THE OPERATING AND FINANCIAL REVIEW: SOME EVIDENCE ON ITS IMPLEMENTATION IN IRISH PUBLISHED ACCOUNTS

Robert Kirk

University of Ulster at Jordanstown

ABSTRACT

The Operating and Financial Review *(OFR) was published in July 1993 as a first attempt by the Accounting Standards Board to introduce some form of regulation and structure into the presentation of the narrative content contained at the front of the Annual Report. It was introduced initially as a voluntary document and this paper sets out to examine the extent to which it has been complied with in Ireland in its first year of operation.*

The paper sets out a classification scheme developed to measure and analyse the increase in volume of OFR disclosures as a surrogate for improved quality. It concludes by acknowledging that the volume of disclosure has increased in relation to the information provided in the Financial Review, though this has been fairly minimal. Very little additional information has, however, been provided in the Operating Review. There are exceptions but these are almost exclusively provided by companies which have adopted a policy of providing a stand-alone document for the Operating and Financial Review rather than including the information as part of the Chairman's Statement/Chief Executive's Review.

INTRODUCTION

In July 1993 the Accounting Standards Board (ASB) published a Statement of Best Practice entitled *Operating and Financial Review* (OFR). This was the first-ever statement of its type as, unlike the Financial Reporting Standards (FRSs), it is not considered to be a compulsory document. However, it has succeeded in finding support not only from the Financial Reporting Council but also, more importantly, from the London Stock Exchange.

The OFR is defined by the ASB as:

> ... a framework for the directors to discuss and analyse the business's performance and the factors underlying its results and financial position, in order to assist users to assess for themselves the future potential of the business.

Many large public companies, both in the United Kingdom and Ireland, have attempted to publish over the last few years some form of narrative discussion about and interpretation of their financial statements. However, in this Statement of Best Practice, the ASB has decided that more emphasis should be placed on the overall content and communication of such data so as to assist users to better assess the performance and future viability of the business. This was to counter the increasing disparity and lack of regulation that had emerged around Chief Executive Reviews. The narrative tended to highlight the more positive and ignore the more negative aspects of the business. The information would probably have been supplied either in the Chairman's Report or the Chief Executive's Review. The OFR still permits reporting entities to present their operating and financial disclosures within these documents. They do not have to be published within a stand-alone document.

The publication of the Review is also timely since it links in with some of the proposals emanating from the Cadbury Report (1992) which called upon listed companies to include in their Annual Reports a 'balanced and understandable assessment of the company's position'.

The catalyst for change in this field emerged from developments in the United States. As long ago as 1974 the Securities and Exchange Commission (SEC) required a *Management Discussion and Analysis* (MD&A) for reporting entities listed on US stock exchanges. These must be filed as part of their Annual Return Forms (Form 10K). Over the last 20 years, the rules and interpretations of this document have changed but it is still essentially one which looks towards releasing more prospective information to the reader of the Report. Unlike the OFR, however, the MD&A is compulsory.

RATIONALE FOR AN OPERATING AND FINANCIAL REVIEW

The Annual Report has altered substantially over the last 20 years. Professional designers are now intimately involved in ensuring that the final product has been attractively packaged and much more attention is being placed on the narrative explanations and discussions about the company's performance for the period under review.

Evidence (Schroeder and Gibson, 1990; Weetman, Collins and Davie, 1994) suggests that readers of listed company Annual Reports pay more attention to the first half of that report which also tends to incorporate numerous eye-catching photographs and graphs. These vehicles are better communicators to non-financial readers than the more mundane and often boringly presented financial information contained at the back of the Report. However, this half of the annual report is unaudited, voluntary and subject to little, if any, regulation.

The rationale behind the introduction of the OFR is an attempt by the accounting profession to develop a broad framework in relation to the structure of these narrative sections. The ASB does not, however, wish to impose strict rules at this stage. It regards the publication as a first step in its evolutionary approach to changes in financial reporting.

By enhancing the level of content in the Annual Report, the OFR should also help to enhance public confidence in the accounting profession, since its main objective is to improve the quality of communication of accounting information from preparers to users.

One illustration of its proposals, for example, is to provide more forward-looking information and to identify the key trends and uncertainties facing the entity in the future.

