

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



**Words, Pictures
and Intangibles
in the
Corporate
Report**

**Researchers:
Jane Davison
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**WORDS, PICTURES AND
INTANGIBLES IN THE
CORPORATE REPORT**

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Published by

The Institute of Chartered Accountants of Scotland
CA House, 21 Haymarket Yards
Edinburgh EH12 5BH

First Published 2007
The Institute of Chartered Accountants of Scotland

© 2006
ISBN 978-1 904574-21-1
EAN 9781904574211

This book is published for the Research Committee of
The Institute of Chartered Accountants of Scotland.
The views expressed in this report are those of the authors
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Printed and bound in Great Britain
by T J International

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The Research Committee is grateful to all those who participated in the refereeing process.

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'What is the use of a book', thought Alice, 'without pictures or conversations?'

Lewis Carroll, *Alice's Adventures in Wonderland*

FOREWORD

This report considers the use of discretionary words and pictures in modern corporate reporting. Words and pictures are powerful communication tools, and therefore an area which requires due consideration by both the accounting profession and policy makers.

Intangible assets have become increasingly important to business, and represent a significant proportion of a company's net worth. It is argued, in the report, that 'traditional' accounting deals inadequately with intangible assets and that companies have no alternative but to use other means, such as words and pictures, of communicating these assets.

The report firstly considers the reporting patterns of FTSE 100 companies. There is a continuing trend towards companies producing a summary document (the *Annual Review*) in addition to their full *Annual Report*. The resulting two documents often have very similar presentation and combined with the lack of standardisation in title and content amongst companies can lead to readership confusion. The length of the *Annual Report* has doubled since 1988, with an increase in regulatory disclosures, whilst discretionary material, including words and pictures, has gained pre-eminence in the summary document (the *Annual Review*).

An analysis of the content and style of selected discretionary words and pictures is undertaken. The research demonstrates that discretionary words and pictures are mainly being used to communicate business intangibles, particularly in the *Annual Review*. Intangibles which are communicated in this way include: products; management; markets; business development; consumers; and the workforce.

Next, the authors look at the relationship between the use of discretionary words and pictures and the value of intangibles. The research finds that companies publishing summarised financial statements have larger intangible assets than those that only publish an *Annual Report*. In addition, there is a clear association between a greater

quantity, use and strength of style of discretionary words and pictures and greater values for intangibles.

Finally, the report concludes on the findings of the research and looks at the policy implications of the research. The authors recommend that: measures should be taken to standardise annual reporting and avoid readership confusion; there should be more clarity between discretionary and non-discretionary, and audited and non-audited information in annual reporting; accountants should develop greater sensitivity to the messages portrayed by discretionary words and pictures; consideration should be given to include communication and presentation in accountants' training; and policy-makers should reform the traditional accounting framework to deal more adequately with business intangibles, whilst giving greater attention to the use of discretionary words and pictures in corporate reporting.

The authors identify challenges for future research, including: research into readership to establish what type of reader is using the *Annual Report* and *Annual Review*, and any confusion arising from these two documents; research into the attention which readers give to pictures; research into how companies approach the task of producing their corporate reports; comparative studies of practice in the US and continental Europe; and studies into the eventual migration of the *Corporate Annual Report* to the web.

This project was funded by the Scottish Accountancy Trust for Education and Research (SATER). The Research Committee of the Institute of Chartered Accountants of Scotland has also been happy to support this project and is pleased that the results are available at a time when the subject matter is so topical.

The Committee recognises that the views expressed do not necessarily represent those of ICAS itself, but hopes that the project will contribute to the development of corporate reporting.

David Spence
Convener of Research Committee
February 2007

ACKNOWLEDGEMENTS

We are indebted to a number of organisations and individuals in conducting this research, to whom we should like to record our gratitude.

We should like firstly to thank the hundred companies who sent us copies of their annual reporting documentation, and who were very willing in answering our questions regarding their reporting practice. We are particularly grateful to Allied Domecq, AstraZeneca, Boots, Cadbury Schweppes, Kingfisher, Legal and General, Marks and Spencer, Royal and SunAlliance, Standard Chartered, The BOC Group, The Sage Group, Tesco, Unilever, Whitbread, and WPP, for granting us permission to reproduce extracts from their reports.

The referees to the project gave us good advice regarding its design, and its progress at various stages. We should like to express our particular thanks to Professors Vivien Beattie and Christine Helliard, the Directors of Research at ICAS during the period of the research, for their good advice and support, and to Professor Jane Broadbent and Professor Chris Mallin for their comments and support. George Newman generously undertook painstaking reading of early drafts. Isobel Webber was always most helpful and efficient in administering the project in the early stages. Angie Wilkie had the complex task of navigating the report through its final stages, dealing capably and cheerfully with the various twists and turns of the proofing process. Michelle Crickett, the Assistant Director of Accounting and Auditing, gave us constructive and valuable comments on technical aspects of the regulatory background.

We should also like to recognise the tireless dedication of our research assistant, Andrew, in compiling much of the database.

Finally, the Research Committee and the researchers are grateful for the financial support of the Trustees of the Scottish Accountancy Trust for Education and Research without which the research would not have been possible.

EXECUTIVE SUMMARY

The *Corporate Annual Report* is a kaleidoscopic mosaic: an ever-changing composite of disparate elements. Originally the carrier merely of a set of rudimentary financial accounts, it has developed not only to provide more complex and ever more regulated financial and corporate governance statements and an accompanying wealth of notes, but also to include an accelerating proportion, and sophistication, of discretionary words and pictures. From their beginnings as modest explanations and embellishments within the *Annual Report*, presentational aspects have in many cases virtually supplanted the accounting information in the financial reporting process.

While words, and especially pictures, have traditionally been regarded by accountants as lightweight elements of the annual reporting package, it may be argued that they are, on the contrary, heavyweight ingredients, both in the richness and variety of their messages, and in their potency. The communicative power of graphical representations is now recognised. Discretionary words and pictures occupy much greater space than graphs in annual reports, and are arguably more powerful communication tools, yet their import has been neglected.

Furthermore, in response to surveys of users' needs and changes in company law in the United Kingdom, an increasing number of large companies now send by default to shareholders and other interested parties what is generally known as the '*Annual Review*' document, in place of the *Annual Report*. The *Annual Review* commonly devotes a small part of its content to summary accounting statements and their graphical representation, amidst a much greater proportion of narrative, photographs and other creative design material than is usually included in the *Annual Report*.

Companies have recognised the importance of communicating, rather than simply recording, their activities; they have, for example, invested in media or corporate communications departments who commonly use websites and presentations, in addition to annual reports, to communicate with stakeholders. Accounting practitioners, regulators and researchers alike have lagged behind and are inclined to side-step presentational issues and to focus on the financial statements. Yet as has previously been argued, accountants should educate and involve themselves in questions of communication and its potential for perception engineering.

At the same time, intangible assets have become increasingly important to businesses, yet traditional accounting deals inadequately with their recognition, measurement and disclosure. It would seem likely that companies resort to alternative ways of communicating with investors, notably through the use of discretionary words and pictures. Prior to this research there had been no investigation into the systematic links between the use of presentational material and the existence and value of business intangibles.

This study starts to address these presentational issues. The research presented is fairly comprehensive: it includes all UK FTSE 100 companies, all the reporting documents they produced for one reporting year (165 in total), and a detailed examination of their contents (about 20,000 observations in all). It is important for a number of reasons, which include the following:-

- *Readership confusion.* Where two annual reporting documents are produced, there is potential readership confusion between the documents, exacerbated by the use of presentational devices.
- *Proportion of words and pictures in the summary document.* Given the likely readership confusion, it is all the more important to record up-to-date evidence regarding the nature of the contents of each of the two documents and in particular the large proportion of space

occupied by discretionary words and pictures in the summary document.

- *Readership attitudes.* Previous research has shown that both lay and expert readers are likely to pay more attention to the discretionary information presented in words and pictures than to the accounting statements.
- *Content and style of words and pictures.* Since discretionary words and pictures occupy a large amount of space, it is important to have systematic analysis regarding *what* they are being used to convey (content) and *how* they are conveying such aspects (style).
- *Intangibles and the inadequacy of traditional financial reporting.* The research is presented in the context of the current professional discussion regarding the inadequacy of financial reporting in communicating business intangibles.
- *Shift towards qualitative disclosures.* There has been a commensurate move towards regulated qualitative disclosures, such as the *Operating and Financial Review*, seen as being more able to communicate business intangibles.
- *Value of intangibles.* Companies whose businesses incorporate large values for intangibles are more likely to feel a need to use discretionary words and pictures to assist in communicating the existence of business intangibles.
- *Objectivity.* Such voluntary disclosures are neither regulated nor fully audited.

Research objectives and methods

The main research objectives may be summarised as follows:

- To document and analyse the current overall pattern of the structure of reporting practice among major UK companies;
- To establish whether companies are conveying intangible aspects of their businesses through the use of discretionary words and pictures, by examining their content and style; and
- To ascertain whether relationships exist between the proportions and use of discretionary words and pictures and the importance in monetary value of intangible assets.

The investigation was undertaken in the period 2003 to 2004 and was conducted by a combination of manual qualitative analysis and quantitative statistical techniques. The primary information consisted of the corporate annual reporting documents of the UK FTSE 100, augmented by information obtained from company offices by telephone. A database was constructed from an individual scrutiny and analysis of the documents and other information, recorded on a pre-prepared research template. The database was subjected to a variety of further statistical and other analyses.

Findings from analysis of reporting practice

Overall structure of reporting practice

The majority of FTSE 100 companies (65%) produced two annual documents in 2003; the growing trend towards two documents, started by Bradford and Bingley plc in 1987, is still continuing. Custom regarding titles, size/cover, length and content varied. The main reporting document containing the full statutory accounts and other

regulatory information was referred to by the majority of companies as the *Annual Report*, *Annual Report and Accounts* or similar variant. Where a secondary document was produced, it was generally referred to as the '*Annual Review*' or an equivalent variation. However, practice with regard to titles was not uniform, and could be confusing. For example, the main document was alternatively referred to by some companies as the Directors' Report and Accounts or The 2002 Results and the subsidiary document was sometimes entitled the *Annual Report* or the *Summary Annual Report*.

The majority of documents were of standard A4 size, but a large number of companies (30%) preferred alternative formats. It is noteworthy that where two documents were produced the overwhelming majority (92%) were of very similar presentation, having either identical front covers (28%) or matching front covers (64%), which adds to the potential confusion between the documents.

The length of documents had more or less doubled since the last academic survey was published in 1994. The average length was 90 pages in the case of those companies producing one *Annual Report*, and 103 pages plus 35 pages in the case of companies producing an *Annual Report and Annual Review*; there were wide variations from the average, to a maximum of 340 pages for the *Annual Report* and 100 pages for the *Annual Review*.

Companies varied as to what they included, and where two documents were produced many replicated considerable amounts of material. On average, the regulated content was found to have increased enormously, whereas the proportion of voluntary material had remained relatively static. However, of that voluntary presentational content, it is worthy of comment that across both documents more space was occupied on average by discretionary words and pictures (52%) as compared to graphs (7%). In the case of the *Annual Review* it was particularly striking that the average voluntary content was a very high proportion (47%) of the total, and thus discretionary words and pictures were a dominant part of the document.

Content and style in the discretionary words and pictures

Further analysis of the discretionary words and pictures revealed that all parts of the discretionary words and pictures were being used to communicate intangible attributes of the company. It was estimated that 94% of pictures communicated intangible aspects of companies' businesses. Products were the most frequently promoted, closely followed by management, markets, business development, consumers/customers, the workforce, aspirations for the future, corporate responsibility and brands. Quality awareness, history/reputation and corporate governance also featured as intangible assets which companies sought to advertise, but less frequently. The *Annual Review* was found to be the document used more for this purpose.

Moreover, there was much evidence of the use of stylistic devices throughout the discretionary words and pictures. Three well-known devices were selected for examination: repetition, emphasis and contrast. Of these three devices, repetition was the most frequently used, followed by straightforward emphasis, with contrast or antithesis used to a lesser extent. Again, stylistic devices featured more strongly in the *Annual Review*.

Associations between disclosures and high values of intangible assets

Having established the promotion of intangible assets through the content and style of the discretionary words and pictures, the research was extended to investigate whether this was a systematic approach by companies whose book and market values were heavily weighted by intangible assets.

It was confirmed that those companies with high values of intangible assets were those whose *Annual Reports* and *Annual Reviews* contained the most references to intangibles in discretionary narratives, and contained

the most pictures; it was particularly clear in the case of companies with high uncapitalised intangible assets represented by market values.

It was further identified that those companies with high values of intangible assets were those which were the most likely to use stylistic devices to assist in communication.

Companies with high intangibles were also the most likely to produce an *Annual Review*.

Issues for consideration

The research identified a number of issues relevant to current reporting practice and the use of discretionary words and pictures that would merit further consideration by practitioners, regulators and researchers.

Readership confusion

An increasing majority of large companies are producing two separate annual reporting documents. Where two separate documents are produced, there is great potential for readership confusion: the titles, size, and front covers of the documents frequently make it difficult to distinguish between them at first glance; the content of the documents varies; and the regulatory status of the contents is unclear to the uninitiated. Moreover, the *Annual Review* is generally the default document sent to shareholders and to researchers, and often occupies a more prominent position on web pages. Much anecdotal evidence from groups of students over several years confirms the evidence of confusion, which would benefit from a systematic readership survey.

Proportion of discretionary words and pictures

Discretionary words and pictures represent a very high proportion of the annual reporting package. Most strikingly, pictures constitute on

average one quarter of the *Annual Review*. The rapid recent increase in regulated disclosures has, paradoxically, resulted in their displacement to a less circulated document produced primarily for filing purposes. Meanwhile the discretionary material has gained pre-eminence in the more widely circulated *Annual Review* that has developed beyond the original notion of summary financial statements. Since research has shown that both lay and expert readers pay attention to this discretionary material, it is an issue to which accountants should be sensitive.

The question of intangibles

Concomitant with the emergence of the *Annual Review* and its discretionary words and pictures, intangible assets have also become progressively more important to companies. This research shows that there is a systematic link between the two states of affairs, and that companies, particularly those with high intangible values, are using presentational material to promote the intangible aspects of their business. It is accepted that accounting for intangibles is restrictive, with the result that they are generally excluded from accounts. It is clear that companies are finding alternative ways of communicating with stakeholders.

Objectivity and audit

The communication power of graphical presentation is well established. Discretionary words and pictures occupy more space than graphs and are arguably more powerful components of annual reporting, yet have been dismissed by regulators as insignificant. Auditors vary in the degree of responsibility that they accept for such material in annual reports: while some report that they have reviewed the 'other information' for inconsistencies, others affirm that their opinion does not extend to 'any other information'. The research presented here has not sought to examine the objectivity of individual cases, but has demonstrated that

specific and systematic use is being made of the discretionary words and pictures. Practitioners, regulators and researchers would be advised to give greater weight to the often complex messages communicated by discretionary words and pictures.

Communication

Fundamentally, these are all issues of communication. Accountants have traditionally not been eager to involve themselves in communication matters. As times have changed, the sources and volume of information and opinions have increased at an accelerating rate, and thus clear understanding and presentation of salient messages become all the more important. Accountants should be wary of dissociating themselves from customs which are not a vogue but an established trend.

CHAPTER ONE

INTRODUCTION

It is a commonplace that the *Corporate Annual Report* has for some time increasingly included discretionary words and pictures in addition to the accounting information and other regulated elements. Research and regulation have not, however, kept pace with the growth in volume and craftsmanship of such material. Recent years have witnessed a step change in corporate reporting practice where companies frequently now produce two annual documents: a full *Annual Report* plus a separate publication incorporating summary financial statements. Since it was first permitted in 1990, shareholders and others increasingly receive, by default, this separate document, often referred to as the '*Annual Review*', which contains a wealth of presentational discretionary words and pictures in addition to the summary accounts.

Why does this matter? The communicative power of graphical representations was recognised in a UK Accounting Standards Board 2000 discussion paper *Year-end financial reports: improving communication*, where it was advised that particular care should be taken regarding their objectivity. Discretionary words and pictures occupy much greater space than mere graphs in annual reports, are arguably more powerful communication tools, and carry a much richer variety of messages, yet their import has been relatively neglected.

Companies have recognised the importance of communicating, rather than simply recording, their activities; they have, for example, invested in media or corporate communications departments which commonly use websites and presentations in addition to annual reports to communicate with stakeholders. Accounting practitioners, regulators and researchers alike have lagged behind, inclined to side-

step presentational issues and to focus on the financial statements. Yet as Courtis (2002) has argued, accountants should educate and involve themselves in questions of communication and its potential for perception engineering.

Financial reporting models

Concomitant with the emergence of corporate communication departments and the *Annual Review*, intangible assets have also become more important to companies. As western economies have progressively moved away from manufacturing and towards service industries, the human capital of companies has progressively become of more consequence than its physical capital. Again, accounting has lagged behind, its traditional models arguably no longer sufficient in this new world.

The shortcomings of the existing accounting framework are increasingly recognised in professional discussion (Holgate, 1999; Paterson, 2001). The Institute of Chartered Accountants in England and Wales has recently published a document entitled *Information for Better Markets: New reporting models for business* (ICAEW, 2003). The report considers, for example: the differing information needs of multiple stakeholders, the efficiency or otherwise of regulation in improving disclosure, the valuation of intangibles in the modern economy, and whether it is appropriate to concentrate only on what is numerically quantifiable, or whether some information is better communicated in words. The report details eleven proposals for the reform of business reporting that have emerged globally over the past decade or so. These all consider new ways of recognising intangibles, and they also all attach greater importance to qualitative, narrative reporting.

Developments in regulation

Recent regulatory developments have similarly encouraged the move from quantitative to qualitative information. In the UK, an Accounting Standards Board Discussion Paper *Year-end financial reports: improving communication* (ASB, 2000) proposed that some companies, particularly those, such as former utilities, with large numbers of shareholders, might in future wish to send their shareholders a simplified narrative review in the place of summary financial statements. The Discussion Paper specifically considered the issue of presentation, yet adopted an uncertain and sometimes contradictory stance in making recommendations. The communicative power of graphical presentation was recognised, and it was advised that particular care should be taken to ensure its objectivity. Yet, regarding the promotional material, which occupies far more space than graphs in annual reports, the Discussion Paper made no recommendations. It recognised the need for flexibility and encouraged innovation, but took the communicative power and significance of such content less seriously, by referring to it variously as 'distracting promotional material' or 'less significant information' (ASB, 2000, pp.21-22).

The recent UK government white paper *Modernising Company Law* (DTI, 2002) continues to endorse the production of simplified summary statements, leaving the specification of their content to the Accounting Standards Board. In the white paper, 'the Government agreed that companies should provide more qualitative and forward looking reporting' and 'recognises that companies are increasingly reliant on intangible assets such as the skills and knowledge of their employees, their business relationships and their reputation' (DTI, 2002, p.24).

