**Headnote**

Abstract

The purpose of this study is to contribute to research on impression management in corporate annual reports in an Australian context. A research question is investigated: do the most profitable Australian companies, assessed by percentage change in profit before tax, organise the chairmen's statements of their corporate annual reports and disclose information in a way that is significantly different from the least profitable companies? The results of this study are indicative that impression management had occurred in chairmen's statements of Australian corporations.

Keywords: Australia, chairmen's statements, impression management, narrative disclosure

Introduction

Corporate annual reports are widely recognised as an important medium of communication between organisations and stakeholders (McQueen, 2001; Bartlett & Chandler, 1997; Healy & Palepu, 2001). Over the past decades, many researchers have worked to clarify the strategies adopted for preparation of those reports (e.g. Bettman & Weitz, 1983; Dierkes & Antal, 1986; Neu et al., 1998; Preston et al., 1996). Deliberately adopted strategies, which aim to portray a positive corporate image and control the impressions formed by outsiders of a company, are described as impression management (Leary & Kowalski, 1990).

Researchers have been keen to learn about the application of impression management in organisational settings so as to facilitate more efficient capital allocation decisions. Much research to this effect has focused on corporate annual reports. This paper investigates the textual characteristics of chairmen's statements published in corporate annual reports of the most and the least profitable Australian companies.

Impression management

Many studies explored the application of impression management in accounting narratives. Not only is the chairman's statement the most widely read part of a corporate annual report (Courtis, 2004; Bartlett & Chandler, 1997), it is also likely to be the most reviewed section. Perhaps the most frequently used review strategy is content analysis. As an example of research of this kind, Smith and Taffler (2000) related selfpresentational narrative disclosures to future corporate solvency. They identified 33 failed companies, paired them with financially sound companies in the same period and performed both form (objective) and meaning (subjective) oriented content analysis. The results showed that it is possible to use the chairman's statement alone to classify, with a high degree of accuracy, firms as likely to become bankrupt or financially viable in the future. However, as Smith and Taffler (2000) restricted analysis to the time period between 1978 and 1985, it is possible the findings may have limited external validity for current times.

In another UK study, Clatworthy and Jones (2006) focused on the textual characteristics of information disclosed in the 1997 chairmen's statements of the 50 top and bottom performing UK companies. Clatworthy and Jones identified a series of variables to measure the textual characteristics of the chairmen's statements, including the total length of the statement, number of passive sentences used, number of personal pronouns employed, number of references to key financial indicators, number of quantitative references and the amount of discussion regarding the companies' future. They found that unprofitable companies were more reluctant to give lengthy chairmen's statements, focused less on key financial indicators, quantitative references or personal pronouns in their discretionary disclosures, but tended to use more passive sentences and included more discussion about the future. These results partially coincide with those from their 2003 study (Clatworthy & Jones, 2003).

The readability of narratives is another area of study in impression management. Some academics working in the area have taken a macro view to focus on variations in the readability of corporate annual reports across multiple countries (Courtis, 1995; Jones, 1996; Courtis & Hassan, 2002). A common problem faced by research of this kind was the small sample size used, which resulted in a lack of generalisation power. Other researchers adopted a micro view where they tried to identify the determinants of obfuscation and clear communication through study of readability, usually within a particular region (Smith & Taffler, 1992; Courtis, 1998; Gist et al., 2004; Linsley & Lawrence, 2007). As Courtis purported, linking readability to other corporate elements such as performance, size and industrial classification was important to further explore the issue of obfuscation.

Investigation into the presentation of financial figures has been a popular topic for scholars in business-related research as reflected in the earliest studies on impression management. Steinbart (1989) may be the earliest study in this area. He examined the auditor's responsibility for the accurate use of graphs in corporate annual reports.

The importance of research into impression management stems from several reasons. Firstly, impression management is a process that is initiated by one party (the report preparers) with an aim to influence the other party's (the report users) perceptions and, in turn, their subsequent decisions. Consequently, the study of impression management can facilitate an understanding of certain decision-making patterns of report users. From a preparer's standpoint, impression management research will help identify the presentation format that is the most favourable for the company, which should be addressed at the report designing phase.

Secondly, it is important to know whether the subsequent decisions made by the report users as a result of reviewing the documents were severely distorted or misled. Studies can help provide this information. If an effect does exist, and it significantly violates widely accepted ethical practices as well as the financial market, legislation may need to be developed. Subsequently, the study of impression management can also benefit stakeholders at large.

