An Analysis of the Qualitative Characteristics of Management Commentary Reporting by New Zealand Companies

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Abstract

The narrative section of annual reports has considerable value to its user groups, such as financial analysts and investors (Barlett & Chandler 1997; International Accounting Standards Board (IASB) 2006; Tiexiera 2004). This narrative section including chairpersons'/presidents' statement contains twice the quantity of information than the financial statements section (Smith & Taffler 2000). However, the abundance of information does not necessarily enhance the quality of such information (IASB 2006). This issue of qualitative characteristics has been long foregone by researchers. This issue has attracted the attention of IASB (2006). Following the dearth in research in regard to qualitative characteristics of reporting this paper explores whether investors' required qualitative characteristics as outlined by the IASB (2006) have been satisfied in the management commentary section of New Zealand companies' annual reports. Our result suggests that the principal stakeholders', that is, investors' qualitative characteristics requirements have been partially met in this section of annual reports. The qualitative characteristic of 'relevance' and 'supportability' have been satisfied in more annual reports compared to that of 'balance' and 'comparability'.

Key Words: Management commentary, New Zealand companies, qualitative characteristics

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Introduction and Background

Annual Reports are a medium of communication (Barlett & Chandler 1997; Courtis 1995) that have enjoyed considerable attention by many researchers (Abeysekera & Guthrie 2004; Beattie & Jones 2000). Kent and Ung (2003) for example employed a disclosure index based on statements made by management in either the director or chairman's report or reports on individual business regarding future operating outcomes, all gleaned from the annual reports. They based their disclosure index on the annual report because it was deemed the predominant source of voluntary corporate disclosure to investors and was the single communication medium over which management had complete editorial control and was not subject to potential re-interpretations and distortions by the media.

Such attention has demonstrated how narrative reporting contained within annual reports is used as an impression management technique by preparers in securing a positive image of the entity (Stanton, Stanton & Pires 2004). These techniques typically use graphs (Beattie & Jones, 2000; 2001; 2002), variegated colours (Courtis 2004), human resource metrics (Abeysekera & Guthrie 2004) and intellectual capital information (Abeysekera & Guthrie 2005).

Traditionally, there are two parts to an annual report: a voluntary narrative section and a mandatory statutory financial statements' section. The former section includes tables and graphs (Stanton et al. 2004) together with narratives of the chairperson's/presidents' statement, which may contain twice the quantity of information as that contained in statutory financial statements (Smith & Taffler 2000). The latter section is normally statutory bound.

Clatworthy and Jones (2001) claim that the abundance of information in the voluntary narrative section is due to the absence of any regulatory guidelines, Brown and Astami (2006), for example, found much of a Chairman's Report was grounded in bombast and persiflage which was used to elevate a company's performance.

This narrative section is claimed to contain useful information for decision-making by annual report users, such as financial analysts and investors (Barlett & Chandler 1997; IASB 2006; Tiexiera 2004) but has sometimes been criticised for its lack of qualitative characteristics (IASB 2006) and its overuse of stylised diction and tone (Brown & Astami 2006).

This paper examines the qualitative characteristics of narrative reporting as recommended by the IASB (2006) in the context of the management commentary section of New Zealand companies' annual reports. The research question is expressed as follows:

RQ: To what extent do management commentary sections of New Zealand companies' annual reports fulfil the qualitative characteristics of IASB's (2006) guidelines?

Sources of legislation touching upon financial reporting by New Zealand companies include the Companies Act (1993) and accounting standards and requirements of the New Zealand Stock Exchange. Crucially disclosures in the management commentary section of New Zealand companies' annual reports are not guided by any legislation.

This is an extremely timely and important study because corporate reporting standards in New Zealand are well recognised, and much time and resources have been devoted by New Zealand and Australian accounting standards setting bodies to align Australian and New Zealand accounting standards. The Trans-Tasman Standards Advisory Group, for example, is composed of members from the Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB), the professional accounting bodies and officials from the Australian Treasury and the New Zealand Ministry of Economic Development (FRC 2010).

In recent times, the Group has attempted to present a protocol of co-operation between the New Zealand Financial Reporting Standards Board (FRSB) and AASB to be used when working through each standard. This protocol sets out processes issued in Australia and New Zealand in ensuring that Australia and New Zealand present similar positions at international forums. However, unlike Australia, there is no New Zealand Companies' Act or New Zealand Financial Reporting Act requirement to disclose a director's report. Brown, Taylor and Walter (1999) note that considerable criticism was leveled at the quality and frequency of Australian Stock Market enforced listing rules relating to the maintenance of an informed market. Thus, the results of this study, will be of interest not only to advisory groups of Trans-Tasman accounting cooperation but to those Australian and New Zealand practitioners, regulators and academics with an interest in the qualitative characteristics of narratives that are completely discretionary.

Prior Research- Narrative Disclosure

Prior research in the area of narrative reporting has concentrated on the use of graphs, status of reporting and reading ease of the narrative section of annual reports. These studies are discussed below.

Studies in the Area of the Status of Graphical Reporting in Narrative Sections of Annual Reports

Corporate graphical reporting in annual reports was investigated by Beattie and Jones (2000; 2001; 2002). The extent to which the front half of an annual report is used by management to provide a positive impression with the inclusion of financial graphs was analysed by Beattie and Jones (2002). The authors reported that, in some countries financial graphs were used selectively and displayed measurement distortion, and that the motivation behind providing such distorted graphs was to provide a more favourable view of financial performance than the actual one. Beattie and Jones (2002) also found that the accuracy of comparative judgements is affected by the graph slope.