The ASB subsequently produced a statement *Operating and Financial Review* (ASB, 2003) of 'persuasive, rather than mandatory force' (p.3). While it does not consider presentational material, it does recommend that companies should report on intangible assets not reflected in the balance sheet:

Such items might include: corporate reputation and brand equity; intellectual capital; licences, patents, copyright and trademarks; research and development; customer/supplier relationships; proprietary business processes; websites and databases; market position/dominance (p.13).

and on measures taken with respect to future performance:

Examples might include: human capital policies and practices, including employee training; pure and applied research which may lead to potential new products, services or processes; development of new products and services; investment in brand equity, through advertising and other marketing activities for example; technical support to customers; refurbishment and maintenance programmes (p.14).

The position is comparable in the US. A qualitative and narrative 'Management Discussion and Analysis' is now a mandatory requirement under the rules of the Securities and Exchange Commission; there is interpretative guidance to this disclosure, but no mention is made of promotional material (SEC, 1999). The Financial Accounting Standards Board is working on a project entitled 'Improving business reporting - insights into enhancing voluntary disclosures' (FASB, 2004); again there is no reference to promotional material.

Audit

There is no direct statutory requirement in the UK for promotional material to be audited, but auditing is covered under International Standard on Auditing (UK and Ireland) 720 *Other Information in Documents Containing Audited Financial Statements* (APB, 2004). Auditors are required not to express an opinion on what is referred to as the 'surround' to the financial statements, but to consider whether this surround impinges on the truth and fairness of the financial statements

through inconsistency. The white paper *Modernising Company Law* (DTI, 2002) continues to endorse this approach, but also recommends that the regime should be extended to the surround to the summary statement and the *Operating and Financial Review* (p.203).

In the audit reports of the FTSE 100 companies covered by this research study, audit opinions regarding the 'other information' fell into three categories, each offering a different level of assurance:

- A review of other information for inconsistencies;
- A review of selected and detailed information for inconsistencies; and
- A statement that their responsibility did not extend to any other information.

Since auditors have already expressed concerns regarding proposals to review the *Operating and Financial Review*, and given the auditing profession's reluctance to extend its liability to a review of internal controls following the Turnbull Report, it is unlikely that they would wish to accept greater responsibility for the wealth of, potentially ambiguous, messages carried by the discretionary words and pictures of annual reports.

Given the foregoing, the main research objectives were formulated as follows:

- To document and analyse the current overall pattern of the structure of reporting practices among major UK companies;
- To establish whether companies are using discretionary words and pictures to convey intangible aspects of their businesses, by examining their content and style; and

- To ascertain whether relationships exist between the proportions and use of discretionary words and pictures and the importance in monetary value of intangible assets to companies.

Monograph structure

The following chapter reviews the relevant prior research, and Chapter Three provides an outline of the research objectives of the study presented here and the methods used. Chapter Four investigates and records current reporting practice regarding the documents produced, their size, titles, front covers and content breakdown. The fifth chapter provides an analysis as to whether and how companies are using the discretionary words and pictures to communicate intangible assets through content and style. Chapter Six examines systematic links between the proportions and use of discretionary words and pictures and the importance in value of intangible assets to companies. A final chapter summarises the issues, considers the implications, points out the limitations of this research and outlines avenues for further investigation.

CHAPTER TWO

PRIOR RESEARCH

The questions raised by the emergence of the *Annual Review* in addition to the *Annual Report*, together with the use of discretionary words and pictures, are complex, many and varied. The expertise of a host of other disciplines, such as psychology, sociology, linguistics, literary and art theory in addition to accounting and areas of business analysis such as marketing, might usefully be brought to bear. Although increasing attention is being given by accounting research to the business reporting package within which the financial statements are embedded, it is a domain which remains little researched relative to other areas (Beattie, 2005).

Relevant prior research in accounting falls into four broad categories and are discussed in turn:

- Issues related to structure and format;
- Readership studies;
- Archival studies of words, graphs and pictures; and
- Links between disclosures and intangibles.

Structure and format

Earlier studies have specifically considered the question of dual-structured annual reporting. Schroeder and Gibson (1992) have investigated whether summary annual reports in the US reduce

information overload. They find that although summary reports are shorter, simpler documents they display little improvement in readability. Another US-based study by Bushman, Gigler and Indjejikian (1996) considered, in a theoretical model of the trading strategies of investors, whether it is appropriate to circulate professional investors with the more detailed *Annual Report and accounts*, and private investors with a simpler summary document; they argued that this two-tiered approach to financial reporting might be detrimental to unsophisticated investors because it eliminated important value-relevant information. Both these papers suggest that all investors should receive the full and detailed document, and would indicate that the current standard and legal practice in the UK of sending shareholders the summary document by default and the full report only on request may be inappropriate.

Bagshaw (1999) specifically considers summary financial statements (frequently referred to as the *Annual Review*) in the UK. Her book is based on an analysis of the summary financial statements of 20 UK FTSE 100 companies, from the perspective of best practice and examining seven summary statements in detail. The work includes survey details of the other elements of the summary document. The research presented here has a different perspective in analysing both the *Annual Review* and *Annual Report*, focusing on the discretionary words and pictures and their association with intangible assets, and in covering the entire FTSE 100.

A few authors have considered questions of format and layout. For example, Baxter (1981) analyses the influence of standard accounting layout in France and Germany, as compared to more flexible approaches in the UK and the US. Aboody (1996) finds, in the annual reports of American oil and gas companies, a smaller effect on stock prices when write-downs of the value of oil and gas reserves are disclosed in footnotes rather than in the accounting statements. Hopkins (1996) finds that analysts value companies differently according to whether complex capital instruments are classified as equity, debt or as a separate category

in-between. Although these studies concentrated on the accounts rather than the surround to the accounts, they are nonetheless evidence that format is important to investors.

The underlying question is that of framing. Promotional narrative and visual material may influence financial communication through the mechanism of framing (Kahneman and Tversky, 1984).

Framing is controlled by the manner in which the choice problem is presented as well as by norms, habits, and expectancies of the decision maker ... the framing of decisions depends on the language of presentation, on the context of choice, and the nature of the display (Tversky and Kahneman, 1986, pp.257 & 273).

For example, words and pictures portraying a company's history may provide an impression of permanence and stability behind its current financial results. The concept of framing is well understood in the analysis of auditing decisions (for example, Emby, 1994).

The format of financial statements have been analysed further in studies of the limited attention that is a product of the amount of information in the modern environment. For example, Hirshleifer and Teoh (2003) suggest that an over-abundance of material leads readers to be influenced by the salience (or prominence) of items, and to underweight abstract, statistical information; thus, discretionary words and pictures might overshadow the accounting statements.

Readership studies

Pertinent to this study of promotional material, research has shown that both lay and expert readers look beyond the accounting numbers for enlightenment. Bartlett and Chandler's (1997) survey study into private shareholder readership of the corporate report finds 'a marked decline in the general readership of the balance sheet and the profit and loss account' while 'the narrative sections of the report seem to attract wider

readership'. A recent paper on analysts' use of earnings (Barker, 2000) finds, *inter alia*, that 'earnings (and accounting data generally) play only a limited role in the analysts' information environment' (p.95); analysts need to have a broader knowledge of the company and understanding of the industry. Most interestingly, another recent paper on the information used by analysts in their stock recommendation decisions (Breton and Taffler, 2001), finds that:

...non-financial qualitative factors are the most significant drivers of analyst judgement; in particular an analysis of corporate management and strategy Demonstrably, analysts rely crucially on non-financial, soft, qualitative and imprecise information in their primary task of making stock recommendations (pp.91 & 99).

Further studies assess the impact of chairmen's statements on readers' decisions, with mixed findings. These include Smith and Taffler's paper (1995), which investigates how well respondents can predict failure from the chairman's narrative compared with accounting ratios. Despite determining that the narrative material tends to be optimistic, they find that its incremental impact is zero, suggesting that respondents may find it difficult to extract information from narrative material. In contrast, Abrahamson and Amir (1996), find a significant association between share returns and the narrative in the Chairman's statement in the *Annual Report and Accounts*. Smith and Taffler (2000) find that, in predicting company failure, the chairman's narrative is informative, its being equivalent to using a discriminant model with financial ratios. Smith (1998) details an experiment conducted to establish whether readers registered differing views on the financial health of a sample of companies according to whether they were supplied with financial statements or chairmen's statements; he finds that these narratives introduce an element of confusion into readers' perceptions.

Mixed findings are again apparent in studies of the impact of different forms of presentation on readers. As an extension to their work on graphs, Beattie and Jones (2002a and 2002b) examine the effect on readers of measurement distortion and slope parameters in graphs in annual reports, and define points at which distortion makes a difference to readers' understanding. So and Smith (2002) examine the role of colour within accounting communication, and find evidence for the claim that colour graphics improve decision-making. Preliminary findings from unpublished work by Collis (2002) are that communication may be enhanced by attention to presentation. A recent paper by Sedor (2002) finds that when information is presented to analysts as a scenario, their interpretation of the information becomes optimistic; it is possible that discretionary promotional words and pictures provide a background, or indeed foreground, scenario to accounting statements. Stanton and Stanton (2004) examine the effect on readers of impression management in the *Annual Report* of a well known Australian public company; they find no significant difference in the assessment of the company's performance.

Archival studies of words, graphs and pictures

Archival studies of accounting narratives, concentrating on documentary evidence, have taken a variety of approaches. Some examine causal reasoning patterns, attributional content or readability with the aid of statistical techniques, often seeking evidence for a correlation with corporate well-being (Aerts, 1994, 2001; Clatworthy & Jones, 2003; Courtis, 1995, 1998; Jones, 1997; Jones and Shoemaker, 1994; Smith and Taffler, 1992a, 1992b). An interesting and more recent approach has used indices based on linguistics (Sydsærf and Weetman, 1999, 2002). Davison (2002) uses literary analysis to examine the role of antithesis as a persuasive device in words and pictures.

Other archival narrative studies consider the use of rhetoric. Walters-York (1996) provides a good philosophical exposition of rhetoric and the device of metaphor in particular, and throws light on its general use in accounting language, while Amernic (1996) considers metaphor and other figures of speech in the opinions of public accounting firms in their submissions to the Ontario Securities Commission. Brennan and Gray (2000) analyse rhetoric and argument in profit forecasts and take-over documents, rhetoric very loosely defined as the art of persuasion; they find that 'efforts to persuade are considerable'.

Regarding visual material, there is a strong corpus of archival work which analyses the use and objectivity of graphs in annual reports (for example, Beattie and Jones, 1992, 1997), some of which is referred to in the above-mentioned UK Accounting Standard Board's Discussion Paper *Year-end Financial Reports: Improving Communication* (ASB, 2000). Beattie and Jones (2002a) outline the ways in which research has established the communicative advantages of graphs: for example, their capacity to attract readers' attention and their reliance on spatial rather than linguistic intelligence, which enables data to be seen in a direct and immediate way and also facilitates the perception of comparisons, and the identification of patterns, trends and anomalies. Beattie and Jones' research examines the many ways in which graphs may be used to manipulate impressions, whether through selectivity, measurement distortion or other techniques.

Archival work on other visual content in an accounting context is more sparse. It includes three papers in a special issue of *Accounting, Organizations and Society* (1996) devoted to the theme of images in annual reports, prefaced by Hopwood. Graves, Flesher and Jordan (1996) analyse the influence of television in American corporate reports. Preston, Wright and Young (1996) have drawn on contemporary art criticism to explore the significance of selected visual images in US annual reports during the late 1980s and early 1990s. McKinstrey (1996) has traced the history of design in the annual reports of Burton plc from

1930 to 1994, aiming at the same time to highlight communication and persuasion techniques. A further 'picture essay' by Preston and Young (2000) displays the concept of globalisation in American annual reports of the 1990s. Image management through signalling gender and diversity in photographs is investigated by Bernardi, Bean and Weippert (2002, 2005). Davison (2004) suggests that the visual space of financial reporting may bear traces of archaic religious attitudes, and analyses specific images in annual reports, in the light of religious and cultural associations with the notion of ascension.

Links between disclosures and intangible assets

Beattie (2005) has recently pointed out that accounting research interest in intangibles has accelerated due to the growing disparity between the book and market values of companies. This disparity largely arises because intangible assets fall outside the traditional recognition criteria for assets. Importantly, for this study, she goes on to note:

As a consequence, there is considerable interest in ways of reporting on such assets outside the audited financial statements (p.103).

In the US, Lev (2001) in his recent book *Intangibles: Management, Measurement and Reporting* focuses on value-related matters. Others have examined the reliability and value relevance to intangibles, particularly the measurement of future earnings of specific types of voluntary disclosure. For example, Nagar and Rajan (2001) report that non-financial quality measures are better than financial measures for predicting the future revenue implications of product quality. Chen, DeFond and Park (2002) examine the voluntary disclosure of balance sheet information in quarterly earnings announcements, finding that more such disclosure takes place when earnings information is less informative about the future. Jamal, Maier and Sunder (2003) evaluate in the US the voluntary development of information for shareholders in

e-commerce, where intangible assets are important and earnings are not a suitable indication of the ability of the company to generate future cash flow, and find little evidence of poor quality information. Of particular relevance to the work of the present study is a paper by Gelb (2002) which finds that US analysts rate voluntary publications more highly than the *Annual Report and Accounts*, for companies whose expenditure is higher on research and development and advertising.

Outside the US, there is more case study and theoretical work. In the UK Roslender and Fincham (2001) call for a more critical approach to the reporting of intellectual capital, while in Scandinavia Mouritsen, Larsen and Bukh (2001a, 2001b, 2001c, 2002) have been at the forefront of alternative approaches to defining, establishing and communicating intellectual capital, including the use of pictorial diagrams.

Contribution of this study

The present study therefore adds to accounting research as follows:

- It provides an up-to-date analysis of the structures of current reporting practice by the FTSE 100 companies in the UK, and in particular the emergence of a separate *Annual Review* document.
- It adds to readership studies, in considering whether there is any confusion between the two documents, compounded by the use of presentational techniques;
- It adds to archival research into discretionary words and pictures in providing the first attempt at a methodical recording of their content and style across an extended sample including:
 - The frequency with which intangibles are communicated in the content; and

- The extent to which the stylistic devices of repetition, emphasis and antithesis are used to stress the importance of intangibles.
- It contributes to the growing literature on intangibles, in recording the extent to, and manner in, which intangibles are made evident through discretionary words and pictures, and also in examining systematic links between the proportion and use of discretionary words and pictures and the monetary importance of intangibles to companies.

CHAPTER THREE

RESEARCH QUESTIONS AND METHODS

The research was undertaken in the period 2003 to 2004 and was conducted by a combination of manual qualitative analysis and quantitative statistical techniques. The primary information set consisted of the corporate annual reporting documents - *Annual Report* and *Annual Review* - of the entire UK FTSE 100 for periods ending in 2002, augmented by information obtained from company offices by telephone. The companies are listed in Appendix One. A research template, reproduced as Appendix Two, was constructed to collect information. General key information was recorded for each company, followed by more detailed analysis to answer the research questions.

A database was constructed from scrutiny and analysis of all the documents and over 20,000 individual observations were recorded. The database was then subjected to a variety of further statistical and other analyses. Discussion regarding research thinking and methodology is provided following each group of research questions below.

The main research objectives were as follows:

- To document and analyse the structure of reporting practice among major UK companies;
- To establish whether companies are using discretionary words and pictures to convey intangible aspects of their businesses, through examining their content and style; and

- To ascertain whether relationships exist between the proportions and use of discretionary words and pictures and the importance in monetary value of intangible assets to companies.

Overall structure of reporting practice

The first set of research objectives was concerned with providing up-to-date documentation of current reporting practice among major private sector companies, before examining in more detail the nature and likely purpose of aspects of annual reporting.

Overall reporting patterns: '*Annual Report*' and '*Annual Review*'

The first group of questions concerned the practice of publishing two documents which had developed since Lee (1994) had last analysed reporting practice in 25 British companies between 1965 and 1988. There has been almost no prior research into the existence and extent of this new dual reporting structure, and the research was firstly interested in conducting a systematic survey of the current state of affairs and the apparent future trend among major companies. The research questions may be summarised as follows:

- What is the current structure of reporting practice among major UK companies?
 - How many companies produce two documents?
 - When did they first produce a second document and what is the trend?

To answer these questions, published annual reporting documents were collected from all companies forming part of the FTSE 100 as of March 2003. Company offices were subsequently telephoned in all cases for further information: firstly, to confirm reporting practice regarding

the documents published, and secondly to establish the date of first publication of an *Annual Review*, where such a summary document was produced.

Presentation and readership issues

The research regarding the overall structure of reporting practice was secondly concerned with questions of readership, and considered the scope for confusion between the *Annual Report* and *Annual Review*, encouraged by the first impressions given by documents' front covers. Prior research has shown the importance of framing (Kahneman and Tversky, 1984; Tversky and Kahneman, 1986) and of limited attention (Hirshleifer and Teoh, 2003). However, these issues have not previously been considered with regard to the dual structure and presentation of corporate annual reports. Since the nature of the information carried by each of the two documents is often quite different in depth and reliability, and since the *Annual Review* is often now distributed in preference to the *Annual Report*, it is fundamental that readers should be clear as to the status of the document with which they are presented. A second group of questions within the overall structure of reporting practice were therefore formulated as follows:

- Is there the potential for readership confusion between the *Annual Report* and *Annual Review*?
 - Are the documents the same size in area?
 - Do the titles of the two documents clearly distinguish their contents?
 - Do the front covers cause confusion by having identical or matching designs?
 - Do the front covers carry identical captions or pictures?

To answer these questions, a research template was constructed. An initial section of the template was designed to collect information regarding the documents' front covers and to compare the *Annual Report* and *Annual Review* (Appendix Two, Table A - Front covers). The physical size in area of each document was recorded, and a note of its title kept in a separate list. Where two documents were provided, the covers were analysed from a variety of angles which had the potential for causing confusion between the identity of the two documents. Were the covers identical in size and design? If not identical, were they matching by the use of various standard techniques, such as presenting the *Annual Review* in strong colours and the *Annual Report* in muted colours, or the same picture or pattern in different colours, or variations of the same picture, or a picture on the *Annual Review* and not the *Annual Report*, or were the covers identical in design but not in size? Did they contain identical words, captions and/or pictures?

The data, having been collected manually on an individual report basis, was entered into a database and statistics extracted.

Page content

Again, since Lee (1994) analysed reporting practice between 1965 and 1988 through examination of the reports of 25 British companies, there has been no updated published research of the current content of annual reports. This too is all the more important now that two differing documents are in circulation for most major companies, and since readers may already be unclear as to the status of documents through confusing first impressions generated by front covers. The research was therefore interested to establish whether *Annual Reports* and/or *Annual Reviews* were longer than in 1988, whether the balance between regulatory and discretionary content had continued to drift in the direction of greater discretionary content, whether the narrative and/or pictorial content had continued to increase, and whether there was systematic difference between the content of the *Annual Report* and the *Annual Review*.