This paper sets out to examine the major features of the new Statement and to assess the effect that the OFR has had on Irish published reports in its first year of operation. Thirty of the top Irish listed public companies (as defined in terms of turnover) and public interest bodies have been examined. An analysis of the changes in information disclosed immediately prior to the advent of the OFR has been compared with that disclosed after the publication of the document. Preliminary conclusions have been drawn from this to see whether or not the exercise of publishing the OFR has provided any additional information and indicating where further research could and should be undertaken.

It is difficult to measure the quality of the narrative information provided but an increase in the volume of items disclosed should provide more useful information to readers, provided the entity has adopted a balanced approach to its preparation. This paper takes the view that an increase in disclosure should enhance the quality of the OFR and can be adopted as a 'rough' surrogate for quality assessment. It is recognised, however, that increased volume does not necessarily by itself result in increased quality.

The Operating and Financial Review (OFR)

The OFR provides a framework within which the Directors can discuss and analyse the main factors underlying the entity's financial performance and position so as to assess for their shareholders the future potential of the business.

The Directors are encouraged to present the OFR in a way that best complements the format of their annual financial statements. It is not intended to be a straightjacket. The essential features of an OFR are contained within paragraphs 3 to 5 of the statement:

- It should be written in a clear and succinct style and be readily understood by the user
- It should be balanced and objective – both good and bad news should be presented
- It should refer to previous comments that have not been borne out by subsequent events
- It should be analytical rather than numeric in content
- It should be presented as a 'top down' discussion of individual aspects of financial and operating performance but still be viewed within the overall context of the business
- It should explain the reasons for, and the effects of, any changes in accounting policies

- It should explain how published ratios relate to the financial statements
- It should discuss recent trends and uncertainties surrounding the business.

These aspects are all obviously open to considerable subjective interpretation of how to apply them in practice.

The remainder of the OFR indicates how these general principles can be developed in the two main areas of the statement – the Operating and the Financial Reviews.

Operating Review

The main purpose of this review is to enable the reader to understand the 'dynamics' behind the various lines of business undertaken by the company. Essentially, it involves the company providing an analysis of the significant features of operating performance for the accounting period covering all aspects of the profit and loss. It should therefore investigate changes in turnover, profit margins and exchange rates as well as the introduction of new activities and/or the discontinuance of old.

The OFR should examine the main factors and influences that could have a major impact on future results. In particular, a discussion of the principal risks and uncertainties in the main lines of business would be required and how those risks are being managed.

A discussion about future investment is important for users, and particularly a comparison of the present level of investment with any planned future capital expenditure. As well as capital there are a number of other expenses which are treated as revenue expenditure but which are more in the nature of an investment in that they result in the creation of future rather than current income. These were termed 'Revenue investment' in FRED 1 (forerunner of FRS 3) and include expenditure on marketing and advertising campaigns, training programmes, refurbishment and maintenance expenditure, and research and development. The Operating Review requires disclosure of any amounts expended in these important investment areas.

The company should discuss the overall return attributable to shareholders in terms of not only dividends but also increases in wealth. As a result, it should include coverage of the main features in the Statement of Total Recognised Gains and Losses.

Financial Review

One of the principal objectives of the Financial Review is to require reporting entities to explain to the reader of the Annual Report the entity's treasury policy, how the capital of the company has been structured and generally to provide details about the overall dynamics of its financial position.

Taxation actually charged in the financial statements should be discussed if the figure is significantly different from standard rates. A comment on current liquidity is also required.

As part of the Cadbury Report proposals, the Directors are advised to include their going concern confirmation as part of their financial statements. Guidance on how that might be achieved, however, was only released by the Cadbury Committee in November 1994 in the document *Going Concern and Financial Reporting* and was therefore not relevant during the survey period.

In this section, as well as discussing the strengths of the balance sheet, the document suggests that some comment may be made on those valuable resources which the company controls but which do not meet the precise recognition criteria required for an asset under FRS 5 *Reporting The Substance of Transactions* – for example, inherent brands and other intangibles. These could be valued in the Financial Review to give users some idea of the 'hidden resources' controlled by the company.

