6,184
Depreciation	62	77	96	122[1]	220	278	393
Income taxes	227	404	629	978[1]	1,819	2,261	2,770
Minority interests	—	—	—	—	167	200	227
Net earnings	250	428	615	993	1,503	2,080	2,794
Financial Position ($000)							
Working capital	365	680	1,091	5,299	6,392	7,419	14,395
Inventories	499	877	1,607	4,190	7,298	10,236	17,662
Fixed assets—net	768	845	1,068	3,181	3,828	5,303	9,994
Total assets	1,796	2,626	3,715	11,277	16,055	20,391	42,775
Long-term debt	22	12	44	450	460	445	10,517
Shareholders' equity	1,130	1,557	2,341	8,222	10,461	12,676	15,431
Per Common Share ($)							
Net earnings	.16	.27	.37	.52[2]	.67	.93	1.24
Dividends paid	—	—	—	—	—	—	.06
Cash flow[3] from operations	.19	.32	.43	.62[2]	.93	1.17	1.56
Net asset value	.70	.97	1.41	3.80	4.69	5.65	6.84
Stock market price: High	4.10	7.00	9.38	14.50	12.75	17.25	23.88
Low	2.35	4.55	4.05	8.38	6.00	9.50	16.00
Close	3.10	5.88	8.88	12.13	9.38	15.88	23.88
Ratios and Statistics							
Number of shares outstanding	1,604,906	1,605,101	1,664,874	2,165,141	2,229,890	2,245,412	2,256,278
Net earnings ÷ Sales	.06	.08	.08	.07	.06	.06	.06
Net earnings ÷ Shareholders' Equity	.22	.27	.26	.12	.14	.16	.18
Net earnings ÷ Total Assets	.14	.16	.17	.09	.09	.10	—[4]
Sales ÷ Shareholders' Equity	3.91	3.38	3.15	1.80	2.42	2.60	2.80
Sales ÷ Total Assets	2.46	2.00	1.99	1.31	1.58	1.61	—[4]
Shareholders' Equity ÷ Total Assets	.63	.59	.63	.73	.65	.62	.36
% Growth[5]							
Net Earnings per Share		69	37	41	29	39	33
Net Earnings		71	44	61	51	38	34
Sales		19	40	101	71	30	31
Cash Flow[3] per Share		68	34	44	50	28	31
Working capital ratio	1.6:1	1.6:1	1.8:1	3.0:1	2.5:1	2.2:1	1.9:1
Price-earnings ratio[6]	19.4	21.8	24.0	23.3	14.0	17.1	19.3

NOTES TO SEVEN YEAR REVIEW

1. During 1969, the rates of depreciation were changed to conform with revised estimates of the useful life of fixed assets and the company converted from the taxes payable to the tax allocation method of providing for income taxes. Prior years figures as shown above have not been restated.
2. Based on weighted average of 1,907,012 shares outstanding.
3. Net earnings + Depreciation and amortization + Deferred income taxes + Minority interests.
4. Not calculated because assets of subsidiary acquired in December are included but sales and earnings are not.
5. Increase during year divided by level at beginning of year.
6. Closing stock market price per share for the year divided by net earnings per share for the year.

APPENDIX 3

ANNUAL REPORT FOR TREATMENT YO

CANADIAN RETAIL LIMITED

Annual Report 1972

APPENDIX 3--continued

PRESIDENT'S REPORT

The past year was an outstanding one for Canadian Retail Limited. New records were set in both sales and earnings and at the same time the largest expansion program in the company's history took place.

Sales in the year ended December 31, 1972 rose to \$43,150,847 compared to \$32,912,385 in 1971, an increase of 31 percent. Net earnings increased by 34 percent to \$2,794,012 or \$1.24 per share, compared with \$2,079,776 or \$.93 per share in the previous year.

It should be pointed out that although the Consolidated Balance Sheet as at December 31, 1972 includes the assets of Consumer Durables Limited, the Consolidated Statements of Earnings and Retained Earnings for 1972 do not include the sales and earnings of Consumer Durables Limited.

During the past year 14 retail stores were added, bringing the total to 6[illegible]. Retail selling space now amounts to 617,000 square feet.

Towards the end of the year, your company acquired Consumer Durables Limited. This acquisition broadens our corporate market area considerably. Your company is now integrating the two firms' lines of merchandise to provide a greater diversity of products for both Canadian Retail and Consumer Durables operations.

This new subsidiary supplies consumer durable goods and hardware to a chain of 229 dealer franchised stores and in addition carries on a wholesale industrial account business to the building trades. Fifteen Canadian Retail stores are now benefitting from Consumer Durables expertise in durable consumer goods while rubber and canvas footwear items have been made available to Consumer Durables dealers.

In the latter part of 1972 Canadian Retail purchased an additional 17 percent interest in Clothing Importers Limited, one of our importing subsidiaries

Larger warehousing and head office facilities, purchased early in 1972, have now been renovated and redecorated and the move to the new location is underway. The building provides Canadian Retail with 180,000 square feet for the distribution centre and executive offices and 45,000 square feet for importing operations.

A dividend policy was introduced in 1972 commencing with a semi-annual dividend of six cents per share paid in August. A similar dividend was paid in February 1973.

Along with the physical expansion has gone a strengthening of management personnel at both the executive and senior management levels. The expertise of our key people has been invaluable in the past year and we express our appreciation to these and our many other loyal employees.

You will notice that, for the first time, we include with our financial statements a forecast for the year 1973. In addition, we present below an indication of the reasoning behind our forecast. Though no one can predict the future with certainty, we believe that our forecast and explanations may be useful to you in assessing the future of your company.

Next year's annual report should be even more useful. It will follow up on this forecast, explaining any difference between our 1973 forecast and the year's actual results, as well as forecasting results for 1974.

We foresee another good year ahead, with sales rising to \$79,162,000 and earnings per share to

APPENDIX 3--continued

\$1.79. This includes the sales and earnings of Consumer Durables, to be consolidated for the first time in 1973.

Our 1973 forecast is based on the assumption that the Canadian economy will continue with the momentum evident at the end of 1972. Consumer spending and retail sales are expected to expand in 1973 at rates close to their 1972 rates (which were 11.6% and 10.9%, respectively). Inflationary pressures are unlikely to abate significantly, and price conscious shoppers should continue to look favourably upon our long-standing policy of quality merchandise at reasonable prices.

Our forecast also assumes that government-proposed tax changes will become law and that certain stock options will be exercised during the year. The validity of these assumptions is not, however, critical to the forecast. Only marginal differences in earnings and earnings per share would result if these assumptions proved unfounded.

The retail division will open 21 new stores (16 clothing stores, 4 junior department stores, and 1 full-line department store) with combined space of more than 190,000 square feet. This division will continue to base its marketing concepts on the successful formula developed by its experienced management personnel as it branches out to serve an ever larger segment of Canada.

New stores, although open for only a portion of 1973, will contribute to sales and earnings. Stores opened in 1972 will show sizeable increases in sales and earnings by virtue of having been open for the whole of 1973. These and other existing stores will benefit from broadened merchandise lines and increased consumer demand for both durables and non-durables.

Sales volume for Consumer Durables during the coming year will increase from its 1972 rate and will provide a contribution to profit. Growth in this division will result from expanded merchandise lines and from an increase in outlets. A program of spring and summer footwear has already been introduced into 45 franchised stores with excellent consumer reaction. Plans are underway to introduce clothing into the fall program for all franchised stores with suitable facilities. The development of new franchised dealers will be accelerated and company owned stores will be opened in larger centres where there will be no conflict with dealer outlets.

Other segments of the company will also grow in sales and earnings in 1973. Exceptional growth is expected once again for Clothing Importers as product lines will continue to be broadened and new customers will be added.

The company's profit margin percentage will decrease somewhat, due primarily to the addition of sales from the lower margin Consumer Durables division. Ability to control costs has always been a strength of your company, however, and will continue to be emphasized. The present organization is well equipped with personnel and facilities to pursue the planned growth without undue increases in corporate overhead costs.

On behalf of the Board

President

APPENDIX 3--continued

Retail Division

The retail division continues to be the largest and most important, while other divisions provide the company with depth and stability. The retail division is now 19 years old and has grown from a single store to a chain of outlets. The table below sets out the growth in number of stores operated from 1967 to 1972.

Number of Stores

	1967	68	69	70	71	72
Clothing stores	10	11	12	17	32	44
Junior department stores	—	1	4	6	10	12
Department stores	—	1	5	5	5	5
	10	13	21	28	47	61

Originally Canadian Retail marketed only family clothing, but as it grew, so did its lines of merchandise. Each new location is studied carefully and depending on the results of area surveys, a new store may be one of several different types. In some communities, Canadian Retail is the major department store.

The table below provides an analysis of retail sales by type of store for the years 1967 to 1972.

Percent of Retail Sales

	1967	68	69	70	71	72
Clothing stores	100	96	46	46	52	52
Junior department stores	—	—	20	24	25	29
Department stores	—	4	34	30	23	19
	100	100	100	100	100	100

The company has been developed to take full advantage of the economic benefits of volume purchasing and central distribution which have increased as the company expanded. Mass merchandising, primarily on a cash and carry basis, is a concept which has proven successful for Canadian Retail and continues to be encouraged in most locations. Credit departments are, however, incorporated into full line department stores where customers purchase major appliances and furniture.

Retail sales volume from the older established outlets has increased at the same time that expansion into new market areas was taking place.

Consumer Durables Limited

Through the years Consumer Durables has developed a successful marketing concept using the dealer franchise system and today distributes a variety of brand name consumer durable goods to 229 dealer owned stores. The company supplies goods for retail, along with advertising material, merchandising and promotional programs and any other business assistance the independent operator may require. Three distribution centres are operated. The two major centres supply franchise dealers and industrial accounts. The third serves only industrial accounts.

Consumer Durables is now providing an expanded range of durable goods to 15 of the larger Canadian Retail outlets and the infusion of clothing carried by Canadian Retail into the Consumer Durables program provides dealers with the opportunity to expand into general merchandising.

The management of Consumer Durables has many years experience with the firm and has been retained to continue operation of this division.

Importing, Wholesaling, and Manufacturing

Your company has two importing subsidiaries, one wholesaling subsidiary and one manufacturing subsidiary.

Clothing Importers Limited imports ladies' sportswear and some children's and men's wear from the Far East. The company's sales force operates from centres across Canada, selling to leading department stores, chain stores, wholesalers, and distributors. Less than ten percent of the company's volume is sold to Canadian Retail.

The other importing subsidiary also brings in merchandise from the Far East, primarily canvas and rubber footwear. In addition, the company is a distributor for a line of stereo components and radios.

The wholesaling subsidiary distributes domestic and imported shoes, mainly European, to leading stores.

The manufacturing subsidiary is a producer of men's tailored and semi-tailored clothing. Both double-knit and woven garments are sold to national department stores and leading men's wear shops. Less than ten percent of the company's production is sold to Canadian Retail.

