repec

Revista de Educação e Pesquisa em Contabilidade
Journal of Education and Research in Accounting
Revista de Educación e Investigación en Contabilidad

Quarterly journal, digital and free published by Brazilian Academy of Science in Accounting

ABRACICON
ACADEMIA BRASILEIRA DE CIÊNCIAS CONTÁBEIS

ISSN 1981-8610

REPeC, Brasília, v. 8, n. 4, art. 1, p. 344-360, Oct./Dec. 2014
Available online at *www.repec.org.br*
DOI: http://dx.doi.org/10.17524/repec.v8i4.1119

Profit and Loss From the Management Perspective: How are the Earnings Presented in the Management Reports?

Abstract

This paper aims to analyze how textual information on company earnings are presented in the Management Reports in alternating periods of profit and loss. The theoretical foundations were based on the agency theory and on impression management. A qualitative-quantitative approach was adopted and the data were analyzed through statistical tests of comparison of means based on content analysis. Management Reports were analyzed from 30 companies listed on BM&FBovespa – which presented profit in 2009 and loss in 2010. The main evidence found in the management report analysis were: i) difference in the number of lines and words between the profit and loss periods; ii) in loss periods, the occurrence of terms that express this result is limited and the terms Ebitda and gross margin are highlighted; and iii) there are signs of deviation of the users' attention from the earnings to other indicators through the selection and repetition of financial terms, reducing the exposure of the negative results and enhancing the positive indicators. These results indicate an environment that reflects the information asymmetry problems, in which regulatory entities should develop policies to monitor the discretionary choices on Financial Statements that can mislead the market participants.

Key words: Disclosure. Management reports. Impression management.

Luiz Henrique Fernandes Vargas
M.Sc. in Accountancy from Universidade Federal do Espírito Santo and Administrative Assistant at Instituto Federal de Educação, Ciência e Tecnologia do Espírito Santo (IFES). **Contact:** Av. Vitória, 1729, Jucutuquara. Vitória-ES. CEP.: 29040-780.
E-mail: luizfvargas@gmail.com

José Elias Feres de Almeida
Ph.D. in Controllership and Accounting from the University of São Paulo (USP) and Adjunct Professor II at Universidade Federal do Espírito Santo (UFES). **Contact:** Av. Fernando Ferrari, 514, CCJE, ED-VI, sl. 618, Goiabeiras. Vitória-ES. CEP.: 29075-910.
E-mail: *jose.e.almeida@ufes.br*

Elizeu Maria Junior
M.Sc. in Accountancy from Universidade Federal do Espírito Santo and Assistant Professor I at Universidade Federal do Espírito Santo. **Contact:** Av. Fernando Ferrari, 514, CCJE, ED-VI, sl. 618, Goiabeiras. Vitória-ES. CEP.: 29075-910.
E-mail: *elizeu.maria@ufes.br*

Published in Portuguese, English and Spanish. Original Version in Portuguese.

Received in 5/18/2014. Ask to Revise on 8/10/2014. Resubmitted on 8/28/2014. Accepted on 10/3/2014 by Valcemiro Nossa (Editor).
Published on 12/24/2014. Organization responsible for the journal: Abracicon.

1. Introduction

The influence of the discretion of the users involved in the elaboration process of the financial statements cannot be ignored. According to Lopes and Martins (2005), the managers, who possess more information than the external users and investors, use accounting for the sake of selective communication, not providing all information but simply what they consider to be most convenient for their own interest. This information asymmetry originates in the separation between property and control, reported in the seminal study by Jensen and Meckling (1976), and constitute the essence of the agency theory.

Non compulsory information about the entity's performance and situation, disseminated by publicly traded companies, are available in the management reports and correspond to a narrative part of the companies' annual statements. According to Iudícibus (2010, p. 115), these reports contain disclosures like the company and sector's growth plans and future expectations which, although normally biased towards "inconsequent optimism", are relatively important, provided that they are not audited because of this bias.

The literature has presented research about the information in the management reports, as well as their arrangement or use of graphs and images, like in the study by Clatworth and Jones (2006), which discuss the trend towards selective data use, presenting favorable information and a positive view on the corporate performance. In these reports, the characteristics of impression management are observed, that is, how the economic agents could perceive the corporate image. For these authors, the way the entities' management uses voluntary information contained in the annual reports, as a means to provide a view on its own interests with regard to the performance, is characterized as an interesting area for research.

The management report presents the management's perspective on the company's performance in the period, based on the financial information published, as well as the way the external environment affects the company. As the management report does not follow a pattern, the executives can choose not only what information to include, but also terms, figures and graphs that can be used to their own or the company's benefit, in view of the environmental conditions they are inserted in. In short, the executives can create a bias in the interpretation of the data and their choice, besides the way they are reported.

Thus, considering that the company's top management can adopt disclosure strategies that enhance or reduce the information asymmetry, the research question is: How is the information on the annual income of publicly traded companies listed on BM&FBovespa presented in the annual reports in the periods of profit (2009) and loss (2010)?

Thus, the objective in this study is to analyze how the information on the annual reports of publicly traded companies with stock traded on BM&FBovespa is presented in the management reports for the profit period 2009 and the loss period 2010.

The methodological cut adopted, analyzing the companies in 2009 and 2010, at a time of favorable and unfavorable performance, respectively, can capture the change in the entities' discourse between a period of profit and one of loss, besides enhancing the understanding about the disclosure strategy.

In general, the results indicate the existence of impression management in the reports analyzed with regard to the size of the texts that reports on the financial earnings, the number of lines in the report as a whole and the use of financial indicators in the loss period. In the same period, signs of a selective approach are observed in the presentation of terms that represent the result and the use of emphasis through the repetition of financial terms throughout the texts.

Thus, this study strengthens earlier Brazilian and international evidence that information asymmetry problems can be enhanced to mitigate external users' perception on the companies' occasional losses or to strengthen the corporate image at times of profits. In the Brazilian context, based on the results of the sample analyzed, this evidence shows that economic agents like investors, creditors, regulators, analysts and minority shareholders need to understand the disclosure strategies of company management to reduce the information asymmetry problems that can negatively affect the information environment and enhance agency conflicts.

