Università Commerciale

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Doctoral Dissertation

FINANCIAL COMMUNICATION STRATEGY:

AN INVESTIGATION OF THE STRUCTURE OF

ACCOUNTING NARRATIVES AND FIRM FINANCIAL

PERFORMANCE :

EMPIRICAL EVIDENCE FROM ITALY

By

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Acknowledgements

This thesis is a testimony of respect to all the professors I had during my PhD study years at Bocconi university, to all the professors I had in Tunisia.

It's just the beginning, the best is coming !

To my Parents, Hédi & Najiba;

To my brothers, Slim & Moez;

To my beloved, Ines.

Financial Communication Strategy:

An Investigation of the Structure of Accounting Narratives and Firm Financial Performance :

Empirical Evidence From Italy

Abstract:

The objective of this research is to investigate the relationship between the structure of accounting narratives and firms financial performance. Three dimensions are investigated: (a) text ease of readability (text complexity), (b) wording structure and (c) thematic structure. The MD&A of 40 listed companies were analyzed. Results indicate that narratives are assessed as difficult to read independently of firm financial performance opening the way to interpretations about how much attention is given to writing style in the reporting process. From another hand, less performers seem using positive word in excess in order to hide bad achievements. This gives too much positive coloration to their messages which may be a source of impression management Also, we found that the only notable difference between the two groups of companies respective to thematic analysis lies at the level of forward looking-information. Less performers behave as performers by focusing on prospective information. This research is timely seen the need that many parties are expressing in understanding business reporting structure especially after the recent financial scandals.

Key words: Accounting narratives, Impression management, Financial Performance, Financial communication.

Satrategia di Communicazione Finanziaria :

Un analisi della struttura dell'informazione contabile testuale

E la Performance Finanziara :

Evidenza Impirica dall'Italia

Reassunto

L'obiettivo di questa ricerca é di studiare la relazione tra la parte testuale degli « annaul reports » conosciuta come « accounting narratives » e la performance finanziaria. Sono analizzate tre dimensioni: (a) la complessità del testo, (b) la natura delle parole usate e (c) la struttura tematica. Le relazione sulla gestione di 40 aziende quotate sono analizzati. I risultati indicano che il testo é classificato difficile independentemente della performance realizzata. Da un altro lato, abbiamo trovato che le aziende meno performanti fanno un eccessivo uso di parole con connotazione positiva. Questo apre la porta alla tesi che i narratives sono gestiti in funzione della performance e magari per nascondere una performance non sufficiente. Al livello della struttara tematica, l'unica differenza notata tra performers e non performers é al livello delle informazioni prospettive (Forward-looking). I meno performanti riportano più informazione sul futuro rispetto agli altri lasciando pensare ad un comportamento di impression management. Questa ricerca è di attualità e rivela una grande utilità per diverse parti che potrebbero essere interessate a capire la struttura della comunicazione finanziaria soprattutto dopo gli ultimi scandali finanziari.

Prole chiave: Informzione Contabile Testuale, Impression Managment, Perfromance Finanziaria, Communicazione Finanziaria.

Stratégie de Communication Financière:

Une Investigation de la Structure des Informations Comptables Textuelles et de la Performance Financière:

Etude empirique dans le contexte Italien

Résumé

L'objectif de cette recherche est d'analyser la relation entre la structure de la partie textuelle des reports annuels (informations comptables textuelles) et la performance financière des entreprises. Trois dimensions sont étudiées : (a) la complexité du texte (la facilité de lecture), (b) la nature des expressions utilisées et (c) la structure thématique. Les résultats montrent que les textes sont classéS comme difficiles à lire indépendamment de la performance financière. Ceci laisse à penser que les préparateurs des rapports annuels ne donnent pas encore une grande importance à la manière dont le texte est écrit. D'un autre coté, il s'est avéré que les entreprises moins performantes ont tendance à utiliser avec excès des expressions à connotation positives. Ce qui laisse à croire à une tentative de gestion des impressions à travers le texte. Finalement pour l'analyse thématique, on a trouvé que l'unique différence entre les performants et les moins performants se trouve au niveau des informations prospectives (Forward-looking). Les moins performants semblent suivre les performants dans leur structure thématique avec une concentration sur les informations prospectives. Cette recherche est d'actualité et révèle une très grande utilité pour les parties intéressées à la manière dont le reporting financier se fait et surtout après les récents scandales financiers.

Mots clés : Informations Comptables Textuelles, Gestion des Impressions, Performance Financière, Communication Financière.

INDEX

Tables

Figures

"Our Knowledge can only be finite, while our ignorance must necessarily be infinite"

Popper, K.

<u>INTRODUCTION</u>

"We create a picture of an organization… and on the basis of that picture…people think and act. And by responding to that picture of reality they make it so"

(Hines, 1988)

Financial Communication Strategy:

An Investigation of the Structure of Accounting Narratives and Firm Financial Performance :

Empirical Evidence From Italy

INTRODUCTION

Last decade witnessed huge debates in the corporate reporting arena about reforms of how companies – Should – communicate with their investors. Arguing that the old financial reporting model is not anymore up-to-date to the new needs of shareholders, many regulators and professional bodies called for a reform of the reporting system (AICPA: 1994; ICAEW: 1998,2003; FASB: 2001). Several notable accounting firms also followed the stream and proposed different reporting frameworks[1] more adapted to the new economic realty. For instance, the former Arthur Anderson (2001) argue that the old "Push" model of measurement and reporting is fast becoming obsolete. The future is a "Pull" model, one in which a transparent, user-driven system allows stakeholders to access what they need to know. Therefore, more information has to be disclosed beyond the conventional financial statements (Clarkson et al: 1994, Francis & Schipper: 1999). Corporate annual reports have became the primary interest of many parties (AICPA: 1994, ICAEW: 1998, 2003).

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[1] For instance, PriceWaterhouseCoopers issued the *ValueReporting Franework* in response to the "information gap" existing between companies and shareholders. It stresses on enhanced, voluntary disclosure of future oriented information – Financial and non-Financial (PriceWaterhouse Coopers: 2001).

Today, corporate annual reports are considered as one of the most important communication channels between firm and its stakeholders (Anderson & Epstein: 1996, Epstein & pava: 1993). They are intended to inform stakeholders, particularly shareholders, about a firm's business history, its current financial position and its expected future (Epstein & Pava : 1993, Courtis : 1995, 1998).

Quoting from Epstein & Pava (1993):

> "The purpose of annual report is to communicate information to the corporate shareholders and other stakeholders (or potential stakeholders). The information should communicate about the financial condition of the enterprise, and other information that would likely be of interest to the user. It is the shareholder who is the owner of the company, and t is the existing shareholder who must be the primary audience" (Epstein & Pava: 1993, p.3)

Even though, in some countries (USA for example), annual reports are a statuary-based formal communication means, corporate reports are very important for effective business communication. Evidence showed that shareholders reliance on stockbrokers declined over years to leave more space to reliance on annual reports and shareholders' own financial analysis (Anderson & Epstein: 1996, Epstein & Pava: 1993).

Several authors (Lee: 1994, Stanton & Stanton : 2002) are arguing that corporate financial communication is becoming more and more complex and annual reports are intended to be an integral part of the companies' investment to create and maintain a certain corporate image. Stanton & Stanton (2002) stressed the importance and influence that annual reports might have:

> "Depending on the perspective adopted, an annual report could be a proactive document constructing and projecting a particular image, or merely a reactive document, responding to the concerns of particular groups. More explicitly, many utilizing the [impression] image management perspective view annual reports are proactive documents used to develop and maintain a particular corporate image, and to present information as favorable as possible, those examining reactions to crises such as bad news saw annual reports as reactive documents" (Stanton & Stanton 2002, p.493).

Financial statements are not anymore the means of predilection to analyze companies performance and evidence has been provided on the declining value-relevance of financial statements (Francis & Schipper: 1999). In that, annual reports (sections other than that of financial statements) are showing to be very present in the business environment. In particular, accounting narratives are playing an increasing role in shaping the way financial information is disclosed (Clatworthy & Jones: 1997, Smith & Taffler: 1995) and they are considered as very influencing on annual reports users decision making (Breton & Taffler : 2001, Stanton & al: 2004). Their importance is acknowledged since some years (Clatworthy & Jones: 1997) and most important accounting bodies called for its consideration with more importance in disclosure. For instance, since 1973 The A.I.C.P.A (1973) stated that "Financial reporting should not be limited solely to quantified information. Amplification in *narrative form* of data included in statements may be required". And more recently, the same issue was raised by the I.A.S.B (2001) with a project that "*would explore whether the I.A.S.B should provide guidance on the presentation of information presented outside the financial statements in the form of management's explanation of the enterprise's financial conditions…*"

Accounting narratives' importance is not to neglect anymore since they are becoming imposing parts in the annual reports (Clatworthy & Jones: 1997)[2]. Only in England for instance, Arthur & Anderson (2001) indicate that 57% of the annual report was devoted to accounting narratives – Against 45% in 1996 (an increase of 12% in 5 years) of 100 UK public quoted companies. Once seen as an interesting side-issue, accounting narratives are now jostling for equal status along the financial statements themselves as representing the core of the annual reports (Beattie & al: 2004)[3]. Barlett & Chandler (1997) show that private shareholders rank five narrative sections of the annual report (financial summary, Chairman's letter, Chief executive's review, financial review and operating review) among the top six sections in terms of perceived usefulness. Also, there is a growing evidence regarding analysts reliance on the narrative sections of the annual reports to assess their decisions (Previts et al: 1997, Rogers & Grant: 1997).

Recent financial scandals around the world (Enron, WorldCom and Xerox in the USA, Parmalat in Italy, Batam in Tunisia, Al-Khalifa holding in Algeria, Vivendi in France) were mainly the results of long time financial accounts manipulation based on creative accounting techniques (Pigé: 2002, Stolowy: 2000). Thinking deeper, an interesting question would be: how did these firms manage to maintain the image of successful companies for such long periods and how did they manage to lead public to invest more and more in their equities? We believe that corporate image, mainly vehiculated by the means of annual reports, was playing a major role in that. as it is becoming a common

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[2] The former chairman of the ASB, David Tweedie, has expressed the view that more importance needs to be placed on the narrative attached to company accounts, with the OFR in particular becoming more important (Accountancy Age: 1999).

[3] Arthur Anderson (1996) comment "What surprised us was that the narrative pages exceeded or equaled the number of the statutory financial statements in half of our survey companies" (p.5)

belief to see corporate reports as communication documents of symbols *selected* and *ordered* to *give meaning* to a story (Stanton & Stanton : 2002)..

Hopwood (1996) supports this claim arguing that corporate annual reports have become a highly sophisticated product of the corporate design environment, the main purpose of which is to proactively construct a particular visibility and meaning rather than revealing "*what was there*".

Accounting narratives seen as communication means of selected and ordered symbols to give a meaning to a story (Stanton & Stanton: 2002) will play an important role in corporate image spreading. Narratives even though are qualitative data in nature, are more complicated and influencing than they are usually thought to be (Kaplan et al: 1990, Clarkson et al: 1994, 1999; Previts et al: 1997, Breton et taffler:2001) . As mentioned by Epstein & Pava (1993), annual reports (accounting narratives included) are becoming more and more read by a large audience that does not have neither the skills or the financial power of institutional investor to access to other data. These narratives are easily accessible to anybody who is interested in knowing about the company, consequently this kind of textual information convey an image of the company that can influence in a large prospects readers' decision making process (Kaplan et al: 1990, Stanton et al: 2004).

Research on the nature of accounting narratives is timely because of the current large, discretionary and unaudited nature of accounting information provided to shareholders. While financial statements are subject to auditing by a third party (external auditor), accounting narratives (the CEO's letter, Management Discussion and Analysis) are largely at management's discretion. Proximity to the audited financial statements gives a

certain degree of credibility to the narratives. This apparent credibility combined to the dissemination of the annual report to relevant publics provides managers with an opportunity to design a particular organizational image for their relevant publics (Guthrie & Parker: 1989).

This flexibility may open ways to manipulation through well structured linguistics games and it is not inconceivable that managers will use the opportunity to interpret events to their own benefits (Hines: 1988, Ginzel et al: 1993, Rutherford: 2003). Scholars who theorize about the management of information symbols, and impressions by corporate officers have argued that when shareholders' impressions are open to interpretation, officers use communication strategies that favor their own interests (Pfeffer: 1981). Managers may abuse of this flexibility and make the text more complex to read in order to obfuscate backdrop in performance for example (Subramaranian et al: 1992, Courtis: 1998) or they simply may focus on some themes more than others to distract readers from more important issues (Kohut & Segars: 1992).

Language is usually used to guide reader to a particular interpretation (Thomas : 1997, Compin: 2004). How words are used, presented, their frequencies and how verbs are ordered, themes, justifications and apologies are all structures that influence reader's attention. Consequently, a less informed shareholder may easily be misled by a well structured game of words, a not easy to read text or by specific themes discussed in the communication. Annual reports (Accounting narratives) may not lie, however they may suggest and imply (Thomas : 1997). Thus, not surpassingly, managers gradually learned that while the events that affect performance often *cannot be* controlled, *the way* that people perceive these events *can* be controlled (Revsine: 1991). Taken from this

perspective, accounting narratives disclosures are not anymore a ritualistic behavior as stated by Gibbin et al (1990) but go beyond that to become a means to influence and control how people perceive and see the company (McKinstrey: 1995, Preston et: 1996). Thus, Changes in company's financial performance is likely to produce changes in the way companies communicate with their investors (McKinstrey: 1995, Preston et: 1996).

Impression management theory, is a valid framework for the current research. Defined in simple words, impression management is the set of ways of controlling what others think of us (Rosenfeld & al : 1995). The theory has origins in cognitive and social psychology (Shlenker: 1980, Tedeschi: 1981). Impression management implies significant management of information (Staw & al: 1983). It may be applied in different accounting settings where behavior manipulation is in game. Managers have exact information about companies financial performance, but seek to manage presentations of the news in that way to control the impression that outsiders will create about the company. In a more restrictive perspective, the theory is related to the agency theory framework, where managers - (agents) are in possess of private information they are willing to conceal to the shareholders (principals) in order to preserve a certain image and status (Jensen & Meckling: 1976).

Thus, The main objective of this research is to investigate whether accounting narratives, namely the Management Discussion and Analysis, of Italian listed companies are adapted/managed according to financial performance. Explicitly we aim at analyzing the relationship between the MD&A structure (text complexity, wording structure and thematic structure) and financial performance.

In this study we are attempting to give some insights to the following questions:

- Are performing companies and less performing companies adopting the same writing styles ?

- Are bad performers hiding their bad achievements by the means of some impression management tactics based on accounting narratives structures ?

The contribution of this research may be considered from several respects. It is useful for (1) scholars by adding to the body of previous research and by validating the theoretical basis and (2) for practitioners by shading the light on some aspects which didn't get the deserved attention till here (accounting narratives in the reporting framework) :

- While studies researching disclosure theory mainly focused on accounting methods choice or determinants of financial disclosure (Fields et al: 2001, Healy & Palepu: 2001) research investigating accounting narratives are still few compared to this first stream (Jones & Shoemaker: 1994, Clatworthy & Jones: 2001). Moreover, it is still seen that the area of corporate financial communication in general is vastly under-investigated (Smith: 2004). Our study will be a new addition to enrich the research field on accounting narratives and corporate financial communication in general. It adds new evidence on the relationship of accounting narratives and firm's financial performance.

- We notice that most of previous research on accounting narratives exclusively concentrate on English speaking countries[4] such as Australia and New Zeeland (Anderson & Epstein : 1996), United States (Ingram & Frazier: 1983; Pava & Epstein : 1993), United Kingdom (Clatworthy & Jones : 2001, 2003), Canada (Courtis: 1986), Hong Kong (Courtis: 1998). Few are the exceptions that studied

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[4] Or countries where English is very present as a second language.

non-English speaking countries like Belgium (Aerts: 1994, 2003) and France (Onee & Chekkar: 2005). To fill this gap and to better understand the rationale of narratives reporting on a larger scale, Courtis (1998) called for more empirical investigations of the analysis of accounting narratives in different contexts. Our research is a reply to this call. It builds on previous literature by adding some further grounds about a new country not previously investigated in the literature, namely Italy.

- Italy is a very interesting country to study. First, It is among the most visible industrialized countries at the world level, at the regional level and at the European Union level. it has well established regulation and financial system allowing economic partners to conduct their business. However, not much is known about financial reporting in this country. We are working through this research on giving some addition about the subject matter. Second, Even though the Italian financial market is relatively small compared to other Europeans counterparts, but it's an active market where major Italian companies are listed and more governmental efforts are put to strengthen it (IMF: 2006). This leads to think about the state of the art of financial communication, how it is currently performed and about its future. Our research is a first attempt to handle some of these issues. Third, Italy is a country with long tradition in financial reporting. In that it is the country where modern accounting is born and where the first interest in Management Discussion & Analysis showed up 50 years ago *"Relazione Sulla*

Gestione[5]" (Ricabbone & Ghirri: 1994). This makes the context more interesting to explore. From an another perspective, Italy witnessed one of the most notable financial scandals in Europe and the world, The Paramalat case (Ramonet: 2004). In that sense this research is more timely than ever in order make better understanding and appreciation of the structure of financial communication of Italian companies.

- This study is the first in its category investigating financial reporting in Italy from an accounting narratives perspective. It builds on other studies dealing with financial disclosure (Prencipe: 2004 for instance) by shading the light on the narrative part of annual reports. No previous published studies, at our knowledge, analyzed the relationship between the structure of narratives and the financial performance of Italian companies. This will be with added value to better understand financial reporting and financial communication in Italy.

- On a wider scope, This research is an addition to the few studies which dealt with continental Europe. Research investigating continental Europe are very scarce. Aerts (1994) and (2001) studies are the only published[6] ones investigating a continental European country (Belgium). We note that although Aerts (1994, 2001) is analyzing accounting narratives, his scope is different from ours. He is analyzing the self-attribution structures in the narratives with relation to financial performance, whereas in our study is more focused on the textual structure itself.

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[5] The MD&A (Relazione Sulla Gestione) in Italy is discussed with more details in the method of research chapter.
[6] Some other studies researched other countries like France (Onee & Chekkar: 2005), however they were with limited impact since they were written in local language and published at the local level.

- Large number of accounting narratives studies researched the chairman's letter since it's known – at least in Anglo-Saxon countries, that it's one of the document the most read by people interested in the company's activities (Barlett & Chandler: 1997, Arnold & Moizier: 1984). Although it is very influencing on investor decision making, last years witnessed a greater interest in the Management Discussion & Analysis (MD&A). This document is still under-investigated and more research needs to be done on it. Some researchers addressed the utility of document (Clarkson et al: 1999, Rutherfrod: 2003, Beattie et al: 2004) but more needs to be done. This research is a contribution to better go through this document and better understand its structure. This allows to see the importance of the document in the reporting process.

- Most of the studies that have been dealing with accounting narratives are over 10 years old. The data sets being analyzed are consequently old. New contributions are required on more updated annual reports, especially given the changes in emphasis on these documents in recent years (Clatworthy & Jones: 2003). Our study is giving new evidence about accounting narratives by analyzing very recent annual reports (2003).

- Recent corporate financial scandals send a clear message to the financial community on the importance of revising how firms communicate with investors. The extensive use for instance of US GAAP by Enron prevented investors from knowing about the real financial distress of the company (Pigé: 2002), but also financial communication played a significant role. The corporate image that the corporation transmitted to the market for years helped in burying the economic

troubles it was experiencing. Same observations are also valid for Parmalat in Italy, as it is considered the Italian Enron (Ficarella & Gavridis: 2004, Ramonet: 2004). Studying firms financial communication through annual reports is more than ever interesting and timely. Our research is helping to assess some reality about firms financial communication. Understanding how firms communicate with the market is very important for several parties such us auditors and regulators in order to prevent such collapses and their dramatic economic effects.

- From a practitioner point of view, this research on corporate communication strategies help investors who depend on corporate communication to guide investment decisions. It also helps auditors by providing some insights on the relation between narratives and financial statements. Auditors will be more concerned with the content of accounting narratives as they are doing with financial statements.

- This study is also with added value for annual reports prepareers. In fact, the findings will reveal some aspects about narratives such as the level of text complexity. Writing difficult prose for instance may impede effective communication between the company and its shareholders. And that's why companies have to be aware of the issue to ensure an effective communication with its environment. Effectiveness is viewed as the transmission of the desired message to the intended user in an accurate and understandable way (Smith & Smith : 1971) and our study is helping to better consider this scope.

- This research is very important for accounting regulators since it highlights some reality may be until recently is under-estimated. By knowing the relation between

accounting narratives and financial performance, regulators will be more keen to vote rules and standards on how accounting narratives should be disclosed so that to prevent any potential manipulation of financial disclosure and communication and consequently to avoid the dramatic economic and social consequences it leads to.

The remaining of this study is organized as follow: (1) First we review previous literature on accounting narratives' structure and financial performance, (2) in a second chapter we outline the theoretical background and the research hypotheses, (3) Third, the method of research is discussed   (5) In the fifth chapter the main findings and discussion are presented, (6) the limits of the study are discussed in chapter six and finally (7) The last chapter draws the conclusion and future perspectives.