Statement of Compliance

As this is a voluntary statement of best practice, the Directors are not required to include any formal statement of compliance but some comment on the extent of their compliance is regarded as providing useful and relevant information to the reader. If any fundamental departure has occurred, however, this should be mentioned, especially if it is implied that the principles of the OFR are not being followed.

PRIOR RESEARCH

Because of the narrative and largely subjective nature of this field of financial reporting, prior research has been relatively sparse. The SEC (1989) undertook a four-phase study of MD&A disclosures in the United States and noted both a failure to disclose what was mandatorily required but also a dearth in the detail of content disclosed. As a result the MD&A was amended in 1989 with FRR 36 providing additional interpretative guidance on what information preparers ought to provide.

Schroeder and Gibson (1990) investigated the readability of the MD&A using the Flesch test to estimate the education level needed to comfortably comprehend the document. They concluded, *inter alia*, that the statements were not written with shareholders in mind and that there was a need to limit the vocabulary to common words and to write sentences in the active voice in order to hold the reader's attention.

Weetman et al. (1994), in a research project for the Institute of Chartered Accountants of Scotland, investigated the views of analysts and institutional investors as to the purpose and usefulness of the OFR. This came about as a direct result of the lack of comments received by the ASB on the issue of its original discussion paper on the subject. Their research study recommended the continuation of publication of the OFR but in order to make it more useful and relevant, entities should disclose more information on the key uncertainties surrounding the business and be more forward looking in their presentation. It also recommended the implementation of a compulsory document. Companies should not be permitted to hide behind confidentiality as an excuse for non-disclosure.

Collins, Davie and Weetman (1993) also investigated the practice of those UK companies quoted on US stock exchanges (and therefore having to file a Form 10K) in complying with MD&A disclosures as compared to their US counterparts. They concluded that UK companies were actually providing more information. It was concluded in the study that this was partly as a result of the 'fear' factor felt by UK companies in dealing with a government body such as the SEC.

The first attempt to study the actual content of the MD&A itself was undertaken by Hooks and Moon (1993a). They found the attempt to measure the quality of the substantive content of text, rather than an attribute such as readability which can be objectively determined, to be extremely difficult. The researcher would need to have access to actual internal data about the company, which is generally available only to management, in order to assess quality properly. The second problem they encountered was perceived to be the large percentage of disclosures required by the MD&A which are only triggered off by certain events. Absence of their disclosure in a company's report does not therefore necessarily mean that the company is not prepared to disclose that information. It may not actually exist.

A third difficulty that emerged was what Hooks and Moon describe as 'generalisability' – that different industries have legitimately different types of transactions and the frequencies of these also differ across industry. What is appropriate in one sector may not be appropriate in another. The quality of the MD&A may also vary according to the preparer, the size of the company, its nearness to a share issue, etc.

Hooks and Moon (1993b) concluded that the only appropriate method of studying MD&A quality was by way of a content analysis structure that would permit the identification of the existence of disclosure items as a surrogate for quality and that this should also incorporate the expected frequencies of underlying events and transactions. This paper will attempt to partially replicate Hooks and Moon's study by adapting a similar classification system for Irish published accounts.

SURVEY OF IRISH PUBLISHED ACCOUNTS

The survey of 30 of the top Irish companies and public interest bodies follows the method of content analysis adopted by MacArthur (1988) and Collins, Davie and Weetman (1993). The analysis is based on the number of lines in the OFR and a coding of those lines has been carried out in examining the documents for relative content under the headings required by the OFR.

The companies were randomly chosen from a database of 130 Irish published accounts held in the University of Ulster, representing approximately 80% of all quoted and public interest bodies in Ireland, North and South. The accounting year-ends chosen for each reporting entity were those immediately prior to the date of implementation of the OFR and those immediately after that date (31 December 1993.) No attempt was made to analyse specific industries and as a result the sample is quite diverse (see **Appendix**).

The first stage in developing a suitable classification scheme for the OFR was to identify the required disclosure items in the statement itself. Some 58 separate items were recognised from a line-by-line examination of the OFR and these have been broken down into four separate categories as follows:

Category A: Should be disclosed on an annual basis (includes changes in turnover, profit margins, liquidity, earnings per share, etc.)