This study is divided in five sections; ii) theoretical framework on agency theory, impression management and earlier studies; iii) research method; iv) qualitative and quantitative analysis of the results; and v) final considerations and suggestions for future research.

2. Theoretical Framework

2.1 Agency Theory and Accounting Information

The classical economic theory, which theoreticians used in the past, is based on the premises that companies rationally optimize the economic income and have only one owner, granting the idea that there are no conflicts of interest. The emergence of the modern corporation, in which ownership is separated from management, makes the classical theory distant from the corporate reality, as conflicts of interest can emerge in this new type of company, between stockholders and administrators. Thus, the agency theory breaks with the paradigm present in the classical economic theory by affirming the possibility of these conflicts (Lopes & Martins, 2005, p. 28).

Jensen and Meckling (1976) affirm that the agency theory is based on the separation problems between ownership and control. According to these authors, the agency relation is established by hiring a person; the agent, to execute the service on behalf of one or more people; the principal, delegating some kind of decision power to the agent. Considering that both parties aim to maximize their utility, however, there are good reasons to believe that the agent will not always act on behalf of the principal's interest, as the authors affirm.

The information problems developed in the agency theory are linked to accounting since, as the investors do not have the same information level, they need independent instruments that enable them to analyze the company's actual situation (Lopes & Martins, 2005, p. 31).

According to Lopes and Martins (2005, p. 55):

> [...] As the sending of information is discretionary, the administrators can manipulate the information, providing figures to deceive the users about the company's "actual" situation. On the other hand, this same discretion permits the publication of the information.

According to Lopes, Ribeiro, Filho Pereira, Pederneiras, Silva and Santos (2010), the choice of the management regarding the disclosure level in the entity's management reports is related to the accounting profit. The managers naturally tend to provide further information when the benefits gained are higher than the costs. These authors' research permits the interpretation that, for the managers, it is more beneficial to enhance the information disclosure in case of profit than loss.

In addition, as Tessarolo, Pagliarussi and Luz (2010) affirm, the studies illustrate the trend to appropriate the positive effects of the earnings to internal causes and the negative effects to external causes, with a view to building a favorable image of the company. Thus, these studies motivate the analysis of the annual reports' textual part.

2.2 Impression Management

According to Hendriksen and Breda (2009), the trend to present optimistic expectations about the company in the management reports makes them lose much of their meaning. As it is not audited, this type of report contains information susceptible to impression management which, according to Clatworthy and Jones (2006), corresponds to individuals or organizations' trend to selectively use data to present favorable signals about the data and a positive view on the corporate performance. According to these authors, although the management's desire to present this positive view is present in all companies, it is particularly evidenced when the performance is based. The information contained in the management reports, as a part of the annual reports, express the managers' view on the organization and can present a positive information bias.

According to Mendonça and Amantino-de-Andrade (2003, p. 40), however, "although certain forms of impression management are used dishonestly, others involve the honest and accurate presentation of the subjects or objects' attributes [...]". Hence, according to the authors, one way to also understand impression management is as a communication process through which one creates and sends messages to an audience with a view to transmitting a certain image or impression.

In line with Patelli and Pedrini (2013), the ethical dimension of the discourse in the companies' reports in sometimes neglected in the literature, which concerns them because empirical evidence demonstrates the importance of these reports in investors' decisions. In this study, when analyzing American companies between 2008 and 2009, the authors found that there is a significant link between an optimistic tone and the financial performance. They conclude that, in impression management, the rhetorical tone is seen as a form of manipulation to distract the reader's attention from the past performance and distort the future expectations as, in communicative action, the past performance molds the rhetorical tone and offers useful information to foresee the future expectations.

In a way, the preference to favorably picture oneself through impression management figures as an understandable human attribute but, in the context of the financial reports, there is a risk of ceasing to be so and violating the basic premise of presenting information neutral and impartially in these reports, according to Clatworthy and Jones (2006).

According to Beattie and Jones (2002), there are incentives for the preparers of the corporate reports to manipulate or at least manipulate the impression of the content transmitted in the management reports. In general, it serves to create a more favorable view of the performance than what actually happens in the company.

In that sense, Clatworthy and Jones (2006) affirm that the impression management is based on the managers' overshadowing of the errors and highlighting of the successes. In line with Osma and Guillamón-Saorín (2011), information is selected to distort the readers' perception of the corporate conquests.

Aerts (2005) appoints the importance of information for the relation agent-principal and also as a communication device sensitive to the context. The author highlights the discretion of the accounting narratives' discourse to construct the investors' support and convincing. In addition, a trend to attribute positive results to the company's own actions and negative results to external factors or opportunity is appointed. In his study, the author evidences that, in publicly traded companies, an opportunistic attitude exists in the dissemination narrative, where the tests are more explanatory but not more extensive or deep. In addition, positive news is constructed and a higher level of defensive attitude exists to explain negative results.

In this case, overshadowing occurs, which is a discretionary measure of management that partially influences the additional length (size) of the reports to try and deviate the attention from the bad news, caused by the difficulty to describe losses or transitory income. When reporting on a weak performance, the managers can write longer and more complex reports in the attempt to distract the investors by discussing bad news through good news (Bloomfield, 2008).

According to Beattie and Jones (2000), the impression management can be divided in accounting figures, which consists in the basic manipulation of the measuring and disclosure of the figures and the manipulation of the presentation, which refers to the control of the information presented regarding its content or formats, figures or graphs. The authors also affirm that, besides colored and distracting, the graphs can be used in the impression management process, where the management can highlight performance variables that improved and suppress those that worsened, strengthening the impression of the performance it wants to transmit.