A comparative study of graphical reporting practices of 50 companies from each of the six countries, that is, Australia, France, Germany, the Netherlands, the UK and the US was conducted by Beattie and Jones (2001). They investigated the existence of graphs, the existence of key performance variable (KPV) graphs, the topics graphed, the prominence of presentation and the length of time period graphed in each topic in their study. They found minute variation in the percentage of companies using graphs, while comparing between companies belonging to respective countries. KPVs such as sales, earnings, dividends per share , earnings per share, return on capital employed (ROCE) and cash flow were graphed by more than 25% of companies in each of these countries. Their results indicated topics graphed by these companies was related to their country of association. For example, only Dutch companies graphed cash flow, only U.S. companies graphed ROCE, while only German companies graphed sales. Their evidence suggests that graphical practices in the micro-based countries (Australia, the Netherlands, the U.K., and the U.S.) were notably different from those in the macro-based countries (France and Germany).

Some concern was raised by Beattie and Jones (2000; 2002) in regard to impression management with the use of graphs by companies in their annual reports. Beattie and Jones (2001) reported that there exist differences in graphical reporting practices of companies between countries. However, none of these studies included a comprehensive measure of qualitative characteristics of the corporate annual reports' narrative section.

Studies in the Area of the Status of Narrative Reporting

Deloitte (2006) conducted a longitudinal survey from 1996 to 2006 of the narrative disclosure by 100 U.K. listed companies in their annual reports. The result was that the length of annual reports increased in this ten year period, that is, an average of 71 pages in 2005 and 85 pages in 2006 compared to 45 pages in 1996. More companies were reporting principal risks and uncertainties facing their entity in 2006 compared to 2005, that is, 74% compared to 54%. Their results also indicated an improvement in reporting about these companies non-financial information in 2006 compared to 2005 and 1996. Forward-looking information was reported sparingly, though it was improving.

The report by Deloitte (2006), which indicates that the lengths of companies' annual reports are increasing, raises concern as to whether this additional information is increasingly satisfying investors' required qualitative characteristics. Hence, our research concentrates on qualitative characteristics. The next section outlines previous research concentrating specifically on the management commentary section of annual reports.

Studies in the Area of the Extent of Reading Ease in Management Commentary Section of Annual Reports

Courtis and Hassen (2002) investigated whether differences in language of reporting affects the reading ease. The authors measured the readability levels by observing chairman's address written in English and Chinese for a sample of 65 Hong Kong annual reports, and written in English and Malay for a sample of 53 Malaysian annual reports. Courtis and Hassen (2002) scored identical passages from the chairman's address in both languages using Flesch and Yang formulas for Hong Kong, and Flesch and Yunus formulas for Malaysia respectively. They suggest, following their observation, that the indigenous language versions were easier to read than their corresponding English versions. Their evidence also indicated that the English passages in Malaysian annual reports were easier to read compared to those in Hong Kong annual reports. The authors suggest following their observation that transnational analysts and investors reading English versions experience diversity across jurisdictions.

Clatworthy and Jones (2001) surveyed the Chairman's statement of 60 UK companies to investigate whether there was variability in these statements' reading ease. They concluded that the introduction paragraphs of these chairman's statements were easier to read than later paragraphs. The authors found no evidence that readability variability was used in these statements to suppress 'bad news'. The variability in reading ease was determined by the theme of reporting in each paragraph of chairman's statements. First passages in chairman's statements were easier to read as they only discussed an overview of the business rather than technical discussions of financial results as in later paragraphs. As with Courtis and Hassen (2002), Clatworthy and Jones (2001) did not provide a comprehensive measure of qualitative characteristics of Charman's statement.

Teixeira (2004) found management commentary can be incomplete and biased if it does not report 'bad news' together with 'good news'. The author suggested that management commentary should describe the main business, together with operational and strategic factors facing an entity. A similar suggestion was provided by the IASB (2006), which states that to attain a higher quality ranking, management commentary should provide equal emphasis to good and bad news.

IASB (2006) provides a framework that outlines investors' required qualitative characteristics in the management commentary section of annual reports. Following the dearth of literature examining or proposing a framework of qualitative characteristics in the management commentary section of corporate annual reports the present study adopts the framework suggested by the IASB (2006).

The IASB (2006) Framework of Qualitative Characteristics

Preparers of financial statements need guidance in regard to reporting management commentary. Following such need the IASB (2006) issued a discussion paper which suggests those areas that management should consider while reporting their management commentary. The strength of the framework suggested by the IASB (2006) is that it is based on the required qualitative characteristics of the principal stakeholder group, that is, investors. This is due to investors' inherent risks of investing in a company. The framework's guiding financial statements also suggest 'investors' are the principal user of such statements (IASB 2006). A similar emphasis of satisfying shareholders' information requirements was suggested in previous studies (Cook & Sutton 1995; Joshi & Abdulla 1994).

IASB (2006) recommends that the management commentary should describe the achievement of financial and non-financial performance, indicate the implications of past performance for the future and outline future prospects of the organisation. In order to meet investors' information requirements, IASB (2006) suggests that management commentary should posses the qualitative characteristics of understandability, relevance, supportability, balance and comparability. These characteristics are discussed in more detail in the section devoted to the measurement of qualitative characteristics.

Our research compares quantity of information disclosed by a sample of New Zealand companies with the qualitative characteristics of such disclosure in their management commentary section. This comparison will provide insight as to whether the disclosure in management commentary section of annual reports satisfies investors' qualitative characteristics requirements.

Stakeholder Theory

The aim of the paper to explore whether investors' required qualitative characteristics as outlined by the IASB (2006) are satisfied in the management commentary section of annual reports. Stakeholder theory is applied in the context of this question.

There are two branches of stakeholder theory, that is, the ethical branch and the managerial branch. The ethical branch attributes equal emphasis on fulfilling the expectations of all groups of stakeholders irrespective of their power. On the other hand, the managerial branch emphasises that company management is expected to meet the expectations of powerful stakeholder groups. Such power may result from the control of limited resources, such as finance and labour, access to media or ability to take legislative action against the company or the ability to influence the goods and services consumed by the company (Deegan 2006).