APPENDIX 3--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS

for the year ended December 31, 1972 (with comparative figures for 1971 and a comparative forecast for 1973)

	1971	1972	UNAUDITED FORECAST 1973
Sales	$32,912,385	$43,150,847	$79,162,000
Cost of goods sold and operating expenses before the following	27,828,110	36,484,947	69,151,000
Depreciation and amortization	277,613	393,365	711,000
Interest - current	187,070	260,053	431,000
- long-term	79,394	221,568	888,000
	28,372,187	37,359,933	71,181,000
Earnings from operations before income taxes and minority interests	4,540,198	5,790,914	7,981,000
Income taxes - current	2,150,892	2,657,735	3,668,000
- deferred	109,989	112,288	157,000
	2,260,881	2,770,023	3,825,000
Minority interests	199,541	226,879	113,000
Net Earnings for the year	2,079,776	2,794,012	4,043,000
Retained earnings, beginning of year	4,653,965	6,733,741	9,393,000
	6,733,741	9,527,753	13,436,000
Dividends		135,114	271,000
Retained earnings, end of year	$ 6,733,741	$ 9,392,639	$13,165,000
Net earnings per share	$.93	$1.24	$1.79

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 3--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

as at December 31, 1972 (with comparative figures for 1971 and a comparative forecast for 1973)

Assets	1971	1972	UNAUDITED FORECAST 1973
Current Assets			
Cash and term deposits (note 1)	\$ 1,184,981	\$ 6,370,584	\$ 699,000
Accounts receivable	2,018,056	5,909,523	6,800,000
Inventories (note 2)	10,236,133	17,662,300	22,990,000
Prepaid expenses	79,090	92,892	160,000
	13,518,260	30,035,299	30,649,000
Non Current Receivables			
Notes receivable in installments to 1981		368,990	333,000
Mortgages	6,983	148,624	140,000
	6,983	517,614	473,000
Fixed Assets (note 3)	5,302,806	9,993,961	12,085,000
Unamortized Debt Discount and Expense (note 4)		343,338	307,000
Other Assets	66,652	66,652	67,000
Goodwill (notes 1 and 5)	1,496,578	1,818,467	1,818,000
	\$20,391,279	\$42,775,331	\$45,399,000

Notes to consolidated financial statements are an integral part of this statement.

AUDITORS' REPORT

To the Shareholders of Canadian Retail Limited:

We have examined the consolidated balance sheet of Canadian Retail Limited and its subsidiaries as at December 31, 1972 and the consolidated statements of earnings and retained earnings, and source and use of working capital for the year then ended. We have not examined the forecast financial statements in this annual report and we express no opinion on them. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

APPENDIX 3--continued

Liabilities	1971	1972	UNAUDITED FORECAST 1973
Current Liabilities			
Bank loans payable (note 6)	$ 2,216,310	$ 7,675,818	$ 5,590,000
Accounts payable and accrued liabilities	3,055,833	6,206,800	7,187,000
Income and other taxes payable	814,737	988,347	1,392,000
Long-term debt due within one year	12,826	769,560	949,000
	6,099,706	15,640,525	15,118,000
Long-Term Debt (notes 6 and 7)	444,942	10,516,725	9,568,000
Deferred Income Taxes	341,483	821,238	979,000
Minority Interests (notes 1 and 10)	829,644	365,716	479,000
Shareholders' Equity			
Share Capital (note 8)	5,941,763	6,038,488	6,090,000
Retained Earnings	6,733,741	9,392,639	13,165,000
	12,675,504	15,431,127	19,255,000
	$20,391,279	$42,775,331	$45,399,000

Approved by the board:
J. Smith, Director
K. Brown, Director

In our opinion, these consolidated financial statements present fairly the financial position of the companies as at December 31, 1972 and the results of their operations and the source and use of their working capital for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

February 28, 1973 Chartered Accountants

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SOURCE AND USE OF WORKING CAPITAL

for the year ended December 31, 1972 (with comparative figures for 1971 and a comparative forecast for 1973)

	1971	1972	UNAUDITED FORECAST 1973
Source of Working Capital			
Net earnings for the year	$ 2,079,776	$ 2,794,012	$ 4,043,000
Depreciation and amortization	277,613	393,365	747,000
Deferred income taxes	109,989	112,288	157,000
Earnings of minority interests	199,541	226,879	113,000
Provided from operations	2,666,919	3,526,544	5,060,000
Bank loans (note 7)		6,718,170	
Debentures and deferred income taxes of newly acquired subsidiary (note 1)		4,239,467	
Issue of shares (note 8)	133,903	96,725	52,000
Proceeds from disposal of fixed assets	280,588		
Decrease (increase) in other assets	(6,983)	838	45,000
	3,074,427	14,581,744	5,157,000
Use of Working Capital			
Purchase of fixed assets of subsidiary (note 1)		2,001,717	
Purchase of other assets of subsidiary (note 1)		854,806	
Purchase of other fixed assets	2,033,077	3,082,803	2,801,000
Purchase of additional share in partially owned subsidiary (note 1)		1,012,696	
Dividends paid		135,114	271,000
Current portion of new bank loans and reduction in other long-term debt	14,326	518,388	949,000
	2,047,403	7,605,524	4,021,000
Increase in Working Capital	1,027,024	6,976,220	1,136,000
Working Capital, beginning of year	6,391,530	7,418,554	14,395,000
Working Capital, end of year	$ 7,418,554	$14,394,774	$15,531,000

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 3--continued

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of consolidation. The consolidated financial statements include the accounts of all subsidiaries. The results of the operations of subsidiary companies have been included only from the dates of acquisition (except as noted below) and provision has been made for minority interests. The purchase method has been used in accounting for the acquisition of all subsidiaries.

   (a) Acquisition of Consumer Durables Limited:

   As of December 1, 1972, Canadian Retail Limited purchased all of the issued and outstanding shares of Consumer Durables Limited for cash of $9,170,170. The excess of purchase price over net book value, an amount of $850,663, was applied to land. The assets and liabilities of Consumer Durables as at December 1, 1972 have been included in the company's consolidated balance sheet as at December 31, 1972.

   The unaudited net earnings of Consumer Durables for the month of December, 1972 amounted to $19,400 with sales of $1,370,000. These earnings and sales have not been included in the company's consolidated statements of earnings and retained earnings and source and use of working capital for 1972. The unaudited forecast for 1973 does include sales and earnings of Consumer Durables.

   (b) Acquisition of additional share interest in Clothing Importers Limited:

   During the third quarter of 1972, the company purchased for cash of $1,012,694 an additional 17% share interest in this subsidiary, bringing the company's present share holdings to 92%. The excess of the purchase price for this additional interest over the proportionate value of the subsidiary's net assets at the date of acquisition was $321,689 which has been allocated to goodwill.

2. Inventories. Inventories are valued at the lower of cost or estimated net realizable value less normal profit margins.

3. Fixed assets

	1971	1972			Unaudited Forecast-1973		
	Net Book Value	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Land	$1,120,968	$ 3,065,591	–	$3,065,591	$ 3,599,000	-	$ 3,599,000
Buildings	2,440,572	5,873,365	$1,305,185	4,568,180	7,200,000	$1,566,000	5,634,000
Fixtures and equipment	1,444,604	3,548,410	1,564,855	1,983,555	4,356,000	1,960,000	2,396,000
Leasehold improvements	296,662	496,051	119,416	376,635	605,000	149,000	456,000
	$5,302,806	$12,983,417	$2,989,456	$9,993,961	$15,760,000	$3,675,000	$12,085,000

4. Unamortized debt discount and expense. This will be amortized at the rate of $36,300 per annum over the term of the debentures.

5. Goodwill. This amount is made up of:

	1971	1972	Unaudited Forecast 1973
Purchased	$ 260,150	$ 260,150	$ 260,000
On consolidation	1,236,428	1,558,317	1,558,000
	$1,496,578	$1,818,467	$1,818,000

   The above amounts are carried in the accounts at cost without amortization.

6. Bank indebtedness. The company has assigned the loss proceeds of certain fire insurance policies and lodged with the bank certificates of title to certain real properties as security for short-term and long-term indebtedness to the bank. Accounts receivable of a subsidiary company are assigned from time to time to the bank as security for its bank indebtedness, of which none was outstanding as at December 31, 1972.

   The company has provided a letter of undertaking to its bankers to provide them on request with a debenture incorporating both a specific charge over fixed assets and a floating charge over all assets of the company and certain of its wholly-owned subsidiaries.

   In arranging for financing for the acquisition of Consumer Durables the company agreed to furnish the following to the bank as security for loans:

   (i) Collateral mortgages on certain properties.
   (ii) An additional assignment of loss proceeds of fire insurance policies on certain other properties.
   (iii) Certificates of title to certain other real properties.
   (iv) Pledge of all outstanding shares of Consumer Durables Limited.

APPENDIX 3--continued

7. Long-term debt

	1971	1972	Unaudited Forecast 1973
6% Sinking Fund Debentures, Series "A" due May 15, 1982	$	$ 4,114,000	$ 3,872,000
Bank Loans (Note 6)			
Payable with interest at rates not exceeding 2% over the prevailing prime bank rate and maturing at various dates to 1982		6,718,170	6,243,000
Mortgages			
Payable with interest at 9% per annum and maturing in 1984	400,725	395,259	355,000
Others at various interest rates and maturity dates	57,043	58,856	47,000
	457,768	11,286,285	10,517,000
Deduct amounts due within one year	12,826	769,560	949,000
	$444,942	$10,516,725	$ 9,568,000

Sinking fund payment requirements on the 6% debentures are $363,000 annually. The sinking fund payment for 1973 is anticipated to be reduced by $121,000, which is the amount of debentures purchased and tendered to the Trustee as at December 31, 1972. The 6% debentures are secured by a first floating charge on all assets, business and undertakings of Consumer Durables Limited.

Payments required for retirement of debentures and other long-term debt over the next five years are:
1973 - $769,560 1974 - $948,640 1975 - $982,520 1976 - $1,029,710 1977 - $1,090,210

8. Share capital

		No. of shares	
Authorized: Common shares of no par value		4,000,000	
Issued:	Balance, December 31, 1971	2,245,412	$ 5,941,763
	Shares issued on options exercised during the year for cash	10,866	96,725
	Balance December 31, 1972	2,256,278	6,038,488
	Shares expected to be issued on options exercised during 1973 for cash (unaudited forecast)	6,000	51,960
	Expected balance December 31, 1973 (unaudited forecast)	2,262,278	$ 6,090,448

Certain employees have options to purchase 15,715 shares at $8.66 per share, 800 shares at $14.70 per share and 9,000 shares at $22.90 per share.

The total options for 25,515 shares expire in the following years:
1973 - 6,000 1974 - 12,015 1975 - 3,700 1976 - 2,000 1977 - 1,800
No material dilution of earnings per share results from these options. The unaudited forecast indicates that the company will continue to offer share options to key employees and that no material dilution of earnings per share will result from these options.