The expectation was that the trend toward more discretionary content reported by Lee would have continued, and that there would in general be a greater proportion of discretionary material in the *Annual Review* as compared to the *Annual Report*. A final group of questions regarding overall reporting structure may therefore be summarised as follows:

- What is the nature of the content of the two documents?
 - What is their length?
 - What are the relative proportions of regulatory and discretionary content in each document?
 - What proportion of each document consists of discretionary words and pictures?

A second section of the research template (Appendix Two, Full analysis of each document) then analysed each *Annual Report*, and *Annual Review*, where published, by page content. The total number of pages was recorded. The page breakdown was analysed into regulatory elements at that time ('Operating and financial review'; 'Other narrative' such as corporate governance disclosures; 'Directors' biographies'; and the 'Accounts and notes') and discretionary elements ('Captions', 'Pictures, photographs and patterns', 'Graphs', 'Financial highlights', 'Narrative introduction', 'Chairman's Statement', 'Chief Executive Officer's (CEO's) statement').

Again, a computerised database was compiled so that statistics regarding the relative proportions of regulatory and discretionary content in each of the *Annual Report* and *Annual Review* could be prepared, and an assessment made of the relative proportions of discretionary words and pictures in each document.

Content and style in discretionary words and pictures

Having established the overall structure of reporting practice, and the existence and proportion of discretionary words and pictures in the *Annual Report* and *Annual Review*, the second phase of the research sought to examine how companies were using this material. An initial review of documents indicated that the discretionary words and pictures of corporate reports were primarily being used to communicate companies' intangible assets, and the research aimed to establish systematically the extent to which this was indeed the case. Again, this is a previously unresearched issue, and an important matter, since traditional accounting deals inadequately with intangibles, and since research has shown that readers are looking beyond the accounts for enlightenment (Bartlett and Chandler, 1997; Barker, 2000; Breton and Taffler, 2001). Since, additionally, the relatively new dual reporting structure adopted by many companies means that readers may be relying on the *Annual Review* without fully understanding the nature of the document, it is essential that accountants and other users and preparers of annual reporting documents should have objective evidence of the messages it contains.

The analysis was concentrated on the following presentational material:

- Words
 - Captions
 - Introductory narrative
 - Chairman's statement
 - CEO's statement
 - Directors' biographies
- Pictures

Content

The first group of questions focused on the content depicted by discretionary words and pictures. The research was interested to establish whether the discretionary words and pictures were being used to communicate intangibles, and if so, which intangible assets received the most attention; it was anticipated that evidence of organised presentation of intangibles by companies would be found, but the research was open regarding the identity of the intangibles being presented most or least frequently. The research also aimed to ascertain which disclosures were used the most frequently; again it was open regarding findings. Finally, it was sought to establish which document was the more used to promote intangible assets, expecting to find that the *Annual Review* had the more important role. Research questions may therefore be summarised as follows:

- Are companies using discretionary words and pictures to convey intangible aspects of their businesses?
 - Which intangibles feature most, and least, frequently?
 - Of the discretionary words and pictures, which disclosures are used most frequently to convey intangibles?
 - Are there differences between the content of the *Annual Report* and the *Annual Review*?

For this part of the study, a list of intangible assets commonly attributed to companies was compiled on the research template (Appendix Two, Table B - Full analysis of each document) and used to record whether or not a given intangible attribute featured for a given disclosure in the *Annual Report* and the *Annual Review*, where published separately. As far as narratives were concerned no attempt was made to gauge the frequency or quality with which it featured within a given document; occurrence alone was recorded. With respect to pictures, the

number of pages devoted to a given intangible was estimated in addition to its occurrence. The list was extended as the work progressed to include further intangibles that were frequently found to be mentioned. This resulted in a final list of twelve intangible attributes as follows:

- Products;
- Brands;
- Markets;
- Business development;
- Consumers/customers;
- Management;
- Workforce;
- Corporate responsibility;
- Corporate governance;
- Quality;
- History/reputation; and
- Future prospects.

Style

A second line of analysis was interested in gauging the extent to which stylistic devices were evident in the discretionary words and pictures. The reasoning here was that it was likely that companies would wish to emphasise any communication of the existence of intangible assets through the use of stylistic devices. Again, the research was interested to ascertain which techniques were being used, and which disclosures, while being open to any findings. As with content, it was anticipated that the *Annual Review* would reveal more evidence of the use of stylistic devices than the *Annual Report*. Regarding such techniques of style, research questions were formulated as follows:

- Are companies using stylistic techniques to frame or emphasise their intangible assets?

- What technique features most and least frequently?
- Of the discretionary words and pictures which disclosure uses the most, and the least, stylistic techniques?
- Are there differences between the *Annual Report* and the *Annual Review*?

Style is a vast area of study in arts disciplines, and the approach to its analysis varies between the literary and visual arts. Style is highly individualistic and operates at a very detailed level; it is, therefore, ill suited to the mass collection of data and formal statistical interpretation. Any analysis across a sample of corporate reports is, as a consequence, necessarily expediently crude. Three stylistic devices were selected for examination on the basis that they stemmed from rhetoric, were simple to analyse, had crossover points between words and pictures, and were all concerned with emphasis:

- **Repetition.** Repetition may be used in words and pictures to emphasise an aspect of a company's activities. For example, repetitive pictures of products may be used to promote a company's investment in brands.
- **Emphasis through typesetting.** The straightforward mechanical device of highlighting words through such means as the use of larger fonts, bolding and headings may be used to emphasise intangible aspects of a company's business.
- **Contrast, or antithesis.** Antithesis may be used in words and pictures to frame and emphasise one aspect of the company's activities in the context of a contrasting aspect of its activities. For example, expenditure on development and innovation may be placed in the context of a company's long history and reputation; or a company promoting products or activities with possible harmful side-effects to health or to the environment may seek to place this in the context of an attitude of overall responsibility.

Style was not only recorded for its type and occurrence, but its strength was also evaluated and awarded a score of one to three, where a three represented the greatest strength. Again, it was recorded on the research template according to disclosure and for each document separately as to *Annual Report* and *Annual Review* (Appendix Two, Full analysis of each document).

Associations between disclosure and the value of intangibles

The final phase of the research aimed to take the study a stage further. It sought to investigate whether systematic effort to communicate intangible assets in the discretionary words and pictures of annual reports could be more closely linked to those companies with high values of intangible assets than to those companies with low values of intangible assets. Intangibles were defined both as those capitalised in companies' balance sheets as well as those apparent through market values attached to companies. The reasoning here was that, given the growing disparity between book and market values of companies (Beattie, 2005), there was increasing recognition of the need for changes to the traditional accounting framework to accommodate intangibles (Lev, 2001). Further, the use by analysts of voluntary publications (for example, Gelb, 2002), made it particularly likely that companies with high values for intangibles, that could not be recognised under standard accounting, would seek to find alternative ways of communicating such values to investors.

Two measures of intangibles were investigated: (i) capitalised intangibles (predominantly goodwill and brands) as a proportion of net assets, manually extracted from the accounts; and (ii) uncapitalised intangibles which are reflected in the market/book ratio, extracted from the Fame database. These were then statistically compared to the data collected earlier regarding the nature of the *Annual Report* and the *Annual Review* on the research template reproduced as Appendix Two.

One document or two?

The first research objective was to examine whether the practice of publishing a separate *Annual Review* in addition to the *Annual Report* appeared to be systematically associated with companies that had high capitalised and/or uncapitalised intangibles. It was anticipated that this would be the case, as the initial survey of *Annual Reviews* had indicated that they devoted considerable space to presenting intangible assets through discretionary words and pictures. Again, this is important, since research has shown that readers rely on soft, qualitative information (Breton and Taffler, 2001; Hirshleifer and Teoh, 2003). The analysis was therefore designed to answer the following questions:

- Are companies with high values of intangible assets capitalised in their balance sheets more likely to publish a separate *Annual Review*?
- Are companies with high values of intangible assets evident in their market values more likely to publish a separate *Annual Review*?

To produce a quantitative analysis, statistical techniques were used to compare the data collected regarding the values of intangibles in companies with that collected regarding the publication of separate *Annual Reviews*.

The extent of discretionary words and pictures provided by companies: associations with the value of capitalised and uncapitalised intangibles

Another line of investigation was interested in ascertaining whether there was a correlation between the amount of space devoted to discretionary words and pictures and the values of intangibles to companies. It was anticipated that companies with higher values for

intangibles would devote a greater amount of space to discretionary words and pictures, to give them the opportunity to communicate messages regarding their intangibles. Research questions were:

- Are companies with high values of intangible assets capitalised in their balance sheets more likely to devote greater space to discretionary words and pictures in their annual reporting documents?

and

- Are companies with high values of intangible assets evident in their market values more likely to devote greater space to discretionary words and pictures in their annual reporting documents?

Statistical techniques were again used to compare the data collected regarding the values of intangibles with that regarding the page counts for discretionary words and pictures. Five types of narrative disclosure were examined (Captions, Narrative introduction, Chairman's statement, CEO's statement, Directors' biographies) together with pictures.

Content and style of words and pictures: associations with the value of capitalised and uncapitalised intangibles

The final line of enquiry aimed to focus the analysis more specifically, and to establish whether there was a correlation between the use made of discretionary words and pictures to present intangibles and those companies with higher values for intangibles, and also whether those companies made greater use of stylistic devices in presenting their intangibles. It was again expected that this would be the case for both content and style. The research questions were as follows:

- Are companies with high values of intangible assets capitalised in their balance sheets more likely to give greater weight to presenting

their intangibles through the content and style of the discretionary words and pictures of their annual reporting documents?

- Are companies with high values of intangible assets evident in their market value more likely to give greater weight to presenting their intangibles through the content and style of the discretionary words and pictures of their annual reporting documents?

The coverage of intangibles in content and style was examined in four main types of narrative disclosure (Captions, Narrative introduction, Chairman's statement, CEO's statement) together with pictures.

Summary

The research proceeded methodically from the general annual reporting scene to finer detail at all stages. The first phase considered overall reporting practice, the new dual document structure employed by many companies, whether this could be confusing to readers, particularly since front covers often employed similar displays, and whether the content of the two documents could be differentiated regarding discretionary disclosures and the use of words and pictures. The second phase used a closer lens to record and analyse the content and style used in the discretionary words and pictures, with a particular interest in their communication of intangible assets. The final phase consisted of statistical analyses to discover whether there were systematic links between the use of discretionary words and pictures to present intangibles and the values of capitalised and uncapitalised intangibles to companies. The results of the three phases are presented in the following three chapters.

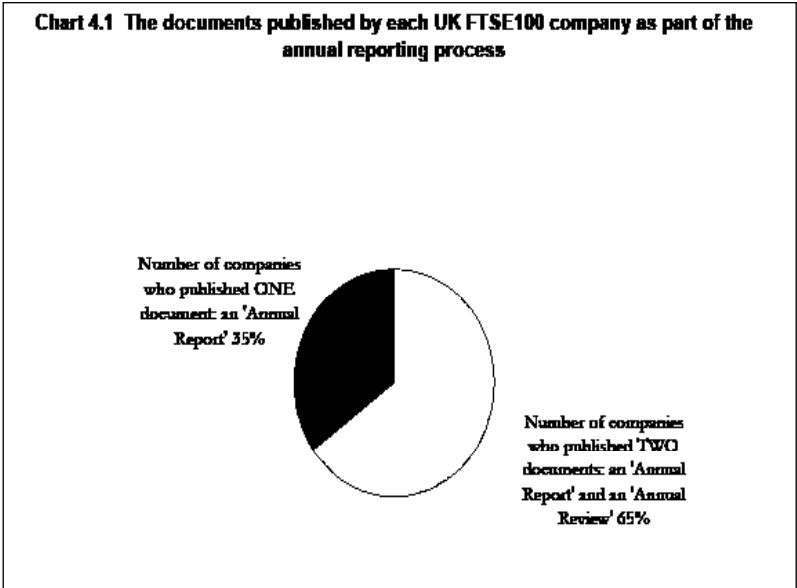
CHAPTER FOUR

ANNUAL REPORTING PRACTICE: STRUCTURAL ANALYSIS OF DOCUMENTS

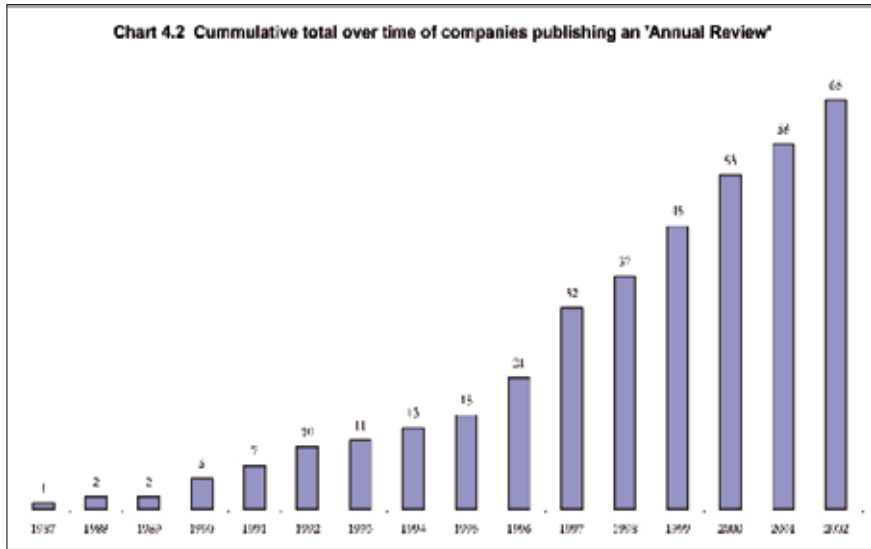
The first phase of the research established and recorded the current annual financial reporting practice of the UK FTSE 100. It started from the overall question of the number of companies producing both an *Annual Report* and *Annual Review*. It moved on to consider the physical appearance, the titles and front cover presentation of the two documents, and whether there was potential for readers to be confused; this is the first research in accounting to have considered such presentational issues. Finally, the content of the documents was analysed, with the aim of systematically recording up-to-date practice, of considering the changes that have taken place since the study (based on corporate practice between 1965 and 1988) by Lee (1994) was published, and of ascertaining whether there was a continuing tendency towards longer documents, and with a higher discretionary content, particularly of words and pictures.

Overall reporting patterns: *Annual Report* and *Annual Review*

Chart 4.1 shows that in 2002 the majority (65%) of UK FTSE 100 companies produced two separate documents as part of their annual reporting procedure: a detailed *Annual Report* containing the full accounts and other regulatory and voluntary information, plus a more readable document most frequently entitled the *Annual Review* containing summary accounts and other material.



As can be seen in Chart 4.2, the move towards the publication of two separate documents has been a steady trend which is still continuing. The first companies to institute this practice were building societies and privatised former nationalised companies which have a large number of small shareholders: Bradford and Bingley in 1987; British Airways in 1988; and Abbey National, BT and Rolls Royce in 1990. The most recent, in 2002, were Hilton, Kingfisher, the newly demerged mm0₂, and Prudential. Some companies, such as Capita Group, issued two documents briefly and subsequently discontinued the practice.



Presentation and readership issues

Having ascertained the importance of the *Annual Review* as a separate reporting document, the next group of questions sought to establish the clarity of its status *vis-à-vis* the *Annual Report* from the first impressions given by its size, title and front cover.

Size

Any document gives important initial signals by its physical appearance. The majority of corporate reporting documents (113 out of 165) were published in A4 format, as shown in Table 4.1. Those who used a different size predominantly chose something close to A4. A4 has evolved as the standard paper size used by the business and office worlds, and the corporate report is therefore no exception to this rule. By choosing an A4 format, companies are signalling that their *Annual Report* is very much a business and official document.

When a separate *Annual Review* was published, it was in the vast majority of cases of the same physical size and shape as the *Annual Report* and, therefore, indistinguishable by its physical appearance alone.

A number of companies chose different paper sizes (Table 4.1). For example, Gallaher and Smith and Nephew produced both their *Annual Report* and *Annual Review* in neat A5 format. On the other hand, United Utilities published its *Annual Review* in an A3 size bearing some resemblance to a small and readable newspaper, in contrast to its *Annual Report* which was produced in the standard business A4 format.

Table 4.1 The size in area of the annual reporting documents published by UK FTSE 100 companies

Size	Total	Annual Report*	Annual Report+	Annual Review+
A4	113	19	47	47
A5	4	0	2	2
Other	48	16	16	16
Total	165	35	65	65

* Companies that produce one document
+ Companies that produce two documents

Titles

Title is another key signal, and one which has the obvious potential for confusion, yet there is no regulation which standardises the titles that companies give to their reports. Table 4.2 lists the titles adopted by companies for their regulated full report and accounts: thirteen different titles were recorded. The most frequent and familiar title was *Annual Report and Accounts*, used by 46% of companies. Variants that included the words *Report* or *Accounts* constituted 99% of the titles. The only

company not conforming to this pattern was Reuters, which named its document *The 2002 Results*. Thus, although the exact title might not be completely standardised, there was more or less general consensus as to the name of the full statutory document.

Table 4.2 *Titles of the document containing the statutory accounts and other regulatory information*

Title of Document	Number
Annual Report and Accounts	46
Annual Report and Financial Statements	10
Annual Report and Accounts and Form 20-F	3
Annual Report and Form 20-F	3
Report and Accounts	3
Report and Financial Statements	3
Annual Accounts	2
Report and Accounts 2002 incorporating the Annual Report on Form 20-F	1
Report and Accounts and Form 20-F	1
Annual Report and Accounts/Form 20-F	1
Directors' Report and Accounts	1
The 2002 Results	1
Total	100

The title adopted for the document containing the summary financial statements showed similar consensus, although with a little more variety and confusion. Twenty different titles in all were recorded, as shown in Table 4.3. The most common was *Annual Review*, adopted by 23 companies (35%), or *Annual Review and Summary Financial Statement(s)*, adopted by a further 20 companies (31%). The words *Review*, *Summary Financial Statement(s)*, or *Summary* appeared in 97%

of the titles. Five companies specifically referred to shareholders in the title, and one (Whitbread) to stakeholders.

*Table 4.3 Titles of the document containing the summary financial statements, if published**

Title of Document	Number
Annual Review	23
Annual Review and Summary Financial Statement(s)	20
Annual Report and Summary Financial Statement	3
Summary Financial Statement	2
Annual Report	2
Summary Financial Statements	1
Annual Review and Summary Financial Report	1
ANNUAL REVIEW and Summary Financial Statement	1
The 2002 Review	1
Summary Annual Review	1
Summary Report	1
Summary Annual Report	1
Annual Report and Summary Financial Statements	1
Annual Report and Accounts Summary	1
Report to Shareholders & Summary Financial Statement	1
Shareholders' Review incorporating the Summary Financial Statement	1
The 2002 Annual Review for our Shareholders	1
'Shareholder Review'	1

* Titles are reproduced as they appeared regarding capitals and bolding

*Table 4.3 (Continued) Titles of the document containing the summary financial statements, if published**

Title of Document	Number
Review The Shareholders' Review 2002 incorporating the Summary Financial Statement	1
Stakeholder Review Shareholders Customers Employees Society	1
Total	65

* Titles are reproduced as they appeared regarding capitals and bolding

Confusion with the main document arose particularly where the word *Report* was used for the secondary document, in 12% of titles. Two companies (BP and Smiths) entitled their secondary document *Annual Report*. Table 4.4 lists examples of comparative titles by company where readers might well be confused as to the nature of the two documents.

