

## NARRATIVE DISCLOSURES IN COMPANY ANNUAL REPORTS: A CASE STUDY

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### ABSTRACT

*Reporting business performance is one of the major tasks to be undertaken by the companies in order to ensure that all relevant information in understandable manner is provided to the various external parties. Annual reports contain financial information which are important for decision making purpose. But non-financial information (also called narratives) is equally important when it comes to decision making. The regulatory authorities and various accounting bodies have issued guidelines which every company have to strictly follow while preparing the accounting statements but there are no standardized procedures for presentation of non-financial information. Every company report narratives in their own manner. Many researchers have focused their researches on importance of narrative disclosures for decision making and found that they are equally important as financial disclosures. The aim of this study is to evaluate narrative disclosures practices followed by Hawkins Cooker Ltd., a private sector company, in its published annual report, as a case study, and suggest some improvements in narrative reporting as a corporate disclosure policy.*

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**Keywords:** Business Performance, Financial information, Narrative Disclosures, Integrated Reporting.

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### Introduction

#### Concept of Financial Reporting

Financial reporting is defined as reporting of their performances by business entities to external users including shareholders, creditors, customers, government authorities, suppliers and the public. In India, the Government and The Institute of Chartered Accountants of India (ICAI) have issued various accounting standards and rules and guidance notes which are applied for the objective of company financial reporting. International Accounting Standard Board (IASB) in its Conceptual Framework for Financial Reporting (2010)<sup>1</sup> states that "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resource to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit."

According to Lal (2017)<sup>2</sup> "when it comes to financial reporting companies must follow full disclosure concept which requires that a business enterprise should provide all relevant information to external users for the purpose of sound economic decisions. This concept implies that no information of substance or of interest to the average investors will be omitted or concealed from an entity's financial statements. The quality of information available to the users of accounting information, lead to more efficient allocation of resources in a country's economy." In developing countries where resources are inadequate, capital is the scarcest and most important productive factor. It is important for a company to give all useful information to users which help them in taking the right decision. Investment decision is a process which is undertaken by the external users to get maximum information about a company. Investors are interested in knowing the investments which will give them maximum returns with minimum amount of risk. For this purpose investors calculate company's future growth and prospects so that they can forecast their future income in form of dividends and capital appreciation. Annual Reports not only help investors but also help other users such as business managers in the company in analyzing performance of a firm and take decision for future.

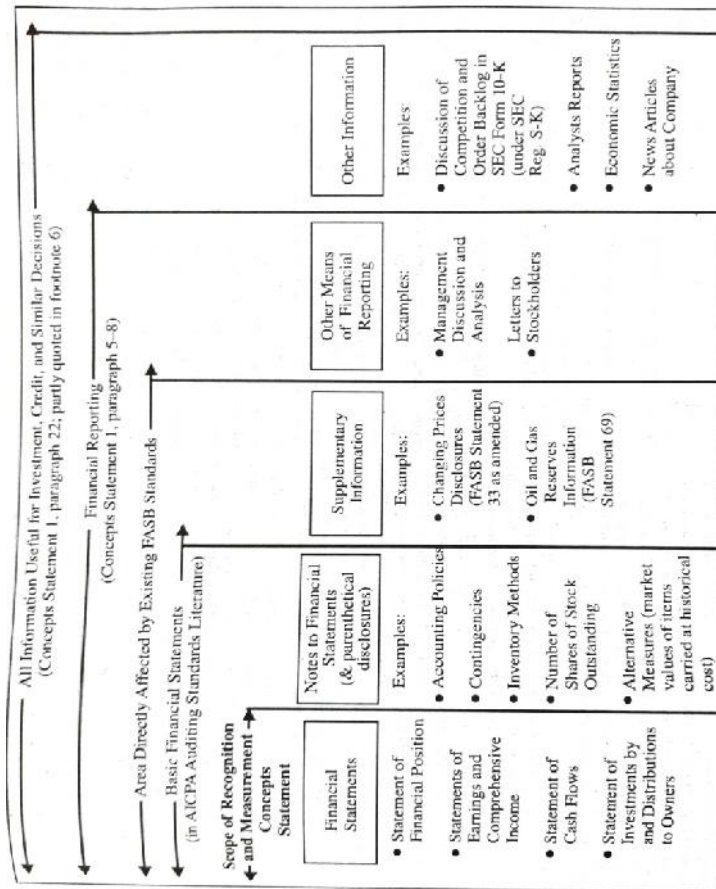
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**Narrative Disclosures – Concept and Importance**

