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AN APPROACH TO CONTENT EVALUATION OF ACCOUNTING NARRATIVES: A CORPORATE SOCIAL RESPONSIBILITY PERSPECTIVE

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Abstract

Despite the growing range of alternative corporate information sources, the annual report remains the primary source of information for interested users. Companies have a social responsibility to ensure that the information they provide, particularly in narrative form, is both readable and understandable. This paper, therefore, reviewes the most recent attempt at meeting this challenge: the texture index. The texture index was applied to a sample of selected annual reports, using the scoring rules developed by Sydserf and Weetman. Our results confirm earlier research conclusions that annual report narratives are difficult to read and understand by most users of Accounting information.

1. Introduction

Accounting has been seen as a scientific process, which is about the provision of financial information to take economic decisions particularly in respect of the acquisition and use of scarce corporate resources. as well as the elimination of waste in the wealth creation chain. As a professional discipline, Accounting involves the systematic gathering, classification, recording, analysis, interpretation and transmission of information based on data that are of monetary nature. Such financial data, which provide information about the net resources, the productive activities, and profitability of a business, according to Randle (2003) are "required by owners and managers alike in order to assess the health of the organisation and ascertain the changes in the stock of the wealth of shareholders." The health of an organisation can only be ascertained through financial statements, which the Directors of a company are obliged to prepare each year. The financial statements are expected to comply as far as applicable with the form and content provided in Schedule 2 of Companies and Allied matters Act (CAMA 1991) and the current accounting standards issued by the Nigerian Accounting Standards Board (NASB). Recent events around the world have tended to cast doubts on the real worth of financial statements of companies. The recent Enron saga did not help matters as investors are now concerned that if they could not trust management of Enron, then what company could they trust. According to Sanmi (2003) " the members of the public are now wiser that not all glittering and impressive accounting statements are golden" At the root of these problems are the annual financial reports that are craftly drafted by organisations. As at today, the annual report continues to be the primary medium through which corporate information is communicated. As noted by the United States Securities and Exchange Commissions and cited in Justin and Courtney (2003) " the annual report to shareholders is the principal document used by most public companies to disclose corporate information." Thus, it remains a primary source of information for investment and other decision- making for users of those reports. This is the reason that accounting narratives is important in the context of corporate social responsibility in these days of major company crashes.

As noted by (Courtis 1998) and (Justine and Courney 2003) accounting narratives constitute a substantial part of annual reports. They should inter alia, satisfy the main objectives of general purpose financial reporting. These objectives are described in terms of providing useful information for decision making and discharging accountability. It has also been recognised by several authors including (Jones 1997) that accounting narratives play a crucial role in communicating a variety of corporate information. It is therefore obligatory on business organisations to ensure that the quality of the information contained in their annual report disclosures is high. The question now is: where does such a duty arise?

i. Legal Responsibility

The Companies and Allied Matters Act (CAMA 1991) requires every company to keep financial records and prepare, present and publish there-from, annual financial statements. According to Sanmi (2003) "the requirement for publicity of accounts is part of the price to be paid for the privileges of corporate personality." Such disclosure serve present and prospective investors with necessary information and data, which will form the basis of their decision to either, invest in or divest from a particular company. Such information also enables the public to monitor corporate performance with regards to its contribution and responsibility to the larger society.

Specifically, Section 331(CAMA) mandates that the accounting records shall, in particular, contain –

a. Daily entries of all sums of money recorded and expended by the company and the matter for which the money was received or expended.

b. A record of all the assets and liabilities of the company.

The products of the above section are the financial report which section 334 (2) of CAMA expressly defines as including –

a. a statement of the accounting policies.
b. the balance sheet as at the last day of the year
c. a profit and loss account or in the case of a company not trading for profit an income and expenditure account for the year.
d. notes on the accounts
e. the auditors report
f. the directors report

Besides, section 342 of CAMA mandates the directors to prepare "directors' report" every year. The directors' report contains statements, which go far beyond the finances of the company. The report shall state inter alia, the significant change(s) in the activities of the company over the year, an indication of the likely future developments of the company, directors interests in the company, money given to charity organisations, number of persons employed during the year, policy and practice of the company on training, retirement, health, safety and welfare of staff. (Sanmi 2003) From the fore-going, it is clear that there is no express statutory requirement that the 'directors' report must provide a true and fair view of the state of affairs of the company. This is however, without prejudice to section 342 (6), which imposes a penalty for failure to company with the Act. "Failure to comply with the requirement of the Act," within the context of section 342 can only logically mean failure to file a Directors' report. It does not cover a case where untruthful statements, partial truths or embellishments are contained in the report. The question that comes to mind is whether the legal obligation results in a social responsibility on the part of companies to present accounting narratives of a particular standard.