Table 4.4 Examples of comparative titles by company - 2002 reporting

<i>Company</i>	<i>Main document</i>	<i>Summary document</i>
BP	Annual Accounts	Annual Report
Smiths	Annual Report and Accounts	Annual Report
Reuters	The 2002 Results	The 2002 Review
Bunzl	Directors' Report and Accounts	Annual Review and Summary Financial Statements
Centrica	Annual Report and Accounts	Annual Report and Summary Financial Statements
Sainsbury	Annual Report and Financial Statements	Annual Report and Summary Financial Statements
Shire	Annual Report and Accounts	Annual Report and Summary Financial Statements
Tesco	Annual Report and Financial Statements	Annual Report and Summary Financial Statements
Alliance & Leicester	Annual Report and Accounts	Summary Annual Report
Hanson	Annual Report	Summary Annual Report

It is of note that, subsequent to the initial research programme in 2002, most of these companies have joined the majority practice of referring to an *Annual Report* and an *Annual Review*. Table 4.5 shows the updated position for this small group of companies in 2004. However, Bunzl still refers to its main document as a *Directors' Report and Accounts*, and Alliance and Leicester and Hanson still refer to their secondary document as a *Summary Annual Report*. Interestingly, between 1997 and 2001 Hanson had previously referred to its summary document as an *Annual Review*, and is thus unusual in actively diverging from the norm.

Table 4.5 Examples of comparative titles by company - 2004 reporting

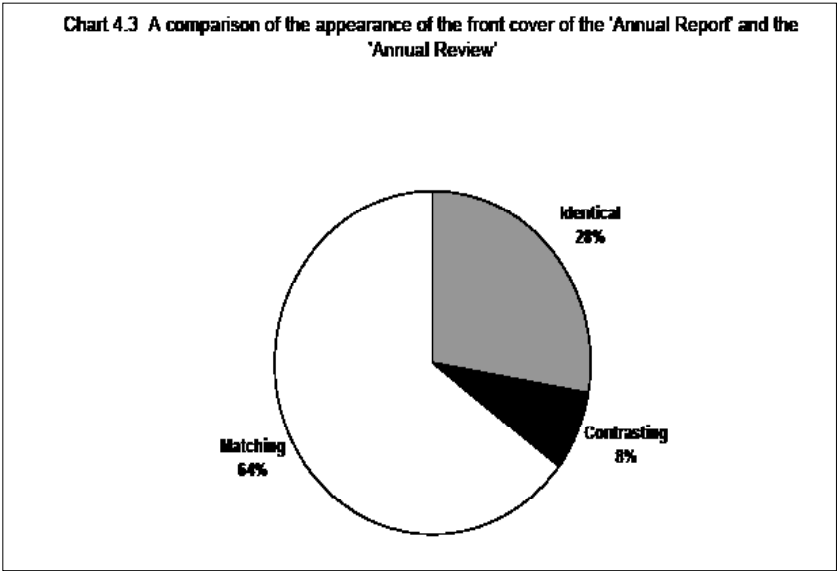
<i>Company</i>	<i>Main document</i>	<i>Summary document</i>
BP	Annual Report and Accounts	Annual Review
Smiths	Annual Report	Annual Review
Reuters	Annual Report and Form 20-F	Annual Review
Bunzl	Directors' Report and Accounts (2003)	Annual Review and Summary Financial Statements (2003)
Centrica	Annual report and Accounts	Annual Review and Summary Financial Statements
Sainsbury	Annual Report and Financial Statements	Annual Review and Summary Financial Statements
Shire	Annual Report and Accounts	Annual Review and Summary Financial Statements
Tesco	Annual Report and Financial Statements	Annual Review and Summary Financial Statements
Alliance & Leicester	Annual Report 2004	Summary Annual Report
Hanson	Annual Report and Form 20-F	Summary Annual Report

Titles of annual reporting documents are clearly important to companies, and the research found that most companies in the FTSE 100 preferred to follow a generally accepted practice despite the lack of regulation regarding titles. However, although this general custom and practice broadly distinguished between an *Annual Report* and an *Annual Review*, it is unlikely to be clear even to expert readers that the *Annual Report* is the full and regulated information, whereas the *Annual Review* contains the summary and less fully regulated accounting information together with a larger proportion of presentational material. Moreover, corporate web pages rarely clarify the distinction, and often direct readers to the *Annual Review* in preference to the *Annual Report*. Anecdotal

evidence from conversations with students and others confirms that confusion arises; it is an issue which would benefit from a systematic readership survey. It is, furthermore, likely that practice is more varied outside the FTSE 100, where there is less analyst following and press coverage.

Front covers

Readership confusion between the two documents is further made possible through the presentational techniques adopted by the companies in the design of their front covers. Of the 65 companies that produced two documents, the overwhelming majority chose to design their front covers so that the documents resembled one another: 28% chose identical covers and 64% matching covers (Chart 4.3). Only five companies chose entirely different front covers for their two documents.



An example of identical front covers is given in Figure 4.1, which shows those of *Allied Domecq*. As can be seen in the case of *Allied Domecq*, one document could easily be taken for the other through the striking and colourful evocation of its intangible 'Brands and People' that dominates the cover, even though the titles are at least distinctive and make clear that one document is the *Summary Financial Statement*. However, in many cases where the front cover presentation was identical, the only difference between the two documents was the previously discussed fine differentiation between the titles *Annual Report* and *Annual Review*, whose meaning was unlikely to be clear to all readers.

Figure 4.1 Identical front covers: Allied Domecq Annual Report and Accounts 2002 & Summary Financial Statement 2002



Figure 4.1 (Continued) Identical front covers: Allied Domecq Annual Report and Accounts 2002 & Summary Financial Statement 2002



Where front covers were matching rather than identical, companies employed a variety of matching techniques, as recorded in Table 4.6. One common technique was to present the *Annual Review* cover in strong colours, and the *Annual Report* in more sober muted colours or black and white; another technique was to employ different colours of similar strength; another was to use the same picture or photograph with some variation; others used a picture or photograph on the *Annual Review*, but none on the *Annual Report*; a final group varied the size of the documents. ICI, for example, matched the front covers of its documents by an interesting variation of the same pictures and words: the pictures of paint, fruit, a sweet and a flower predominated on the *Annual Report*, and the accompanying words, ‘smoother’, ‘brighter’, ‘fresher’, ‘sweeter’, ‘vital’ predominated on the *Annual Review*.

Table 4.6 A comparison of the appearance of the front covers of the ‘Annual Report’ and ‘Annual Review’ with examples

Nature of front covers	Number of companies	Percentage of companies	Examples
Identical	18	28	Allied Domecq Liberty International Pearson
Matching	42	64	
Strong colours (Review) <i>ν</i> Muted (Report)	15	23	Rio Tinto Scottish & Newcastle Uniliver
Different colours	11	17	Centrica
Variations of the same picture	7	11	Compass Diageo Glaxo ICI Marks & Spencer Rexam Sainsbury

Table 4.6 (Continued) A comparison of the appearance of the front covers of the 'Annual Report' and 'Annual Review' with examples

Nature of front covers	Number of companies	Percentage of companies	Examples
Picture (Review) <i>v</i> no picture (Report), but otherwise identical design	6	9	Boots
Different sizes	3	4	Alliance Leicester
Contrasting	5	8	Royal Bank of Scotland
TOTAL	65	100	

The use of identical captions or pictures may also confuse readers of the two documents: of the 40 companies whose covers displayed captions, 30 captions were identical; of the 58 *Annual Reports* and *Annual Reviews* whose covers contained pictures, 32 pictures were identical. Unilever, for example, shown in Figure 4.2, displayed a picture of a young couple preparing a meal using a *Knorr* packeted brand: the picture is identical on both front covers, and both are captioned 'Meeting everyday needs of people everywhere'; the only identifying differences between the two documents are the titles (*Unilever Annual Report and Accounts 2002 and Form 20-F* versus *Unilever Annual Review 2002 and Summary Financial Statement*) and that the picture is in colour on the 'Report' and a subdued monochrome on the 'Review'.

Frequently, although not invariably, the *Annual Review* was the more reader-friendly document, enticing the reader's attention through the use of more, and stronger, colour, more photographs and captions. Sometimes, more subtle differences were observed, such as a smiling face adorning the Review opposed to a sober face on the Report; for example, Marks and Spencer employed this technique (see Figure 4.3).

Figure 4.2 Matching front covers: Unilever Annual Report & Accounts 2002 and Form 20-F & Annual Review 2002 and Summary Financial Statement

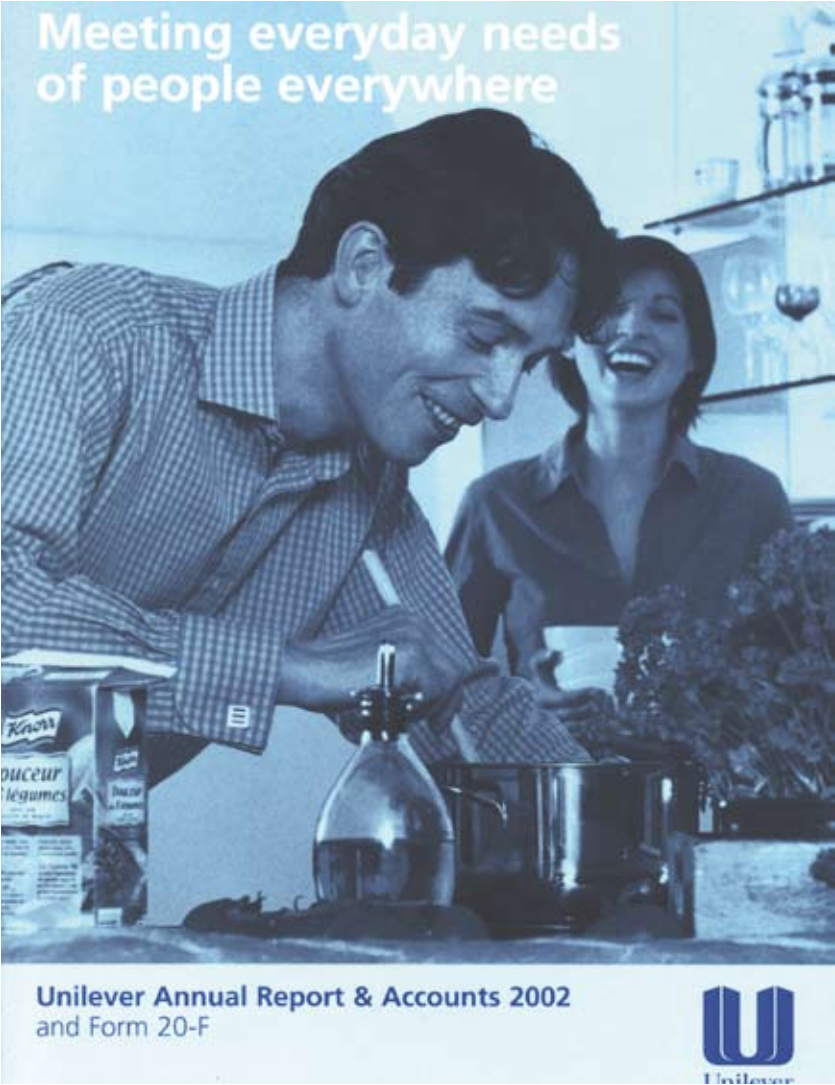


Figure 4.2 (Continued) Matching front covers: Unilever Annual Report & Accounts 2002 and Form 20-F & Annual Review 2002 and Summary Financial Statement



Figure 4.3 Matching front covers: Marks & Spencer Annual Report and Financial Statements 2002 & Annual Review and Summary Financial Statement 2002

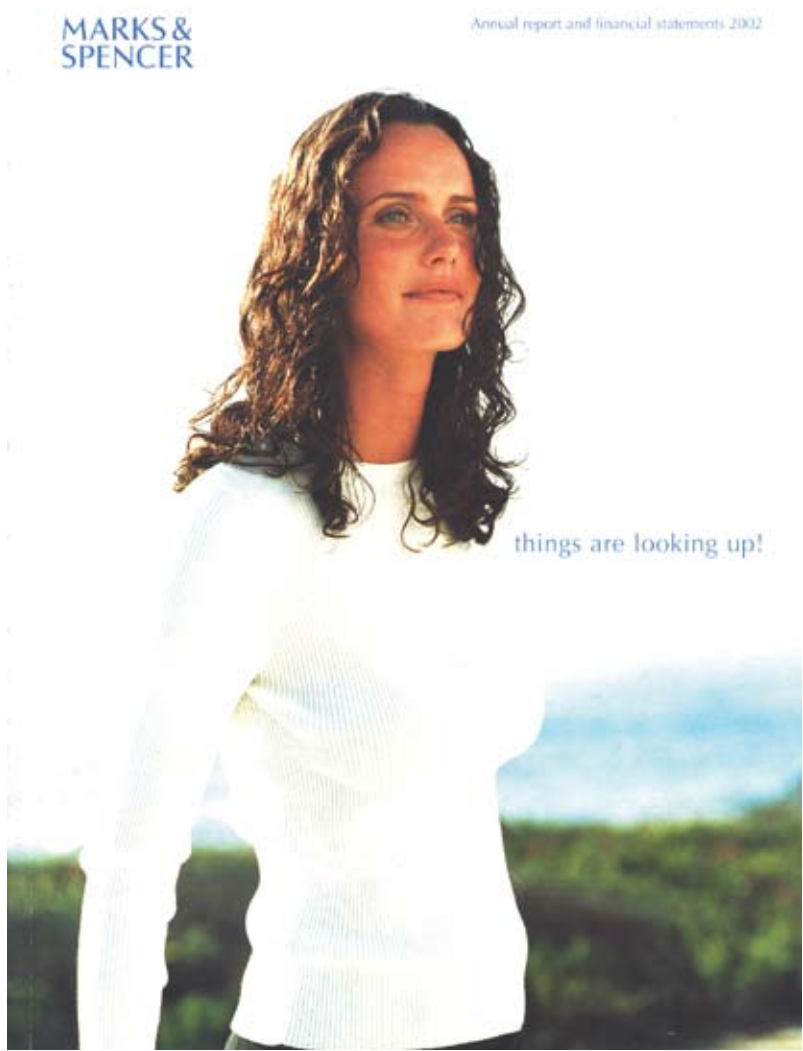
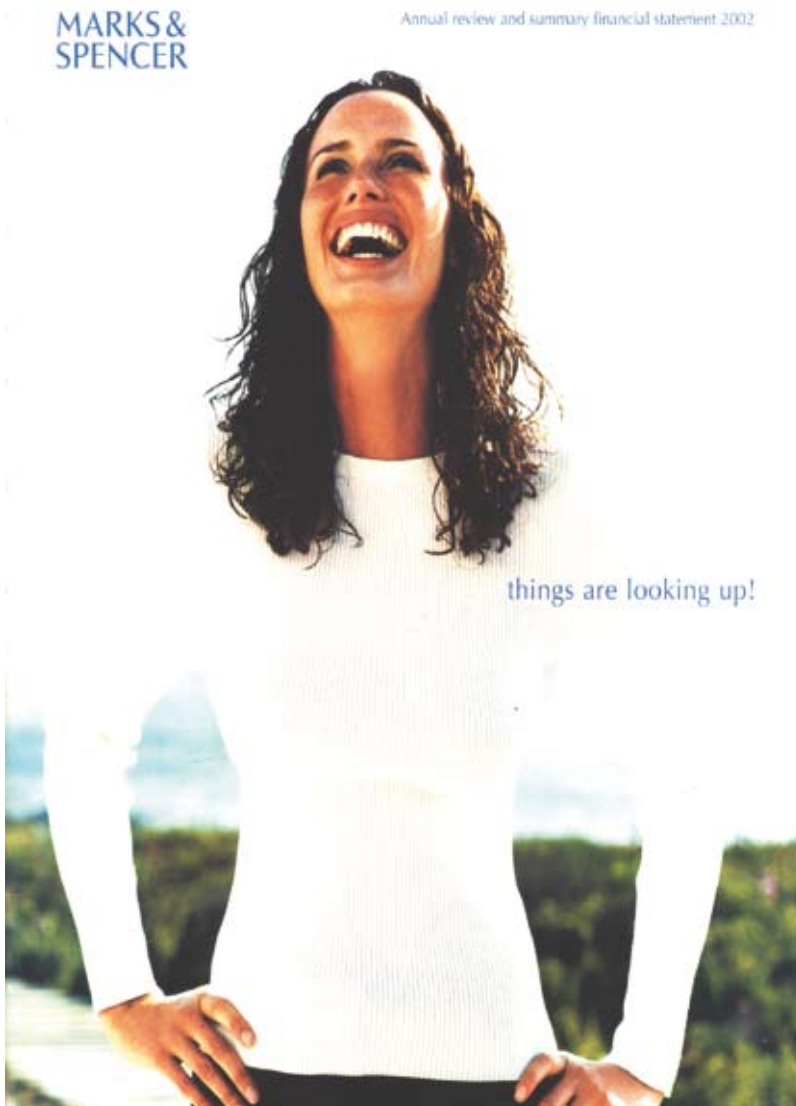


Figure 4.3 (Continued) Matching front covers: Marks & Spencer Annual Report and Financial Statements 2002 & Annual Review and Summary Financial Statement 2002



The results of this archival research into first impressions through document presentation therefore demonstrates quite clearly that there is scope for confusion between the full regulatory report and the summary document. Since the status and contents of the two documents are generally quite different these findings have potential policy implications, and would benefit from further research into lay and expert reader opinions through questionnaires, experiments or focus groups.

Page content

Following on from considering the overall presentation of annual reports, the research subsequently examined up-to-date patterns of the length and content of annual reporting documents in the FTSE 100, in order to have a systematic record of the average contents of the documents, and to be able to compare the *Annual Report* and *Annual Review*.

Length

Since Lee (1994) commented on the changing form of the *Corporate Annual Report* between 1965 and 1988, its structure has become more complicated, and it has grown even longer. At the time of Lee's paper, based on 25 large British companies, the *Annual Review* was virtually unknown, and Lee's statistics were therefore based on the *Annual Report* document alone. The average length in 1988 according to Lee was 54 pages. Table 4.7 shows that in the 2002 FTSE 100, the average number of pages in companies producing one document had increased to 90, and 103/35 pages (*Annual Report/Annual Review*) in companies producing two documents. In 2002 the divergence from the average was also higher in both cases, with the maximum pages in the FTSE 100 being as high as 200 and 340/100 respectively, and the minimum pages 48 and 40/8. HSBC produced the longest *Annual Report* (340 pages), and Shire Pharmaceuticals the longest *Annual Review* (100 pages).

