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Discretionary Accounting Narratives in Contemporary Corporate Reporting: Review and Framework

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ABSTRACT

This paper reviews prior research on discretionary accounting narratives, adopting a preparer perspective. We develop an analytical framework to organize our review which classifies prior research according to three components: antecedents, characteristics, and consequences of disclosures. We first overview our framework. We then discuss each framework component. Antecedents comprise the external context and internal environment. The paper addresses multiple discretionary accounting narrative characteristics. Consequences comprise share price reaction studies, experimental studies of users' responses to discretionary accounting narratives, and firm consequences such as corporate reputation, image, legitimacy and trust. We conclude the paper with an extensive agenda for future research.

Keywords: Discretionary disclosure; Accounting narratives; Financial reporting; Corporate reporting; Communication.

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1. Introduction

Some view accounting narrowly as a technical practice focusing on recording economic transactions via financial statements for financial decision-making. However, Carnegie, Parker and Tsahuridu (2021: 69) conceptualize accounting as

> "a technical, social and moral practice concerned with the sustainable utilisation of resources and proper accountability to stakeholders to enable the flourishing of organisations, people and nature."

Thus, accounting involves measuring, processing, and communicating financial and non-financial information. Accounting communicates quantitative and qualitative information in a range of formats (i.e., financial statements, corporate reports, corporate press releases, etc.) and media (i.e., corporate websites, social media, etc.) by organizations to external audiences (i.e., shareholders, stakeholders, financial analysts, the media, etc.), to either comply with legal or stock exchange requirements or voluntarily.

Brennan and Merkl-Davies (2018) and Merkl-Davies and Brennan (2011) conceptualize, and Merkl-Davies and Brennan, (2007) and Brennan and Merkl-Davies (2013) review, research on discretionary accounting narratives. Corporate reports, such as regulated annual reports (including the financial statements), initial public offering prospectuses, takeover documents, half-yearly and quarterly reports and stock exchange regulatory news announcements include discretionary information in narrative format, i.e., accounting narratives. While these documents are regulated, there is considerable scope for discretion concerning narrative disclosures. Discretionary accounting narratives amplify or complement quantitative information, especially in the audited financial statements, and provide both financial and non-financial information. Davison (2011) calls these discretionary accounting narratives the "paratext" or "surround" to the audited financial statements. Auditors restrict audit report scope to the financial statements and the notes therein. Auditors are careful to make that scope limitation clear in the precision with which they word their audit reports. Even though audited financial statements contain accounting narratives, most prior research focuses on accounting narratives outside the audited financial statements. We use the term "discretionary accounting narratives" to distinguish them from accounting narratives supporting numerical information in audited financial statements.

We develop an analytical framework (see Figure 1) to organize our review. To categorize prior research on discretionary accounting narratives, we adapt Wiedman's (2000) three-component framework: disclosure environment, disclosure attributes and disclosure impacts, which we label antecedents, characteristics, and consequences. In developing her framework, Wiedman

(2000) draws on Gibbins et al. (1990, 1992) innovative studies applying grounded theory to theorizing financial reporting. Hirst et al. (2008) and Rakow (2010) (using Hirst et al.'s (2008) approach) apply Wiedman's (2000) framework to earnings forecast disclosures. We first overview our framework. We then discuss each framework component. Antecedents comprise the external context and internal environment. The paper distinguishes the dichotomy in accounting research between "discretionary disclosures" quantitative studies in the North American tradition and qualitative "discretionary accounting narratives" studies in the European tradition. Consequences in the discretionary disclosures steam of research comprise share price reaction studies and experimental studies of users' responses to certain disclosures. Consequences for discretionary accounting narratives include corporate reputation, image, legitimacy and trust. We conclude the paper with an extensive agenda for future research.

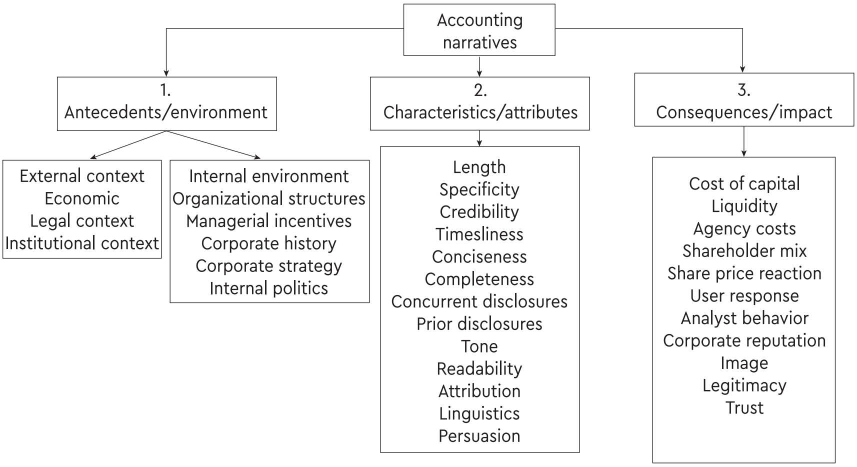
Accounting research uses the term "reporting" (e.g., annual reporting, corporate reporting, corporate social reporting (CSR)), which refers to corporate financial, social and environmental discretionary accounting narratives outside the financial statements to external audiences. The term "reporting" derives from Latin *re* (back) and *portrare* (to carry, to bring), i.e., to carry/bring back. This wording implies that corporate reporting purpose is to relay or convey information about events and effects from which the "accounting actor" is removed (Lee, 1982: 158). This perspective regards the process as a "neutral conduit for transmitting independently existing information" (Craig, 2007: 127). Theoretical accounting literature adopts the term "accounting communication" to highlight the dynamic and reciprocal aspects (i.e., two-way dynamic interactive communication between organizations and their audiences), oral (e.g., conference calls, CEO speeches and media interviews) and non-traditional forms of communication (e.g., social media). In reviewing prior research, we include studies from the two traditions.