ii. Social Responsibility

The concept of social responsibility derives from the fact that organisations do not exist in isolation or are not independent of the environment in which they operate. They must be interested in what happens around them. Corporate social responsibility involves obligations and the obligations enable organisations to give something back to the society as compensation for what they have taken. There is no doubt therefore that clear links exist between social responsibility and corporate annual reports. Organisations meet the needs for accounting through the provision of information. And the information is provided through corporate annual reports. There is a growing societal demand for greater corporate social responsibilities in a wider variety of areas today.

So, beyond the role of providing information to proprietors, accounting has social obligations as the stakeholders in the enterprise are not only many, their objectives are also diverse. According to Randle (2003)

This legion of stakeholders, which include creditors, employees, suppliers, government, customers and potential investors, depend on financial information for their economic decision to invest, divest and/or diversify their investments portfolio. Accounting information affords these numerous stakeholders the opportunity to assess the stewardship of managers of corporate resources as well as the worth and viability of the enterprise.

Thus, the information generated through the accounting process serves diverse purposes both in the public and private sectors and herein lies the social contract.

Courts (1995) opined that " responsibility rests on those who prepare annual reports to ensure that investment influencing information in prose form meets the fluent comprehension skills of the vast majority of those for whom messages are intended."

Courtney and Justin (2003) concluded, following Courtis's opinion above that " the responsibility (and the information it ensures) exists to allow users to make informed investment decision. This being the case, it is right to assume a link between corporate annual reports and corporate social responsibility.

iii. Narrative Evaluation

Accounting narratives are those aspects of company financial statements in prose form, which generally give an overview of the state of affairs of the company. The Directors report is one of them. At times, they are craftily drafted to conceal the true picture, which the figures in the statements portray. From the relationship constructed from the preceding paragraphs, it can be inferred that there is a need to evaluate the quality of information provided by companies and to ensure its usefulness. This need arises from the fact that users of accounting information rely on such information to make investment decisions. To a degree above average, the quality of investment decisions made depend on the quality of the corporate information provided. Given the level of reliance placed on these reports by users, it stands to reason that the quality of the information be assessed. Many researchers including Courtis (1998) agree that the readability level of most corporate reports is difficult. According to Courtney and Justin (2003) " the degree of difficulty is reflected in statements that paint a more favourable picture of corporations than is actually the case. This introduces the role of the narrative evaluation function'' However, it is not in all cases that companies paint favourable picture of their accounts. There are circumstances where it may be beneficial to do otherwise, for instance, for purpose of tax evasion or avoidance. The question now is: What is the best approach to evaluate accounting narratives? As at today, there is a lack of definitive methods of assessing and judging the quality of the information contained in corporate reports. It therefore requires that measures must be devised that allow for establishing rules for the quality of information. It is hoped that the identification of an appropriate method will lead to an improvement in the quality of accounting narratives. This paper employs the perspective of corporate social responsibility in seeking to hold corporations more accountable, through the creation of a viable assessment mechanism. The remainder of this paper focuses on the Texture Index as a form of assessment of information contained in corporate reports.

Section two of this paper reviews existing literature on the subject; section three establishes our objectives and methodology. Result of the study is considered in the fourth section while section five is the conclusion. The paper directs its attention on the evaluation model developed by Sydserff and Weetman (1999).

2. Literature Review

Different authors have conducted researches into the quality of accounting narratives. The aims of those researches have been to determine what elements make up effective and efficient written communication within the framework of assessing accounting narratives. Two schools of thought have emerged. The first is via readability tests and the second is via texture indices. Both methods of evaluating accounting narratives have recorded some good degree of attention from scholars.

i. Readability

Readability formulas have been used to evaluate the usefulness and quality of accounting narratives. These formulars predict "whether a target audience is likely to be able to read a prose passage'' Courtis (1998). The readability approach is based on the analysis of word characteristics and sentence length. The longer the sentence and the number of syllables the greater the difficulty in understanding the message conveyed. According to Smith and Talfler (1992), three common formulas that assess readability are the Flesch score, the Fog index and the Lix measure.