**Fig.1 - Overview of the Problem –
Do narratives stick to numbers ?**

Economic
Event

Company

Rporting /
Disclosure

**ACCOUNTING NARRATIVES
(Management Discussion)**

Rporting /
Disclosure

**FINACIAL PERFROMANCE
INDICATORS**

Good / Bad

**FOLLOW
EACHOTHERS ?**

**Financial
communication**

Shareholders

**OBFUSCATION Through
STRUCTURE ?**

- **Text Complexity**
- **Wordings**
- **Themes**
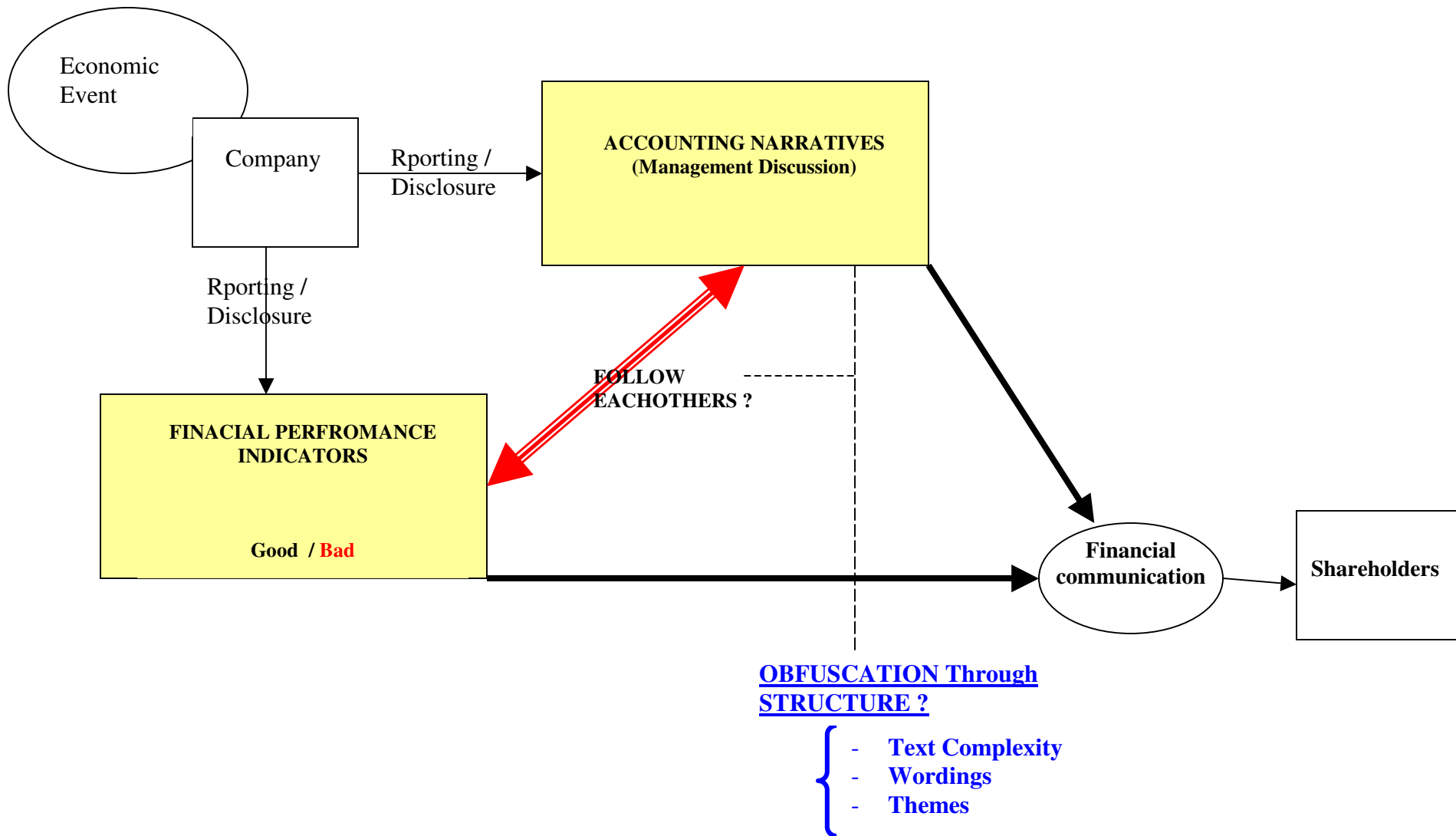
II. LITERATURE REVIEW

"When we are in an unfamiliar territory, we tend to reflect and to think,

has anyone been here before ?"

(Boettcher, 2001)

TEXTUAL STRUCTURE

AND

FINANCIAL PERFORMANCE

Early studies on disclosure mainly focused on economic aspects of the phenomenon (Verrechia: 1983; Dye: 1985)[1]. With the large proportion accounting narratives is taking in the communication process, more interest is given to analyze texts and their relation with companies' financial achievements. Early studies analyzed the footnotes complexity (Smith & Smith: 1971) and recent ones analyzed more complex parts of the annual reports such as letter to the shareholders and MD&A (Clatworthy & Jones: 2003, Rutherford: 2003). At present, disclosure management theory does not offer direct and unambiguous arguments to infer the impact of performance results on the construction on narrative structures (Aerts 2001). However, It is believed that managers will use all the means at their disposal to obfuscate bad performance and to blur readers' attention (Figure.II). Managers can abuse of text complexity to make narratives more difficult to apprehend by the interested parties (Section 1), also managers may adapt the wordings connotation to convey a positive and optimist image of the company although the financial reality is indicating the opposite (Section 2). Moreover, they can play on the choice of the themes being discussed, according to the financial results (section 3). .

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[1]On the one hand, managers whish to protect proprietary information in order to exploit their potential economic advantage (Dye: 1985). On the other hand, managers may whish to disclose information in order to enhance the firm value especially when the market is aware of the existence of bad news (Verrechia: 1983).

II.1. Impression Management: Syntactic Complexity Of The Text And Financial Performance

Research on syntactic complexity of texts (usually approached by narratives' ease of readability[2], quantified by sentence length, number of syllables, words, etc. are the oldest research on texts characteristics and financial performance (Adelberg: 1979; Smith & Smith: 1971). A revival of interest in these type research showed up these last years (Courtis: 1986, Jones: 1988, Kohut & Segars: 1992, Subramranian & al: 1993, Rutherford: 2003). The objective of these studies is mainly to assess the complexity of the text relatively to the financial performance. The inquiry is whether there is a relation between text complexity and financial achievements ? Smith & Taffler (1992) suggest that the complexity of the content differs dependent on the financial status of the company under consideration. However, literature on the issue does not provide a coherent set of answers and findings diverge. As stated by Rutherford (2003, p.189) "*The question of whether management of poorly performing organizations deliberately make their narratives more difficult to read by increasing their textual complexity is still open*" and "*results are confused and contradictory*" (Jones & Shoemaker: 1994, p.228).

Adelberg (1979) identified for non-standardized notes a significant correlation between complexity and return consistent with the obfuscation hypothesis. Adelberg (1979) also examined standard form notes but found no significant relationship between return and complexity. MD&A were also investigated in Adelberg's study (1979): he found no significant relationship between return and complexity. Adelberg (1979) argues that "*management knowingly or unknowingly introduces an interpretative bias into their non*

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[2] Readability formulas.

standardized messages" (p.186) and that it is perfectly natural to expect "*that some managers would obfuscate their failures and underscore their successes*" (p.187).

Courtis (1986) looked at whether readability levels of the chairman's address and foot notes sections were related to financial performance variability. His hypothesis is that readability levels, as measured by the Flesch index, may be manipulated to mask or accentuate particular levels of financial performance, as approached by profitability and risk. Courtis (1986) failed to give significant statistical evidence to the relationship between low readability levels and low profitability and high risk. Accordingly, he suggests that poor readability quality is related to writing skills, traditions and corporate policy followed by individual chairmen and chief accounting officers.

Also Jones (1988) did not find a systematic relationship between readability and return in a longitudinal study of one company (1952-1985). However, he does find that there is a negative statistically significant relationship between readability and volume of sales. This supports his a priori argument that as firm grows in size it becomes more complex, and this complexity makes the annual report more sophisticated and consequently more difficult to read.

Baker & Care (1992) reached a contradictory result according to the measure of return. They first find no relationship between the Flesch score of readability and net profit, but from the other side they find a 95 percent correlation between the Flesch index and Return on Equity. The direction of the relationship was consistent with the obfuscation hypothesis.

Contrary to the findings of Courtis (1986), Smith & Taffler (1992) demonstrate a link between clarity of exposure and firm performance. They found a significant relationship

for most but not all the measures of risk and complexity. They compared failed with non failed companies over a 7 year-period. Their results indicate that the Lix and Flesch indexes can be predictors of corporate failure and corporate failure is significantly correlated with more difficult text. "*Poor readability is associated with poor performance and ease of readability with financial success*" (Smith & Taffler: 1992, p.86).

Subramaranian & al (1993) analyzed the difference in performance textual communication in a sample of top performers and low performers (performance categorization is contingent upon an increase or decrease in net profit or loss from 1987 to 1988). They find significant relationship between performance and readability. Annual reports (letter to shareholders) are easier to read for good performers than those of poor performers.

Courtis (1995) finds contradictory results according to the measure of text complexity he used (Flesch, Lix and Fog). In comparing 16 profitable firms versus 16 unprofitable firms (ranked by ROI), he reached the conclusion that there is a positive relationship between profitability and text complexity according to the Lix index. He failed to find to find a significant relationship between Flesch and Fog indexes and profitability. However, he warranted on the use of these results as the sample is relatively small to infer valid conclusions. Courtis (1995) important conclusion is that all readability indexes showed that narratives are difficult to read.

Researching the differences in communication between top and bottom 25 fortune 500 companies ranked by Return On Equity (ROE), Kohut & Segars (1992) only found a significant difference in the number of words in the CEO letter. They find no significant

difference between performers and less performers according to other textual characteristics such as: number of sentences, syllables per word, words per sentence.

Recently two studies, Courtis (1998) and Clatworthy & Jones (2001) examine variability in textual complexity between sections within the same annual report (chairman's statement) for profitable and unprofitable firms. Courtis (1998) started from the hypothesis that readability of accounting narratives is more variable for less profitable firms whereas it is more stable for good performing ones since mangers of unprofitable companies tend to obfuscate bad news by making it less readable. Studying a sample of 30 profitable and 30 unprofitable companies, Courtis did not find support for his hypothesis.

Clatworthy & Jones (2001) replicate Courtis (1998) study in a sample of top 30 performing UK companies and bottom 30 performing UK companies. They did not find any evidence that managers obfuscate bad news through variation in readability as suggested by Courtis (1998). However, Clatworthy & Jones (2001) attribute readability variability to the difference in themes discussed in the chairman's letters between profitable and unprofitable companies.

Sydreff & Weetman (2002) investigated whether the textual sections of 'good' performers and 'bad' performers are significantly different (Flesch, ease of readability index, Transitivity index, Diction index). Their results were not conclusive and no significant relationship is found between performance and syntactical complexity of the text. However, the overall conclusion they provide is that the two index, transitivity and DICTION provide "*useful alternatives for accounting researchers investigating impression managemen*t" (Sydreff & Weetman: 2002, p.539)

Rutherford (2003) examined whether poorly performing companies use textual complexity to obfuscate in the Operating and Financial Review (OFR). He found that prolixity (text length) is following from technical imperatives of organizational size and complexity rather than obfuscation. Moreover, no significant correlation between syntactical complexity and performance was detected. The author concludes that poorly performing companies do not obfuscate by the use of text complexity.

Hammami (2004), researching the ease of readability of 20 Italian annual reports (letter to the shareholders), did not find any clear pattern between firm performance and text ease of readability. However, the author find that Letters to shareholders are difficult to read as approached by the Flesch and the LIX readability formulas.

More than text complexity, researchers in financial communication showed interest in the way words (positive, negative) are used according to financial performance.

II.2. Impression Management: Good / Bad News Reporting And Financial Performance

According to Abrahamson & Park: 1994, the reporting of news should mirror the underlying performance of the company. However, company management have incentives to represent their company's performance in the best possible light, which may cause what Revsine (1991) calls 'selective financial representation'. Previous literature indicates that managers are willing to select the positive/negative wordings depending on the financial performance of the company (Abrahemson & Park: 1994; Clatworthy & Jones: 2003) and some others only assumes that management, as human beings, psychologically tend to focus on positive wordings in their communication independently

of the reported financial performance – the Pollyanna Hypothesis (Hilderbrant & Snyder: 1981).

Clatworthy & Jones (2003) studied how the top 50 and bottom 50 listed UK companies (ranked by percentage of change in profit before taxation) do report good/bad news in their accounting narratives (letters to the chairman). Findings suggest that both groups of companies prefer to emphasize the positive aspects of their performance. In line with the underlying corporate performance, improving performers present more good news than bad news. Declining performers do report extensive bad news, but using keyword analysis the authors found that they focus more on good news. The authors conclude that for declining performers there is no correspondence between the accounting narratives and the financial statements as these companies did not address the issue of their financial performance head on.

Abrahmson & park (1994) studied the number of negative words in the chairman's letter relatively to the financial performance (Return on Assets). The authors hypothesize that officers tend to reveal poor organizational performance in financial statements. Thus they must make the content of the president's letter appear consistent with these lackluster financial statements. Their study revealed that changes in company's financial performance have a significant impact on the number of negative words in the president's letter. The greater the decline in the financial performance of the company, the greater was the disclosure of negative outcomes in the annual narratives. The relationship also held for the absolute financial performance level. Financial performance and changes in financial performance were [positively] correlated with the negative discourse in the president's letter" . When financial performance is low, corporate officers, disclose more

negative organizational outcomes. The authors note that "*The SEC and the accountants may reinforce this tendency by forcing officers to disclose poor financial results*" (p.1321).

However, Hilderbrandt & Richard (1981) reached different findings. They start from the hypothesis that communication in annual letters is predominantly positive regardless of the financially good or bad years (the Pollyanna hypothesis). Studying a sample of 24 letters over a two year-period (1975-1977) they found that positive words occur more frequently than negative in annual letters to stockholders regardless of whether the studied corporations had a financially good or bad year. The authors conclude that annual letter may underplay the negative news, replacing it by good news.

In a different context, Khlif & Zeghal (2002) studied whether the degree of confidence terms was correlated with firm's profitability. They studied a sample of the 30 financially best-performers listed companies in Toronto's stock exchange. In their analysis of the letter of the president, they found that there is a significant correlation between profitability and level of confidence conveyed through the document. More the firm shows financial performance, more the managers seem confident about the future and tend to show it in their communication.

Studying apparent structure of narratives according to financial performance seems to be not enough. Some other financial communication scholars researched the thematic structure of texts.

III.3. Impression Management: Thematic Structure And Financial Performance

Kohut & Segars (1992) see that studying companies' communication strategy involve the investigation of text technical characteristics and the themes discussed through the narratives. Several studies investigated the difference in discussed themes between companies according the reported financial performance. Managers may choose the themes to focus on in their presentations in order to conceal some other information, sometimes more important. Results indicate that the thematic structure of narratives do change between performing and less performing companies. Although no general trend of themes is depicted, some researchers constructed performance prediction models based on themes in accounting narratives (Frazier & al: 1984; Kohut & Segars: 1992; Smith & Taffler: 2000; Clatworthy & Jones: 2001; Beynoun & al: 2004).

Frazier & al (1984) used a computer program to develop factor scores (themes) based on occurrences and co-occurrences of words in narrative texts of annual reports. They extracted 12 themes (continued progress, strength of future progression; Tax effect and segment losses; Increase in debt to reduce stock; Environmental improvements; Domestic decline accompanied by foreign growth; Comparison of earnings to last year losses; Effect of strike on demand and income; substantial improvements in fourth-quarter earnings; Effect of raw material costs on profits; Increase in common dividends; Decrease in revenue resulting from price increase; Effect of government regulation on return on investment and expectation for improvement in economy). The authors conclude that there is no particular difference in thematic structure between performers and non performers. Themes do not clearly distinguish between the two categories of

firms. Frazier et al (1984) note that the narratives concentrate on a number of environmental attributes that are common across the firms rather than concentrating on individual particularities. An alternative explanation they suggest is that poor performers may provide signals that imitate good performers. Also, they suggest that disclosures may be considered as ex-ante signals of performance rather than ex-post signals of performance. "*If managers of – performance firms were attempting to misrepresent performance, the disclosures provided in the annual reports should not have been indicative of the firm's future performance*" (p.326). Thus, in a second step they studied the predictive ability of narratives using factor scores (themes scores) as independent variables in descriminent models. The sign of the Cumulative Average Residual (CAR) for 1979, the year following the annual report year, was the dependent variable. They find that narrative data can reasonably predict financial performance with a correct classification rate of 70%.

Kohut & Segars (1992) uncovered some structured patterns in themes depending on how firms perform. They proceed to a sentence by sentence coding to extract the themes. Each theme is thus quantified by the number of sentences they are related to. Also, each sentence was classified as prospective or retrospective according to the time it connotes. All the extracted themes were classified either 'Past looking' or 'Future looking'. Their analysis released five recurrent themes: (1) Environment, (2) Growth, (3) Operating Philosophy, (3) Markets and products, (4) Unfavorable Financial References and (5) Favorable Financial References. The authors find that for both categories of firms, management tend to focus on past events to explain dramatic corporate information, however the tendency is significantly visible in less performing firms. From another side,

it is interesting to note the high percentage of future references to operating philosophy are disclosed by low ROE firm.

As a second step of the analysis, the authors built a descriminent model, according to the extracted s themes. The model correctly classified 78 % of the companies as good or bad performing depending only on textual patterns (the previous cited themes). Their results confirm that "*within annual reports, consistent communication strategies are being followed based on favorable/unfavorable company performance*" (p.17).Therefore, textual characteristics may be considered as predictors of future performance of the company.

Clatworthy & Jones (2001) relate ease of readability of annual reports (chairman's letter) and thematic structure. As mentioned in earlier section, variability in readability is due to thematic structure rather than obfuscation. The authors extracted 11 major themes, namely: (1) Future and/or outlook, (2) results, (3) employees, (4) acquisition and disposals, (5) outline of major events, (6) discussion of major events, (7) overview of the year, (8)board changes, (9) operations, (10) business segments and (11) Finance/Investments. The authors did not find a strong statistical evidence that that thematic structure of profitable companies is different from unprofitable companies, however they note that profitable companies are keen to discuss their results early in the chairman's statements in order to create good impression.

Impression management theory is used as the theoretical background of this research. Rationale behind the theory and research hypotheses are presented in next chapter.

III.

THEORY AND HYPOTHESES

DEVELOPMENT

"Today virtually all financial decisions in both the private and the public sector use accounting surrogates rather than directly observed events as the basis for action. Manipulating the surrogates provides decision makers with a means for influencing peoples' perceptions of managerial performance."

(Revsine, 1994)

THEORY AND HYPOTHESES DEVELOPMENT

IMPRESSION MANAGEMENT OR THE ART OF BLURRING

A large part of the information conveyed by the company to its shareholders is on a discretionary basis. This flexibility provides managers, to certain extent, with an opportunity to shape the information to communicate, its content and extensiveness. The objective behind is to maintain the company portfolio of stockholders and not to lose reputation. In the accounting literature of earnings management, agency theory suggest that managers will take advantage of accounting regulation flexibility in order to maximize their own interests through voluntary adoptions of disclosures (Jensen & Mekcling: 1976, Watts & Zimmerman: 1986, 1990;). Agency theory is view as a part of a larger theoretical framework known as impression management theory. Impression management is a valid framework to give explanation for the variation in style and content of the narrative reports (Stanton & Stanton: 2002, So & Smith: 2004).

In the following sections we trace the origins and foundations of impression management theory and show how it may be applied in the context of financial communication (section 1). Specifically how text complexity may become a tool for impression management (section 2) and how the choice of wordings are used as an impression management tool (section 3). Also, when choosing the themes to discuss in the annual reports firms may be tempted to adopting impression management (section 4).

III.1. Impression Management: The Theory

Through words we communicate information to receivers, and depending on the message form and content, the receiver is willing to construct an image about the sender. In social psychology, this phenomenon is known as *Impression management*. It is the process through which people try to control the impressions other people form of them (Rosenfeld et al: 1995). According to Shneider (1981), impression management is primary concerned with the behaviors people exhibit for others to create and maintain the desired perceptions of themselves. The goal is for one to present themselves the way in which they would like to be thought of by the individual or the group they are interacting with. Although studies about impression management seem relatively recent, the seminal work however, is traced to the sociology literature and the research by Goffman (1959). Sociologist Erving Goffman (1959) is most often credited with the modern-day popularization of impression management. He defined impression management as a sort of mutual ritual that helps to smooth and control social relations and to avoid embarrassment. He observed that :"*Information about the individual helps to define the situation, enabling others to know in advance what he will expect from them and what they expect from him*" (p.9)

The theory regards the members of an organization as "actors" engaging in "performances" before "audiences" (stakeholders, investors, creditors, etc) in various "settings" (environment, market, etc). the actor and audience interact to develop a "definition of the situation", which provides the environmental cues to stimulate action (Goffman: 1959, Gardner & Martikno: 1988).

According to Schlenker & Weigold (1992), impression management is a broad phenomenon in which we try to influence the perceptions and behaviors of others by controlling the information they receive.

> "Through impression management, people try to shape an audience's impression of a person (e.g., self, friends, enemies), object (e.g., a business organization, a gift, a customer product), event (e.g., transgression, a task performance), or idea (e.g., pro-life versus pro-choice policies, capitalism versus socialism)." (Schlenker web site: http://schlenker.socialpsychology.org)

Goffman (1959) contented that even actions which at first glance appeared to be innocuous, might be actually strategically calculated to show that social actor in the best possible light. We attempt to control our impression management behaviors because they are a primary means of influencing how we are treated by other people (Rosenfeld et al: 1995).

Although, recent perspectives see impression management as a very broad and common phenomenon and fundamental part of all interpersonal interactions, impression management is still seen as a form of interpersonal manipulation occurring in very confined settings or as applying to a limited set of behaviors (Rosenfeld et al: 1995). Rosenfeld et al (1995) argue that this view supports a common perception of impression management: that it is something bad, involving actions performed primarily to attain the upper hand over others.

Leary and Kowalsky (1990) posit that people are more motivated to impression-management when the impressions being made are relevant to the fulfillment of goals such as social and material outcomes, self-esteem maintenance and identity development. They add that motivation will be stronger when one's behavior are public. Additionally,

when a person is dependent on others for valuated outcomes, the impressions he makes on them are more important this perfectly adheres to reporting activity performed by firms towards their public.

From an organization point of view for instance, organizations use spokespersons to provide positive interpretations of controversial actions (Pfeffer & Salancik: 1978). These interpretations include using impression management tactics to portray structures and actions in ways to garner endorsement and support (Schlenker: 1980).