Research on discretionary accounting narratives has grown. As mentioned earlier, two research streams, based on different research perspectives, have developed concurrently. North American-style disclosure research views accounting information as an economic good and applies economic and psychological theories to explain motivations and demands for and responses to accounting communication. Such researchers view accounting communication as providing decision-relevant information to capital market participants in the context of information asymmetry and potential agency conflicts between company managers and investors. This disclosure research stream is mainly quantitative and focuses on information content, quantity, quality (particularly readability) or frequency of disclosures. By contrast, European-style narrative research draws on diverse theories from various academic disciplines, sociology, media studies, linguistics, etc., to explore meaning-related aspects of accounting communication, including storytelling, sensemaking and discourse (Merkl-Davies & Brennan, 2017). This discretionary accounting narratives research stream uses various qualitative methods, such as rhetorical or visual analysis or critical discourse analysis, and focuses on accounting communication by a wide variety of organizations, including listed companies, public-sector and not-for-profit organizations, such as charities, social movements, and non-governmental organizations (NGOs). This research stream adopts a broad view of the purpose of accounting communication as providing relevant information to various external audiences, discharging accountability to both stakeholders and society, and a means of legitimation and managing conflict in society (Merkl-Davies & Brennan, 2017).

1.1 Framework

Figure 1 shows the framework which structures our paper. Our framework comprises three components: Antecedents/environment, characteristics/attributes and consequences/impact. Wiedman (2000: 663) describes the "disclosure environment" as "characteristics of the environment in which disclosure decisions are made". "Disclosure attributes" relate to the actual disclosures made, "such as type, frequency, timeliness, and credibility". "Disclosure impact" includes the effect on corporate elements such as cost of capital, liquidity, agency costs, and shareholder mix. In applying Wiedman's (2000) framework to management forecasts, Hirst et al. (2008: 316) extend these conceptualizations. Antecedents are environmental and firm-specific characteristics such as the legal setting and managerial incentives that influence disclosure. Disclosure characteristics include form, forecast horizon and level of detail in forecasts. Finally, they identify consequences such as stock price changes and analyst behavior. Consequences comprise decision-making by corporate audiences (e.g., analyst recommendations, press coverage) and feedback effects (e.g., cost of capital, liquidity, and corporate image, reputation and legitimacy).

Figure 1: Framework for analysing accounting narratives prior research



2. Theories on accounting narratives

Wiedman (2000) does not consider theory in her discussion. Hirst et al. (2008) observe that existing theories focus on *why* managers choose to disclose and the consequences of those decisions, concluding that theories primarily address antecedents and consequences. They highlight opportunities to develop theory on managerial choices concerning disclosure characteristics, noting how few studies examine *how* managers *choose* disclosure characteristics.

We present five broad theoretical perspectives on accounting narratives, namely the economic perspective, (Section 2.1), the psychological perspective, (Section 2.2) the sociological perspective, (Section 2.3) the critical perspective (Section 2.4), and the rhetorical and linguistic perspective (Section 2.5). The economic and psychology perspectives explain the antecedents of discretionary accounting narratives by focusing on managerial motivations. By contrast, the sociological and the critical perspectives focus on environmental factors, such as the legal, economic, and institutional context. Finally, the rhetorical and linguistic perspective explains the characteristics of discretionary accounting narratives.

2.1 Economic perspective

Agency theory

Agency theory (Jensen & Meckling, 1976) provides the basis for the economic incentives' approach to disclosure choice. Agency theory explains managerial motives where firm ownership (principal/shareholder) is separated from the control function, which managers (agents) carry out, acting on behalf of shareholders (Beattie, 2014). Principals can limit divergences from their interests by establishing appropriate incentives for agents and by incurring monitoring costs designed to limit agents' aberrant activities. Monitoring costs include auditing, control systems, budget restrictions and incentive compensation systems to align managers' and shareholders' interests more closely. Expenditure on monitoring can reduce agency costs, such as publication of accounting reports. Firm disclosures can serve as a monitoring mechanism for the agency relationship between managers and shareholders. Managers benefit from producing accounting information voluntarily because they can do so at a lower cost than if shareholders were to produce the same information. Thus, agency theory posits that voluntary disclosure/discretionary accounting narratives function to reduce agency costs. Conversely, agency theory predicts that managers are opportunistic in their disclosure choices and are motivated by self-interest and the firm performance they wish to portray.

The dominant theoretical perspective in discretionary accounting narrative research is agency theory. However, agency theory has limitations and drawbacks.

Much disclosure research is premised on the *mala fides* assumptions of agency theory. Managers are assumed to be self-interested or, as Heslin and Donaldson (1999: 81) say, managers will “steal the silver” unless incentivized to do otherwise. Brennan (1994: 38) objects to the cynicism of agency theory. He says that Jensen and Meckling‘s (1976) agency theory model “rests on the assumption that the manager will steal what he does not own, so that it is probably more efficient to give it to him at the outset rather than put him to the trouble of stealing it.” (Brennan, 1994: 36-37). Brennan wryly conjectures that managers with such a disposition probably need to be replaced rather than tolerated in organizations! These assumptions about human behavior and what motivates people have become widely accepted in business, so much so that some authors conjecture that agency theory is auto-suggestive, is a self-fulfilling prophecy, thereby contributing to low moral standards in business. As Alvesson and Kärreman (2011: 1136) observe:

> “… the issue of theories having truth effects, i.e., becoming self-fulfilling prophecies … with the problematic aspects of economic theories producing truth effects – like the assumption of individuals maximizing their self-interest leading to people doing that…”.

Signaling theory

Signaling theory (Morris, 1987; Spence, 1974) posits that managers of higher-quality firms can credibly communicate private information to investors and thereby receive above-average market valuation by undertaking actions that lower-quality firms find too costly to mimic. Managers of higher-quality firms have incentives to signal to the market their higher quality to distinguish themselves from average or lower quality firms. One form of signaling is voluntary disclosure about firm operations. Firms with superior information decide on the level of disclosure, considering the impact on the market and on competitors. The only way informed firms can communicate their prospects to capital markets is by disclosing information of direct usefulness to competitors. Firms, therefore, face a trade-off in their disclosure decisions.