Bunzl produced the shortest *Annual Report* (40 pages) and Alliance and Leicester, British Airways, Reckitt and United Utilities the shortest *Annual Reviews* (8 pages).

Table 4.7 Extension of Lee's (1994) findings on mean average total page counts, standard deviations, maxima and minima

	Lee		
	1965	1978	1988
	Annual Report		
<i>Total pages</i>			
Mean total	26	36	54
Standard Deviation	8	8	10
Maximum	Not known	Not known	Not known
Minimum	Not known	Not known	Not known

	Davison & Skerratt		
	2002		
	<i>'Annual Report'</i> [*]	<i>'Annual Report'</i> [†]	<i>'Annual Review'</i> [†]
<i>Total pages</i>			
Mean total	90	103	35
Standard Deviation	32	52	17
Maximum	200	340	100
Minimum	48	40	8

* Companies that produce one document

† Companies that produce two documents

The *Annual Review* appears on average to be a document published by companies whose *Annual Reports* are longer, and which would therefore particularly benefit from a summary version. However, even the average *Annual Review*, at 35 pages, is of more or less the same length as the average full *Annual Report* that Lee recorded for the year 1978. Also, companies publishing two documents are producing on average a total of 138 pages of information, even though some of this might be replicated between the *Annual Report* and *Annual Review*. Not only is the total information still therefore increasing, but the rate of growth has accelerated even further: a steady extrapolation of the same rate of growth found by Lee between 1978 and 1988 would have resulted in an average report length of a lesser 81 pages by 2002.

Regulatory and discretionary

The research was then interested to establish the up-to-date breakdown of information provided by companies, to see the relative proportions of regulatory and discretionary material in both the *Annual Report* and the *Annual Review*, and the trend since Lee's research. The pages of the documents were allocated to a variety of pre-determined headings which represented the average disclosure types found in the majority of annual reports.

Table 4.8 provides a breakdown of the observations into regulatory and discretionary disclosures. Accurate comparisons are difficult to make between Lee's findings and the 2002 data. Firstly, Lee did not specify what was included in the regulatory and discretionary page counts. Secondly, in 2002 there was a wider variety of corporate practice as to what was incorporated in each document, and considerable amounts of material were frequently replicated between the two documents. However, Table 4.8 includes for 2002: as regulatory content, the accounts and notes, the relatively recent operating and financial review, and other semi-regulated narrative such as corporate governance disclosures and corporate social responsibility statements; and as discretionary content,

narrative introduction, pictures, Chairman's statement, CEO's statement, Financial highlights, Graphs and Directors' biographies.

It had been anticipated that the trend towards increasing proportions of discretionary content observed by Lee would have continued. Unexpectedly it was, on the contrary, the regulated content that increased relative to Lee's observations, from 25 pages on average in 1988 to 68 pages (for companies publishing only an *Annual Report*) and 89/18 pages (for companies publishing an *Annual Report* and an *Annual Review*). The discretionary content appears, surprisingly, to have declined a little. This huge and increasing weight of regulatory information would be one motivation for companies to publish a separate *Annual Review*, and it was indeed those companies with heavier regulatory disclosures (89 pages on average as compared to 68) who chose to produce an *Annual Review*. The discretionary page content of the *Annual Review* as a proportion can be seen to be much higher than for the *Annual Report*, but again, surprisingly, not as high as in Lee's findings for the latest year of 1988. However, it should be reiterated that the comparative breakdown between these figures may be imprecise.

Table 4.8 *Extension of Lee's (1994) findings on regulatory and discretionary breakdown* ⁽¹⁾

	Lee		
	1965	1978	1988
	Annual Report		
<i>Regulatory page count</i>			
Mean total	15	22	25
<i>Discretionary page count</i>			
Mean total	11	14	29
<i>Total page count</i>	26	36	54

Table 4.8 (Continued) Extension of Lee's (1994) findings on regulatory and discretionary breakdown⁽¹⁾

	Davison & Skerratt		
	2002		
	<i>'Annual Report'</i> [*]	<i>'Annual Report'</i> ⁺	<i>'Annual Review'</i> ⁺
<i>Regulatory page count</i>			
Mean total	66	88	16
<i>Discretionary page count</i>			
Mean total	24	15	19
<i>Total page count</i>	<i>90</i>	<i>103</i>	<i>35</i>

* Companies that produce one document

+ Companies that produce two documents

- [1] Note that the comparison is imprecise. Lee (1994) did not specify what was included in the regulatory and discretionary page counts. For 2002, regulatory includes accounts and notes, OFR, corporate governance disclosures, corporate social responsibility statements; discretionary includes Chairman's Statement, Chief Executive's Statement, narrative introduction, directors' biographies, other narrative, pictures, graphs, financial highlights.

Discretionary words and pictures

Further analysis of the discretionary content and the different presentational modes of words, pictures and graphs is shown in Table 4.9. Again, an entirely accurate comparison with Lee (1994) is not possible, as less detail was provided by Lee. However, it can be seen that the average total amount of narrative provided has continued to increase, particularly in those companies that publish two documents, from 19 pages in 1988 to 24 pages (for companies publishing only an *Annual Report*) to 24/17 pages (for companies publishing two documents).

The average amount of space devoted to pictures has remained more or less static, at nine to ten pages. However, it should be noted that for pictures there was a very wide variation, and the maximum observed was a very considerable 30 pages in the *Annual Report* (when only one document was produced) and 18/35 pages (when two documents were published). The proportion of pictures in the *Annual Review* is particularly noteworthy: an average of about nine out of eighteen pages, or about 50%. This is very high for the default document sent to shareholders, which was previously observed to be frequently the more reader-attractive, yet it is not fully regulated and contains only summary accounts. The confusion between the presentation of the two documents previously mentioned may now be seen to be all the more important.

Table 4.9 Discretionary Disclosures - Extension of Lee's (1994) findings on words and pictures; comparison with graphs ⁽¹⁾

	Lee		
	1965	1978	1988
	Annual Report		
<i>Words page count</i>			
Regulatory	Not known	Not known	Not known
Discretionary	Not known	Not known	Not known
Mean total	8	6	19
Standard deviation	4	3	8
Minimum	Not known	Not known	Not known
Maximum	Not known	Not known	Not known
<i>Pictures page count</i>			
Mean total	3	7	10
Standard deviation	4	5	4
Minimum	Not known	Not known	Not known
Maximum	Not known	Not known	Not known
<i>Graphs page count</i>			
Mean total	Not known	Not known	Not known
Standard deviation	Not known	Not known	Not known
Minimum	Not known	Not known	Not known
Maximum	Not known	Not known	Not known

Table 4.9 (Continued) Discretionary Disclosures - Extension of Lee's (1994) findings on words and pictures; comparison with graphs⁽¹⁾

	Davison & Skerratt		
	2002		
	'Annual Report' *	'Annual Report' +	'Annual Review' +
<i>Words page count</i>			
Regulatory	13	19	6
Discretionary	11	5	11
Mean total	24	24	17
Standard deviation	12	19	7
Minimum	7	1	2
Maximum	62	114	41
<i>Pictures page count</i>			
Mean total	10	4	9
Standard deviation	7	5	6
Minimum	0.3	0	1.5
Maximum	30	18	35
<i>Graphs page count</i>			
Mean total	1	1	1
Standard deviation	1	1	1
Minimum	0	0	0
Maximum	5	7	4

* Companies that produce one document

+ Companies that produce two documents

- [1] Regulatory words include OFR, corporate governance disclosures, corporate social responsibility statements; discretionary includes Chairman's Statement, Chief Executive's Statement, narrative introduction, Directors' Biographies, other narrative.

It is also worthy of comment that discretionary words and pictures occupy far more space than graphs, to which only one page is devoted on average. This makes it all the more surprising how little the rich and often ambiguous messages of words and pictures have been researched relative to those of graphs.

Summary of findings

This first phase of the research examining reporting practice from an overall perspective found that most (65%) UK FTSE 100 companies produced a separate *Annual Review* in 2002, and this has been a continuing trend. There is clear potential for readership confusion between the *Annual Report* and the *Annual Review* due to a predilection among companies for presenting the two documents in a very similar way, so that they are difficult to differentiate in size, title or front cover. The content of the *Annual Report* has altered substantially since 1988: the average total page count of the *Annual Report* has almost doubled; the increase appears to be in the regulatory rather than the discretionary content, and in the narrative disclosures. Notably in the *Annual Review*, discretionary words and pictures occupy a large amount of space on average, and yet their presentational role has been very little researched compared to that of graphs, which occupy much less space on average.

CHAPTER FIVE

CONTENT AND STYLE ANALYSIS OF SELECTED DISCRETIONARY WORDS AND PICTURES

The results detailed in Chapter Four established that in 2002 companies continued to devote large amounts of space in their *Annual Reports* and *Annual Reviews* to discretionary words and pictures. This chapter takes the analysis a stage further, by focusing more closely on this material. Although the Chairman's Statement has received some research attention across samples of documents, discretionary narratives remain almost totally unresearched, and pictures have received only limited attention, and then on a case study, rather than a sample, basis.

Two perspectives are taken in the study. Firstly, there is an analysis of the frequency with which the discretionary words and pictures were used to convey intangible aspects of corporate business. Secondly, there is an examination of both the frequency and strength with which certain stylistic devices were employed.

Boulton, Libert and Samek (2000) examined the long-term decline in the ratio of book value to market value of US companies, and noted the inadequacies of traditional accounting. They predicted that:

In the not-so-distant future it will become clear that what is most enduring is also what is most intangible - relationships and knowledge. At the same time, what was once regarded and measured as an asset (for example, things) is now regarded as an expense. [...] On the other hand, everything that was either defined as an expense or overlooked (people, customers, research and development, insight) is now an asset -something to be acquired and cherished (p.45).

While the financial statements remain inadequate it is likely that companies will look for alternative ways of communicating the existence and quality of their intangible assets. Companies are aware of the importance of their intangible assets, expressed in statements such as:

In an era in which intangible assets can be as significant as more conventional tangible ones, a strong corporate brand can add value to the group's activities (United Utilities, Annual Review 2002, CEO's Statement, p.3).

Content of discretionary words/pictures and intangibles

The research firstly investigated the extent to which the content of the discretionary words and pictures was used to express intangible assets. Data was collected regarding a list of twelve intangible attributes, as follows: Products and services; Brands; Markets; Business development; Consumers/customers; Management; Workforce; Corporate responsibility; Corporate governance; Quality awareness; History/reputation; and Future prospects. In the first instance a cumulative assessment was established of occurrence alone, that is whether a given intangible was mentioned once in a particular disclosure; it proved too onerous a task to gauge the verbal frequency with which an intangible was cited within a particular narrative disclosure, or the narrative space devoted to it, although such a project might be possible using computerised techniques. Five disclosure types were examined: Captions; Narrative introduction; Chairman's statement; CEO's statement; and Pictures.

The findings regarding types of intangible are shown in Chart 5.1. The chart demonstrates the overall occurrences recorded for all twelve intangibles throughout all five disclosure types in all 165 documents examined of the FTSE 100. It can be seen that all twelve intangibles featured, but with wide variation between the most frequently mentioned

and the least frequently mentioned, depending on the nature of the company’s business. Products were the most frequently promoted, closely followed by management, markets, business development, consumers/ customers, and the workforce. The next most frequently cited group of intangibles were aspirations for the future, corporate responsibility and brands. Quality issues, history/reputation and corporate governance also featured, but not so frequently.

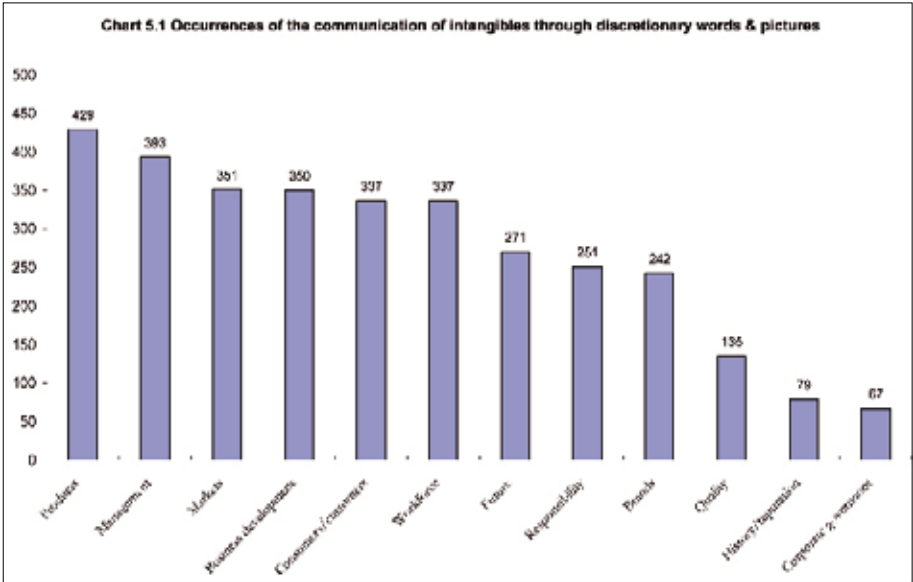
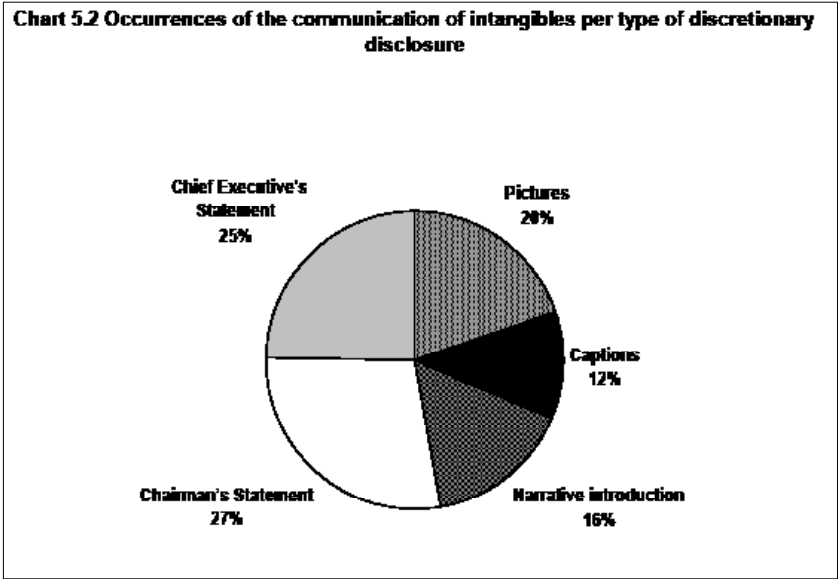
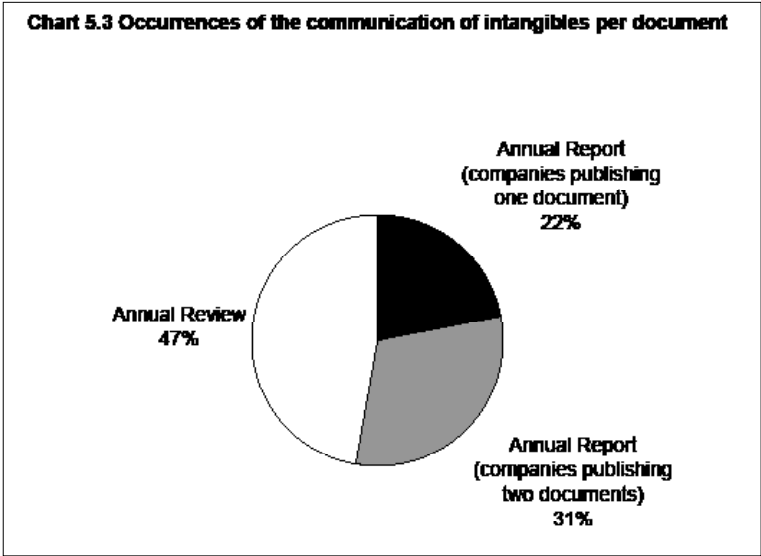


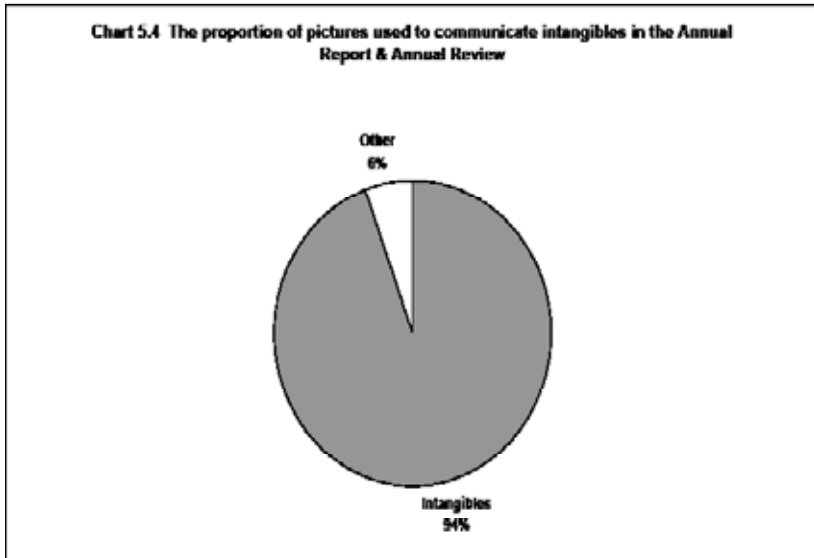
Chart 5.2 analyses these overall occurrences by the five types of disclosure examined. Here, it can be seen that references to intangibles are to be found across all the discretionary disclosures, with no real domination or under-representation by any particular disclosure type. Although the analysis seems to indicate that the Chairman’s statement and the CEO’s statement are used a little more for this purpose than other disclosures, this is not necessarily a just interpretation, since no adjustment was made for the relative lengths of these disclosures.



Given the findings detailed in the previous chapter regarding the potential for readership confusion between the *Annual Report* and the *Annual Review*, it is of interest to see whether there is great differentiation between the documents in the extent to which they are used to communicate intangibles. Chart 5.3 analyses the overall occurrences of references to intangibles by document type. The *Annual Review* dominates this chart from two points of view. Firstly, by far the majority of references to intangibles were recorded for those companies publishing two documents (78% in total), as opposed to those companies publishing a single *Annual Report* (22% in total). Secondly, for those companies that produced two documents, the *Annual Review* was used to promote intangibles to a greater extent (47%) than the *Annual Report* (31%).



Finally, in the case of pictures, unlike words, it had been possible to estimate the number of pages devoted to a given intangible in addition to straightforward occurrence. Since the total number of pages of pictures had also been recorded for each document, the overall proportion of pictures being used to communicate intangibles could be calculated. Chart 5.4 shows these proportions on an overall basis across all documents, and reveals that references to intangibles dominate the pictures. The research findings clearly indicate that the prime communicative purpose of the pictures in annual reporting is associated with business intangibles.



