Available online at www.sciencedirect.com

SCIENCE DIRECT

Accounting Forum 28 (2004) 205–236

ACCOUNTING FORUM

www.elsevier.com/locate/accfor

A methodology for analysing and evaluating narratives in annual reports: a comprehensive descriptive profile and metrics for disclosure quality attributes

Vivien Beattie[a,*], Bill McInnes[b], Stella Fearnley[c]

[a] *Department of Accounting and Finance, University of Glasgow, 65-73 Southpark Avenue, Glasgow G12 8LE, UK*

[b] *Department of Accounting and Finance and Law, University of Stirling, Stirling FK9 4LA, UK*

[c] *Department of Accounting and Management Science, University of Portsmouth Business School, Richmond Building, Portland Street, Portsmouth PO1 3DE, UK*

Abstract

There is a consensus that the business reporting model needs to expand to serve the changing information needs of the market and provide the information required for enhanced corporate transparency and accountability. Worldwide, regulators view narrative disclosures as the key to achieving the desired step-change in the quality of corporate reporting. In recent years, accounting researchers have increasingly focused their efforts on investigating disclosure and it is now recognised that there is an urgent need to develop disclosure metrics to facilitate research into voluntary disclosure and quality [Core, J. E. (2001). A review of the empirical disclosure literature. *Journal of Accounting and Economics, 31*(3), 441–456]. This paper responds to this call and contributes in two principal ways. First, the paper introduces to the academic literature a comprehensive four-dimensional framework for the holistic content analysis of accounting narratives and presents a computer-assisted methodology for implementing this framework. This procedure provides a rich descriptive profile of a company's narrative disclosures based on the coding of topic and three type attributes. Second, the paper explores the complex concept of quality, and the problematic nature of quality measurement. It makes a preliminary attempt to identify some of the attributes of quality (such as relative amount of disclosure

* Corresponding author. Tel.: +44 141 330 6855.
E-mail address: V.Beattie@accfin.gla.ac.uk (V. Beattie).

0155-9982/$ – see front matter
doi:10.1016/j.accfor.2004.07.001

and topic spread), suggests observable proxies for these and offers a tentative summary measure of disclosure quality.

Keywords: Business reporting; Disclosure; Disclosure quality; Narratives; Annual reports; Content analysis; Forward-looking information; Non-financial information; Qualitative information

1. Introduction

In recent years, the nature of business has changed fundamentally. Competitive advantage increasingly involves value creation processes that rely on intangible assets not recognised in the financial statements. To serve the information needs of the market and provide the information required for corporate transparency and accountability, there is now a consensus that the business reporting model needs to expand beyond the traditional financial reporting model that emphasises backward-looking, quantified, financial information (e.g., AICPA, 1994; Elliott, 1992; FASB, 2001a; ICAEW, 2003; ICAS, 1999; Lev, 2001; Lev & Zarowin, 1999; Wallman, 1995, 1996, 1997).[1] The general thrust of these articles and reports is that there is a need for more information that is forward-looking and non-financial in nature. It is recognised that much of this new information will be ‘soft’, i.e., either unquantified or unquantifiable.

Of particular note is the report published by the AICPA (1994), which has become extremely influential (the Jenkins Report). This set out to improve business reporting by adopting a customer focus, i.e., by meeting the information needs of investors and creditors. The report proposed a comprehensive model of business reporting that embraced a ‘broader, integrated range of information’ (p. 131). This model comprised eight main topics (financial data, operating data, management analysis, forward-looking information, information about management and shareholders, objectives and strategy, description of business and industry structure) and many sub-topics. In response to the report, FASB set up a business reporting research project to consider the types of information that companies are voluntarily providing and the means for delivering it. Reporting on the first of these two issues, FASB stated that ‘the importance of voluntary disclosures is expected to increase in the future because of the fast pace of change in the business environment’ (2001b, p.v).

Worldwide, narrative communication in annual reports is viewed as the crucial element in achieving the desired step-change in the quality of corporate reporting and regulators are focussing attention on the management discussion and analysis statement in the annual report (referred to as the MD&A in most countries and the operating and financial review (OFR) in the UK).[2] In some jurisdictions, guidelines are being extended and revised; while in others, disclosures are becoming mandatory. In the US, post-Enron, MD&A regulations are being strengthened (e.g., SEC, 2003). In Canada, the Canadian Institute of Chartered Accountants (CICA) issued more detailed MD&A guidelines that set out six disclosure

[1] The recent wave of accounting scandals has provided further impetus to the drive for enhanced transparency and accountability.

[2] Corporate communication is now an established interdisciplinary field (van Riel, 1997).