2.2 Psychology perspective

Research in social psychology provides an alternative perspective on why and how managers provide voluntary information. It explains managerial bias by differentiating between deliberate bias and ego-centric bias or self-deception. Whereas the former constitutes “a deliberate attempt to distort one’s responses in order to create a favorable impression with others,” the latter is “a dispositional tendency to think of oneself in a favorable light,” (Barrick & Mount, 1996: 262). Self-deception is a cognitive bias arising because individuals do not behave perfectly rationally. In a financial reporting context, this manifests in managerial bias –

optimism/overconfidence/hubris – that entails managers overestimating their abilities. Hubris involves portraying the firm in a positive light driven by irrational managers displaying behavioral biases, such as optimism and overconfidence. This managerial optimism (hubris) assumption is widespread in research in explaining the motives for mergers. Scholars have adopted hubris to explain the reporting bias inherent in discretionary accounting narratives (e.g., Brennan & Conroy, 2013).

Attribution theory

Attribution theory is concerned with people's explanations of events. Research suggests that people's attribution of actions and events is biased because they tend to take credit for positive and deny responsibility for negative events and outcomes (Knee & Zuckerman, 1996: 78). Self-serving bias entails attributing positive organizational outcomes to internal factors (taking credit for good performance) and negative organizational outcomes to external circumstances (assigning blame for bad performance), to influence investors' perceptions of financial performance (Aerts, 1994, 2001; Aerts & Cheng, 2011; Clatworthy & Jones, 2003; Hooghiemstra, 2010).

Clatworthy and Jones (2003) examine differences in reporting good/bad news in UK listed firms' chairmen's statements with improving/declining performance. Irrespective of financial performance, they find that firms take credit for good news and blame the external environment for bad news. Hooghiemstra (2010) compares explanations of the causes of good/bad news in US and Japanese CEO letters to shareholders. They find cross-cultural differences in performance attributions. Both US and Japanese CEOs claim responsibility for good news. However, Japanese CEOs are more prone to ascribe bad news to external circumstances beyond their control. Merkl-Davies et al. (2011) view managerial behavior as subject to social biases arising from the (imagined) presence of organizational audiences whose behavior management tries to anticipate. Their analysis of UK chairmen's statements focuses on the linguistic manifestations of the psychological processes underlying corporate reporting processes, characterized by the managerial anticipation of the feedback effects of information. Managers use discretionary accounting narratives in chairmen's statements to engage in sensemaking through retrospective framing of organizational outcomes.

However, just as in the economic perspective, organizational actors are regarded as responding to an objective external reality through strategic goal-oriented behavior. Research from the economic perspective conceptualizes some discretionary accounting narratives as management introducing reporting bias into corporate narrative documents to benefit from increased compensation, particularly via managerial stock options (Adelberg, 1979; Courtis, 2004; Rutherford, 2003). By contrast, research from the psychological perspective conceptualizes accounting narratives introducing reporting bias as self-serving bias arising from the anticipation of an evaluation of organizational performance by shareholders and stakeholders to obtain rewards and avoid sanctions (Frink & Ferris, 1998).

2.3 Sociological perspectives

Environments put two types of demands on organizations: (i) technical, economic and physical demands that require organizations to produce and exchange goods and services in a market; (ii) social, cultural, legal, or political demands that require organizations to play particular roles in society and to establish or maintain certain outward appearances. In contrast to the economic and the psychological perspectives, the sociological perspective considers "the social conditions and interconnections in making choices" (Letza et al., 2008: 24). The behavior and actions of organizational actors are regarded as driven by social constraints and structures. This approach analyzes social practices, such as discretionary accounting narratives. Discretionary accounting narratives are regarded as being motivated by the demands and expectations of organizational audiences. For example, this entails (seemingly) responding to the concerns and demands of various stakeholder groups (stakeholder theory) or (seemingly) demonstrating conformity with social norms and rules (legitimacy theory and institutional theory).

Stakeholder theory

Stakeholder theory includes other relevant parties interested in the operations of companies. The theory is premised on the notion of the firm as a legal or artificial person operating in a community, and on the view that "there should be some explicit recognition of the well-being of other groups having a long-term association with the firm – and therefore an interest, or stake, in its long-term success" (Keasey, Thompson & Wright, 1997: 9). Stakeholder theory regards firm corporate reporting as a response to the demands and expectations of various stakeholders, such as employees, customers, government agencies, lobby groups, etc. Firms are assumed to engage in narrative reporting to influence the perceptions of particular stakeholder groups. Hooghiemstra (2000) shows how Shell, after abandoning its plans to sink the Brent Spar oil rig in the Atlantic, engaged in a dialogue with its key stakeholder groups to change their perceptions.

Legitimacy theory

Underlying legitimacy theory is the notion of the firm engaging in a social contract with society. Consequently, survival depends, to some extent, on operating within the bounds and norms of society. From this perspective, corporate narratives are not a proactive strategy proposed by agency based approaches, but are responses to organizational audiences' concerns and demands. Within legitimacy theory, disclosures (particularly social and environmental disclosures) are assumed to alter perceptions of organizations' legitimacy. For example, corporate social disclosures are regarded as a response to public pressure and increased media attention. Campbell (2000), Hooghiemstra (2000), Ogden and Clarke (2005), Linsley and Kajüter (2008), and Aerts and Cormier (2009) apply legitimacy theory to analyze corporate narratives in a corporate reporting context. They regard corporate narratives as attempting to affect organizational audiences' perceptions of the company (Hooghiemstra, 2000; Aerts & Cormier, 2009) to restore legitimacy or satisfy stakeholder demands.

In a longitudinal study of the retailer Marks & Spencer's annual reports, Campbell (2000) applies legitimacy theory to investigate how the firm used corporate social narrative disclosures to manipulate outsiders' perceptions of the firm. He suggests that successive chairmen used corporate social disclosures as a means of reality construction. Using legitimacy theory, Hooghiemstra (2000) analyzes Shell's strategies in its corporate communications to handle the public controversy regarding its plans to sink the Brent Spar oil rig in the Atlantic in 1995. Ogden and Clarke (2005) use legitimacy theory to analyze the strategies used in the annual reports of privatized UK water companies. Focusing on environmental disclosures, Aerts and Cormier (2009) argue that managers manage perceptions of firm environmental performance through environmental disclosures in annual reports and environmental press releases that represent predictable legitimation opportunities. Different forms of verbal accounts affect legitimacy by attenuating organizational responsibility for controversial events and accentuating such events' positive aspects. Linsley and Kajüter (2008) use legitimacy theory to analyze the annual report of Allied Irish Banks plc following a fraud. They focus on using symbolic management in the form of defensive strategies and decoupling to restore firm reputation and legitimacy.