9. Lease commitments. Minimum annual rentals for property leases in each of the next five years are:
1973 - $942,913 1974 - $914,563 1975 - $886,641 1976 - $763,598 1977 - $631,776
Certain of the leases provide for additional rentals based on sales, as well as other occupancy charges.

The unaudited forecast indicates the following minimum rentals will prevail at December 31, 1973:
1974 - $1,694,000 1975 - $1,646,000 1976 - $1,527,000 1977 - $1,379,000 1978 - $1,137,000

10. Contractual obligations. The company has an obligation under certain circumstances to purchase for cash the minority interests' share holdings of 8% in a subsidiary company. The company also has an option under certain circumstances to acquire these minority interests for a prescribed cash consideration. This option expires December 31, 1989.

11. Remuneration of directors and senior officers. The aggregate remuneration paid or payable by the company and its subsidiaries to the directors and senior officers of the company for 1971 and 1972 was $203,885 and $210,962 respectively. The unaudited forecast for 1973 is $218,000.

12. Subsequent event. On January 3, 1973, the directors of the company declared a dividend of six cents per share payable February 15, 1973 to shareholders of record on February 1, 1973.

APPENDIX 3--continued

SEVEN YEAR REVIEW *and one year forecast*

	1966	1967	1968	1969	1970	1971	1972	UNAUDITED FORECAST 1973
Operating results ($000)								
Sales	4,417	5,256	7,382	14,809	25,347	32,912	43,151	79,162
Earnings from operations before the following:	540	910	1,339	2,093	3,709	4,819	6,184	8,692
Depreciation	62	77	96	122[1]	220	278	393	711
Income taxes	227	404	629	978[1]	1,819	2,261	2,770	3,825
Minority interests	—	—	—	—	167	200	227	113
Net earnings	250	428	615	993	1,503	2,080	2,794	4,043
Financial Position ($000)								
Working capital	365	680	1,091	5,299	6,392	7,419	14,395	15,531
Inventories	499	877	1,607	4,190	7,298	10,236	17,662	22,990
Fixed assets—net	768	845	1,068	3,181	3,828	5,303	9,994	12,085
Total assets	1,796	2,626	3,715	11,277	16,055	20,391	42,775	45,399
Long-term debt	22	12	44	450	460	445	10,517	9,568
Shareholders' equity	1,130	1,557	2,341	8,222	10,461	12,676	15,431	19,255
Per Common Share ($)								
Net earnings	.16	.27	.37	.52[2]	.67	.93	1.24	1.79
Dividends paid	—	—	—	—	—	—	.06	.12
Cash flow[3] from operations	.19	.32	.43	.62[2]	.93	1.17	1.56	2.24
Net asset value	.70	.97	1.41	3.80	4.69	5.65	6.84	8.51
Stock market price: High	4.10	7.00	9.38	14.50	12.75	17.25	23.88	
Low	2.35	4.55	4.05	8.38	6.00	9.50	16.00	
Close	3.10	5.88	8.88	12.13	9.38	15.88	23.88	
Ratios and Statistics								
Number of shares outstanding	1,604,906	1,605,101	1,664,874	2,165,141	2,229,890	2,245,412	2,256,278	2,262,278
Net earnings ÷ Sales	.06	.08	.08	.07	.06	.06	.06	.05
Net earnings ÷ Shareholders' Equity	.22	.27	.26	.12	.14	.16	.18	.21
Net earnings ÷ Total Assets	.14	.16	.17	.09	.09	.10	—[4]	.09
Sales ÷ Shareholders' Equity	3.91	3.38	3.15	1.80	2.42	2.60	2.80	4.11
Sales ÷ Total Assets	2.46	2.00	1.99	1.31	1.58	1.61	—[4]	1.74
Shareholders' Equity ÷ Total Assets	.63	.59	.63	.73	.65	.62	.36	.42
% Growth[5]								
Net Earnings per Share		69	37	41	29	39	33	44
Net Earnings		71	44	61	51	38	34	45
Sales		19	40	101	71	30	31	83
Cash Flow[3] per Share		68	34	44	50	28	31	44
Working capital ratio	1.6:1	1.6:1	1.8:1	3.0:1	2.5:1	2.2:1	1.9:1	2.0:1
Price-earnings ratio[6]	19.4	21.8	24.0	23.3	14.0	17.1	19.3	

NOTES TO SEVEN YEAR REVIEW AND ONE YEAR FORECAST

1. During 1969, the rates of depreciation were changed to conform with revised estimates of the useful life of fixed assets and the company converted from the taxes payable to the tax allocation method of providing for income taxes. Prior years figures as shown above have not been re-stated.
2. Based on weighted average of 1,907,012 shares outstanding.
3. Net earnings + Depreciation and amortization + Deferred income taxes + Minority interests.
4. Not calculated because assets of subsidiary acquired in December are included but sales and earnings are not.
5. Increase during year divided by level at beginning of year.
6. Closing stock market price per share for the year divided by net earnings per share for the year.

APPENDIX 4

ANNUAL REPORT FOR TREATMENT YP

CANADIAN RETAIL LIMITED

Annual Report 1972

APPENDIX 4--continued

PRESIDENT'S REPORT

The past year was an outstanding one for Canadian Retail Limited. New records were set in both sales and earnings and at the same time the largest expansion program in the company's history took place.

Sales in the year ended December 31, 1972 rose to $43,150,847 compared to $32,912,385 in 1971, an increase of 31 percent. Net earnings increased by 34 percent to $2,794,012 or $1.24 per share, compared with $2,079,776 or $.93 per share in the previous year.

It should be pointed out that although the Consolidated Balance Sheet as at December 31, 1972 includes the assets of Consumer Durables Limited, the Consolidated Statements of Earnings and Retained Earnings for 1972 do not include the sales and earnings of Consumer Durables Limited.

During the past year 14 retail stores were added, bringing the total to 61. Retail selling space now amounts to 517,000 square feet.

Towards the end of the year, your company acquired Consumer Durables Limited. This acquisition broadens our corporate market area considerably. Your company is now integrating the two firms' lines of merchandise to provide a greater diversity of products for both Canadian Retail and Consumer Durables operations.

This new subsidiary supplies consumer durable goods and hardware to a chain of 229 dealer franchised stores and in addition carries on a wholesale industrial account business to the building trades. Fifteen Canadian Retail stores are now benefitting from Consumer Durables expertise in durable consumer goods while rubber and canvas footwear items have been made available to Consumer Durables dealers.

In the latter part of 1972 Canadian Retail purchased an additional 17 percent interest in Clothing Importers Limited, one of our importing subsidiaries.

Larger warehousing and head office facilities, purchased early in 1972, have now been renovated and redecorated and the move to the new location is underway. The building provides Canadian Retail with 180,000 square feet for the distribution centre and executive offices and 45,000 square feet for importing operations.

A dividend policy was introduced in 1972 commencing with a semi-annual dividend of six cents per share paid in August. A similar dividend was paid in February 1973.

Along with the physical expansion has gone a strengthening of management personnel at both the executive and senior management levels. The expertise of our key people has been invaluable in the past year and we express our appreciation to these and our many other loyal employees.

You will notice that, for the first time, we include with our financial statements a forecast for the year 1973. In addition, we present below an indication of the reasoning behind our forecast. Though no one can predict the future with certainty, we believe that our forecast and explanations may be useful to you in assessing the future of your company.

Next year's annual report should be even more useful. It will follow up on this forecast, explaining any difference between our 1973 forecast and the year's actual results, as well as forecasting results for 1974.

We foresee another good year ahead, with sales rising to $64,445,000 and earnings per share

APPENDIX 4--continued

to $1.48. This includes the sales and earnings of Consumer Durables, to be consolidated for the first time in 1973.

Our 1973 forecast is based on the assumption that the Canadian economy will continue with the momentum evident at the end of 1972. Consumer spending and retail sales are expected to expand in 1973 at rates close to their 1972 rates (which were 11.6% and 10.9%, respectively). Inflationary pressures are unlikely to abate significantly, and price conscious shoppers should continue to look favourably upon our long-standing policy of quality merchandise at reasonable prices.

Our forecast also assumes that government-proposed tax changes will become law and that certain stock options will be exercised during the year. The validity of these assumptions is not, however, critical to the forecast. Only marginal differences in earnings and earnings per share would result if these assumptions proved unfounded.

The retail division will open 8 new stores (5 clothing stores, 2 junior department stores, and 1 full line department store) with combined space of more than 70,000 square feet. This division will continue to base its marketing concepts on the successful formula developed by its experienced management personnel as it branches out to serve an ever larger segment of Canada.

New stores, although open for only a portion of 1973, will contribute to sales and earnings. Stores opened in 1972 will show sizeable increases in sales and earnings by virtue of having been open for the whole of 1973. These and other existing stores will benefit from broadened merchandise lines and increased consumer demand for both durables and non-durables.

Sales volume for Consumer Durables during the coming year will increase from its 1972 rate and will provide a contribution to profit. Growth in this division will result from expanded merchandise lines and from an increase in outlets. A program of spring and summer footwear has already been introduced into 48 franchised stores with excellent consumer reaction. Plans are underway to introduce clothing into the fall program for all franchised stores with suitable facilities. The development of new franchised dealers will be accelerated and company owned stores will be opened in larger centres where there will be no conflict with dealer outlets.

Other segments of the company will also grow in sales and earnings in 1973. Exceptional growth is expected once again for Clothing Importers as product lines will continue to be broadened and new customers will be added.

The company's profit margin percentage will decrease somewhat, due primarily to the addition of sales from the lower margin Consumer Durables division. Ability to control costs has always been a strength of your company, however, and will continue to be emphasized. The present organization is well equipped with personnel and facilities to pursue the planned growth without undue increases in corporate overhead costs.

On behalf of the Board

President

APPENDIX 4--continued

Retail Division

The retail division continues to be the largest and most important, while other divisions provide the company with depth and stability. The retail division is now 19 years old and has grown from a single store to a chain of outlets. The table below sets out the growth in number of stores operated from 1967 to 1972.

Number of Stores

	1967	68	69	70	71	72
Clothing stores	10	11	12	17	32	44
Junior department stores	—	1	4	6	10	12
Department stores	—	1	5	5	5	5
	10	13	21	28	47	61

Originally Canadian Retail marketed only family clothing, but as it grew, so did its lines of merchandise. Each new location is studied carefully and depending on the results of area surveys, a new store may be one of several different types. In some communities, Canadian Retail is the major department store.

The table below provides an analysis of retail sales by type of store for the years 1967 to 1972.

Percent of Retail Sales

	1967	68	69	70	71	72
Clothing stores	100	96	46	46	52	52
Junior department stores	—	—	20	24	25	29
Department stores	—	4	34	30	23	19
	100	100	100	100	100	100

The company has been developed to take full advantage of the economic benefits of volume purchasing and central distribution which have increased as the company expanded. Mass merchandising, primarily on a cash and carry basis, is a concept which has proven successful for Canadian Retail and continues to be encouraged in most locations. Credit departments are, however, incorporated into full line department stores where customers purchase major appliances and furniture.

