

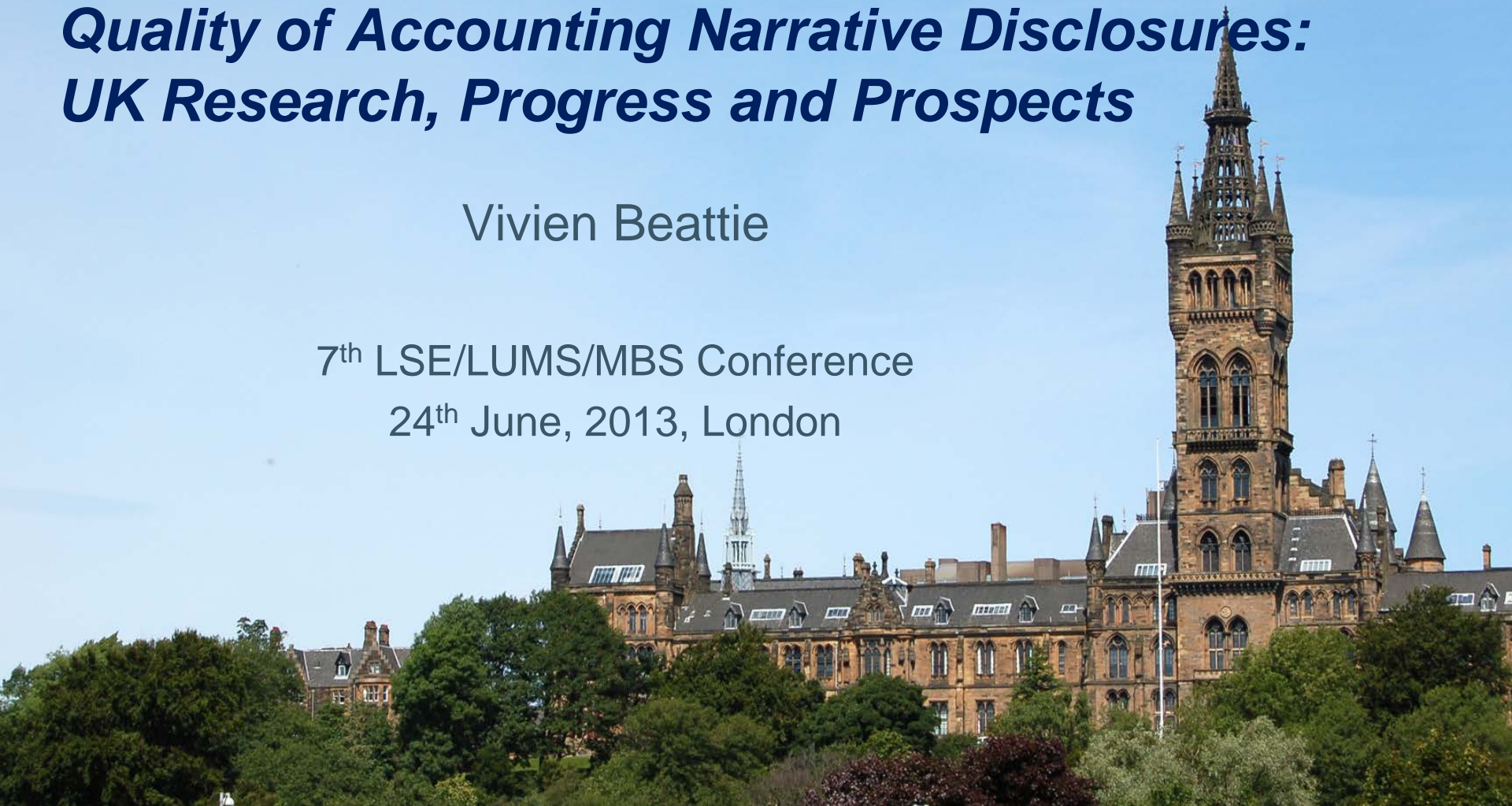


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Quality of Accounting Narrative Disclosures: UK Research, Progress and Prospects

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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 [\approx North American tradition]
- Narratives [\approx 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

