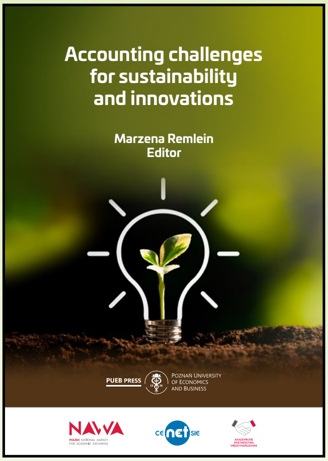

Accounting challenges for sustainability and innovations

Marzena Remlein
Editor

POLISH NATIONAL AGENCY FOR ACADEMIC EXCHANGE

AKADEMICKIE PARTNERSTWA MIĘDZYNARODOWE

eISBN 978-83-8211-055-5

https://doi.org/10.18559/978-83-8211-055-5

PUEB PRESS

Poznań University of Economics and Business

Accounting challenges for sustainability and innovations, pp. 45–60
https://doi.org/10.18559/978-83-8211-055-5/03

3.

NARRATIVE REPORTING

Katarzyna Czajkowska
Poznań University of Economics and Business

Marek Masztalerz
Poznań University of Economics and Business

Ana Rep
Faculty of Economics and Business, University of Zagreb

Abstract: For years financial and management accounting reports were based primarily on "hard" numbers. Extensive written descriptions and explanations were not common in practice. However, in recent decades there has been a significant shift towards "softer" and more narrative communication in accounting. The purpose of the chapter is to identify and describe the determinants of the development of accounting narratives in practice, and to explain why narratives are gaining importance in accounting communication. The chapter presents the links between accounting and language, the development of accounting narratives and the factors determining the use of narratives.

Narratives give economic units the opportunity to explain the situation and the achieved financial results. The use of narratives helps to better meet the information needs of stakeholders. There are still many challenges ahead of narrative financial reporting, such as determining the minimum content of reports, ensuring comparability of reports or the issue of external control of narrative financial reporting.

An insufficient application of professional accounting materiality judgment is considered as one of the main causes of disclosing too much irrelevant information and not enough relevant information. Preparers of narrative reports should be aware that without applying materiality principle the information disclosed in the reports are not considered transparent and stakeholders lose confidence in such companies.

Keywords: accounting, communication, language, materiality principle, narrative reports, narratives, reporting, reporting accounting, transparent reporting.

3.1. Accounting communication—from numbers to text

Accounting is commonly called the "language of business" as it enables communication between preparers and users of accounting information. Accounting is also a tool for describing and constructing the image of the economic reality in which an entity operates. While natural language reflects phenomena in the real world, accounting reflects phenomena in the business world. Accounting communication may be also referred to as a process of creating and sharing meaning (Jack, Davison, & Craig, 2013).

A question arises at this point: is accounting a language or does accounting just use natural language? According to Masztalerz (2018a), the links between accounting and language may be analysed by adopting four different approaches:

- structural approach: accounting is a language as it has similar structure—dictionary and grammar);
- functional approach: accounting is a communication tool and performs all language functions);
- semiotic approach: accounting is a system of signs and meanings;
- social approach: accounting is a socio-cultural phenomenon and an instrument of social construction of the image of reality.

There is also the second face of linguistic issues in accounting, namely the use and role of natural language (and thus also narratives) in accounting. The use and role of language in accounting communication may be considered, *per analogiam*, by using four approaches to the accounting as a language. Firstly, under the structural approach, natural language is used in accounting in order to name, classify, and reflect the economic transactions and other phenomena that need to be taken into consideration while preparing financial statements and other accounting reports. Secondly, under the functional approach, language and text are used in order to facilitate the communication process and to provide comprehensive and understandable information from senders (e.g. accountants) to receivers (e.g. financial statement users). Thirdly, under the semiotic approach, the use of language is required for constructing meaning(s) and create a real or imagined picture of the economic reality in which an entity operates, or even to manage the impression on the users of information. Finally, under the social approach, language is used in the accounting communication process in order to integrate the members of a community (e.g. within an organization), or to accumulate knowledge, but it may also be a tool for constructing the reality.

For years accounting reports (especially financial statements) were based primarily on "hard" numbers (accompanied by brief narrative notes to the items of the financial statements), and accounting communication was equal to providing information. Extensive written descriptions or explanations were not common in practice. However, in recent decades, there has been a significant shift towards "softer" and more narrative communication in accounting. This "narrative turn" in accounting gives rise to new research challenges and perspectives (Beattie, 2014; Brennan & Merkl-Davies, 2013; Masztalerz, 2018a). The purpose of this section is to present the development of accounting narratives and to explain why narratives are still gaining importance in the process of accounting communication processes.