The rest of this section moves from overall statistics to a consideration of each intangible asset in turn, and how it had benefited from narrative and pictorial disclosures. Verbal and pictorial examples are provided from particular company's documents, together with added commentary.

Products and services

From a set of accounts the reader is left with little idea of a company's products and services other than through its turnover figures and segmental analysis. Discretionary words and pictures were often used to expand on this aspect of a company's business. Retail companies were amongst those most likely to display their wares prominently: for example, Safeway devoted twenty pages of its *Annual Report* to pictures of products on its shelves, and Boots plc illustrated its *Review of Operations* with friezes of pictures representing its products and services (Figure 5.1).

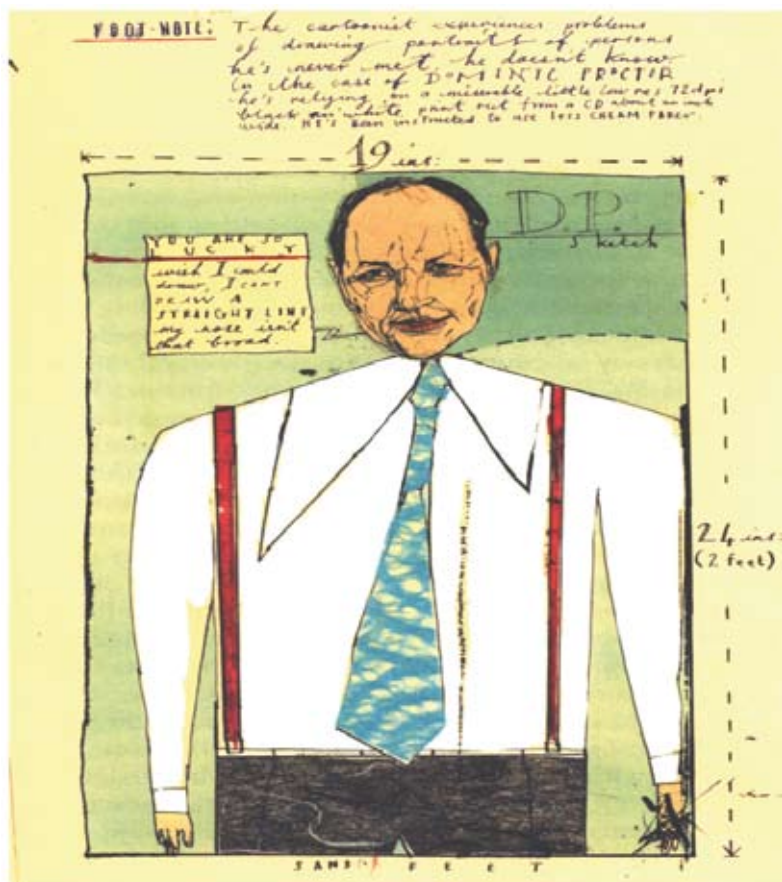
Figure 5.1 Boots Annual Review 2002, pp.10 & 11



Management

Management is always a key element in the value of a company, yet accounts are silent regarding its identity and quality, other than through communicating value and profit performance, and recording remuneration. With the exception of Amvescap and Morrisons, all FTSE 100 companies displayed the standard parade of photographs of their directors and most devoted a certain amount of narrative to explain board changes and management strategy. WPP, that has won several awards for its annual reports, and is a media communications group with exceptionally high values for intangibles, commissioned a more unusual and striking series of artist's impressions of its top management, which occupied nine pages of its 2002 *Annual Report*; an example is given in Figure 5.2

Figure 5.2 WPP Annual Report 2002, p.31 (Artist: David Hughes)



Dominic Proctor
Chief Operating Officer
MindShare

Markets

Although accounts provide some insight into the markets in which companies operate through segmental analysis, they are not as eloquent as discretionary words and pictures, and give no indication of future

operations. Tesco, for example, indicated its new expansion in Asia through its front cover, (Figure 5.3) and through a succinct narrative and tabular account of its stores and future plans (Annual Review, p.4).

Figure 5.3 Tesco Annual Report and Annual Review 2002 front cover



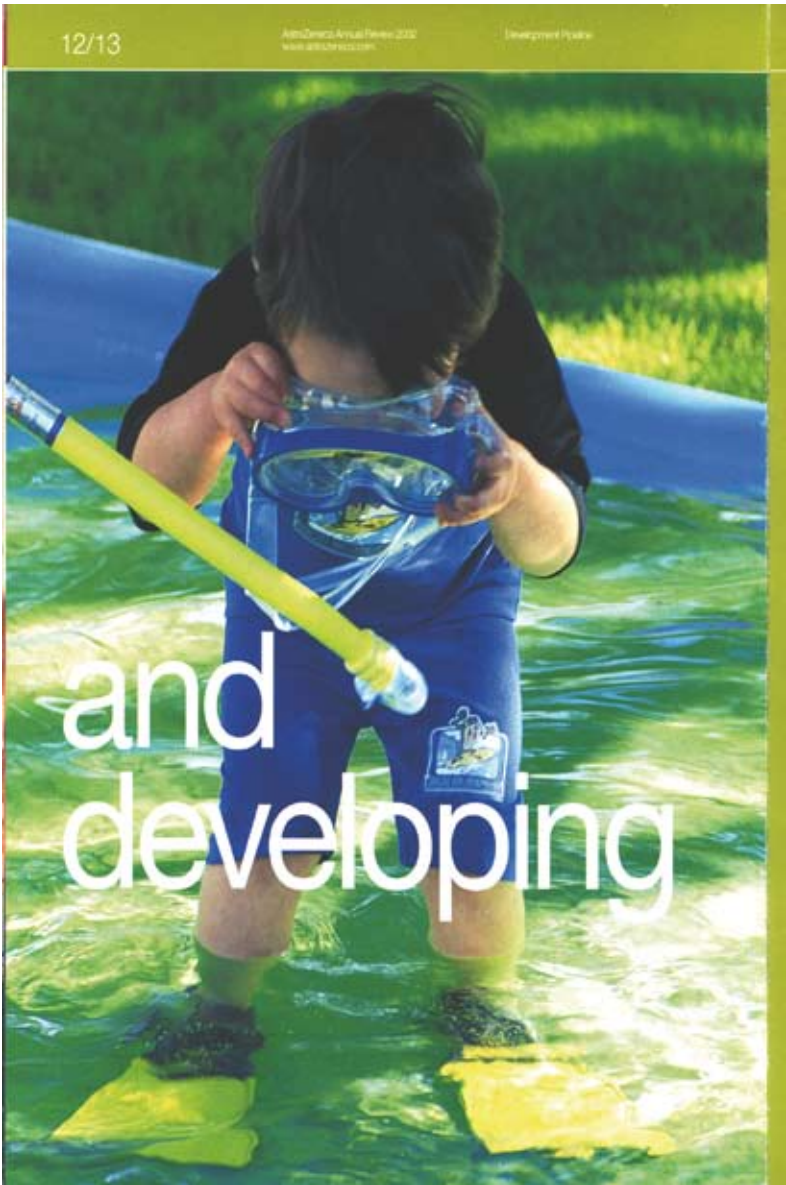
Business development

Business development, and particularly research and development, has long been an intangible aspect of companies' operations that many advocates of change, notably Lev (2001), have argued should be an asset rather than an expense. The pharmaceuticals companies AstraZeneca and Shire Pharmaceuticals both spent about 18% of their revenues on research and development in 2002, and both used discretionary disclosures to provide useful charts of their 'development pipelines', together with some indication of future milestones. Shire displays its 'pipeline' alongside key products that have been successfully launched in the past (*Shire Pharmaceuticals Annual Review and Summary Financial Statement*, pp.6-7). AstraZeneca additionally emphasises its intangibles through discretionary words and pictures. The caption on the back cover of its *Annual Review* states:

We're focused on achieving our vision by leading, managing and inspiring our people and developing medicines to create a healthy future.

Key words from this caption are used as headings for a series of illustrative pictures. For example, 'developing' takes the image of a child in diver's kit staring intently through a pair of goggles at the water in which he is standing, and thus making associations with human development, close examination, freshness of ideas and contribution to health (Figure 5.4).

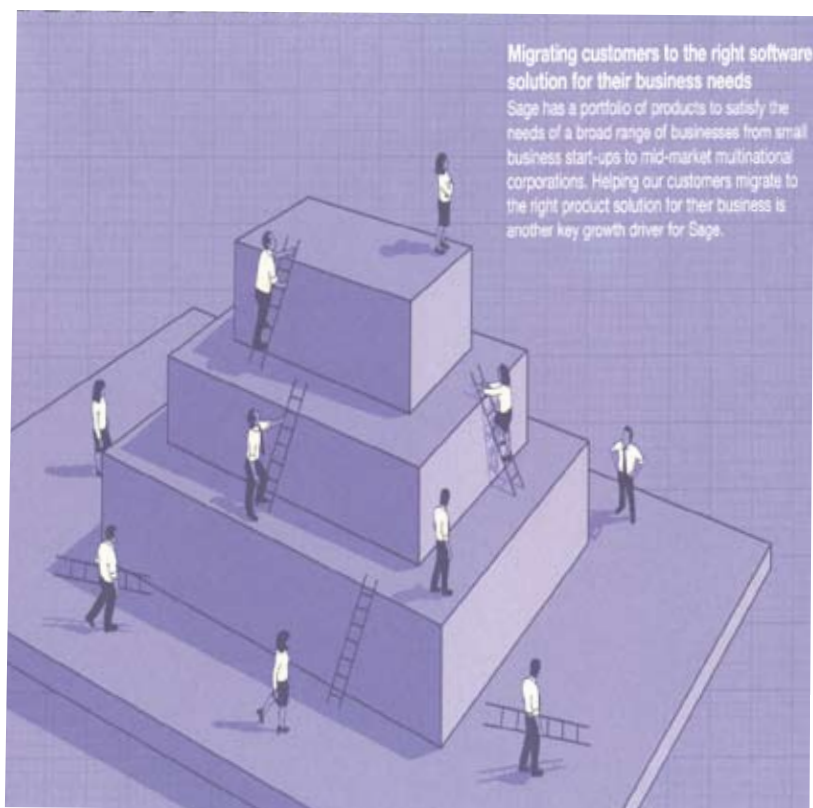
Figure 5.4 AstraZeneca Annual Review 2002, p.12



Consumers/Customers

Most companies were concerned to emphasise the importance they accorded to their consumers or customers. Businesses know the importance of their customer base or client list, but this intangible asset does not feature in accounts other than in the turnover figure. Sage emphasised its customers above all else, over a generous ten pages of its 58 page *Annual Report*, and illustrated in a striking manner by images reminiscent of the symbol of ascension, found elsewhere in annual reports (Davison, 2004) (Figure 5.5).

Figure 5.5 The Sage Group Annual Report and Accounts 2002, p.12



Workforce

The quality of the workforce is, along with management, an important contributor to the performance of a company. Again, the quality, or even existence of the workforce, does not feature in a traditional set of accounts, but is frequently recognised in the surrounding material. United Utilities' Chief Executive's statement emphasised the importance of the workforce in words, prominently placed in the first paragraph, and in a bold font of a different colour from the rest of the text:

If I had to express our strategy in a single sentence, it would be this: to create value for our shareholders by taking the skills of our people out into the world at large (United Utilities Annual Review CEO's Statement 2002, p.3).

Tesco promoted its 'One Team' in pictures and narrative (*Annual Review 2002*), Whitbread stressed its 'People business' (*Stakeholder Review*) and AstraZeneca emphasised the contribution of its 'People', (Figure 5.6).

Figure 5.6 AstraZeneca Annual Review 2002, p.10



Future aspirations

Financial reporting has long been criticised for the fact that it is out of date and backward-looking rather than forward-looking. Again, this is a gap filled in a variety of ways by discretionary disclosures. In the 2002 FTSE 100 they ranged from specific attempts by the pharmaceutical companies to outline their research and development projections mentioned above, to more general statements. Chairmen's and CEOs' statements often ended with statements regarding the future.

For example, in Smith and Nephew's annual report, captioned 'Delivering Sustainable Growth', the CEO's concluding paragraph, entitled 'Outlook', ended with:

We remain confident that we can deliver sustainable growth over the next three years (Smith and Nephew Annual Report and Accounts 2002, p.9).

In Old Mutual's report, captioned 'The Strengths of Diversity. The Power of Focus', the CEO's concluding paragraph was also entitled 'Outlook' and began:

Each of our businesses faces 2003 with some confidence, and each draws support from the whole (Old Mutual Annual Report and Accounts 2002, p.9).

Legal and General constructed its *Annual Report* on the notion of building: "Building our Business" proclaimed the front cover. The narrative introduction expanded repetitively on the metaphor of building, emphasising intangibles and culminating in its customers' perceived concerns about the future:

Building relationships...

Building a reputation...

Building competitive advantage...

Building on our strengths...

Building for the future. Customers coming to Legal and General are thinking about the future. Whatever the appropriate solution - be it a savings vehicle or a form of life or property protection - customers are making decisions about the kind of future they want for themselves and their dependants. Our ambition is to fulfil our customers' expectations, their plans and their hopes for the future.

(Legal and General Annual Report 2002, p.1).

Each of these was used as the basis of a section of the report. The future was further illustrated by the dual symbol of children, representing

the collective future of society, wearing the fancy dress of sunflowers, representing the product of a well-tended garden (Figure 5.7).

Figure 5.7 Legal and General Annual Report 2002, p.19



Corporate responsibility

In describing its aspirations for the future, Legal and General was at the same time stressing the importance that it attached to behaving responsibly as a company, with broader objectives beyond the profit motive:

We believe that behaving responsibly as a company is good for our business, our society and our environment (Legal and General Annual Report 2002, p.18).

This growing awareness of the role and value of business ethics is an intangible aspect of corporate life that cannot be expressed by the financial statements. Whitbread took a page of its unusually entitled *Stakeholder Review. Shareholders, Customers, Employees, Society*, the title itself indicative, to communicate its sense of responsibility through discretionary narrative (Figure 5.8).

Brands

Companies with large investments in brands generally devoted considerable space in their annual reports to their promotion, even though they may already be recognised in the accounts, unlike many of the other intangibles discussed here. For example, Cadbury Schweppes encased its Annual Report and Accounts in a pouch that emphasised its brands, reproduced again as a pull-out page to the front cover of its Annual Review (Figure 5.9, overleaf).

Figure 5.8 Whitbread Stakeholder Review 2002, p.18

SOCIETY: HELPING YOUNG PEOPLE ACHIEVE THEIR POTENTIAL

**WHITBREAD HAS A SPECIAL
ROLE TO PLAY...**
Keen, Hard-working, Responsible.
Those words are perhaps not the first you'd associate with the youth of today. But the fact is that young people are not so very different to how they've always been. They're energetic and eager to try new experiences. But they're also easy prey, prone to error and needful of support when things don't work out as planned.

Our brands have a special affinity with the under 25s. A high percentage of our employees and potential employees fall into that category, as do many of our customers. It's a natural step for us to focus our resources on where they can do most good for our people and our customers.

But although we've tightened the focus of our Community Investment Programme to strengthen the bond between our brands and young people, this is not altruism or patronage for its own sake. Instead, it's a hard-edged business approach that also delivers value at the bottom line. There are many instances where our involvement creates both a win for society and also a win for our business.

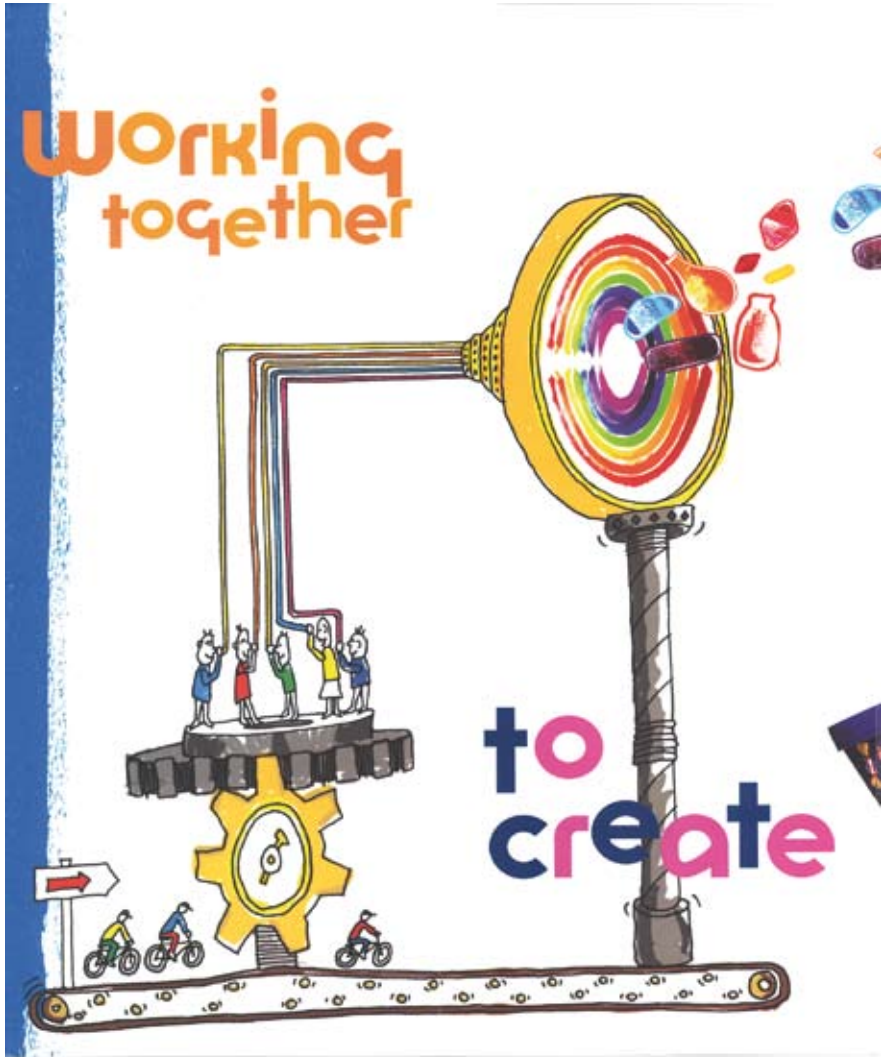
There's a fine tradition at Whitbread for giving time, expertise and resources to the community. From raising money for Sport Relief to helping schoolchildren understand more about the hospitality business or donating furniture from hotels and restaurants to hostels for the homeless, we know that we're actively contributing to a better society.

Young people are the future of our world and of our business. Whether they work with us, enjoy their leisure time with us or need some real help, to achieve what they want in life we want to help them seize that future with both hands.

David Thomas
Chief Executive
Whitbread

DAVID THOMAS
Chief Executive and Chairman
of the Community Investment
Programme

*Figure 5.9 Cadbury Schweppes Annual Review and Summary
Financial Statement 2002, pull-out pages of front cover*





Quality

A concern for quality control in its various guises is an intangible which featured in the discretionary words and pictures, but, perhaps surprisingly, to a lesser extent. British Land's *Annual Report and Accounts* was particularly imaginative in communicating the importance it attached to quality. The company is a sponsor of the Royal Ballet, and used twelve pages of colour photographs of ballet dancers in mid pose to illustrate quality in its *Annual Report*.