Sternberg (1997) criticised the ethical branch of stakeholder theory as it was unlikely organisations could meet the expectations of everyone. Sternberg (1997) also took a narrow view of stakeholder theory claiming that organisations should meet the expectations of shareholders. The ethical branch was also criticised by Boesso and Kumar (2007). Boesso and Kumar (2007) suggested that companies will only voluntarily communicate those key performance indicators (KPIs) that principal stakeholders need.

Following the criticism by Sternberg (1997) and Boesso and Kumar (2007) the present study adopts the managerial branch of stakeholder theory, which has been applied by a large number of researchers to explain corporate disclosure (Boesso & Kumar 2007; Qu & Leung 2006; Roberts 1992; Smith, Adhikari & Tondkar 2005; Yongvanich & Guthrie 2005).

Similar to previous studies the present study adopts stakeholder theory to explore the pattern of information disclosure in the management commentary section of annual reports, including the extent of such disclosure and their qualitative characteristics.

Research Method and Information Analysis

Research Method

The research method analyses the management commentary section of annual reports of a sample of New Zealand companies for a five year period, 2002 to 2006. Management commentary includes the Chairperson's statement and Chief Executive Officer's statement. The sample of companies includes the 50 top companies by market capitalisation listed on the New Zealand Stock Exchange. This list was obtained from the Weekly Diary published by the New Zealand Stock Exchange, as on the 15th December, 2006. The rationale behind selecting top 50 companies is due to previous studies suggesting that larger firms possess the resources and expertise to meet the diverse requirements of various groups of stakeholders (Ahmed 1994). 'Market capitalisation' was used as a proxy to measure firm size in previous studies (Craven & Marston 1999; Debreceny, Gray & Rahman, 2002). Subsequently 15 companies were excluded because their reports were not available for all five years of the sample period, leaving a sample of 35 companies.

Information Analysis

A scoring system based on content analysis was formulated to measure the quantity of information disclosed in the management commentary section. A separate scoring system based on the IASB (2006)'s framework was formulated to measure the qualitative characteristics of information disclosed. This was followed by the comparison of the quantity and qualitative characteristics based scoring, under each category of information disclosure.

MEASURE OF QUANTITY

Quantity of information disclosed in management commentary was measured by 'content analysis'. Content analysis has been widely used to measure the extent of disclosure in previous studies (Cunnigham & Gadenne 2003; Harte & Owen 1991). Content analysis requires the selection of recording units, such as a sentence, word, a group of words, a paragraph or an entire document (U.S.Government Accountability Office G.A.O.1982). This paper utilises the 'sentence' as a recording unit. The rationale behind using a 'sentence' as the recording unit rather than a 'word' or 'group of words' is that sentences convey greater contextual meaning than 'words' or 'group of words' by themselves (Milne & Adler 1999). A 'paragraph' or an 'entire document' are less suitable to use as a recording unit for this study because a paragraph in management commentary section may contain a mix of information items that encompass different information categories. Under the scoring system of this study, each relevant sentence was counted as one point. Graphs, diagrams, pictures and captions to pictures of activities were excluded from analysis as inclusion of them would lead to a high level of subjectivity (Ahmed & Sulaiman 2004).

To conduct the analysis, categories were developed as they provide the structure of grouping recording units (G.A.O 1982). Categories were developed by taking previous literature from a wide range of background, including environmental reporting (Ahmed & Sulaiman 2004; Thompson & Cowton 2004) and human resource reporting (Abeysekera &

Guthrie 2004). New Zealand companies' annual reports were also reviewed in preparing the categories to capture a wide range of disclosure. These categories are as follows:

1. Company Profile
2. Product and/or service information
3. Investor Information
4. Human Resource
5. Social Information (excluding environmental information)
6. Environmental Information
7. Financial Information
8. Corporate Governance
9. Other

MEASURE OF QUALITATIVE CHARACTERISTICS

IASB (2006) suggest that the management commentary should possess the qualitative characteristics of understandability, relevance, supportability, balance and comparability over time. Following this suggestion by the IASB (2006) the extent of qualitative characteristics satisfied by companies under each of these categories was investigated following the development of a scoring system.

UNDERSTANDABILITY

Understandability is enhanced by writing in plain language so that it is understandable to users and more specifically investors. This can be further enhanced by the use of graphs, diagrams and tables (IASB 2006). 'Understandability' is a broad concept involving some level of subjectivity. Hence, this aspect of qualitative characteristics was not investigated in this paper.

RELEVANCE

Relevance is enhanced by providing an evaluation of past, present or future events or confirming/correcting past evaluations (IASB, 2006). Hence, the scoring system is as follows:

CHARACTERISTICS	SCORE (minimum-maximum)
Evaluation of past events	0-indefinite (1 point for 1 sentence)
Evaluation of present events	0-indefinite (1 point for 1 sentence)
Comments about future expected events	0-indefinite (1 point for 1 sentence)
Confirming/correcting past evaluations	0-indefinite (1 point for 1 sentence)

For example, the following sentences were assigned one point under respective categories:
Evaluation of past events
"*In the past nine years, capacity has only grown by 1.4 per cent per annum due to lack of reinvestment and capacity constraints in key markets such as London." (1 point)* (Air New Zealand 2005, p8)
Evaluation of present events
"*The audited after tax operating surplus for the year to 31 March 2005 was $73.2 million, an increase of 18 percent on previous year's result." (1 point)* (Trust Power Limited 2005, p3)
Comments about future expected events
"*We are well positioned to continue our fleet reinvestment plan and by 2008 our average fleet age will reduce to less than six years from eight years currently." (1point)* (Air New Zealand 2005, p6)

Confirming/correcting past evaluations
"*As expected, in October 16.8 million convertible notes were converted into shares following the receipt of conversion notices from noteholders." (1 point)* (APN News & Media 2005, p4).