Organizational legitimacy is regarded as a social construct because it is subjectively perceived and ascribed to an organization's actions and outcomes (Palazzo & Scherer, 2006: 71). Prasad and Mir (2002) argue that the manipulation of meaning in CEO letters to shareholders by oil companies in the 1970s and 1980s served to deflect from the crisis of legitimacy in the oil industry. However, they base their analysis on a non-rational view of organizational actors' actions and adopt a critical stance.

Institutional theory

Institutional theory suggests that firms adopt social norms by emulating the practices of other firms to reduce attention from economically powerful stakeholders. Institutional theory examines whether firms engage in mimetic isomorphism (i.e., copying the behavior or reporting strategies of other firms, such as industry leaders) (see DiMaggio & Powell, 1983).

Arndt and Bigelow (2000) use institutional theory to analyze the annual reports of US hospitals, applying narrative reporting strategies to invoke coercive and mimetic pressures to account for a major structural reorganization. In this context, narratives are conceptualized as symbolic management (legitimacy theory) or decoupling (institutional theory). Symbolic management entails adopting strategies that make the organization *appear* to respond to stakeholder concerns or *appear* to be congruent with society's norms and expectations (Ashforth & Gibbs, 1990). Firms facing a major legitimacy threat engage in symbolic management by separating the negative event (e.g., fraud, scandal, product safety issue) from the organization as a whole by providing normalizing accounts (e.g., by using excuses, apologies, or justifications) and by engaging in strategic restructuring (e.g., executive replacement, establishing monitors or watchdogs). Normalizing accounts entail using verbal remedial strategies such as excuses and apologies. Strategic restructuring entails "selectively confess[ing] that limited aspects of its operations were flawed" (Suchman, 1995: 598) and then decisively and visibly remedying them by introducing small and narrowly tailored changes, such as creating monitors and watchdogs and disassociation. Disassociation entails symbolically distancing organizations from negative influences. For example, executive replacement allows organizations to dissociate themselves from legitimacy-threatening events by blaming individuals in organizations. Organizations can also dissociate themselves from de-legitimated procedures and structures.

By contrast, decoupling refers to organizational structures and processes *appearing* to conform to social and institutional norms and rules (DiMaggio & Powell, 1983). Decoupling manifests itself in espousing socially acceptable goals, redefining means as ends, and ceremonial conformity. Espousing socially acceptable goals involves, for example, claiming customer-focus or equal-opportunities' employer status, when, in effect, the opposite is the case. Redefining means as ends involves recasting the meaning of organizational ends or means, for example, by justifying the closure of employee pension schemes based on the introduction of a new accounting standard. Finally, ceremonial conformity entails adopting practices considered consistent with rational management, even though they do not improve organizational practices. For example, public sector organizations introduce private-sector management accounting practices or performance evaluation schemes (see Merkl-Davies & Brennan, 2011).

2.4 Critical perspectives

The critical perspective regards managers as powerful organizational actors who use corporate narrative documents to impose their perspective of their organizations and organizational activities and outcomes (Amernic & Craig, 2004), of specific organizational stakeholders who are in conflict with their organizations or with the industry in which organizations operate (Driscoll & Crombie, 2001; Prasad & Mir, 2002), or of socio-economic and socio-political issues which impact on the activities or reputation of organizations, such as climate change, minimum pay, or human rights (Livesey, 2002). The critical perspective is informed by insights from various critical approaches, including Critical Theory, Marxism and Foucauldian philosophy. Corporate narrative documents are assumed to have ideological effects in the sense that "they can help produce and reproduce unequal power relations between [management and employees, shareholders and stakeholders] through the ways in which they represent things and position people" (Fairclough & Wodak, 1997: 258). Corporate narrative documents are thus used to establish and maintain unequal power relationships in society. Language is regarded as a medium in which prevailing power relations are articulated.

The critical perspective focuses on notions of power and ideology, emphasizing how organizational actors use discretionary accounting narratives to persuade organizational audiences to accept managers' versions of reality or how social structures determine corporate discourse. Adopting an agency perspective, Crowther et al. (2006) analyze ten privatized UK water companies' discretionary accounting narratives. They show how senior managers use binary opposition in discretionary accounting narratives to "control the way in which the corporate story is interpreted" (Crowther et al., 2006: 199). Amernic and Craig (2004) argue that Southwest Airlines' management appropriates symbolic representations in the 2001 letter to shareholders to show their company positively. By contrast, Livesey (2002) analyzes the discourse on climate change in Exxon Mobile's advertorials. She finds that the binary opposites of health/harm are exploited to establish the hegemony of the economic discourse on climate change. Craig and Amernic (2008) analyze the discourse of privatization in Canadian National Railway's annual letters to shareholders. They demonstrate how accounting performance measures and accounting language "have been invoked to show that the vision of the promoters of the privatization has been achieved, and that the decision to privatize has been a sagacious one" (Craig & Amernic, 2008: 1087).

Studies adopting a political economy perspective regard corporate narratives as ideologically biased documents whose main purpose is to maintain the status-quo – as communication vehicles used by "top management [to] impose its perspectives" (Amernic, 1992: 2). In their analysis of the annual reports of the UK water industry, Crowther et al. (2006) use the analogy of corporate reporting as storytelling. Management are the "authors" of narrative corporate report sections that represent "the script of corporate reporting." This constitutes an attempt by the script authors "to control the way in which the corporate story is interpreted" (p. 199). In this vein, various studies demonstrate how corporate leaders use discretionary accounting narratives to imprint their view of reality and thus control outsiders' perceptions of the firm (e.g., Amernic & Craig, 2022; Craig & Amernic, 2021).