To evidence the division and the strategies adopted to present the information, with regard to the impression management, in the narrative sections of the annual reports, the identification of seven analytic approaches can be observed, which Brennan, Guillamón-Saorín and Pierce (2009) used in their study: 1) syntactic manipulation, which consists in the analysis of the language used in the accounting narratives, where the managers use the language to overshadow the performance, especially when negative; 2) rhetorical manipulation, which also analyzes the form of overshadowing and covering up the negative performance; 3) attribution of results, related to the analysis of the attribution of positive results to internal factors and negative results to external factors; 4) thematic manipulation, which analyzes the use of positive and negative themes in the accounting narratives; 5) selectiveness, which analyzes how the management selects performance figures that picture the company in the best possible way; 6) visual presentation effects (emphasis), analyzes the three forms of emphasis used, in which the visual emphasis refers to the disclosure of certain information to the reader, such as location or position, the repetition of an item and the reinforcement, in which a qualifier is used in combination with the term presented; and 7) impression management, using performance comparisons, in which the analysis considers reference points and benchmarks in the reports.

In their study, Osma and Guillamón-Saorín (2011) evidence that strong corporate governance mechanisms favor the inclusion of negative information in the disclosures and reduce the incidence of impression management in the narrative disclosure. The more optimistic disclosure is related to the expectation of good news in the subsequent period. According to the authors, impression management is a mechanism inserted in the companies' complex communication strategy.

In summary, it can be inferred that each choice transmits signals to the market and that, depending on the financial information disseminated, the top management issues its opinion, enhancing positive aspects and mitigating the effects of financial indicators that are negative or below the market's expectations. In combination with the discretion, all of these choices can contribute to increase or reduce the information asymmetry that can affect the agency problems.

2.3 Earlier Research in Brazil

In their investigation of management reports, Silva and Rodrigues (2006) found a bias in the information disseminated in these reports, which can negatively affect or even distort the financial information users' perception. In addition, the authors affirm that the management tends to blame the external environment and the economic conjuncture for the inferior performance, and be optimistic on the administrative reforms as a prize for the work developed, thus assuming the good results.

In an analysis of the management reports of companies listed on Bovespa's corporate governance levels in 2004, Gallon and Beuren (2007) evidenced that there is a difference among the governance levels with regard to the disclosure content of the study items. They concluded that declarative phases, in which the qualitative information is presented in the descriptive form only, were more frequent.

Silva, Rodrigues and Abreu (2007) verified the representation of the management reports as a source of information about the companies. The conclusions of this study are that companies with growing assets and larger companies have more extensive reports, that is, disseminate more information. The future performance influenced the extent of the report and the reports of companies with lower assets and equity than in the past were more pessimistic. They also found that optimistic reports contained more phrases on the administrative reform and the pessimistic reports are concentrated on the economic conjuncture.

To verify the existence of information that indicate companies' financial risk of bankruptcy, Pagliarussi and Scotá (2009) apply the model Smith and Taffler used in the year 2000 in the Brazilian context, which consists in an objective analysis of the content, by counting the words; and a subjective analysis, guided by the meaning of the texts studied. The results found demonstrate that the management reports are important sources to preview the companies' future performance.

Tessarolo, Pagliarussi and Luz (2010) investigated the justification process of Brazilian companies' organizational performance based on the analysis of the annual reports in 2002 and 2003. The authors conclude that the results indicate the attempt to create a positive image of the company, even in cases of a negative performance in a favorable external context. According to the authors, however, companies with a positive performance in a good or bad year equivalently blame the external negative effects.

Guimarães (2011) investigated the consistency in the messages transmitted in the narrative sections of the annual reports about the performance of the companies listed on Bovespa in 2009, applying a research developed in 2005 by Balata and Breton. The study concludes that there is a partial conflict in the information, as the text is not completely consistent with the figures. It was also observed in this study that the companies predominantly transmit positive information, with a stronger emphasis on positive points, while the negative situations are minimized through mitigating arguments.

3. Method and Sample Selection

This study analyzes the management reports of publicly traded companies listed on BM&FBovespa in periods of profit and loss. The strategy adopted is qualitative-quantitative. The qualitative approach is used to analyze the textual results and reports, while the quantitative approach is used for the statistical comparisons between the information means surveyed through the content analysis of the documentary research.

The data were interpreted through content analysis, which according to Bardin (2007) consists in obtaining quantitative indicators or that do not permit the inference of knowledge from the messages with regard to the production and reception conditions through a set of communication analysis techniques that use systematic and objective procedures to describe the content of messages. Thus, the information volume published in the reports analyzed was surveyed, which involves counting the number of pages, paragraphs, lines, graphs, tables, figures, characters, connectors and financial indicators in the management reports.

The study population corresponds to all publicly traded companies traded on BM&FBovespa in 2009 and 2010, which Management Reports were published and available on the website of the São Paulo Stock Exchange and whose financial information was available. The filtering and selection of the companies in the study sample and the companies' sectorial classification were done in the database Economática.

Based on the filter established, the research sample is restricted to 30 publicly traded companied that reported a net profit in the annual financial statements for 2009 and a loss in 2010. Thus, 60 management reports were analyzed for these two years. In this study, the terms favorable performance and unfavorable performance were adopted, the former representing the companies that reported a net profit in 2009, and the latter companies that reported a loss in 2010.

As the files of the reports studied were in the text format (doc) in 2009 and in the open format (pdf) in 2010, the information was surveyed manually.

The periods (years) studied were selected due to the changes the Brazilian Securities Comission (CVM) made through CVM Instruction 457 in 2007, which enabled publicly-traded companies to anticipate the adoption of international accounting in Brazil (IFRS). As this adoption of the international accounting standards can influence the companies' performance, the information in the management reports about this adoption and the possible effects on the earnings was also verified, as well as the companies that justified their performance based on external events. This information will be explored in the analysis of the results.

The companies in the study sample are listed in Figure 1, as follows:

Banco Cruzeiro do Sul	Clarion	Lupatech
Banco Panamericano	Oderich	Millenium
BHG	Better	OGX
Buettner	Lix da Cunha	Pettenati
CEMEPE	Ferrovia Centro Atlântica	Rasip Agro Pastoril
CELPA	General Shopping	Rede Energia
CASAN	Gruçaí Participações	Refinaria de Petróleo Manguinhos
CEEE-D	Hotéis Othon	RIMET
Schlösser	J. B. Duarte	Springs
Cia Melhoramentos SP	JBS	Tecnosolo

Figure 1. Sample companies

3.1 Study Hypothesis

To achieve the proposed objective, the Wilcoxon-Mann-Whitney test of comparison of means was used to verify four hypotheses (H1, H2, H3 and H4), which are presented next. The use of this non-parametric test is justified by the sample size.