Thirdly, as more indepth studies of impression management are conducted, it is possible that some other reasonable disclosure strategies may be proposed or discovered. As in the development of accounting theory, where the research focus has shifted from normative theories in the 1960s to positive theories in the 1980s, a similar trend may be anticipated in the realm of behavioural accounting.

Theories

In business research, top-level managers (the report preparers) have been identified as acting opportunistically to maximise their personal benefits (Staw et al., 1983; Abrahamson & Amir, 1994). These findings are supported by the positive accounting theory (PAT). PAT assumes that individuals behave to advantage themselves. Every incident is driven by self-interest rather than for the good of society. Possibly the most widely applied theory among PAT is agency theory, which raises the concept of agency cost that occurs whenever there is an agency relationship (e.g. Fogarty et al., 2009). Such a relationship is an implication of the conflict of interests between owners and managers.

Agency theory is based on the assumption that information asymmetry exists between different interest groups. It is this gap in knowledge that results in problematic performance only likely to be realised in the future, and it renders the opportunistic behaviours of managers unidentifiable at least in the short term.

While the application of agency theory concentrates on poorly performing corporations, signalling theory, which was first proposed by Smith and Taffler (1992) and further discussed by Rutherford (2003), tends to focus on managers' behaviours in positively performing companies. Managers in prosperous companies utilise impression management in such a way that they signal their superiority through greater transparency in their disclosure of information (Merkl-Davies & Brennan, 2007). Signalling theory has gained increasing attention in reputation management, where firms seek to signal their commitment to shareholders to create a better corporate image (Toms, 2002; Branco & Rodrigues, 2006). Signalling theory may be viewed as an extension of agency theory, because it is also based on the notion of personal interests, and it predicts that people take advantage of information asymmetry.

As agency theory and signalling theory both work as the theoretical background for the realisation of self-interest through opportunistic behaviour, they are useful in explaining the managers' motivation to carry out impression management as an 'everyday occurrence' (Merkl-Davies & Brennan, 2007, p. 125). In contrast, another focus of impression management is on the non-routine reporting context, where information not related to corporate financial performance is strategically disclosed. For instance, Deegan et al. (2000), Milne and Patten (2002) and O'Donovan (2002) considered pollution and environmental information. Ogden and Clarke (2005) investigated the disclosure strategies adopted by the privatised water industry in the UK. Instead of proposing agency theory, the authors of the latter four papers found that legitimacy theory underlies the strategic disclosures of this nature.

Because the disclosure (or concealment) of financial achievements and quantitative statistics of chairmen's statements are the main issues considered in this study, agency theory and signalling theory were applied to the theoretical framework of this study.

Research question and methodology

The ASX 500 index as at 30 June 2011 was used as a data source for the current study. The ASX 500 index contains information on the leading 500 listed companies and is available publicly. Profit margins after tax were used to differentiate between profitable and unprofitable companies. After identifying the best performing 50 companies and the worst performing 50 companies, an additional sample of 50 companies was randomly selected from the rest of the population of the ASX 500 index to comprise a third subgroup (a middle-range group). This group, together with the most and the least profitable group, were then analysed to find any significant differences proposed in the below hypotheses. The use of a middle-range sample aimed to strengthen the validity of the study by testing whether any trends found were continuous. Corporate annual reports were sourced from the Aspect Huntley Annual Reports Online Database (2011).

To answer the initial research question of whether the reporting strategies of Australian listed companies differ significantly between the most and the least profitable companies, the following general null hypothesis was generated:

H0: There is no systematic difference in the textual characteristics of information in the chairmen's statements for the year ended 2010 between the most and the least profitable Australian companies.

This general hypothesis was tested using a variety of measures, which required the development of six secondary null hypotheses.

Based on the findings of Kohut and Segars (1992) and Clatworthy and Jones (2006), companies may provide narrative reports of different lengths according to their financial performance for the reporting year. Profitable companies tend to provide lengthier reports than unprofitable ones, because presumably they are more confident in discussing their past year's operations. Therefore, the length of the report constitutes a means of evaluating impression management. However, apart from Godfrey et al. (2003) who investigated impression management surrounding CEO changes, very little evidence exists on the issue of impression management in relation to firm performance in Australia. To investigate this issue further, the following hypothesis is proposed:

Ha: There is no significant difference in the length of chairmen's statements in corporate annual reports between the most and the least profitable Australian companies for the year ended 2010.