The importance of language in accounting communication has increased significantly in the last decades. Contemporary accounting, both in its theoretical and practical dimension, can no more be simply regarded as a technical and number-based discipline. It has been constantly developing in a rather "soft" and text-based direction (Brennan & Merkl-Davies, 2013). Accounting written narratives appear, for instance, in annual reports, financial statements, management commentaries, social responsibility and sustainability reports, integrated reports, intellectual capital reports, management accounting and performance reports, national and international accounting standards and other regulations, principles and guidelines issued by numerous professional accounting bodies, accounting textbooks, papers, articles and monographs. There are several reasons why language and narratives have been systematically gaining importance in the processes of accounting communication. According to Merkl-Davies and Brennan (2013), voluntary and discretionary narrative disclosures in accounting are determined by the following causes:

- providing incremental information in order to improve the process of decision-making by users operating in the conditions of information asymmetry;
- managerial hubris, i.e. the belief of managers that they have control over all the effects of their decisions, and through narratives in reports, they try to reduce cognitive dissonance among the recipients of the information;
- retrospective sense-making for past events in order to maintain control;
- impression management, i.e. presentation of the company's performance in the best possible light through a variety of communication measures to build reputation or create positive image.

Masztalerz (2016) identifies eight reasons why language and narratives have been gaining importance in accounting communication (Figure 3.1). An important contributor is the increasing complexity of economic phenomena, involving the necessity of giving additional written explanations in order to ensure intelligibility. The accounting narratives aim to enable in-depth understanding of those complex phenomena. A given number in a financial statement may be insufficient for the information user if the nature of the related item or phenomenon is not clearly described and explained. The increasing complexity of economic phenomena had a significant impact on the growing needs of accounting information users and decision makers, who want to understand the determinants of a company's financial position and performance, so they expect not only relevant information, but also intelligible explanations to be included in corporate reports. Around each enterprise there are groups of stakeholders interested in different aspects of the organization's performance. If an organization aims to fully satisfy their information needs, some relevant explanatory narratives must be included in the financial statements, reports or other messages containing accounting information.

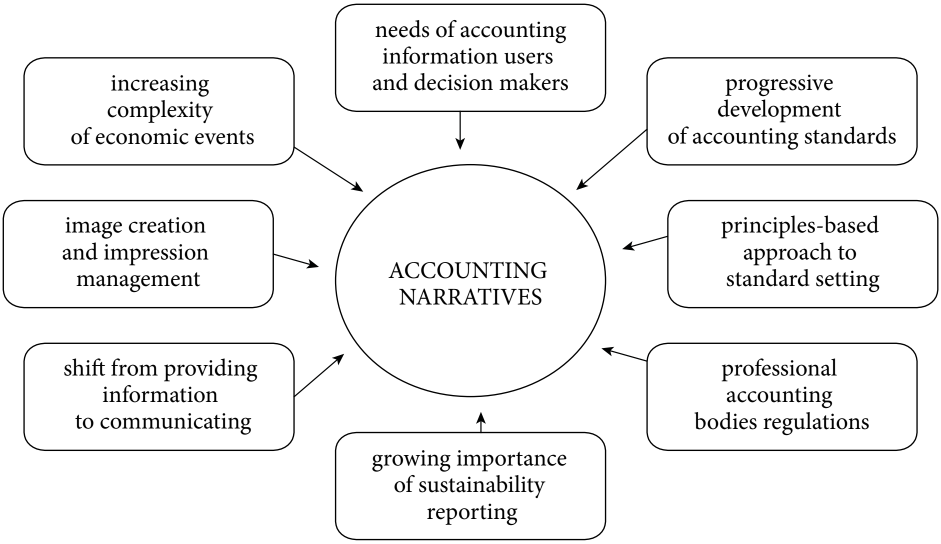

Figure 3.1. Determinants of the development of narratives in accounting

Source: (Masztalerz, 2016, p. 102).