The size of the communication form in the management reports under study is in line with the study by Clatworthy and Jones (2006), who verified that there is no difference in the length (size) of the management reports between profitable and non-profitable companies. In this study, the number of pages, paragraphs, lines, graphs, tables, figures, characters and connectors (but, however, nevertheless, although) in the management reports was used to verify the length of the companies' communication to the market during the study periods. The analysis of the number of connectors aims to observe the use of these elements to justify the result for the period. A difference in the extent of these reports is expected between the alternatingly favorable and unfavorable periods, as follows:

H1: *A statistically significant difference exists in the extent of the management reports between the periods of favorable and unfavorable performance.*

As regards the use of financial indicators in the management reports, Clatworthy and Jones (2006) rejected the hypothesis that the reports from the president of profitable and non-profitable companies contain the same number of financial indicators, which they defined as profit, sales, dividends and earnings per share. In line with those authors, the usage similarity of the following financial indicators in the management reports is tested between the favorable and unfavorable periods: Earnings (profit, net profit, loss, net loss, earnings and net earnings), Gross Profit, Ebitda (Earnings Before Interest, Taxes, Depreciation and Amortization) and Gross Margin. A difference is expected in the use of these financial indicators between the favorable and unfavorable periods in the reports studied. As follows:

H2: *A statistically significant difference exists in the use of financial indicators in the management reports between periods of favorable and unfavorable performance.*

This study also aims to discover whether there is a difference in the length of the specific presentation of performances in the management reports in favorable and unfavorable periods. Therefore, the amount of lines and words dedicated to the theme were used. A quantitative difference is expected in the length of the texts specifically dedicated to the performance levels between the favorable and unfavorable periods. Thus:

H3: *A statistically significant difference exists between the length of the texts that specifically communicate the favorable and unfavorable performances.*

In addition, with regard to this communication form, this study verifies the possibility of different positions in the presentation of favorable and unfavorable performance in the management reports for the study periods. Brennan, Guillamón-Saorín and Pierce (2008) affirm that the location or position of disclosures can depend on whether the event is positive or negative or on whether the disclosure refers to earnings. In this study, to verify this position, the number of paragraphs and lines was used between the start of the report and the paragraph that disseminates the performance. A difference is expected in the position of the texts that describe the performance between the favorable and unfavorable periods in the reports studies, so that:

H4: *A statistically significant difference exists in the distance between the start of the management report and the text that presents the performance levels between the profit and loss periods.*

In the second part of this study, it is verified in qualitative terms how the favorable and unfavorable performances are presented in the text of the management reports and what emphasis the manager uses to elaborate the reports in these periods. The researcher's analysis aims to look for signs of impression management in the management reports, in that the manager presents strategies in his text to overshadow negative results and enhance the visibility of positive results in the periods studied.

4. Evidence from Management Reports

4.1 Data Analysis and Hypothesis Tests

Initially, the summary is presented with the number of pages, paragraphs, lines, tables, figures, graphs, characters and connectors in the management report as a whole and its variation between the favorable (2009) and the unfavorable performance period (2010). Then, descriptive statistics are presented on the information surveyed and the data on the specific reports of the earnings in the study period. Next, the results of the comparison of means are presented (Mann-Whitney) to check whether there is a statistical difference between the periods.

Table 1
General data from reports

	2009[a]	2010[a]	Difference[b]	Variation %[b]
Pages	337	307	(30)	(8.90)
Paragraphs	2,376	2,177	(199)	(8.38)
Lines	8,184	6,998	(1,186)	(14.49)
Tables and Figures	150	159	9	6.00
Graphs	75	105	30	40.00
Characters	575,874	572,088	(3,786)	(0.66)
Connectors[c]	46	46	0	0.00
Result[d]	101	71	30	(29.70)
Gross Profit	34	32	2	(5.88)
EBITDA	109	207	98	89.91
Gross Margin	15	32	17	113.33

Obs.: (a) Observed quantities for the total number of companies in the sample. Periods of favorable (2009) and unfavorable performance (2010). (b) Parentheses indicate negative percentages. (c) Connectors used in the texts to justify results for the period (but, however, nevertheless, although). (d) The following terms are considered as result: profit, net profit, loss, net loss, earnings and net earnings.

In Table 1, a nominal reduction is observed in the space for the presentation related to the periods of unfavorable performance in comparison with the favorable period. Among the companies that reduced the number of pages, a company from the Finance and Insurance sector is highlighted, which in 2009 presented a 20-page report and reduced this number to seven pages in 2010, a reduction by 65%. On the other hand, a company from the Oil and Gas sector increased the number of pages from nine to 16 between the period of favorable and unfavorable financial results, representing an increase by 77.78%.

The total number of graphs between the favorable and unfavorable performance period increased by 40% though, as exemplified by a company from the Food and Beverage sector, which in 2009 presented three graphs, against 17 graphs in the report for 2010. In addition, a reduction is observed in the use of financial terms that express the annual income (29.70%) in these periods and an increase in the terms Ebitda (89.91%) and gross margin (113.33%).

Based on the descriptive statistics, the existence of a performance dissemination strategy can be supposed in the companies' different accounting-financial conditions, either to increase the explanation about a change in results (reduction of information asymmetry) which the market may not have expected, or to reduce the degree of information disseminated to the market (increase of information asymmetry).

Table 2
Descriptive statistics of general data

	2009				2010			
	Mean	**Stan. Dev.**	**Min.**	**Max.**	**Mean**	**Stan. Dev.**	**Min.**	**Max.**
Pages	11.23	10.18	1	38	10.23	8.11	1	28
Paragraphs	79.20	68.98	5	242	72.57	58.23	6	216
Lines	272.80	232.23	18	945	233.27	163.96	13	577
Tables and Figures	5.00	8.75	0	43	5.30	8.89	0	40
Graphs	2.50	4.35	0	14	3.50	5.30	0	17
Characters	19195.80	18736.08	1077	68289	19069.60	17188.07	878	63067
Connectors	1.53	2.93	0	15	1.53	1.81	0	7
Result	3.37	4.41	0	21	2.37	3.48	0	15
Gross Profit	1.13	3.61	0	19	1.07	2.92	0	15
EBITDA	3.63	9.16	0	47	6.90	16.73	0	78
Gross Margin	0.50	1.31	0	6	1.07	3.17	0	16

Obs.: Periods of favorable (2009) and unfavorable (2010) performance.

