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They are among the most common of corporate communications to investors – forward-looking statements about company prospects, accompanied by warnings that these projections could differ materially from actual future results. Commonplace though such cautionary disclaimers may be, there is much controversy about their value. Do they do more to foster useful information-sharing or to give companies, as one plaintiffs attorney has said, a "license to lie"? Do they keep investors from being unduly swayed by forward-looking statements, or are they more like water off a duck's back?

The questions arise from a 1995 federal law, the Private Securities Litigation Reform Act (PSLRA) – specifically from a provision that offers firms protection ("safe harbor," as it is called) from investor claims that forward-looking statements were misleading. Such claims, the act provides, can be summarily dismissed in court if forward-looking statements were identified as such and were accompanied by cautionary disclaimers.

Now a study in one of the **American Accounting Association's** scholarly journals, ***The Accounting Review,*** sheds new light on these disclaimers by investigating their effects on relatively unsophisticated investors. The new research suggests that, while supposedly protective of companies and investors alike, disclaimers tend to do less to protect investors from losses than to protect the firms that occasion those losses.

"Cautionary disclaimers provide nonprofessional investors little protection from the economic harm that can result from undue reliance on forward-looking statements," write the study's co-authors, H. Scott Asay of the University of Iowa and Jeffrey Hales of Georgia Institute of Technology. In contrast, such disclaimers "reduce the extent to

The first is that, when nonprofessional investors are presented with either of two press releases announcing earnings results for the same company, one containing optimistic forward-looking statements the other not, the former elicits a markedly higher valuation of the firm than the latter. The finding, the authors observe, "is consistent with regulatory concerns that investors may not sufficiently distinguish between the reliability of backward- and forward-looking statements."

The second finding is that, although disclaimers alert investors to the potential of being misled by forward-looking statements, they have little or no effect on their valuation of the company issuing them. In the words of the study, although the investors "process the disclaimer as a warning…[ít] has little impact on the extent to which they incorporate information from positive forward-looking statements into their valuation judgments [and so provides] little protection from the economic harm that can result from undue reliance on forward-looking statements."

In sum, even though forward-looking statements may provide investment information of value, there is a need for *something* to protect investors from being misled by them. And, although cautionary disclaimers as now constituted have some effect, they fall short of doing the job.

The study's findings derive principally from two experiments carried out with subjects enlisted through a crowd-sourcing Internet marketplace often used in social-science research. In the first experiment 241 participants were presented with brief background information of some 100 words in length about a hypothetical firm described as "one of the world's premier beverage companies, refreshing consumers for more than 60 years." Participants were asked how low or high they would value the firm's common stock on a scale from zero to 100, after which they were presented with the company's press release on its latest quarterly earnings. The press release revealed results that fell short of expectations, but countered this disappointment with forward-looking statements providing reasons for future improvement. Half the

earlier estimates was roughly the same for the two groups, leading the professors to observe that "cautionary disclosures are viewed by nonprofessional investors as informative warnings, but they have difficulty translating that belief into a change in how they view the prospects of the firm when making a valuation judgment."

In the second experiment, 200 participants were given the same background information and earnings press release that were used in experiment 1, with, once again, half the press releases including a cautionary disclaimer about forward-looking statements and half lacking a disclaimer. In addition, all participants were asked to assume that the press release had led them to increase their investment in the company and that its optimistic projections had failed to materialize resulting in a stock-price decline and a substantial personal investment loss. Finally, half the subjects in each group (disclaimer and no-disclaimer) were informed that available evidence suggested management knew at the time of the press release that its positive forward-looking statements were false or misleading, while the remaining half were told the statements reflected management's true beliefs.

When told that forward-looking statements were made in good faith, participants indicated only mild feelings that they were entitled to financial compensation whether or not the earnings press release included a cautionary disclaimer. But, when told management knew the statements to be false or misleading, not only did participants feel more strongly that they deserved compensation but they felt it significantly more if there was no disclaimer than they did if there was one (4.35 versus 3.86 on a scale of 1 to 7).

In other words, even when companies use forward-looking statements to mislead investors and it results in investment losses, cautionary disclaimers reduce feelings of being wronged and being entitled to compensation.

Still, notwithstanding this mitigating effect, the professors note that “investors

litigation reform may be needed to more effectively balance the needs of investors with protections afforded to firms.”

As for what investors themselves and companies might do to improve the balance, they write, “Nonprofessional investors might protect themselves from placing undue reliance on positive forward-looking statements…by generating counter-explanations for why management plans might fail…Cautionary disclaimers might be more effective if they contain less boilerplate language, are written in plain English, are presented more saliently, or are integrated within the disclosure so that they qualify specific forward-looking statements rather than qualifying forward-looking statements more generally.”

The study, entitled “Disclaiming the Future: Investigating the Impact of Cautionary Disclaimers on Investor Judgments Before and After Experiencing Economic Loss,” is in the July issue of ***The Accounting Review***, a peer-reviewed journal published six times yearly by the **American Accounting Association**, a worldwide organization devoted to excellence in accounting education, research, and practice. Other journals published by the AAA and its specialty sections include *Auditing: A Journal of Practice and Theory, Accounting Horizons, Issues in Accounting Education, Behavioral Research in Accounting, Journal of Management Accounting Research, Journal of Information Systems, Journal of Financial Reporting, The Journal of the American Taxation Association,* and *Journal of Forensic Accounting Research.*

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