2.5 Rhetorical and linguistic theories

Rhetorical and linguistic theories focus on managerial motivations (antecedents) to provide discretionary accounting narratives and the linguistic manifestations of the disclosures (characteristics). Managers choose rhetorical strategies in discretionary accounting narratives to persuade others of the validity and legitimacy of a claim. Managers can use language to attempt to convince organizational audiences of the validity, legitimacy or necessity of organizational changes, to portray financial scandals as isolated incidents, or to persuade organizational audiences of the exceptional circumstances resulting in negative financial performance. Language use in corporate documents is never "innocent" because it is used to achieve various economic, social and political goals and is thus "as ideologically saturated as … text[s] which wear [their] ideological constitution overtly" (Kress, 1993: 174). Thus, discretionary accounting narratives can be viewed as part of "routine" corporate communication managers use to "control the way in which the corporate story is interpreted" (Crowther et al., 2006: 199). Hamilton and Winchel (2018) comprehensively review prior theoretical research explaining how investors process financial communications and are thereby persuaded by the messages.

How organizations respond to their environment depends on how they construct and interpret their environment. Conditions of the environment cannot be separated from perceptions of those conditions. The metaphor of storytelling lies at the heart of the social constructionist perspective. Research in psychology, law, philosophy, and sociology suggests that "social life is itself storied and that narrative is an ontological condition of social life" (Somers & Gibson, 1994: 38). Thus, managers understand their experiences through narrative (Llewellyn, 1999). Corporate narrative documents are regarded as "narratives", i.e., stories through which organizational realities are constructed (Boje, 1998: 1). Based on insights from the social constructionist movement in various disciplines, including sociology and organization theory, organizational actors are assumed to use corporate narrative documents to engage in "sensemaking" (Weick, 1995). Enactment theory (Weick, 1995) assumes that the organizational environment is constructed from intersubjectively shared beliefs about the environment, including beliefs about organizational audiences' perceptions and assessments of organizations. Thus, discretionary accounting narratives may entail managerial attempts to control meaning by creating a "story" from a particular perspective. The focus of analysis is not on specific discretionary accounting narrative strategies, but on how organizational actors use language to create and sustain a particular version of events.

Thomas (1997) analyzes transitivity structures (active and passive) and thematic structures in the letter to shareholders of a firm over five years during which the firm experienced a decline in profitability. She finds that the firm uses language to "positioning [the] company according to the priorities of those who are in control" (Thomas, 1997: 51). Hyland (1998) focuses on metadiscourse in CEOs' letters to shareholders. Linguistic devices, such as hedges, emphasis, attributors and attitude markers serve to "organize and evaluate [the] information [provided] in order to direct readers how they should understand and appraise the subject matter" (Hyland, 1998: 224). Jameson (2000) investigates narrative devices, such as level of directness, use of narrators, alternative perspectives, and implied reader to present a particular version of events. She differentiates between (i) fabula (the underlying materials of the story, including events, actors, time, and place), (ii) story (the fabula presented in a certain way in terms of sequence, duration, frequency, focus, and point of view), and (iii) text (the realized story, i.e., the finite, structured whole converted into words by a narrator). Thus, by selecting specific materials and specific linguistic devices, organizational actors can "foster a specific 'definition of the situation'" (Fisk & Grove, 1996: 7). Research on discretionary accounting narratives also features in other disciplines such as marketing, politics, and social psychology, which may offer new insights for application in a financial reporting context. Stanton and Stanton (2002) identify marketing, political economy, and accountability as additional perspectives adopted in analyzing annual reports. Huang (2003) points to empirical evidence from marketing and consumer behavior studies regarding firm manipulation of consumer perceptions of risk, as potentially relevant for accounting research.

3. Prior empirical research on accounting narratives

We select some prior research on discretionary accounting narratives as exemplars to illustrate Wiedman's (2000) and Hirst et al.'s (2008) frameworks of accounting narratives antecedents/environment, characteristics/attributes and consequences/impact. In selecting papers, we include a range of topics and approaches. It is impossible to neatly disentangle antecedents/environment, characteristics/attributes and consequences/impact, and some papers exemplify elements of the three components.

3.1 Antecedents

Antecedents include environmental and firm-specific characteristics such as the legal setting and managerial incentives influencing disclosure. Table 1 summarizes some recent studies of discretionary accounting narratives focusing on antecedents to their disclosure. External antecedents include hostile takeover bids (Brennan et al., 2010), the 2008 financial crisis (Keusch et al., 2012), the UK Corporate Bribery Act 2010 (Islam et al., 2021), the legitimacy crisis at Barrack Gold's Tanzanian gold mine in the 1990s, leading to the displacement of the local community (Lauwo et al., 2020) and the unique once-in-a-100-years' COVID-19[1] context (Brennan et al., 2022). We base our internal antecedents' exemplars on managerial retrospective sensemaking (Merkl-Davies et al., 2011), incidents in ten companies' assembly plants affecting employees (Li & Haque, 2019) and a case company's corporate performance (Edgar et al., 2022).

Table 1: Prior accounting research on antecedents to discretionary accounting narratives

