

Comments On Clarity and Conciseness of Financial Narrative Disclosures: Does the Practice Statement Matter?

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- The paper investigates whether the implementation of IFRS influences the clarity and conciseness of management commentary.
- It reveals a decline in the clarity and conciseness of narratives when firms adopt IFRS.

01

Contribution and Further Elaboration

- Assessing whether the observed textual complexity associated with IFRS annual reports is a function of the disclosure of more complex words in the reports, consistent with the exposure draft recommendations (page 1).
- Distinguishing itself from existing research on IFRS and complexity/readability measures. ... explores how IFRS adoption influenced the textual characteristics of management commentary as identified by ED 2021/6. (page 2).
- Examining not only the initial impact of adopting IFRS but also studying the persistence of complex narratives over time (page 3).

I agree authors' views.

Management commentary is defined as:

*"A narrative report that **relates to financial statements** that have been prepared in accordance with IFRSs....."*

Accounting standards are becoming increasingly complex:

- China has a voice: the significance of accounting standards is being lost.
- We should follow the law instead of accounting standards because the law places more emphasis on facts.

I disagree with the above statement, but it indicates that people in China are concerned about the complexity of accounting standards.

Data

- pre-IFRS (2000-2004) and post-IFRS (2006-2010)
- Sample from the UK FTSE all-share index

Further Elaboration--should consider the main or difficult standards during 2006-2010

IFRS 2 *Share-based Payment* Share-based Payment--- Effective from 1 January 2005

IFRS 3 *Business Combinations* Business Combinations--- amended versions of [IAS 36](#) and [IAS 38](#) ---Effective for business combinations for which the agreement date is on or after 31 March 2004

IFRS 4 *Insurance Contracts* Insurance Contracts---Effective from 1 January 2005

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* Non-current Assets Held for Sale and Discontinued Operations---Effective from 1 January 2005

IFRS 6 *Exploration and Evaluation of Mineral Resources* Exploration for and Evaluation of Mineral Resources---Effective from 1 January 2006

IFRS 7 *Financial Instruments: Disclosures* Financial Instruments: Disclosures---Effective from 1 January 2007

IFRS 8 *Operating Segments* Operating Segments---Effective from 1 January 2009, superseding [IAS 14](#)

Further Elaboration--should consider the main or difficult standards during 2006-2010

➤ Although the authors have mentioned in the introduction

[The 20 years of IFRS have seen several changes including the introduction of key standards such as IFRS 9 (Financial Instruments), IFRS 15 (Revenue from Contracts with Customers), and IFRS 16 (Leases) that have reshaped how companies report their financials. These standards have led to an increase in accounting complexity. Other notable changes are impairment testing and fair value measurement. These changes brought with them additional levels of complexity.]

➤ I think it would be better to consider those standards in the empirical context.

02

Hypothesis Development

(1) The hypothesis requires more elaboration.

- In the “Theoretical framework and hypothesis development” section, the paper argues that *[Therefore, the adoption of International Financial Reporting Standards (IFRS) might be expected to reduce complexity by providing clearer financial statement numbers and narratives, assuming the standards are of high quality. However, managers may have incentives to increase textual complexity to obscure negative information from investors, despite the increased transparency brought by IFRS adoption]* (page 7).
 - The statement indicates that IFRS adoption would reduce complexity, but managers are motivated to increase textual complexity.

(1) The hypothesis requires more elaboration.

- Then, the paper mentions that [*However, successful mandatory adoption of IFRS should enhance the uniformity and transparency of financial reports, potentially reducing earnings manipulation and increasing informativeness and comparability*] (page 7).
 - The statement indicates that IFRS adoption would suppress managers' motivation of obfuscation and thus reduce complexity.
- Overall, IFRS adoption will **reduce** the complexity of reporting.

(1) The hypothesis requires more elaboration.

- The discussion on the increased complexity resulting from IFRS adoption is given little emphasis.
 - The paper states that *[However, there may be an increase in the complexity of disclosures due to the increased disclosure requirements and complexity of transactions reported under IFRS]* (page 7).
- However, the subsequent conclusions and hypotheses indicate that IFRS adoption **increases** disclosure complexity.
 - Hypothesis 1 (H1): *[Narrative disclosures associated with IFRS adoption increase the level of complexity, leading to decreased clarity and conciseness in financial disclosures]* (page 8).

(1) The hypothesis requires more elaboration.

- I recommend refining the discussion of how IFRS adoption **increases** complexity and ensuring logical clarity.
- In this way, the hypothesis can be better supported.

(2) Distinguish between two theoretical viewpoints

- Bushee et al (2018) distinguish between two theoretical viewpoints regarding textual complexity:
 - *the information viewpoint*: informative technical disclosure about the business
 - *the obfuscation viewpoint*: linguistic complexity intended to reduce the informativeness of the disclosure
- After introducing the two theoretical viewpoints proposed by Bushee et al (2018), the authors mention that *[While we did not directly test these theories, we aim to develop expectations about the relationship between IFRS adoption and narrative complexity based on these viewpoints]* (page 7).

(2) Distinguish between two theoretical viewpoints

- It is necessary / more interesting to distinguish between these two theoretical viewpoints.
 - The paper explores how the IFRS adoption affects the clarity and conciseness of Management Commentary, in response to whether we support the proposals outlined in Chapter 13 of the exposure draft, with a focus on 'Clarity and Conciseness'.
 - If a decrease in clarity and conciseness is caused by the obfuscation viewpoint, the proposals should be agreed upon. However, if the increase in complexity is due to the information viewpoint, it is debatable whether it is necessary to focus on 'Clarity and Conciseness'.

(3) Discussion about management motivation

- The paper mentions that *[If the management obfuscation hypothesis holds true, then complexity would be higher in poorly performing firms, as managers may make bad news difficult to discern]* (page 7).
- It would be more interesting to incorporate an analysis of management incentives in the empirical examination.
- The IFRS adoption has varying impacts on corporate disclosure among companies with different management motivations.

03

Research Design

(1) The changes in IFRS after 2004

- The paper did not pay attention to the changes in IFRS after 2004, some of which led to an extreme increase in accounting complexity, such as impairment testing of goodwill, fair value method in share-based payment accounting, and so on.
- I suggest excluding those changes in the accounting standards factor to test the hypothesis.
 - The authors could put the number and complexity of accounting standards changes as control variables which also can affect complexity.

(2) Company fixed effects

- It is imperative to incorporate company fixed effects in the model when examining the impact of policy implementation (IFRS adoption).

Overall, it is a good topic and interesting paper.

Thank You