In response to the growing needs of accounting information users, many professional accounting bodies have been (and undoubtedly will be) issuing standards, principles, guidelines, and other regulations or statements which may be considered as accounting narratives themselves, but on the other hand, they have also had a significant impact on the use of language in accounting communication practice. The most visible example is the progressive development of accounting standards, particularly the International Financial Reporting Standards (IFRS). Since 2001 the International Accounting Standards Board (IASB) has issued an average of over one new standard per annum, not to mention the renewals of numerous formerly published standards (IAS). Currently, along with all the accompanying documents such as bases for conclusions, implementation guidance, illustrative examples, interpretations and a practice statement, the complete text of the IFRS has nearly 4,000 pages, and it will undoubtedly grow in the future. The influence of the IFRS, on the use of narratives in annual reports results from at least two reasons. On one hand, the IFRS have been requiring more and more compulsory written disclosures in the notes to the financial statements (in order to present and explain accounting policies, judgments, estimations, etc.), and on the other hand, since the publication of the IFRS practice statement Management Commentary in 2010, the IASB has been encouraging entities to prepare these non-binding narrative reports to provide context within which to interpret the entity's position, performance and progress. The major objective of the management commentary is to supplement the financial statements with additional explanations of the amounts presented in the financial statements and the conditions and events that shaped that information, and to complement the financial statements with financial and non-financial information about the entity's position, performance and progress. Management commentary should communicate information about the enterprise's economic resources and explain the main trends and factors that are likely to affect the enterprise's future performance, position and development. All that information requires narrative disclosure.

Another reason for the increase in using narratives in accounting communication is the principles-based approach to standard setting. According to this approach, accounting standards are not designed to regulate the accounting treatment of all possible particular phenomena or events (as it is in case of the rules-based standards), but rather to indicate general principles focused on achieving accounting objectives. The application of the principles-based standards in the preparation of financial statements requires regular use of professional judgment, and hence the use of verbal descriptions in order to explain accounting policies and all underlying assumptions and estimations to the information users.

Not only the financial reporting standards strengthen the role of narratives in the process of accounting. This is also the case of particular professional accounting bodies regulations. The Global Management Accounting Principles (GMAP) issued in 2014 by two international professional bodies—Chartered Institute of Management Accountants (CIMA) and American Institute of Certified Public Accountants (AICPA)—may serve as a glaring example. The document was designed to guide management accounting practice and includes four principles: Communication provides insight that is influential; Information is relevant; Impact on value is analysed; and Stewardship builds trust. According to CIMA and AICPA (2014, p. 6), "numbers usually require explanation [and] management accounting helps organizations translate numbers into meaningful narrative analysis". The GMAP stresses the importance of verbal description in management accounting reports as narratives make the accounting information more understandable for its users.

The next reason for the increasing use of verbal descriptions in the process of accounting communication is the growing importance of sustainability reporting, which is a natural consequence of the growing importance of sustainable development and the concept of corporate social and environmental responsibility. In recent years several bodies have published documents containing guidelines and principles for organizations interested in reporting social and environmental issues. An illustrative example is the International Integrated Reporting Framework published in 2013 by the International Integrated Reporting Committee (IIRC). According to IIRC (2013, p. 7), "an integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value". Integrated reporting encompasses such elements as organizational overview and external environment, governance, business model, risks and opportunities, strategy and resource allocation, performance, outlook, and basis of preparation and presentation (IIRC, 2013, pp. 24–29). An integrated report contains both quantitative and qualitative information as each provides context for the other. Numbers and indicators need narrative explanation in order to ensure effective communication, whilst narratives need numbers and indicators in order to support and justify the verbal commentary.

What is a common feature for many recent pronouncements made by different accounting and reporting professional bodies, is the focus on communication. This explicit shift from providing information to communicating results in a much greater use of narratives in internal and external reporting. As mentioned above, contemporary regulations and guidelines issued by professional accounting and reporting bodies (e.g. CIMA, AICPA, IIRC) put a lot of emphasis on communication. For example, in 2008 the American Institute of Management Accountants (IMA) published a new definition of management accounting, which undermines the traditional role of management accountants as information providers and stresses their active and partnering role in decision-making. According to IMA (2008, p. 2), management accountants provide the conceptual framework for converting data into information and fulfil the role of a enabler and strategic business partner along the entire information value chain. In turn, CIMA and AICPA (2014, p. 8), define management accounting as "the sourcing, analysis, communication and use of decision-relevant financial and non-financial information to generate and preserve value for organizations". The GMAP strongly emphasize the importance of communication because "management ac-counting begins and ends with conversations" (CIMA & AICPA, 2014, p. 9). By communicating insightful information at all stages of decision-making, processes management accounting leads to better decisions. The method and style of communication should be tailored to the information users, to the decision under discussion and to different decision styles. In order to improve the users' understanding, management accounting should rely largely on explanatory narratives enabling deeper insight into the entity's financial and non-financial position, performance and prospects.