Study	Antecedent	Measure	Features of accounting narratives	Influences	Findings
External context					
Brennan et al. (2010)	Hostile takeover bid	Thematic, visual and rhetorical manipulation	Attacking versus defensive themes; Rhetoric: repetition and reinforcement; Lexical devices: verbal form, engagement	Defense against hostile takeover bids	Attacking and defensive sentences comprise the majority of the defense documents analyzed. Sentences exhibited varying visual and rhetorical emphasis, which served to award greater or lesser prominence to the information conveyed by target company management.
Keusch et al. (2012)	Economic crises versus non-crisis contexts	Narratives in European company letters to shareholders	Positive/negative, internal/external attributions/casual explanations/cause-effect relations	Firm size, financial leverage, industry-controlled profitability, financial performance change	Crisis context results in more managerial self-serving bias. Managers use external economic conditions to present themselves in the best possible light.
Islam et al. (2021)	Legal setting: UK Corporate Bribery Act 2010	Disclosures on curbing bribery before/after the Act	(i) Presence/absence of disclosure index (ii) Thematic analysis, four themes: top management/human resource policy, risk assessment, due diligence measures, monitoring	News media coverage Full decoupling (Malignant separation – Non-disclosure, separation) Slight decoupling (Symbolic adoption – Ceremonial, ritualistic, generic. Disclosure present but not substantial) No decoupling (Complete implementation –Substantive, detailed, full disclosure)	The Act prompted significant change in anti-bribery disclosure, consistent with the theory of institutional coercive pressure. The study found decoupling, with disclosures not substantively reflecting incidents of bribery, mostly from underprivileged developing nations.
Lauwo et al. (2020)	How a stigmatized industry/company used CSR reporting	Narratives relating to a crisis at a mine	Stigma mirroring; Strategic responses: Denial, Evasion of responsibility, Excuses, Disassociation,	Not applicable	Documentary content analysis of emerging narratives and discourses exploring manifest (visible components) and latent evidence of underlying meanings in the text
Brennan et al. (2022)	COVID-19 profit warnings: Crisis communication in a context of extreme uncertainty	Disclosure quality score	Forecast characteristics (4); Items disclosed (8)	Forecast horizon, firm size, profitability, leverage, listing status, regulatory guidance, industry, risk	Companies regress to silence when investors most need guidance. The research finds poor-quality disclosure, coy ambiguous language, possibly reflecting minimal regulatory guidance on this form of corporate report.
Internal environment					
Merkl-Davies et al. (2011)	Managerial incentives: Retrospective framing	Positive/negative organizational outcomes	Psychological dimension of word use	Firm size, industry	Negative organizational outcomes prompt managers to engage in retrospective sensemaking to make sense of firm performance.
Li & Haque (2019)	Employee-related incidents in assembly plants	Linguistic hedging in employment-related narratives in corporate responsibility reports	Frequency of hedge words, from a dictionary of hedge words	Not applicable	Hedging is used in employee-related disclosures to manage legitimacy challenges due to employee-related incidents.
Edgar et al. (2022)	Corporate performance	Carillion profit warnings, contemporaneous conference calls, board meeting minutes	Rhetorical properties of accounting narratives	Logos, ethos, pathos	The narratives reveal the board and management initially in denial of the company's performance, followed by defiance, leading to desperation and, ultimately, the company's defeat

3.2 Characteristics/attributes

Characteristics of discretionary accounting narratives include disclosure attributes shown in Figure 1. Table 2 summarizes some recent studies focusing on characteristics of discretionary accounting narratives. Elliott et al. (2012) examine the accounting narrative disclosure format, text-based versus video. Riley et al. (2014) examine accounting narrative disclosure concreteness/abstractness by reference to detailed linguistic characteristics considering verb, adjective and noun usage. Athanasakou and Hussainey (2014) assess forward-looking discretionary accounting narratives from the perspective of their credibility. Finally, Iatridis et al. (2022) consider the readability of annual report discretionary accounting narratives using automated textual analysis.

Table 2: Prior accounting research on characteristics of discretionary accounting narratives

Study	Characteristics	Measure	Features of accounting narratives	Influences	Findings
Elliott et al. (2012)	Text-based press release versus video to announce earnings restatement	Experimental instrument	Internal/external attribution for a restatement	Trust in the CEO, CEO denies/accepts responsibility for the restatement	When a CEO accepts responsibility for a restatement via video/text, investors recommend larger/smaller investments in the firm. When the CEO denies responsibility for a restatement via video/text, investors recommend smaller/larger investments in the firm. Investor trust mediates the effect of disclosure venue and attribution.
Riley et al. (2014)	Linguistic characteristics	Accounting narratives with verbs versus adjectives/nouns	Concretely/abstractly written narratives Descriptive/interpretive action verbs, state verbs Adjectives/nouns Positive/negative valence words	Not applicable	The language in press releases is more concrete/abstract when the associated financial information is positive/negative. Investors are least/most likely to invest when a negative/positive narrative is written concretely.
Athanasakou & Hussainey (2014)	The credibility of forward-looking narrative performance disclosures	Forward-looking narrative performance disclosure index	List of 35 forward-looking keywords	Earnings per share growth, earnings growth, aggregate stock return, earnings	Firms having a reputation for high-quality earnings benefit in terms of higher credibility for their narrative disclosures.
Iatridis et al. (2022).	Narrative disclosure quality	Automated textual analysis of annual report commentaries	Five linguistic measures of annual report narratives	Goodwill impairment charge	The research finds that goodwill impairments of firms with low-quality narrative disclosures are less timely than the impairments of firms with high-quality disclosures. The market response to goodwill impairments is more negative for firms with low disclosure quality.

3.3 Consequences/impact

Table 3 summarizes some recent studies of discretionary accounting narratives focusing on their impacts, including the decision-making of corporate audiences (e.g., shareholders, debtholders, financial analysts, the media, etc.) and feedback effects (e.g., share price movements, cost of debt, cost of capital, liquidity, reputation, legitimacy, etc.). Lehavy et al. (2011) examine the impact of readability of accounting narratives on analyst following. They conclude that more complex written communication impairs audiences' ability to extract information, thereby increasing demand for third-party interpretations by financial analysts. Wisniewski and Yekini (2015) consider the effect of discretionary accounting narratives on share prices, Yekini et al. (2016) consider their effect on future share prices. In a very original study, Lee and Sweeney (2015) examined the effect of discretionary accounting narratives on jury awards concerning environmental issues. Leung and Snell's (2021) study is located in an intriguing context, the gambling industry. Discretionary accounting narratives camouflaged rather than engaged in openness.

Table 3: Prior accounting research on consequences of discretionary accounting narratives

Study	Consequence	Measure	Features of accounting narratives	Influences	Findings
Lehavy et al. (2011)	Analyst following, analyst effort and informativeness of analyst forecasts	Readability as a proxy for complexity		Firm size, growth, number of segments, institutional ownership, previous management forecasts, advertising expense, research & development	Analyst following, analyst effort (length of time for analysts to issue their first forecast revision following the 10-K filing), and the analyst report informativeness are positively related to firm communication complexity.
Wisniewski & Yekini (2015)	Future stock returns	DICTON content analysis of 209 FTSE-350 annual report narratives	Two linguistic variables, activity and realism	Risk, firm size, returns, earnings surprise, change in sales, change in leverage	Two linguistic indicators, capturing 'activity' and 'realism', predict subsequent price increases,
Yekini et al. (2016)	Share price reaction	Tone (Optimism)	Frequency of positive keywords	Firm size, returns, earnings surprise, change in sales, change in leverage	Tone of UK company annual report narratives is related to market reaction around the disclosure date. suggesting that such narratives are conduits for disseminating price-sensitive information
Lee & Sweeney (2015)	Jurors' punitive damage awards	Discretionary environmental accounting narratives on investor relations' websites	Discretionary narrative disclosure on company websites about future plans for environmental abatement and control measures, or no disclosure	Industry, perceptions of trust in firm management, Jurors' political ideology	Jurors assess lower punitive damage awards for firms providing discretionary website accounting disclosure on future environmental abatement and control narratives. Firm industry moderates the negative relation. Jurors' perceptions of trust in management mediate the prior moderating effect. Juror political ideology affects awards. Liberal jurors levy comparatively higher awards than conservative jurors.
Leung & Snell (2021)	Legitimacy (i.e., corporate reputation)	Corporate social disclosure narratives	Curtailing disclosure, zero disclosure, disclamation (health warning to consumers, risk to investors), defensive façade	US firms, Macau firms	Gambling firms camouflage legitimacy gaps about sensitive topics by adopting assertive or defensive façades, disclaiming ethical responsibility, curtailing disclosure, or offering zero disclosure.