Company financial reporting is a wider concept. It includes financial as well as non-financial information. Keeping in mind the usefulness of reports, companies should not only focus on financial information but also on non-financial information called narratives. It is not just the numbers by which one can judge a company; non-financial information also helps users in forming an opinion about a company. Narratives are integral part of business reports without which reports are incomplete. Global Law Firm, Norton Rose Fulbright (2021)<sup>3</sup> observes “Narrative Reporting describes the non-financial information included in annual reports to provide a broad and meaningful picture of company’s business, its market position, strategy, performance and future prospects. This includes the strategic report, the director’s report, the chairman’s statement, the director’s remuneration report and corporate governance disclosure.” Through narrative reporting the company communicates with its stakeholders and investors. They not only provide explanation relating to current year performances but also give insight about the past results and future outlooks as well. As said earlier it’s not just the numbers but management commentary is also important to analyze a company.

Narrative reporting imposes responsibility on Company management to analyze how effectively they are using their time on real issues. Keeping track of their own activities enables them to contribute to the maximum in the best interest of the company. Narrative reporting also helps in convincing the stakeholders as to why the company opted for the chosen strategy and how it will help in taking the business forward. Efforts of a company to provide as much narrative information as they can help a company build its image thus lowering the cost of capital. Narrative reporting not only give better insight of the company’s operations to its users but help company to build reputation and enhance their image in the market, in this way they can outplay their rivals. Financial Accounting Standards Board (USA) (1984)<sup>4</sup> has recognized the importance of narrative information in corporate financial reporting while illustrating the types of information useful in investment, credit and similar decisions. (Figure 1).



## Review of Literature

Many studies have been conducted by the researchers in the area of narrative disclosures and its different aspects such as importance, content, users and relevance etc. Some studies have been reviewed herein.

**Lugt, Baue and Thurm (2018)**<sup>5</sup> are of the opinion “that there is growing realization of the critical role of strategic narrative to put performance into proper context. In their study they found that professional accountancy associations have stated publicly that corporate reporting has to go beyond the financial statements. They suggest that corporate reporting needs to provide a more holistic picture of the performance of a business, including its future outlook and prospects, strategy and intentions, as well as performance measured against non-financial operational objectives that are often more leading indicators than the lagging indicators.”

**Orens and Lybaert (2007)**<sup>6</sup> investigated the behavior of financial analysts in their use of non-financial information. According to them financial analysts have two most important functions: Firstly, providing information to investors and secondly, monitoring firm management. As earnings are less informative, the importance of both functions increases. In their research they found that financial analysts use non-financial information to perform both functions. They also concluded that less experienced financial analysts, and the financial analysts following a larger number of firms, make more efforts to use corporate non-financial information.

**According to Aerts (2015)**<sup>7</sup> “narrative accounting disclosures are an integral part of the corporate financial reporting package. They are deemed to provide a view of the company “through the eyes of management “. Narrative accounting disclosures are studied from an informational perspective through usefulness surveys, predictive ability research and thematic and readability studies. Presentational studies are related to impression management and primarily focus on selectivity and bias in the content patterns of narrative disclosures. In addition, contextual factors affecting the content of the narrative disclosures have been investigated. Cross-sectional and temporal variation in narrative accounting disclosures may originate from internal sources and external forces.”

**El-Sayed, Adal, Elmougy, Fawzy, Hatem and Elhakey(2020)**<sup>8</sup> conducted a research and found “that simple (more readable) disclosures improve non-professional investor’s judgement towards firm’s future performance. In addition, it is found that non-professional investors are prone to a recency effect from the intentional ordering of narrative information, when using complex (less readable) narratives. However, no primary effect is found, when using simple (more readable) disclosures. The results further provide evidence that the inclusion of graphical representations, along with the manipulated narrative disclosures, can moderate the recency effect of information order, when using less readable and complex narrative disclosures.”

**Clatworthy and Jones (2003)**<sup>9</sup> conducted a research on top 50 and bottom 50 listed UK companies. Their findings suggest “that both groups of companies prefer to emphasize the positive aspects of their performance. In addition both groups prefer to take credit for good news themselves, while blaming the external environment for bad news. Thus, despite reporting on markedly different financial performance, management approach it in the self-serving way. The current auditing regulations could usefully be extended so that the narratives are more rigorously reviewed.”