Even though the readability method has been used to evaluate accounting narratives, it has however come under serious attack from Scholars. The main criticisms include the following.

- There is the focus on the word level and sentence feature but not whole text aspects. (Jones and Shoemaker 1994)
- The motivation and interest of the reader were not considered. (Courtis 1998)
- The readability formulars were originally developed for use to evaluate narratives for children, and therefore not appropriate for adult based literature, especially the technical narratives that exist in annual reports (Courtney and Justin 2003)

ii. Readability and Understandability

It is the view of authors generally that readability and understandability should be the principal objective of narratives evaluation. Courtis (1998) opines that " the usefulness of an annual report is dependent on the extent to which inter alia, its content is readable and understandable." However, Adelberg and Razak (1984) do not see any distinction between understandability and readability. Jones (1988) however, states that an assumption of readability studies is that "readability reflects understandability." It is a matter of debate whether readability equates understandability. In our view, readability does not automatically create understandability. The subject matter and the literacy level of the readers must be taken into consideration. Arising from the above criticism of the readability approach, other evaluation approach should be developed to cater for both readability and understandability. It is in response to this call that the texture index has been developed.

iii. Texture index approach

The texture index approach was developed by Sydserf and Weetman (1999). It is the most current addition to the literature on the issue of evaluating accounting normatives. Sydserf and Weetman are of the opinion that their idea provides an initial solution for the production of a defensible, reliable and representative measure of readability that also considers variability. The texture index is composed of seven indexicals that are used to evaluate the narratives. Sydserf and Weetman (1999) identified the indexicals as topicality, intertextuality conjuction, connectivity, shift in information category, specificity and situationality. These indexicals, according to Courtney and Justin (2003) are a combination of the standards identified by De Bemigrade and Dressler (1981) and Rosiberry (1995). In carrying out the evaluation, all indexicals are applied to each narrative. The sum of each individual score equals the texture. Sydserf and Weetman (1999) view the whole text approach of the texture index to provide an indicator of accounting narrative quality that should be adopted because of the belief that it captures factors not captured by readability formulas. (See appendix 1 for a definition of each indexical as given by Syderff and Weetman (1999).

iv. Validity:

In readability researches. objectivity, reliability and validity have been identified as the main criteria for successful readability. (Sydserff and Weetman 1999). Of these criteria, validity deserves special consideration because without validity, all efforts would amount to nought. So, apart from objectivity and efficiency. validity needs to be attained (Jones and Shoemaker 1994) The question now is: How is validity obtained in narrative evaluation? Weber (1990) introduced the concept of face validity. This, according to Courtney and Justin (2003) " Suggests that a method is valid if it measures what it sets out to measure" They further added that although readability tests achieve face validity as they successfully measure readability, and reading ease according to word and sentence characteristics per their intention, the question becomes whether this is entirely adequate for the provision of quality information?

Having regard to the criticisms against readability approach to content evaluation, the "face validity" as put forward by Weber (1990) cannot stand the test of time. This is because we must measure and determine whether what is actually measured by readability test is useful in evaluating narratives. It is in this context that Sydserff and Weetman (1999) contend texture method replaces readability as the most valid approach to evaluating narratives.

3. Methodology

Various models of narratives have been developed in this paper. Of these, the texture index is deemed superior and therefore proposed as an appropriate and valid text of quality. The texture index seeks to determine both readability and understandability. As a result, our objective in this paper becomes to test the strength of the texture index proposed by Sydserff and Weetman (1999). By this, the paper adds to the on-going debate and search for tools and techniques utilised in the assessment and evaluation of accounting narratives.
The reporting function as at today is under the control of corporations. Courtis (1998) found evidence to support the fact that many corporations engage in crafting their annual report in a manner that is complicated and less than user friendly. In some cases, results have shown that even users of the greatest sophistication have difficulty in fully comprehending financial narratives. If this is true, then an undertaken like this paper that attempts to improve the situation is worthwhile.