The descriptive statistics of the information in the management reports as a whole (Table 2) demonstrate that, on average, the extent of the management report decreases by one page between one period and the other. When related to the maximum number of pages of the management reports in the companies under study, this reduction corresponds to 26.32%.

On the other hand, the graphs increase between one period and the other. It was observed that, in general, in the loss period, the companies focused their graphs on revenues, expenses, margin, production and profit, without a pattern in the types of graphs. Some companies did not publish any graphs with the annual income. This shows the attempt to explain the result occurred using variables that drive the users' attention to what the top management considers relevant to justify the loss or to reduce the attention paid to this loss. In the management reports studied, it could be observed that 56.66% of the companies do not use graphs in their reports and that 43.33% do not use Tables and Figures, which justifies the above-average standard deviations and the minimum number of zero for these items. In line with this information, the existence of a reduction in the textual information can be observed in the management reports, as well as an increase in illustrative information through the use of graphs.

Similarly, it is observed that, on average, the mean number of financial terms that remit to the annual income drops between the favorable and unfavorable performance periods. On the other hand, the terms Ebitda and Gross Margin increased between both periods.

Table 3

Descriptive statistics of annual earning reports

	2009				2010			
	Mean	**Stan. Dev.**	**Min.**	**Max.**	**Mean**	**Stan. Dev.**	**Min.**	**Max.**
Lines	4,37	2,17	0	9	3,20	2,52	0	10
Words	53,23	28,72	0	139	39,33	30,72	0	130
Position of the paragraph	37,33	47,27	0	221	30,17	34,54	0	160
Position of the line	134,73	169,24	0	709	103,60	111,72	0	488

Obs.: Periods of favorable (2009) and unfavorable performance (2010).

In the descriptive statistics in Table 3, related to the specific reporting of the annual income in the management reports, the impact of the companies that did not discuss the annual income could be observed through the minimum number of lines, words, paragraph position and line position equal to zero. It was verified that, in the favorable performance period, two companies did not present any text on the annual income. This number increased to five companies in the unfavorable performance period.

As regards the positions of the texts used to report on the earnings during the study periods, considering the first paragraph and line of the management report until the paragraph and line that starts the report of the annual income, on average, the favorable performance period is more distant from the start of the report. The same is observed regarding the maximum number found in the verification of the reports. In this respect, it should be highlighted that the total number of pages, lines and paragraphs in the reports influence these positions.

Table 4

Results of Mann-Whitney test

	Means 2009[(a)]	**Means 2010[(a)]**	**Prob > |z|[(d)]**
Results of H1			
Pages	11,23	10,23	0,4820
Paragraphs	79,20	72,57	0,3182
Lines	272,80	233,27	0,0803
Tables and Figures	5,00	5,30	0,5209
Graphs	2,50	3,50	0,2404
Characters	19.195,80	19.069,60	0,7343
Connectors[(b)]	1,53	1,53	0,2519
Results of H2			
Result[(c)]	3,37	2,37	0,0162
Gross Profit	1,13	1,07	0,4861
EBITDA	3,63	6,90	0,0285
Gross Margin	0,50	1,07	0,0255
Results of H3			
Lines	4,37	3,20	0,0199
Words	53,23	39,33	0,0321
Results of H4			
Position of Paragraph	37,33	30,17	0,3595
Position of Line	134,73	103,60	0,2575

Obs: (a) Periods of favorable (2009) and unfavorable (2010) performance. (b) Connectors used in the texts to justify the annual income (but, however, nevertheless, although). (c) The following terms are considered as result: profit, net profit, loss, net loss, earnings and net earnings. (d) Prob > |z| corresponds to the statistical significance of the non-parametric test to verify the difference between two means (Mann-Whitney).

Based on Table 4, considering a 10% significance level, it can be observed that there exists insufficient evidence to reject H1 with regard to the number of pages (Prob > |z| = 0.4820), the number of paragraphs (Prob > |z| = 0.3182), the number of tables and figures (Prob > |z| = 0.5209), the number of graphs (Prob > |z| = 0.2404), the number of characters (Prob > |z| = 0.7343) and the number of connectors (Prob > |z| = 0.2519). On the other hand, despite differences in the means and in the textual analysis, no differences could be identified in these patterns at a 10% significance level.

Nevertheless, in the same analysis of H1, there is evidence to partially reject H1 with regard to the verification of the number of lines (Prob > |z| = 0.0803), according to the results found in Table 4. Hence, it can be considered that there is evidence of a difference between the number of lines in the favorable and unfavorable performance periods.

Therefore, concerning the size of the management reports as a whole, the tests are not conclusive, leading to a partial rejection of H1. The partial rejection of this hypothesis is similar to the result found by Clatworthy and Jones (2006) in which, against expectations, the authors could not conclude that there is a difference between the reports of profitable and non-profitable companies with regard to the manager's proneness to dedicate more space and words to the communication of his success than his failure, although these authors analyzed the extent of the reports with regard to the number of words and pages, differently from this study.

Considering a 10% significance level, in Table 4, it is observed that there is evidence to partially reject H2 with regard to the quantity of the indicator annual income (Prob > |z| = 0.0162), the quantity of the indicator Ebitda (Prob > |z| = 0.0285) and the quantity of the indicator Gross Margin (Prob > |z| = 0.0255). In other words, there is evidence of differences between the number of terms related to the annual income (profit, net profit, loss, net loss, earnings and net earnings), to the use of the indicators Ebitda and Gross Margin in the periods of favorable and unfavorable performance. What the indicator Gross Profit is concerned, at a 10% significance level, it is observed that there is insufficient evidence to reject H2 (Prob > |z| = 0.4861).