SUPPORTABILITY
Supportability is enhanced by statements supported by facts. Forward-looking statements should also provide cautionary statements (IASB 2006). Hence, the scoring system is as follows:

CHARACTERISTICS	SCORE (minimum-maximum)
Statements supported by figures/actual facts	0-indefinite (1 point for 1 sentence)
Cautionary statements accompanying forward-looking statements	0-indefinite (1 point for 1 sentence)

For example, the following sentences were assigned one point under respective categories:
Statements supported by figures/actual facts
"We enter 2006 with a strong financial position and with $1.1 billion in cash on hand." (Air New Zealand 2005, p6)
Cautionary statements accompanying forward-looking statements
"It is likely that we are moving into a period of slightly lower economic growth and a more competitive environment. (1 point) This calls for a systematic focus on costs and revenue growth and I believe that ANZ is well paced to meet the future challenges." (ANZ Limited 2005, p8)

BALANCE
Balance is achieved by providing equal emphasis on good and bad news (IASB 2006). Hence the scoring system is as follows:

CHARACTERISTICS	SCORE (minimum-maximum)
Good News	0-indefinite (1 point for 1 sentence)
Bad News	0-indefinite (1 point for 1 sentence)

For example, the following sentences were assigned one point under respective categories:
Good News
"*The audited after tax operating surplus for the year to 31 March 2005 was $73.2 million, an increase of 18 percent on previous year's result." (1 point)* (Trust Power Limited 2005, p3)

Bad News
"*Operating revenue for the year was $612.3 million down three percent on the previous year as a result of lower electricity prices charged to those customers paying spot market prices." (1 point)* (Trust Power Limited 2005, p3).

COMPARABILITY
Comparability is best achieved by providing comparable financial information over time and different entities providing similar comparable information so that the financial results of these companies can be compared. Hence, comparability has two components (i) Comparability over time and (ii) Comparability between entities (IASB 2006). Comparability of financial information between entities may not provide proper indication of 'comparability' as different entities may attach different level of significance to information items (IASB, 2006). Hence, this aspect of comparability was not investigated in our study.

We analyse 'comparability' by only taking 'comparability over time' as the basis. Hence, our scoring system is as follows:

CHARACTERISCTIC	SCORE (minimum-maximum)
Comparison of financial data with previous year(s)	0-indefinite (1 point for 1 sentence)

Following is an example of a sentence qualifying the characteristic of 'comparability'.

Comparison of financial data with previous year (s):

"The audited after tax operating surplus for the year to 31 March 2005 was $73.2 million, an increase of 18 percent on previous year's result." (1 point) (Trust Power Limited 2005, p3)

The above mentioned qualitative characteristics were considered to analyse the extent of qualitative characteristics satisfied by companies under each of the nine categories of information disclosure examined under 'content analysis,' except the qualitative characteristic of 'comparability' which is only applicable to financial information as stated in the IASB (2006)'s framework. There are possibilities of a sentence satisfying some or all of the qualitative characteristics of relevance, supportability and balance. Hence there was double counting.

Results

This section provides the results of the analysis. The analytical tables are provided in the appendix.

Quantity of Information Disclosure

Table 1A reports the quantity of information disclosed under various categories. The first 5-year panel shows the aggregate number of sentences disclosed by 35 companies in each of the 5 years, classified by categories of information. In the second 5-year panel we report the annual average number of sentences per company. The third panel shows the 5-year average of aggregate sentences and the average number of sentences per company over the 5-year period. For example, in 2002, the 35 companies showed a total of 930 sentences about company profile, an average of 26.57 per company.

The last column in Table 1A reports the average number of sentences per company in the management commentary section by categories, over the 5-year period. The average was 107.13 sentences per company. For each of the nine categories of information there was a significant difference across companies in the number of sentences attributed to each category. However, for all but one category there was no significant difference across the 5 years. Table 1B provides the result of a two-factor ANOVA reporting a significant difference for investor information across the 5-year period. Referring to Table 1A, this was mostly due to the unusually large number of sentences in 2005 (520).

Analysis of Qualitative Characteristics

RELEVANCE

Table 2 reports the number of sentences qualifying the qualitative characteristic of ‘relevance’. In all the years 2002 to 2006 most of the sentences possessing the qualitative characteristic of ‘relevance’ concentrated on the ‘evaluation of past events’ (65.40% across all categories) followed by ‘comments about future expected events’ (21.70%) and the ‘evaluation of present events (11.73%)’. Sentences ‘confirming/correcting past events’ were the least in number.

SUPPORTABILITY

Table 3 reports the number of sentences qualifying the qualitative characteristic of ‘supportability’. In all the years 2002 to 2006 most of the sentences qualifying for ‘supportability’ are ‘statements supported by figures/actual facts’ (77.94% on average). The largest number of sentences (45%) ‘supported by figures/actual facts’ was in the category ‘financial information’. Statements providing caution in regard to forward-looking statements were low in number, an average of 22.02% over the 5-year period. About 49.34% of these cautionary statements were about ‘company profile’.

BALANCE

Table 4 reports the number of sentences qualifying the qualitative characteristic of ‘balance’. The balance between reporting good and ‘bad news’ was not attained by companies. This is due to the over emphasis of companies on ‘good news’ (84.3% of sentences over the 5-year period) compared to ‘bad news’ (15.7% of sentences).

COMPARABILITY

Table 5 provides the number of sentences containing financial information and qualifying the qualitative characteristic of ‘comparability’. Out of those sentences reporting financial information, the company average varied from a low of 1.69 sentences in 2006 to a high of 2.66 in 2004. The average over the 5-year period was 2.17 sentences per company.

