TAMARA JOURNAL Vol 4 Issue 4.2 2005 ISSN 1532-5555

Manufacturing Corporate Identities: An Analysis of Financial Statement Footnote Disclosures

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Abstract

Financial reporting of organizational performance is facilitated primarily through financial statements and the related supplemental disclosures found in the annual report or Form 10-K. Standardized financial statements, such as the income statement, balance sheet and statement of cash flows, are mostly uniform in format and thus provide for inter-firm comparisons of various financial metrics. This "boilerplate" format provides for simple "net income" or "current assets" comparisons between firms given the uniformity of the content contained within each financial statement; however, there are supplemental disclosures contained within these reports that should provide additional information to illuminate and thereby enhance the financial statement content.

We previously studied a McDonald-ized or scripted boilerplate discourse in place for corporate financial reporting that extended beyond the financial statement format (Hillon & Smith, 2004). Due to the lack of specific requirements on management discussion and analysis and financial disclosure footnote formatting, the prevailing theory on organizational identity suggests that firms should use financial narratives to differentiate themselves from their competitors thereby manufacturing their corporate identity. Given this, we expected to find a wide array of supplemental reporting content that was also as unique and differentiable as the firms themselves. To test this we obtained a random sample from the S&P 500 Index of firms and examined the frequency distributions of the number of footnotes and related page number totals contained in each of the supplemental financial footnote disclosures from each firm within our sample. We found a clustering tendency, which is suggestive of a homogeneous rather than heterogeneous firm identity. We next performed a content analysis of the supplemental footnote disclosures. When we categorized the footnotes by actual title using the firm with the fewest number of footnotes as the minimum, over 70% of the sample firms had identical or similar footnote titles. We then analyzed the related footnote content and found an even stronger relationship with over 90% of the firms reporting the same or similar content. The implications of our preliminary findings are important in light of corporate identity as they are more supportive of a homogeneous reporting regiment rather than a heterogeneous firm identity. We conclude with these implications and the need for further research in this area.

Introduction

The origins of research into organizational identity can be traced back much further than the field of organization studies itself. For instance, the looking-glass self was a phrase coined by one of the luminaries in the field of sociology (Cooley, 1909) to describe the construction of identity as a reflexive socialization process. We look into the mirror of society to see how others view and judge our behavior, and over time, a

distinctive identity is shaped and constructed (Tischler, 2002). Corporate identities can also be viewed as the products of reflexive social interaction, as annual reports, financial disclosures, and feedback from both shareholders and regulating entities constitute a process that is analogous to looking into a mirror to both assess and influence the perceptions of society.

Glynn, Barr, & Dacin (2000, p. 730-731) have observed that "because an identity is self- reflexive, it influences how the organization's strategic issues are defined and resolved." However, the major difficulty in assessing the social influences on identity construction is the necessity of identifying the salient contextual factors that enable separation of an organization from its environment, as well as categorization of components within the organization. This continual search for novel dimensions of comparison implies that social identities never completely coalesce around static values and terminal meaning. Also, the concepts of status and legitimacy are presumed to be transient. Hence, motivated by an imbalance in social status, an organization that compares unfavorably in strategic competencies to its competitors may attempt to showcase other more favorable attributes to enhance its identity (Chattopadhyay, Tluchowska, & George, 2004).

Hogg & Terry (2002, p. 125) suggested that benchmarking with a set of differentially prestigious organizations is "one way in which organizations may deliberately manipulate the inter-group social comparative context." Financial data in both quantitative and qualitative form is the lingua franca of benchmarking studies, thus, within a social identity theory frame, one would expect to find salient differences in form and content of all such identity defining prototypes. For our study, this implies that creative responses to ameliorate the perceived inequalities among corporations should appear, at least from time to time, in the identity construction tools available to each organization. Thus, we should expect to occasionally see distinctive form and content in the financial metrics and narratives of corporate disclosures. At the very least, we should expect to see some form of stratification based on prestige or attempts at social mobility.