Retail sales volume from the older established outlets has increased at the same time that expansion into new market areas was taking place.

Consumer Durables Limited

Through the years Consumer Durables has developed a successful marketing concept using the dealer franchise system and today distributes a variety of brand name consumer durable goods to 329 dealer owned stores. The company supplies goods for retail, along with advertising material, merchandising and promotional programs and any other business assistance the independent operator may require. Three distribution centres are operated. The two major centres supply franchise dealers and industrial accounts. The third serves only industrial accounts.

Consumer Durables is now providing an expanded range of durable goods to 15 of the larger Canadian Retail outlets and the infusion of clothing carried by Canadian Retail into the Consumer Durables program provides dealers with the opportunity to expand into general merchandising.

The management of Consumer Durables has many years experience with the firm and has been retained to continue operation of this division.

Importing, Wholesaling, and Manufacturing

Your company has two importing subsidiaries, one wholesaling subsidiary and one manufacturing subsidiary.

Clothing Importers Limited imports ladies' sportswear and some children's and men's wear from the Far East. The company's sales force operates from centres across Canada, selling to leading department stores, chain stores, wholesalers, and distributors. Less than ten percent of the company's volume is sold to Canadian Retail.

The other importing subsidiary also brings in merchandise from the Far East, primarily canvas and rubber footwear. In addition, the company is a distributor for a line of stereo components and radios.

The wholesaling subsidiary distributes domestic and imported shoes, mainly European, to leading stores.

The manufacturing subsidiary is a producer of men's tailored and semi-tailored clothing. Both double-knit and woven garments are sold to national department stores and leading men's wear shops. Less than ten percent of the company's production is sold to Canadian Retail.

APPENDIX 4--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS
for the year ended December 31, 1972 (with comparative figures for 1971 and a comparative forecast for 1973)

	1971	1972	UNAUDITED FORECAST 1973
Sales	$32,912,385	$43,150,847	$64,445,000
Cost of goods sold and operating expenses before the following	27,828,110	36,484,947	55,850,000
Depreciation and amortization	277,613	393,365	666,000
Interest – current	187,070	260,053	398,000
– long-term	79,394	221,568	888,000
	28,372,187	37,359,933	57,802,000
Earnings from operations before income taxes and minority interests	4,540,198	5,790,914	6,643,000
Income taxes – current	2,150,892	2,657,735	3,057,000
– deferred	109,989	112,288	133,000
	2,260,881	2,770,023	3,190,000
Minority interests	199,541	226,879	97,000
Net Earnings for the year	2,079,776	2,794,012	3,356,000
Retained earnings, beginning of year	4,653,965	6,733,741	9,393,000
	6,733,741	9,527,753	12,749,000
Dividends		135,114	271,000
Retained earnings, end of year	$ 6,733,741	$ 9,392,639	$12,478,000
Net earnings per share	$.93	$1.24	$1.48

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 4--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

as at December 31, 1972 (with comparative figures for 1971 and a comparative forecast for 1973)

Assets	1971	1972	UNAUDITED FORECAST 1973
Current Assets			
Cash and term deposits (note 1)	$ 1,184,981	$ 6,370,584	$ 2,946,000
Accounts receivable	2,018,056	5,909,523	5,360,000
Inventories (note 2)	10,236,133	17,662,300	18,803,000
Prepaid expenses	79,090	92,892	131,000
	13,518,260	30,035,299	27,240,000
Non Current Receivables			
Notes receivable in installments to 1981		368,990	333,000
Mortgages	6,983	148,624	140,000
	6,983	517,614	473,000
Fixed Assets (note 3)	5,302,806	9,993,961	10,214,000
Unamortized Debt Discount and Expense (note 4)		343,338	307,000
Other Assets	66,652	66,652	67,000
Goodwill (notes 1 and 5)	1,496,578	1,818,467	1,818,000
	$20,391,279	$42,775,331	$40,119,000

Notes to consolidated financial statements are an integral part of this statement.

AUDITORS' REPORT

To the Shareholders of Canadian Retail Limited:

We have examined the consolidated balance sheet of Canadian Retail Limited and its subsidiaries as at December 31, 1972 and the consolidated statements of earnings and retained earnings, and source and use of working capital for the year then ended. We have not examined the forecast financial statements in this annual report and we express no opinion on them. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

APPENDIX 4--continued

Liabilities	1971	1972	UNAUDITED FORECAST 1973
Current Liabilities			
Bank loans payable (note 6)	$ 2,216,310	$ 7,675,818	$ 2,574,000
Accounts payable and accrued liabilities	3,055,833	6,206,800	5,880,000
Income and other taxes payable	814,737	988,347	1,162,000
Long-term debt due within one year	12,826	769,560	949,000
	6,099,706	15,640,525	10,565,000
Long-Term Debt (notes 6 and 7)	444,942	10,516,725	9,568,000
Deferred Income Taxes	341,483	821,238	955,000
Minority Interests (notes 1 and 10)	829,644	365,716	463,000
Shareholders' Equity			
Share Capital (note 8)	5,941,763	6,038,488	6,090,000
Retained Earnings	6,733,741	9,392,639	12,478,000
	12,675,504	15,431,127	18,568,000
	$20,391,279	$42,775,331	$40,119,000

Approved by the board:
J. Smith, Director
K. Brown, Director

In our opinion, these consolidated financial statements present fairly the financial position of the companies as at December 31, 1972 and the results of their operations and the source and use of their working capital for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

February 28, 1973 — Chartered Accountants

APPENDIX 4--continued

CANADIAN RETAIL LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SOURCE AND USE OF WORKING CAPITAL

for the year ended December 31, 1972 (with comparative figures for 1971 and a comparative forecast for 1973)

	1971	1972	UNAUDITED FORECAST 1973
Source of Working Capital			
Net earnings for the year	$ 2,079,776	$ 2,794,012	$ 3,356,000
Depreciation and amortization	277,613	393,365	702,000
Deferred income taxes	109,989	112,288	133,000
Earnings of minority interests	199,541	226,879	97,000
Provided from operations	2,666,919	3,526,544	4,288,000
Bank loans (note 7)		6,718,170	
Debentures and deferred income taxes of newly acquired subsidiary (note 1)		4,239,467	
Issue of shares (note 8)	133,903	96,725	52,000
Proceeds from disposal of fixed assets	280,588		
Decrease (increase) in other assets	(6,983)	838	45,000
	3,074,427	14,581,744	4,385,000
Use of Working Capital			
Purchase of fixed assets of subsidiary (note 1)		2,001,717	
Purchase of other assets of subsidiary (note 1)		854,8[illegible]	
Purchase of other fixed assets	2,033,077	3,082,803	885,000
Purchase of additional share in partially owned subsidiary (note 1)		1,012,696	
Dividends paid		135,114	271,000
Current portion of new bank loans and reduction in other long-term debt	14,326	518,388	949,000
	2,047,403	7,605,524	2,105,000
Increase in Working Capital	1,027,024	6,976,220	2,280,000
Working Capital, beginning of year	6,391,530	7,418,554	14,395,000
Working Capital, end of year	$ 7,418,554	$14,394,774	$16,675,000

Notes to consolidated financial statements are an integral part of this statement.

APPENDIX 4--continued

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of consolidation. The consolidated financial statements include the accounts of all subsidiaries. The results of the operations of subsidiary companies have been included only from the dates of acquisition (except as noted below) and provision has been made for minority interests. The purchase method has been used in accounting for the acquisition of all subsidiaries.

(a) Acquisition of Consumer Durables Limited:

As of December 1, 1972, Canadian Retail Limited purchased all of the issued and outstanding shares of Consumer Durables Limited for cash of $9,170,170. The excess of purchase price over net book value, an amount of $850,663, was applied to land. The assets and liabilities of Consumer Durables as at December 1, 1972 have been included in the company's consolidated balance sheet as at December 31, 1972.

The unaudited net earnings of Consumer Durables for the month of December, 1972 amounted to $19,400 with sales of $1,370,000. These earnings and sales have not been included in the company's consolidated statements of earnings and retained earnings and source and use of working capital for 1972. The unaudited forecast for 1973 does include sales and earnings of Consumer Durables.

(b) Acquisition of additional share interest in Clothing Importers Limited:

During the third quarter of 1972, the company purchased for cash of $1,012,694 an additional 17% share interest in this subsidiary, bringing the company's present share holdings to 92%. The excess of the purchase price for this additional interest over the proportionate value of the subsidiary's net assets at the date of acquisition was $321,889 which has been allocated to goodwill.

2. Inventories. Inventories are valued at the lower of cost or estimated net realizable value less normal profit margins.

3. Fixed assets

	1971	1972			Unaudited Forecast 1973		
	Net Book Value	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Land	$1,120,968	$ 3,065,591	–	$3,065,591	$ 3,098,000	–	$ 3,098,000
Buildings	2,440,572	5,873,365	$1,305,185	4,568,180	6,368,000	$1,549,000	4,819,000
Fixtures and equipment	1,444,604	3,548,410	1,564,855	1,983,555	3,841,000	1,934,000	1,907,000
Leasehold improvements	296,662	496,051	119,416	376,635	536,000	146,000	390,000
	$5,302,806	$12,983,417	$2,989,456	$9,993,961	$13,843,000	$3,629,000	$10,214,000

4. Unamortized debt discount and expense. This will be amortized at the rate of $36,300 per annum over the term of the debentures.

5. Goodwill This amount is made up of:

	1971	1972	Unaudited Forecast 1973
Purchased	$ 260,150	$ 260,150	$ 260,000
On consolidation	1,236,428	1,558,317	1,558,000
	$1,496,578	$1,818,467	$1,818,000

The above amounts are carried in the accounts at cost without amortization.

6. Bank indebtedness. The company has assigned the loss proceeds of certain fire insurance policies and lodged with the bank certificates of title to certain real properties as security for short-term and long-term indebtedness to the bank. Accounts receivable of a subsidiary company are assigned from time to time to the bank as security for its bank indebtedness, of which none was outstanding as at December 31, 1972.

The company has provided a letter of undertaking to its bankers to provide them on request with a debenture incorporating both a specific charge over fixed assets and a floating charge over all assets of the company and certain of its wholly-owned subsidiaries.

In arranging for financing for the acquisition of Consumer Durables the company agreed to furnish the following to the bank as security for loans:

(i) Collateral mortgages on certain properties.
(ii) An additional assignment of loss proceeds of fire insurance policies on certain other properties.
(iii) Certificates of title to certain other real properties.
(iv) Pledge of all outstanding shares of Consumer Durables Limited.