History

Corporate history and reputation were emphasised less frequently in annual reports than might have been expected. Nonetheless, there were times when it was deemed appropriate. Both Alliance and Leicester and Standard Chartered celebrated 150 years of business in their 2002 annual reports. Standard Chartered used celebratory balloons on the identical front covers of its *Annual Report* and *Annual Review*, positioned against photographs depicting its experience in the new markets of Asia (Figure 5.10).

With 150 years in the emerging markets the Group has unmatched knowledge and understanding of its customers in its markets (Standard Chartered Annual Report and Accounts and Annual Review 2002, narrative introduction p.1).

Figure 5.10 Standard Chartered Annual Report and Accounts 2002 front cover



Corporate governance

Good systems of corporate governance were clearly felt to be a business asset, but only by a minority of companies. Typically, communication of corporate governance matters would take the form of narrative paragraphs in the Chairman's or CEO's statement.

Style of discretionary words/pictures and intangibles

The research's second aim in examining the discretionary words and pictures was to assess the extent to which there was evidence of the use of stylistic devices, to assist in the communication of business intangibles. As detailed in Chapter Three, three commonly used stylistic devices dating back to antiquity had been chosen for evaluation: repetition, emphasis and contrast, or antithesis. As with the content analysis, the occurrence of a particular style was the first judgement to be made in evaluating each document. In the case of style, a further assessment was made in each case to award the occurrence a strength rating on a scale of one to three, where a three represented the greatest strength. (The findings with regard to strength were used to draw correlations in the final phase of the research detailed in Chapter Six.) Data was again collected from all five disclosure types: Captions, Narrative introduction, Chairman's statement, CEO's statement and Pictures.

The overall findings regarding the types of style are shown in Chart 5.5. The chart displays the breakdown between the three styles throughout the five disclosure types in the 165 documents examined of the FTSE 100. It can be seen that repetition and emphasis dominate more or less equally, with contrast being very much a minority choice. This may be because repetition and emphasis are simpler and more straightforward techniques to use, whereas antithesis requires a little more forethought and crafting.

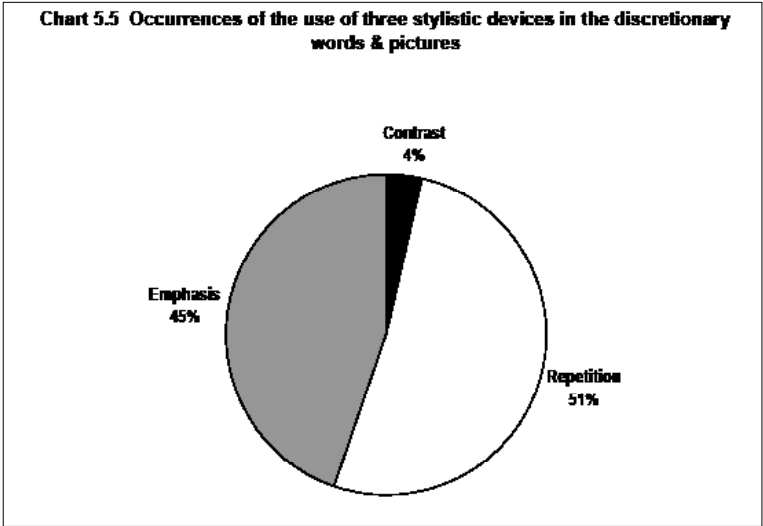
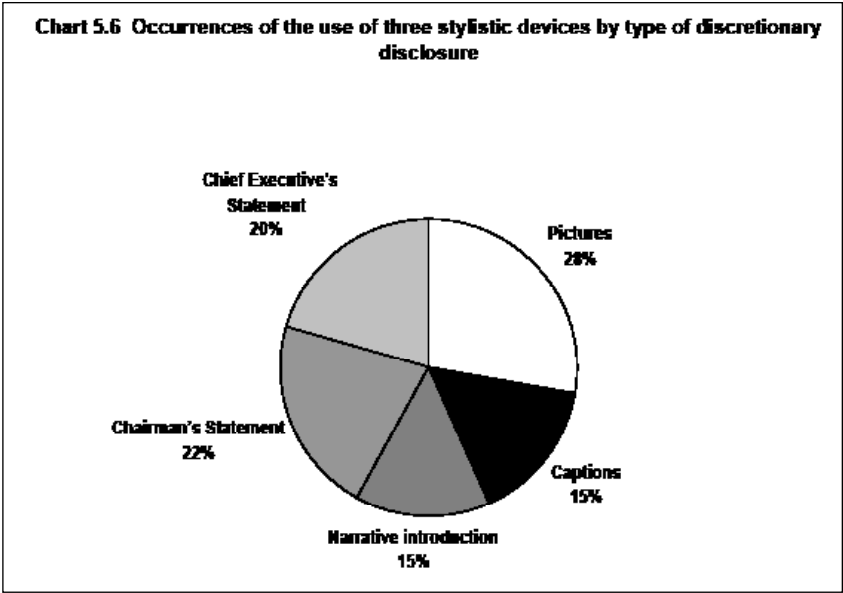
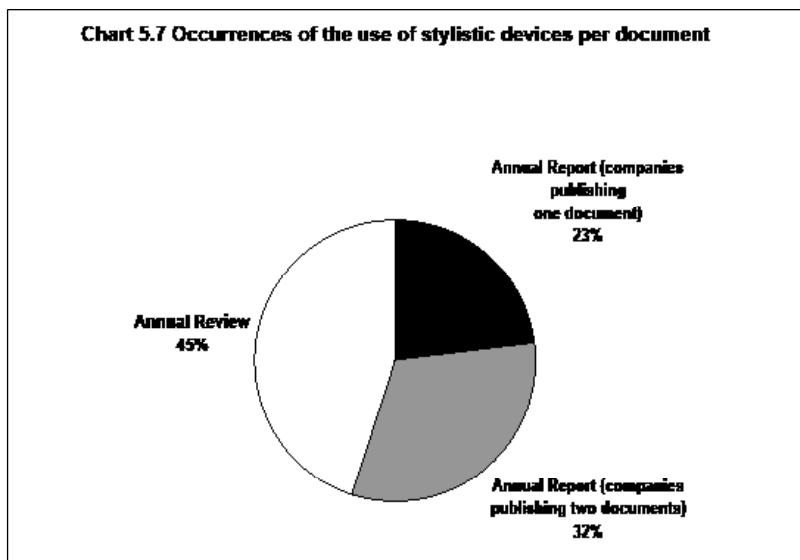


Chart 5.6 provides a different analysis, in showing the use of all three types of style broken down by the five different disclosure types. The results are very similar to the analysis of intangibles content given in Chart 5.2, and show a fairly even spread between the types of disclosure. Pictures now feature alongside the Chairman’s statement and CEO’s statement as the disclosures showing the greatest evidence of style, but again the interpretation may not be reliable, since no adjustment was made for the relative length of these disclosures. It was in the pictures also that the greatest concentration of one stylistic device, repetition, was found.



As with content, the analysis was again extended to investigate whether more attention was being paid to presentational style in the *Annual Review* as opposed to the *Annual Report*, shown in Chart 5.7. An almost identical breakdown was revealed as for that of the occurrence of intangibles in the content (Chart 5.3), indicating that there was general evidence of considerably more craftsmanship in the *Annual Review* compared to the *Annual Report*. Again, this is important, since there is potential readership confusion regarding the nature of the *Annual Review*, which has been shown to be especially used for communicating intangible assets.



The rest of this section moves from analyses provided on an overall basis to consider, on an individual company scale, some examples of each type of stylistic device and how they were used to stress the existence and importance of a variety of intangible assets.

Repetition

Repetition was used in a host of ways in both the words and pictures of *Annual Reports* and *Annual Reviews*. Boots used simple but striking captions on the front cover of its *Annual Review* that were repeated again inside to introduce different sections of the narrative introduction (Figure 5.11).

What we said...

What we did...

Where we're heading...

Figure 5.11 Boots Annual Review and Summary Financial Statement 2002 front cover



Annual Review and Summary Financial Statement
for the year ended 31st March 2002

What we said...
What we did...
Where we're heading...



In similar vein to Legal and General's repetition of 'Building', the Royal Bank of Scotland used the caption 'Make it happen' on the front cover of its *Annual Review*, and this was repeated in headings throughout the inner pages, three examples of which were:-

Make it integrated. Make it happen.
Make it deal of the year. Make it happen.
Make it a European record. Make it happen.

Under the headings were displayed a variety of intangible aspects of the company's activities, from integrating its systems with those of NatWest following takeover, to its retail links such as those with Tesco and Direct Line, to its work with the community.

Safeway used repetition in its pictures to display its product range (*Annual Report and Accounts*, p.28). Kingfisher created a repetitive series of motifs based on a combination of national flags and supermarket goods in the shape of supermarket trolleys to communicate the number of its new stores (Figure 5.12).

Figure 5.12 Kingfisher Summary Annual Review 2002, p.14



Emphasis

Emphasis was similarly used throughout the discretionary disclosures. A standard technique was the use of bold headings, in a different colour and larger size. Some companies used more imaginative forms of emphasis. BOC, for example, combined emphasis of font size and colour with the use of other languages, to emphasise the international nature of its business (Figure 5.13).

Contrast or antithesis

Antithesis was used by a smaller number of companies, but to great effect. For example, at a time when the company was undergoing considerable change, Royal and SunAlliance placed its future aspirations in the context of the company's past record dating back to 1710. Stated succinctly in the Chairman's Statement:

I am confident the future will see Royal and SunAlliance produce the results that a company with its pedigree should (Annual Review, p.5).

the message had already been expressed both verbally and pictorially in the introductory pages (Figure 5.14, overleaf).

Figure 5.14 Royal & SunAlliance Annual Review 2002, pp.2-3

Who we are

Royal & SunAlliance is one of the world's leading global insurers. We are also one of the world's most successful operators having our roots back in 1710.

After more than two centuries of our business as global insurers and reinsurers in the UK, Europe and international territories, the most significant of our 2002 achievements, going as far as the New York stock markets as the Standard & Poor's Composite 100, is the successful merger of the two companies.

We expect our merged financial performance for the coming year to be even better than the previous year, which has not changed and where we believe that the benefits and growth to be greater than the next five years.

History

The history of Royal & SunAlliance is a story of growth and change. The story of our roots goes back to 1710, when the first of our companies was founded. In the next 200 years, it has grown to become one of the world's leading insurers. The first of our companies was founded in 1710, when the first of our companies was founded. The first of our companies was founded in 1710, when the first of our companies was founded.

Business Performance

Our business performance for the year 2002 is a story of growth and change. The story of our roots goes back to 1710, when the first of our companies was founded. In the next 200 years, it has grown to become one of the world's leading insurers. The first of our companies was founded in 1710, when the first of our companies was founded.

1710 Sphere of Influence since 1710
Sun founded
The oldest insurance company transacting business in its own name

1720 London founded

1782 Phoenix founded

1824 Alliance founded

1836 Liverpool & London & Globe founded

UK EUROPE US & CANADA

Summary of findings

The second phase of the research examined in more detail the contents of the *Annual Report* and *Annual Review*. The principal findings were that a wide variety of intangible assets, (notably products, management, markets, business development, consumers/customers and the workforce) were being communicated in the content of discretionary words and pictures, spread across all disclosure types. Pictures were used almost exclusively to communicate intangible aspects of companies' businesses. Companies also gave strength to their presentation of intangible assets through the use of stylistic devices, notably repetition and emphasis, which were also spread across all disclosure types, and especially pictures. The communication of intangibles, both in content and in style, was more in evidence in the *Annual Review* as compared to the *Annual Report*.

CHAPTER SIX

THE RELATION BETWEEN THE USE OF DISCRETIONARY WORDS AND PICTURES AND THE VALUE OF INTANGIBLES

Previous chapters examined: (i) the reporting adopted by companies, in their *Annual Review* and *Annual Report* as well as the page content of the discretionary material that they contained; and (ii) how the documents were used to communicate intangible assets such as management, customers, products and business development. This chapter explores whether there is a systematic link between the use of discretionary words and pictures and the financial desirability for the company to communicate its intangible assets to investors and other stakeholders.

The backward-looking and conservative nature of traditional accounting compels companies to communicate with stakeholders in alternative, and more effective, ways. The research examines whether greater use is made of discretionary words and pictures to communicate intangibles by companies that are more reliant on intangible assets for their sustainable financial performance. Specifically, the communication of intangibles through discretionary words and pictures was analysed in relation to the intangible assets capitalised in balance sheets, predominantly goodwill and brands, and the uncapitalised intangible assets implicit in company share prices relative to book values.

One document or two?

In Chapter Five, Chart 5.3 documented that the communication of intangibles through discretionary words and pictures took place

more significantly in the *Annual Review* than the *Annual Report*. An initial objective was, therefore, to ascertain the financial characteristics of companies that issued two documents (an *Annual Report* and an *Annual Review*) compared with those publishing just one document (an *Annual Report*).

Table 6.1 shows that companies that provided two documents tended to be those with greater financial strength in intangible assets. These companies had larger capitalised intangible assets, mainly in the form of goodwill and brands, than those providing an *Annual Report* alone. Also, companies that published two documents had greater uncapitalised intangible assets implicit in their share prices than those that provided an *Annual Report* alone, with an average share price to book value of 3.84 compared with 2.08.

Following the findings detailed in Chapter Five, the publication of an *Annual Review* by companies with high financial values for intangibles suggests that there is a systematic use of discretionary words and pictures to emphasise these intangible assets, and that companies are concerned to signal their earnings potential through forms of disclosure that are alternative to the accounts.

Table 6.1 The financial characteristics of FTSE 100 companies

	Companies producing only an Annual Report	Companies producing both an Annual Report and an Annual Review
Number of companies	35	65
Average value of total intangible assets	£620m	£2,712m
Goodwill	£534m	£1,908m
Brands	£27m	£181m
Ratio of share price to book value of net assets	2.08	3.84

Discretionary words and pictures and the value of intangibles

In order further to investigate the link between the communication of intangibles in discretionary disclosures and financial values of intangibles, the number of pages by type of disclosure were examined across both the *Annual Report* and *Annual Review*. Discretionary words and pictures were categorised into: Captions; Narrative introduction; Chairman's statement; CEO's statement; Directors' biographies; and Pictures.

Companies were classified into quartiles with each group consisting of 25 companies ranked according to the value of their capitalised intangibles. The characteristics of the group with the lowest value of intangible assets was compared with the group with the highest value of intangibles. The results are given in Table 6.2.

Table 6.2 *Discretionary words and pictures and the value of intangibles*

	Companies with the lowest capitalised intangible assets	Companies with the highest capitalised intangible assets
Number of companies	25	25
Average capitalised intangible assets	£55m	£6,363m
Average ratio of share price to book value of assets	2.13	6.76
	<i>Average number of pages</i>	<i>Average number of pages</i>
Captions	5.1	6.2
Narrative introduction	1.0	1.9
Chairman's statement	3.1	2.8
CEO's statement	2.1	3.2*
Directors' biographies	1.6	2.6*
Pictures	11.9	14.9
All discretionary words & pictures	24.9	31.8*

Note 1: The averages are given for the Annual Report and Annual Review taken together, and are calculated as follows:- the score from the Annual Report is added to the score for the Annual Review (where it exists) to give a score for the company. An average is then taken over all the 100 companies. Effectively, this procedure gives a zero score for the Annual Review for companies that do not produce an Annual Review.

*Note 2: * indicates that the averages of the groups with the highest and lowest intangibles are significantly different at the 5% level.*

It should firstly be observed that those companies with a low value for capitalised intangible assets also had lower market capitalisation in relation to book value, and *vice versa*. Companies in the group with low

values of intangibles had an average share price to book ratio of 2.13, whereas those companies in the group with high values of intangibles had an average share price to book ratio of 6.76. There is, therefore, a strong association between the uncapitalised intangible value implicit in the share price and the value of intangible assets in the balance sheet.

Table 6.2 also shows the average number of pages devoted to the different types of discretionary material. Across nearly all types of disclosure, a higher average number of pages is found in those companies with higher values for intangibles: for example, the narrative introduction is nearly twice as long (1.9 compared to 1.0), the CEO's statement is longer (3.2 compared to 2.1), directors' biographies are longer (2.6 compared to 1.6), and more pages are devoted to pictures (14.9 compared to 11.9). These differences between companies with high and low values for intangibles suggest that discretionary words and pictures are used to a greater extent to communicate intangibles by companies with higher financial values for intangible assets. However, this page count is merely suggestive of this correlation, and the content of this material is examined in the following sections.

Intangible content of words and pictures and the value of intangibles

Words

The coverage of intangibles by companies with differing financial strength in intangibles were examined in four main types of discretionary narrative: Captions; Narrative introduction; Chairman's statement; and CEO's statement.

The list of intangibles used in Chapter Five was also used in this analysis. Again, the measurement in this analysis was by occurrence rather than by page. If a particular intangible was mentioned in one narrative type, a score of one was recorded. As before, companies were

classified into quartiles, with each group consisting of 25 companies ranked according to the value of their capitalised intangibles. The characteristics of the group with the lowest value of intangible assets were compared with those of the group with the highest. The results are given in Table 6.3.

Table 6.3 The occurrence of intangible assets in discretionary narratives and values of intangibles

	Companies with the lowest capitalised intangible assets	Companies with the highest capitalised intangible assets
Number of Companies	25	25
Average capitalised intangible assets	£55m	£6,363
Average ratio of stock price to book value of assets	2.13	6.76

Table 6.3 (Continued) *The occurrence of intangible assets in discretionary narratives and values of intangibles*

	Companies with the lowest capitalised intangible assets	Companies with the highest capitalised intangible assets
<i>Type of intangible</i>	<i>Average occurrence</i>	<i>Average occurrence</i>
Consumers	2.5	3.2
Brands	0.9	2.4*
Products	3.0	3.2
Markets	2.4	3.6*
Business development	2.8	3.2
History	0.6	0.8
Management	2.3	3.0
Workforce	2.2	3.3*
Shareholders	2.0	2.6*
Responsibility	1.4	2.8*
Future	2.6	2.6
Quality	1.0	1.3
Corporate governance	0.4	1.0*
All types of intangible	24.0	33.0*

Note 1: The four narrative types are: Captions; Narrative introduction; Chairman's statement; and CEO's statement.

Note 2: If the intangible was mentioned in all four locations in the document, then the company was scored 4.

Note 3: The averages are given for the *Annual Report* and *Annual Review* taken together, and are calculated as follows:- the score from the *Annual Report* is added to the score for the *Annual Review* (where it exists) to give a score for the company. An average is then taken over all the 100 companies. Effectively, this procedure gives a zero score for the *Annual Review*, for companies that do not produce an *Annual Review*.