Schlenker and Weigold (1989) posit that accountability makes social control possible. Without accountability, no one would be interested in the impression that is being made on the rest of the organization and therefore impression management would not exist. Accountability is also linked to performance. Quality performance occurs because of accountability, which is then linked with reward, avoidance of punishment, or adherence to norms.

Using Goffman's (1959) dramaturgy metaphor, narrative disclosures in annual reports allow managers to stage and direct the play they whish their public to see, to pick the characters, to select the script and to decide which events will be highlighted and which will be omitted (Neu & Wright: 1992, Neu & al: 1998). And as the design literature notes, these textually mediated discourses can be used to send the "right message" (Pettit: 1990) to relevant publics to "*shape the way various publics "know" or "feel" about the corporation*" (Preston & al: 1996).

As a broad framework for accountability (Schlenker & Wilgold: 1989), impression management is implemented in several accounting settings and research issues. We cite as examples just few: the accounting profession (Neu: 1991), earnings manipulation

(Watts & Zimmerman: 1986, 1990), graphs (Steinbart: 1989, Arunachalam et al: 2002; Beattie & Jones: 1992, 1997; So & Smith: 2004) and photographs (McKinstry: 1996; Preston et al: 1996) and accounting narratives (Clatworthy & Jones: 2003; Kohut & Segars: 1994; Courtis: 1986, 1995, 1998).

The objective of accounting is to provide relevant and reliable financial information about the company or organization users system, which includes the actual and potential users of accounting information (Hendriksen & Van Breada: 1992). Impression management seems going against of what accounting is preaching about presenting an unbiased and neutral view of financial performance.

Impression management studies in accounting demonstrate that the practice is motivated by management's desire to dictate the corporate reporting agenda and to present a self-serving view of corporate performance so that to manage the interpretation of financial reports (Saorin & al: 2006, Gibbens et al: 1990, Neu & al: 1998).

One important feature of narrative disclosure, as it happens with no obvious parallel for accounting numbers, is the extent to which a text is clear: is it easy to follow and understand ? or is it obscure and opaque ? This is of particular importance if the narrative is to assist in achieving transparency for non-expert shareholders (Rutherford: 2003). Next section details the relationship between text complexity and financial performance in an impression management framework.

III.2. Clarity of Text Exposure and Firm Performance: The Obfuscation Alternative

Agency theory is concerned with the principle-agent problem in the separation of ownership and control of firm (Jensen & Meckling: 1976). The managers and companies' officers are usually mandated to act on the behalf of shareholders. Managers ought to serve the interests of firm's owners (Friedman: 1970). Shareholders theory proponents see that the management of value created by the company is only pertinent insofar as that value accrues to the shareholders of that firm. Therefore, the concerns are focused upon how to manage performance for the shareholders and how to report upon that performance (Myners: 1998).

In the agent – principle relationship, the manager within its role is using the funds at its disposal to for purposes authorized by the shareholders (Hasnas: 1998; Smith & Hasnas: 1999). As owners, shareholders are so far expecting that their wealth and property is to be used in their own benefits.

However, according to Pfeffer (1981) corporate officers use communication strategies that favor their own interests on behalf of the shareholders, whom impressions are open to interpretations. The idea behind is, if managers act self-interestingly, separation between control and ownership produce conflicts. In saying that, left to their own devices, managers will prefer different options to those that would be chosen by the stockholders. Managers will follow their own interests as opposed to that of the shareholders (Krowther & Sukhadia: 2001). To avoid these deviations from the desired

goals, usually contracts and remuneration schemes are considered so that managers act in the interests of stockholders.

In theory, managers have incentives to present their firm under the best lights, with the brightest image, which may lead to the "selective financial misrepresentation" (Revsine: 1991):

> " In summary, the selective misrepresentation hypothesis argues that managers prefer reporting methods that provide latitude in income determination (e.g, requiring choices among mutually acceptable alternatives) rather than methods that tightly specify statement numbers under given economic conditions. By providing managers with control over when they can report externally driven events, loose reporting standards can be used by managers to increase compensation, to hide perquisite consumption, incompetence, or laziness"
> (Revsine: 1991, p.18).

Hiding a bad performance or a lack in the management operations is not to exclude. If managers have the opportunity to do it with regulated alternatives like deliberate choice of accounting standards and methods, so why can't they do it with more flexible and less regulated alternatives such as accounting narratives ? Management may well seek to manage their narratives just as they manage other items, such earnings. Adelberg (1979, p.187) noted that " *…the placing of managers of complete control of the accounting communication process which monitors their performance breeds a situation wherein it is perfectly natural to expect that some managers would obfuscate their failures and underscores*"

Generally, annual report is found to be an important source of information, but its usefulness is limited to by shareholders' difficulties in understanding it (ICAEW: 2003).

If annual reports are badly written, this may impede interested parties to fully appreciate the message conveyed in the texts.

Courtis (1998) goes further and states that reading ease manipulation is more likely to take place if management has engaged in "earnings management" because of a desire to avoid scrutiny. Obfuscation then becomes a potential tool to mask this behavior by reducing a reader's desire to investigate more closely.

By acting on texts structure and complexity managers can *hide* undesirables. Do managers write with less clarity when corporate performance decline ? Obfuscation through text complexity is a loophole provided to bad performers to hide unsatisfactory achievements by manipulating annual reports users' impressions. Playing on writing style is a new way of communication manipulation still under-investigated and that should be t more seriously taken in consideration.

Rutherford (2003) notes in that sense that:

> "Clarity is, of course, important in itself, but of particular interest in the regulation of accounting narrative disclosure is the issue of whether prepares manipulate transparency by reducing clarity when they whish to disclose less about their underlying circumstances, for example, when they are poorly performing" (p.189).

Previous research findings, provide an insight in that text complexity is a powerful obfuscation instrument (Subramaranian & al: 1993; Smith & Taffler: 1992) in that Writing clarity influences the speed, comprehension and accuracy by which content can be interpreted (Courtis & Hassan: 2001). As stated by Courtis & Hassan: (2001), if noise impedes accurate belief confirmation or revisions there will likely be an impact on

resource allocation payoffs. Sub-optimal resource allocation decisions will result in opportunity or actual costs to investors and society,

It might be expected that good financial performers will be associated with clear financial messages and that poor financial performance will be associated with a difficult to read narrative message. (Smith & Taffler: 2000). An additional argument would be profitable companies have more resources to devote to the annual report exercise and that this should result in improved readability (Courtis: 1995).

Therefore, the first hypothesis we are investigating reads as follow[1] :

> **H.1. *There is no significant difference in MD&As complexity between performers and less performers..***

Ease of readability assessment is well documented in the linguistic literature (Dubay: 2004). One of the most effective methods are the techniques known as readability formulas. More than 80 formulas exist and some of them have been extensively used in accounting communication literature (Klare: 1964, Jones: 1994, Courtis: 1995). Incontestably, the Flesch formula[2] has been the most popular approach followed in prior accounting studies (Adelberg: 1979, Jones: 1988, Subramaranian & al : 1993, Courtis: 1995, Clatworthy & Jones: 2001). However, for confirmatory reasons most of prior research have been using more than a formula to draw conclusions about text complexity (Jones: 1988; Courtis: 1986, 1995, 1998; Rutherford: 2003, Watson: 2005). In

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[1] Hypothesis is presented in the null form.
[2] A more detailed discussion about readability formulas follows in the method of research chapter.

concordance with that idea, we are using more than a readability index and comparing Flesh findings to a second readability assessment formula: the LIX index[3].

Accordingly, hypothesis about text complexity is tested according to two dimensions – Flesch and Lix. Therefore, sub-hypothesis (1) reads as follow:

H1a. According to Flesch index, text complexity is not significantly different between performers and less performers.

And Sub-hypothesis (2) reads as follow:

H1b. According to Lix index, text complexity is not significantly different between performers and less performers

Text complexity may be treated as a very effective tool to obfuscate non satisfying organizational performance. However, other techniques are still at the disposal of the management to engage in impression management. As clearly stated by Rutherford (2003), "*the absence of obfuscation by text complexity can not be interpreted as implying that poorly performing companies do not seek to obfuscate in their accounting narratives. Some alternative obfuscatory mechanisms can be found*" (p.190). Among the other techniques, we cite the choice of words used in communication. The following section discusses the use of positive/negative wordings and its relations with good/bad performance.

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[3] A more detailed discussion about readability formulas follows in the method of research chapter

III.3. The Choice of Wordings: POSITIVE or NEGATIVE Coloration of the Message

Another alternative for impression management is the adoption of a strategy based on the choice of communicated words. Positive and negative mentions are worth being analyzed since they may influence the perceived image about firm's current financial achievements and future financial prospects. Playing on the nature and the quantity of these words in a message might be a strong tool to distort readers' impressions. The message might look too optimistic when it is mainly composed of words conveying positive meaning. The contrary is also true. A message where a dominance of words with negative connotation may send a less optimistic message to the receiver. By choosing specific words, narratives producers can easily influence readers' opinion about the company. Choosing the wording structure may lead text readers to see what the writer wants them to see. In that way, some readers may be distracted from more important truth about the economic well being of the company (Thomas: 1997, Clatworthy & Jones: 2003).

Managers should work at presenting narratives mirroring financial performance reported in the financial statements. Text may follow numbers however the choice of the positive/negative connotation of words may be very influencing. As words may not lie but they may imply (Thomas: 1997), managers may play on words connotation to undervalue bad performance or to overvalue good performance. Less performers may jeopardize the integrity of financial reporting through narratives by adapting words to some hidden intention. Hence, It might be expected that poor performance will be

associated with a narrative message which obscures the communication from the accounting statements with some misleading optimism (Smith & Taffler: 2000).

According to Elsbach & Sutton (1992), companies are usually attempting to attenuate the negative meaning and accentuate the positive meaning in their communications. Thus, the excessive use of positive wordings in bad performing companies might be considered as a sign of impression management. In fact, prior research suggest that poor performing firms may provide signals to imitate good performers (Frazier et al: 1984). They may use positive wordings to give an impression of good being as if they are financially performing well. Through the information they are communicating they construct the image that they want audience to adhere to.

Thus, the second hypothesis to test in this research is the following:

> *H2. wording structure (Positive Vs Negative) is not significantly different between performing companies and less performing companies .*

Hypothesis 2 is divided into six specific sub-hypotheses (H2.a – H2.f). Like Clatworthy and Jones (2003), in the interests of symmetry and completeness, we have formulated hypotheses for good financially performing companies and less financially performing companies. However, we would expect the incentives for impression management to be greatest for companies with low financial performance. Table. 1 summarizes the investigated sub-hypotheses.

		Performers		Less Performers	
		Positive	Negative	Positive	Negative
Performers	Positive		H2.c	H2.a	H2.e
	Negative			H2.f	H2.b
Less Performers	Positive				H2.d
	Negative				

Table. III.1 –

Sub-hypotheses – wording structure.

H2a. There is no significant difference in the number of positive words as reported by performers and less performers

H2.b. There is no significant difference in the number of negative words as reported by performers and less performers.

H2.c. There is no significant difference between the number of positive words and negative words as reported by good financially performing firms

H2.d . There is no significant difference between the number of positive words and negative words as reported by less financially performing firms

Hypotheses H2.a and H2.c are more related to firms with good financial performance. Firms with good financial results are less motivated to engage in impression management technique since financial data already gives favorable image about the company. In prima face, there is no incentive that they don't report good news about their achievements and consequently report more positive words. Hypotheses H2.b and H2.d are related to firms

with bad performance. For these companies there seem to be more incentive to indulge in impression management, especially if we think that poor performance may affect management compensation (Revsine: 1991).

H2.e There is no significant difference between the number of positive words in performers' communication compared to the number of negative words in less performers' communication (Numbers should be equivalent).

H2.f. There is no significant difference between the number of negative words in performers' communication compared to the number of positive words in less performers' communication (Numbers should be equivalent).

As the reporting of news, as reflected in the words used – positive, negative, should report the underlying performance, deviations from this pattern would indicate that companies were not reflecting their actual financial performance in their narratives and were adapting some impression management tactics. That is, companies are attempting to put more emphasis on the positive meaning of events rather than the negative meaning (Elsbach & Sutton: 1992).

Smith and Taffler (2000) see that content analysis may be divided as "form oriented" analysis and "meaning oriented" analysis. In the first two sections of this chapter we were interested in the "form oriented" analysis of narratives (Readability analysis and wording structure analysis). In the coming section we focus our attention on the ideas portrayed by the texts through a thematic analysis.

III.4. The Hidden Meaning Behind The Lines: Is There A Thematic Difference ?

In this section, we are approaching the subject matter from another dimension specifically by analyzing text meaning and ideas transmitted behind the lines. According to the American Heritage of the English Language, a theme is defined as "an implicit or recurrent idea" in a text or a discourse. Many definitions exist to thematic Analysis. Jones & Shoemaker (1994) make a clear distinction opposing thematic analysis to syntactic analysis . The objective of thematic analysis is "*to extract and analyze themes inherent within the message*" (p.143). They define it as the procedure "*identify[ing] specific trends, attitudes, or content categories through the text and then draw inferences from them*" (p.143). Perhaps one of the most known definitions is that of Popping (2000). According to the author, thematic analysis can be described as :"*the identification what and how frequently concepts occur in texts*". Concepts are related to ideas reported in the text and ideas are usually reported to what the message sender wants to pass through the discourse. Going further, Iker (1974, p.95-96) assumes that "*words which correlate highly with each-other have much in common in defining topic or content reference while those with little correlation have little in common*". Although the last assertion is more statistically and quantitative oriented, it still gives a clear vision about what a theme is.

Studying the relationship that might exist between the syntactical complexity of the text and financial performance is very interesting however it is limited to the apparent structure of the text. The message conveyed through the communication is also important to analyze. As stated by Kohut & Segars (1992) "*much more need to be known*

about the content of these communications in terms of themes before actual communication strategy can be inferred." (p.13).

Jones & Shoemaker (1994) observe that the strength of thematic analysis is its ability to identify the motivations and concerns of accounting communicators. Taken from an impression management perspective, managers will try to hide non satisfactory performance by stressing on some themes rather than others. Themes selection do offer to management a new insight to manipulate communication. We share Compin (2004) vision about the new tendency in the financial communication discourse when talking about the new financial communication "gourous" . He notes that the skill of how to present information becomes the nucleus of financial communication – rather of focusing on firms economic health, managers are more concerned with the financial discourse content.

Literature on accounting narratives does not provide a coherent set of themes subject of discussion by firms according to financial performance. However, the choice of themes may still be a tactic of obfuscation put at the disposal of corporate officers. Ideas explicitly or implicitly sent in the communication process may easily sway readers' perceptions about the company. The reasoning conveyed through words may be more convincing than calculations or numbers (Perelman *in* Compin: 2004). In this, Language is not neutral, it leads the reader to perceive images that the communicator wants him to perceive (Saussure: 1996).

Recent calls to make richer the financial reporting process by providing much more information about companies activities, their prospects, governance, etc. make thematic analysis more arousing. Many reports have been published on how companies should

best report on their activities. Of particular note is the report issued by the AICPA (1994), commonly known as the Jenkins' report[4]. These reports provide a framework of what kind of information firms should provide to the their shareholders. In other words, these frameworks are providing a bunch of themes that firms should discuss in their communications so that they satisfy their investors' needs. Companies are expected to work at sticking to the reports' recommendations in order to appear in the brightest images. This obviously does not exclude that thematic manipulation will arise and less performers for instance will concentrate their discourses on some themes more than others.

The discussion below leads to the third hypothesis which reads as follow:

H3. Thematic structure is not significantly different between performers and less performers.

Beattie et al (2004) stated that the general thrust of the corporate reporting reports is that it is desirable to have more information that is more forward-looking and non-financial in nature. Taken form this perspective, the Jenkins' report defines five groups of information that ought to be disclosed by firms (Table.IV.3).

Building on the Jenkins' report, the third hypothesis of this research is divided into 5 sub-hypothesis :

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[4] A more thorough discussion of the Jenkins' report will follow in the method of research chapter.

H3.a. There is no significant difference between performers and less performers according to the financial and non financial data reported in the MD&A.

H3.b. there is no significant difference between performers and less performers according to information related to "Management's analysis of financial and non financial data".

H3.c. There is no significant difference between performers and less performers according to information related to "forward-looking".

H3.d. There is no significant difference between performers and less performers according to according to information related to "information about management and shareholders".

H3.e. There is no significant difference between performers and less performers according to information related to "Background about the company".

The following chapter outlines the methodological part of this research.

IV.

METHOD OF RESEARCH

"*We have to remember is that what we observe is not nature in itself but nature exposed to our method of questioning*"

(Heisenberg, 1958)

METHOD OF RESEARCH

This chapter outlines the research method of our study. The research sample consists of 40 companies listed in the Milan Stock Exchange (section 1). In concordance with our research objective two groups are set up and their MD&As analyzed (section 2). MD&A is a very important document conveying too much information in narrative form about company activity (section 2.1). Also this document reveals a particular importance for the Italian reporting context (section 2.2). As we are dealing with text analysis, The MD&A section of every annual report was analyzed using content analysis as the investigation method (section 3). Specifically, we are analyzing text ease of readability (section 3.1), wording structure (section 3.2) and thematic structure (section 3.3). Two control variables were considered in this study: firm size and industry in which the firm operates (section 4).

IV.1. SAMPLE SELECTION

Forty companies (40) divided into two groups of 20 each, according to their financial performance, have been selected for the purpose of this research (section 1.1). annual reports investigated are written in English, arguments and justification of this choice are reported in section 2.2. Moreover, this study is a cross sectional analysis researching the structure of the 2003 annual reports (Section 2.3). Section 1.4 briefly outlines how we proceeded to collect our data.

1.1. Companies

Our analysis is dealing with a sample extracted from the listed Italian companies in the Milan stock Exchange (Borsa Italiana). Listed Italian companies are usually considered as the most visible and the most regulated in the Italian economy, thus we consider that their financial reporting system would be more sophisticated than the non-listed ones. Listed companies have a diversified portfolio of shareholders with whom they have an obligation of communication/information. To ensure a minimum level of communication with their shareholders/investors these companies have to disclose information on their economic activities and situation through annual reports.

We consulted the *DataStream* database and we got information on 159 companies. Our population includes various industries. In our study, as we are analyzing further, we are not considering industry in its very detailed aspect as presented in *DataStream.* Companies selected in the analysis are classified either in 'manufacturing companies' or 'service providers' companies[1].

Beforehand, banks and companies operating in the financial industry are cancelled from the analysis seen the specific characteristics of their operations and their special legal framework. Also we had to check for repetition in the database. As we are interested in the consolidated financial disclosures, we eliminated companies that are subsidiaries of other mother companies. Our final data set consisted of 94 companies.

Companies were then ranked according to their financial performance (ROE) from high performing to low performing. We then extracted the 20 top performing and the 20 bottom performing.

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[1] This classification is deliberate and follows Borsa Italiana classification : "Settori: (i) industria, (ii) servizi, e (iii) finanza".

In line with our research objective, our sample consisted of two subsets:

- Good financially performing companies (good performers) : the 20 top Firms with the highest financial performance indicator (ROE) and;

- Less performing companies (bad/less performers): the 20 bottom firms with the Lowest financial performance indicator (ROE).

1.2. Language of the documents under investigation

This research is conducted in an Italian business environment, however the annual reports we analyzed were exclusively written in English. Today, double language reporting is becoming common in several countries and usually English is the second reporting language. For instance, companies in Hong Kong issue a Chienese version of the annual reports and an English version (Courtis: 1995), in Greece the same phenomenon is noted (Leventis & Weetman: 2004) and also in Germany (Doupnik & Richter: 2003) just to cite few. This tendency of dual language reporting is expected to grow in the coming years in Europe especially with expansion of the European Union (Smith: 2004). In all this, Italy does not make the exception.

Courtis and Saleh (2002) insisted on the importance of the language of the document to be analyzed. The choice of English written annual reports was deliberate and justified by the following reasons:

- First of all, the global era we are living makes boundaries between financial markets more fuzzy. The intensity and extensity of contemporary cross-border financial flows are such that national financial systems are becoming increasingly enmeshed (Held et al: 1999). Notwithstanding the limited size of equity market in Italy (IMF: 2006), the

Milan Stock Exchange is an important financial hub in Europe, where most of the major Italian companies are listed. Baring in mind that international pressures influence companies to adopt a global market culture rather than a specific country culture (Zarzeki 1996), dual language reporting (with an English annual report as a second report) is a sign of the global attitude many companies are adopting. Today, English is considered as the global language by excellence. As a significant part of the business is done in English., we choose to analyze the English version of annual reports.

- Second, almost all Italian listed companies publish an Italian and an English version of their annual reports. Initially, companies issue a first Italian version of the document, then in a second step they translate the original text to English. The decision to issue an English annual report may be a signal to the market to consolidate the visibility of the company and to let it more open to international investors (Leventis & Weetman: 2004). In fact, research has shown that language has an influence on investor behavior and that by publishing in more than one language investor base can be increased (Grinblatt & Keloharju: 2001).

- Third, from an academic point of view, literature on accounting narratives mainly dealt with the analysis of annual reports in English speaking countries: USA (Kohut & Segars: 1992, Baker & Park: 1992), UK (Clatworthy & Jones: 2001, 2003, Rutherfrod: 2003), Canada (Courtis: 1986), Hong-Kong (Courtis: 1995). Thus studying English written documents, even though in a non-English speaking environment, will strength the comparability of our findings with other studies.

- Finally, from a linguistic perspective, Italian language is structurally different from English. Readability formulas we are using in hypothesis one are exclusively used in English language. Thus our choice was also motivated by linguistic reasons.

1.3. Year 2003 Annual Reports

Recently, several scholars called to the use of more dated annual reports as large number of studies are using samples of annual reports dating from at least 10 years ago (Clatworthy & Jones: 2003; Courtis: 1998). Moreover, seen the emphasis that accounting narratives are getting in the new economic environment the replications of studies researching the structure of annual reports are welcome. In particular, as Lee (1994) points out, annual reports has evolved from a financially-driven document to one used to construct a corporate image. Thus a study of more recent annual reports will reflect the "*contemporary public relations nature of many annual reports*" (Clatworthy & Jones: 2003).

