Quality of Accounting Narrative Disclosures: UK Research, Progress and Prospects

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Confusing terminology: Disclosure vs. Narratives

- Anne: ‘voluntary disclosure’
- Feng: ‘annual report narratives’
- Per: ‘disclosure’
- Vivien: ‘narrative disclosure’
- [worrying day, wondering if anything left for me to say???]
Introduction: Disclosure vs. Narratives

- Disclosure [≈North American tradition]
- Narratives [≈European tradition]
Disclosure

- Disclosure of objective ‘facts’
- Economic info asymmetry arguments & agency theory (positivism)
- Rational, utility maximisers
- Linguistics (the scientific study of human language)
Narratives

- The ‘narrative turn’ refers to interest in narrative in literary studies that spread to other disciplines
- Narrative (written or spoken discourse) is fundamental for creating (subjective) meaning for human actors
- Behavioural theories
- Social theories
Outline of talk (my brief)

- Outline existing research
- Review current developments/WIP
- Future research

[UK perspective]
Figure 1: Financial Reporting Quality

FRQ

Disclosure: within financial statements

Numbers: e.g. earnings

Narrative: Annual report surround

Company-sourced information outside annual report

Audit quality
IASB (2013) Disclosure survey (n=233)

- 80% said there is ‘a disclosure problem’
- Spread throughout the annual report
- Source of problem?
  - Not enough relevant information? Mixed views.
  - Too much irrelevant information? Agree.
  - Poor communication? Agree.
Growing status of narrative

- Was: ‘surround’ to financial statements
Early North American studies

- First readability studies published TAR & JAR (e.g. Soper & Dolphin, 1964; Haried, 1972)
- Readability indicator of ‘understandability’? No, so interest waned
- ‘Scientific turn’ had taken hold; PAT/MBAR interest grew in 1970s & 80s
Subsequent studies to 1994

- Sporadic research: Review of 32 readability studies (26 of which address annual report narratives) (Jones and Shoemaker, 1994)

Problems:
- Measures designed for children’s writings inappropriate for adult, technical writings
- Focus on word and sentence-level features and ignore aspects of the text as a whole
- Take no account of the interests and motivations of the reader (user).
Influences from linguistics

- Sydserff & Weetman (1999): used applied linguistics to evaluate accounting communications – the texture index

- The texture index captures a much richer set of text characteristics than readability scores and is *not* associated with readability scores.
Method is grounded in the linguistic theory (de Beaugrande and Dressler, 1981) and the texture index developed from this (Roseberry, 1995)

Seven principles that determine the communicative effectiveness of narratives

Some principles text-centred; some user-centred

Six criteria for evaluating narratives, which are termed indexicals

Text unit defined as one independent clause with all subordinate clauses attached to it

Text units scored for each indexical as 0, 1, or 2 (0 indicating the absence of a particular characteristic of texture and 1 and 2 indicating defined degrees of its existence)
Indexicals

(summed to provide an overall texture score)

- topicality,
- intertextuality,
- conjunction,
- connectivity,
- information category shift, and
- specificity.

Authors caution against assuming that the higher the texture score the better, given the low correlation observed between indexicals.

Low correlation with readability measure
Sydserff & Weetman (2002)

- Used DICTION software to evaluate ‘tone’
- Influential review article recognised need for methods innovation in relation to the development of computer-based analysis of aspects of natural language to permit large-scale studies (Core, 2001)
- Overall aim of this line of research - relate objective linguistic features with company-specific characteristics, such as performance.
Resurgence of interest in North America

- Response by Feng Li (2008; *JAE*) applies readability measure (FOG index) and raw word count
- Hobson *et al.* (2012: *JAR*) use software to examine vocal markers of cognitive dissonance on conference calls – association with financial statement irregularities
- Price *et al.* (2012: *JBF*) use software to analyse tone in conference calls – predictive of abnormal returns
- Hales *et al.* (2011: *JAR*) use software to examine vividness (emotionally persuasive)

Literature on impression management (of narratives) parallels earnings management (of numbers)
Early narrative research outside North America

- Term used by Adelberg (1979) – ‘narrative disclosure’
- Two roles identified – communication or manipulation?
- Manipulation in terms of obfuscation of negative outcomes
Ideas from behavioural disciplines introduced