APPENDIX 4--continued

7. Long-term debt:

	1971	1972	Unaudited Forecast 1973
6% Sinking Fund Debentures, Series "A" due May 15, 1982	$ -	$ 4,114,000	$ 3,672,000
Bank Loans (Note 6)			
Payable with interest at rates not exceeding 2% over the prevailing prime bank rate and maturing at various dates to 1982	–	6,718,170	6,243,000
Mortgages			
Payable with interest at 9% per annum and maturing in 1984	400,725	395,259	355,000
Others at various interest rates and maturity dates	57,043	58,856	47,000
	457,768	11,286,285	10,517,000
Deduct amounts due within one year	12,826	769,560	949,000
	$444,942	$10,516,725	$ 9,568,000

Sinking fund payment requirements on the 6% debentures are $363,000 annually. The sinking fund payment for 1973 is anticipated to be reduced by $121,000, which is the amount of debentures purchased and tendered to the Trustee as at December 31, 1972. The 6% debentures are secured by a first floating charge on all assets, business and undertakings of Consumer Durables Limited.

Payments required for retirement of debentures and other long-term debt over the next five years are:
1973 - $769,560   1974 - $948,640   1975 - $982,520   1976 - $1,029,710   1977 - $1,090,210

8. Share capital

		No. of shares	
Authorized:	Common shares of no par value	4,000,000	
Issued:	Balance, December 31, 1971	2,245,412	$ 5,941,763
	Shares issued on options exercised during the year for cash	10,866	96,725
	Balance December 31 1972	2,256,278	6,038,488
	Shares expected to be issued on options exercised during 1973 for cash (unaudited forecast)	6,000	51,960
	Expected balance December 31, 1973 (unaudited forecast)	2,262,278	$ 6,090,448

Certain employees have options to purchase 15,715 shares at $8.66 per share, 800 shares at $14.70 per share and 9,000 shares at $22.90 per share.

The total options for 25,515 shares expire in the following years:
1973 - 6,000   1974 - 12,015   1975 - 3,700   1976 - 2,000   1977 - 1,800
No material dilution of earnings per share results from these options. The unaudited forecast indicates that the company will continue to offer share options to key employees and that no material dilution of earnings per share will result from these options.

9. Lease commitments. Minimum annual rentals for property leases in each of the next five years are
1973 - $942,913   1974 - $914,563   1975 - $886,641   1976 - $763,598   1977 - $631,776
Certain of the leases provide for additional rentals based on sales, as well as other occupancy charges.

The unaudited forecast indicates the following minimum rentals will prevail at December 31, 1973:
1974 - $1,222,000   1975 - $1,186,000   1976 - $1,150,000   1977 - $992,000   1978 - $883,000

10. Contractual obligations. The company has an obligation under certain circumstances to purchase for cash the minority interests' share holdings of 8% in a subsidiary company. The company also has an option under certain circumstances to acquire these minority interests for a prescribed cash consideration. This option expires December 31, 1989.

11. Remuneration of directors and senior officers. The aggregate remuneration paid or payable by the company and its subsidiaries to the directors and senior officers of the company for 1971 and 1972 was $203,885 and $210,983 respectively. The unaudited forecast for 1973 is $218,000.

12. Subsequent event. On January 3, 1973, the directors of the company declared a dividend of six cents per share payable February 15, 1973 to shareholders of record on February 1, 1973.

APPENDIX 4--continued

SEVEN YEAR REVIEW *and one year forecast*

	1966	1967	1968	1969	1970	1971	1972	UNAUDITED FORECAST 1973
Operating results ($000)								
Sales	4,417	5,256	7,382	14,809	25,347	32,912	43,151	64,445
Earnings from operations before the following:	540	910	1,339	2,093	3,709	4,819	6,184	7,309
Depreciation	62	77	96	122[1]	220	278	393	666
Income taxes	227	404	629	978[1]	1,819	2,261	2,770	3,190
Minority interests	–	–	–	–	167	200	227	97
Net earnings	250	428	615	993	1,503	2,080	2,794	3,356
Financial Position ($000)								
Working capital	365	680	1,091	5,299	6,392	7,419	14,395	16,675
Inventories	499	877	1,607	4,190	7,298	10,236	17,662	18,803
Fixed assets–net	768	845	1,068	3,181	3,828	5,303	9,994	10,214
Total assets	1,796	2,626	3,715	11,277	16,055	20,391	42,775	40,119
Long-term debt	22	12	44	450	460	445	10,517	9,568
Shareholders' equity	1,130	1,557	2,341	8,222	10,461	12,676	15,431	18,568
Per Common Share ($)								
Net earnings	.16	.27	.37	.52[2]	.67	.93	1.24	1.48
Dividends paid	–	–	–	–	–	–	.06	.12
Cash flow[3] from operations	19	.32	.43	.62[2]	.93	1.17	1.56	1.90
Net asset value	.70	.97	1.41	3.80	4.69	5.65	6.84	8.21
Stock market price: High	4.10	7.00	9.38	14.50	12.75	17.25	23.88	
Low	2.35	4.55	4.05	8.38	6.00	9.50	16.00	
Close	3.10	5.88	8.88	12.13	9.38	15.88	23.88	
Ratios and Statistics								
Number of shares outstanding	1,604,906	1,605,101	1,664,874	2,165,141	2,229,890	2,245,412	2,256,278	2,262,278
Net earnings ÷ Sales	.06	.08	08	.07	.06	.06	.06	.05
Net earnings ÷ Shareholders' Equity	22	.27	.26	.12	.14	.16	.18	.18
Net earnings ÷ Total Assets	.14	.16	.17	.09	.09	.10	–[4]	.08
Sales ÷ Shareholders' Equity	3.91	3.38	3.15	1.80	2.42	2.60	2.80	3.47
Sales ÷ Total Assets	2.46	2.00	1.99	1.31	1.58	1.61	–[4]	1.61
Shareholders' Equity ÷ Total Assets	63	.59	.63	.73	.65	.62	.36	.46
% Growth[5]								
Net Earnings per Share		69	37	41	29	39	33	19
Net Earnings		71	44	61	51	38	34	20
Sales		19	40	101	71	30	31	49
Cash Flow[3] per Share		68	34	44	50	28	31	22
Working capital ratio	1.6:1	1.6:1	1.8:1	3.0:1	2.5:1	2.2:1	1.9:1	2.6:1
Price-earnings ratio[6]	19.4	21.8	24.0	23.3	14.0	17.1	19.3	

NOTES TO SEVEN YEAR REVIEW AND ONE YEAR FORECAST

1. During 1969, the rates of depreciation were changed to conform with revised estimates of the useful life of fixed assets and the company converted from the taxes payable to the tax allocation method of providing for income taxes. Prior years figures as shown above have not been restated.
2. Based on weighted average of 1,907,012 shares outstanding.
3. Net earnings + Depreciation and amortization + Deferred income taxes + Minority interests.
4. Not calculated because assets of subsidiary acquired in December are included but sales and earnings are not.
5. Increase during year divided by level at beginning of year.
6. Closing stock market price per share for the year divided by net earnings per share for the year.

APPENDIX 5

QUESTIONNAIRE ONE

Questions to be Answered After Analyzing the Annual Report

1. What is your best estimate of Canadian Retail Limited's net earnings per share for 1973? (dollars and cents) $ ____.____

2. Give upper and lower bounds for the estimate you have just made, such that you are reasonably confident that the actual net earnings per share will fall between these bounds.

   Upper bound: (dollars and cents) $ ____.____

   Lower bound: (dollars and cents) $ ____.____

3. What is your best estimate of the market price per share of Canadian Retail Limited common at the end of 1973? (dollars and cents) $____.____

4. Give upper and lower bounds for the estimate you have just made, such that you are reasonably confident that the actual market price will fall between these bounds.

   Upper bound: (dollars and cents) $ ____.____

   Lower bound: (dollars and cents) $ ____.____

5. How long has it taken you to analyze the annual report and answer these questions? ________ minutes

6. How much experience have you as a professional analyst? ________ years

(Please return both this sheet and the annual report to the researcher.)

8/21/73

APPENDIX 6

QUESTIONNAIRE TWO

Questions to be Answered After Making Forecasts

1. Please list the factors (as many as 10) which you considered in making your forecasts for Canadian Retail Limited.

Earnings per Share Forecast	Market Price Forecast
________________	________________
________________	________________
________________	________________
________________	________________
________________	________________
________________	________________
________________	________________
________________	________________
________________	________________
________________	________________

2. Indicate the importance of each of the above factors in your forecasting for Canadian Retail Limited, by rating each factor on a scale from 1 to 5. For example, place a 1 beside the factor if it was very important to you, and a 5 if it was of little importance to you.

Number for matching with forecasts ______

APPENDIX 7

INSTRUCTIONS TO SUBJECTS

Explanation and Instructions to be Read Before Proceeding Further

Thank you for agreeing to participate in my study of forecasting by investment analysts. The study can succeed only with the participation of many analysts like you. I think you will find your task to be interesting and will not take long to complete. (Participants in earlier sessions have taken less than an hour on the average.) Results of the study should be of interest to participants and preliminary results will be made available within three to four weeks.

What I would like you to do is the following:

1. Read the questions which you will be asked to answer. (Reverse side of this sheet.)

2. Analyse the annual report of Canadian Retail Limited in order to answer questions 1, 2, 3, and 4. To the extent possible (and I realize it is not entirely possible) use whatever analysis techniques you would use if you were making an investment recommendation on the common shares of the company.

   The annual report is based upon that of a real Canadian company, but significant features have been altered.

   Rest assured there are no tricks in the report. I expect you will be able to do a reasonably straightforward analysis of the company and make the forecasts called for in the questions.

   No doubt you typically study the economic and industry environment in doing an analysis of this type. For purposes of this study, however, you are asked to devote most of your effort to the company's annual report. You are asked to assume, for purposes of this analysis, the following economic forecast for 1973:

Growth in GNP (current dollars)	11.5%
Growth in GNP (constant dollars)	6.5%
Inflation (GNE price deflator)	4.8%
Growth in consumer spending (personal expenditures on consumer goods and services)	11.0%
Growth in retail sales	11.0%
Unemployment (annual average)	5.8%

   In doing your analysis do not refer to other published material or to other persons. Above all, do not communicate with other participants in the study.

3. Answer all of the questions.

4. Return all materials to me.

Your answers will be treated confidentially. Neither individual participants nor their firms will be identifiable in any report of the results. Results will be disclosed only in terms of the entire group of participants, or subgroups with particular characteristics.

Thank you once again for your cooperation.