The verification of a significant difference in the length of the texts specifically dedicated to the performance in favorable and unfavorable periods was elaborated through hypothesis H3. A difference is expected in the length of the texts addressing the annual income. In Table 4, it is verified that there is sufficient evidence to reject H3 with regard to the number of lines (Prob > |z| = 0.0199) and words (Prob > |z| = 0.0321). Hence, it can be considered that the number of lines and words to present the earnings changes in the favorable and unfavorable performance periods.

To check for differences in the position and location of the text that presents the earnings in the periods under analysis, hypothesis 4 was elaborated. A difference is expected in the location of the texts addressing the earnings in the periods studied. It can be observed in Table 4 that there is insufficient evidence to reject H4 with regard to the position of the paragraph (Prob > |z| = 0.3595) and line (Prob > |z| = 0.2575). Hence, the difference between the position of the texts related to the earnings in the favorable and unfavorable performance periods is not statistically significant.

4.2 Analysis of the Annual Income Reports

To qualitatively enhance the discussion of how the information on the companies' performance is presented in the management reports, in this part, signs of impression management are presented that were found in these reports in the selected sample.

Although many aspects can be observed in the analysis of the management reports, considering the disclosure of the financial information, this study does not intend to exhaust them, in view of the extent and complexity of the theme. Hence, this analysis was concentrated on three aspects: 1) the observation of the use of specific financial terms in the management report; 2) the format in which the annual income are reported; and 3) the use of different financial terms to specifically present the annual income. This qualitative reading could help the stakeholders of the publicly traded companies to stay alert when reading the management report.

Concerning the first point in this analysis, based on the reading of the reports, it is observed that the terms normally used to represent the annual income are used differently in periods of favorable (2009) and unfavorable performance (2010).

The usual terms to present earnings are profit, net profit, net earnings, loss and net loss, which were analyzed in this research. When grouping these more usual terms under the term annual income, it is verified that, in the favorable performance period, 46 occurrences of this group of terms were found, against 33 in the unfavorable performance period. Therefore, a drop by 28.26% is observed in the number of occurrences related to the annual income in the management reports as a whole.

Also, with regard to the financial terms used in the management reports, others terms can be found that represent performance, such as Gross Margin and Ebitda, with an upward variation between one period and the other. As observed, in the study periods, the use of the term Gross Margin increased by 100%, from nine occurrences in the favorable performance period to 18 in the unfavorable period. As regards the term Ebitda, an increase by 133% was observed, from 51 occurrences in the favorable to 119 occurrences in the unfavorable performance period.

This strategy can be observed, for example, in a company from the Food and Beverage sector, which presented the following paragraph at the start of the first page of its management report in 2010, the unfavorable performance period:

> The year 2010 was marked by several conquests. The integration of Pilgrims Pride in our operations Americanas stood out, as well as that of Bertin in our Mercosur operations. In the operational context, it is important to highlight the growth in our sales, which exceeded R$55 billion, with an organic growth of 14.2% and an Ebitda of R$ 3.75 billion, moving from an Ebitda margin of 3.7% in 2009 to 6.8% in 2010.

The term Ebitda is highlighted in the company report as a whole, with a position variation between one period and the other. In the previous year, however, when the company showed a favorable performance, the same term only appears on the 25th page of the management report, accompanied by the earnings.

In the management reports of the companies in the study sample, it is verified that, despite the reduction in the total and average numbers of pages, paragraphs and lines, displayed in Tables 1 and 2, the use of the terms Ebitda and Gross Margin increases substantially in the unfavorable performance period. Besides this increase, the occurrence of the term Ebitda in the unfavorable period is more expressive than the result terms.

The managers' choice represents their strategy to further emphasize other terms than the earnings for the unfavorable period, thus showing positive values. The approach of the visual presentation effects described in Brennan, Guillamón-Saorín and Pierce (2009) can be observed in this strategy, emphasizing the terms in the course of the texts through repetition and the use of performance comparisons through reference points in the reports.

The second point in this analysis is related to the specific presentation of the texts that report on the earnings for the study period, in which the analysis is made in the paragraph where the earnings are reported. It was verified that, in the favorable performance period, two companies did not include any text on the annual income and three presented qualitative texts, without including the annual income. This number of companies changes in the unfavorable performance period, with an increase to five companies that did not present text on the earnings and a reduction to two companies with qualitative texts.

As an example of qualitative text used to present the result of the favorable financial period, the management report of one company from the sector Others can be observed, focused on construction and engineering, in 2009:

> Profitability – the increase in the net profit in relation to the previous year is based on the growth in the companies' activities in the Construction area, which due to the enhanced competition, in a market share expansion strategy, partially compromised the profitability margins. Thus, the presented service costs represented 74.61% of the Operating Income. In 2008, these costs represented 78.71% of the Operating Income.

For the unfavorable performance period, as an example of qualitative texts used to present the result, the report of a company from the Food and Beverage sector is observed in 2010:

> Analysis of the Annual Operating Income – at year-end 2010, there was a negative operating income due to the shipment blocking problems to Argentina, due to the negative exchange rate variations and the drop in the practices practiced by the sector in the internal market.

In the unfavorable performance period, a reduction was observed in the number of lines and, consequently, in the number of words to present the income, according to Table 3. For the periods studied, it was observed that 46.66% of the companies reduced the number of lines to report the income, while 36.67% maintained this number and 16.66% increased the number of lines. As an example of this reduction in the number of lines, a company from the sector Others, focused on hotel services, used six lines and 71 words from the management report to express its favorable result (2009):

> At year-end 2009, BHG obtained a net profit of R$ 2.6 million, basically in function of the impact of three main factors: (i) improvement in the Company's operating performance and growth of the hotel network; (ii) asset equivalence in discontinued businesses to the amount of R$ 15.3 million; (iii) and reversal of provision for reduction to the salvage value of assets to the amount of R$ 7.8 million.

When reporting an unfavorable result in 2010, however, the same company changes its presentation strategy, using one line and 16 words from the management report to express its result:

> At year-end 2010, BHG presented a net loss of R$ 6,172 thousand.

