

# **Examining the Readability of Critical Audit Matters (and what it suggests to educators)**

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## **Abstract**

This paper identifies clear writing techniques that we as educators can encourage our students to improve/apply early on their career path. Specifically, this paper investigates utilization of certain clear writing techniques recommended by the SEC - and what the findings suggest for accounting educators. We develop a checklist of SEC recommended clear writing techniques and then manually review a sample of 84 critical audit matter (CAM) narratives in 50 auditor reports. For additional insight, we calculate the StyleWriter's BOG readability index for 84 CAMs and then benchmark against management's critical accounting estimates/policy SEC 10-K disclosures. Findings include the underutilization of: subheadings, bulleted lists, and shorter sentences. In addition, the CAMs scored 10% lower on readability than management's critical accounting estimates/policy 10-K disclosures. This paper also offers a supplemental study relating to the use of bulleted lists and finds an estimated potential improvement to readability of 22%.

## **Introduction**

This paper examines a sample of accounting and auditing disclosures for the purpose of identifying underutilized clear writing techniques (i.e., opportunities to improve). Specifically, this paper manually examines 84 critical audit narratives (CAMs)<sup>1</sup> through the lens of the SEC Handbook (1998) for writing clear disclosure documents. Drawing on the results of this study, the paper identifies three relatively quick/easy to apply straightforward clear writing techniques for students to practice in order to maximize career success.

Extensive accounting research recognizes that career success is associated with writing skills (Low, Samkin and Liu 2013; Bui and Porter 2010; Albrecht and Sack 2000; Henry and Razzouk 1988; Roy and MacNeill 1967). Therefore, the findings are particularly relevant to accounting educators who are in a position to encourage greater student awareness and practice of clear writing techniques early in the student's career path.

History shows us that reading and writing is a work in progress. In the context of U.S. history and the American Revolution, the importance of communicating through reading and writing was recognized as far back as the colonial army at Valley Forge, during the winter of 1778 (Dubay 2007). General George Washington directed chaplains to teach soldiers to read and write. Later in the 1800s, grade schools developed an awareness that students learn better with materials written at their reading level, which in turn evolved into grouping students by grade level. During the 1900s, readability formulas were developed to assist in matching the reading level of educational materials to specific

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<sup>1</sup> AS 3101, requires that CAMs be reported in the Audit Report. The disclosure includes why it is a CAM, and how the auditor addressed of it.

grade levels. Later, readability formulas were adapted to improve the readability of newspapers and training materials for adults. This historical development underscores the evolving importance of clarity in communication, a theme that continues to resonate in the modern context of accounting and auditing disclosures.

For purposes of this paper, readability is defined as the degree to which a class of people find certain reading matter compelling and comprehensible (McLaughlin 1969). Accounting research suggests that a disclosure narrative that is difficult to comprehend may be subconsciously treated by readers as a heuristic cue that information is not truthful or can't be relied upon in making related judgments (Rennekamp 2012; Shah and Oppenheimer 2007; Reber and Schwarz 1999). With respect to CAMs, a PCAOB report finds that investors are using CAMs to better understand the work of the auditor and company disclosures (PCAOB 2020). Unfortunately, the 2020 PCAOB interim analysis report on CAM disclosures also found that only 55% of investors surveyed viewed the CAMs as easy to understand (PCAOB 2020). It's not surprising that CAMs are also identified as a 2024 audit priority (PCAOB 2023).

Using the SEC Handbook (1998) as a guide, a 'clear writing' checklist was developed to record each narrative's usage of clear writing techniques. For additional insight, the StyleWriter's BOG readability index was calculated for use in benchmarking the auditor CAM narratives against management's discussion of critical accounting estimates/policy (MD&A) in the SEC 10-K. The CAM narratives scored lower on readability.

Generally, accounting research has encouraged educators to recognize the importance of writing skills to the student's career success by developing writing assignments and incorporating them into the accounting curriculum (Huber et al. 2020; Riley and Simons 2013; Scofield and Combes 1993). This paper extends extant research by identifying three underutilized and relatively simple clear writing techniques for educators to encourage students to apply.