Carson Duncan
Ph.D. Candidate
School of Business Administration
The University of Western Ontario

APPENDIX 8

RAW DATA FROM EXPERIMENT

Subject	Earnings Per Share Forecast ($)			Stock Price Forecast ($)			Time Spent (Min.)	Exper-icnce (Years)
	Best	High	Low	Best	High	Low		
N- 1	1.42	1.55	1.35	21.30	25.00	15.00	60	2
N- 2	1.60	1.90	1.25	32.00	38.00	25.00	60	3
N- 3	1.37	1.42	1.35	23.00	26.00	19.00	40	4
N- 4	1.18	1.30	1.10	16.50	21.50	14.25	50	4
N- 5	1.35	1.50	1.24	16.25	22.50	14.88	30	6
N- 6	1.40	1.50	1.25	19.00	21.00	17.00	20	6
N- 7	1.45	1.60	1.30	18.80	22.00	15.50	30	4
N- 8	1.47	1.55	1.40	20.25	21.50	19.00	35	33
N- 9	1.27	1.30	1.25	22.20	25.40	19.00	50	5
N-10	1.55	1.67	1.40	22.00	27.00	17.00	35	5
N-11	1.31	1.35	1.20	18.00	20.00	16.00	60	2
N-12	1.60	1.70	1.52	22.50	26.50	19.25	40	4
NO- 1	1.70	1.80	1.65	25.00	28.00	20.00	30	6
NO- 2	1.90	2.10	1.50	15.00	19.00	12.00	60	2
NO- 3	1.80	1.90	1.70	35.00	40.00	20.00	15	2
NO- 4	1.90	2.00	1.30	38.00	42.00	34.00	50	5
NO- 5	1.80	2.00	1.65	29.00	46.00	23.00	60	1
NO- 6	1.25	1.66	1.00	15.00	20.00	12.00	30	14
NO- 7	1.75	1.90	1.60	26.00	29.00	23.00	20	1
NO- 8	1.65	1.80	1.50	20.00	29.00	18.00	34	6
NO- 9	1.71	1.75	1.70	32.50	34.00	28.00	60	1.5
NO-10	1.70	1.90	1.50	34.00	45.00	25.00	40	2
NO-11	1.55	1.59	1.51	21.00	24.75	18.00	30	1
NO-12	1.70	1.89	1.41	24.00	30.12	19.75	45	3

APPENDIX 8--continued

Subject	Earnings Per Share Forecast ($)			Stock Price Forecast ($)			Time Spent (Min.)	Experience (Years)
	Best	High	Low	Best	High	Low		
YO- 1	1.70	1.80	1.40	21.00	28.00	20.00	30	0.5
YO- 2	1.60	1.70	1.45	25.60	28.90	20.30	45	2
YO- 3	1.51	1.70	1.40	28.50	38.00	23.00	28	1
YO- 4	1.50	1.85	1.20	18.00	23.00	12.00	60	3
YO- 5	1.60	1.80	1.45	24.00	27.90	22.50	45	1
YO- 6	1.68	1.70	1.65	23.50	25.20	22.50	50	5
YO- 7	1.70	1.77	1.65	27.50	29.00	26.00	40	8
YO- 8	1.54	1.69	1.39	32.00	35.00	29.00	50	0.7
YO- 9	1.65	1.70	1.50	19.80	28.00	15.00	69	4
YO-10	1.64	1.67	1.60	32.50	36.00	27.90	60	1.5
YO-11	1.95	N.A.	1.65	38.00	38.00	23.00	55	5
YO-12	1.75	1.80	1.70	25.00	28.00	22.00	50	2
YP- 1	1.30	1.50	1.00	15.00	18.00	12.00	80	0.3
YP- 2	1.35	1.40	1.20	24.25	27.00	20.00	45	8.5
YP- 3	1.55	1.75	1.48	N.A.	33.25	20.72	40	3.5
YP- 4	1.75	1.80	1.65	24.50	31.50	21.00	50	2
YP- 5	1.55	1.62	1.50	27.50	31.00	21.75	75	4
YP- 6	1.40	1.50	1.30	20.00	25.00	15.00	20	10
YP- 7	1.45	1.50	1.30	20.00	24.00	17.00	35	2
YP- 8	1.55	1.60	1.45	22.00	31.00	18.50	50	4
YP- 9	1.55	1.62	1.45	20.00	26.00	14.50	60	1
YP-10	1.40	1.50	1.30	20.00	22.50	17.00	20	4
YP-11	1.40	1.50	1.35	31.00	32.25	29.50	50	20
YP-12	1.60	1.70	1.40	25.00	34.00	14.00	60	7
YP-13	1.30	1.40	1.20	19.50	25.00	17.00	40	3

N.A. indicates no answer.

APPENDIX 9

CORPORATIONS IN THE SAMPLE

Algonquin Building Credits Ltd.
Andres Wines Ltd.
Biltmore Hats Ltd.
Block Bros. Industries Ltd.
Cambridge Leaseholds Ltd.
Canadian Breweries Ltd.
Canadian Equity & Development Co. Ltd.
Canadian General Electric Co. Ltd.
Canadian Utilities Ltd.
Cassidy's Ltd.
Celanese Canada Ltd.
Combined Engineered Products Ltd.
Consumers Distributing Co.
Richard Costain (Can.) Ltd.
Crestbrook Forest Industries Ltd.
Dale-Ross Holdings Ltd.
Dawson Developments Ltd.
Domtar Ltd.
Donlee Manufacturing Ind. Ltd.
Douglas Leaseholds Ltd.
Dustbane Enterprises Ltd.
Farmers & Merchants Trust Co. Ltd.
Fraser Co. Ltd.
Gesco Distributing Ltd.
GSW Ltd.
John Inglis Co. Ltd.
Inter-City Gas Ltd.
Interprovincial Pipe Line Co.
Kaps Transport Ltd.
Keeprite Products Ltd.
Laura Secord Candy Shops Ltd.
Lawson & Jones Ltd.
Lincoln Trust & Savings Co.
M. Loeb Ltd.
Logistec Corp.
MacLaren Power & Paper Co.
Magnasonic Canada Ltd.
Magnetics International Ltd.
Maher Shoes Ltd.
Maritime Telegraph & Telephone Co. Ltd.
Melton Real Estate Ltd.
Molson Industries Ltd.
Montreal Trust Co.
Morse Corp. Ltd.
Newfoundland Light & Power Co. Ltd.
Orlando Realty Corp. Ltd.
Peel-Elder Ltd.
Pembina Pipe Line Ltd.

APPENDIX 9--continued

Pennington's Stores Ltd.
Petrofina Canada Ltd.
Photo Engravers & Electrotypers Ltd.
Scott Paper Ltd.
Shore to Shore Corp.
Shully's Industries Ltd.
Steintron International Electric Ltd.
United Corporations Ltd.
Universal Sections Ltd.
Wall & Redekop Corp. Ltd.
Zeller's Ltd.
Zenith Electric Supply Ltd.

BIBLIOGRAPHY

Accountants International Study Group. Published Profit Forecasts, 1974.

Alexander, M. O. "Financial Forecasting--A Part of the Accountant's Professional Work." Canadian Chartered Accountant, October, 1969, pp. 259-62.

American Institute of Certified Public Accountants. Guidelines for Systems for the Preparation of Financial Forecasts. New York: AICPA, March, 1975.

________. Presentation and Disclosure of Financial Forecasts. New York: AICPA, August, 1975.

Anton, H. R. "Objectives of Financial Accounting: Review and Analysis." Journal of Accountancy, January, 1976, pp. 40-51.

Archibald, T. R. "A Shareholder's Prespective on External Accounting Reports." Canadian Chartered Accountant, February, 1971, pp. 105-10.

Asebrook, R. J., and Carmichael, D. R. "Reporting on Forecasts: A Survey of Attitudes." Journal of Accountancy, August, 1973, pp. 38-48.

Backer, M. Financial Reporting for Security Investment and Credit Decisions. New York: National Association of Accountants, 1970.

________. "Financial Reporting and Security Investment Decisions." Financial Analysts Journal, March-April, 1971, pp. 67-72, 79.

Barrett, M. E. "Financial Reporting Practices: Disclosure and Comprehensiveness in an International Setting." Journal of Accounting Research, Spring, 1976, pp. 10-26.

Basi, B. A. "The CPA's Liability for Forecasts." CPA Journal, February, 1976, pp. 13-17.

________; Carey, K. J.; and Twark, R. D. "A Comparison of the Accuracy of Corporate and Security Analysts' Forecasts of Earnings." The Accounting Review, April, 1976, pp. 244-54.

Bedford, N. M. Extensions in Accounting Disclosure. Englewood Cliffs: Prentice-Hall, 1973.

Belkaoui, A., and Kahl, A. "What Canadian Bank Financial Statements Don't Tell." CA Magazine, June, 1977, pp. 32-35.

BIBLIOGRAPHY--continued

Benjamin, J. J.; Francia, A. J.; and Strawser, R. H. "The RIA's Views: Financial Reporting: Current and Future." Cost and Management, November-December, 1973, pp. 6-10.

Beresford, D. R., and Neary, R. D. "Financial Reporting Briefs." Financial Executive, May, 1977, pp. 10-16.

Bevis, H. W. "The CPA's Attest Function in Modern Society." Journal of Accountancy, February, 1962, pp. 28-35.

Birnberg, J. G., and Dopuch, N. "A Conceptual Approach to the Framework for Disclosure." Journal of Accountancy, February, 1963, pp. 56-63.

Bissell, G. S. "Critique of the Brown Paper." Corporate Financial Reporting: Ethical and Other Problems. Edited by J. C. Burton. New York: American Institute of Certified Public Accountants, 1972.

Bodenhorn, D. "An Economist Looks at Industrial Accounting and Depreciation." The Accounting Review, October, 1961, pp. 583-88.

Brandon, C. "The Disclosure of Forecasts in Annual Reports." Unpublished Ph.D. dissertation, University of Georgia, 1972.

Brown, R. G. "Ethical and Other Problems in Publishing Financial Forecasts." Financial Analysts Journal, March-April, 1972, pp. 38-45, 86-87.

Burton, J. C. "Management Auditing." Journal of Accountancy, May, 1968, pp. 41-46.

________. "Communication and Innovation in Financial Reporting." Financial Analysts Journal, January-February, 1969, pp. 134-37.

________., ed. Corporate Financial Reporting: Ethical and Other Problems. New York: American Institute of Certified Public Accountants, 1972.

________. "The Changing Face of Financial Reporting." Journal of Accountancy, February, 1976, pp. 60-63.

Buzby, S. L. "Selected Items of Information and Their Disclosure in Annual Reports." The Accounting Review, July, 1974, pp. 423-35.

________. "Company Size, Listed Versus Unlisted Stocks, and the Extent of Financial Disclosure." Journal of Accounting Research, Spring, 1975, pp. 16-37.

Carmichael, D. R. "Reporting on Forecasts: A U. K. Perspective." Journal of Accountancy, January, 1973, pp. 36-47.

________. "Financial Forecasts--The Potential Role of Independent CPAs." Journal of Accountancy, September, 1974, pp. 84-86.

Carpenter, C. G.; Francia, A. J.; and Strawser, R. H. "Perceptions of Financial Reporting Practices: An Empirical Study." MSU Business Topics, Autumn, 1971, pp. 56-62.

Casey, F. C. "Earnings Forecasts and the Management Accountant." Cost and Management, May-June, 1977, pp. 42-45.

Chandra, G. "A Study of the Concensus on Disclosure Among Public Accountants and Security Analysts." The Accounting Review, October, 1974, pp. 733-42.

________. "Information Needs of Security Analysts." Journal of Accountancy, December, 1975, pp. 65-70.

Chang, D. L. S., and Liao, S. S. "Measuring and Disclosing Forecast Reliability." Journal of Accountancy, May, 1977, pp. 76-87.