To fill this gap, we choose "2003 annual reports" as a documents to investigate in our study. 2003 is a convenient year to study because it has no particular economic event that may influence the way information is reported. As opposed for example to the very particular year 2005, where too much attention is put on annual reports since it's the transition year to the IFRS reporting standards.

Another reason that drove us to choose 2003 annual reports was that to avoid any particular repercussions that the Parmalat case may have on our results. In fact, as Parmalat was the greatest financial scandal in Europe since 1945 (Ramonet: 2004), all media and regulators, control bodies were wise eyes open to catch any law transgressor. To avoid political visibility (Watts & Zimmerman: 1986) we think that firms that have

manipulation intention will just avoid it and this will distort their actual reporting by making it more rigorous for instance.

1.4. Data Collection

Getting advantage of internet technology, all the listed Italian companies publish their annual reports as well as other financial information on their internet web sites. Usually this information is disclosed in a specific rubric entitled "*investors relations*". Once we specified the companies to study, we looked for their web site . In a second step, we downloaded the whole annual reports and get a printed copy of each one. The Management Discussion & Analysis (MD & A) are identified and taken apart for analysis. The title of the section was indicative of the starting point of the MD & A. The MD&A section had different titles, the ones we found are "*Management Discussion and Analysis*", "*Management Analysis*", "*Directors' Reports*", "*Directors Analysis of operations*", *Management Analysis of Operations*", "*Analysis of Operations*".

Although several English titles have been used to designate MD&A, in the Italian version of annual reports usually the title "*Relazione sulla Gestione*" is being used. All the documents we downloaded were in *.pdf, .doc or .jpg* formats. We then transformed them to text files *.txt* .

IV.2. The Document: Management Discussion & Analysis

Accounting narratives are gaining more and more importance in the new reporting environment (Barlett & Chandler: 1997, Beattie & al: 2004). Many scholars recognized the value-relevance of accounting narratives and their effects on users decision making (Kaplan et al: 1990, Francis & Schipper: 1991, Knutson: 1992, Rogers & Grant: 1997,

Breton & Taffler: 2001). One of the most studied accounting narratives is the chairman address (Courtis: 1986, Jones: 1988, Subarmaranian et al: 1993, Clatworthy & Jones: 2001, 2003; Courtis: 1995, 1998). But Not too much emphasis from the other hand was given to the Management Discussion & Analysis (MD&A).

MD&A is a very important document in the new reporting model (ICAW: 2001) and recently, a growing body of evidence in the USA suggests that the SEC and users of financial reports view MD&A as particularly important (Barron & al: 1999). Knutson's (1992 *in* Botosan: 1997, p 7) position paper for the AIMR states "other than the financial statements themselves, perhaps the most useful single part of the annual report is the management discussion and analysis". Notwithstanding the emphasis placed on the MD&A by regulators, little is still known about disclosures in MD&A (Clarkson & al: 1999).

The importance of this document is also manifest in the Italian history of financial reporting. Companies since the 50's of last century were required by law to issue the "*Relazione sulla Gestione*" , the equivalent of the MD&A. In the following, the first sub-section introduces the importance of the MD&A and the second sub-section reports on the Italian context.

2.1. The importance of MD &A

Management Discussion and Analysis commonly known as MD&A is a section of a company's annual report in which management discusses several aspects of the company, both past and present (SEC: 2003).

In the United States, the SEC introduced MD&A requirements in 1980 with similar regulations being adopted in Canada in 1989. Internationally, the MD&A is very considered in the agenda of the International Accounting Standard Board (IASB) (Accountancy: 2001). In the UK, the corresponding statement, the Operating and Financial Review (OFR), is non-mandatory, although it is encouraged by the ASB and the London Stock Exchange.

In a separate release (SEC: 1980), the SEC expressed its belief that the MD&A would provide investors with relevant information for evaluating the amounts and certainty of cash flows from operations and from outside sources. It usually reminds companies that MD&A disclosure is intended to satisfy three principal objectives:

- to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management;

- to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and

- to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.

The SEC gives too much importance to the document and enhances firms to give the required level of attention when issuing this narrative. It is stated in the release note n.33 - 8182 (international release series n.1266):

"The Commission has long recognized the need for a narrative explanation of financial statements and accompanying footnotes and has developed MD&A over the years to fulfill this need. The disclosure in MD&A is of paramount importance in increasing the transparency of a company's financial performance and providing investors with the disclosure necessary to evaluate a company and to make informed investment decisions. MD&A also provides a unique opportunity for management to provide investors with an understanding of its view of the financial performance and condition of the company, an appreciation of what the financial statements show and do not show, as well as important trends and risks that have shaped the past or are reasonably likely to shape the future."
(SEC: 2003, www.sec.gov/rules/final)

This spirit is supported by OCS[2] policy statement 5.10 in its introduction, where the primary objective of MD&A is to "*enhance investors understanding of the users' business by providing supplemental analysis and background material to allow a fuller understanding of the nature of an issuer, its operations and known prospects of the future*" (Scott: 2003).

The importance of MD&A is well emphasized relatively to financial statements:

"There are practical constraints on the amount of information that can be effectively conveyed in financial statements, which are generally subject to generally accepted accounting and auditing standards. Important transactions, events and conditions are not always fully reflected in the financial statements and some are not easily expressed in dollar amounts. Additional disclosure and analysis beyond the financial statements is necessary to provide an adequate basis for assessment of an issuer's recent history and outlook for the future."
(OSC, P.S n.5.10, www.osc.gov.on.ca)

The "additional disclosure and analysis" referred to is oriented to management discussion and analysis of its current financial statements and future prospects (Scott: 2003).

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[2] O.S.C: Ontario Securities Commissions.

The MD&A is a very important document which aim is to level the informational playing field by giving market participants an opportunity to look at a firm "through the eyes of management" by providing an historical and prospective analysis (Morse: 1980, SEC: 1989).

Despite the fact that some studies shade doubts about the usefulness of this narrative (Epstein & Pava: 1993), many others on the contrary praised the importance of the document and showed that it is among the most widely read section of the annual report (Lee & Tweedie: 1976, Barelett & Chandler: 1997).

Moreover, it has been established that MD&A contains incremental new information that is useful to users in general and analysts in particular (Rogers & Grant: 1992, Clarkson & al: 1999, Barron et al: 1999). Clarkson et al (1999, p.115) state that "*Overall, the evidence is uniformly supportive of the view that MD&A is a source of both new and useful information and confirms that MD&A is used for financial analysis purposes by at least one significant user group, sell side analysts who are members of the TSFA*" (Clarkson & al: 1999, p115). According to Rogers and Grant (1997), compared to other types of financial disclosures, the MD&A contains the largest proportion (over 30 percent) of the information cited in the sell-side analysts' reports. Also, Barron et al (1999) found that high quality MD&A were associated with less errors and less dispersion in analysts earnings forecasts.

Italy's experience with Management Discussion & Analysis dates from decades. The document has long tradition in the Italian financial reporting framework. Next section introduces the case.

2.2. MD & A in the Italian context

Italian companies have long and rooted tradition in financial reporting . Although, double-entry bookkeeping was first invented in Italy (Pacciolo treaty), the first regulatory framework for accounting reporting was promulgated by the commercial code in 1865 (Riccaboni & Ghirri: 1994). The regulatory framework experienced several stages of evolution to reach the Italian current reporting system. The director's reports became compulsory only in 1942 as required by the civil code. However, the law remained silent by reference to its content. Managers considered annual reports as a legal document but not that important to include all the information about the normal functioning of their companies.

> "An opportunity for improving financial disclosure was provided by the inclusion in the Italian Civil Code of 1942 of the requirement of a published director's report. However, in the event, this innovation made scarcely any impact, since the law in its original form made n mention of content. Director's reports were often general discussions of the state of the world economy and the sectors of industry in which the company operated. On the other hand information about the activity of the business in the past financial year tended to be scarce and imprecise." (Riccaboni & Ghirra: 1994, p.89).

This lack of a clear definition of the content of management's report was overcome in two periods, respectively 1976 and 1991. The Civil Code (Artcle 2429 bis, 1976) explicitly required directors to include in their reports information on the activities of the business in each sector the company was involved in, on investments, costs and revenues. Valuation criteria adopted, accounting policies for amortization and provisions, changes in the values of assets and liabilities.

Management report was often confound with the notes to accounts. According to Ricaboni & Ghirra (1994), "*The directors' report was meant to give information on both:*

(1) The management of the business and (2) the valuation criteria followed and the reasons for the changes occurring in the balance sheet items" (p.85)

With the implementation of the fourth European Directive, a clear separation was made between the notes to accounts (*Note integrative*) and Management Report (*Relazione sulla Gestione*). According to decree 127, the notes to accounts should supply specific information regarding some of the items in the annual accounts and explain the reasons for the procedures followed when dealing with accounting policy choices (Riccaboni & Ghirra: 1994). The fourth directive stresses that the notes are an integral component of the financial statements The Management Report (*Relazione sulla Gestione*) will be a supportive document accompanying the financial statements.

> "The management report is prepared by the directors and has the goal of illustrating the company's situation, business activities and prospects, both as whole and with reference to the company's sectors of activity (with a particular attention to costs, revenues and assets)...The management report must specify:
>
> 1. Any important event that have occurred since the end of financial year;
>
> 2. The company's likely future development (Italian legislation has particularly emphasized this aspect);
>
> 3. Activities in the field of research and development;
>
> 4. details of the acquisition of own shares
>
> Italian legislation regarding the management report also calls for information concerning relations with subsidiary, parent nd associated undertakings, as well as details of the shares owned by the parent company." (Riccaboni & Ghirra: 1994).

In the next section we proceed with data extraction and content analysis description.

IV.3. DATA EXTRACTION

Weber (1990, p.41) stated that "*Researchers must…tailor their methods to the requirements of their research by selecting specific techniques and integrating them with other methods, substantive considerations and theories*". Following the objective of our research, we selected content analysis as an appropriate research method for this study.

3.1. Method - Content analysis

Content analysis is a research method that uses a set of procedures to make valid inferences from the text. These inferences are about the sender (s) of the message, the message itself, or the audience of the message (Weber: 1990,). The method is appropriate for discriminating general themes within a large set of data or when the subject's own language is crucial to investigation (Holsti, 1969). Content analysis enables researchers to sift through large amount of data with relative ease with systematic fashion (Stemler: 2001). It can be a useful technique allowing researcher to discover and describe the focus of individual, group, institutional or social attention (Weber: 1990). More explicitly, the basic goal of content analysis is to take a verbal, non quantitative document and transform it into quantitative data. The results of content analysis can generally be presented in tables containing frequencies o percentages, in the same manner as a survey data (Bailey: 1997).

Content analysis is conductive to the use of formal hypotheses, scientifically drawn samples, and qualitative data that can be analyzed with modern statistical techniques (Bailey: 1997). Holsti (1969) lists seven purposes for content analysis in addition to scientific hypotheses testing:

(1) To describe trends in communication content;

(2) To relate known characteristics of sources to messages they produce;

(3) To audit communication content against standards;

(4) To analyze techniques of persuasion;

(5) To analyze style;

(6) To relate known attributes of the audience to the messages produced for them;

(7) To describe patterns of communication.

For textual documents, content analysis seems to be the best-fitting method if not the only one. Krippendroff (1980) notes that much content analysis is motivated by the search for techniques to infer from symbolic data what would be either to costly, no longer possible, or too obtrusive by the use of other techniques.

Content analysis is a useful research method to investigate how language is constructed and how text is presented. Accounting narratives are words and through words mangers can influence their audience. Differences in accounting narratives between firms might reflect different cognitions and perceived realities, as language mirrors mental processes (Chomsky: 1972).

A particular feature of content analysis is that it is unobtrusive, in that sense the researcher is able to evaluate documents, without the cognizance of the prepares of the document (Clatworthy & Jones: 2001). Before starting the analysis we needed to prepare the text.

Preparing the text:

Text preparation is a very important step in content analysis. Usually texts come in a raw format and need to be encoded (transform them in a readable computer format as required by the software in use). For this research most of the documents were collected from internet – companies' web sites. 87% of the annual reports (35 out of 40) were in a Printable Document File format (.Pdf). the 5 remaining documents were collected as a MsWord files (.doc) (4 reports) or an image file (.JPG) (1 report).

The first step was to transform all the files to text readable format (ASCII). Specific software, like ADOBE and MsWord, allowed us to do it. For the image document, we had to have a printout of the document, to scan it and to save it in the required form. Once we had all the files in the required format, We then extracted the MD&A part.

In a second step , all the tables, footnotes and graphs are canceled to only keep narratives. To facilitate upcoming modification on the text, sentences were identified and we started each sentence in a separate line. All the process took around two weeks and a half.

The first variable we are investigating in this research is text complexity. It is assessed by means of readability formulas or readability indexes.

<u>*Syntactical complexity[3]: (Readability Formulas)[4]*</u>

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[3] "Two key elements of readability are syntactic complexity and vocabulary load. Syntactic complexity is the difficulty of the structure of the language. Several common causes of syntactic complexity are the use of passive voice rather than active voice, multiple clauses per sentence and complex grammatical structures. Conventionally, shorter sentences are perceived to be easier to understand than longer ones. The vocabulary load is simply the words used. Generally, shorter Anglo-saxon based words are easier to understand than their Latin equivalents. Thus 'car' is easier than 'automobile'. In essence, therefore, shorter words and sentences make text easier to understand than their longer equivalents." (Jones: 1994)

[4] Readability is what makes some texts easier to read than others. It is often confused with legibility, which concerns typeface and layout (DuBay: 2004). George Klare (1963) defines readability as "the ease of understanding or comprehension due to the style of writing".

In the 1920's, educators discovered a way to use vocabulary difficulty and sentence length to predict the difficulty level of a text. They embedded this method in readability formulas, which have proven their worth in over 80 years of application (DuBay: 2004)

Readability formulas, also known as readability scores or readability indexes, originated in the assessment of children writings. Their applications to accounting texts such as annual reports is relatively is well rooted (Sydreff & Weetman : 2002 for a review). and raised criticisms (Jones & Shoemaker : 1994; Jones : 1997).

A readability score is a calculated score which is matched to predetermined standards of written materials graded according to reading difficulty. At one end of the scale the score could match with reading material at the very easy-to-read level of the community. At the other end of the scale, the score could match with scientific or very-difficult to read literature (Courtis : 1995; 1997).

"*Readability scores are based on counts of language variables in a written document to generate an estimation of reading difficulty…Most measures of readability rely on sentence and word length as primary determinants of the reading level of a given document. Typically, a mathematical model is used to ascertain the reading level by weighting different combinations of variables*" (Baker & Kare: 1992, p.1). Readability formulas are therefore "*a function of the length of sentences and the size of words in a text*" (Harrisson & Bakkar: 1998, p.122).

Consequently, all the readability formulas are based on the same two features :

(a) word length (W) : related to speed of recognition

(b) Sentence length (S) : related to a recall of words in the immediate memory.(memory span).

Readability formulas produce single summary reading ease scores for measured passages of prose and thereby indicate whether the passages are likely to be read and understood by the intended readership (Courtis : 1995)..

These formulas present many advantages and there are several convincing reasons for using them. They represent an objective and quantitative method of predicting whether narratives are likely to be readable by a target user (Courtis : 1995). They are reliable and not expensive to use (Sydreff & Weetman : 2002). Moreover, readability formulas have been widely adopted as alternatives to reader feedback and comprehension tests in assessing the difficulty of narrative passages, on the assumption that they generate common conclusions (Smith & Taffler : 1992). Also, They can be helpful in detecting certain obvious classes of error such as certain excessive sentence length (Schriver : 1989 *in* Sydreff & Weetman : 2002) .

Approximately 70 versions of readability formulas have been developed (Klare : 1964 *in* Courtis : 1995). Main differences arise because of different measures of word length and different weightings applied to the component parts (Smith & Taffler : 1992)[5]. Some years ago, to compute readability formulas researchers needed special software. With

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[5] The success of a readability formula depends on the elements it considers and that are related to the reader comprehension. These elements could come from content, format and organization style. Only the last of these have been incorporated ion readability formulas. Specifically our focus is on word length and sentence length.

software progress, many text editors propose quantitative texts statistics (number of words, numbers of sentences, etc). MsWord for instance, proposes a computation of Flesch formula. From the other hand, to compute the LIX formula we combined MsWord and MsExcel features.

Assessing readability formulas validity is a complex task and Courtis (1998) challenged researchers in accounting communication field to find a validation approach for the readability formulas. Consequently, readability scores are still in use and they showed their efficacy as research tool.

Among the well known ones and the most extensively in use, we've chosen two for detailed examination : (a) The Flesch reading ease formula and (b) the Lix index.

(a) The Felsch formula :

The Flesch (1974) Reading Ease measure has been the most popular approach followed in prior accounting studies dealing with readability (Jones & Shoemaker: 1994, Courtis : 1995, 1998). It is straightforward and easy to apply, comprising sentence length and syllables per 100 words. The formula is presented as follow :

$$Flesch = 206.385 - 0.84W - 1.015S$$

Where

W : word length = Number of syllables per 100 words.

S : Sentence length = Total number of words / total number of sentences.

The closer the Flesch score is to zero, more difficult the text is. The underlying assumption is that the longer the sentences and the longer the words within these

sentences, the more difficult the text being measured (Sydes & Hartley: 1997). This formula is easy to compute apart of determining the number of syllables in certain problem words (e.g : stopped, USA, 1987) (Smith & Taffler : 1992). The calculation represents a deduction from the base constant for both word and sentence complexity, so that the higher the score the easier the readability. The predetermined standards against which measured reading ease scores can be compared are shown in table.2. Most accounting communications have been shown to record scores of less than 50, some of less than 30 (Smith & Taffler : 1992).

Reading ease rating	Description of style	Educational level	Typical style of magazine
0 – 30	Very difficult	Postgraduate degree	Scientific
30 – 50	Difficult	Undergraduate degree	Academic
50 – 60	Fairly difficult	Grades 10 – 12	Quality
60 – 70	Standard	Grades 8 – 9	Digests
70 – 80	Fairly easy	Grade 7	Slick fiction
80 – 90	Easy	Grade 6	Pulp fiction
90 – 100	Very easy	Grade 5	Comics

Table.IV.1 –

Flesch reading ease scores

(b) The Lix index :

Anderson (1983) and Bjornsson (1983) first found this index to improve speed and readability of calculation and to be a reliable and consistent measure across five languages. Therefore it would appear reasonable to extend this consideration to accounting narrative in the annual reports. The use of the Lix index in accounting reporting studies is relatively new and not as much spread as the use of Flesch index (Courtis : 1986; Courtis : 1995 ; Smith & Taffler : 1992). The Lix formula writes as follow :

$$Lix = W + S$$

Where

W = The percentage of words of seven or more letters. (The advantage of a specified word length is that it makes the calculation faster and more reliable).

S = Average number of words per sentence

A low Lix index is consistent with high levels of readability. Table.3 summarizes the Lix predetermined standards. For example we see that a score of 20 corresponds to very easy, whereas a score of 60 and more corresponds to very difficult prose.

Text difficulty	*Score*
Very easy	20 –25
Easy	30 – 35
Medium	40 – 45
Difficult	5à – 55
Very difficult	60 +

Table.IV.2 –

Lix scores predetermined standards

Several other readability scores are interesting to use (like the Fog index for instance) and showed their validity in previous accounting literature (Courtis: 1986, Hammami: 2004), however for the scope of this research we limited our choice to the two above mentioned formulas. We note that, all these readability formulas that has been used in annual reports analysis studies have been designated for and validated on English written prose (Courtis : 1986, 1995, 1998; Smith & Taffler : 1990, 1992). This supports our consideration of English versions of Italian annual reports.

Besides text ease of readability the second dimension tackled by this study is the wording structure of narratives.

Negative and Positive words Analysis

One of the first things an investigator wants to know about a narrative is which words appear in the text and how they actually are used (Weber: 1990). To have a frequency list of words from each document we used a special text analysis software, namely TEXTSTAT. TEXSTAT is an open source software developed by Matthias

Hunning from the Free university of Berlin. This program allows researcher to extract all the words with their frequency of occurrence in the text. It also permits a concordance analysis of texts. Concordance analysis consists of seeing the word in its context (the sentence or expression in which it is written).

A frequency list is created for each document. All the frequency lists are then transformed to EXCEL files for easy management. We created a special macro that organizes words in the way allowing us to easily sum up the number of positive and negative words in the coming steps.

In order to maximize coders commitment to the coding process, we position ourselves from a shareholder perspective. Considering ourselves as shareholders or potential investors of the firm will help us to better appreciate what is written in the annual report. A shareholder position to analyze annual reports is very welcome and helpful for appreciating the nature of reported words. This goes in the same spirit – the shareholder/investor perspective – of what major regulatory bodies are preaching for : a major investor oriented financial reporting (AICPA – Jenkins's report: 1994 for example).

Like in other studies we posit that the amount of space devoted to a specific category of words provides an emphasis placed by reports producers on that category of words. This measure provides a quantitative analysis of the considered words (Cowen et al: 1987, Guthrie & parker: 1989, Gray: 1992, Neu et al: 1998).

Building on Abrahamson & Park (1994), as a first step, we read all the words and every time when it happens that a word may have a positive or negative connotation it is marked in the category it belongs to. Thus, in the end we had a list of words that

exclusively had either a positive or a negative connotation. Since a word meaning is largely affected by the context in which it is written a word in context analysis is performed in a second step. According to Grice (1991), the acts of language are partly explained by the situation they are produced in. Thus, to convey the connoted impression and meaning words should not be dissociated from their contexts.