To test Ha, the length of the chairmen's statements was measured by counting the number of words as well as number of pages of each document.

Narratives of companies that experience poor financial performance tend to present in a style that distracts the reader away from this message (Thomas 1997). Some follow-up studies have further recognised that such rhetorical device works as a 'proxy for obfuscation' (Merkl-Davies & Brennan, 2007, p. 139; Pennebaker et al., 2003). The use of passive voice is one example; however, whether this is true in the Australian context needs to be examined:

Hb: The chairmen's statements in corporate annual reports of the most and the least profitable Australian companies will contain a similar percentage of passive sentences for the year ended 2010.

The proportion of passive sentences in the chairmen's statements was measured as a percentage of the total number of sentences.

Another issue recognised by Thomas (1997) is that there tends to be a positive relationship between company performance and use of personal pronouns. This is not surprising because more profitable companies are motivated to organise their narratives in corporate annual reports in a way that engages readers to feel the success the corporation has attained. However, less profitable companies are more likely to divert the readers' attention by making less use of the personal pronoun 'we'. Further investigation of whether Thomas's (1997) conclusion has generalisability is necessary. Therefore, a third hypothesis was developed for testing:

Hc: The chairmen's statements in corporate annual reports of the most and the least profitable Australian companies will contain a similar number of personal pronouns for the year ended 2010.

As in the study by Clatworthy and Jones (2006), we counted the use of first person singular pronouns (i.e. I, me, my) and first person plural pronouns (i.e. we, us, our) in the chairmen's statements.

Some prior studies indicated that references to quantitative information including financial tables, trend graphs and general descriptions of market developments can also be used as means for impression management (e.g. Beattie & Jones, 1999; Arunachalam et al., 2002; Clatworthy & Jones, 2006). For the current study, quantitative information was defined as performance-related numbers, either in absolute or percentage form following the assumptions of Clatworthy and Jones (2006). This includes any reference to key financial indicators such as earnings per share (EPS), profit, sales and dividends.

Hd: The chairmen's statements in corporate annual reports of the most and the least profitable Australian companies will contain a similar number of references to key financial indicators for the year ended 2010.

The number of references to key financial indicators was counted and recorded for each of the chairmen's statements.

To further explore the use of quantitative information in the chairmen's statements in corporate annual reports of the most and the least profitable companies, another hypothesis, He, was developed. While Hd focuses on the number and type of key financial references employed within the chairmen's statements, He is concerned about the overall frequency of monetary references within the chairmen's statements. A closer look at the frequency might be an indicator of how willing firms were to disclose their performance. The references were counted in two categories: monetary and percentage. As predicted by Skinner (1994), profitable companies are more likely to use intuitive quantitative references than unprofitable ones. It is thus reasonable to make such a prediction here:

He: The chairmen's statements in corporate annual reports of the most and the least profitable Australian companies will contain a similar number of quantitative references for the year ended 2010.

The number of quantitative references (monetary and percentage references) were counted and recorded for all chairmen's statements.

Another possible difference in discretionarily disclosed information lies in the level of emphasis companies put upon future development. This was first raised and examined by Kohut and Segars (1992). Since that time, numerous other studies have investigated the use of forward-looking information in chairmen's statements of corporate annual reports. For instance, Aljifri and Hussainey (2007) found that the extent of information disclosure regarding the company's future was correlated with corporate debt ratio; thus the following hypothesis is proposed:

Hf: The chairmen's statements in corporate annual reports of the most and the least profitable Australian companies will focus equally on the future for the year ended 2010.

We examined the chairmen's statements and recorded the number of references in relation to future prospects of the companies.

Results and discussion

Table 1 below presents descriptive financial statistics on the three sample groups. As expected, financial performance, in the form of percentage increase in profit after tax, differed significantly across the three groups for the fiscal year 2010. Therefore, the three sets of companies reported on markedly different performance backgrounds. It is also noticeable that companies with performance at each end of the spectrum had a smaller scale of market capitalisation on average ($1413m and $681m), whereas the middle range group had a significantly higher average market capitalisation ($2453m).