The final reason for why accounting narratives have been gaining importance is related to image creation and impression management. Every entity (be it a company, a manager, a standard setter, a textbook author, a professional body, etc.) is naturally interested in presenting the best possible image of its position, performance and prospects. Brennan and Merkl-Davies (2013) argue that impression management can play a role in restoring reputation, image or legitimacy in times of crisis or change. As far as financial reporting is concerned, this goal may be achieved by using creative or aggressive accounting methods (in the area of measurement, disclosure and presentation of specific items or transactions), what leads to the apparent improvement of the entity's financial position and performance reported in financial statements. Nonetheless, the impression management in accounting communication refers rather to the use of narratives and visuals in order to make and give the desired sense and meaning of the accounting information, and to influence the reader's perception, understanding and (re)actions.

3.2. Narrative financial reporting

As commonly understood, the purpose of accounting is to represent the situation and performance of economic units in numbers. However, accounting has always been, to a greater or lesser extent, related to narrative. Previously, the use of natural language in accounting was limited to explaining the accounting policy by entities and additional explanations to the financial statements. The significance of words in accounting has steadily increased and continues. The current annual reports largely consist of a verbal description.

In the accounting system financial information is expressed and described (Błażyńska, 2014, p. 164). In the specialist language of accounting, the adjective "financial" may indicate connections with the term "finance". The adjective "financial" in accounting can also connote the business financing. In another context, the adjective "financial" may also refer to financial reporting (Masztalerz, 2018b, p. 194).

In most publications concerning narratives in accounting, the presence of text in accounting is associated with reports provided by practice. Quantitative financial results are seldom communicated separately. Information provided to investors by economic units is a combination of quantitative and qualitative information. Annual reports of companies, which contain financial statements presenting information primarily in the form of numbers, also include management reports summarizing the most important events of the past year (Riley & Yen, 2019, p. 2).

Financial narratives have developed in the last decade (Moreno-Sandoval, Gisbert, Haya, Guerrero, & Montoro, 2019, p. 7). One of the first scientists who used the adjective "narrative" in the context of reporting was A.H. Adelberg (Kobiela-Pionnier, 2018, p. 102). In his article "Narrative Disclosures Contained in Financial Reports: Means of Communication or Manipulation?" he pointed out that public companies often influence investors or even manipulate their reactions in order to keep share prices at a satisfactory level or to raise capital at a lower price or on more favourable terms. In his work, he referred to research from the 1960s and 1970s on the readability and understandability of reports (Adelberg, 1979, p. 179).

Although accounting is traditionally numbers-oriented, the role of language in communication in accounting is increasingly noticeable in recent years. The reason is that qualified financial results, such as sales revenue or net profit, are rarely communicated without any other comments. There is often an additional accompanying narrative. Narratives allow entities to elaborate on their financial performance (Riley & Yen, 2019).

Initially, the textual description in practice of accounting was used only in the notes, the part of the financial statements. Over time, reports using narrative accompanying financial statements began to be produced. Currently, the variety of forms of narrative reports and the scope of information disclosed there is growing.

Accounting, in theoretical and practical terms should not be associated only with numbers. In accounting practice, narratives appear primarily in parts of financial statements, management commentaries, social responsibility reports and integrated reports.

Some of the most common additional reports accompanying annual financial statements include:

- activity report;
- economic risk report;
- report on the impact of activities on the natural environment;
- intellectual capital report (Samelak, 2013, p. 118).

The increase in the level of disclosure of information in reports concerning environmental issues was the result of society's increasing expectations of companies to run activities that minimize the negative impact on the natural environment (Dyduch, 2017, p. 34). The scope of disclosure of environmental information (financial and non-financial) in corporate reporting depends mainly on the legal regulations in this area and the information policy of enterprises.

Business reporting needs to go beyond the traditional financial reporting. The end of traditional accounting understood as a system of recording and financial reporting is predicted. "It will lose its current character and will transform into the science of universal economic description, where narrative accounting replaces numerical values" (Kamela-Sowińska, 2014, p. 107).

There is no one generally accepted definition of narrative reporting in the literature (Mazurowska, 2014, p. 246). One of the definitions was presented by PWC (2007, p. 4) who cites it as comprehensive information provided together with financial statements in order to guarantee a better understanding of the entity's activity, its market position, strategy, results and prospects for future. Narrative reporting should therefore be understood as information supplementing the annual financial statements.