As mentioned earlier, TEXTSAT allows the Word-In-Context Analysis (also known as Key-Word-In-Context-Analysis). Each word is then checked in its own context so that we determine whether it has a positive or negative connotation. Weber (1990, p44) states that   KWIC "*shows the context in which each word appears*". Also kWIC provides "*structured information that is helpful in determining whether the meaning of particular words is dependent on their use in certain phrases or idioms*" Weber (1990, p.44).

Deciding whether a word has a positive or negative connotation is a subjective task depending on researcher perceptions. However, some general rules may apply to render the procedure more objective. For the sake of reliability and aiming at reducing the risk of classifying words, another coder is instructed for this task. The second coder is a PhD student majoring in accounting. The choice was intentional so that we are sure that he is able to read and correctly understands the reports.

Reliability pertains to the ability to replicate results (Shoemaker & Jones: 1994). "*A reliable procedure should yield the same results from the same set of phenomena regardless of the circumstances of application*" (Krippendorf: 1980, p129). Weber (1990) and Kippendorf (1980) agree on three types of reliability in content analysis:

stability[6], reproducibility and accuracy[7]. Here in, seen the context of our study we are only interested in reproducibly.

Also called inter-coder reliability, it refers to the extent to which content classification produces the same results when the same text is coded by more than one coder (Weber: 1990). High reproducibility is a minimum standard for content analysis. Weber (1990) also notes: "*to make valid inferences from the text, it is important that the classification procedure be reliable in the sense of being consistent. Different people should code the same text in the same way*" (p.12). That's why we need to compute an inter-coder reliability index.

Mline & Adler (1999) provide a detailed exploration of reliability measures in content analysis. The simplest measure of reliability is the coefficient of agreement, which is the ratio of the number of pair wise inter-judge agreements to the total number of pair wise judgments. Many reliability measures are in use (Cohen's kappa, Krippendroff's alpha, Leigh's Lambda) and a minimum degree of agreement has to be reached between the involved coders. For example, Holsti (1969) proposed 92% of agreement between the coders as a reliability level and Milne & Adler (1999) proposed 80 %. The coders will discuss any disagreement until a convenient solution is reached.

For this research inter-coder reliability index was just a coefficient of correlation between the number of extracted words in each document. The average coefficient of reliability reached between the two coders was 72 %, which we considered as satisfying.

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[6] Stability refers to the extent to which the results of content classifications are invariant over time. (Weber: 1990, p17)
[7] Accuracy refers to the extent to which the classification of text corresponds to a standard or a norm. (Weber: 1990, p.17)

Extracting themes:

Themes discussed in the MD&A refer to ideas that management is analyzing or trying to concentrate on. Thus extracting these ideas is a very important task which has to be done with precaution.

Many studies dealing with thematic analysis were criticized because of researchers subjectivity in theme extraction (Kohut & Segars : 1997, Clatworthy & Jones: 2001). The authors read the document and determined the themes according to their own perceptions of the ideas discussed by management. Validity of research instruments is very important in order to allow replications (Bailey: 1997) and thus a valid research instrument is always needed.

For validity purposes, in the current research we used a classification scheme that is well rooted in empirical accounting research, namely the *Jenkins's report Framework*. As stated by Beattie et al (2004), this framework has become widely accepted and has been used extensively by researchers in disclosure index studies (Botosan: 1997, Robb et al: 2001).

To extract themes, "Sentence" was considered as a the unit of analysis. The advantage of using sentences is that they are easily identified. It has also been agreed that it is an appropriate and valid unit of analysis in previous research (Ingram & Frazier: 1980, Kohut & Segars: 1992) . Sentences extracted from text files were recorded in an excel spreadsheet. In columns Jenkins report themes are recorded whereas sentences are recorded in lines. Instructions were to read each sentence and place a check on the worksheet adjacent to the appropriate category in each dimension. The number of checks were then totaled to compute the total score for each category (theme) for each firm.

It happens that a sentence may contain more than a single chunk of information (a sentence is related to more than one specific theme). One alternative was to follow Beattie & al (2004) and consider every "*single piece of information*" as a coding unit. Another, , was to still consider "sentence" as a coding unit but the same sentence may be related to more than one particular theme. We choose the second alternative.

The Jenkins' report is a very valid framework that will allow us to extract MD&As themes. It has been considered in several accounting studies (Robb et al: 2001, Beattie et al: 2004).

The Jenkins's report:

The report was issued in 1994, by the AICPA special committee on financial reporting (Jenkins committee) : *Improving Business Reporting – A Customer fo*cus. Central to the report is the concept of "*Business reporting*", which goes far beyond financial reporting and encompasses high level operating data and performance measurements as well as more forward looking information. The committee's business reporting model contains five broad categories of information, encompassing ten elements (Table. IV.3).

The report recommends improvements in four areas: business reporting, financial statements, auditor involvement and the reporting environment. All focus on the needs of users – investors and creditors, and their advisors, who use business reporting as a basis for their capital allocation decisions (Orenstein: 1995)

The Committee undertook a comprehensive study to determine the information needs of users to identify the types of information most useful in predicting earnings and cash

flows for the purpose of valuing equity securities and assessing the prospect of repayment of debt securities or loans. The Committee designed the study to ensure that the findings were representative of a broad group of users and to distinguish between the types of information users really need and the types that are interesting but not essential. It also considered how users' needs for information might change over time (Jenkins report ch.1).

Based on the information needs of users as well as the costs and benefits of potential improvements, the Committee developed recommendations to improve business reporting. Key points about those recommendations are:

- To meet users' changing needs, business reporting must:

  (a) Provide more information with a forward-looking perspective, including management's plans, opportunities, risks, and measurement uncertainties.

  (b) Focus more on the factors that create longer term value, including non-financial measures indicating how key business processes are performing.

  (c) Better align information reported externally with the information reported to senior management to manage the business.

- Users believe auditor involvement with financial information is essential. To serve its customers better, the auditing profession should prepare to be involved with all types of information in business reporting to the extent companies and users may decide is necessary.

- Participants in the business reporting process must do a better job of anticipating change by:

(a) Focusing on users' information needs and finding cost-effective ways of better aligning reporting with those needs.

(b) Developing and maintaining a comprehensive model of business reporting reflecting the kinds of information that users need (the Committee has designed and illustrated such a model).

(c) Adopting a longer term focus by developing a vision of the future business environment and users' future needs for information.

- The current legal environment discourages companies from disclosing forward-looking information. Companies should not expand reporting of forward-looking information until there are more effective deterrents to unwarranted litigation.

The model divides reporting into elements (general types of information) that address the broad range of users' needs for information. As financial statements provide a useful structure for financial information, so would the elements of the model provide a useful structure in the broader arena of business reporting (Jenkins' report - ch.5). More detailed description of every type of information is provided in Apendix.1.

The objective of this research is to investigate accounting narratives structure (complexity, wordings, themes) according to financial performance . ROE was selected as the financial performance indicator. Also, two control variables are considered: (i) company size and (ii) industry.

THE TEN ELEMENTS OF THE COMMITTEE'S MODEL OF BUSINESS REPORTING
Financial and non-financial data   • Financial statements and related disclosures   • High-level operating data and performance measurements that management uses to manage the business
Management's analysis of the financial and non-financial data   • Reasons for changes in the financial, operating, and performance-related data and the identity and past effect of key trends
Forward-looking information   • Opportunities and risks, including those resulting from key trends   • Management's plans, including critical success factors   • Comparison of actual business performance to previously disclosed opportunities, risks, and managemnt's plans
Information about management and shareholders   • Directors, management, compensation, major shareholders, and transactions and relationships among related parties
Background about the company   • Broad objectives and strategies   • Scope and description of business and properties   • Impact of industry structure on the company

Table IV.3. The Jenkins' reporting framework (AICPA: 1994)

3.2. Financial Performance

Organizational performance is expected to have an influence on the structure of the information conveyed by the managers to companies' outsiders (Aerts: 1994, 2002; Abrahenson & Park: 1994; Ingram & Frazier: 1984; Clatworthy & Jones: 2001, 2003; Kohut & Segars: 1992). That's why it is strongly believed that financial performance has a strong contribution in shaping corporate reputation (McGuire et al: 1988). Financial performance may be approached by different scales of measurement and financial literature is generous in providing more than one.

Financial indicators vary in accuracy and relevance according to the context they are used in. For example Bowman (1978) recommended that return on equity (**ROE**) rather than sales to be used to compare firms across industries. Shareholders may be interested in some ratios more than others depending on what they are looking for from the firm.

In our study, in order to achieve an optimal choice we position ourselves from a shareholder perspective to see the 'best' indicator. We decided to choose the Return On Equity (**ROE**) as a proxy of the financial performance. ROE reveals the true financial strength and investment appeal of the entity. This ratio has been extensively considered in the literature as a measure of financial performance (Lenz: 1981, Kohut & Segars: 1992 ; Schmidt & Fowler: 1990). Sample firms were ranked according to their ROE to contrast less successful companies with more successful companies.

The relationship between corporate characteristics and disclosures has been the subject of attention by accounting scholars (Ahmed & Courtis: 1999). In particular two variables

seem to have a very direct impact, namely (i) firm size and (ii) industry. In this analysis we are considering these two factors (size and industry) as control variables .

3.3. Firm size

Company size is considered one of the most influencing factor in research where differences in corporate financial disclosure are investigated (McNeally & al: 1982, McKinnon & Dalimunthe: 1993, Ahmed & Courtis: 1999, Choon & al: 2000). Most of the studies reported confirmatory results on firm size effects on reporting characteristics (Ahmed & Courtis: 1999, Lee & Mose: 1990).

Positive accounting theory proposes that political visibility may be an explanation of this relationship (Watts & Zimmerman: 1986). Large firms are more visible and thus are more targeted by political process. In this, large companies tend to communicate more and they are expected to have more complex annual reports (Meek & al: 1995). More complex annual reports means more complex narratives with more complex wording structure and longer writing styles. Therefore, readability might be highly affected by firm size. In order to test for the influence of firm size we use total sales. The same proxy has been used in previous financial disclosure studies (Ahmed & Courtis: 1999, Prencipe: 2001) Moreover, in line with previous Literature we used the natural Logarithm in order to cope with the problem of heterocedasticity (Ahmed & Courtis: 1999, Prencipe: 2001, Aerts: 2002).

3.4. Industry

According to Ahmed & Courtis (1999) disclosure studies are inconclusive with regard to the industry membership effect on disclosure. However, according to Watts & Zimmerman (1986), a firm's accounting policy choice may be affected by the industry to which the company belongs. Several studies supported the evidence that industry is affecting the way companies issue their annual reports (Ward: 1998). Industry – effect hypothesis could be explained by the fact that consumer-oriented industries are more likely to be concerned with the corporate image portrayed in annual reports (Cowen & al: 1987). Given that prior research has shown that industry peculiarities can influence the content of annual reports (Meek & al: 1995, Stanton & Stanton: 2002), it might be that industry distinctive features will influence narratives in annual reports, their complexity and their structure.

Industry in this research is approached as a dummy variable distinguishing between manufacturing and services sectors. At the early beginning, we thought of adapting industry classification portrayed by *DataStream*. This industry division was not convenient because it was too detailed for the small sample we are studying (8 different industries for 40 companies). We then subdivided industry into three sets: (i) Services, (ii) Manufacturing and (iii) Information Technology. The problem we faced was that in the IT pool we only got three companies. Their effects was derisory in the analysis. In the end, to best assign firms to industry we decided to rely on a basic simple distinction adopted by *Borsa Italiana*.

Borsa Italiana distinguishes between three industry groups: (i) Services, (ii) Manufacturing and (iii) Financials. As financial institutions are not considered in our study, we only classified companies as services operating companies and manufacturing operating companies.

Findings of this research are very interesting and are reported in the following chapter.

V.

RESULTS AND DISCUSSION

"When you make the finding yourself – even if you are the last person on earth to see the light – you never forget it "

(Sagan, 1988)

RESULTS & DISCUSSION
OF FINDINGS

In this chapter we report the findings of our research (Part.1) and their discussion (Part2). Results are very interesting and show that performers and less performers have almost the same annual reports structures (Section 1). Ease of Readability analysis is presented in section 2 and showed that Italian companies independently of their financial position report difficult accounting narratives. Wording structure gives striking results and show that less performers may be engaging in some impression management tactics (section.3). Finally, Less performance and performers present a divergence in their thematic structure at the level of forward-looking information reported in their MD&As (section 4).

All the statistical tests have been performed using the Statistical Package for Social Sciences (S.P.S.S v.10).

V.1. Hypotheses Testing

V.1.1. Annual Reports / MD&A sizes

The broad objective of this research is to analyze the narrative reporting structure between good financially performing companies and bad performing companies. Table.2 reports some descriptive data related to the accounting narratives contained in the annual reports.

Annual report Number of pages. It is very interesting to notice that both groups of companies devote almost the same number of pages to their annual reports. Less

Performing companies annual reports are as a large as their counterparts published by performers. In fact, less performers' annual reports consist of 146 pages on average against 149 pages for performers. Means comparison indicates that the difference is not statistically significant at the .05 level (t = -0.32, p = 0.975).

MD&A number of pages. We remind that the scope of our research is to analyze the structure of the MD&A part of the annual report. We see that less performers in average devote 46 pages to their MD&A whereas performers only devote 41 pages. In other terms, Less performers devote 31.50 % of their total communication to the MD&A whereas performers devote 27.51 % Less performers seem devoting more space to discuss their achievements than performers do. However, the difference is not statistically significant (*t = 0.975, p = 0.615*).

	Performers (20)		Less performers (20)	
	Tot. Pages in reports	MD&A pages	Tot. Pages in reports	MD&A pages
Minimum	37	9	63	11
Maximum	304	110	213	121
Mean	149,68	41,79	146.7	46.94
Srd deviation	67.86	31.40	51.90	31.78

Table. V.1 –

Annual reports and MD&A number of pages

Ease of readability is the first narrative characteristic we are analyzing in this study.

Results of hypothesis testing are reported in the following section.

V.1.2. Text Ease Of Readability (Hypothesis 1)

Hypothesis 1 investigates the difference in text complexity between the two groups using readability analysis. As it was previously discussed, we are approaching readability through two proxies namely the Flesh index and the Lix index. In a first subsection we present findings related to first index (Flesch), in a second subsection we present findings relative to second index (Lix).

1. Flesch Index

According to the Flesch score, the closer a score is to zero, the more incomprehensible is the writing (TableIV.2). Analyzing the whole sample (40 companies), we see that the lowest Flesch score is 10.1 corresponding to a "very difficult" to read text and the highest index scores 41.3 corresponding to a "difficult" to read text. Thus, the first conclusion we draw is that all the MD&As released by companies in our sample, independently of their financial performance, are regarded as difficult to read. This finding is consistent with previous literature where narratives in annual reports are usually assessed as not easy to read and requires a fairly adavanced level of education (Jones: 1988, Courtis: 1986, 1995, 1998).

		Performers	Less Performers	T-test	P-Value
Flesch Index	Maximum	38.3	40.6		
	Minimum	10.1	18		
	Mean	29.4 (difficult)	31.15 (difficult)	-.747	.230
Lix Index	Maximum	78.25	44.5		
	Minimum	33.40	34.25		
	Mean	39.49 (difficult)	42.68 (difficult)	1.180	.170

Table. V.2 – Flesch and Lix Indexes for
performing and less performing companies.

Comparison of narratives complexity between companies (Table.V.2) revealed that Performers' texts are ranked as difficult and present an average Flesch score of 29.4. Less performers from the other side also report a difficult to read text with an average score of 31.15. At a first glance, performers' narratives are more complex than less performers' narratives (29.4 Vs 31.15). This conclusion is not statistically verified and means comparison reveals that the difference is not statistically significant (t = -0.747, p = 0.230).

Going further in the analysis, we decided to see to which extent the relationship between text complexity and financial performance is sound. We performed a Pearson correlation between the Flesch index and financial performance (ROE) for the whole sample (Table.V.3). Findings are very interesting. In fact, we find a negative significant correlation between the two variables ($r = -0.353$, $p = .013$). When the ROE increases, the Flesch index decreases. More explicitly, when financial performance improves,

MD&A text becomes more complex. These findings go to the opposite of the hypothesized direction stated by impression management theory: Less performing companies will try to obfuscate bad performance by presenting more difficult to read texts. We found is that complexity is increasing with performance.

	Coef. of Correlation	P-Value	Significance
ROE * Flesch	- .353	.013	significant
ROE * Lix	. 383	- .015	significant

Table. V.3 -
Correlation between ROE * Flesch and ROE * Lix

Analysis based on the Lix index provided similar findings to what we found in the Flesh analysis. Results are reported in the next section.

2. LIX index

Lix scores are interpreted in the opposite direction of Flesch scores. According to the LIX index, when the computed score goes up this means that the text is getting more difficult. More it is close to zero, more the text is easy to read (Table.IV.2). Looking at the whole data set we find that the highest reported Lix score is 78.26 indicating "very difficult" to read narratives. The lowest score is 33.41 indicating that the text is on the border between easy and difficult, almost going to difficult . The average score of the whole sample is 41.09 showing once again that MD&A narratives are considered as "Difficult" to read.

This finding confirms what we previously found based on the Flesch analysis. Also, it supports antecedent accounting narrative studies stating that annual reports texts are assessed as complex (Jones: 1988, Courtis: 1986, 1995, 1998).

From another hand, comparison between performing and less performing companies on the basis of Lix index reported interesting results. Lees performers' MD&A reported higher score (42.68), they seem to be more complex and difficult to read than performers' MD&A for which Lix index scores 39.49. T-test comparison however, shows that the difference between means is not statistically significant ($t = 1.180, p = .170$).

We also performed a correlation analysis between Text difficulty (as measured by Lix) and financial performance (ROE). In accordance with Flesch index findings, results show that a positive significant correlation between the ROE and the LIX index exists ($r = 0.383, \qquad p = 0.015$). When ROE increases, Lix index also goes up. More explicitly, when financial performance improves, text complexity increases. That's what we found performing Flesch based analysis.

We failed to provide evidence that less performers are willing to disclose more difficult to read narratives in order to obfuscate bad financial achievements. On the contrary we found that text ease of readability is the same between performing and less performing companies. Texts are assessed as difficult to read. At this level, we accept the first hypothesis stating that there is no significant difference between performers and less performers relatively to text complexity.

To check the strength of the relationship between text complexity and financial performance, we decided to verify previous findings using another financial performance indicator, namely Earnings Per Share (EPS). Like ROE, EPS has been validated in other

studies as a reliable financial performance indicator (Salancik & Meindell: 1984). This short term financial indicator plays an important role in capital markets. It reflects a company's investment/capital market potential (salancik & Meindell: 1984).

3. Ease of Readability and Earnings Per Shares (EPS)

Findings about text complexity and financial performance are also confirmed when we considered Earnings Per Shares (EPS) as a financial indicator. We ramked companies of our sample according to their EPS (from highest to lowest) and we run the previous analyses. The 20 best performers and the 20 less performers are compared and results are reported in Table.V.4.

	Performers (EPS)	*Less Performers (EPS)*	*T - test*	*P-Value*
Flesch index	29.54	31.01	- .622	.538
Lix index	40.89	41.89	.456	.651

Table.V.4 –
Comparison of text difficulty between
performers and less performance (EPS)

Table.V.4 shows that there is no significant difference between the two groups according to Flesch and Lix. For the Flesh index, we note that text is still assessed as difficult to read for both performers (Flesch = 29.4) and less performers (Flesch = 31.01). T-test analysis reports that readability means between performers (EPS) and less performers (EPS) is not statistically different (*t = -0.622, p = 0.538*).

The same conclusions are valid for the Lix index. Text is assessed as difficult with performers scoring 40.89 and less performers scoring 41.89. Difference between companies in terms of Lix scores is not statistically different (*t = 0.456, p = 0.651*).

Overall, there does not seem to be any evidence in this sample that less performers are obfuscating their bad achievements by arranging the writing of narratives making them more difficult to read.

To better investigate reporting patterns and their association with ease of readability levels, we decided to investigate the reading variability between MD&A parts. Readability variability is seen as a sign of obfuscation (Courtis: 1998, Clatworthy & Jones: 2001) when a certain pattern exist. The prevalence of variability raises the idea that management is not neutral in his communication (obfuscation hypothesis). The following section investigates this issue.

4. Analysis of variability

According to Courtis (1998), information asymmetry between managers and readers of annual reports provides a framework of presenting an obfuscation hypothesis. Here we are trying to extend the analysis to see whether readability scores varies in the MD&A according to the placement of prose in the document. Variability would be associated with management's tendency to manipulate or arrange prose to enhance "good news" for instance with easier to read writing, and mask "bad news" with more difficult writing (Courtis: 1998).

We state that under the obfuscation framework, management of companies which report low performance will seek to manipulate their communication, meaning that we are

expecting lower readability scores (texts are more difficult) and higher variability in their reports.

We choose the coefficient of variation as indicator of variability in readability levels between sections. Each MD&A was divided into three parts. For each part a readability score (Flech) was computed. The greater the coefficient of variation, the greater is the variability between the three reading scores. The further the coefficient departs from zero, the less reliable is the mean readability score as representative proxy of company's readability. The advantage of using the coefficient of variation is that it de-emphasize size effects of the series of numbers and concentrates on a standardized measure of variability, which is then easily comparable between companies (Courtis: 1998).

Analysis shows that there is an important discrepancy between the coefficients of variability themselves. The smallest V is 3.68 per cent whereas the highest V is 39.89 per cent. We also notice that 80% of total companies (31 companies out of 40) display a coefficient of variation exceeding 10 per cent (Table.V.5). This indicates that a remarkable variability do exist in the writing style of Management Discussion & Analysis (MD&A) sections.

Coef.Variation	Number of companies	Percentage of companies	Cumulative Percentage
90% - 100%	2	5	100
80% - 90%	0	0	95
70% - 80%	0	0	95
60% - 70%	0	0	95
50% - 60%	0	0	95
40% - 50%	1	2.5	95
30% - 40%	2	5	92.5
20% - 30%	9	22.5	87.5
10% - 20%	17	42.5	65
Less than 10%	9	22.5	22.5
Total	40	100	

Table.V.5 –

Coefficient of Variation Distribution

The question is whether this pervasiveness of variability is an indication of specific pattern of prose writing. Usually the most important information are disclosed in the mid-section of the narratives (Courtis: 1998). Thus we suppose that management would make this part more difficult to read in order to mask some non satisfactory news. Courtis (1998, p.465) suggests that "management would use the mid-passages of this address to 'bury' adverse or negative news through a writing style that is more difficult to read than the introduction and the conclusion passages of the narratives".