The primary finding of this paper suggests there is room to improve which has implications for students and educators. Several potentially quick/easy straightforward opportunities to improve are identified with respect to greater use of: subheadings, bulleted lists, and shorter sentence length. To provide additional insight, for illustrative purposes, this paper also offers a before and after test relating to the use of bulleted lists.

## II. Background and Research Question Development

AS 3101 (PCAOB 2017) requires that a CAM disclosure consists of three parts: Part One, the definition of a CAM; Part Two, what was identified as a CAM and why; and Part Three, how the auditor addressed the CAM. The importance of the disclosure flows from what is essentially a window into the thought process of the auditor with respect to which audit matters were critical and why, as well as how the auditor addressed the CAM in the audit.

Why does readability matter? Prior research relating to financial reports/disclosures (e.g., SEC 10-K reports) finds that readability influences investors, analysts, and financial markets. Specifically with respect to assessing lower risk. For example, recent financial literature includes findings where greater readability is associated with: a lower cost of equity financing (Rjiba et al. 2021; Garel et al. 2019); extending higher levels of trade credit (Xu et al. 2020); less stock price crash risk (Kim et al. 2019); and lower litigation risk (Humphery-Jenner et al. 2019). Similarly, earlier research finds positive benefits associated with greater readability:

- more favorable bond ratings, less bond rating disagreement, and lower cost of debt (Bonsall IV and Miller 2017);
- less analyst disagreement and decreased levels of uncertainty (Bozanic and Thevenot 2015; Lehavy et al. 2011);
- less stock return volatility and earnings surprises (Loughran and McDonald 2014); and
- clearer and more concise disclosures are associated with increased levels of investment and profit (Lawrence 2013).

### *Research Question*

Failure to assess and explore every opportunity to clearly communicate accounting disclosures threatens to impoverish a useful source of information. This paper benchmarks CAMs against MD&A because they share the same audience, and both represent matters material to the financial statements. Is it possible that certain CAM topics may be more complex? Of course (see Table 3) - but for purposes of this paper (the utilization of clear writing techniques) it's not relevant. Therefore, we develop the following research question:

**RQ1:** In the context of the SEC Handbook (1998) for creating clear disclosure documents, are there underutilized clear writing techniques?

### **III. Experimental Design**

Eighty-four CAMs were sourced from a random sample of 50 Securities and Exchange Commission (SEC) 10-K reports submitted by Fortune 500 companies. The Fortune 500 is an annual list of the 500 largest companies in the U.S. based on revenue. The companies (numbered 1-500) were selected through the use of a random number generator. A sample size of 50 was chosen to allow for a manageable review of each disclosure while maintaining a sufficient diversity of industries. The sample includes CAMs in financial, technology, insurance, airlines, industrial, retail consumer products, utility, and energy industries.

AS 3101 requires each disclosure include the definition of a CAM. The definition is essentially “boilerplate” or standard language, which as a practical matter, is not within the control of the writer. Therefore, this study of readability *excludes* the CAM definition. For benchmarking/comparability purposes, tables/charts and related introductory sentence/text were *excluded* from MD&A disclosures prior to calculating the BOG score.

Using the SEC Handbook (1998) as a guide, a ‘clear writing’ checklist of 17 attributes was developed for use in testing each CAM narrative against the SEC’s suggestions for writing clear disclosure documents (see Appendix B). The handbook is a product of the combined efforts of the SEC staff as well as representatives from the private sector (e.g., including academia, corporate, and legal sectors); and included field tests at public workshops. The SEC Handbook (1998) suggestions are also consistent with writing techniques viewed as critical to users’ understanding of written materials in non-financial contexts, including the military, healthcare, and law (DuBay 2004).

Since there is only one accounting educator/reviewer for the 84 narratives, there is a potential for reviewer bias. Especially with respect to judging attributes or problems that do not lend themselves to being quantified. For example, good flow, superfluous words, legal and financial jargon, use of technical terms or undefined terms, use of abstract words, unnecessary details, unreadable design & layout. However, as discussed below in the Results section, there is objective support for the three attributes identified as relatively quick/easy to apply straightforward (but underutilized) clear writing techniques.