Narrative in accounting means the presentation of quantitative or qualitative information that complement the data from the traditional financial statements and appear before it (e.g. management commentary) or after it (all other additional reports). Their primary task is to provide an interpretative context for data on financial situation and performance (Kobiela-Pionnier, 2018, p. 105). The IFRS Management Commentary displays these documents as narrative report which provides interpretations about entity's position and performance. It is intended to extend and supplement the information presented in the financial statements.

Narratives are mainly used to expand and explain information presented in numbers. The textual description allows for a more detailed explanation of the situation and the results of activities of economic units.

The narrative information is generally more understandable than numbers, especially to users who do not have sufficient knowledge of financial data. Therefore the narrative can be a very good way of communication between an entity and its stakeholders.

Figures in a financial statement without descriptions and explanations may not be sufficient for stakeholders. Each enterprise can have some stakeholders who are more interested in some aspects of company's activity or results. If an organisation wants to provide required information, it should add some textual explanations to financial statement or other reports.

The use of narratives in accounting allows to better meet the needs of information users. Thanks to the textual description, this information can be explained in detail and be more understandable. More detailed explanations may increase shareholders' confidence in the information which they receive. By expanding the scope of information and the greater variety of forms of its transmission, stakeholders are more likely to find information that they are interested in.

The most important stakeholders using narrative reports are external users of information, such as investors, state administration institutions or local authorities. Internal users have access to a wide range of information, while for external users it is the narrative reporting that becomes a source of information on, for example, environmental impact or social responsibility. Thanks to narrative reporting, stakeholders can benefit from detailed information and explanations of entities' situation, financial results, plans and forecasts. Recipients of the information receive comprehensive explanations of the entity's situation, activities and future prospects. The narratives also enable reporting in areas such as environmental impact, economic risk or Corporate Social Responsibility.

Narratives provide stakeholders with detailed information and explanations of the entity's situation, financial results, plans and forecasts. Such use of the narrative is assessed positively. However, narrative reporting is criticized for too much freedom, staying out of control and for its use in marketing purposes.

The problem of narrative reports is their comparability. The lack of unambiguous requirements relating to reports using a textual description, the freedom to create them, and lack of a common length makes any attempt to compare them an extremely difficult task.

The reasons for the emergence of the concept of integrated reporting should be seen between others in insufficient financial reporting. Integrated reporting is a combination of financial and non-financial information. The essence of integrated reporting is providing financial and non-financial information to stakeholders. Therefore, the scope of the integrated report is greater than obligatory financial statements. Most of the integrated reports are prepared based on generally applicable standards and guidelines for reporting social responsibility, such as GRI guidelines and the ISO 26000 standard. These documents precisely outline the scope and type of non-financial information that should be disclosed in an integrated report. One must however remember that there are no such guidelines to the financial part of the integrated report (Garstecki, 2015, p. 503).

There are currently no detailed guidelines regarding the type of financial information disclosed in an integrated report. It has also not been settled whether the financial statements and other financial information should be the core of an integrated report, or just one of its many equivalent items (Garstecki, 2015, p. 506).

Accounting narratives are an increasingly important source of financial information. Narratives occupy a significant place in the reports of companies, especially in the annual report. They enable management to present a complex description of financial performance in a way which can be understandable for more recipients.

According to IFRS the financial statements contain financial information. They are not defined explicitly, but indirectly by identifying qualitative characteristics that financial information should have in order to be useful to the recipients of that information. It can be concluded that the mere fact of including information in the financial statements makes it financial information (Błażyńska, 2014, p. 162).

Financial statements are audited by external experts and are subject to control, while narrative reports are far more free and at risk of confusion and manipulation (Balata & Breton, 2005, p. 5). Currently, there are no detailed rules for the preparation of narrative reports that define, *inter alia*, their scope, volume or required information, as is the case with financial statements. There is also no general obligation to examine all narrative reports.

The results of the research by Balata and Breton (2005) suggest that narrative reports and financial statements, generally, present the same view of a situation although some differences can occur when the financial situation is not good. Even if the financial statement contains a loss, the thick, colourful and rich narrative report can suggest something else.

Scientists noticed managers' aversion to disclose bad news which may have an influence on company's value or reputation (Moreno-Sandoval et al., 2019, p. 7).