Previous research has suggested a need for further exploration of this phenomenon, as Hillon and Smith's (2004) financial socialization pilot study found more of a McDonaldized or scripted "boilerplate" discourse in place for corporate financial reporting. Due to the lack of specific requirements on management discussion and analysis and financial footnote disclosure formatting, the prevailing theory on organizational identity suggests that firms should use these financial narratives and metrics to differentiate themselves from their competitors. The capital markets need financial information to differentiate firms and thereby avoid the problem of adverse selection. According to Scott (2003, p. 11-12):

> To understand how financial accounting can help to control the adverse selection problem, it is desirable to have an appreciation of how investors make decisions. This is because knowledge of investor decision processes is essential if the accountant is to know what information they need. ... The accounting reaction to securities market efficiency has been full disclosure, that is, the supplying of large amounts of information to help investors make their own predictions of future firm performance....the form of the disclosure does not matter – it can be in notes, or in supplementary disclosures such as reserve recognition accounting and management discussion and analysis, in addition to the financial statements proper.

From another perspective, the FASB issued a pronouncement addressing the

usefulness of financial disclosures in Statement of Financial Accounting Concept (SFAC) Number 2. This authoritative pronouncement essentially defined the relevance of financial information in assisting the financial statement users to form their own understanding of financial events relative to their expectations. In addition to present events, the financial information can also assist the user in forming predictions of events such as future profitability. SFAC 2 (1996, p. 1035) stated in part:

> Relevant accounting information is capable of making a difference in a decision by helping users to form predictions about outcomes of past, present, and future events or to confirm or correct prior expectations. Information can make a difference to decisions by improving decision makers' capacities to predict or by providing feedback on earlier expectations. Usually, information does both at once, because knowledge about the outcomes of actions already taken will generally improve decision makers' abilities to predict the results of similar future actions. Without knowledge of the past, the basis for a prediction will usually be lacking. Without an interest in the future, knowledge of the past is sterile.

From an organizational perspective, Scott (1981, p. 89) noted that "interaction with the environment is essential for open system functioning." Information is an essential link between the firm and the environment in which it operates and the financial information disseminated by a firm is extremely important to outside investors and financial decision-makers, the primary constituents of the capital markets. Authoritative literature in accounting and management presupposes that the financial information disclosed by management will be understood and appropriately utilized by the capital markets (Jones & Shoemaker, 1994), regardless of the accounting methods applied. However, as the gatekeeper to essentially perfect information about the firm, management controls access to sensitive proprietary information. Accordingly, management selectively offers information disclosures to the capital markets, rather than all firm information, in order to shape its corporate identity.

The FASB stated in SFAC 1 (1996, p. 1018) that: "the usefulness of financial information as an aid to investors, creditors, and others in forming expectations about a business enterprise may be enhanced by management's explanations of the information. Management knows moreabout the enterprise and its affairs than investors, creditors, and other "outsiders"

Given that it has this superior information, management may choose to selectively communicate financial information to those outside of the firm by means of financial disclosures. Thus, management must balance the needs for disseminating information in the interest of securities market efficiency against its own needs for continually shaping and constructing its social identity. The FASB addressed this responsibility for balanced reporting by management in SFAC 1 (1996, p. 1014) as follows:

> Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.

In light of management's dual purposes for information dissemination, we cannot overemphasize the necessity for users of their financial disclosures to exercise due diligence in attaining a balanced understanding of the information content to thus make judicious investment decisions.

Failure to fully observe and

comprehend all of the disclosed financial information does not adversely impact the quality of the financial information. However, such a partial view into Cooley's (1909) looking-glass of reflexive identity would likely distort the reflected image, contrary to the firm's intent. Thus, in anticipation of potential image distortion, we would expect firms to overemphasize, rather than underplay, their salient and distinctive features through all channels at their disposal. Supplemental financial disclosures were intended by the FASB to aid in clarifying the unique business circumstances that arise in the life of every firm. Information reifies the corporate identity, and thus, we would expect supplemental financial disclosures to enable investors to further differentiate among firms. To test this assertion, we turned our attention to a practical assessment of the management's use of financial information as a versatile tool of corporate identity construction.