The 84 CAMs were also categorized into 8 topic categories and an average BOG score is calculated by topic (see Table 3). The BOG readability measure is a component of the comprehensive StyleWriter editing software package. Other readability measures (e.g., Flesch-Kincaid, Gunning Fog) focus on average sentence length and the number of syllables. The BOG was selected because it offers a multidimensional calculation of readability (see Appendix A), which includes certain clear writing attributes also suggested in the SEC Handbook (1998). Plus, another distinguishing feature (relative to other edit software) is the use of a proprietary graded word list instead of just syllables per word or word length to calculate readability. The BOG index was also validated in Bonsall, Leone, Miller and Rennekamp (2017) and utilized in recent accounting research (e.g., Rjiba et al. 2021; Rahman et. al. 2021; Blanco et al. 2020; Humphery-Jenner et al. 2019; and Bonsall IV and Miller, 2017).

## IV. Results

### *Quick Fixes*

In the context of the SEC Handbook (1998) for creating clear disclosure documents, are there underutilized clear writing techniques? A manual review of the 84 narratives identifies three underutilized writing techniques that are relatively straightforward ‘quick fixes’ requiring an awareness/reminder of the technique (vs additional time consuming special/lengthy training). Specifically: subheadings, bulleted lists, and shorter sentence length. See Appendix B.

Subheadings: 46% of the narratives lacked subheadings (e.g., a subheading introducing/calling attention to: how the CAM was addressed by the auditor).

Bulleted Lists: Consistent with the SEC Handbook (1998), a bulleted list is a vertical list of items that is introduced by a complete sentence that ends with a colon. Instead of a bulleted-list, 22 (or 26%) of the narratives use a single sentence to communicate three or more audit procedures taken to address the CAM (or why an audit matter was considered a CAM). A single sentence with five plus items was not uncommon.

Sentence Length: the average sentence length for the CAMs was 22% longer (33 words versus an average sentence length of 27 words for MD&A. Although difficult to judge, this still represents a potential area for improvement. CAM sentences in excess of 40-50 words were not uncommon. The powerful role that sentence length plays is demonstrated in a recent study of 410 newspapers that found readers understood less than 10% at a sentence length of 43 words (The American Press Institute 2020).

### *Miscellaneous Findings*

The study also identifies attributes or writing problems that (although important) are not relatively straightforward quick fixes. Specifically, the study observed certain attributes or problems that didn’t lend themselves to an objective measure and collectively appear to be more appropriately addressed by further training, individual coaching or feedback provided in a technical writing course. For additional detail, see the Miscellaneous line item on Table 1, Summary of Manual Review, and the Clear Writing Checklist in Appendix B.

On a positive note, consistent with the SEC Handbook (1998) suggestions, 100% of the narratives use: left justified/flexible right margins; legible font and line spacing; and were well organized (i.e., they complied with the organization structure required by AS 3101).

### *BOG Index Score*

Higher BOG scores are associated with relatively less readability. The BOG index was 10% higher for the CAM narratives which suggests there is room for improvement. The average BOG score for the 84 narratives is 108.86. While the average BOG score for the 50 MD&A disclosures was significantly different at 99.28. A t-test analysis between the two groups results in a  $t(132) = -3.252$ ,  $p$ -value = 0.001, which is statistically significant (see Table 2 Panel A). Therefore, the BOG score suggests the CAM narratives are significantly more difficult to read than MD&A. A potential avenue for future research is to compare the results of the BOG readability index with those of other widely recognized readability measures, such as the Gunning Fog Index and the Flesch-Kincaid.

In addition, Table 3 provides the individual BOG score for each of the 8 CAM categories/topics. Given the sample size of 84, the standard deviation of 19.75 is high and suggests that some topics were much more challenging to write than others. Specifically, the Other Intangibles categories are the most challenging, and Income Taxes the least challenging.

### *Supplemental Illustrative Bulleted List Study*

As noted above, 22 of the narratives (or 26%) use a single sentence instead of a bulleted list. For further insight, we reconstructed the 22 single sentences to utilize a bulleted list, and the BOG score was recalculated. The BOG score improved by 22% (see Table 2 Panel B) which supports the notion that a bulleted list offers an opportunity to improve.