Other researchers investigated the relationship between readability of narrative accounting disclosure and financial performance (Souz, Rissatti, Rover & Borba, 2018, p. 59). According to that, narrative accounting is more complex when financial performance is worse. Managers can deliberately include complex financial information in narrative reports when performance is unsatisfactory. The complex narratives are sometimes used to hide negative financial information. Complex narratives are more difficult to understand and costlier in analysis. Complicated narrative reports can even discourage readers from reading them.

Accounting narratives are not as regulated and standardised as financial statements so there are a lot of ways to use them to create a positive image of a company. The content of narrative reports can be selectively chosen and help managers to portray a company and its performance in the most positive light.

Entities can change the scope of information disclosed in narrative reports. On one hand, they may omit areas where the information is negative from their point of view. On the other hand, they can display information that they want to share with their stakeholders.

Impression management in accounting narratives can be conducted in two principal ways (Clathworthy & Jones, 2003, p. 182). Usually, good news is more willingly presented than bad news. It should be in line with financial results. On the other hand, companies with less optimistic results do not concentrate on bad news but focus more on good news. Therefore, for less prosperous companies there may be some differences between accounting narratives and financial statements. In general, entities use more positive than negative keywords. The other issue is the explanation of causes of the results. Companies tend to attribute positive results to themselves and negative to the environment.

Narrative reports are intended to show non-financial issues, often uncountable or difficult to measure, and link them to financial results. The narrative is often used by entities as a tool for improving the image. While from the user's point of view, it has a specific financial dimension, which gives better possibilities of assessing the value creation mechanism. To make it possible the narrative must be integrated with the financial data and create a holistic picture of the company's activity (Kobiela-Pionnier, 2018, pp. 122–123).

The information provided shows that the growing scope of the use of narratives in reporting brings undoubted benefits for entities, as well as for information users. Entities can provide stakeholders with information they deem appropriate in an accessible form, while recipients receive comprehensive explanations of the entity's situation, activities and future prospects. However, despite the advantages of using narratives in accounting, one should be aware of the imperfections of such a way of presenting information and the associated risks.

On the basis of the presented content, it is possible to formulate several main postulates regarding narrative financial reporting:

- indication of obligatory narrative reports containing financial information;
- setting the minimum content of financial information in individual narrative reports;
- ensuring the comparability of narrative reports;
- resolving the issue of external control of narrative financial reports.

3.3. Importance of materiality principle in narrative reporting

Accounting principles represent the fundamental rules that have to be used within the whole accounting process (collection—processing—reporting). Some of the accounting principles include the going concern principle, accrual principle, cost principle, objectivity principle, materiality principle, consistency principle, prudence principle, full-disclosure principle, matching principle, principle of purchase price or production cost and substance over form. Over time, some of them proved to be particularly significant so they were given the status of generally accepted accounting principles (GAAP). The materiality principle is one of them.

Previous research showed that financial statements are becoming more extensive (the average length of annual report in UK increased from 26 pages in 1965 to 75 pages in 2004 (Beattie, Dhanani, & Jones, 2008), while Deloitte UK reported that its average length in 2016 was 155 pages) (Rep, 2020). In that context, the IASB has started the initiative entitled *Better Communication in Financial Reporting* in order to examine the existing problems in financial reporting and to find applicable solutions. In the beginning of the initiative, in 2012, the IASB conducted a research which led to the conclusion that financial statements do not contain enough relevant information, contains too much irrelevant information, and that there is a poor communication of disclosures (IASB, 2013, p. 35). An insufficient application of professional accounting materiality judgment is considered to be one of the main causes of the disclosure problem. Accordingly, the IASB started the project Disclosure Initiative which has been separated in several areas. One of the projects that directly focused on the materiality principle was the *Definition of Material (Amendments to IAS 1 and IAS 8)*. In order to spread and strengthen the awareness of the importance of materiality principle and to simplify its application, the IASB clarified and aligned the terms and the definition of materiality in the IFRSs and revised the *Conceptual Framework for Financial Reporting* to help improve consistency in the application of the materiality concept.

According to the IASB definition stated in the *Conceptual Framework*:

> Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial

> reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation (IASB, 2018, par. 2.11).