**Price Water House Coopers (2007)**<sup>10</sup> in their comprehensive report on Narrative Reporting have suggested 10 key steps to effective narrative reporting as follows:

- Adopt the right mindset
- Obtain Board sponsorship and buy-in
- Develop a picture of possible content
- Build a blueprint report
- Benchmark the blueprint
- Identify the information gaps
- Assess adequacy of supporting systems and procedures
- Determine the level of accuracy and reliability
- Create cohesion and clarity
- Develop an implementation plan

**Orens and Lybaert (2010)**<sup>11</sup> conducted another research study on non-financial information used by Belgium financial analysts. They developed a disclosure index containing 71 non-financial information items to be reported in corporate annual reports. Their disclosure index has the following major categories of information:

- Category ANA: Management's analysis of financial, operating and performance-related data
- Category FWL: Forward-looking information
- Category MAN: Information about management and shareholders
- Category BI: Background information about the firm
- Category IC: Intellectual capital information

**Garefalakis, Dimitras, Floros, Lemonakis (2016)**<sup>12</sup> proposed "a new checklist called Management Commentary Index (Ma.Co.I) that was developed for the detailed evaluation of financial reporting quality and was initially presented by FASB and the IASB in the 2010. The amount of narrative information revealed in annual report is what determines an MC's quality. The Ma.Co.I includes 37 constituent points classified into five categories as follows:

Category 1: The nature of the business

Category 2: Objective and strategy

Category 3: Key resources, risks and relationships

Category 4: Results and prospects

Category 5: Performance measures and indicators"

**Mishra and Halder (2019)**<sup>13</sup> made a survey of literature on narrative reporting and observed that "narrative disclosures is perhaps more useful to the users who lack the tools, expertise and resources to garner and interpret exceedingly complex quantitative corporate information. In their opinion, corporate reporting is no longer limited to only balance sheet and income statement, but also includes wide range of narrative disclosures relating to the unconventional assets value drivers and issues of competitive advantages of the new economy business for catering to the needs of various stakeholders." According to them, due to lack of any specific format or any agreed conceptual framework or any common policy of what to include and what not, the growth is becoming multi-dimensional and even seems unbounded, making the narrative parts uncomparable with each other even for technical experts.

#### **Objective of Study**

The objective of this study is to evaluate narrative disclosure practices in the published annual report of Hawkins Cooker Limited<sup>14</sup> for the year 2020-21, as a case study. This will help us understand narrative disclosure practices followed by this company and to give some suggestions to make narrative reporting meaningful to users. The narrative disclosures found in the annual report of company selected for the study are presented here.

- **DNA of Company**

The annual report started with speech delivered by the chairman of the company in Annual General Meeting, in which he mentioned about the seven strands in the DNA of Hawkins Cookers as follows:

- "Follow the Golden Rule. "Do unto others as you would that they do unto you".
- Respect both Ends and Means. "The results have to be achieved and the means have to be right.
- Seek the Best. From the choice of materials and machines to the selection and promotion of our people, we choose to work with the best we can get or create.
- Hot Focus. Today, as a result of following this policy of Hot Focus over many decades, we know as much or more than any other manufacturer in the world.
- Prudence. We don't "Bet the Company" on anything- no matter how exciting the prospect.
- Courage and Resolution. Where an important principle is involved, be bold, brave and resolute.
- Do Your Best and Leave the Rest to God. Apart from anything else, this allows us to sleep soundly at night."

The seven strands of Hawkins clearly explain the vision and mission of the company.

- **Financial Performance: A five year summary**

The next section consists of financial performance of company of five years. The results are presented in terms of Sales, Profit before Tax, Profit after Tax, Net Worth, Return on Net Worth, Dividend per share and Price per share. The company provides notes to this statement in the form of narratives. This helps us to understand the statement better.