Thus, the manager's strategy is to present the results more extensively in favorable performance periods and bad results in a more objective manner in unfavorable performance periods. Therefore, signs of impression management are observed to reduce the exposure of the result in negative performance periods. These findings are confirmed in Beattie and Jones (2000), who assert that there is evidence that the companies try to enhance positive news and minimize negative news.

Although the use of terms in the management reports has already been discussed here, in this third and final point of analysis, the use of different terms to specifically present the annual income was verified. The analysis of the management reports in the study period showed that the terms net profit and loss are replaced by other terms to represent the result, terms that in many cases do not report the real annual net income.

For the favorable performance period, it is observed that 15 companies presented the term net profit, 50% of the companies, to express the net annual income, while the other 15 companies in the sample, 50%, presented, besides the companies that did not present the income, other terms: activity result, positive result, profit (without specifying what kind of profit), earnings, operating income, adjusted net profit, net operating income and gross profit. In a company from the sector Others, which is active in real estate exploitation, the term adjusted net profit was observed, presented in the favorable performance period to report the annual income:

> In 2009, the Company registered an adjusted net profit of R$ 25.8 million, against a loss of R$ 4.7 million in 2008. Without the linearity effects (*), the **adjusted net income** for 4T09 would correspond to R$ 10.2 million, representing a growth by 189.8% in relation to 4T08. (Our highlights)

For a company from the sector Others, active in hotel services, in the favorable performance period, the use of the term net operating income was observed to report the annual income:

> The **Net Operating Income** showed a result 9% higher when comparing 2009 x 2008, while the RevPar surpassed the year before by 15%. (Our highlights)

In addition, for the favorable performance period, it was evidenced that the closest term a company from the Textile sector used to refer to the annual income is the gross profit:

> **Gross profit** – The **gross profit** dropped 1.2%, from R$353.0 million in 2008 to R$348.9 million in 2009. This is the result of the Company's efforts to cut costs and improve the sales mix. (Our highlights)

In the unfavorable performance period, it was observed that 16 companies used the term loss, 53.33% of the companies, to express the negative result for the period, while the other 14 companies in the sample, 46.67%, presented other terms, besides those companies that did not present the result: activity result, negative result, net profit in the 4^{th} term, adjusted net earnings, EBITDA, positive result, operating income and gross profit. It was observed that a company from the sector Others, active in real estate exploitation, used the term adjusted net income to refer to the annual income, during the unfavorable performance period:

> In 4T10, the company registered a negative adjusted net income of R$ 14.4 million, in comparison with the adjusted net profit of R$ 7.6 million in 4T09. In 2010, the negative **adjusted net income** corresponded to R$ 11.3 million, when compared to the adjusted net profit of R$ 25.8 million in 2009. (Our highlights)

As observed, a company from the sector Others, active in hotel services, did not use the term loss during the unfavorable performance period, and directs the user to the term EBITDA to present the annual income:

> The **Ebitda** (Operating Earnings before Financial Expenses, Taxes, Depreciation and Amortization) for 2010 corresponded to R$9,267, an evolution by 323% in relation to the Ebitda of the year before, which amounted to R$2,044. (Our highlights)

For the unfavorable performance period, for a company from the Textile sector, the term loss was not present in its report, driving the reader towards other positive earnings variables like the gross profit:

> **Gross profit** – The **gross profit** increased 14.2%, from R$337.7 million in 2009 to R$385.7 million in 2010, due to the combination of the abovementioned points. (Our highlights)

It was also verified that only one company justified its unfavorable performance in function of the adoption of the international accounting standards, more specifically the adoption of CPC - 29 Biological Assets, and that two other companies reported that this adoption may have affected their unfavorable performance. None of the companies quantified the impact, or possible impact of the adoption of the international accounting standards on their performance, nor did they attribute their favorable performance to the adoption of the same standards.

Based on the analyses observed, it can be considered that the managers may have practiced impression management through their discretion in using other accounting-financial indicators that do not represent the net income to indicate positive aspects in their perspectives or to highlight factors that alter the external expectations with regard to the organizations' conditions. The selectiveness approach described in Brennan, Guillamón-Saorín and Pierce (2009) can be observed in this strategy when verifying that the managers aim to evidence a selection of performance indicators to picture the company in the best possible way.

5. Final Considerations

This study analyzed how the information on the annual income of publicly traded companies traded on BM&FBovespa are presented in the management reports with regard to the profit period in 2009 and the loss period in 2010.

As regards the length of the reports, four hypotheses were tested to verify how the dissemination takes place. The results found, with respect to the quantitative analysis, indicate that, in the sample analyzed, there is a difference in the length of the texts specifically aimed at presenting the income between the favorable and unfavorable performance periods. In the favorable period, the texts tend to be more extensive.

When analyzing the terms, financial indicators, used to present the annual income, statistically significant differences are observed for Ebitda, gross margin and terms related to the income (profit, net profit, loss, net loss, income and net income) between one period and the other. As the term gross profit shows no statistically significant difference, however, the hypothesis tested for the use of financial indicators as a whole was partially accepted.

As regards the length of the management reports as a whole, the results indicate that the number of pages, paragraphs, tables, graphs, figures, characters and connectors did not differ between one period and the other. The amount of lines shows a significant difference though. Hence, the hypothesis tested for the length of the management report as a whole was partially accepted. Concerning the specific position of the text that presents the income, no significant difference exists in this position between the study periods.

The content analysis of the text reports presents signs of impression management in the three points addressed in this study phase. The reports show the repetition of financial terms with greater emphasis on the Ebitda and gross margin, which were more frequent in the favorable than in the unfavorable performance period. The reduction in the number of lines and words used to specifically express the income in the unfavorable period when compared to the favorable period can be considered as a way to reduce the exposure of the losses. The financial terms used to present the annual income specifically indicated the selective approach, where the managers use performance indicators that better represent the company income.

As study limitations, the sample size and the researcher's own limitation in relation to the content analysis are highlighted. The sample was obtained due to the method used to achieve the study objective of investigating the same companies in profit (2009) and loss periods (2010). Hence, the results and conclusions presented are restricted to the selected sample. It is important to highlight that making a loss can be part of the business due to conjuncture changes or internal reorganizations, and that other financial indicators can more appropriately represent the organizations' economic reality in these periods.