Although the IFRSs present the fundamentals for financial reporting and disclosure requirements, they also require some non-financial disclosures. Furthermore, preparers of both financial and non-financial statements should consider materiality principle and use their professional judgment when disclosing information. Reports that contain irrelevant information do not meet stakeholders' needs (e.g. disclosure of accounting policies related to assets that the enterprise does not possess or defining the accounting categories in the notes already defined by the accounting standards). Likewise, reports that do not contain enough relevant information also do not meet all the stakeholders' needs. Narrative reporting in both financial and non-financial reporting should be based taking into account the materiality principle. Immaterial and generally known information increases only the length of report but decreases its quality. The length of report is not necessarily positively correlated with the quality of information disclosed. Reports that contain immaterial (irrelevant) information alongside relevant information require more attention of users, who might think that company wants to hide some information by disclosing immaterial information. Even worse scenario is disclosure of only immaterial (irrelevant, generally known) information without disclosing relevant information that stakeholders seek.

Nowadays, there are numerous examples of excellent narrative financial and non-financial reports, as well as a multitude of bad ones. The reason lies in the fact that most SMEs do not recognize benefits of such narrative financial and non-financial reporting. In addition, for most micro enterprises costs related to preparation of narrative reports overcome their benefits since most of micro enterprises are family businesses and do not perceive the benefits of reporting, in contrast to large, public, and multinational companies. Most micro enterprises do not perceive benefits of financial and non-financial reporting. However, there is a great potential of both financial and non-financial information to manage an enterprise in a more effective way and to make better business decisions.

In order to facilitate reporting process for micro enterprises, Directive 2013/34/EU allows member states to exempt them, alongside other simplifications, from the obligation to prepare notes to the financial statements as long as certain information is disclosed at the foot of the balance sheet (art. 36, 1. (b)). Not many member states transposed that possibility into their national legislation since micro entities present a major share in the economies. By doing so, a great information potential would be lost since in most economies micro entities make around 90%

of all entities. The problem of disclosing too much irrelevant information and not enough relevant information is also present in large companies. The IASB is still looking for a solution on how to motivate preparers to use professional judgment when it comes to the materiality principle. One idea that had been floated, but not brought into active use is the creation of a new standard which would contain only disclosure principles. By creating a standard such as that, preparers would have all the disclosure requirements set in one place, which could be a road map for drawing the notes. On the other hand, micro and small entities would even more benefit if the notes would be standardized in prescribed form, but considering the materiality of information disclosed.

To conclude, preparers have to be aware that users expect relevant information disclosed in the narrative reports to be able to make business decisions. All the reports, financial and non-financial, have to give a true and fair view of the business.

Task

Choose a well-known and long-lasting public company. Go to its corporate website and enter the “Investor Relations” or “For Investor” section. Compare the information presented by the company in the last year and (for instance) 10 or more years ago. Compare the scope of reporting (financial and non-financial, e.g. CSR reports, integrated reports, sustainability reports). Compare the length of the reports and their sections, like accounting policy or notes to the financial statements. Look at the forms of presentation (narratives and visuals). Do you see the difference? Can you explain why it is so?

Questions

1. List at least three examples of narrative reports.
2. Explain the goals of narrative financial reporting.
3. Identify the benefits of narrative financial reporting and the risks associated with it.
4. What are the main problems regarding the content of financial statements?
5. Application of which generally accepted accounting principle is necessary for the disclosure of significant information specific to the reporting company?
6. Explain the meaning of materiality principle and why is it important in the process of preparation of narrative reports.