Comparison- Quantity of Disclosure Versus Sentences Qualifying the Qualitative Characteristics

Quantity Versus Qualitative Characteristic of Relevance

Table 6 provides a comparison between the quantity of disclosure, measured in number of sentences and the number of those qualifying for the qualitative characteristic of ‘relevance’. Over the 5-year period, 31.83% of management commentary was identified as ‘relevant,’ with slight variations around this percentage from year to year. Table 6 reports the highest percentages of sentences which were relevant were in regard to investor information and environmental information, both averaging more than 50%. The percentage of those sentences about company profile, product/service information, corporate governance, financial information and human resources qualifying the quality of ‘relevance’ was lower and closer to the overall average.

Quantity Versus Qualitative Characteristic of Supportability

Table 7 reports a comparison between quantity of disclosure, measured in number of sentences and the number of sentences with the characteristic of ‘supportability’. Over the 5-

year period 25.85% of the total number of sentences in management commentary was supported by facts and/or cautionary statements, with annual percentages varying from 24.14% in 2006 to 27.30% in 2002. Not unexpectedly the majority of this support was for financial information, with the next highest percentage for investor information.

Quantity Versus Qualitative Characteristic of Balance

Table 8 provides a comparison between quantity of disclosure, measured in sentences reporting news and the number of sentences reporting 'good news' and 'bad news' respectively. Out of the total annual average number of sentences communicating news (496), 60.2% over the 5-year period reported 'good news' and 11.1% reported 'bad news'. Across all companies the reporting of 'good news' was about 5 times higher than 'bad news' across all the years. The reporting of 'good news' exceeded 'bad news' over all categories of information except for corporate governance in 2003, when 'bad news' (58.3%) exceeded 'good news' (16.7%). However, the disclosure of information under the category 'corporate governance' in 2003 was low compared to the total number of sentences containing news reported in regard to all other categories except human resource, social and environmental information.

Quantity Versus Qualitative Characteristic of Comparability of Financial Information

Table 9 reports a comparison of the number of sentences containing financial information and those falling under 'comparability'. Out of the total number of sentences reporting financial information, sentences containing financial data between years was sparse with the highest percentage reported in 2004 (13.6%). The lowest was 9.5% in 2006. Over the 5-year period the average was 11.9%.

Analysis and Discussion

The sample companies on average reported over 100 sentences in the management commentary section of their annual reports. Nearly half (45.39%) the information reported related to their 'company profile' and 'products or services. About 80% of the information related to investor information (10.71%) and financial information (17%). 4.23% of sentences reported 'human resource' information, 1.92% reported 'social' information and 1.65% reported 'environmental' information. About 5% of the sentences constructed were about 'corporate governance'. The following paragraphs seek to identify the extent to which disclosed information possessed four of the five features of quality identified in IASB (2006) – relevance, supportability, balance and comparability.

The highest percentage of sentences concerning the qualitative characteristic of 'relevance' fell under the category of 'environmental information' (64.84%). The lowest percentage came under the category of 'social information' (42.86%). In three of the five years, 2003, 2005 and 2006 the highest percentage of 'relevant' sentences related to 'environmental' information, perhaps reflecting the world-wide concern for the environment. Over all categories of information, there appears to be a U-shaped trend with the percentage of sentences containing relevant information declining over the years 2002 to 2004 and then increasing over 2005 to 2006, finishing at about the 2002 level. On average, across all the years, it appears that between 30% and 33% of sentences in management commentary contain information possessing the quality of 'relevance' as defined in IASB (2006).

Sentences in regards to the qualitative characteristic of 'supportability' were fewer in number than those of relevance'. In 2002 the highest percentage (62.05%) of sentences fell under the qualitative characteristic of ‘supportability’. On the other hand, the lowest percentage reported in 2005 (3.57%) concerned the category of ‘corporate governance’. In all the years 2002 to 2006 ‘investor information’ contained the second highest percentage of sentences qualifying the quality of ‘supportability’. On average over the 5-year period, 58.32% of those sentences containing ‘financial’ information were supported while 37.84% of sentences reporting ‘investor’ information were supported. Overall, 25.86% of sentences in management commentary were supported by figures/facts/cautionary statements.

Companies performed poorly in qualifying the qualitative characteristic of ‘balance’ in their management commentary in all the years 2002 to 2006 due to their abundant reporting of ‘good news’ while ‘bad news’ was sparingly reported. Over the 5 years reporting of ‘good news’ was between 4.7 and 6.3 times that of ‘bad news’ reaching the highest in 2006, that is, more than 6 times. The 5-year average ratio over all categories of information was about 5.4 to 1 of good news to bad news. In 2002 no ‘bad news’ was reported by companies under the categories of social information, environmental information and corporate governance; no ‘bad news’ in 2003 under financial information; none in 2004 under investor information, human resource information or corporate governance; none in 2005 under social or environmental information; and none in 2006 under social information or corporate governance. Strangely there was no ‘bad news’ under corporate governance in any year except 2003 and 2005. In 2003 ‘bad news’ under ‘corporate governance’ exceeded ‘good news’ by a ratio of about 3.5 to 1.

The management commentary section of annual reports also lacked the quality of ‘comparability’. Out of the sentences reporting financial information, only an average of 11.92% over the 5-year period reported comparisons with previous years.

Conclusion

Our results suggest that the principal stakeholders’ that is, investors’ qualitative characteristics requirements were partially met in the ‘management commentary’ section of New Zealand companies’ annual reports. The qualitative characteristic of ‘relevance’ and ‘supportability’ were satisfied in more annual reports compared to that of ‘balance’ and ‘comparability’. These companies need to provide more emphasis to the aspect of ‘balance’ and ‘comparability’ together with further improving ‘relevance’ and ‘supportability’.