Chevalier, G. "Should Accounting Practices be Universal?" CA Magazine, July, 1977, pp. 47-50.

Cianciolo, S. T. A. "Private Investors' Behavioral Response to Financial Forecasts and Related Auditor's Reports." Unpublished Ph.D. dissertation, Michigan State University, 1975.

Clark, J. J., and Elgers, P. "Forecasted Income Statements: An Investor Perspective." The Accounting Review, October, 1973, pp. 668-78.

Clarke, R. W. "Extension of the CPA's Attest Function in Corporate Annual Reports." The Accounting Review, October, 1968, pp. 769-76.

________. "Extending the Auditor's Role in Corporate Reporting." Michigan Business Review, January, 1970, pp. 12-19.

BIBLIOGRAPHY--continued

Committee on Basic Auditing Concepts. "Report of the Committee on Basic Auditing Concepts." The Accounting Review, Supplement, 1972, pp. 15-74.

Committee on External Measurement and Reporting. "Report of the Committee on External Measurement and Reporting." The Accounting Review, Supplement, 1973, pp. 243-51.

Committee on External Reporting. "An Evaluation of External Reporting Practices." The Accounting Review, Supplement, 1969, pp. 79-123.

Committee on Foundations of Accounting Measurement. "Report of the Committee on Foundations of Accounting Measurement." The Accounting Review, Supplement, 1971, pp. 1-48.

Committee to Prepare A Statement of Basic Accounting Theory. A Statement of Basic Accounting Theory. Evanston, Illinois: American Accounting Association, 1966.

Cook, G. B. "Evolving Role of the Professional Analyst." Financial Analysts Journal, May-June, 1973, pp. 18-20, 22, 76.

Cooper, W. W.; Dopuch, N.; and Keller, T. F. "Budgetary Disclosure and Other Suggestions for Improving Accounting Reports." The Accounting Review, October, 1968, pp. 640-48.

Copeland, R. M., and Marioni, R. J. "Executives' Forecasts of Earnings Per Share Versus Forecasts of Naive Models." Journal of Business, October 1972, pp. 497-512.

Corless, J. C., and Norgaard, C. T. "User Reactions to CPA Reports on Forecasts." Journal of Accountancy, August, 1974, pp. 46-54.

Corn, I. G., Jr. "The Case Against Forecasting Earnings." MSU Business Topics, Summer, 1974, pp. 11-16.

Coughlan, J. W. "Industrial Accounting." The Accounting Review, July, 1959, pp. 415-28.

________. "Working Capital and Credit Standing." Journal of Accountancy, November, 1960, pp. 44-50.

________. "Accounting and Capital Budgeting." The Business Quarterly, Winter, 1962, pp. 39-48.

BIBLIOGRAPHY--continued

Cragg, J. G., and Malkiel, B. G. "The Concensus and Accuracy of Some Predictions of the Growth of Corporate Earnings." Journal of Finance, Vol. 23, No. 1, 1968, pp. 67-84.

Cramer, J. J., and Sorter, G. H., eds. Objectives of Financial Statements, Volume 2, Selected Papers. New York: American Institute of Certified Public Accountants, 1974.

Daily, R. A. "The Feasibility of Reporting Forecasted Information." The Accounting Review, October, 1971, pp. 686-92.

Davidson, S. "Accounting and Financial Reporting in the Seventies." Journal of Accountancy, December, 1969, pp. 29-37.

Davison, I. H. "Public Offerings and Profit Forecasts in the United Kingdom." CA Magazine, September, 1973, pp. 52-56.

Deakin, E. B. "On the Usefulness of Annual Report Information For Common Stock Investment Decisions." Unpublished Ph.D. dissertation, University of Illinois at Urbana-Champaign, 1972.

Dev, S., and Webb, M. "The Accuracy of Company Profit Forecasts." Journal of Business Finance and Accounting, Autumn, 1972, pp. 26-39.

Dirksen, C., and Scheibelhut, J. "The Annual Reports of Large Canadian Companies." Collected Papers. The Canadian Region of the American Accounting Association, June, 1976.

Dixon, W. J., and Massey, F. J., Jr. Introduction to Statistical Analysis. 3rd ed. New York: McGraw-Hill, 1969.

Duncan, C. M. "Disclosure of Future-Oriented Information by Canadian Industrial Corporations: A Thesis Proposal (Draft #5)." Unpublished paper, The University of Western Ontario, 1973.

Edwards, J. D. "Unfinished Business in Accounting." Canadian Chartered Accountant, May, 1971, pp. 346-49.

Elliott, J. W., and Uphoff, H. L. "Predicting the Near Term Profit and Loss Statement with an Economic Model: A Feasibility Study." Journal of Accounting Research, Autumn, 1972, pp. 259-74.

BIBLIOGRAPHY--continued

Elton, E. J., and Gruber, M. J. "Earnings Estimates and the Accuracy of Expectational Data." Management Science, April, 1972, pp. 409-24.

Fess, P. E., and Martin, S. J. "Company Forecasts and the Independent Auditor's Inexorable Involvement." CPA Journal, October, 1973, pp. 868-73, 876.

Financial Analysts Federation. "Objectives of Financial Accounting and Reporting from the Viewpoint of the Financial Analysts." Canadian Chartered Accountant, August, 1972, pp. 42-49.

________. Disclosure of Corporate Forecasts to the Investor. New York: Financial Analysts Federation, March, 1973.

Financial Executives Research Foundation. Public Disclosure of Business Forecasts. New York: Financial Executives Research Foundation, 1972.

Fischer, D. E., and Jordon, R. J. Security Analysis and Portfolio Management. Englewood Cliffs: Prentice-Hall, 1975.

Foster, G. "Stock Market Reaction to Estimates of Earnings Per Share by Company Officals." Journal of Accounting Research, Spring, 1973, pp. 25-37.

Fraser, I. J. "Accountancy and the Merger Movement." The Accountant, September 9, 1971, pp. 353-55.

Gibson, C. J. "Can the Auditor's Opinion be Extended to Include Budgets?" The Chartered Accountant in Australia, September, 1971, pp. 17-19.

Gillis, J. G. "Legal Aspects of Corporate Forecasts." Financial Analysts Journal, January-February, 1973, pp. 72-76.

Gonedes, N. J., and Dopuch, N. "Capital Market Equilibrium, Information Production, and Selecting Accounting Techniques." Journal of Accounting Research, Supplement, 1974, pp. 48-129.

Gonedes, N. J.; Dopuch, N.; and Penman, S. H. "Disclosure Rules, Information Production, and Capital Market Equilibrium: The Case of Forecast Disclosure Rules." Journal of Accounting Research, Spring, 1976, pp. 89-137.

Gormican, G. M. "CPA - Obligation to Audit Forecasts?" Massachusetts CPA Review, July-August, 1973, pp. 24-27.

BIBLIOGRAPHY--continued

Graham, J. "The New Takeover Code." Accountancy, June, 1969, pp. 451-53.

Green, D., Jr. "Towards a Theory of Interim Reports." Journal of Accounting Research, Spring, 1964, pp. 35-49.

Green, D., and Segall, J. "The Predictive Power of First-Quarter Earnings Reports: A Replication." Journal of Accounting Research, Supplement, 1966, pp. 21-36.

________. "The Predictive Power of First-Quarter Earnings Reports." Journal of Business, January, 1967, pp. 44-55.

Greenball, M. N. "Discussion on the Usefulness of Financial Accounting Information to Security Analysts." Journal of Accounting Research, Supplement, 1970, pp. 49-54.

Grenside, J. P. "Accountants' Reports on Profit Forecasts in the U. K." Journal of Accountancy, May, 1970, pp. 47-53.

Guy, D. M. "Auditing Procedures for Projected Financial Statements: A Suggested Approach." Canadian Chartered Accountant, June, 1972, pp. 20-27

Hakansson, N. H. "Interim Disclosure and Public Forecasts: An Economic Analysis and a Framework for Choice." The Accounting Review, April, 1977, pp. 396-416.

Heller, H. "Disclosure Requirements Under Federal Securities Regulation." The Business Lawyer, January, 1961, pp. 300-20.

Hendriksen, E. S. Accounting Theory. 3rd ed. Homewood, Illinois: Irwin, 1977.

Henry, E. J. "A New Funds Statement Format for Greater Disclosure." Journal of Accountancy, April, 1975, pp. 56-62.

Herwitz, D. R. "The Risk of Liability for Forecasting." Objectives of Financial Statements, Volumne 2, Selected Papers. Edited by J. J. Cramer and G. H. Sorter. New York: American Institute of Certified Public Accountants, 1974.

Hicks, I., and Johnson, E. C. "Expansion of Company Reporting." The Accountant, November 15, 1969, pp. 639-42.

Hipgrave, D. J. "Published Financial Forecasts--New Opportunities for Operations Research?" CA Magazine, November, 1976, pp. 28-30.

BIBLIOGRAPHY--continued

Hofstedt, T. R. "Some Behavioral Parameters of Financial Analysis." The Accounting Review, October, 1972, pp. 679-92.

Holsti, O. R. "Content Analysis." The Handbook of Social Psychology, Volume Two. 2nd ed. Edited by G. Lindzey E. Aronson. Reading, Massachusetts: Addison-Wesley, 1968.

Hull, J. "Profit Forecasts--The English Experience." Public Reporting of Corporate Financial Forecasts. Edited by P. Prakash and A. Rappaport. New York: Commerce Clearing House, 1974.

Ijiri, Y. "On Budgeting Principles and Budget-Auditing Standards." The Accounting Review, October, 1968, pp. 662-67.

________. Theory of Accounting Measurement. Sarasota: American Accounting Association, 1975.

Imke, F. J. "The Future of the Attest Function." Journal of Accountancy, April, 1967, pp. 51-58.

Kapnick, H. E. "Will Financial Forecasts Really Help Investors?" Financial Executive, August, 1972, pp. 50-54.

Kearney, A. T., Inc. "Public Disclosure of Business Forecasts." Public Disclosure of Business Forecasts. New York: Financial Executives Research Foundation, 1972.

Keller, R. "Disclosure of Projected Financial Information in Corporate Annual Reports." Unpublished Ph.D. dissertation, Louisiana State University and Agricultural and Mechanical College, 1973.

Kidd, R. H. Earnings Forecasts. Toronto: The Canadian Institute of Chartered Accountants, 1976.

Kripke, H. "The Objective of Financial Accounting Should be to Provide Information for the Serious Investor." The CPA Journal, May, 1972, pp. 389-97.

Linowes, D. F. "Future of the Accounting Profession." The Accounting Review, January, 1965, pp. 97-104.

Lorek, K. S.; McDonald, C. L.; and Patz, D. H. "A Comparative Examination of Management Forecasts and Box-Jenkins Forecasts of Earnings." The Accounting Review, April, 1976, pp. 321-30.