- **Director's Report to Shareholders**

This is one of the most important narrative section in any annual report. Hawkins divided this section in two parts:

- 2020-21 Operations : Main Results
- 2020-21 Operations : Other Aspects

Following are the details:

- **2020-21 Operations : Main Results**

This section started with brief information relating to performance of the company in terms of sales and revenue during the current year and previous year. Hawkins included following items under this head:

- **Management Discussion and Analysis(MDA):** Narrative under this head started with the note by the management on the business and the industry. They informed that post covid first wave demand for their products have increased due to increased cooking at home. Company also provided information relating to total number of employees during the company and stated that decrease was due to normal attrition and recruitment. MDA included following narrative information:
  - ✓ Key Financial Ratios
  - ✓ Control Systems
  - ✓ Risks and Concerns
  - ✓ Opportunities and Threats
  - ✓ Outlook
- **Directors** - Under this head Hawkins provided details of directors of the company. Company then provided details of the director who resigned, appointed and retired during the year.
- **2020-21 Operations: Other Aspects**

In the beginning of this section company provided information in brief regarding its three activities. Firstly, it disclosed value of exports during current and previous year. Secondly, the company informed about their Research and Development Unit which is recognized by the Department of Scientific and Industrial Research. Thirdly, they provided details of Fixed Deposits taken during the year. Further, in this section company provides narratives of following information:

- Dividend Distribution Policy
- Appropriations and Dividend
- Code of Conduct
- Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013
- Business Responsibility Report
- Corporate Governance
- Auditors
- Secretarial Audit
- Cost Records and Cost Audit
- Annual Return
- Contracts or Arrangements with Related Parties
- Corporate Social Responsibility
- Director's Performance Evaluation
- Remuneration
- Vigil Mechanism

Other subsidiary information in the form of Appendix are attached with the Director's report.

**Appendix I:** It relates to Research and Development activities undertaken by the company.

**Appendix II:** This is Secretarial Auditor's Report to the members of the company. Along with Company also attached Form No. MR-3 for the financial year ended 31<sup>st</sup> March, 2021.

**Appendix III:** This is Annual Report on Corporate Social Responsibility. It provide brief outline of the company's CSR policy.

**Appendix IV:** Narrative information under this section relates to Disclosure about managerial employees as below.

- Name of the employee
- Age
- Designation and Nature of Duties
- Gross Remuneration
- Qualification
- Experience
- Date of Start of Employment
- Last Employment – Name of Employer and Position held

Hawkins also informed about:

- Remuneration of each Director/Company Secretary in 2020-21
- Number of permanent employees on rolls during the year
- Comparison of average remuneration per employee of current year with the previous year

In the end, the chairman certified that Hawkins has complied with the Corporate Governance Code of Conduct.

- **Business Responsibility Report**

Company presented its Business Responsibility Report as a narrative report consisting of four sections as follows:

**Section A:** General Information about the Company

**Section B:** Financial Details of the Company

**Section C:** BR Information

Contents of section C relates to following:

- Details of Director/Directors responsible for BR
- Principle-wise policies
- Governance related to BR

**Section D:** Principle-Wise Performance

Contents of section D relates to following:

- Principle 1; To conduct and govern the business with Ethics, Transparency and Accountability
- Principle 2: To provide goods and services that are safe and contribute to sustainability throughout their life cycle
- Principle 3: Promote the well-being of all its employees
- Principle 4: To respect the interest of, and be responsible towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized
- Principle 5: To respect and promote human rights
- Principle 6: To respect, protect and make efforts to restore the environment
- Principle 7: When engaged in influencing public and regulatory policy, the Company shall do so in a responsible manner
- Principle 8: To support inclusive growth and equitable development
- Principle 9: To engage with and provide value to its customers and consumers in a responsible manner

- **Independent Auditor's Report on Governance**

This report is for the members from the auditors of the company. They certified their engagement with the company. They also commented on Management's Responsibility, Auditor's responsibility, their Opinion and Restriction on use of the certificate.

- **Report on Corporate Governance**

The annual report presents report on Corporate Governance. This report contains narrative information relating to:

- Company's Philosophy
- Details of Board of Directors – Name, identification Number, no. of meetings attended, whether attended last AGM, directorship in other companies, names of other listed Companies and category of directorship, number of committee positions in other companies.

- Audit Committee
- Nomination and Remuneration Committee
- Director's Remuneration
- Stakeholders' Relationship Committee
- Risk Management Committee
- General Body Meetings
- Means of Communication
- Disclosures
- Shareholder Information
- **Independent Auditor's Report on Ind AS**  
This section contains narratives of following items:
  - Opinion of auditors
  - Basis of opinion
  - Key Audit Matters
  - Other Information
  - Management's Responsibility for the Ind AS Financial Statements
  - Auditor's Responsibilities for the Audit of the Ind AS Financial Statements
  - Report on Other Legal and Regulatory Requirements

- **Financial Statements**

Narratives are also provided in the form of notes to financial statements which relate to Basis of Accounting, Preparation of Financial Statements and Accounting Policies adopted by the company is disclosed.