Using the Flesch index, we expect that the first part would portray a high score (easy to read), the second part would have the lowest score (The most difficult to read) and the last part would have a score between the highest and lowest one.

To determine whether this pattern exists, each of the three Flesch indexes was identified by a letter, namely A (the easiest part = the highest Flesch), B (the following difficult part = Score lower than the previous one, A) and C (the most difficult part = The lowest Flesch index). For instance the sequence ACB indicates that the first part is the easiest to read, the second part is the most difficult to read and the last part is in the between. In total, we expect 6 combinations to appear: ABC, ACB, BAC, BCA, CAB, CBA. If no phenomenon appears, there is an equi-probability that each of the sequences appears with the same frequency. Every sequence would appear 6.66 times. Frequencies are reported in table.V.6.

Sequence	Frequency	Percent	Cumulative Percent
abc	4	10.0	10.0
acb	14	35.0	45.0
bac	4	10.0	55.0
bca	8	20.0	75.0
cab	4	10	85.0
cba	6	15	100.0
Total	40	100.0	

Table.V.6 –

Sequence frequencies

The sequences ACB and BCA indicate that the mid-part is the most difficult to read. Looking at our findings we see that these two sequences accumulate the large parts of

appearance frequencies with a rate higher than 50 % (ACB 35%; BCA 20%). Figure.V.1 is very suggestive about these findings.

This shade some doubts on the relationship between prose location and text ease of readability. Explicitly, more than 50% of te companies report a mid-seection difficult to read. Is this intentional knowing that large part of the analysis is done in this mid-part ? We also notice that 25% of the companies begins their MD&A with not easy to read introductory part. Cases where conclusion is difficult to read (C is the sequence last letter) represent 20% of the total number of companies. Table.V.7 details companies distribution according to their performance.
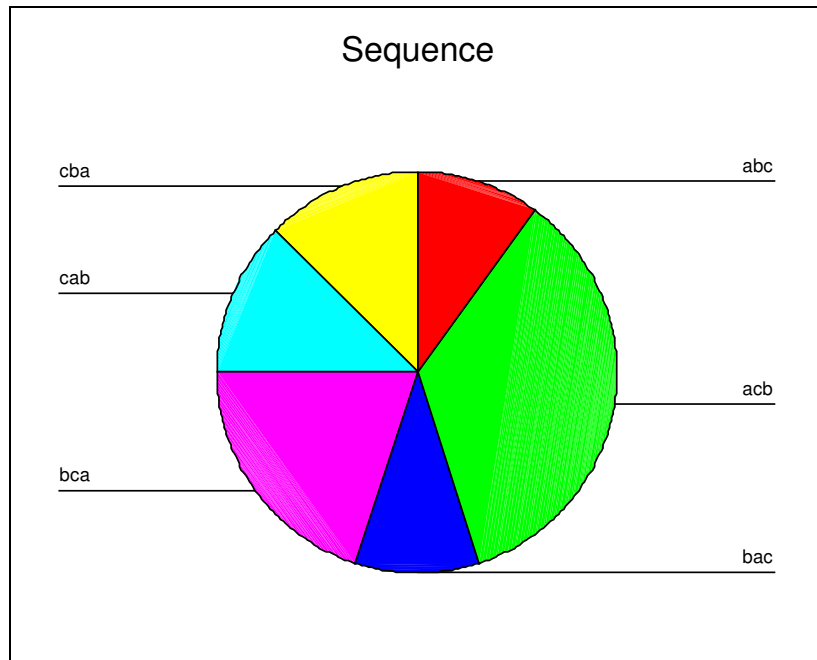
Figure.V.1 –
Sequence distribution

Chi-square test on sequences distribution was significant at 0.05 level ($X2 = ; p = 0.045$). These results indicate that letter orders in sequences do not follow a uniform distribution and that some patterning of reading difficulty may exist.

Sticking to the objective of our research, comparing the two groups of companies, we found that in both sets mid-passages ranked as difficult to read are dominant (ACB, BCA). In the performers group, they represent 60 % (12 companies out of 20) and in the less performer they represent 50% (10 companies out of 20). This confirms the tendency we've been just describing.

Sequences	Total	Performers	Less performers
abc	4	1	3
acb	14	7	7
bac	4	3	1
bca	8	5	3
cab	4	2	2
cba	6	2	4
Total	40	20	20

Table.V.7 –

Sequence distribution between performers and less performers

Figures V.2 and Figure.V.3 better represent this distribution.
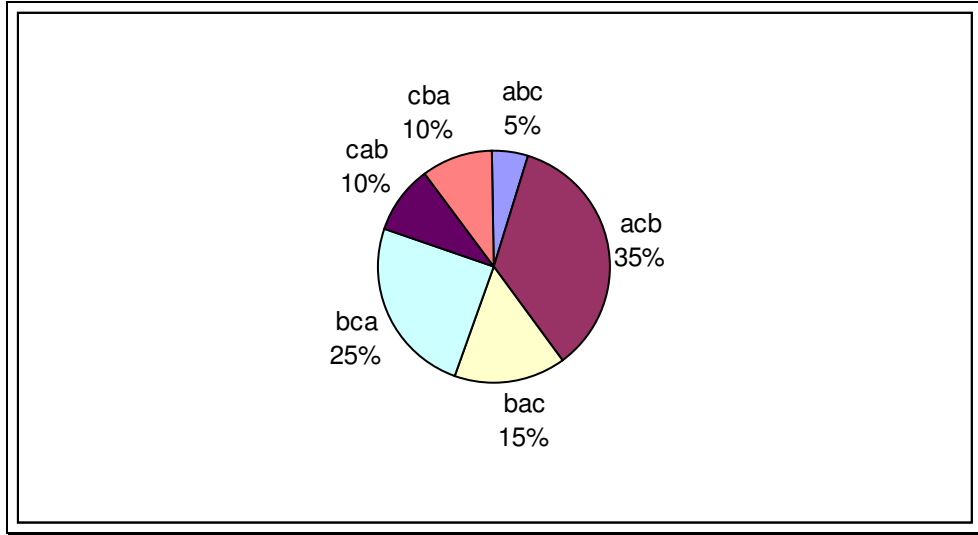
Figure.V.2 –

Sequences Distribution -Performers
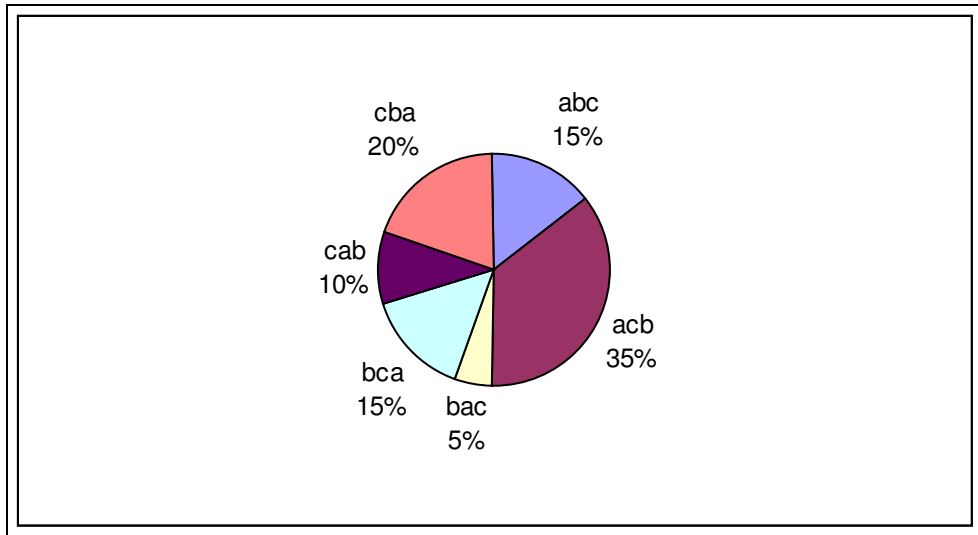
Figure.V.3 –

Sequences distribution – Less Performers

Coefficient of variation average scores 16.05 per cent for less performing companies whereas it scores 32.91 per cent for performing companies. Under the obfuscation hypothesis, less performers should present higher variability in ease of readability scores. Our findings go in the opposite direction, variability in ease of readability index is higher

in the performing group. T-test comparison of means between groups indicate that the difference is not statically significant at the 0.05 level (*t=1.53; p = 0.137*).

Thus, we can not conclude on the presence of some impression management tactics since no difference is detected between the two groups of companies. Control variables are studied next.

5. Control Variables: SIZE and INDUSTRY

We performed this analysis in order to see whether the results we get are influenced by company size and the industry in which the company operates. Regression analysis is performed and results are reported in Table.V.8 (Flesch index) and Table.V.9 (Lix index).

Flesch = α + $\beta 1$ ROE + $\beta 2$ SIZE + $\beta 3$ INDUSTRY + ε

Model (a)	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
Constant	35.727	12.294		2.906	0.006
ROE	-0.133	0.055	-0.378	-2.435	0.020
SIZE (L.Sales)	-0.423	0.852	-0.077	-0.497	0.622
Industry	2.666	2.273	0.181	1.173	0.248

(a) Flesch: Dependent Variable

**Table.V.8 –
Flesch - Size and Industry effects.**

Flesch = 30.223 – 0.378 ROE + 0.077 Size - 0.181 Industry (1)

Regression analysis shows that texts are difficult to read independently of the company size. SIZE coefficient is not statistically significant ($p = 0.622$). Also, it appears that companies publish difficult to read MD&A independently of their field of activity. INDUSTRY coefficient is not also statistically significant ($p = 0.248$). None of the coefficients of SIZE and INDUSTRY is affecting text complexity (Table.V.8). these results have to be interpreted with caution since the model is not very strong showing an $R2 = 16\%$ but an adjusted $R2 = 9\%$.

$\underline{Lix = \alpha + \beta1\ ROE + \beta2\ SIZE + \beta3\ INDUSTRY + \varepsilon}$

We get similar findings when we regressed text ease of readability as approached by the second indicator (Lix) on SIZE and company INDUSTRY (Table.10)

Model (a)	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
Constant	52.087	14.219		3.663	0.001
ROE	0.148	0.063	0.362	2.338	0.025
SIZE (L.Sales)	-0.754	0.985	-0.119	-0.766	0.449
Industry	-1.692	2.629	-0.099	-0.644	0.524

(a) Lix: Dependent Variable

Table.V.10 –
LIX - Size and Industry effects.

$$Lix = 41.151 + 0.382\ ROE - 0{,}119\ Size - 0.099\ Industry\ (2)$$

Companies still report a difficult to read texts independently of their size and the industry they operate in. The coefficients are not statistically significant ($p_{size} = 0.499$, $p_{industry} = 0.524$). the coefficient of determination $R2 = 17\%$ whereas the adjusted $R2 = 10\%$.

In the following we are studying the second dimension of this research, specifically the wording structure of MD&A.

V.1.3. Wording Structure: Positive Vs Negative Words (Hypothesis 2)

Hypothesis 2 states that there is no significant difference between performers and less performers relatively to the structure of the reported negative and positive words. As mentioned in a previous section, hypothesis 2 is divided into 6 sub hypotheses. Table.V.3 reports the average number of words in each category for each group of companies.

Means\Status	Performers	Less Performers
Positive	306.30 (1)	296.55 (3)
Negative	81.65 (2)	130.70 (4)

Table.V.11 –

Average number of Positive and Negative words reported

Figure V. already gives us some preliminary ideas about words distribution between Performers and less performers MD&As.
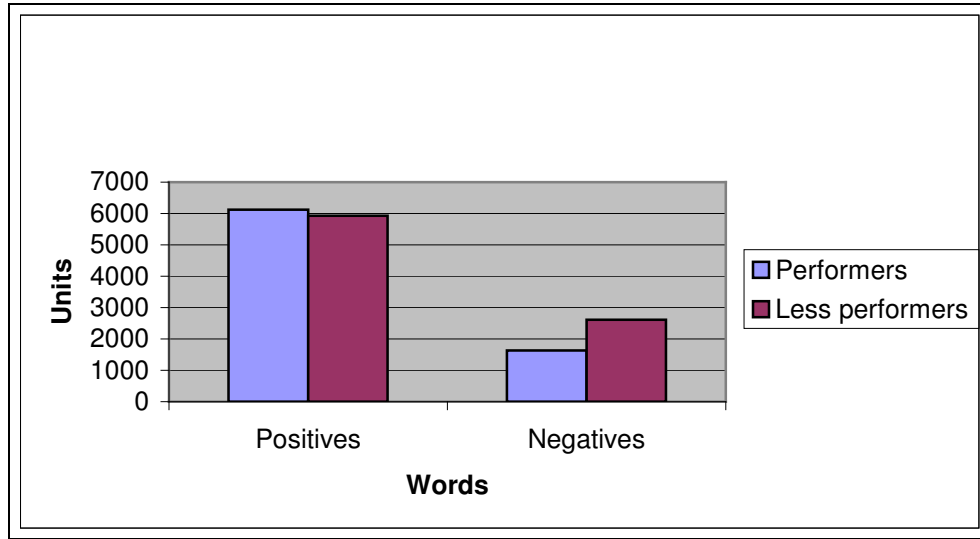
Figure.V. 4 –

Words distribution between Performers and Less performers.

1. Sub-hypotheses

H2.a. There is no significant difference in the number of positive words as reported by performers and less performers: (1) Vs (3)

According to Table.V.11, performers and less performers almost report the same number of positive words. Performers disclose an average of 307 positive words whereas less performers disclose an average of 297 positive words in their respective communications. Analysis of means difference indicates that the difference is not statistically significant at .05 level (*t = 0.136, p = 0.447*). Less performers seem to be using positive words in a similar way as performers are doing. We conclude that reporting pattern of positive words is similar between the two groups companies. Hypothesis *H2.a* is then accepted, there is no significant difference in the number of positive words as reported by performers and less performers (Figure V.2).

H2.b. There is no significant difference in the number of negative words as reported by performers and less performers: (2)Vs (4)

Results in Table.V.11 show an apparent discrepancy between the average number of negative words reported by the two groups of companies. Contrary to H2.a, less performers seem to significantly report more words with negative connotation than performers. In fact, they do report nearly 40% more negative words than performers do. On average a less performer company reports 131 negative words in its MD&A whereas a company with high ROE does report 82 negative words. The difference is statistically significant at .05 level (*t = -2.235; p = .0015*). High ROE firms and low ROE companies present different negative words reporting patterns.

H2.b is therefore rejected, there is a significant difference in the number of negative words as reported by performers and less performers. Less performing companies report more negative words than performing companies (Figure.V.4)

H2.c. There is no significant difference between the number of positive words and the number of negative words as reported by good financially performing firms: (1) Vs (2)

At this level the analysis is more focused on the reporting patterns of positive words and negative words in the same group of companies – specifically the performers group at this step. It is very clear from Table.V.11 that the number of positive words is much more higher than the number of negative words. Performers disclose 307 words with positive significance, a number about 4 times as higher as the space devoted to negative words : 82 words. Significantly fewer words are with negative connotation.

According to T-student, the difference is statistically significant at the .05 level (t = *4.408; p = .000*).

Then, H2.c is also rejected. There is a significant difference between the number of positive words and the number of negative words as reported by good financially performing companies. A dominance of positive words exist in the communication patterns of performing companies.

H2.d . There is no significant difference between the number of positive words and the number of negative words as reported by less financially performing firms: (3) Vs (4)

Investigating the difference between positive words and negative words in less performers MD&A gave interesting results. Table.V.11 indicates that Less performing companies disclose much more positive words than negative words. Average positive words disclosure is 297 units against 130 units for negative words (more than twice). T-test indicates that there is significant difference between the number of positive words and the number of negative words (t = *3.012; p = .002*). Less performers report much more positive words than negative words in their MD&A.

H2.d can be rejected on the basis of this evidence. There is a significant difference between the number of positive words and the number of negative words as reported by less financially performing companies. Number of positive words is higher than the number of negative words.

H2.e There is no significant difference between the number of positive words in performers' MD&A compared to the number of negative words in less performers' MD&A:[1] (1) Vs (4)

Findings show that number of positive words in performers ' MD &A is higher than the number of negative words in the Less performers' MD&A (Table.V.11). Whereas performers report 306 positive words, less performers report 130 negative words. This is expected since discourse content should mirror performance (Abrahamson & park: 1994). The difference is again statistically significant at .05 level (*t = -3.377; p =.001*) indicating a systematic bias in the way that financial performance is reported.

Therefore, H2.e is rejected. A significant evidence of asymmetry in the reporting of good and bad news do exist between positives in performers' MD&A and negatives in less performers' MD&A . The number of positive words in performers' communication is higher than the number of negative words in less performers' communication.

H2.f. There is no significant difference between the number of negative words in the performers' MD&A compared to the number of positive words in the less performers' MD&A: (2) Vs (3)

Test of the reporting of bad news (negative words) by performers relatively to reporting of good news (positive words) by declining performers also reveals clear asymmetry. Results in Table.V.11 report that the number of negative words in performers' MD&A is 3 times smaller that the number of positive words in Less

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[1] According to Abrahemson & park (1994), the reporting of news should mirror the underlying performance. Less performers should have a negative coloration of their communication since they have to justify bad financial achievements. Performers from the other hand should have a more positive oriented discourse to praise the good financial achievements. We remind that the objective here is to compare whether the reporting trend of positive words is really different from the reporting trend of negative words.

performers' MD&A. On average, performers report 82 negative words against 297 positive words in less performer's MD&A. This finding seems logic since firms with good financial positions will focus on positive aspects of their achievements so the most prevailing wording style will be based on words with positive connotation. Difference is statistically significant at.005 level (*t = -3.973; p =.000*).

H2.f is also rejected, there is a significant difference between the reported amount of negative news in performers' MD&A and the reported amount of positive news in Less performers' MD&A. The number of positive words in less Performers' MD&A is much higher than the number of negative words in performers' MD&A.

Hypothesis 2 structure is very interesting and complex. Overall, we may say that there is a significant difference in the wording structure between performers and less performers (except for the reporting of positive words). Although, not all the sub' hypotheses support the obfuscation hypothesis, some go in the direction of impression management[2].

Table.V.12 summarizes the research findings for the second hypothesis:

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[2] Refer to the Discussion section.

Hypothesis	Acceptance / rejection	Details
H2.a. Pos (perf) Vs Pos (Less perf)	Accepted	Average of positive words (perf) is not statistically different from average of positive words (Less perf): **Supports obfuscation.**
H2.b. Neg (perf) Vs Neg (Less perf)	Rejected	Average of neg words in perf is less than average neg words in less perf.: **Does not support obfuscation**.
H2.c. Pos Vs Neg (Perf)	Rejected	Average of pos words is higher than average of neg words in performers: **Does not support obfuscation.**
H2.d. Pos Vs Neg (Less perf)	Rejected	Average of positive words is higher than average of negative words in Less performers: **Supports obfuscation.**
H2.e. Pos (Perf) Vs Neg (Less Perf)	Rejected	Average of positive words (perf) is higher than average of negative words (less perf): **(Partially) supports obfuscation.**
H2.f.. Neg (Perf) Vs Pos (Less Perf)	Rejected	Average of neg words (perf) is smaller than average positive words (less performers) : **supports obfuscation.**

Table.V.12 –

Findings summary for hypothesis 2

2. Words and Earnings Per Shares (EPS)

Before moving to test hypothesis 3, we decided to go for some further analysis as we did for text ease of readability. We wanted to confirm that performance is influencing the way companies report positive and negative words. EPS was considered as the second financial performance indicator (Table.V.13). For the EPS analysis we didn't go through the 6 sub- hypotheses text but we only tested the difference in words reporting (Positive/negative) between groups.

	Performers (EPS)	Less Performers (EPS)	T - test	P-Value
Positives	259.2	343.65	-1.199	.238
Negatives	79.7	132.65	-2.439	0.20

Table.V.13 –
Comparison of words reporting patterns between
Performers (EPS) and less performers (EPS)

The table above (Table.V.13) reports that there is significant difference between performers and less performers in the number of negative words. In fact, as found with the ROE analysis, performers disclose less negative words than less performers. The first report on average almost 80 words in their MD&A whereas less performers report 133 words.

We also notice that less performers report more positive words that performers. Less performers disclose on average 343 words whereas performers disclose on average 259.

This may be a sign of impression management. No significant difference is detected between the two groups (t = -1.199, p = 0.238).

To conclude, performers (EPS) and less performers (EPS9 don't differ according to the reporting of positive words (similar findings are for ROE). Difference is significant relatively to the reporting of negative words (similar findings are for ROE). The ROE conclusions are then still valid.

Control variables effects are reported in next section.

3. Control variables: SIZE and INDUSTRY

Negatives = α + $\beta1$ ROE + $\beta2$ SIZE + $\beta3$ INDUSTRY + ε

Model (a)	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	-167.071	117.051		-1.427	0.162
ROE	- 0.755	0.521	- 0.218	-1.450	0.156
SIZE	19.950	8.108	0.370	2.462	0.019*
Industry	- 14.853	21.639	-0.102	-0.686	0.497

(a) Negatives: Dependent Variable

Table.V.14 –
Negatives – Size and Industry effects

Negatives = - 167, 071 – 0,218 ROE + 0,370 SIZE* – 0,102 INDUSTRY

Size seems to be the only significant variable with effect on the amount of disclosure of negative words. More the company goes large, more its disclosure of negative words goes important. However, R2 of the model is approximatively 22% and adjusted R2 is 16 %. We should consider variables effects with caution.