Note 4: * indicates that the averages of the groups with the highest and lowest intangibles are significantly different at the 5% level.

Table 6.3 shows that the average occurrence of all intangibles taken together is scored at 33 for companies with high financial values for intangibles, compared with 24 for companies with low financial values for intangibles. Specific intangibles categories, where there is a substantial difference between the two groups of companies include: brands (2.4 compared with 0.9); markets (3.6 compared with 2.4); responsibility (2.8 compared with 1.4); and workforce (3.3 compared with 2.2). These differences were all the more striking since the scoring only took account of the occurrence of intangibles in the narrative and not the length of that text. The findings are evidence that discretionary words are used to a greater extent to communicate intangible aspects of the performance of the company in the case of those companies with the greatest financial strength in intangible assets.

Pictures

The coverage of intangibles by companies with differing financial strength communicated through pictures was also examined. As related in Chapter Five, the page count of the pictures found that the vast majority (94%) of pictures were devoted to communicating intangibles (Chart 5.4).

Again, the characteristics of the companies with the lowest value of intangible assets were compared with those of the group with the highest. The results are given in Table 6.4.

Table 6.4 The average page content of the pictures and values of intangibles

	Companies with the lowest capitalised intangible assets	Companies with the highest capitalised intangible assets
Number of companies	25	25
Average capitalised intangible assets	£55m	£6,363m
Average ratio of share price to book value of assets	2.13	6.76
<i>Type of intangible</i>	<i>Average page content of pictures</i>	<i>Average page content of pictures</i>
Consumers	0.6	1.5*
Brands	0.5	2.3*
Products	3.4	2.9
Markets	0.3	0.6
Business development	0.7	0.6
History	0.0	0.3
Management	2.4	3.3
Workforce	0.9	0.9

Table 6.4 (Continued) The average page content of the pictures and values of intangibles

	Companies with the lowest capitalised intangible assets	Companies with the highest capitalised intangible assets
<i>Type of intangible</i>	<i>Average page content of pictures</i>	<i>Average page content of pictures</i>
Shareholders	0.1	0.0
Responsibility	0.5	1.2*
Future	0.0	0.2
Quality	0.9	0.0
Corporate governance	0.0	0.2
All types of intangible	10.3	14.0

Note 1: The averages are given for the Annual Report and Annual Review taken together, and are calculated as follows:- the score from the Annual Report is added to the score for the Annual Review (where it exists) to give a score for the company. An average is then taken over all the 100 companies. Effectively, this procedure gives a zero score for the Annual Review, for companies that do not produce an Annual Review.

*Note 2: * indicates that the averages of the groups with the highest and lowest intangibles are significantly different at the 5% level.*

The main finding shown in Table 6.4 is that for “brands”, “consumers” and “responsibility” the average number of pages of pictures is greater for companies with high financial values for intangibles than for companies with low financial values for intangibles in two important areas. Pictures of brands, for example, occupy an average of 2.3 pages

in the documents of companies with the greatest strength in intangibles, as compared to only 0.5 pages in the documents of companies with low values of intangible assets. Similarly, on average, there were 1.2 pages devoted to pictures of corporate responsibility for the group with the highest intangibles, compared with 0.5 pages for the group with lowest intangibles.

As for discretionary words, the findings showed that the pictures in annual reporting documents are used to a greater extent to communicate the intangible aspects of performance of a company by those companies with the greatest financial strength in intangible assets.

Strength of style in discretionary words and pictures and the value of intangibles

A final examination of the discretionary material assessed the style used in the text and illustrations of companies with differing financial strength in intangibles. The three stylistic devices selected, discussed earlier in Chapter Five, were: contrast; repetition; and emphasis.

Style was identified, and its strength gauged, on a scale of one to three (three being the strongest) for the following types of discretionary material:

- Words
 - Captions
 - Narrative introduction
 - Chairman's statement
 - CEO's statement
- Pictures

As before, companies were ranked by the value of their intangible assets, and the characteristics of the group with the lowest value of intangibles were compared with those of the group with the highest. The results of the analysis are given in Table 6.5.

Table 6.5 Strength of style in the discretionary words and pictures and values of intangibles

	Annual Report & Annual Review taken together		Annual Report		Annual Review	
	<i>Capitalised and uncapitalised intangibles</i>		<i>Capitalised and uncapitalised intangibles</i>		<i>Capitalised and uncapitalised intangibles</i>	
	<i>Low</i>	<i>High</i>	<i>Low</i>	<i>High</i>	<i>Low</i>	<i>High</i>
Number of companies	25	25	25	25	25	25
Average capitalised intangible assets	£55m	£6,363m	£55m	£6,363m	£55m	£6,363m
Ratio of share price to book value of assets	2.13	6.76	2.13	6.76	2.13	6.76
<i>Style</i>	<i>Low</i>	<i>High</i>	<i>Low</i>	<i>High</i>	<i>Low</i>	<i>High</i>
Contrast	0.08	0.20	0.08	0.00	0.00	0.20
Repetition	4.16	5.96	2.68	2.04	1.48	3.92
Emphasis	2.36	2.44	1.76	1.08	0.60	1.36
Contrast, repetition & emphasis	6.60	8.60	4.52	3.12	2.08	5.48

Note 1: The same companies are used in all three analyses: the 'Annual Report' and 'Annual Review' taken together; the 'Annual Report'; and the 'Annual Review'. In the first column, where averages are given for the 'Annual Report' and 'Annual Review' taken together, they are calculated as follows: the score from the 'Annual Report' is added to the score for the 'Annual Review' (where it exists) to give a score for the company. An average is then taken over all the 25 companies. Effectively, this procedure gives a zero score for the Annual Review for companies that do not produce an 'Annual Review'. Similarly, in the third column, where averages are given for the 'Annual Review', a zero score is given for companies that do not produce an 'Annual Review'.

Note 2: The strengths reported are the averages across the group of companies of the sum of strengths in the five areas (captions, pictures, narrative introduction, chairman's statement, CEO's statement). The strength in each area is assessed on a scale of 1 (weak), 2 (moderate), 3 (strong).

Table 6.5 firstly displays the results across all documents. The first column shows that the group with the highest values for intangibles used more style in its discretionary words and pictures than the group with the lowest values for intangibles (a total score of 8.6 compared with 6.6). The strength of repetition was the main difference between the groups (a score of 5.96 for the high intangibles group compared with 4.16 for the low intangibles group).

The results were then analysed between the *Annual Report* and the *Annual Review* to see which document used more style. As anticipated, the difference between the high and low intangibles groups lay in the *Annual Review* rather than the *Annual Report* (bearing in mind that fewer companies with low intangibles publish an *Annual Review* as shown in Table 6.1). In all aspects of style in the *Annual Review*, the difference between the two groups was substantial: 5.48 was scored by the group with high intangibles, compared with 2.08 for the group with low intangibles. Additionally, companies with high intangibles were using more stylistic devices in the *Annual Review* (scored at 5.48) compared with the *Annual Report* (scored at 3.12) and were using fewer stylistic devices in the *Annual Report* than companies with low intangibles (scored at 4.52). The evidence therefore suggests that companies with high intangibles are more likely to have an *Annual Review* which is a carefully crafted document intended to inform users about companies' intangible assets.

Summary of findings

The final phase of the research found that companies publishing an *Annual Review* in addition to an *Annual Report* have larger capitalised and uncapitalised intangible assets than those providing an *Annual Report* only. In examining the discretionary words and pictures more closely, they were used to more effect in all aspects by companies with greater intangible assets: the average number of pages devoted to discretionary

words and pictures was higher; the occurrence of references to intangibles in discretionary words was more frequent; the average number of pages devoted to pictures was higher; style, particularly repetition, was used to a greater extent ; and more stylistic devices were used in the *Annual Review* than in the *Annual Report*.

CHAPTER SEVEN

CONCLUSIONS

The *Corporate Annual Report* includes a rich and varied tapestry of discretionary words and pictures. This chapter summarises the main conclusions and implications for policy makers arising from the foregoing analysis of the current practice of the UK FTSE 100.

Dual reports and presentation

In 2002, 65% of UK FTSE 100 companies produced a summary document in addition to their full *Annual Report*, and this has been a continuing trend across all sectors. Annual reporting represents a great and increasing challenge to companies, and summary documents have much to commend them, including cost benefits and greater readability. At the same time, however, dual reporting is, by nature, more complex and raises different issues.

Although the majority of FTSE 100 companies appeared by consensus to have adopted a variant of *Annual Report* as the title of their full document and *Annual Review* for their summary document, practice is not uniform. Merely by title, there is potential for readership confusion as to the nature of the document received. Occasionally companies refer to the secondary document as the *Annual Report*. Often *Annual Review* alone is used as the title of the summary document, with no further advertisement of the fact that it is an abbreviated report.

This confusion is compounded by the fact that in the overwhelming majority of cases, the documents are of the same size and carry identical or matching front covers. Frequently the summary document has a variant that is more eye-catching, whether through the use of stronger

colour, or more pictures or captions. While the latter may be in the spirit of a more user-friendly document, it also means that it is possible that readers are attracted to a document which they believe to be the full *Annual Report*. While appreciating the benefits of variety and of imaginative design, there is a case for some degree of standardisation, as shown in the list of policy implications below.

Regulatory and discretionary content

On average the page count of the *Annual Report* has doubled to 90 pages since 1988 (Lee, 1994). However, the average masked great variation in practice, from extremes of short eight-page *Annual Review*, to a lengthy 340-page *Annual Report*. The increase across all companies was largely due to increased regulatory disclosures.

Again, there is scope for readership confusion. Firstly, where there are two documents, practice varies as to what is included in each document; also there is often replication between the two documents, although the reiteration is not always identical. Secondly, in all documents the status of the information is very unclear as to whether it is regulatory or discretionary, and as to which parts have been audited.

The recent company law review (DTI, 2002) consulted as to whether the summary document should be mandatory rather than optional (paragraph 8.73). It was decided against making it mandatory, as it was thought to be difficult to regulate. However, there is a case for some degree of standardisation between companies and documents.

Comparison with graphs

The page count of discretionary words and pictures was high, particularly in the *Annual Review*, where it was about half of the document on average. Again, the average masked great variation, and pictures occupied as much as 35 pages (out of 76) in one case. Moreover,

words and pictures occupied far more space (52% on average) than graphs (7% on average). This makes it all the more surprising how little the rich and complex messages of discretionary words and pictures have been researched relative to those of graphs.

Intangibles in the discretionary words and pictures

The findings in Chapter Five demonstrated that discretionary words and pictures were being used to communicate business intangibles, particularly in the *Annual Review*. In the case of pictures, an overwhelming 94% of the page content is estimated as being concerned with intangibles and includes all those aspects of corporate activities that a businessman would recognise as being important, but which traditional accounting does not communicate. Thus, a wealth of messages are conveyed regarding products, management, markets, business development, customers, employees, future aspirations, corporate responsibility and brands. Many of these overlap with the areas of business operations which it is recommended that the *Operating and Financial Review* should cover, such as corporate reputation and brands, intellectual capital, research and development, customer relationships, market position/dominance, human capital policies and practices. A variety of stylistic devices are also in evidence throughout the use of discretionary words and pictures, especially repetition.

Association with the value of intangibles

Analysis was undertaken to see whether all companies were using discretionary words and pictures to portray business intangibles, or whether it was a communication path used predominantly by those companies that had high capitalised and uncapped values for intangibles. Uncapped values were of particular interest, since these are the business assets represented by such aspects as customer

relationships or employees' skills that are not recognised by traditional accounting techniques.

As had been anticipated, there was a clear association between a greater quantity, use and strength of style of discretionary words and pictures and greater values for intangibles. Since, in addition to the inadequacy of the accounting framework, there is also evidence that both lay and expert readers take more note of discretionary disclosures than of the financial statements, it is not surprising that companies communicate the existence and quality of the intangible aspects of their business in this way.

Communication

Ultimately, these are all issues of communication. Accountants have traditionally not been eager to involve themselves in broader communication matters. As times change, the sources and volume of information and opinions have increased at an accelerating rate, and thus a clear understanding and presentation of salient messages becomes all the more important. Accountants should be alert to questions of presentation, which are not a vogue but an established trend.

Policy implications

The implications for policy makers arising from the foregoing analysis of the current practices of the UK FTSE 100 are:

- The titles which companies use for their annual reporting documents could be standardised;
- The sizes of documents could be standardised. There might be a case for proposing that the full document should be A4 size (which is current standard practice), while the summary document should be A5 size;

- The design of the front cover should differentiate between the full report and the summary information;
- The respective content of the documents could be standardised by category;
- There could be greater clarity regarding the discretionary nature, or otherwise, of categories of information;
- There could be greater clarity regarding audited information and non-audited information;
- Discretionary words and pictures in annual reports, and especially the summary documents, should be taken as seriously by policy-makers as graphs;
- Accountants should develop greater sensitivity to the messages portrayed by discretionary words and pictures, and to the ways in which this narrative and visual material can enrich the communication provided by the financial statements;
- There is need for reform in the traditional accounting framework to deal more adequately with business intangibles; and
- Consideration should be given to extending accountants' training to include communication and presentation.

Challenges

This report has provided a comprehensive analysis of current practice regarding the use of discretionary words and pictures in the *Corporate Annual Report* of the UK FTSE 100. However, a number of matters would benefit from further consideration. This study has been archival and would benefit from reinforcement through research into readership to ascertain what type of reader is using the *Annual Report* and *Annual Review* and whether readers are confused by the two documents, by the distinction between discretionary and regulatory

information and between audited and non-audited information; research is also currently lacking regarding the attention which readers give to pictures. Comparative studies would be useful regarding practice in the US and continental Europe, and regarding the eventual migration of the *Corporate Annual Report* to the web. Analysis regarding association between reporting practice and shareholder type, industrial sector type or creative designer would enrich the findings. Finally, there remains much work to be done on the design process itself, and how companies approach the annual task of moulding together a set of accounts and other regulatory and discretionary information to form a coherent, succinct, informative and attractive package.

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APPENDIX ONE

LIST OF UK FTSE 100 COMPANIES IN SAMPLE

3i

Associated British Foods

Abbey National

Alliance & Leicester

Alliance UniChem

Allied Domecq

Amersham plc

Amvescap

Anglo American

AstraZeneca

Aviva

Bradford & Bingley

BA

BAA

BAE Systems

Barclays

BAT

BG Group

BHP Billiton

BOC

Boots

BP

British Land

B Sky B

BT Group

Bunzl
Cadbury Schweppes
Canary Wharf Group
Capita
Centrica
Compass Group
Diageo
Dixons Group
DMGT
Emap
Exel
Friends Provident
Gallaher Group
GKN
Granada
GSK
GUS
Hanson plc
Hays plc
HBOS plc
Hilton Group plc
HSBC
ICI
Imperial Tobacco Group plc
Invensys
Johnson Matthey
J Sainsbury
Kingfisher
Land Securities
Legal and General
Liberty International
Lloyds TSB Group
Marks and Spencer
Man Group plc
mm0₂

Morrisons
National Grid
Next
Northern Rock
Old Mutual
P & O Princess
Pearson
Prudential
RBS
Reckitt Benckiser
Reed Elsevier
Rentokil Initial
Reuters
Rexam
Rio Tinto
Rolls Royce
Royal and SunAlliance
SAB
Safeway
Sage
Schroders
Scottish and Newcastle
Scottish Power
Scottish and Southern Energy
Severn Trent
Shell
Shire Pharmaceuticals
Six Continents
Smith + Nephew
Smiths
Standard Chartered
Tesco
Tompkins
Unilever
United Utilities

Vodafone
Whitbread
Wolseley
WPP
Xstrata

APPENDIX TWO

RESEARCH TEMPLATE

Key Information

Company ABC plc
Date of year-end 31.12.2002

Table A Front Covers

Front covers		
	ANNUAL REPORT	ANNUAL REVIEW
Structure of covers		
Size in area	A4	A4
Identical covers	0	0
Matching covers	X	X
Strong colours (Review) v muted (Report)	0	0
Different colours	X	X
Variations of the same picture	0	0
Picture (Review) v no picture (Report), but otherwise identical design	0	0
Different sizes but otherwise identical design	0	0
Contrasting covers	0	0

Table B Full Analysis of Each Document

Review	Large captions (no.)	Total pages	Visual material	Financial highlights	Graphs	Narrative intro
Structure						
Pages	7	32	12.5	0.7	1.1	0
Content						
Products	X		4			N/A
Brands	X		1.8			N/A
Markets	0		0			N/A
Business development	X		0			N/A
Consumers/ customers	X		0			N/A
Management	0		2.5			N/A
Workforce	X		0			N/A
Corporate responsibility	X		0			N/A
Corporate governance	0		0			N/A
Quality	0		0			N/A
History/ reputation	0		0			N/A
Future prospects	0		0			N/A
Style						
Contrast	0		0			N/A
Repetition	1		3			N/A
Emphasis	0		0			N/A

Table B (Continued) Full Analysis of Each Document

Review	Narrative CS	Narrative CEO	Narrative op/fin/ bus rev	Narrative other	Directors biographies	Accounts & stat info	Blank
Structure							
Pages	1.85	0	7.5	0	1.8	4.7	0
Content							
Products	X	X					
Brands	X	X					
Markets	X	X					
Business development	X	X					
Consumers/ customers	X	X					
Management	X	X					
Workforce	X	X					
Corporate responsibility	X	X					
Corporate governance	0	0					
Quality	0	0					
History/ reputation	0	0					
Future prospects							
Style							
Contrast	0	0					
Repetition	0	0					
Emphasis	1	1					

TABLE NOTES

Table A

Front covers:

- x means that the aspect was assessed and an occurrence was found.
- 0 means that the aspect was assessed but no occurrence was found.

Table B

Structure:

The numbers indicate the number of pages given to each aspect of a report.

Content:

The numbers in the column marked ‘Visual Material’ indicate the number of pages given to each type of content.

- x means that the aspect was assessed and an occurrence was found.
- 0 means that the aspect was assessed but no occurrence was found.

Style:

The numbers indicate the strength of the style found on a scale of 1 (weak) to 3 (strong). 0 indicates that the style was not found.

Words, Pictures and Intangibles in the Corporate Report

With the increase in complexity of corporate reporting, the issue of how companies communicate with stakeholders is becoming ever more important. This increase in complexity has come at the same time as intangible assets have become increasingly important to business. The authors argue that since, as is generally accepted, traditional accounting communicates the existence of intangible assets inadequately, companies have apparently sought to use other means, such as words and pictures.

This report looks at the reporting practices of FTSE 100 companies, including: the trend towards companies producing both an *Annual Report* and an *Annual Review*; the potential for readership confusion between the two documents; and the relatively high proportion of pictures in the *Annual Review*. The research identifies that words and pictures are being used to communicate business intangibles, such as products and management.

The report concludes with policy implications and areas requiring further research. It is hoped that this research will alert accountants to the communicative importance of discretionary words and pictures, and to the ways in which this narrative and visual material can supplement the financial statements.

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ISBN 978-1 904574-21-1

EAN 9781904574211



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