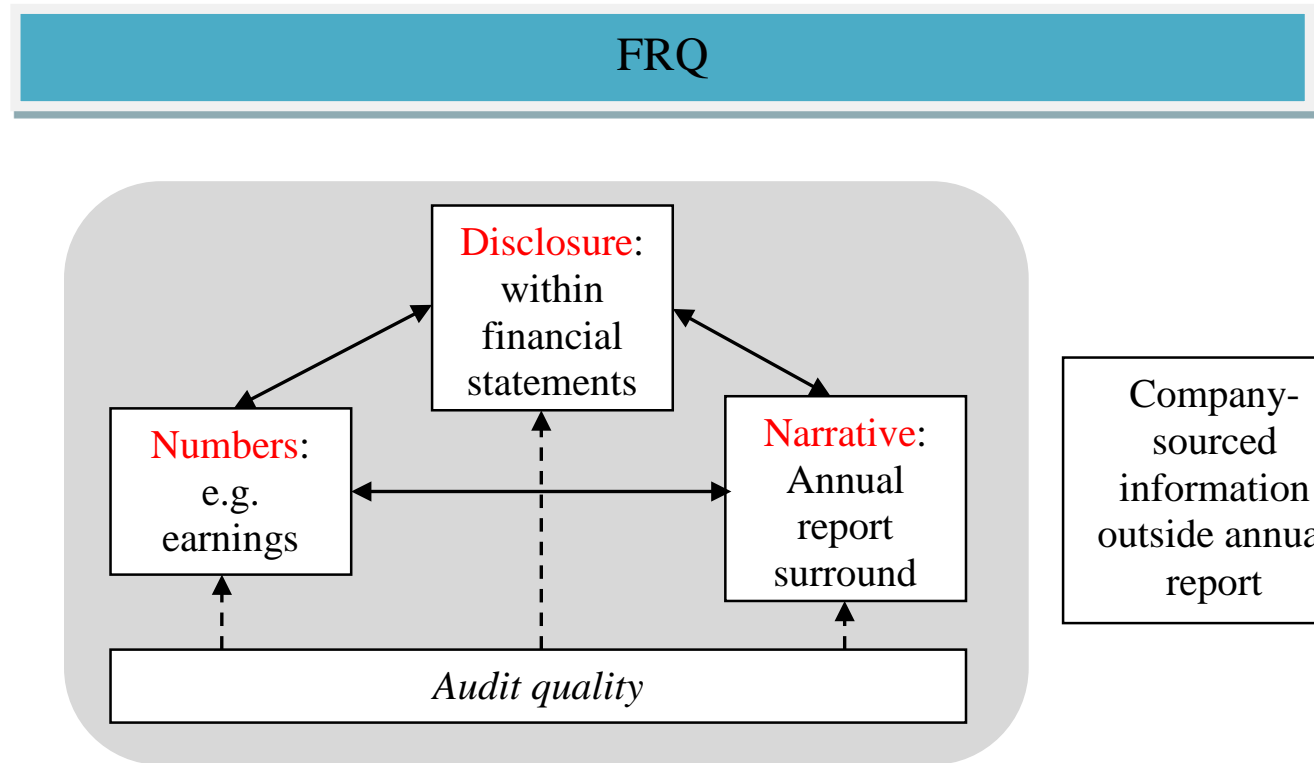


Outline of talk (my brief)

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

[UK perspective]

Figure 1: Financial Reporting Quality





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
- Now: 'essential supplement and complement', esp. MD&A, OFR, MC



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.



Texture index

- 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

- 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, focussing 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).
- Beattie, McInnes and Fearnley (2004), **A Methodology for Analysing and Evaluating Narratives in Annual Reports: A Comprehensive Descriptive Profile and Metrics for Disclosure Quality Attributes**, Accounting Forum.



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?

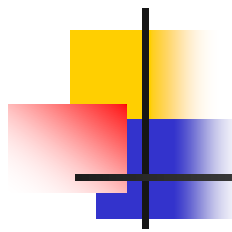

[Subjective evaluation]

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

$$Q_c = \sum q_i / 4$$

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

- 'A framework for the analysis of firm risk communication' (IJA, 2004)
- 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

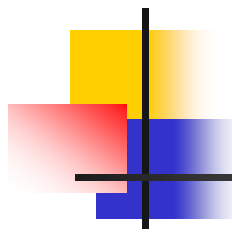


Approaches

- 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.