4. Future research

Prior research focusing on the characteristics of discretionary accounting narratives is largely based on quantitative content analysis, with some qualitative studies. However, conventional content analysis approaches are limited in their ability to differentiate between the nuances of language and linguistic use. More qualitative content analysis or linguistic approaches might be better suited to uncover the underlying managerial intent, providing valuable insights on managerial motives concerning discretionary disclosure decisions.

Social psychology explains managerial motives to present discretionary narrative disclosures and suggests alternative ways to construct such disclosures. Leary and Kowalski (1990) offer opportunities for application in narrative reporting. They identify three factors motivating discretionary accounting narratives, the primary motivation being to maximize expected rewards and minimize expected punishments, consistent with agency theory explanations focusing on opportunistic managerial behavior. The strength of managerial motivation depends on (i) the goal-relevance of the discretionary narrative disclosures, (ii) the value of the desired outcomes, and (iii) the discrepancy between one's desired and current social image. Individuals are motivated to provide discretionary accounting narratives if relevant to achieving one or several goals – the maximization of social and material outcomes, the maintenance and enhancement of self-esteem, and identity creation.

Since discretionary accounting narratives are publicly available, we can assume that managers are strongly motivated to present information to obtain the various material and social benefits (and possibly to enhance self-esteem and create desired identity). This conjecture could be tested, as not all firms attract the same level of public attention. Managers' social and material benefits depend on the approval of both internal and external audiences, prompting them to present discretionary accounting narratives. Internal boards of directors vary in passivity, and external shareholders and stakeholder groups vary in pro-activity. These variations provide opportunities to research their influence.

The value of the desired outcomes is also a factor in discretionary accounting narratives. The higher the value attached to a particular outcome, the stronger the motivation to present discretionary accounting narratives. The value of desired outcomes is a function of resources. This means that discretionary accounting narratives motivation is higher when resources are scarce. Thus, the frequency and/or length of discretionary accounting should increase during economic downturns and when firms are in heightened competition for funds. These factors provide opportunities for enhanced study of motives behind discretionary accounting narratives. Designing studies where these factors are strongly/weakly manifest should enhance our understanding of the influence of each on discretionary accounting narratives in corporate narratives.

Leary and Kowalski (1990) further state that individuals tend to portray images of themselves that are biased in the direction of their desired self-image. Individuals also strive to ensure that their public image is consistent with their social role. In particular, they try to match their social images to prototypical characteristics fitting their role. In addition, individuals construct images of themselves that match the values and preferences of significant others. In a corporate reporting context, this tendency can be applied to investigate whether firms present discretionary accounting narratives which emulate the target values of important stakeholder groups or interest groups in society regarding issues such as environmentalism, gender and racial equality, or ethical concerns, such as fair trade issues. In this context, and as suggested earlier, adopting a stakeholder theory perspective that focuses on mimetic isomorphism – copying behavior (see DiMaggio & Powell, 1983) of other best-in-class firms, could be fruitful. Finally, Leary and Kowalski (1990) state that discretionary accounting narrative construction also depends on individuals' current and potential image in the future, resulting from future revelations about the individual. Based on information others are likely to receive in the future, this potential image constrains discretionary accounting narratives strategies. Public failures or embarrassments compel individuals to present discretionary accounting narratives to counter or repair their damaged image using excuses, apologies, and self-serving attributions.

Leventis and Weetman (2004) discuss the provision of second-language annual reports. Such reports can offer insights into managers' perceptions of users, which can explain managers' voluntary disclosure and discretionary accounting narrative practices. So and Smith (2002) highlight the importance of matching information presentation style to user characteristics and to the interactions thereof. We also need to understand more about managerial beliefs regarding the effectiveness of various discretionary accounting narrative strategies on users. Although the effects of discretionary accounting narratives and views of user perceptions formation are related, useful additional nuanced insights can be gained by considering them separately. While there has been some research on discretionary accounting narratives to meet/beat analysts' forecasts (Schrand & Walther, 2000; Yuthas et al., 2002) or to shape analysts' expectations of future performance (Davis et al., 2012), analyst-orientated discretionary accounting narratives research is still in its infancy.

Previous discretionary accounting narratives research uses content analysis techniques to investigate whether and how managers use corporate narrative documents for discretionary accounting narrative purposes and what factors might influence this behavior. Due to their agency theory affiliations, most discretionary accounting narrative studies are methodologically rooted in the positivist tradition, and involve large sample sizes, statistical analysis, etc. Since quantitative content analysis requires reducing large amounts of text to quantitative data, it does not provide a complete picture of meaning. By contrast, qualitative content analysis allows a richer investigation that focuses on the deeper meaning of the text. Newbold et al. (2002: 249) note that it "exposes the ideological, latent meaning behind the surface of texts, allowing us to grasp the power relations within them." Since crafting discretionary accounting narratives is a subtle activity, it necessitates methodological approaches that can handle these subtleties. More in-depth investigations based on alternative theoretical explanations and methodological approaches are required. Likely fruitful avenues include case studies and longitudinal analyzes using qualitative content analysis techniques, in the vein of Craig and Amernic (2010) and Crowther et al. (2006).