## **V. Implications**

The results of this study suggest that there is an opportunity for us as educators to encourage greater awareness of clear writing techniques early in the accountant's career. As noted previously, student writing skills influence their career success. In addition to incorporating writing assignments into the curriculum, by drawing on this study, educators at all levels are able to encourage students to practice/improve their writing skills by applying underutilized clear writing techniques. For example, simply include in every accounting course's first day overview/introduction a reference to the SEC Handbook (1998) as a useful self-help resource for clear writing (and particularly note the use of bullets, headers, and sentence length). Finally, I hope that this study encourages an awareness of clear writing practices.

This paper does not aim to evaluate the content quality of CAMs but instead focuses on improving their readability through clear writing techniques. However, the results call our attention to certain fundamental clear writing techniques that may be underutilized and therefore offer an opportunity to improve. Writing an accounting disclosure involves both skill and art, with the ultimate goal of clearly communicating complex accounting and auditing information. Ultimately, however, it falls to the writer's judgement to develop the most clearly written narrative possible for your audience.

The results of this study identify three relatively time efficient opportunities (quick fixes) to improve CAM readability:

- **Subheadings:** As noted in the SEC Handbook (1998), subheadings make the information easier to “digest” by alerting the reader to the upcoming topic as well as presenting the overall information in “bit-sized” pieces. For example, specific to CAMs, is the use of a subheading to introduce how the CAM was addressed by the auditor.
- **Bulleted Lists:** The SEC Handbook (1998) also suggests using bulleted lists to make information “easier to absorb”. Specific to CAMs, bulleted lists may be useful where the auditor provides multiple reasons why an audit matter was considered a CAM and/or to describe several audit procedures taken to address the CAM.
- **Sentence Length:** It's not surprising that sentence length represents an opportunity to improve. Although potentially overly simplistic, it's long been accepted that sentence length is a primary attribute with respect to readability (Gunning 1952; Dubay 2007; and the SEC 1998). The main reason sentence length is a useful measure of readability is that it is a measure of relationships (Gunning 1952). Gunning states: “The longer sentences are, the more words; the more words, the more relationships between them – and, consequently, the more effort for the reader.”

Intuitively, the exact point at which a sentence “fails” likely varies according to the subject matter and the reader's experience and training. Although this paper does not suggest a precise limit on sentence length (i.e., the appropriate length is left entirely to the judgement of the writer), the average CAM sentence length was 22% longer than MD&A. Therefore, the results suggest that the average sentence length of a CAM narrative is a potential opportunity to improve readability. Sentence length also represents a potential future accounting research topic. For example, with respect to specific accounting/financial topics and differing reader training/experience, at what point does sentence length “fail”?

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**TABLE 1**  
**Summary of Manual Review Findings (See Appendix B)**

Straight Forward Quick Fixes

CAMs Failing to Use Subheadings	46%
CAMs Failing to Use Bullets	26%
Average Sentence Length	33*
Miscellaneous:	Passive voice, weak verbs, lack of definitions for technical terms, superfluous words, legal/financial jargon/acronyms, overuse of defined terms, and the use of abstract words.

\* Average sentence length is determined by the average number of words per sentence.

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**Table 2**  
**Additional Statistics**

**Panel A - T-Test Results and BOG Score for 84 CAMs vs. 50 MD&A Disclosures**

Average CAM score (Std. Dev.):	Average MD&A Score (Std. Dev.):	t statistic (df) ( <i>p</i> -value)
108.86 (19.75)	99.28 (8.44)	-3.252 (132) (0.001)

**Panel B - 22 Reconstructed CAM Narratives**

Avg. CAM score without bulleted list	Avg. CAM Score with a bulleted list	Improvement
137.41	107.82	+22%

\*Note 1 - A lower BOG score is associated with relatively greater readability.

\*Note 2 - df = degrees of freedom

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**Table 3**  
**The Readability of 84 CAMs**

CAM Topic	Percent (Number) of Cams in Sample	BOG Index* Mean
Estimated Liabilities	19% (16)	102.13
Other Intangibles 1	17% (14)	113.79
Other Intangibles 2	14% (12)	115.17
Goodwill	14% (12)	107.92
Revenue	11% (9)	111.33
Income Tax	11% (9)	98.11
Other Assets	10% (8)	112.75
Contingent Legal Liabilities	5% (4)	113.25
<b>Overall Average Score (Standard Deviation)</b>		<b>108.86 (19.75)</b>

\*Note - A lower BOG scores suggests something is easier to read.

