BREAKINGVIEWS
Agenda-setting financial insight

REUTERS

Wednesday, 08 February 2012

"Hello," he lied

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07 February 2012 | By Reynolds Holding

A chief executive's phone manner can reveal fibs about company results. All it takes is a shaky delivery or uneven tone during an earnings call, new research suggests. They are among the tip-offs that a boss is being economical with the truth. The evidence isn't reliable enough to land anyone in jail. But for investors seeking an edge, it may pay to listen closely.

Enron, WorldCom and other accounting disasters show how important – and hard – it can be to catch fudged numbers early. But the growing complexity of financial fraud can make standard methods of detection look as obsolete as sharp pencils and a green eyeshade.

The latest approaches are focusing on what comes out of an executive's mouth. Investment research firms like Boston-based Business Intelligence Advisors use former Central Intelligence Agency types to listen for deception on company conference calls. And several studies have found that the absence of personal pronouns and other word patterns can reveal when an executive may be reporting dodgy numbers.

But even nonverbal signals like varying pitch can be a dead giveaway, according to a study by accounting professors at Duke University and the University of Illinois. The authors fed tapes from thousands of quarterly earnings calls through software that searches voices for cues linked with lying. It turns out the calls containing the most cues involved companies with financial statements that later had to be restated.

Like other methods of detecting lies, this one isn't foolproof. It catches fibs about 60 percent of the time, somewhat better than chance. But that's at least on a par with trusted financial-fraud traps like F-score, a system for testing sales, receivables and other publicly reported numbers for red flags. And voice analysis catches lies that the other methods don't.

Of course, determined CEOs might adapt. The study identified some as highly confident in their companies' performance because they held in-the-money options for long periods but didn't cash them in. Even when their numbers turned out to be misleading they didn't display the usual tells, having seemingly rationalized their deceit. Merely mediocre miscreants, on the other hand, would do well to remember that it's not just what you say that counts, but how you say it.

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New research has found that chief executives who lie on earnings calls often give themselves away, for instance in the tone and pitch of their voices. The study, by Jessen Hobson of the University of Illinois and William Mayew and Mohan Venkatachalam of Duke University, used voice analysis to link the way CEOs convey results with subsequent restatements of their companies' financial reports. Their method can identify lying about 61 percent of the time, or 11 percent better than chance, roughly the same as analyses of financial accounting information.