Length of chairmen's statements

Table 2 presents descriptive statistics for the length of chairmen's statements for the most profitable, least profitable and randomly selected companies. Both, the mean number of words and pages of the most profitable firms are higher than those of the least profitable firms (910 words and 817 words, and 1.8 pages and 1.58 pages respectively). The p values of the independent two-sample t-tests for the variable length are summarised in Table 3.

It can be seen from Table 3 that no significant relationship was identifiable across the three groups relating to the length of the chairmen's statements, and Ha is therefore supported.

Use of passive voice

Table 4 below presents the descriptive statistics for the percentage of passive sentences across the three groups of companies. While the mean result for the use of passive voice of the most profitable companies was 11.92 per cent, the figure for the least profitable companies was 15.90 per cent or roughly 33 per cent higher. The average percentage of passive sentences in the random group of companies was 11.58 per cent, the lowest of all three groups. Possible reasons for the discrepancies from the anticipated outcomes, and their statistical significance will be discussed in the next section. It is noteworthy that the overall percentage of passive sentences across the three categories was much lower than was found by Clatworthy and Jones (2006). Although the Clatworthy and Jones paper did not find any significant difference for the percentage of passive sentences in chairmen's statements between the most and the least profitable companies, the results of this study reveal that significant differences do exist as Table 5 suggests. Thus, Hb is rejected.

Personal pronouns

Table 6 below summarises the data for references to personal pronouns. Across the three categories, the use of the personal pronoun in the first person plural subjective case (i.e. we) is higher than that for the first person singular subjective case (i.e. I). Such a high usage of the plural personal pronoun signals an attempt to engage readers and make them feel they share some responsibility in the corporate success/failure.

When the number of singular and plural pronouns was combined and compared across the three categories, the total number of personal pronouns used did not differ much for the three groups. On average, the most profitable companies employed 20.72 personal pronouns in the chairmen's statements as opposed to 19.24 for the least profitable ones. However, the random companies again have demonstrated some distributional abnormality with only 17.48 incidences of personal pronouns.

No significant relationship was identified across the three groups (see Table 7 below). This outcome is inconsistent with that of Clatworthy and Jones (2006). In their study, the authors found the number of references to the pronoun 'our' was significantly different between the most and the least profitable firms, and that the most profitable companies were significantly more likely to use personal pronouns overall. However, the 10% level of confidence used in the 2006 study might be of concern to the reliability of the test results.

Key financial references

Table 8 below presents the descriptive statistics for references to key financial variables in the chairmen's statements. Looking vertically, profit before tax was the least disclosed variable in all categories, despite its relative importance in valuing a company's performance as recognised by Beattie and Jones (1992). However, it is interesting that profit after tax, which is directly derivable from profit before tax, was among the most disclosed variables regardless of the financial performance of the company. This result is inconsistent with the findings of the UK study (Clatworthy & Jones, 2006), where profit before tax was the most widely disclosed performance indicator and reference to profit after tax was not accounted for at all.

Considering the fact that some South Pacific companies prefer using profit after tax to profit before tax as revealed in Warn (2005), such a discrepancy may derive from some cultural differences between the UK and Australia/New Zealand. Dividend is another variable that corporations are more willing to disclose in the chairmen's statements of annual reports. This might be because the main target audiences of the statements are shareholders who are interested in their investment returns. This is also the case with Clatworthy and Jones's (2006) study.

As shown in Table 9 below, Hd could be rejected with confidence. Significant differences were present across all financial indicators in the chairmen's statements of the most and the least profitable companies.

Quantitative references

The descriptive statistics for quantitative references in chairmen's statements for the period ended 2010 are summarised in Table 10. For the most profitable companies, the average number of monetary references was 8.36 per statement, while the average number of percentage references was much lower at 3.42 per statement. However, the large standard deviations suggest that the frequencies of quantitative references varied considerably in different chairmen's statements. The same statistics for the random companies were lower than those of the most profitable companies in every respect, indicating fewer references to quantitative performance-related information. Overall, the frequencies of quantitative references in this study were lower than those of Clatworthy and Jones (2006). Such a systematic difference might again be attributable to nation-specific report-organising strategies.

The results in Table 11 below show that He was supported. However, analysis of the chairmen's statements of the randomly selected companies shows that the quantity of monetary references was significantly different from both the most and least profitable companies.