References

Adelberg, A. H. (1979). Narrative disclosures contained in financial reports: Means of communication or manipulation?. *Accounting & Business Research*, *9*, 179-190.
Balata, P., & Breton, G. (2005). Narratives vs numbers in the annual report: Are they giving the same message to the investors?. *Review of Accounting and Finance*, *4*(2), 5-25.
Beattie, V. (2014). Accounting narratives and the narrative turn in accounting research: Issues, theory, methodology and a research framework. *The British Accounting Review*, *46*(2), 111-134.
Beattie, V., Dhanani, A., & Jones, M. (2008) Investigating presentational change in UK annual reports: A longitudinal perspective. *Journal of Business Communication*, *45*(2), 181-222.
Błażyńska, J. (2014). Informacja finansowa w społeczeństwie informacyjnym. *Zeszyty Naukowe Uniwersytetu Szczecińskiego. Finanse, Rynki Finansowe, Ubezpieczenia*, *69*, 157-165.
Brennan, N. M., & Merkl-Davies, D. M. (2013). Accounting narratives and impression management. In L. Jack, J. Davison & R. Craig (Eds.), *The Routledge companion to accounting communication* (pp. 109-132). London: Routledge.
CIMA & AICPA. (2014). Global management accounting principles. Retrieved August, 2020 from http://www.cgma.org/Resources/Reports/DownloadableDocuments/global-management-accounting-principles.pdf
Clatworthy, M., & Jones, M. J. (2003). Financial reporting of good news and bad news: Evidence from accounting narratives. *Accounting and Business Research*, *33*(3), 171-185.
Directive 2013/34/EU of the European parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC. Retrieved September, 2020 from https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN
Dyduch, J. (2017). Zmiany poziomu ujawnień środowiskowych informacji finansowych w raportach rocznych wybranych spółek publicznych. *Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu*, *479*, 34-43.
Garstecki, D. (2015). Zakres ujawnianych informacji finansowych w raporcie zintegrowanym wybranych przedsiębiorstw. *Zeszyty Naukowe Uniwersytetu Szczecińskiego, Finanse, Rynki Finansowe, Ubezpieczenia*, *77*, 503-512.
IASB. (2013). *Discussion forum-financial reporting disclosure. Feedback statement*. Retrieved September, 2020 from https://www.ifrs.org/-/media/project/disclosure-initative/feedback-statement-discussion-forum-financial-reporting-disclosure-may-2013.pdf
IASB. (2018). *Conceptual framework for financial reporting*. Retrieved September, 2020 from http://eifrs.ifrs.org/eifrs/bnstandards/en/framework.pdf
IIRC. (2013). *The International Integrated Reporting Framework*. Retrieved August, 2020 from http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf
IMA. (2008). *Statements on management accounting: Definition of management accounting*. Retrieved August, 2020 from http://www.imanet.org/docs/default-source/thought_leadership/transforming_the_finance_function/definition_of_management_accounting.pdf
Jack, L., Davison, J., & Craig, R. (2013). The power of accounting communication. In L. Jack, J. Davison, R. Craig (Eds.), *The Routledge companion to accounting communication* (pp. 3-6). London: Routledge.
Kamela-Sowińska, A. (2014). Od rachunkowości do opisu gospodarczego. *Zeszyty Teoretyczne Rachunkowości*, *77*(133), 107-115.

Kobiela-Pionnier, K. (2018). Opowiedzieć historię. Rola narracji w sprawozdaniu zintegrowanym – studium przypadku Novo Nordisk A/S. *Studia i Prace Kolegium Zarządzania i Finansów*, *163*, 99-126.

Masztalerz, M. (2016). Why narratives in accounting? *Research Papers of Wrocław University of Economics*, *434*, 99-107.

Masztalerz, M. (2018a). Komunikacja w rachunkowości – aspekty językowe. Poznań: Wydawnictwo Uniwersytetu Ekonomicznego w Poznaniu.

Masztalerz, M. (2018b). Co oznacza „finansowy" w rachunkowości?. *Zeszyty Teoretyczne Rachunkowości*, *98*, 185-202.

Mazurowska, M. (2014). Idea sprawozdawczości narracyjnej. *Studia Prawno-Ekonomiczne*, *91*(2), 241-257.

Merkl-Davies, D. M., & Brennan, N. M. (2011). A conceptual framework of impression management: New insights from psychology, sociology, and critical perspective. *Accounting and Business Research*, *41*(5), 415-437.

Moreno-Sandoval, A., Gisbert, A., Haya, P., Guerrero, M., & Montoro, H. (2019). Tone analysis in Spanish financial reporting narratives. *Linköping University Electronic Press*, 42-50. Retrieved September, 2020 from https://www.aclweb.org/anthology/W19-6406.pdf

PWC. (2007). *Narrative reporting. Give yourself a head start*. Retrieved September, 2020 from https://www.pwc.com/gx/en/audit-services/corporate-reporting/assets/pdfs/narrative-reporting.pdf

Rep, A. (2020). *Impact of disclosure requirements changes on the improvement of financial reporting model*. (Unpublished doctoral thesis). Zagreb: Faculty of Economics and Business, University of Zagreb.

Riley, T. J., & Yen, A. C. (2019). *Accounting narratives. Oxford Research Encyclopedia of Business and Management*. Retrieved September, 2020 from doi:10.1093/acrefore/9780190224851.013.169

Samelak, J. (2013). *Zintegrowane sprawozdanie finansowe przedsiębiorstwa społecznie odpowiedzialnego*. Poznań: Wydawnictwo Uniwersytetu Ekonomicznego w Poznaniu.

Souza, J. A. S., Rissatti, J. C., Rover, S., & Borba, J. A. (2018). The linguistic complexities of narrative accounting disclosure on financial statements: An analysis based on readability characteristics. *Research in International Business and Finance*, 59-74.