**CAM Topic Summary**

Estimated Liabilities - referenced rewards and rebate programs; refund of prepaid services; insurance claims; product warranties; pension benefits; and environmental remediation.

Other Intangibles 1 - included the value of: trade names, trademarks, franchise rights, and customer relationships.

Other Intangibles 2 - primarily included the value of level 3 instruments.

Goodwill - is discussed in management's estimates related to the annual impairment test for specific reporting units.

Revenue - primarily identified audit concerns relating to sufficiency of audit evidence, or recognition of distinct performance obligations.

Income Tax - included transfer pricing; intra-company transfers; and uncertain tax positions associated with IRS notice and opinion.

Contingent Legal Liabilities - referenced legal proceedings related to product liability.

Other Assets - chiefly addresses the allowance for loan losses.

**Appendix A**

**StyleWriter’s BOG Index**

The Bog index is relatively recent and validated in Bonsall, Leone, Miller and Rennekamp (2017). The index is utilized in recent accounting research: (Rjiba et al. 2021); Rahman et. al. (2021); (Blanco et al. (2020); Humphery-Jenner et al. (2019); and (Bonsall IV and Miller, 2017). Higher scores are associated with relatively less readability.

A distinguishing feature of the index is the use of a proprietary graded word list instead of just syllables per word or word length. Lower scores are associated with relatively greater readability. The StyleWriter editing software calculates a BOG readability measure equal to: Sentence Bog + Word Bog – Pep.

Where:

$$\begin{aligned}
 & \text{(Average Sentence Length)}^2 \\
 * \text{Sentence Bog} = & \frac{\text{-----}}{\text{Long Sentence Limit}} \\
 & \text{(Style problems + Heavy Words + Abbreviations + Specialist Words) x 250} \\
 ** \text{ Word Bog} = & \frac{\text{-----}}{\text{Number of Words}} \\
 & \text{(Names + Interest Words + Conversational) x 25} \\
 *** \text{ Pep} = & \frac{\text{-----}}{\text{Number of Words}} + \text{Sentence Variety}
 \end{aligned}$$

\*Sentence Bog measures the effect of sentence length.

\*\* Word Bog measures word difficulty. The numerator is based on a propriety list of graded words as well as values assigned to abbreviations or acronyms, wordiness, passive verbs, and other style issues.

\*\*\* Pep assigns a value to features that make reading easier and more fun. For example, the use of: names, interesting words, conversational expressions, personal pronouns, contractions, questions, and variable sentence lengths.

## Appendix B

### Clear Writing Checklist - Summary based on SEC Handbook (1998)

#### Clear Writing Attributes to Look for

Uses descriptive headers and sub-headers  
 Depending on the audience, do they define technical terms  
 Well organized structure  
 Presents the big picture  
 Groups related information together  
 The organization should provide good flow for the reader

#### General Observations/Findings

\*\* Sometimes (but 46% did not)  
 \* NO  
 YES (driven by regulation)  
 YES (driven by regulation)  
 YES (driven by regulation)  
 YES (driven by regulation)

#### **Design:**

Uses a bulleted list where appropriate  
 A logical hierarchy  
 Left justified, ragged right margins  
 Legible Font, line spacing, margins

\*\*Sometimes (but 26 % did not)  
 YES  
 YES  
 YES

#### **Common Problems Identified by SEC Handbook (1998):**

Long sentences  
 Unnecessary details; Unreadable design & layout  
 Passive voice/weak verbs  
 Superfluous words  
 Legal and financial jargon and acronyms  
 Numerous defined terms  
 Abstract words

\*\*YES (22% greater than MD&A)  
 YES (driven by regulation)  
 \*YES  
 \*YES  
 \*YES  
 \*YES  
 \*YES

\*Although this attribute was observed among some of the 84 narratives, it doesn't lend itself to meaningful measurement and/or requires the training, coaching or feedback provided in a technical writing course. Therefore, it is not included in the Results as a quick/easy and straight forward opportunity to improve writing skills.

\*\* One of the three quick/easy and straightforward attributes suggested for students to begin practicing/applying.