Positives = α + $\beta 1$ ROE + $\beta 2$ SIZE + $\beta 3$ INDUSTRY + ε

Model (a)	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	-588.877	369.059		-1.596	0.119
ROE	1.021	1.642	0.096	0.622	0.538
SIZE	65.104	25.565	0.392	2.547	0.015*
Industry	-91.086	68.228	-0.204	-1.335	0.190

(a) Positives: Dependent Variable

Table.V.15 –
Positives – Size and Industry effects

Positives = - 588.877 + 0,096 ROE + 0,392 SIZE* – 0,204 INDUSTRY

Similar fining is also true for positives. In fact we see that size the an effect on the disclosure of positive words. The amount of disclosure of positive words invreases when company size increases. The model is robust enough with an R2 totalling almost 18 % and an adjusted R2 of 11%. Once again, industry has no specific affect on the way positives are disclosed.

Tot.Words = α + β1 ROE + β2 SIZE + β3 INDUSTRY + $\mathcal{E}$

Model (a)	Unstandardized Coefficients		Sstandardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	-755.948	470.593		-1.606	0.117
ROE	0.266	2.094	0.019	0.127	0.900
SIZE	85.065	32.598	0.401	2.609	0.013*
Industry	-105.939	86.998	-0.185	-1.218	0.231

(a) Words: (Pos+Neg) Dependent Variable

Table.V.16 –

Words – Size and Industry effects

Words = - 755.948 + 0,019 ROE + 0,401 SIZE – 0,185 INDUSTRY*

We wanted to see the effect of the control variables on the total disclosure of influencing words (Positives + Negatives). Results were similar to the two previous ones. Size was the only variable with significant effect. Its positive sign implies that when company gets bigger, the amount of its disclosure of influencing words automatically gets higher. Industry from the other hand has no significant effect on disclosure. The model is relatively robust with an R^2 almost 18% and an adjusted R^2 of 12%.

V.1.4. Thematic Analysis (Hypothesis 3)

Thematic analysis, as previously stated, is based on Jenkins' report topics. Every one of the tested five sub-hypothesis corresponds to one of the Jenkins' report topics Table.V.17. reports data about thematic structure.

	performers	Less Performers	t-student	P-value
FIN	78.45	74.61	.286	..776
MA	82	81.70	.021	.983
FL	23.55	40.15	-2.343	.024*
MGT	28.75	19.15	-1.180	.245
Background	59.15	67.90	-.563	.577

Table.V.17 –

Thematic structure of Performers and less performers MD&As (Means).

* Significant at .05 level.

FIN: Financial and non financial data.

MA: Management's analysis of financial and non financial data.

FL: Forward Looking information.

MGT: information about Management and Shareholders.

Background: Background information about the company.

1. Sub-hypotheses

H3.a. There is no significant difference between performers and less performers according to the financial and non financial data reported in the MD&A.

Findings in table.V.7 show that performers almost disclose the same amount of "*financial and non financial data*" as less performers. In fact, an average of 79 information item is devoted to the considered theme by performers. 75 information item is devoted the same

theme by less performers., The difference, relatively to this first theme, is not statistically different ($t = .286, p = 0 .776$).

H3.a. is then accepted, there is no significant difference between less performing and performing companies according to the disclosed "financial and non financial information data'.
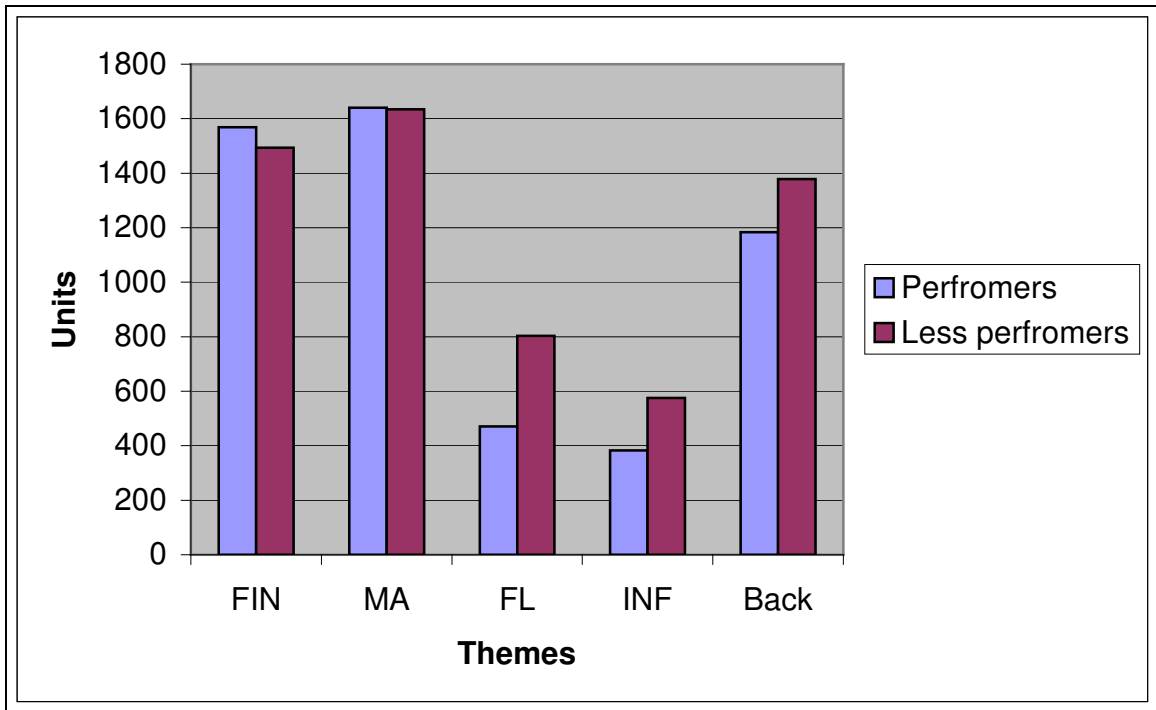
Figure V.5 –

Thematic distribution between Performers and Less performers.
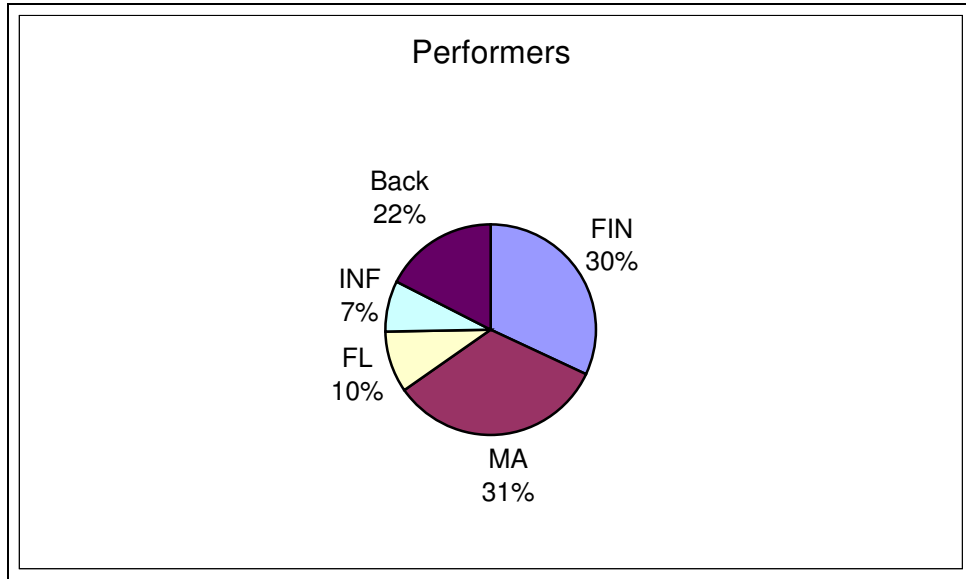
Figure V.6 –

Performers – Themes distribution.
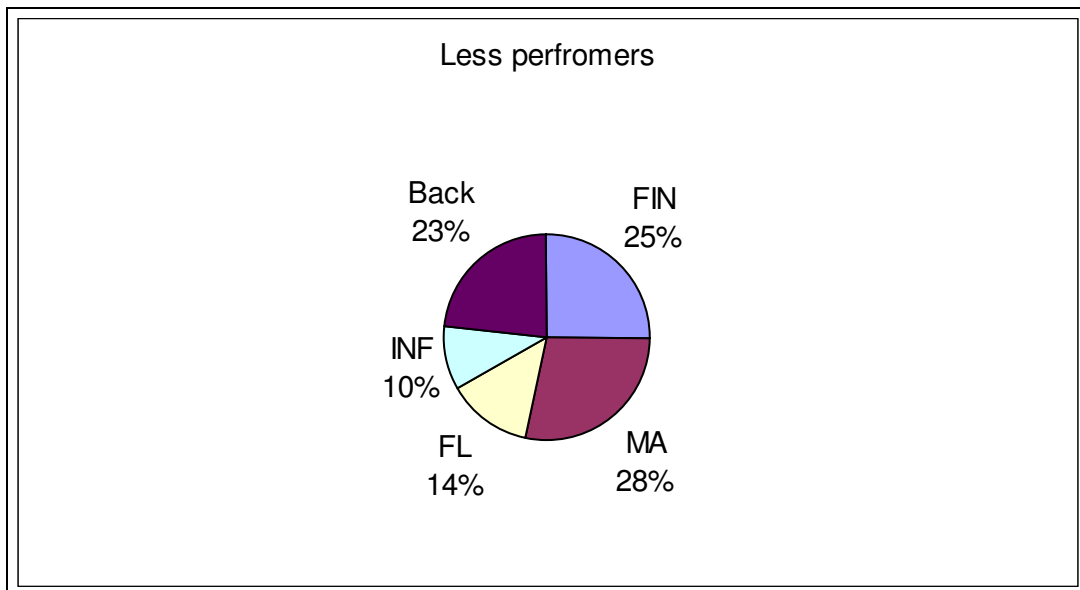
Figure V.7 –

Less Performers – Themes distribution.

H3.b. there is no significant difference between performers and less performers according to information related to "Management's analysis of financial and non financial data".

Results as reported in table.V.17, indicate that less performers devote almost the same number of information items to "*management's analysis of financial and non financial data*" as performers. Performers report an average of 82 piece whereas less performers devote 81.70 items almost 82 items. Once again, t-test indicates that the difference between the two groups is not significant at .05 level (*t = .021, p = .983*).

Hypothesis H3.b is therefore accepted. Performers and less performers devote the same space the discuss their financial and non financial data.

H3.c. There is no significant difference between performers and less performers according to information related to "forward-looking".

Forward-looking information as stated earlier are becoming more and more praised in the new business reporting environment. In fact, this tendency is confirmed by our findings. In table.V.17, We see that less performers devote more space to talk about "forward-looking" information than performers. Less performers have on average 40 items stressing on "*forward-looking*" information against about 24 items (23.55) for performers. "Forward-looking" data is more present in the less performing companies discourse than in their performing counterpart.

Difference between groups is statistically significant at .05 level (t = -2.343, p = 0.024). Thus evidence supports the hypothesis that there is a statistical difference in the reporting

of "forward-looking" theme between performers and less performers.   Hypothesis H3.c is then rejected.

H3.d. There is no significant difference between performers and less performers according to information related to "information about management and shareholders".

For the current sub-hypothesis we also couldn't find any supportive evidence. Performers report on average 20 piece of information whereas less performers report about 29 pieces to talk about management and shareholders. However, T-test indicate that the difference is not statistically significant at the .05 level (*t = -1.180, p = .245*).

Hypothesis H3.d is to accept. There is no significant difference between performers and less performers relatively to the reporting of "information about management and shareholders"

H3.e. There is no significant difference between performers and less performers according to information related to "Background about the company".

"Background information about the company" seem more present in the less performing companies MD&A. In fact, on average performers devote 59 chunk of information to background information whereas less performers devote a higher amount equals to 68 pieces. However, no significant difference is detected between the groups (*t = - 0.563, p = 0 .577*).. Hypothesis H3.e is therefore accepted. There is no significant difference between performers and less performers according to information related to "Background about the company".

2. Themes and Earnings Per Shares (EPS)

As we previously performed in hypotheses 1 and 2, we studied the relationship between themes discussed in the narratives and financial performance as approached by EPS. Results are reported in the following table (Table.V.18):

	performers	Less Performers	t-student	P-value
FIN	59.85	93.25	-2.755	.009
MA	60	103.7	-3.498	.001
FL	21.2	42.5	-3.158	.003
MGT	14.7	33.2	-2.396	0.022
Background	35.9	75.7	- 3.453	0.001

Table.V.18 –

Thematic structure of Performers and less performers (EPS)

Table.V.17 Shows very interesting findings. We notice that performers and less performers, when ranked according to EPS, confirm their differences in terms of the investigated themes. In fact we see that all the differences are significative between the two groups (Table.V.18).

In fact, our findings support what we have found in previous analysis based on ROE in that sense that less performers substantially differ from performers in the way they report themes. Financial performance has a great impact on reporting patterns between firms.

We extended the analysis to see the effect of control variables.

3. Control variables: SIZE and INDUSTRY

Since there is no difference between companies at the level of themes but for forward-looking information, we decided to study the effect of size and industry only on the latter.

$$FL= \alpha + \beta 1\ ROE + \beta 2\ SIZE + \beta 3\ INDUSTRY + \mathcal{E}$$

Model (a)	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	-43.130	37.850		-1.139	0.262
ROE	-0.252	0.168	-0.224	-1.469	0.143
SIZE (L.Sales)	5.745	2.622	0.328	2.191	0.035
Industry	-10.249	6.997	-0.217	-1.465	0.152

(a) Dependent variable: FL

Table.V.19 –

FL – Size and industry effects

FL = - 43130 – 0.224 ROE + 0,328 SIZE – 0,217 INDUSTRY

We see that the only significant variable in this model is size. It seems that more the firm is big, more it has tendency to disclose forward looking information. there is no effect of industry on how forward-looking information is disclosed. The model is relatively robust with an R2 appreciatively 23% and an adjusted R2 almost 16 %.

V.2. Discussion of Findings

In this section we comment on the results of the content analysis reported above. The findings of this research partially support the idea that accounting narratives in Italian companies' MD&As may be used as a means of impression management. The idea of impression management may be supported by the two second hypotheses specifically dealing with wording structure and thematic structure. Text complexity, although it highlights very important results it does not specifically provides evidence on the existence of impression management.

First of all we would like to comment on annual reports thickness as approached by the number of pages. We saw that performers and less performers nearly invest the same number of pages in their annual reports. This same finding is also true for the number of pages devoted to their MD&As. This leads us to think that financial performance does not affect the quantity of pages reported by firms in their annual reports. From an impression management perspective, we were expecting that Less performers will provide longer reports and though longer MD&As to justify their poor achievements.

This non difference in annual reports size seems to be confirmed by the test of the complexity hypothesis. We were expecting that text ease of readability will be lower for less performers. Less performers will use less clearer text to obfuscate their readers. Results does not militate in favor of this thesis and less performers seem not having easy to read texts. Statistics do not provide any difference between performers and less performers according to text complexity. This is also supported by the correlation analysis between level of performance and text complexity. When performance is

increasing we noticed that also text complexity is increasing. One explanation could be that performers do not give too much attention to the way their narratives are written and give much more importance to the information reported in financial statements.

In our opinion, the most important output deriving from the first hypothesis is that ease readability as related to financial performance showed that all companies (good performing and bad performing) disclose narratives in their annual reports (MD&A) that are classified as difficult to read. We note that a similar result has been reached in other countries with different reporting contexts (Jones: 1988, Courtis: 1986, Subramaranian et al: 1993, Courtis: 1995,).

This confirms that narratives in annual reports are dedicated to a specific category of investors that have a minimum level of skill to intercept text complexity. Text difficulty as we may see from previous analysis is confirmed by the two readability scores. These levels correspond to an educational attainment of at least university undergraduate level to fully comprehend the message conveyed in the text.

However, we should be cautious in interpreting these results. Two dimensions should be taken in consideration. First, we shouldn't forget that we are analyzing English narratives issued in a non-English speaking environment – namely the Italian context. Although the prevalence of the idea of globalized markets and international connected investments hypotheses, still we believe that local investors are the primary targets in the Italian stock market. We would though infer that complexity of text may be due to a lack of interest given by companies themselves to the way they write the English narratives. As a consequence not too much is invested in making smoother the reading quality of English report they are issuing.

Second, the problem of dual language reporting should be treated with more attention (Courtis & Hassan: 2002, Leeventis & Weetman: 2004). For our analysis, it is known that Italian language is romance language based on long prose. The opposite is true for English language which is based on short sentences (Strunk: 1918). Translation from Italian to English will certainly have an effect on the final English narratives. As noted by Jones (1996), translation is an important factor that has be taken in consideration when dealing with readability studies, especially when it is not made by some specialized persons or agencies. Also, Courtis (1995) and Courtis & Hassan (2002) stated that the language of origin may have a significant impact on the translated text. Thus if translation was made keeping in mind the original structure of Italian language, we may expect that English texts will be complex with longer sentences that it should normally be. That's why in future research further analysis of original Italian narratives is very appreciated.

Although texts are assessed as difficult, this does not infer the presence of impression management since it seems that it's a general rule valid for performers and less performers alike. Difficulty seems to be more a matter of lack of attention to the way annual reports are reports than anything else.

Analysis of variability between different parts of the MD&A from the other hand reported suggestive results and give us a new revealing picture about narrative reporting by Italian companies. We remind that more variability may be an indication of ease of readability manipulation and thus of some attempt to impression management (Couris: 1998, Clatworthy & Jones: 2001)..

First, a discernible reading ease of readability pattern was present within the MD&As. In fact, More than 50% of the Md&As (22 out of 40) have a mid-section classified as Difficult to read. What is interesting to note at this level is that 60% of performers (12 companies) and 5=% of less performers (10 companies)present this pattern. It seems though that this patter is very present in both groups communications. Less performers would use this pattern tu bury bad news in the mid-part by making it difficult (obfuscation thesis as supported by courtis (1998)), but why would large proposrtion of performers present this same pattern ?!! this pushes towards the direction of rejection of impression management, but instead it supports what we advanced relatively to text complexity: companies don't give too much importance to text clarity. When it happens thatmid-parts are difficult to read, in our opinion, this is due to the fact that most of the important matters are discussed in the mid-sections of narratives (Courtis: 1998) consequently long sentences and long words may be in use.

Second, ease of readability variability results are very interesting. We did find that variability in the analyzed texts exceeds 10% in 77.5 % of the companies (31 companies). This could be a sign of obfuscation unless the phenomenon is specific or exceptional to some company. The phenomenon seems to be general and touches all the companies independently of their financial position. Moreover, no statistical difference is noted between the two sets of companies according to their coefficient of variation. However, we should draw the attention that even no difference is detected, we found that performers experience on average more variability in their MD&As than less performers do. This may imply that less profitable companies do not try to engage in any impression management process through text difficulty in order to build a bridge of confidence with

their intended readers by making their texts more accessible. In fact, firms shouldn't veil negative information in difficult to read prose since they incur the risk of missing an opportunity to forthrightly gain their investors' trust and confidence (Subramaranian et al: 1993).

The complementary analysis that has been done using the EPS as a financial performance indicator confirmed that text difficulty don't significantly change between groups. This confirms that financial performance is not a significant criteria affecting readability. Moreover, similar conclusions are drawn about firm size and industry. Regression analysis does not give any significant relation with ease of readability. This is very interesting confirming what has been previously comes out from all the readability analysis reported in the above lines.

Overall, the observed patterns don't allow us to conclude on the presence of impression management based on text complexity. All the companies have difficult to read texts with an emphasis on the mid-parts of their MD&As. Ease of redability Variability seems to be a common phenomenon of the way companies write their narratives. This supports the idea that the way texts are written is not too much considered. We adhere to Courtis (1986) comment when stating that poor quality of readability may be related to factors such as writing skills, traditions and corporate policy followed by individual chairman and Chief Accounting officer rather than an impression management tactic to hide bad perfromance.

Impression management however seems to show up through the way companies are using positive and negative words in their MD&A. We found that performers report more positive words than negative words in their communication. This seems obvious since

these firms are discussing their performance from the best perspectives in accordance with their achievements. This is understandable and in line with corporate performance.

From the other way round things are somehow doubtful for less performers. In fact, we notices that these companies dwell on their positive words. First, they report an extremely higher proportion of positive words than they are doing with negative words. This is intriguing since we are expecting that these companies will use more negative words in accordance with their profitability. Second, in comparison with their counterparts – performers, they also report almost an equivalent number of positive words. We couldn't find any statistical difference between the two groups. This is very interesting and supports the idea advanced by Smith & Taffler (1992) that by manipulating their wordings structure less performers try to dress their discourse like performers' ones.

Furthermore, we found that less performers report more negative words than good performers. This is logical since companies with non satisfying financial performance are expected to report more narratives with negative connotation. This finding supports the idea that less performers are not using negative words as an obfuscation technique to influence readers visions about the company.

A very important issue has also to be noted. Sticking to the Abrahenson and Park (1994) assertion that news in communication should mirror firm actual performance, we were expecting that the amount of positive words for performers would be equivalent to the amount of negative words for less performers (in normal situations, positive color should be dominant in performers' MD&As and negative color should be dominant in less performers' MD&As). Also, we were expecting that the amount of negative words for performers would be equivalent to the amount of positive words for less performers. We

didn't find any equivalence in the categories of reported words between performers and less performers. However, We see that performers report a number of positive words which is higher than the number of negative words reported by less performers (hypothesis H2.e). This shade the light on a very interesting question, are performers exaggerating the use of positive locutions in their discourse ? According to the analysis it seems so. It is not excluded though that even performers may use the wording choice strategy to accentuate their success.

Comparing the amount of positive words reported by less performers to the amount of negative words reported by performers also reveals striking results. As for the previous hypothesis we were expecting some equivalence between words categories in the reporting process of studied firms (hypothesis 2.f). The equivalence hypothesis is rejected and results reveal that less performers devote more space to positive words than do performers for negative words. An asymmetry in reporting is prevalent. This is in our judgment very suggestive of impression management presence.