- **Cognitive psychology**
  - framing and biases *(Kahneman & Tversky, 1979; Tversky & Kahneman, 1981)*
  - information inductance *(Prakash & Rappaport, 1977)*
    - how people make judgements and decisions *(e.g. Beattie & Jones, 1992)*

- **Social psychology**
  - impression management *(Goffman, 1959)*
    - how people present themselves to others
  - attribution theory *(Heider, 1958)*
    - how people explain cause and effect *(e.g. Bettman & Weitz, 1983: ASQ, Aerts, 1994)*
Critical turning point – AOS 1996

- Special section of 3 papers on form (rather than content) of corporate annual report, focusing on visual aspects
- Drew upon literary theory, sociology and cultural studies, influenced by the ‘narrative turn’ in humanities and social sciences
- During 1980s and 1990s, ‘narrative turn’ had spread to many disciplines
Central role of narratives in social life

‘[N]arrative is international, transhistorical, transcultural: it is simply there, like life itself’

(Barthes, 1977, p.79)
AOS 1996

- Hopwood: radical transformations in annual reports - not just the communication of economic ‘facts’
- Graves et al.: a form of rhetoric; annual report must mimic formats of modern public discourse
- Preston et al.: 3 ways of seeing images
- Papers draw upon work of French theorists
Beattie, McInnes & Fearnley
ICAEW project (2000)

- Project on ‘Stakeholder reporting: management disclosure strategy and user needs’, funded by ICAEW in 2000 (£79K) and PwC (£14K).

- First stage looked at content of front-end on annual reports – holistic, based on AICPA (1994).

Approaches to analysis of narratives

- Subjective (analysts’ rankings)
- Semi-objective:
  - Disclosure index studies (partial; form-oriented content analysis)
  - Textual analysis (holistic):
    - Thematic analysis
    - Linguistic analysis (inc. readability)
A holistic Disclosure Profile

- Develops a 4-dimensional framework for the content analysis of accounting narratives
- Coding of topic and three type attributes
- Topic analysis based on (AICPA, 1994) - a ‘comprehensive model of business reporting’.
- Type analyses captures the time orientation, financial/non-financial and quantitative/qualitative attributes of each text unit.
- A text unit is defined as a phrase containing a single piece of information.
- Computer-assisted (QSR NUD*IST)
Can we recognise quality?  
[Subjective evaluation]

Low-quality disclosures:

- **NTS/ NF/ NQ-JU/ MS-MANAGEMENT**  *We feel, as a management team, in robust condition and look to the future with confidence* (Cadbury Schweppes, 303).

- **NTS/ NF/ NQ-JU/ BOS-OBJ**  *Unilever is dedicated to meeting the everyday needs of people everywhere* (Unilever, 15).

High-quality disclosures:

- **OP-COST/ FL/ F/ Q-M**  *This programme will yield cost savings of £5 million in 2000, rising to £15 million in 2002* (Devro, 290).

- **MA-MKT/ H/ NF/ Q-CH**  *Our sales fell by 11% as a result of losing one customer from the end of March* (Geest, 592).
Quality: concept and measurement

- ‘Quality’ is a key concept in many fields of research (e.g., quality of life, quality of food, and quality of service provision).
- The complex, context-sensitive and subjective nature of the concept is apparent in all cases.
- Some writers argue that indices that collapse measures of different dimensions (or attributes) into a single abstract value have limited appeal.
- Others perceive utility in such summary measures.
4 dimensions of disclosure

- **Relative amount** of disclosure, given the company’s size and complexity. (standardised residuals from a regression of the number of text units on size and complexity)

- **Spread** of disclosures across topics, with a degree of balance (though not necessarily equal coverage) seeming desirable
  - Herfindahl Index for main topic
  - Herfindalh Index for sub-topics
  - number of non-empty sub-topics
Composite quality measure

\[ Q_c = \sum \frac{q_i}{4} \]

where \( q_i \) = proxy for quality dimension

- three spread variables are standardised.
- \( H \) indices have also been reversed (i.e., \( 1 - H \)), so that higher values indicate better spread.
Berretta & Bozzolan


Quality = f(quantity; richness of content)

QUALITY = \frac{1}{4}(RQT + DEN + DPT + OPR)

where RQT = standardized relative quantity;

DEN = standardized density (risk sentences/total sentences);

DPT = standardized depth (sign of economic impact + quantified); and

OPR = standardized outlook profile (actions and programmes indicated).
Botosan discussion