It is positive to note that in all years except 2004 over 50% of the sentences containing investor information qualified the qualitative characteristic of ‘relevance’. Also, ‘investor information’ contained the second highest percentage of sentences after financial information that possessed the qualitative characteristic of ‘supportability. This indicates the significance attached by companies to the qualitative characteristic of ‘investor information’. However, we advise that companies need to provide further attention to the qualitative characteristic of ‘relevance’.

‘Financial information’ contained the highest percentage of sentences showing the qualitative characteristic of ‘supportability’ in every year, the highest being 62.05% in 2002. However, the percentage of sentences under the category ‘financial information’ that satisfied the qualitative characteristic of ‘relevance’ was low, the highest was in 2004 (30.99%). This also requires further improvement.

The reports over-emphasised ‘good news’ in all the years with ‘bad news’ being sparingly reported. Hence, the reports have significantly lacked the qualitative characteristic of ‘balance’. However, this conclusion assumes the existence of undisclosed ‘bad news’. Hence, this needs further investigation. Finally, most of the sentences containing ‘financial information’ lacked the qualitative characteristic of ‘comparability’. This also needs further improvement.

The findings from this study have implications for investors worldwide and accounting standards setting. The study makes a contribution by informing investors in New Zealand companies about the lack of the reporting of 'bad news' and comparable financial information. This is expected to caution investors. The findings of the study are expected to be useful to regulatory and standard setting parties both within and outside New Zealand in the development of accounting standards that addresses qualitative characteristics of corporate management commentary.

Limitations and Directions for Future Research

The research is limited to New Zealand companies and by sample size. Future research is suggested by taking a larger number of companies and companies from other countries.

Future research is advised to investigate the factors that influence disclosures in the management commentary section of annual reports and the role of investors in such disclosure decision.

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Appendix

Table 1A: Number of Sentences (quantity of information disclosure) in Management Commentary section of annual reports

	Number of Sentences					Average Number per Company						
Category	**2002**	**2003**	**2004**	**2005**	**2006**	**2002**	**2003**	**2004**	**2005**	**2006**	**5 year total**	
	Freq	**Freq**	**Freq**	**Freq**	**Freq**	**Mean**	**Mean**	**Mean**	**Mean**	**Mean**	**Av Freq**	**Mean**
1: Company profile	930	753	1,000	961	1,026	*26.57*	21.514	28.571	27.457	29.314	934.00	26.69
2: Product/Service info	830	786	843	685	696	*23.71*	22.457	24.086	19.571	19.886	768.00	21.94
3: Investor Information	364	360	390	520	374	*10.40*	10.286	11.143	14.857	10.686	401.60	11.47
4: Human Resource	162	175	154	144	158	*4.63*	5	4.4	4.1143	4.5143	158.60	4.53
5: Social information	37	91	106	74	52	*1.06*	2.6	3.0286	2.1143	1.4857	72.00	2.06
6:Environmental info	46	91	57	41	74	*1.31*	2.6	1.6286	1.1714	2.1143	61.80	1.77
7: Financial Information	606	637	684	641	618	*17.31*	18.2	19.543	18.314	17.657	637.20	18.21
8: Corporate Governance	195	184	215	168	193	*5.57*	5.2571	6.1429	4.8	5.5143	191.00	5.46
9: Others	479	517	606	554	471	*13.69*	14.771	17.314	15.829	13.457	525.40	15.01
Total	**3,649**	**3,594**	**4,055**	**3,788**	**3,662**	***104.26***	**102.69**	**115.86**	**108.23**	**104.63**	**3,749.60**	**107.13**

Table 1B						
ANOVA - Investor Info						
Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Companies	21972	34	646.2	16.5	0.000	1.516
Years	515.98	4	129	3.294	0.013	2.438
Error	5326	136	39.16			
Total	27814	174				

Table 2: Measure of Quality - Relevance

	Evaluation of past events						Evaln of present events						Comments about future						Confirm/Correct past						Total Score					
Category	**Y1**	**Y2**	**Y3**	**Y4**	**Y5**	**Av**	**Y1**	**Y2**	**Y3**	**Y4**	**Y5**	**Av**	**Y1**	**Y2**	**Y3**	**Y4**	**Y5**	**Av**	**Y1**	**Y2**	**Y3**	**Y4**	**Y5**	**Av**	**Y1**	**Y2**	**Y3**	**Y4**	**Y5**	**Av**
1: Company profile	154	95	203	191	250	5.1	66	31	48	33	51	1.3	64	56	0	83	94	1.7	3	6	6	7	1	0.1	287	188	257	314	396	8.2
2: Product/Service info	173	191	212	131	121	4.7	34	42	36	32	32	1.0	81	64	84	68	82	2.2	8	3	1	2	0	0.1	296	300	333	233	235	8.0
3: Investor Information	127	98	95	178	135	3.6	14	11	11	12	8	0.3	68	77	63	68	62	1.9	1	1	1	2	2	0.0	210	187	170	260	207	5.9
4: Human Resource	40	32	28	30	31	0.9	3	6	12	2	4	0.2	6	3	3	5	6	0.1	0	1	1	0	0	0.0	49	42	44	37	41	1.2
5: Social information	3	27	25	18	12	0.5	1	5	3	4	1	0.1	2	6	5	3	0	0.1	0	1	0	0	1	0.0	6	39	33	25	14	0.7
6:Environmental info	14	52	15	22	40	0.8	2	0	1	1	1	0.0	8	6	2	2	0	0.1	1	1	2	0	1	0.0	25	59	20	25	42	1.0
7: Financial Information	108	106	157	124	143	3.6	32	30	21	29	13	0.7	17	20	32	29	25	0.7	4	0	2	0	1	0.0	161	156	212	182	182	5.1
8: Corporate Governance	77	44	71	70	59	1.8	2	2	7	2	5	0.1	18	7	3	4	4	0.2	0	0	0	0	0	0.0	97	53	81	76	68	2.1
9: Others	54	28	29	46	40	1.1	12	9	22	9	4	0.3	15	15	10	11	14	0.4	0	5	0	1	0	0.0	81	57	61	67	58	1.9
Total	**750**	**673**	**835**	**810**	**831**	**22.3**	**166**	**136**	**161**	**124**	**119**	**4.0**	**279**	**254**	**202**	**273**	**287**	**7.4**	**17**	**18**	**13**	**12**	**6**	**0.4**	**1212**	**1081**	**1211**	**1219**	**1243**	**34.1**