For the sake of future research, the analysis of the impression management in the management reports is suggested, using a larger sample of companies, throughout longer periods and after the full adoption of the IFRS. The literature analysis demonstrated that studies addressing the use of financial graphs, images and figures are an expanding area.

6. References

Aerts, W. (2005). Picking up the pieces: impression management in the retrospective attributional framing of accounting outcomes. *Accounting, Organizations and Society,* 30(6), 493-517. doi: 10.1016/j.aos.2004.07.001.

Bardin, L. (2007). *Análise de conteúdo* (3ª ed.). Lisboa: Edições 70.

Beattie, V. A. & Jones, M. J. (2000). Impression management: the case of inter-country financial graphs. *Journal of International Accounting, Auditing & Taxation,* 9(2), 159-183. doi: 10.1016/S1061-9518(00)00030-6.

Beattie, V. A. & Jones, M. J. (2002). Measure distortion of graphs in corporate reports: an experimental study. *Accounting, Auditing & Accountability Journal,* 15(4), 546-564. doi: 10.1108/09513570210440595.

Bloomfield, R. (2008). Discussion of "annual report readability, current earnings, and earnings persistence". *Journal of Accounting and Economics,* 2(3), 248-252. doi: 10.1016/j.jacceco.2008.04.002.

Brennan, N., Guillamón-Saorín, E. & Pierce, A. (2009). Methodological Insights: Impression management: developing and illustrating a scheme of analysis for narrative disclosures – a methodological note. *Accounting, Auditing & Accountability Journal,* 22(5), 789-832. doi: 10.1108/09513570910966379.

Clatworthy, M. A. & Jones, M. J. (2006). Differential patterns of textual characteristics and company performance in the chairman's statement. *Accounting, Auditing & Accountability Journal,* 19(4), 493-511. doi: 10.1108/09513570610679100.

Gallon, A. V. & Beuren, I. M. (2007). Análise do conteúdo da evidenciação nos relatórios da administração das empresas participantes dos níveis de governança da Bovespa. *UnB Contábil*, 10(2), 11-42.

Guimarães, T. N. (2011). *Conflito de informações em relatórios anuais: um comparativo entre seções narrativas e o desempenho financeiro de empresas listadas na Bovespa.* Dissertação de mestrado, Fundação Instituto Capixaba de Pesquisas em Contabilidade, Economia e Finanças, Vitória, ES, Brasil. Retrieved from http://www.fucape.br/_public/producao_cientifica/8/Disserta%C3%A7%C3%A3o%20Thiago%20Neiva%20Guimaraes.pdf

Hendriksen, E. S. & Breda, M. F. van (2009). *Teoria da Contabilidade* (5ª ed.). São Paulo: Atlas.

Instrução CVM n. 457, de 13 de julho de 2007 (2007). Dispõe sobre a elaboração e divulgação das demonstrações financeiras consolidadas, com base no padrão contábil internacional emitido pelo International Accounting Standards Board - IASB. Diário Oficial da União. Brasília, DF: Comissão de Valores Mobiliários-CVM.

Iudícibus, S. (2010). *Teoria da Contabilidade* (10ª ed.). São Paulo: Atlas.

Jensen, M. C. & Meckling, W. H. (1976). Theory of the firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 3(4), 305 – 360. doi: 10.1016/0304-405X(76)90026-X.

Lopes, J. E. G., Ribeiro, J. F., Filho, Pereira, D. M. V. G., Pederneiras, M. M. M., Silva, F. D. C. da & Santos, R. (2010). Um estudo da relação entre o lucro contábil e o disclosure das companhias abertas do setor de materiais básicos. *Revista de Administração e Contabilidade da Unisinos – BASE*, 7(3), 208-220.

Lopes, A. B. & Martins, E. (2005). *Teoria da contabilidade uma nova abordagem*. São Paulo: Atlas.

Mendonça, J. R. C. & Amantino-De-Andrade, J. (2003). Gerenciamento de impressões: em busca de legitimidade organizacional. *Revista de Administração de Empresas – RAE,* 43(1), 36-48.

Osma, B. G. & Guillamón-Saorín, E. (2011). Corporate governance and impression management in annual results press releases. *Accounting, Organizations and Society,* 4(5), 187-208. doi: 10.1016/j.aos.2011.03.005.

Patelli, L. & Pedrini, M. (2013). Is the optimism in CEO´s letters to shareholders sincere? Impression management versus communicative action during the economic crisis. *Journal of Business Ethics,* 1(10), 1-16. doi: 10.1007/s10551-013-1855-3.

Plagliarussi, M. S. & Scotá, R. (2009). O uso do disclosure narrativo em relatórios anuais corporativos para inferência da continuidade das empresas. *Revista de Contabilidade e Organizações – FEARP/USP,* 3(5), 3-24.

Silva, C. A. T. & Rodrigues, F. F. (2006, julho). Análise das variáveis que influenciam as informações divulgadas nos relatórios da administração das companhias abertas brasileiras: um estudo empírico nos anos de 2001 a 2003. *Anais do Congresso USP de Controladoria e Contabilidade,* São Paulo, SP, Brasil, 6.

Silva, C. A. T. & Rodrigues, F. F. (2006). Análise das variáveis que influenciam as informações divulgadas nos relatórios da administração das companhias abertas brasileiras: um estudo empírico nos anos de 2001 a 2003. *Anais do Congresso USP de Controladoria e Contabilidade,* São Paulo, SP, Brasil.

Silva, C. A. T., Rodrigues, F. F & Abreu, R. L. (2007). Análise dos relatórios de administração das companhias abertas brasileiras: um estudo do exercício social de 2002. *Revista de Administração Contemporânea – RAC,* 11(2), 71-92.

Tessarolo, I. F., Pagliarussi, M. S. & Luz, A. T. M. (2010). The justification of organizational performance in annual report narratives. *Brazilian Administration Review - BAR,* 7(2), 198-212.