Emphasis on the future of the company

Table 12 below reveals that the most profitable companies used approximately 68 words to describe their plans for the future in their chairmen's statements. This number rose to 110 words for random companies and reached the highest level of 114 words per statement for the least profitable companies. The small standard deviation of the most profitable companies indicates that the data do not vary greatly within the group, whereas the much higher standard deviations for the other two categories (least profitable 72.30 and random 95.33) signal a much more scattered data distribution. The results displayed in Table 13 below do not support Hf.

The test results for the current study are summarised in Table 14 below. The existence of the three rejected secondary hypotheses is powerful enough to show what was proposed in H0 does not always hold. In other words, there are only some systematic differences in the textual characteristics of information in the chairmen's statements of the most and least profitable companies in Australia.

Perhaps one of the most profound results of this study is the identification of the trend that as profitability increases, companies do tend to disclose more financial indicators to emphasise positive outcomes.

By telling readers how positive the year has been through the disclosure of multiple performance indicators, chairmen are also signalling higher transparency in corporate information. This strategy thereby convinces the readers that there is a larger chance of getting rewarding outcomes by investing in those companies, because they get told expressly what is going on backstage and how their investments have been managed. Such a strategy of signalling all good news is a clear application of signalling theory.

It appears that the reason why those companies with suboptimal performance chose not to disclose as much performance-related information was because they believed the company (or themselves if agency theory is assumed) would be disadvantaged if they did so. Such disadvantage may take the form of a decreased number of shareholders, reduced market capitalisation, damaged company reputation or, ultimately, diminished financial returns for management-level employees. The more unsatisfactory performance indicators were disclosed, the more the interests of the parties would be harmed. It also appears that the chairmen of those companies would rather sacrifice the stakeholders' rights to know what has happened in exchange for more acceptable potential future returns. In other words, it is reasonable to assert that both agency theory and signalling theory can help explain the impression management efforts in chairmen's statements.

Conclusion

The purpose of this study was to determine if textual differences in chairmen's statements between the most and the least profitable Australian companies were apparent for the year ended 2010. In addition, the study investigated whether companies changed their information disclosure preferences as their performance levels vary.

With three out of six hypotheses being rejected that related to the major research question, the null hypothesis that there is no systematic difference in the textual characteristics of information in the chairmen's statements between the most and the least profitable companies was rejected. Although the results failed to reject all of the null hypotheses underlying the major research question, strong and consistent differences were demonstrated for H , H , and H .

From a theoretical perspective, the significant test results have provided further evidence that information concealment or exaggeration does occur in chairmen's statements of Australian companies, and that it is explainable by agency theory and signalling theory.

This study highlights the ubiquitous trend of impression management in corporate annual reports, especially in the chairmen's statements, which is the discretionary disclosure section. This study serves to encourage horizontal comparisons with other similar international studies such as Clatworthy and Jones (2006). Also, considering the timing of the related studies, this study also enables longitudinal comparisons which may provide some evidence of how trends in disclosure and application of impression management are developing in the discretionary section of corporate annual reports.

Another contribution of this study is the introduction of a middle group for comparison purposes. Consider the study of Clatworthy and Jones and other studies of this kind, only samples at the two extremes of profitability were compared and analysed. Therefore, although such an analysis is more likely to lead to significant outcomes, there is no way to assess whether such a difference was a result of gradual changes that occurred systematically across the companies or whether it just happened randomly. By introducing the randomly selected middle group, this problem can be addressed. The results indicated that at least some variables exhibited clear trends along the profitability axis. However, in some other areas (i.e. He) it does look as though significant differences occurred in an unexpected way.

Concerning the limitations, unlike Clatworthy and Jones's (2006) approach where almost all UK registered companies were considered, the population of this study consisted of the ASX500 companies only. Thus the study results may not have enough representability to generalise to the wider ASX population especially to those companies with a smaller scale. Another possible restriction to generalisability is the time period for the data. In the current study, data were collected for only one year. However, what held in one period may not hold for another. Therefore, better generalisability could be achieved by taking a longitudinal study to expand the time period concerned.

Finally, data for the selected samples were primarily sourced from the Aspect Huntley DatAnalysis and Aspect Huntley Annual Report Online Databases (2009). Full reliance has been placed upon the two databases. It was only assumed that the data collection methods, and therefore the data available in the databases were appropriate and rigorous-no investigation was carried out to test their reliability.

To conclude, at least from this study, it was possible to infer instances where agency theory and signalling theory were in operation when Australian chairmen were writing their statements for corporate annual reports.