It's very interesting to see that the analysis reveals some asymmetry in reporting. Performers devote more space to positive words than do less performers for negative words. This is fully supportive of our hypothesis that wording structure is adapted according to financial performance in order to exercise some impression on annual reports readers. By this, they seem working on attenuating the negative coloration of their dscourse and accentuating its positive side (Elsbach & Sutton: 1992)

The excessive use of positive words from both sides, performers and less performers may be considered as a sign of impression management. However, this Generosity in positive words may also be explained by the famous "Pollyanna hypothesis" (Boucher & Osgood:

1969). According to this theory, human discourse is mostly dominated by positive words. According to Kelly (2003), text words counts finds repeatedly that positive words are used far more often than negative words, among languages and cultures. The prevalence of positive terminology is associated with a general positive tendency, identified as a basic and universal characteristic of human being (Balsco & Rinaldi: 2004). We would adhere the "Pollyanna hypothesis" assertions if the last hypothesis didn't shade some doubts about the possible existence of impression management.

Financial performance is proven to be an influencing variable on how firms report their narratives (Kohut & Segars: 1992, Clatworthy & Jones: 2003). Comparing reporting patterns between performers and less performers according to the EPS indicator, less performers still seem to engage in some impression management process. In fact, the number of positive words reported by the less performers is still significantly equivalent to the number of positive words reported by performers. This finding confirms our idea that less performers, in order to distort readers' feelings, engage in a more positive speech.

Industry seems not having any effect on the reporting pattern of positive and negative words. However, in accordance with previous studies firm size influences disclosure (McNeally & al: 1982, McKinnon & Dalimunthe: 1993, Ahmed & Courtis: 1999). In fact for negatives bigger is the firm, higher the number of negative words reported in the MD&As. The same finding was also true for positives. In our judgment, taken separately we can not infer specific tendency between positives and size from one hand and negatives and size from the other hand. But taken together (positives and negatives) we may say that disclosure increases with size. Therefore, the increasing number of positives

and negatives with reference to size is more attributable to the fact that firms with higher size are keen to disclose more. Rutherford (2003) attributes this to firm complexity. Firms becomes bigger then their organizational structure and their communication processes becomes bigger. So it expected that the amount of disclosure will increase.

Overall, our findings suggest that less performing companies are adapting an impression technique and playing on words to influence readers' perceptions about company's performance. The "joyful" coloration of the conveyed message lead us to think about an intentional mismatch between the accounting narratives and the accounting numbers. Non performing are hiding the achievement by words with positive connotation. It seems also that performers are engaging in some impression management tactics by emphasizing the use of positive words in their communication.

Thematic analysis gives further insights about some structural differences in reporting between performers and less performers. We first notice that both groups mostly concentrate their topics on "Financial and non financial information" (Theme 1) and "Management Analysis of Financial and Non financial information" (Theme 2). This is very interesting since companies have to provide their shareholders and all parties interested in their activities with detailed information about these two issues.

Also companies don't seem neglecting the pressing tendency of disclosing forward-looking information regulators are pushing towards. Forward looking information represent a non neglected proportion of the whole disclosed information (13.65 % for less performers, 9.58 % for performers). Statistical analysis showed a significant difference on the level of reported forward-looking data . Less performers disclose more prospective information than their counterparts.

Previous studies showed that companies with good performance are generally expected to provide more voluntary disclosure of forward information than are firms with bad performance (Lev & Penman: 1990, Clarkson & al: 1994). Our analysis indicated totally the opposite, less performers disclose more forward looking information. does this have an implication on the impression management perspective? Two interpretations are to be considered.

First, from a within group perspective, we see that forward-looking information only account for 13, 64 % of total information disclosed. Even though this information is the source of difference between performers and less performers, it is not the most discussed in less performers' MD&As. Considered from this angle, Forward-looking information does not seen to be used in an impression management perspective. It seems that Less performers are not concentrating on it more than required.

Second, from a between group perspective, less performers are following the same reporting patterns as performers with the notable exception of forward-looking information where they report a higher amount. Considering that less performers try to imitate performers by sending to the market some signals about their well being, we may infer some impression management behavior. Moreover, presenting forward-looking information more than performers do could be interpreted as a sign that are confident in their future and disclose their future visions.

However, the reluctance of performers to disclose much forward looking information may be motivated by the risk that this kind of information implies more responsibility taking. They prefer to be more conservative.

Overall, less performers may be using some impression tactics by trying to imitate good performers in the way they discuss themes. This is accordance with our findings in the second hypothesis about wording structure. Less performers were using positive words in the same way that performers were doing.

The following chapter outlines some limits of the study.

VI.

RESEARCH LIMITS

"*As we advance in life we know the limits of our ability*"

(Froude, 1803)

Research Limits

In order to fully appreciate the findings of our study, observer has to bear in mind some caveats. Major Limits of this research are gathered in three categories: (1) Research sample, (2) Readability formulas and (3) Content Analysis.

1. Research Sample:

Our sample selection presents two limits:

- First, we studied 40 companies (20 per group). The number of companies considered in the analysis seems to be relatively small to infer generalizable conclusions. Even though, this might not be very influential on the conclusion, some caution have to be observed.

- The research sample is deliberately constructed so that we analyze companies with different financial performance. This construction led to interesting results but still it has to be regarded with attention. Non-random sample selection may result in an overstatement of the effect of variables under investigation.

2. Readability Formulas:

Readability formulas have been widely considered as a very effective and valid method to assess text complexity since years (Courtis: 1995, 1998, Dubey: 2004). However, these formulas present some drawbacks. It is argued for instance (Bailin & Grafsteing: 2001) that readability indexes don't take into account the multi-faceted dimensions of text assessment. Specifically, they don't consider the interaction between text properties and readers. Readability formulae, as stated by Fultcher (1997), ignore reader characteristics such background knowledge, reading speed and strategies.

Also, Shriver (1989) notes that readability formulas disregard what is called in linguistics "whole-text aspects". Whole-text aspects are concerned with the positioning and organization of sentences and paragraphs in texts and with how information flows through the text.

3. Content Analysis

Notwithstanding content analysis is the most appropriate method for text analysis (Weber: 1990), this method suffers from some detriments. For instance, the problem of subjectivity: Subjectivity in content analysis is a serious problem that we may reduce it but not eliminating it. Research opinion on the text and how it assess it is very present. An Other disadvantage of content analysis is that it is difficult to implement all its steps in an ideal fashion (Kaid : 1989). For instance we couldn't go through an in depth inter-coder reliability analysis.

From another side, the thematic analysis we went through may present also some shortcomings. In fact, to extract themes we proceeded through an established framework, the Jenkins' report. This report showed its validity in many other contexts (Beattie et al: 2004) however, it limits fully appreciation of companies themes as they are intended by them. Several researchers, used data mining techniques such us fuzzy sets techniques or statistical co-occurrences of words to extract themes as intended by report produces (Frazier et al: 1984, Beaudouin: 2003, Baynoun et al: 2005).

VII.

CONCLUSION &

DIRECTIONS FOR FUTURE RESEARCH

"*Don't let it end like this. Tell them I said something.*"

(Pancho Villa, 1877- 1923)

Conclusion &

Directions for future Research

In the light of the shift business reporting environment is experiencing and the large interest shown towards the presence of accounting narratives in the reporting process, this research is a contribution to the understanding of the relationship between the structure of narratives and financial performance. This study is timely especially after the recent financial scandals that shaked the business communication arena. Is business neutral in reporting its financial performance ? is it using the regulatory flexibility of accounting narratives to build an image of its company that may influence outsiders ?

Accounting narratives are becoming widespread and invading a large proportion in the communication channel between companies and its shareholders (Barlett & Chandlers: 1997). However, still too much has to be known about them, especially in non-English speaking countries like the one we are studying: Italy.

This study comes as a new addition to the existing accounting research on disclosure in Italy (Prencipe: 2004) by stressing on accounting narratives. This allows to better understand the Italian reporting context especially after the recent Parmalat scandal.

In the new reporting frameworks (AICPA: 1994, PricewaterhouseCoopers: 2001, ICAEW:2003 for instance) too much importance is given to the Management Discussion and Analysis (MD&A) section of the annual reports. Although this growing interest, not too much is known about this document (Clarkson et al: 1999) and more research has to

be done on it. This research adds to the body of evidence that this document is worth being analyzed.

Results are very interesting and partially confirm that companies may manage their narratives according to their financial performance. Wording choice and thematic analysis supports that thesis whereas text complexity analysis does not go in favor of text management behavior to the financial performance

Independently of financial performance, MD&As are assessed as difficult to read. This shows that in order to appreciate the content of these narratives a fair advanced level of education is required. These findings are not different from those reported in others studies confirming accounting narratives complexity (Jones: 1988, Courtis: 1986, courtis: 1995, etc). Not easy to read texts seem to be like a validated general tendency for well performing and less performing companies. This leads to think that Italian companies does not give too much importance to the way their narratives are written. Since we are analyzing the English versions of annual reports, results should be taken with some caution considering language effect.

Wording structure also reveals interesting results. Less performers seem engaging in some impression management tactics through the use of positive words. In fact, no significant difference is noted between the two groups of companies based on positives. Moreover, Performers seem also exaggerating the use of positive words. This is very interesting to know since readers may be influenced by a positive coloration of the message.

By reference to thematic structure, performers and less performers differ in the amount of reported "Forward-looking" information with an advantage to less performers. This may

be interpreted as a an impression management tactic since less performers tend to behave like performers (Smith & taffler: 1992).

This study is opens perspectives in several ways. First, for external validity purposes a replication of this research on a larger sample will be welcome. A larger sample will help us to have a wider view of the structure of financial communication – as intended in this research – of Italian companies. More efforts and more persons should be involved in order to handle the large quantity of data that has to analyzed.

Another idea is to enlarge the time span window of research. The current study is a cross-section analysis studying one year. Future research should focus on more than one year. In this, case studies would also be with added value to understand financial communication. The study of one company accounting narrative patterns would give us further insights about how texts adaptations really work according to financial performance. Like several previous studies which focused on a single case (Jones: 1988, McKinstry: 1996, Thomas: 1997) we would suggest that future investigations should focus on particulars like Parmalat.

 Second , from a linguistic point of view readability formulas are showing several limits (Bailin & Grafstein: 2001, Fultcher: 1997). Future research may focus on more literacy rooted techniques such us rhetoric analysis (Compin: 2004) or antithesis analysis (Davison: 2002). Also further analysis may approach texts by taking in consideration several aspects neglected by readability formulas such us the structure of information flow in the prose (Rosberry: 1995, Sydreff & weetman: 1998, Sydreff & Weetmann: 2002). Furthermore, analysis may take in consideration even the grammatical structures appearing in the texts (Thomas: 1997, Davies et al: 2003). Thomas (1997) notes for

instance that active voice and active verbs promote the idea of a company that is moving forward, that is progressive, aggressive and successful in the marketplace. Use of the passive voice is reserved for those occasions when the writer finds it advantageous to be distanced from the message.

In addition to linguitic analysis future research may have recourse to what Hassan & Courtis called triangulation techniques such us paired interview testing. This will help to assess the valisdity of results reached thourgh linguistic based analysis.

A very important feature that may be also taken in consideration is that a more peculiar distinction should be made between understandability and ease of readability. This distinction is not too much considered when analyzing narratives and further analysis should be made in that direction. Although readability and understandability are related, they do differ (Jones: 1996). Understandability is reader centered and is contingent on readers' background, prior knowledge, the purpose of the reader, interest and general reading ability. Readability, by contrast, is text centered. Few are the studies that researched the difference in the accounting context (Smith & taffler: 1992) and much is still to be done.

Investigation can be extended by focusing on more experimental studies to understand the reporting phenomenon. Recent years there were insistent calls for the use of more experimental research in financial accounting seen the importance it reveals in understanding accounting phenomenon like information effects on decsion making (Libby et al: 2002). Our research seems to be a favorable basis on which to build to go through an experimental study on the effect of reporting patterns on decision making for. Limited are the studies that went for some experimental designs to test the existence of

impression management (Stanton & al: 2004) or to test the relevance of various linguistic methods to assess accounting text complexity (Smith & Taffler: 1992). The field is still open to further designs.

Also, This same research could be extended to other sections of annual reports such as the letter to the president, notes, footnotes, etc. An inter-section comparison will help scholars and practitioners alike to understand the characteristics of every single part of the report and its relationship with other sections.

The choice of the use of English written annual reports for the scope of this study is justified by the global market perspective but still cultural specificities should be taken in consideration (Held et al: 1999). Every language has its own specificities that are well rooted in the country culture. That's why an analysis of the original annual reports written in Italian will be a welcome addition to this research. Findings could be compared with ours in order to assess the value relevance of dual language reporting.

Still in the same perspective, Italian business specificities and their impact on narratives reporting may also be considered in further studies. Corporate governance in Italy or business families financial reporting would be very interesting issues to research in relation with the structure of accounting narratives.

Further addition would be to extend similar studies to other European countries in order to have a more general vision about the relation between accounting narratives and financial performance in other European settings. Italy may be the first step in a more ambitious project aiming at studying financial reporting in Europe.

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APPENDICES

Appendix 1

TOTAL PAGES IN ANNUAL REPORTS /TOTAL PAGES IN MD&A

Performers	ROE	Annual Reports	MD&A	Less Performers	ROE	Annual reports	MD&A
GEOX	79.68	138	30	ACEA	4.34	206	31
TELECOM ITALIA MOBILE	43.33	212	108	DAVIDE CAMPARI	4.03	100	37
INDESIT COMPANY	32.56	115	17	BUZZI UNICEM RNC	3.76	204	49
AEM	25.38	242	110	CALTAGIRONE	3.44	120	11
FIERA MILANO	18.88	204	33	DUCATI MOTOR HOLDING	3.22	105	43
LUXOTTICA	18.85	127	14	EDISON	3.22	203	121
CREMONINI	17.82	185	31	LOTTOMATICA	1.39	150	82
MONDADORI ED	17.59	144	57	CIR	0.21	162	23
GRUPPO EDIT.L'ESPRESSO	17.23	84	11	DE LONGHI	0.03	94	18
BREMBO	17.19	144	50	IFIL	-1.69	152	30
PERMASTEELISA	16.88	57	9	PIRELLI	-2.04	213	116
IMPREGILO	16.6	190	70	RICCHETTI	-3.53	63	21
SOGEFI	15.47	37	29	ITALIA MEDIA	-5.88	190	66
BULGARI	15.38	144	20	IFI PV	-6.65	184	24
SAIPEM	15.37	133	64	SNIA ORD	-14.85	63	17
MEDIASET	15.21	304	76	FIAT	-25.72	209	59
ITALCEMENTI	13.59	132	34	FASTWEB	-26.38	157	50
AMGA	13.27	215	33	ALITALIA	-29.39	201	64
RECORDATI	11.08	108	18	IT HOLDING	-29.57	71	22
CAIRO COMMUNICATION	10.79	67	10	Tiscali	-39.36	147	39

Maximum	*304.00*	*110.00*
Minimum	*37.00*	*9.00*
Mean	*149.68*	*41.79*
Std.Deviation	*67.86*	*31.40*

Maximum	*213.00*	*121.00*
Minimum	*63.00*	*11.00*
Mean	*146.73*	*46.94*
Std.Deviation	*51.90*	*31.78*

Appendix 2

TEXT EASE OF READABILITY:
FLESH AND LIX INDEXES

Performers	Readability		Less Performers	Readability	
	Flesch Index	Lix Index		Flesch Index	Lix Index
GEOX	10.10	78.26	ACEA	24.70	41.56
TELECOM ITALIA MOBILE	27.40	42.76	DAVIDE CAMPARI	35.70	37.98
INDESIT COMPANY	38.30	39.44	BUZZI UNICEM RNC	29.90	34.26
AEM	37.10	38.16	CALTAGIRONE	28.80	39.24
FIERA MILANO	36.60	39.09	DUCATI MOTOR HOLDING	36.00	37.88
LUXOTTICA	22.70	42.20	EDISON	24.00	42.06
CREMONINI	34.00	40.17	LOTTOMATICA	19.00	39.50
MONDADORI ED	25.00	35.31	CIR	38.10	34.27
GRUPPO EDIT.L'ESPRESSO	31.30	38.26	DE LONGHI	36.40	42.13
BREMBO	23.40	36.94	IFIL	18.00	41.14
PERMASTEELISA	37.20	33.41	PIRELLI	34.40	41.04
IMPREGILO	33.70	38.32	RICCHETTI	32.00	37.60
SOGEFI	28.80	36.85	ITALIA MEDIA	22.90	40.92
BULGARI	37.50	38.93	IFI PV	31.10	37.58
SAIPEM	31.50	42.51	SNIA ORD	40.60	36.52
MEDIASET	30.40	40.59	FIAT	28.50	38.90
ITALCEMENTI	36.70	38.89	FASTWEB	33.10	41.54
AMGA	24.40	39.62	ALITALIA	41.30	38.65
RECORDATI	30.70	39.50	IT HOLDING	33.00	44.50
CAIRO COMMUNICATION	11.20	74.39	Tiscali	35.60	42.70
Maximum	*38.30*	*78.26*	*Maximum*	*41.30*	*44.50*
Minimum	*10.10*	*33.41*	*Minimum*	*18.00*	*34.26*
Mean	*29.40*	*42.68*	*Mean*	*31.155*	*39.50*
Std.Deviation	*8.12*	*11.74*	*Std.Deviation*	*6.67*	*2.73*

Appendix 3

WORDINGS STRUCTURE:

POSITIVES VS NEGATIVES

Performers	Readability		Less Performers	Readability	
	Postives	**Negatives**		**Positives**	**Negatives**
GEOX	229	50	ACEA	191	42
TELECOM ITALIA MOBILE	873	270	DAVIDE CAMPARI	458	166
INDESIT COMPANY	105	20	BUZZI UNICEM RNC	297	128
AEM	422	153	CALTAGIRONE	47	22
FIERA MILANO	170	51	DUCATI MOTOR HOLDING	283	146
LUXOTTICA	134	64	EDISON	223	93
CREMONINI	117	31	LOTTOMATICA	162	173
MONDADORI ED	393	75	CIR	296	88
GRUPPO EDIT.L'ESPRESSO	170	52	DE LONGHI	228	92
BREMBO	446	82	IFIL	93	72
PERMASTEELISA	123	65	PIRELLI	987	283
IMPREGILO	368	160	RICCHETTI	137	122
SOGEFI	127	19	ITALIA MEDIA	384	137
BULGARI	269	98	IFI PV	133	96
SAIPEM	550	130	SNIA ORD	151	81
MEDIASET	733	125	FIAT	834	351
ITALCEMENTI	425	77	FASTWEB	319	161
AMGA	238	50	ALITALIA	256	156
RECORDATI	84	24	IT HOLDING	147	71
CAIRO COMMUNICATION	150	37	Tiscali	305	134

Maximum	*873.00*	*270.00*	*Maximum*	*987.00*	*351.00*
Minimum	*84.00*	*19.00*	*Minimum*	*47.00*	*22.00*
Mean	*306.30*	*81.65*	*Mean*	*296.55*	*130.70*
Std.Deviation	*219.54*	*61.25*	*Std.Deviation*	*234.02*	*76.71*

Appendix 4

THEMATIC STRUCTURE

Performers	Themes				
	FIN*	MA	FL	MGT	BACK
GEOX	78	166	24	11	38
TELECOM ITALIA MOBILE	98	231	56	10	41
INDESIT COMPANY	29	36	5	12	20
AEM	67	123	34	25	31
FIERA MILANO	51	111	30	7	40
LUXOTTICA	89	67	25	25	27
CREMONINI	112	41	10	15	21
MONDADORI ED	102	56	5	23	173
GRUPPO EDIT.L'ESPRESSO	110	77	31	29	89
BREMBO	143	47	18	44	249
PERMASTEELISA	35	22	15	13	26
IMPREGILO	98	76	31	15	65
SOGEFI	12	28	9	1	12
BULGARI	77	132	46	38	41
SAIPEM	98	77	19	21	36
MEDIASET	176	104	55	44	67
ITALCEMENTI	49	65	12	5	119
AMGA	79	89	34	25	35
RECORDATI	17	59	2	6	12
CAIRO COMMUNICATION	49	33	10	28	41
Total	*1569*	*1640*	*471*	*397*	*1183*
Mean	*78.45*	*82.00*	*23.55*	*19.85*	*59.15*
Std.Deviation	*41.53*	*51.58*	*16.07*	*12.57*	*59.32*

(*)

FIN: Financial and Non Financial Data.
MA: Management Analysis of Fianancial and non Financial Data.
FL: Forward-Looking Information.
MGT: Management and Shareholders Information.
Back: Background Information about the Company.

Less Performers	Themes				
	FIN*	MA	FL	MGT	BACK
ACEA	35	37	39	1	107
DAVIDE CAMPARI	44	57	33	17	78
BUZZI UNICEM RNC	64	69	28	2	107
CALTAGIRONE	35	37	4	1	8
DUCATI MOTOR HOLDING	56	77	41	10	23
EDISON	111	102	91	54	96
LOTTOMATICA	65	53	11	4	123
CIR	74	129	14	1	58
DE LONGHI	40	65	16	12	86
IFIL	45	67	51	21	45
PIRELLI	198	156	77	67	121
RICCHETTI	60	58	35	10	25
ITALIA MEDIA	107	123	46	39	79
IFI PV	31	45	16	10	18
SNIA ORD	55	34	55	16	22
FIAT	98	115	76	34	88
FASTWEB	67	81	22	19	44
ALITALIA	101	141	95	44	78
IT HOLDING	57	57	9	98	54
Tiscali	150	131	44	122	98
Total	*1493*	*1634*	*803*	*582*	*1358*
Mean	*74.65*	*81.7*	*40.15*	*29.1*	*67.90*
Std.Deviation	*42.36*	*38.27*	*27.30*	*33.55*	*36.34*

(*)

FIN: Financial and Non Financial Data.
MA: Management Analysis of Fianancial and non Financial Data.
FL: Forward-Looking Information.
MGT: Management and Shareholders Information.
Back: Background Information about the Company.