Recent research expands our somewhat blinkered view of what constitutes discretionary accounting narratives by applying aspects of communication from other disciplines to corporate reporting contexts. Using a structural poetics perspective (theory of reading of texts), Crowther et al. (2006) analyze rhetoric using seven binary opposites (e.g., synchronicity-diachronicity, accounting-non-accounting, past-future, etc.) in the annual reports of ten UK water industry firms. They conclude that "the authors of the script, [i.e.]… the dominant coalition of management who control… the activities of the company whose performance determines the corporate report" use the corporate narrative sections "to control the way in which the corporate story is interpreted" (Crowther et al., 2006: 199).

These studies demonstrate that qualitative content analysis or linguistic approaches may provide a better understanding of how, and under what circumstances, firms use corporate narrative documents for discretionary accounting narratives, for overcoming information asymmetries, or, indeed for other purposes, such as constructing corporate identity, reputation, or legitimacy.

Social context can be influential in financial reporting research. Psychological research suggests that social context can affect people's cognitions (Huguet et al., 1999; Levine et al., 1993). Further study of corporate contexts that require firms to shape the perceptions of specific groups of firm outsiders regarding financial, environmental or social performance would enhance our understanding of discretionary accounting narratives. Previous research has focused almost exclusively on one aspect of discretionary accounting narratives in a corporate context, namely manipulating perceptions of firm performance and prospects. Are discretionary accounting narratives a day-to-day routine occurrence or are they more likely to occur in non-routine or exceptional circumstances? The application of alternative perspectives allows the analysis of the manipulation of outsiders' perceptions of (i) persons such as managers, the CEO, and the chairman, (ii) the organization as a whole, (iii) environmental performance, social performance, ethical performance, (iv) once-off events such as privatization, demutualization, takeovers, mergers or acquisitions, factory closures, etc., and (v) measures of corporate success other than profits. Other disclosure vehicles provide opportunities for research in non-routine contexts, such as prospectuses for new equity offerings, takeover and merger documents (especially defense documents in hostile takeovers); and other disclosures such as on demutualization, factory closures, strikes, etc. Managerial asset pricing incentives and the risk of adverse capital misallocations in non-routine contexts such as initial public offerings, seasoned equity offerings, takeovers and mergers is higher than in more routine reporting contexts. For example, defending against a takeover bid tends to lead to a bid price increase, which is not the case in agreed bids (Brennan, 1999). The persuasiveness of the takeover defense document may influence the outcome of the bid – an increase in bid price or even failure of the bid. Takeovers present an opportunity to research the effects of discretionary accounting narratives where the market reaction might be easier to measure. Research could also test the association between discretionary accounting narratives and takeover premiums.

In addition to studying non-routine corporate events, bankruptcy, CEO change, hostile takeover bids, and other situations of extreme distress may provide further fruitful contexts for study. As discussed earlier, individuals are motivated to present discretionary accounting narratives if they think that others have an image of them which is inconsistent with the image they wish to convey (usually a less positive image than desired). This is especially the case due to public failures or embarrassing incidents. Leary and Kowalski (1990: 39) note that "both failure and embarrassment increase impression motivation". This leads to attempts at repairing the damage by stressing positive attributes and making self-serving attributions for failure, i.e., attributing negative outcomes to external factors in the form of excuses. In a corporate reporting context, incidents involving firm failure or embarrassment, such as negative environmental impacts or customer service problems, lead to a discrepancy between desired and current image and should thus give rise to increased discretionary accounting narratives behavior.

Most prior research is located in Anglo-Saxon countries. Hooghiemstra (2010) finds different behaviors concerning performance attributions between US and Japanese firms. Thus, it cannot be assumed that managerial practices are consistent across cultures. Additional international studies could also add insights to our understanding of management disclosure practices and choices.

Since image management tends to be more pronounced in individuals employed in highly visible occupations (Leary & Kowalski, 1990), managers of large, well-known firms might be more likely to present discretionary accounting narratives than those in small, less-known, less visible firms. Examples of visible firms are high street stores producing or selling consumer goods or firms in the public spotlight due to scandals, legal proceedings, record profits or losses, etc. This is consistent with the monitoring and political cost hypotheses which state that firms in the public eye experience greater pressure by institutional shareholders, the press, the government, and other audiences to provide voluntary information to allow monitoring and to reduce political costs in the form of increased regulation. Are discretionary accounting narratives a pro-active, future-orientated or a re-active, retrospective-looking strategy? Aerts (2005: 497) differentiates between re-active and pro-active discretionary accounting narratives. Pro-active discretionary accounting narratives entails "a proactive focus on the rationality of future events in a calculative mode". By contrast, reactive discretionary accounting narratives involves retrospective sensemaking and rationality which refers to "a process of ex post explanations or restatements of organizational outcomes and events in order to sustain or restore the image of rationality of the actor". Most studies examining discretionary accounting narratives in the context of financial performance adopt a pro-active focus. In contrast, most studies in the context of environmental and social performance adopt a re-active focus. However, reverse approaches might provide interesting insights into how firms try to influence and control their public image, reputation, and legitimacy with both shareholders and stakeholders.

5. Conclusion

Discretionary accounting narratives are an important and growing area of research, attracting increasing regulatory attention, for example, in relation to companies' environmental, social and governance (ESG) reporting (Klasa, 2022). Wiedman's (2000) framework provides a useful and relatively under-used lens to view research on discretionary accounting narratives. Our paper has applied this framework to review a selection of recent research, thereby illustrating the framework's potential application in research. The paper concludes with suggestions for future research. Discretionary accounting narratives are multi-faceted and complex. Given the important role large organizations, particularly listed companies, play in society as employers, providers of goods and services, and investment vehicles, understanding their use of discretionary accounting disclosures is vital. Their multi-faceted nature gives rise to diverse audiences with often competing interests and diverse views on the purpose of discretionary accounting disclosures, which ultimately provide the basis for the debate on how to distribute the wealth generated by firms amongst managers, shareholders, stakeholders, and society. Therefore, it is not surprising that evidence suggests that discretionary accounting disclosure is often strategic, with companies trying to balance disclosure and transparency with concealment and obfuscation.

Endnotes

[1] The acronym COVID-19 stands for COrona VIrus Disease 2019. Corona virus is so called because of its appearance under microscope as a halo or crown. Following an outbreak in Wuhan China in December 2019, COVID-19 led to the first worldwide pandemic in over one hundred years.

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