Table 3: Measure of Quality - Supportability

	Supported by figures/actual facts						Cautionary statements re future						Total Score					
Category	**2002**	**2003**	**2004**	**2005**	**2006**	**5Y/Co.**	**2002**	**2003**	**2004**	**2005**	**2006**	**5Y/Co.**	**2002**	**2003**	**2004**	**2005**	**2006**	**5Y/Co.**
1: Company profile	92	58	92	69	74	2.20	119	94	102	104	108	3.01	211	152	194	173	182	5.21
2: Product/Service info	137	146	152	129	130	3.97	54	47	26	27	18	0.98	191	193	178	156	148	4.95
3: Investor Information	121	111	148	179	122	3.89	12	13	25	13	15	0.45	133	124	173	192	137	4.34
4: Human Resource	20	21	17	21	19	0.56	8	7	1	3	3	0.13	28	28	18	24	22	0.69
5: Social information	4	14	16	6	5	0.26	0	4	4	2	0	0.06	4	18	20	8	5	0.31
6:Environmental info	3	7	10	3	3	0.15	0	6	3	1	0	0.06	3	13	13	4	3	0.21
7: Financial Information	334	333	363	352	332	9.79	42	30	36	22	14	0.82	376	363	399	374	346	10.62
8: Corporate Governance	5	10	15	4	5	0.22	3	3	4	2	3	0.09	8	13	19	6	8	0.31
9: Other	23	26	21	13	14	0.55	19	20	21	11	19	0.51	42	46	42	24	33	1.07
Total	**739**	**726**	**834**	**776**	**704**	**21.59**	**257**	**224**	**222**	**185**	**180**	**6.10**	**996**	**950**	**1,056**	**961**	**884**	**27.70**

Table 4: Measure of Quality - Good news/Bad news

	Good News						Bad News						Total					
Category	**2002**	**2003**	**2004**	**2005**	**2006**	**5Y**	**2002**	**2003**	**2004**	**2005**	**2006**	**5Y**	**2002**	**2003**	**2004**	**2005**	**2006**	**5Y**
1: Company profile	117	90	125	105	130	3.24	7	7	13	5	8	0.23	124	97	138	110	138	3.47
2: Product/Service info	62	59	47	57	58	1.62	21	21	4	6	10	0.35	83	80	51	63	68	1.97
3: Investor Information	17	22	21	15	16	0.52	3	14	0	2	1	0.11	20	36	21	17	17	0.63
4: Human Resource	10	10	11	6	17	0.31	1	1	0	1	1	0.02	11	11	11	7	18	0.33
5: Social information	1	4	2	4	1	0.07	0	1	2	0	0	0.02	1	5	4	4	1	0.09
6:Environmental info	3	6	7	0	2	0.10	0	2	1	0	1	0.02	3	8	8	0	3	0.13
7: Financial Information	75	65	49	63	66	1.82	14	0	15	23	21	0.42	89	65	64	86	87	2.23
8: Corporate Governance	4	4	1	0	0	0.05	0	14	0	1	0	0.09	4	18	1	1	0	0.14
9: Others	28	23	20	24	28	0.70	19	0	16	11	8	0.31	47	23	36	35	36	1.01
Total	**317**	**283**	**283**	**274**	**318**	**8.43**	**65**	**60**	**51**	**49**	**50**	**1.57**	**382**	**343**	**334**	**323**	**368**	**10.00**

Table 5: Measure of quality - Comparability of Financial Data with previous years

Category	2002 Freq	2003 Freq	2004 Freq	2005 Freq	2006 Freq	2002 Mean	2003 Mean	2004 Mean	2005 Mean	2006 Mean	5 year total Av Freq	5 year total Mean
7: Financial Information	77	74	93	77	59	2.20	2.11	2.66	2.20	1.69	76.00	2.17

Table 6: Quantity versus Quality-Relevance

	2002			2003			2004			2005			2006			5 year Average		
Category	Total #	# Rel	% Rel	Total #	# Rel	% Rel	Total #	# Rel	% Rel	Total #	# Rel	% Rel	Total #	# Rel	% Rel	Total #	# Rel	% Rel
1: Company profile	930	287	30.86%	753	188	24.97%	1,000	257	25.70%	961	314	32.67%	1,026	396	38.60%	934	288	30.88%
2: Product/Service info	830	296	35.66%	786	300	38.17%	843	333	39.50%	685	233	34.01%	696	235	33.76%	768	279	36.38%
3: Investor Information	364	210	57.69%	360	187	51.94%	390	170	43.59%	520	260	50.00%	374	207	55.35%	402	207	51.49%
4: Human Resource	162	49	30.25%	175	42	24.00%	154	44	28.57%	144	37	25.69%	158	41	25.95%	159	43	26.86%
5: Social information	37	6	16.22%	91	39	42.86%	106	33	31.13%	74	25	33.78%	52	14	26.92%	72	23	32.50%
6:Environmental info	46	25	54.35%	91	59	64.84%	57	20	35.09%	41	25	60.98%	74	42	56.76%	62	34	55.34%
7: Financial Information	606	161	26.57%	637	156	24.49%	684	212	30.99%	641	182	28.39%	618	182	29.45%	637	179	28.03%
8: Corporate Governance	195	97	49.74%	184	53	28.80%	215	81	37.67%	168	76	45.24%	193	68	35.23%	191	75	39.27%
9: Other	479	81	16.91%	517	57	11.03%	606	61	10.07%	554	67	12.09%	471	58	12.31%	525	65	12.33%
Total	**3,649**	**1,212**	**33.21%**	**3,594**	**1,081**	**30.08%**	**4,055**	**1,211**	**29.86%**	**3,788**	**1,219**	**32.18%**	**3,662**	**1,243**	**33.94%**	**3,750**	**1,193**	**31.82%**