BIBLIOGRAPHY--continued

Mabert, V. A., and Radcliffe, R. C. "A Forecasting Methodology as Applied to Financial Time Series." The Accounting Review, January, 1974, pp. 61-75.

McDonald, C. L. "An Empirical Examination of the Reliability of Published Predictions of Future Earnings." The Accounting Review, July, 1973, pp. 502-10.

Mandel, J. D., and Altschul, D. E. "Financial Forecasts and Projections: A Pitfall for the Uninitiated Accountant." Journal of Accountancy, May, 1977, pp. 46-50.

Markwalder, A. S. "Vote for Profit Forecasting." Management Accounting, December, 1974, pp. 23-25.

Mautz, R. K., and Sharaf, H. A. The Philosophy of Auditing. Evanston, Illinois: American Accounting Association, 1961.

Mitchell, C. L. "Disclosure of Budgeted Financial Statements." Canadian Chartered Accountant, November, 1969, pp. 326-30.

Morrison, A. M. C. "The Role of the Reporting Accountant Today--II." The Accountant's Magazine, October, 1970, pp. 467-78.

Nickerson, C. A.; Pointer, L. G.; and Strawser, R. H. "Published Forecasts: Choice or Obligation?" Financial Executive, February, 1974, pp. 70-73.

Nielson, O. "New Challenges in Accounting." The Accounting Review, October, 1960, pp. 583-89.

Norr, D. "What a Financial Analyst Wants From an Annual Report." Financial Executive, August, 1970, pp. 20-23.

Nurnberg, H. "The Independent Auditor's Attest Function: Its Prospect for Extension." New York Certified Public Accountant, October, 1971, pp. 727-32, 783-88.

Pacter, P. "English Institute's Statement on Profit Forecasts." Journal of Accountancy, July, 1969, pp. 66-67.

Pankoff, L. D., and Virgil, R. L. "Some Preliminary Findings From a Laboratory Experiment on the Usefulness of Financial Accounting Information to Security Analysts." Journal of Accounting Research, Supplement, 1970, pp. 1-48.

BIBLIOGRAPHY--continued

Patell, J. M. "Corporate Forecasts of Earnings Per Share and Stock Price Behavior: Empirical Tests." Journal of Accounting Research, Autumn, 1976, pp. 246-76.

Pincus, T. H. "The Case for the Realistic Financial Forecast." Public Relations Journal, April, 1968.

Prakash, P., and Rappaport, A., eds. Public Reporting of Corporate Financial Forecasts. New York: Commerce Clearing House, 1974.

Rice, C. D.; Ford, H. C.; Williams, R. J.; and Silverman, G. W. The Businessman's View of the Purposes of Financial Reporting. New York: Financial Executives Research Foundation, 1973.

Rice, S. A. "Uses of Accounting Data in Economics and Statistics." Challenges to the Accounting Profession. The American Institute of Accountants, 1947.

Richards, R. M. "Analysts' Performance and the Accuracy of Corporate Earnings Forecasts." Journal of Business. July, 1976, pp. 350-57.

Ronen, J. "A User Oriented Development of Accounting Information Requirements." Objectives of Financial Statements, Volume 2, Selected Papers. Edited by J. J. Cramer and G. H. Sorter. New York: American Institute of Certified Public Accountants, 1974.

________. "Discounted Cash Flow Accounting." Objectives of Financial Statements, Volume 2, Selected Papers. Edited by J. J. Cramer and G. H. Sorter. New York: American Institute of Certified Public Accountants, 1974.

________. "A Test of the Feasibility of Preparing Discounted Cash Flow Accounting Statements." Objectives of Financial Statements, Volume 2, Selected Papers. Edited by J. J. Cramer and G. H. Sorter. New York: American Institute of Certified Public Accountants, 1974.

Ross, H. I. "The Current Crisis in Financial Reporting." Canadian Chartered Accountant, May, 1967, pp. 384-88.

Roth, J. L. "What's Ahead for Auditors." Journal of Accountancy, August, 1969, pp. 60-62.

BIBLIOGRAPHY--continued

Select Committee on Company Law. 1973 Report on Mergers, Amalgamations and Certain Related Matters. Toronto: Province of Ontario, 1973.

Shank, J. K., and Calfee, J. B. "Pros and Cons of Forecast Publication." Business Horizons, October, 1973, pp. 43-49.

Sidley and Austin. "The Legal Aspects of Public Disclosure of Corporate Financial Forecasts." Public Disclosure of Business Forecasts. New York: Financial Executives Research Foundation, 1972.

Siegel, S. Non-Parametric Statistics. New York: McGraw-Hill, 1956.

Singhvi, S. S., and Desai, H. B. "An Empirical Analysis of the Quality of Corporate Financial Disclosure." The Accounting Review, January, 1971, pp. 129-38.

Skinner, R. M. Accounting Principles. Toronto: The Canadian Institute of Chartered Accountants, 1972.

Skousen, F. K.; Sharp, R. A.; and Tolman, R. K. "Corporate Disclosure of Budgetary Data." Journal of Accountancy, May, 1972, pp. 50-57.

Smith, L. D., and Murphy, G. J. "Earnings Forecasting--Investment Analysts Versus Exponential Smoothing Models." Journal of Business Administration, Fall, 1976, pp. 11-21.

Solomon, K. I. "Pro Forma Statements, Projections, and the SEC." The Business Lawyer, January, 1969, pp. 389-407.

Special Committee on Corporate Forecasts. "Proposals by the Federation for Systematic Disclosure of Corporate Forecasts." Disclosure of Corporate Forecasts to the Investor. New York: Financial Analysts Federation, March, 1973.

Stallman, J. C. "Towards Experimental Criteria for Judging Disclosure Improvement." Journal of Accounting Research, Supplement, 1969, pp. 29-43.

Stanga, K. G. "Disclosure in Published Annual Reports." Financial Management, Winter, 1976, pp. 42-50.

BIBLIOGRAPHY--continued

Sterling, R. R., and Harrison, W. "Discussion of Capital Market Equilibrium, Information Production, and Selecting Accounting Techniques: Theoretical Framework and Review of Empirical Work." Journal of Accounting Research, Supplement, 1974, pp. 142-57.

Stettler, H. F. "CPAs/Auditing/2000±." Journal of Accountancy, May, 1968, pp. 55-60.

Stewart, S. S., Jr. "Research Report on Corporate Forecasts." Financial Analysts Journal, January-February, 1973, pp. 77-85.

Study Group on the Objectives of Financial Statements. Objectives of Financial Statements. New York: American Institute of Certified Public Accountants, 1973.

Sycamore, R. J. "Public Disclosure of Earnings Forecasts by Companies." Canadian Chartered Accountant, May, 1974, pp. 72-75.

Task Force 2000. "Summary Report." Canadian Chartered Accountant, November, 1970, pp. 334-41.

Thomas, R. D. "Current Research Department Activities." CA Magazine, July, 1977, pp. 59-61.

Tompkins, C. R. "The Development of Relevant Published Accounting Reports." Accountancy, November, 1969, pp. 815-20.

Wanger, R. "Discussion of On the Usefulness of Financial Accounting Information to Security Analysts." Journal of Accounting Research, Supplement, 1970, pp. 55-61.

Wilcox, J. W. A Method for Measuring Decision Assumptions. Cambridge: MIT Press, 1972.

Wilkinson, J. R., and Doney, L. D. "Extending Audit and Reporting Boundaries." The Accounting Review, October, 1965, pp. 753-56.

Willingham, J. J.; Smith, C. H.; and Taylor, M. E. "Should the CPA's Opinion be Extended to Include Forecasts." Financial Executive, September, 1970, pp. 80-82, 88-89.

APPENDIX 2--continued

SEVEN YEAR REVIEW

	1966	1967	1968	1969	1970	1971	1972
Operating results ($000)							
Sales	4,417	5,256	7,382	14,809	25,347	32,912	43,151
Earnings from operations before the following	540	910	1,339	2,093	3,709	4,819	6,184
Depreciation	62	77	96	122[1]	220	278	393
Income taxes	227	404	629	978[1]	1,819	2,261	2,770
Minority interests	—	—	—	—	167	200	227
Net earnings	250	428	615	993	1,503	2,080	2,794
Financial Position ($000)							
Working capital	365	680	1,091	5,299	6,392	7,419	14,395
Inventories	499	877	1,607	4,190	7,298	10,236	17,662
Fixed assets—net	768	845	1,068	3,181	3,828	5,303	9,994
Total assets	1,796	2,626	3,715	11,277	16,055	20,391	42,775
Long-term debt	22	12	44	450	460	445	10,517
Shareholders' equity	1,130	1,557	2,341	8,222	10,461	12,676	15,431
Per Common Share ($)							
Net earnings	.16	.27	.37	.52[2]	.67	.93	1.24
Dividends paid	—	—	—	—	—	—	.06
Cash flow[3] from operations	.19	.32	.43	.62[2]	.93	1.17	1.56
Net asset value	.70	.97	1.41	3.80	4.69	5.65	6.84
Stock market price: High	4.10	7.00	9.38	14.50	12.75	17.25	23.88
Low	2.35	4.55	4.05	8.38	6.00	9.50	16.00
Close	3.10	5.88	8.88	12.13	9.38	15.88	23.88
Ratios and Statistics							
Number of shares outstanding	1,604,906	1,605,101	1,664,874	2,165,141	2,229,890	2,245,412	2,256,278
Net earnings ÷ Sales	.06	.08	.08	.07	.06	.06	.06
Net earnings ÷ Shareholders' Equity	.22	.27	.26	.12	.14	.16	.18
Net earnings ÷ Total Assets	.14	.16	.17	.09	.09	.10	—[4]
Sales ÷ Shareholders' Equity	3.91	3.38	3.15	1.80	2.42	2.60	2.80
Sales ÷ Total Assets	2.46	2.00	1.99	1.31	1.58	1.61	—[4]
Shareholders' Equity ÷ Total Assets	.63	.59	.63	.73	.65	.62	.36
% Growth [5]							
Net Earnings per Share		69	37	41	29	39	33
Net Earnings		71	44	61	51	38	34
Sales		19	40	101	71	30	31
Cash Flow[3] per Share		68	34	44	50	28	31
Working capital ratio	1.6:1	1.6:1	1.8:1	3.0:1	2.5:1	2.2:1	1.9:1
Price-earnings ratio[6]	19.4	21.8	24.0	23.3	14.0	17.1	19.3

NOTES TO SEVEN YEAR REVIEW

1. During 1969, the rates of depreciation were changed to conform with revised estimates of the useful life of fixed assets and the company converted from the taxes payable to the tax allocation method of providing for income taxes. Prior years figures as shown above have not been restated.
2. Based on weighted average of 1,907,012 shares outstanding.
3. Net earnings + Depreciation and amortization + Deferred income taxes + Minority interests.
4. Not calculated because assets of subsidiary acquired in December are included but sales and earnings are not.
5. Increase during year divided by level at beginning of year.
6. Closing stock market price per share for the year divided by net earnings per share for the year.