Methods

We took a random sample of 30 companies from the Standard and Poor 500 Index and then obtained the latest year end annual report or Form 10k for each firm selected. Next, we analyzed the form and content of the footnote disclosures for the financial statements contained therein with both quantitative and qualitative approaches. Supplemental footnote disclosures provide needed illumination of the basic set of required financial statements contained in each annual report or Form 10k. These minimum expectations for statement disclosures quite rationally should lead to a uniform "boiler plate" financial statement format, as "organizational fields establish norms that create cognitive expectations for other organizations to follow" (Glynn, Barr, & Dacin, 2000, p. 730). However, the same line of reasoning should not apply to the form and content of supplemental footnotes that purport to illuminate firm-specific elements of the financial statements. Hence, one should very reasonably not expect to find them presented in a uniform or "boiler plate" format.

Next, to facilitate a quantitative content analysis, we began by counting the number of footnote disclosures as well as the related number of pages from each company report from our sample set. These supplemental footnote disclosures provide needed illumination of the basic set of required financial statements contained in each annual report or Form 10-K. While we concede the necessity of a uniform "boiler plate" financial statement format our concern was that the supplemental footnotes that provide additional specific information in order to illuminate the financial statements were not themselves a uniform or "boiler plate" format. We then observed the frequency distributions of the total number of footnotes and the total number of pages containing the footnote disclosures for each firm.

After counting the total number of footnotes and related number of total pages contained in each company report and assessing the sample through descriptive statistics, our next step was to classify and categorize the footnote disclosures by title and then content. We designated the firm with the fewest number of footnotes as our minimum value disclosure and then compared the other firms in the sample by footnote title and then by content to that minimum value firm.

Similarities and differences were then observed for both footnote title used as well as for actual footnote content. For purposes of categorization, our table for the footnote titles consisted of a matrix with the actual titles used in the minimum number of notes firm with four categories of footnote titles classified as either: (a) Same, (b) Similar, (c) Different, or (d) Not Found. For a footnote title to be classified as "Same" the title would have to be identical. For example, the footnote title Income Taxes was found in the minimum footnote firm. Thus, for any firm to be categorized as "Same," the title would have to be labeled identically as Income Taxes. A footnote title of Provision for Income Taxes would be classified as "Similar," as the title includes income Taxes, but is not strictly identical. If references to income taxes were

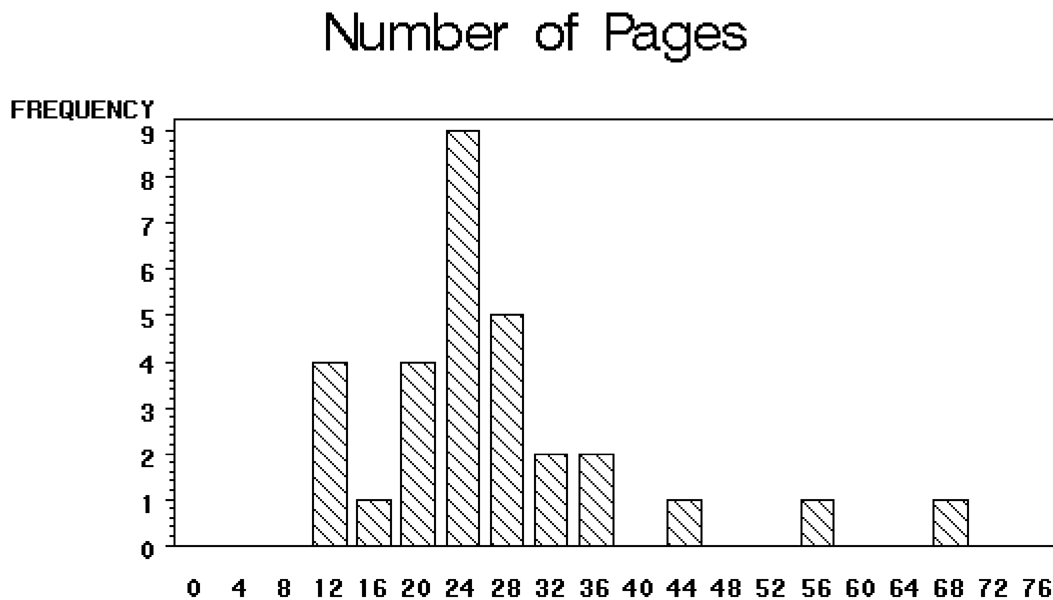
included in a footnote section under a title such as Deferred Obligations, then the classification would be “Different.” Finally, if there were no provision for income taxes in the disclosure notes and thus, no related footnote title, then “Not Found” would be the appropriate classification. We then reviewed the footnote titles matrix for any related content of the footnote disclosures.