Method

Having now determined our objective our task was to select an appropriate means to achieve our aim. The question then became how to test the strength of the texture index in evaluating narratives? Our approach resembles in all respect that which was adopted by Sydserff and Weetman (1999). That is, the texture-based study was conducted using annual reports narratives. The texture-based method was further validated by testing the following hypotheses.

Ho : Accounting Narratives are not easy to read and understand by users of Accounting information.

Hi : Accounting narratives are easy to read and understand by users of Accounting information.

i. Data

According to Sydserff and Weetman, (1999) the texture index could be applied to all narratives. So, we decided to choose the "Directors report" for our study to test the applicability of the texture index. (Sydserff and Weetman 1999) in their study used "operating financial statement." Courney and Justin used the "Letter to shareholders", which is the same as Directors report.

It is generally believed that the Directors' report is the first contact readers have with financial reports. It is also the "mirror" through which the whole financial report can be seen.

The next step involved dividing the directors report into units for evaluation; known as "t-units" The accepted definition of a t-unit is that it is an independent clause with all subordinate clauses attached to it (Sydserff and Weetman 1999). The common division of t-unit is into sentences, but could also be in paragraphs. It is usually a subjective process. In this paper, we have divided t-units according to sentences and the first twenty sentences were examined. The decision is informed by the fact that whatever is to be said should be said at the beginning of the report and this should be within the first twenty sentences.

Sample Size. The next step was to select sample annual reports for testing. We selected twenty companies from different sectors of the economy. (See table I below). A sample of five companies was used in the study by Courney and Weetman (2002) we decided to use a larger sample to get a more robust preliminary picture of how the texture index may work in our environment. Obviously, a much larger sample will mean greater ability to draw inferences about what the texture index actually provides us with. Nevertheless, we were able to make some observations necessary for the purpose of our exercise.

Table I: Companies and Annual Reports Tested

Industrial sector	No. of companies	Quoted	Unquoted
Insurance	4	3	1
Banking	4	3	1
Transportation	2	-	2
Manufacturing	2	1	1
Construction	2	1	1
Medical	1	1	-
Production	3	2	1
Livestock	2	-	2
TOTAL	**20**	**11**	**9**

Note: The year of annual report is not indicated because it is not relevant in this study.

ii. Testing – Indexicals

The texture index was applied to each of the twenty annual reports of the companies selected. Each t-units (sentence) was scored according to a set of determined rules of quality and assigned a value according to the existence of the desired textual characteristics. The rules applied were those used by Courtney and Justin (2002). The rules are presented in appendix (II).

The overall readability of each Director's Report was obtained by adding each of the individual scores and obtaining a simple average. This is because the sample narratives were independently analysed by each author. (See table II below)

Table II: Indexical Ranking of T - Units

COY	1	2	3	4	5	6	7	Scores Obtainable 240	Score obtained	Percentage %
A	15	8	10	16	6	9	20		84	35
B	14	13	14	18	5	10	20		94	39
C	12	11	12	17	7	42	20		90	38
D	15	16	15	14	9	13	20		102	43
E	16	14	15	15	8	15	20		103	43
F	12	10	15	17	7	14	20		95	40
G	13	12	11	18	4	8	20		86	36
H	15	13	12	19	4	9	20		92	38
I	14	14	14	17	5	11	20		95	40
J	11	14	13	15	6	17	20		96	40
K	12	16	15	16	9	12	20		100	42
L	13	10	14	17	7	14	20		95	40
M	13	11	11	18	7	13	20		93	39
N	9	9	10	18	7	13	20		86	36
O	9	11	13	15	6	9	20		83	35
Q	14	13	9	17	6	10	20		89	37
R	15	9	13	18	5	11	20		91	38
S	11	10	11	16	4	12	20		84	35
T	12	12	13	17	8	12	20		94	39
P	12	13	8	16	5	10	20		84	35

Note: Indexical seven "Situationality" satisfied for all Directors' report.