Note: Rel = Relevant

Table 7: Quantity versus Quality - Supportability

	2002			2003			2004			2005			2006			5 year Average		
Category	Total #	# Sup	% Sup	Total #	# Sup	% Sup	Total #	# Sup	% Sup	Total #	# Sup	% Sup	Total #	# Sup	% Sup	Total #	# Sup	% Sup
1: Company profile	930	211	22.69%	753	152	20.19%	1,000	194	19.40%	961	173	18.00%	1,026	182	17.74%	934	182	19.53%
2: Product/Service info	830	191	23.01%	786	193	24.55%	843	178	21.12%	685	156	22.77%	696	148	21.26%	768	173	22.55%
3: Investor Information	364	133	36.54%	360	124	34.44%	390	173	44.36%	520	192	36.92%	374	137	36.63%	402	152	37.80%
4: Human Resource	162	28	17.28%	175	28	16.00%	154	18	11.69%	144	24	16.67%	158	22	13.92%	159	24	15.13%
5: Social information	37	4	10.81%	91	18	19.78%	106	20	18.87%	74	8	10.81%	52	5	9.62%	72	11	15.28%
6:Environmental info	46	3	6.52%	91	13	14.29%	57	13	22.81%	41	4	9.76%	74	3	4.05%	62	7	11.65%
7: Financial Information	606	376	62.05%	637	363	56.99%	684	399	58.33%	641	374	58.35%	618	346	55.99%	637	372	58.32%
8: Corporate Governance	195	8	4.10%	184	13	7.07%	215	19	8.84%	168	6	3.57%	193	8	4.15%	191	11	5.65%
9: Other	479	42	8.77%	517	46	8.90%	606	42	6.93%	554	24	4.33%	471	33	7.01%	525	37	7.12%
Total	**3,649**	**996**	**27.30%**	**3,594**	**950**	**26.43%**	**4,055**	**1,056**	**26.04%**	**3,788**	**961**	**25.37%**	**3,662**	**884**	**24.14%**	**3,750**	**969**	**25.85%**

Note: Sup = Supported by figures/facts or cautionary statements about future

Table 8: Quantity versus Quality - Balance

5 year Totals

	2002			2003			2004			2005			2006			5 yr Average		
Category	Total News	% Good	% Bad	Total News	% Good	% Bad	Total News	% Good	% Bad	Total News	% Good	% Bad	Total News	% Good	% Bad	Total News	% Good	% Bad
1: Company profile	151	77.5%	4.6%	118	76.3%	5.9%	154	81.2%	8.4%	130	80.8%	3.8%	145	89.7%	5.5%	140	81.1%	5.7%
2: Product/Service info	220	28.2%	9.5%	130	45.4%	16.2%	110	42.7%	3.6%	69	82.6%	8.7%	77	75.3%	13.0%	121	54.8%	10.2%
3: Investor Information	33	51.5%	9.1%	47	46.8%	29.8%	49	42.9%	0.0%	57	26.3%	3.5%	49	32.7%	2.0%	47	40.0%	8.9%
4: Human Resource	22	45.5%	4.5%	12	83.3%	8.3%	12	91.7%	0.0%	8	75.0%	12.5%	19	89.5%	5.3%	15	77.0%	6.1%
5: Social information	1	100.0%	0.0%	6	66.7%	16.7%	4	50.0%	50.0%	4	100.0%	0.0%	1	100.0%	0.0%	3	83.3%	13.3%
6:Environmental info	3	100.0%	0.0%	9	66.7%	22.2%	8	87.5%	12.5%	4	0.0%	0.0%	11	18.2%	9.1%	7	54.5%	8.8%
7: Financial Information	108	69.4%	13.0%	102	63.7%	0.0%	77	63.6%	19.5%	106	59.4%	21.7%	110	60.0%	19.1%	101	63.2%	14.6%
8: Corporate Governance	26	15.4%	0.0%	24	16.7%	58.3%	11	9.1%	0.0%	1	0.0%	100.0%	0	0.0%	0.0%	12	8.2%	31.7%
9: Other	55	50.9%	34.5%	55	41.8%	0.0%	47	42.6%	34.0%	50	48.0%	22.0%	44	63.6%	18.2%	50	49.4%	21.8%
Total	619	51.2%	10.5%	**503**	56.3%	11.9%	**472**	60.0%	10.8%	**429**	63.9%	11.4%	**456**	69.7%	11.0%	496	**60.2%**	11.1%

Note: Total news = total number of sentences providing news - good, bad and neutral. Only good and bad news statements were recorded in Table 4.

Thus the percentages above for good and bad news do not add to 100%, the difference being the percentage of neutral news statements.

Table 9: Quantity versus Quality - Comparability

	2002			2003			2004			2005			2006			5 yr Average		
Category	Total Sent.	# Comp.	% Comp.	Total Comp.	# Comp.	% Comp.	Total Sent.	# Comp.	% Comp.	Total Comp.	# Comp.	% Comp.	Total Comp.	# Comp.	% Comp.	Total Comp.	# Comp.	% Comp.
7: Financial Information	606	77	12.7%	637	74	11.6%	684	93	13.6%	641	77	12.0%	618	59	9.5%	637	76	11.9%

Note: # Comp. = Number of sentences containing comparable financial information.