The purpose of this exhaustive review was to further clarify the categorization of the footnotes by incorporating the content. For example, Firm A may have had lease activity disclosed in the footnotes under the title of “Leases”. Firm B may have also had leasing activities but disclosed the content in a footnote titled “Commitments”. By only considering the footnote titles Firm A would be categorized as having lease related disclosures whereas Firm B would not be categorized with leasing activities. This potential obfuscation is thus mitigated when content is considered for purposes of categorization. Accordingly, both firms would be properly categorized as “Similar” in the footnote content matrix and thereby elucidate the similarities among firms that may not be apparent by only considering the footnote titles. A presentation and discussion of the descriptive statistics for our analysis follows in the next section.

Discussion

Our initial quantitative content analysis focused on the number of footnotes and the number of related pages found in each of the financial reports of the firms in our sample. By examining the distributions of these quantifiable measures among the sample, we would expect to observe a wide distribution given the differences among firms and their efforts to create distinctive firm identities. The frequency distribution for the number of pages can be seen in Figure 1.

Figure 1. **Frequency Distribution of Number of Pages of Footnotes.**



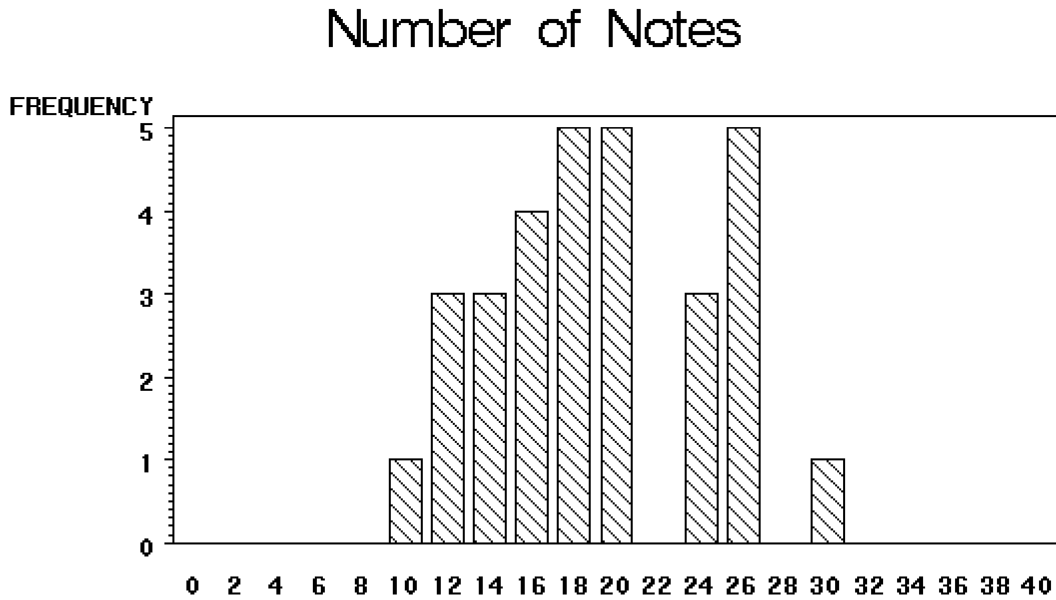
The mean number of pages was 26.3 with a standard deviation of 12.2. The large standard deviation is primarily due to a few firms with pages of footnote disclosures exceeding twice the mean. While the minimum number of footnote pages was 10.0 and the maximum number was 68.0, the large range of 58.0 pages can easily be attributed to the few outlying firms. Notwithstanding these firms, the distribution centers on the median