Maximum Score

Key to table II

1	=	Topicality	40
2	=	Intertextuality	40
3	=	Conjuction	40
4	=	Connectivity	40
5	=	Shift in Information	20
6	=	Specificity	40
7	=	Situationality	20
			===
			240
			===

4. Results

The results of our testing and evaluation as shown in (table II) reveal that the companies had a minimum quality score of 41% and a maximum of 54%. The average texture arrived at was 38%. The study carried out by Courtney and Justin (2002) show that the companies they evaluated had a minimum texture of 36%. a maximum of 59% and an average of 45% respectively. Even though our results are comparable. but there is the general observation that the Nigerian companies have less texture than those of the companies tested by Courtney and Justin (2003). This indicates that the Directors report we analysed were relatively difficult to read and understand. The higher the texture scores, the easier it is to read and understand accounting narratives. Given this scenario, it then means that our findings support the findings of previous researches that have generally shown that annual reports narratives are difficult to read and understand. This finding is further evidenced by test of the hypothesis earlier formulated. The result of the test shows that the null hypothesis should be accepted and the alternative hypothesis rejected. (See below)

i. Test of Hypothesis

The higher the textual scores, the easier it is to read and understand accounting narratives. For the purpose of this study a score of 144 (60%) or above of the total scores obtainable is deemed adequate for reading and understanding accounting narratives and therefore represent the population mean μ. The data from the study show.

Note: The year of annual report is not indicated because it is not relevant in this study.

ii. Testing – Indexicals

The texture index was applied to each of the twenty annual reports of the companies selected. Each t-units (sentence) was scored according to a set of determined rules of quality and assigned a value according to the existence of the desired textual characteristics. The rules applied were those used by Courtney and Justin (2002). The rules are presented in appendix (II).

The overall readability of each Director's Report was obtained by adding each of the individual scores and obtaining a simple average. This is because the sample narratives were independently analysed by each author. (See table II below)

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E	16	14	15	15	8	15	20		103	43
F	12	10	15	17	7	14	20		95	40
G	13	12	11	18	4	8	20		86	36
H	15	13	12	19	4	9	20		92	38
I	14	14	14	17	5	11	20		95	40
J	11	14	13	15	6	17	20		96	40
K	12	16	15	16	9	12	20		100	42
L	13	10	14	17	7	14	20		95	40
M	13	11	11	18	7	13	20		93	39
N	9	9	10	18	7	13	20		86	36
O	9	11	13	15	6	9	20		83	35
Q	14	13	9	17	6	10	20		89	37
R	15	9	13	18	5	11	20		91	38
S	11	10	11	16	4	12	20		84	35
T	12	12	13	17	8	12	20		94	39
P	12	13	8	16	5	10	20		84	35

Note: Indexical seven "Situationality" satisfied for all Directors' report.

Mean $\overline{x}$ score = 91.8
Standard deviation ∂ = 18.6
No. of observation n = 20
Population mean μ = 144
Level of significance $Z\alpha$ = 0.05
Df = n-1 = 20-1 = 19
Ho: $\mu \geq 144$
Ha: $\mu < 144$

Test statistic $Z = \dfrac{\overline{x} - \mu}{\partial / \sqrt{n}}$

$= \dfrac{91.8 - 144}{18.6/\sqrt{20}}$

$= \dfrac{-52.2}{4.16}$

$Z = -12.5$

$Z\alpha\ 0.05 = -1.729$

Rejection rule: Reject Ho if $Z = \dfrac{x - \mu}{\partial \sqrt{n}} =< -1.729$

Since Z = - 12.5 is less than – 1.729 it shows that the value of the test statistic falls within the rejection region. We are therefore justified in concluding that the accounting narratives are difficult to read and understand.

5. Conclusion

The task of evaluating accounting narratives is a difficult one. The reason being that the subject is still relatively new and grey areas exist on which consensus among Accountants and users of accounting information is required. These grey areas, include subjectivity due to individual discretion in:

a. Scoring process
b. Choice of accounting narrative
c. Choice of particular user of accounting information and so on.

The above factors are considered limitations to this study because they could impact on the validity of the texture index as a useful method of narrative evaluation. This notwithstanding, our result show support for the use of texture index in narrative evaluation. The question however remains whether we have measured the elements that truly reflect readability and understandability. The question would remain unanswered until benchmark is created for evaluating narratives and interpreting the quality and quantity of evaluation process. It is recommended that future research work on this subject should address the issue of benchmark in order that the subject of accounting narrative and evaluation could grow. Meanwhile, efforts should be made by organisations to present their Corporate reports in readable and understandable form especially in the interest of users who are less or not literate in financial analysis and techniques. It is hoped that this study has contributed to the refinement, debate and search for an appropriate method of evaluating accounting narratives.

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