In summary, Hawkins Company in its annual reports provides narrative disclosures on vision and mission of the company. Further the Director's Report has been divided in two parts: main results and other aspects. The main results have many parts such as Management Discussion and Analysis, Risks and Concerns, Opportunities and Threats etc. Under the heading 'other aspects' Hawkins provided narrative information on its Dividend Distribution Policy, Code of Conduct, Corporate Social Responsibility, Directors Performance Evaluation etc. Other subsidiary information is attached in the form of Appendix with Director's Report. The company has also provided detailed Business Responsibility Report consisting of four sections and nine principles. Further, the company provided narratives on Corporate Governance containing details about BOD and various committees. The annual report also contain Independent Auditor's Report to the members and various other narratives in the form of notes to financial statements.

The narrative disclosure practices in the published annual report of Hawkins Company contains a large information items reported on a voluntary basis, besides the mandatory information. The company annual report has significant narrative disclosures which would be useful not only to company shareholders but will also be relevant to other external users also. However, narrative reporting is a process of evolution, not of revolution. The International Integrated Reporting Council (IIRC) (2013)<sup>15</sup> has suggested "the preparation of an integrated report which aims to explain to providers of financial capital how an organization creates value over time. An integrated report benefits all stakeholders interested in an organization's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy makers."

The suggestions by IIRC for the integrated report given below equally applies to narrative reporting and could be used by Indian companies to improve their financial reporting practices for the benefit of all stakeholders.

- "Organizational overview and external environment: What does the organization do and what are the circumstances under which it operates?
- Governance: How does the organization's governance structure support its ability to create value in the short, medium and long term?
- Business model: What is the organization's business model?
- Risks and opportunities: What are the specific risks and opportunities that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them?

- Strategy and resource allocation: Where does the organization want to go and how does it intend to get there?
- Performance: To what extent has the organization achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?
- Outlook: What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?
- Basis of presentation: How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?"<sup>16</sup>

### Conclusion

Narrative disclosures in annual report help in understanding the company much better. It's not only the results of the company which matters but vision and mission, the journey, future outlook, management opinion all are equally important for a user to judge a company. All these qualitative information cannot be provided through financial statements. The users should know how to interpret the information provided by the company. Through narratives a company communicate with its users and develop an understanding with them. The annual report of Hawkins Cooker Limited selected for the study have provided narrative information to its users in detail. Important information are also highlighted in Director's report and Auditor's report. While preparing financial reports companies use certain technical terms which is difficult for a layman to understand, narrative reporting can provide explanation to these terms. Narratives helps understand the company better.

### Suggestions

Business enterprises should devote enough time to collect and report narrative information to its users. They focus too much on preparation and presentation of financial statements that sometimes narratives lag behind in this process. Equal importance should be given to narratives as they are an integral part of any annual report. Top management should interact with employees to gather information for narrative reporting. They should make sincere effort on their part by connecting with people working in their organization and develop the content of annual report. Primarily, annual reports are of utmost importance to external user's i.e. prospective investors and stakeholders of the company. A business enterprise should try to find out their information requirement and disclose information accordingly. Understanding the needs of external users indicate that company care for them and helps a company in building its image among public. Reporting information desired by users also helps a company in creating a sustainable value for the business. In order to make information relevant and reliable narratives should be provided along with Industry's key performance indicators. It is considered as a good reporting practice by the companies. Performance of a company can be judged by financial statements but a business enterprise must also report how far they are able to achieve its objectives, opinion of management about the position of enterprise in the industry, company's outlook for the future etc. Having an element of transparency and accuracy in information to be reported helps in developing healthy relationships with stakeholders. Business enterprises need to understand that narrative information should be in depth and in simple language so that they can connect well with its users. Proper planning on the part of management is required to implement the efficient system of framing annual reports. Team members must be sincere in their approach while framing this document and also must understand the importance of narrative disclosures. Users must also understand that gathering relevant and reliable information is not an easy task. A business exists in dynamic environment and it need to change its strategies to adjust according to the changing environment. This change will have impact on reporting framework also. A business entity should be transparent, accountable and open to the idea of narrative disclosures.

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