value of 23.0 pages. Further, while some difference in the total number of pages may possibly be attributed to differences in font size or spacing, such differences did not significantly affect the total page count for each firm.

We were initially surprised by this relatively tight distribution, as there was no coherent reason to expect that firms would go to such similar lengths in disclosing supplemental information concerning firm-specific practices. While we would reasonably expect some firms' footnotes to have similar content, we would not expect to find such a clustering of pages from a randomsample of firms across multiple industries in the S&P 500. This finding would be more supportive of firm homogeneity, rather than of distinctive or heterogeneous firm identity.

Next, the frequency distribution of the number of footnotes for each firm can be seen in Figure 2.

Figure 2. **Frequency Distribution of Number of Footnotes.**



We examined the distribution of the number of supplemental footnotes contained in each financial report. The mean number of notes was 18.5 with a standard deviation of 5.2. This distribution also centered on the median value of 18.0 notes. The minimum number of footnotes was 10.0 and the maximum number was 29.0 with a range of 19.0.

As in the case of the page count, we were also initially surprised by this distribution, as we expected more dispersion of the total number of footnotes. Even though the shape of the distribution was not toward a normal bell curve, there was a clustering tendency toward the median. This finding would also be more supportive of firm homogeneity, rather than heterogeneous firm identity.

In sum, the distributions from the quantitative content analysis seem to suggest homogeneity in supplemental financial disclosures. While we would expect a "boiler plate" similarity in the actual formatted financial statements, we would not expect this similarity to emanate from the supplemental disclosures.

Our next step was to focus on the

footnotes themselves in order to distill any similarities or differences with respect to the actual footnote titles used and the overall topical content contained therein. Table 1 includes the footnote titles used for each of the firms based upon the minimum firm value of ten footnotes.

***Table 1.* Actual Footnote Classifications by Title**

No.	Footnote Title	Identical	Similar	Different	Not Found
1	Summary of Significant Accounting Policies	21	9		
2	Long-Term Debt	5	18	4	3
3	Income Taxes	29	1		
4	Employee Stock Plans	2	21	3	4
5	Leases	10	7		13
6	Employee Benefit Plans	6	24		
7	Basic and Diluted Weighted Average Common Shares	1		15	14
8	Commitments and Contingencies	20	10		
9	Acquisitions and Dispositions	1	16	5	8
10	Quarterly Financial Data (Unaudited)	8	12		10
	Totals	103	118	27	52
	Percentage of Total	34.34%	39.33%	9.00%	17.33%

When the footnotes were categorized by title, 73.67% were found to be either identical or similar. This clustering suggests that firms may be creating standardized homogeneous identities through their financial disclosures, rather than distinctive organizational identities given such a large percentage of "Same" and "Similar." While an exact "Boiler Plate" footnote regiment is not required under GAAP, it is quite an interesting finding that the footnote titles were so similar in description.

Next, for a more qualitative assessment and further refinement of the previous classifications, we read and properly reclassified the actual footnote content, rather than just considering the title used. For example, when we categorized the footnotes by the title Leases, 13 of the firms did not have any footnote title with the term Leases in it.

However, we found references leases in 11 of those 13 firms, but the content was found in various other footnote titles such as Commitments and Contingencies. The results of this reclassification based upon actual content are summarized in Table 2.