- BB framework still based on counts
- Suggested alternative quality framework based on conceptual framework:
  - Quality = f(understandability, relevance, reliability, comparability) (IASB, 1989)

  **BUT**: Understandable to whom?
  Relevant to what decision?
  Reliability generally unobservable
  Comparable over time/with industry?
Quality/quantity debate

- Hooks and van Staden (2010) (environmental disclosure)
- 5-point quality score on index items
- Quality of disclosure is highly correlated to the extent of reporting measured by a sentence count
Continuing interest outside North America - 1

- Growing critique of agency theory (economics-based disclosure motivation)
- Behavioural reasons for disclosure include impression management (Goffman, 1959)
- Strong stream of research into impression management developing (e.g. Merkl-Davies & Brennan, 2007; 2011)
Impression management

- Rhetorical figures of speech (persuasion) infuse all language, e.g. metaphor
- Linguistic features/language choices studied (Amernic et al., 2007; Oakes & Oakes, 2012)
- Analysis of visual images (e.g. Davison, 2004; 2007; 2008; Campbell et al. 2009)
Storytelling

- Emerging notion from field research of accounting narrative as ‘story’ (e.g. Holland, 2004)
- Story is ‘emplotted narrative’
- Emergent stream of research viewing narrative/storytelling as retrospective sense-making, drawing upon ideas of Weick (1995) (e.g. Aerts, 2005; Merkl-Davies et al., 2011)
Disclosure frameworks (in the FS notes)

- e.g. IASB May 2013; EFRAG/ANC/FRC; FASB, 2012

- Concepts:
  - disclosure materiality;
  - static/evolving disclosures,
  - placement,
  - linkage,
  - language,
  - technology-enabled
Narrative Disclosure frameworks (beyond the FS notes)

- e.g. UK OFR (ASB, 2005)
- **Principles:**
  - Through the eyes of the BoD
  - Focus on matters relevant to members’ interests
  - Forward-looking orientation
  - Complement and supplement financial statements
  - Comprehensive and understandable
  - Balanced and neutral
  - Comparable over time
- Disclosure framework: *Elements* cover topics
Integrated reporting framework (IIRC, 2013)

Fundamental concepts
- 6 capitals
- Business model
- Value creation

Principles
- Strategic focus & future orientation
- Connectivity (value creation story)
- Stakeholder responsiveness
- Materiality and conciseness
- Reliability and completeness
- Consistency and comparability

Content elements
Observations

- disclosure/narrative frameworks are here to stay.
- standard-setters, linguists and literary theorists identify a range of (partially overlapping) attributes relating to content, form and structure
- some of which are implicated in the conception of QUALITY.
Agenda for future research

- Accounting narratives offer a rich and complex set of discourses/inscriptions
  - Written/spoken
  - Formal/informal accounts/commentaries by participants
  - Preparer/analyst/regulator/media
  - Multiple-authored; multiple-receivers
  - Multiple-purpose; multiple-motives
- May be studied using diverse set of theories and methods
Approaches

- Quantitative approach (psychology, linguistics)
- Qualitative approaches (social psychology, literary/narrative theory):
  - Accounting narratives a specific genre (genre theory)
  - Storytelling and sensemaking (‘story’ metaphor increasingly featuring in formal documents)
- Mixed e.g. Corpus linguistics and critical discourse analysis (Baker et al., 2013)
Quality: Conceptualisation and measurement issues

‘The concept of quality of life’, *Social Theory and Practice* (Bognar, 2005)

- Subjective evaluations vs objective descriptive indicators
- Generally accepted that objective descriptive indicators not sufficient (reason: weak or no correlation between both)
- Subjective evaluations essential component of measurement
  - easier to scale and can be compared BUT
  - adaptation occurs and not neutral among philosophical theories of welfare
Other quality issues - 1

- An evolving concept over time
- Quality for what user group? Economic indicators (financial capital providers) c.f. social indicators (other stakeholders)
- Interdependencies between dimensions? Composite index meaningful?
- Objective measures create information inductance loop - broker houses already using language analysis; preparers will respond to this
Other quality issues - 2

- Quantity/quality relationship remains unclear (conditional relationship?)
- Determinants/influences at micro/meso/macro levels: individual, company, country, regulatory, cultural differences, language (English c.f. non-English).
- Impact of assurance?
- Consequences: first, second... order effects.