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# Gobbledygook stumps financial professionals too

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- \* Study weighs readability of corporate 10-Ks
- \* Mystified investors turn to analysts for guidance
- \* Less accurate but more influential forecasts

By Mike Miller

DETROIT, June 3 (Reuters) - Baffled by the language of corporate financial reports? You have company. Sometimes the people who get paid the big bucks to plow through them can't make much sense of them either.

Researchers at the University of Michigan analyzed tens of thousands of 10-K reports filed by companies over a 12-year period to assess their level of readability.

The reports, yearly filings required by U.S. securities regulators, are supposed to provide a clear-eyed look at a company's performance. They tend to be drier and more technical than the glitzy illustrated annual reports that companies give their shareholders.

"The less readable these documents are, the more pressure it creates from clients for analysts to provide commentary and forecasts," said Feng Li, an accounting professor who worked on the study.

In other words, when ordinary investors can't make heads or tails of a report, they lean on the professionals to explain what it means.

"This increases the number of analysts who weigh in on these stocks and enhances their influence on investors, even while it reduces the analysts' collective accuracy," Li told Reuters.

To gauge the reports' readability, Li and two university colleagues, Reuven Lehavy and Kenneth Merkley, applied something called the Fog Index to some 33,000 10-K filings.

The Fog Index aims to measure the complexity of a piece of writing as a function of sentence length and the number of "complex" words of three or more syllables.

The index provides an estimate of the number of years of formal education required for a person of average intelligence to read a passage once and understand it. The higher the number, the harder the writing is to understand.

The mean score for the 10-Ks the researchers looked at was 19.53. Someone who spent that many years in the classroom should have at least a master's degree.

Healthcare and insurance companies had the highest scores (20.22 and 20.16), so it's not just their policies that are hard to understand.

Precious metals had the lowest score at 18.43. Gold is a one-syllable word.

Berkshire Hathaway (BRKa.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), known for the chatty shareholder letters of its Chief Executive Warren Buffett, came in at 17.23, making it one of the companies with the highest readability.

Still, that level is well above what most people would consider plain English. Reader's Digest magazine is said to have a Fog score of 8, while the Wall Street Journal's is 12. The story you're reading now, based on a random sample plucked from somewhere in the middle, weighs in at 14.

Not surprisingly, analysts take longer to issue their own reports based on hard-to-read 10-Ks -- 10 percent to 15 percent longer on average, the study found -- and their earnings forecasts based on these reports tend to be less accurate than those from more readable ones.

More surprising, perhaps, is that the less readable a corporate report is, the more influence it appears to have on investors. Analyst forecasts based on 10-Ks in the highest, or least readable, Fog quartile have about 10 percent more influence on investors than those from the lowest, or most readable, quartile, as measured by stock movement on the day of the forecasts.

The study was published in the May/June issue of the *Accounting Review*, a journal of the American Accounting Association. (Editing by Steve Orlofsky)

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