After reclassification of the footnotes based upon actual content, the total percentage of identical and similar content was a staggering 94.0%. This data set is even more suggestive of a standardized or homogenized approach to identity construction, as opposed to the heterogeneous identities that would normally be expected from an array of purportedly distinctive companies. Thus, a contradictory

finding of no support for our original research proposition requires us to revisit our underlying theoretical frame.

***Table 2.* Actual Footnote Classifications by Content**

No.	Footnote Content	Identical	Similar	Different	Not Found
1	Summary of Significant Accounting Policies	21	9		
2	Long-Term Debt	5	24	0	1
3	Income Taxes	29	1		
4	Employee Stock Plans	2	28	0	0
5	Leases	10	18		2
6	Employee Benefit Plans	6	24		
7	Basic and Diluted Weighted Average Common Shares	1	29	0	0
8	Commitments and Contingencies	20	10		
9	Acquisitions and Dispositions	1	26	1	2
10	Quarterly Financial Data (Unaudited)	8	10		12
	Totals	103	179	1	17
	Percentage of Total	34.33%	59.67%	0.33%	5.67%

Conclusion

Our initial findings are suggestive of a homogeneous rather than heterogeneous regiment of supplemental financial disclosures. In concluding that firms apparently use their supplemental financial disclosures to decrease distinctiveness among peers, we end this study with a better

empirical understanding of the complex phenomenon of corporate identity construction. However, the theoretical assumptions of differentiation from previous research may need to be reconsidered in light of our preliminary findings and thus may require that we now consider other sources to provide a more meaningful theoretical basis for future research. Echoing Albert & Whetten (1985), Pratt & Foreman (2000) explored how organizations manage the multiple competing and often conflicting identities within the collective by assessing their self-identified central, distinctive, and enduring attributes. One of the strategic benefits of a diversity of identities noted in their study is that a minimal set of identities serves to increase the organization's repertoire of responses to a complex environment. In essence, a corporate identity is the superficial reflection of the organization's underlying requisite variety. We attempted to extend this line of reasoning by positing that the firm's financial disclosures should also constitute just such a superficial representation of the underlying distinctive competencies. The strategic competitive advantage of an organization must in some way distinguish it from itscompetitors, therefore we quite reasonably expected to see specific and unique features in the form and content of the annual reports – established tools of social identity construction – for the S&P 500 firms in our random sample. Ironically, a strategic focus on core competencies to create a distinctive competitive advantage can work against adaptive capacity by reducing variety within the organization (Glynn, Barr, & Dacin, 2000).

Hence, a possible explanation for the apparent propensity of firms to manufacture standardized corporate identities through their financial disclosures is that many organizations are pursuing variety-reducing strategies to differentiate themselves. In contrast to this strategic orientation, Glynn & Abzug (2002, p. 267) followed an institutional theory frame in arguing that symbolic isomorphism or "the resemblance of an organization's symbolic attributes to those of other organizations within its institutional field" conveys legitimacy. Our theoretical contribution beyond those of the two previous research citations was to show that both strategic and symbolic isomorphism were not confined by industry, interorganizational, or institutional fields, as our sample was randomly drawn from the entire S&P 500.

Therefore, our findings suggest that these theoretical explanations may be insufficient for exploring identity construction. A more expansive secondary socialization (Berger & Luckmann, 1966) model of organizational identity, as indicated by previous research (Hillon & Smith, 2004), may be necessary in order to capture and comprehend a more profound perspective on identity construction through financial narratives and other disclosures of organizational performance. Such an approach could feasibly provide broader theoretical support for the clash of objectives observed in firms pursuing variety-reducing strategies while simultaneously attempting to create distinctive corporate identities.

While we initially attempted to analyze the process of corporate identity construction through supplemental footnote disclosures, we now realize that we have only taken a first step toward revealing the true nature of an apparently homogeneous "boilerplate" supplemental disclosure regiment. Additional research to examine the Management Discussion and Analysis (MDA) section of the annual reports may be needed to provide further insight into this identity de-constructing affinity for standardized reporting and information disclosure.

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