Investors' questions don't get much more basic than this: Has a company made money?

But many companies prefer that investors focus on anything but the bottom line. Instead, the end of a fiscal quarter brings torturous language in news releases and financial statements aimed at polishing corporate performance.

If the accounting tools in this tug of war are obscure, the stakes are not. Wall Street wants transparency in a company's finances so that investment decisions are based on reality, not public relations.

And if this struggle has old roots, it's gaining fresh importance as some companies push the envelope of financial reporting, according to many analysts.

"Many companies would prefer investors focus on management's version of earnings rather than the real, reported earnings," said financial consultant and author Tony Sondhi.

Consider two views of last week's quarterly earnings report from Amazon.com Inc.

The company's news release suggested reason for optimism, which has been in short supply as corporate America slogs through a dismal earnings season.

Amazon.com touted a narrowing of its "pro forma net loss" compared with the year-ago quarter to just $58 million – an apparent milestone for the online bookseller, which has never been profitable. And the headline...
the online bookseller, which has never been profitable. And the headline stated: "Expects Pro Forma Operating Profitability in Fourth Quarter."

But according to the formal earnings statement, prepared using generally accepted accounting principles, the real net loss was $170 million.

So was profitability tantalizingly close, or still $170 million away?

The answer begins with something called GAAP – the acronym for generally accepted accounting principles, the benchmark for assuring uniformity in financial reporting.

But companies that want to put their financial performance in a better light turn to other tools as well.

One is so-called pro forma financial statements, which have gained currency over the last three years. The second is a focus on "operating earnings," instead of the bottom line or net earnings where all manner of one-time charges are excluded.

Both techniques are widespread in corporate America and readily accepted by Wall Street stock analysts. In fact, some corporate executives say these techniques give investors a better picture of a company's core business.

"But now companies are moving far beyond the traditional practices," said Richard Moroney, editor of the Dow Theory Forecasts, which tracks market trends.

Lack of consistency

Critics say that these methods – particularly the use of pro forma statements – undermine the idea of consistency in financial reporting.

"There are no accounting standards for pro forma. It is whatever management wants," said Georgene Palacky, an associate at the Association for Investment Management and Research, the trade group for financial analysts. "You can't really compare one company's results with another, and in some cases you can't even compare the same company from one quarter to the next."

Here's how pro forma works.

At the end of each quarter, companies release financial statements prepared in accordance with generally accepted accounting principles and usually reviewed by independent auditors.

A pro forma statement is similar to the real financial statement, except management will add or subtract whatever items it chooses to better
reflect what they call the true operations of the company.

For example, some companies will exclude interest expense in their pro forma statements on the premise that borrowing is a financial cost, not an operating cost. Other companies might exclude the write-down of inventory on the premise that it is a noncash charge. Not surprisingly, the press releases accompanying the earnings reports usually focus on the pro forma numbers because they are almost always better, Ms. Palacky said.

In the case of last week's Amazon.com report, the pro forma statement excluded, among other items, stock-based compensation, amortization of intangible assets and restructuring charges.

In fairness to Amazon.com, it clearly presented both the financial statements using generally accepted accounting standards and the pro forma statements.

Spokesman Bill Curry said Amazon.com began using pro forma statements in 1998 "to give clarity to the ongoing operations of the business." The company's pro forma statement basically excludes all the noncash charges, he said.

"Investors want to know how much cash the company is generating," Mr. Curry said. "The GAAP numbers can be very opaque in trying to understand what is going on with the core business."

**Cause for concern**

The Financial Accounting Standards Board, which sets accounting standards, is uneasy about the increased use of pro forma statements.

"Pro forma. What does it mean? Does it mean hypothetical, what if? That gives us concern, but we don't have jurisdiction over press releases," said senior project manager Ronald Bossio.

Harvey L. Pitt, chairman of the U.S. Securities and Exchange Commission, told a group of accountants last week in a speech: "Unstructured and undisciplined, this form of financial disclosure starts by rejecting the bedrock of all our financial disclosure requirements – generally accepted accounting principles."

Even companies that don't use pro forma statements can still deflect investor attention from the bottom line by focusing on so-called operating earnings.

Basically, operating earnings are revenue less expenses from ongoing operations and exclude any nonrecurring items. But just as with pro forma, there are no accounting-industry standards.
For example, some companies will exclude interest expense from operating earnings. Others will recast operating expenses as extraordinary charges or recast extraordinary income as operating income, said Srinivas Thiruvadanthia, a consultant at the Levy Forecasting Center in Mount Kisco, N.Y., and co-author of a report on corporate earnings.

"The problem here is that we have to rely on the good faith of the company managers," said Mr. Thiruvadanthia, who estimates that operating earnings for companies in Standard & Poor's 500 index are overstated by at least 20 percent.

**Camouflaged charges**

Analyst Mr. Moroney said investors should take note of the kinds of charges that can be camouflaged by focusing on operating earnings or pro forma earnings.

Cisco Systems Inc., for example, highlighted pro forma earnings of $230 million when it reported third-quarter earnings.

The computer networking giant actually had a net loss of $2.7 billion, much of it from a $2.2 billion inventory write-down.

"Asset write-downs are noncash charges, but any time a company has spent $2.2 billion to acquire something and later admits that those items are valueless, it has implications regarding management's ability," Mr. Moroney said.

Analysts say that to its credit, Cisco has been very forthcoming in reporting on this write-down.

Company spokeswoman Abby Smith said Cisco will report on how much of this inventory is sold each quarter. Since the inventory has been written down to zero, any sales would be all profit, but "we will not count this in our pro forma income."

The potential for fuzziness, though, is why regulators and analysts favor generally accepted accounting principles.

"We should re-examine the language of financial reports," SEC chairman Mr. Pitt said in a speech last week, "replacing jargon as the favored method of expression."