Category B: Should be disclosed if a trigger event occurs (includes changes in inflation rates, exchange rates, capital instruments adopted, etc.)

Category C: On-going disclosure – post event (funding requirements, skill shortages, health and safety, dependence on major suppliers, etc.)

Category D: Optional extras (commentary on resources controlled but not recorded on the balance sheet).

The classification system was largely drawn from the model developed by Hooks and Moon (1993b), with suitable adaptation for the OFR.

The Annual Reports were studied for the inclusion of the 58 disclosure items. Each occurrence of disclosure was recorded without regard for its extent or inferred quality. Disclosure frequency of each item was then accumulated for each year. In line with Hooks and Moon (1993b), the McNemar Test was employed to test the significance of changes in relation to disclosures both before and after OFR implementation.

The McNemar test was chosen because it is a non-parametric test which has the power to analyse the significance of changes in a four-fold table of frequencies for the sample cases in which the samples are related. It is particularly applicable to 'before' and 'after' situations, as required in this study. Other non-parametric tests such as the Chi square were rejected as they require large expected frequencies in each cell.

The remainder of this paper discusses the current OFR requirements and the findings of the study. For each section of the OFR, the disclosure requirements are first presented, followed by the results of the classifiextremely difficult. The researcher would need to have access to actual internal data about the company, which is generally available only to management, in order to assess quality properly. The second problem they encountered was perceived to be the large percentage of disclosures required by the MD&A which are only triggered off by certain events. Absence of their disclosure in a company's report does not therefore necessarily mean that the company is not prepared to disclose that information. It may not actually exist.

A third difficulty that emerged was what Hooks and Moon describe as 'generalisability' – that different industries have legitimately different types of transactions and the frequencies of these also differ across industry. What is appropriate in one sector may not be appropriate in another. The quality of the MD&A may also vary according to the preparer, the size of the company, its nearness to a share issue, etc.

Hooks and Moon (1993b) concluded that the only appropriate method of studying MD&A quality was by way of a content analysis structure that would permit the identification of the existence of disclosure items as a surrogate for quality and that this should also incorporate the expected frequencies of underlying events and transactions. This paper will attempt to partially replicate Hooks and Moon's study by adapting a similar classification system for Irish published accounts.

SURVEY OF IRISH PUBLISHED ACCOUNTS

The survey of 30 of the top Irish companies and public interest bodies follows the method of content analysis adopted by MacArthur (1988) and Collins, Davie and Weetman (1993). The analysis is based on the number of lines in the OFR and a coding of those lines has been carried out in examining the documents for relative content under the headings required by the OFR.

The companies were randomly chosen from a database of 130 Irish published accounts held in the University of Ulster, representing approximately 80% of all quoted and public interest bodies in Ireland, North and South. The accounting year-ends chosen for each reporting entity were those immediately prior to the date of implementation of the OFR and those immediately after that date (31 December 1993.) No attempt was made to analyse specific industries and as a result the sample is quite diverse (see **Appendix**).

The first stage in developing a suitable classification scheme for the OFR was to identify the required disclosure items in the statement itself. Some 58 separate items were recognised from a line-by-line examination of the OFR and these have been broken down into four separate categories as follows:

Category A: Should be disclosed on an annual basis (includes changes in turnover, profit margins, liquidity, earnings per share, etc.)

Category B: Should be disclosed if a trigger event occurs (includes changes in inflation rates, exchange rates, capital instruments adopted, etc.)

Category C: On-going disclosure – post event (funding requirements, skill shortages, health and safety, dependence on major suppliers, etc.)

Category D: Optional extras (commentary on resources controlled but not recorded on the balance sheet).

The classification system was largely drawn from the model developed by Hooks and Moon (1993b), with suitable adaptation for the OFR.

The Annual Reports were studied for the inclusion of the 58 disclosure items. Each occurrence of disclosure was recorded without regard for its extent or inferred quality. Disclosure frequency of each item was then accumulated for each year. In line with Hooks and Moon (1993b), the McNemar Test was employed to test the significance of changes in relation to disclosures both before and after OFR implementation.

The McNemar test was chosen because it is a non-parametric test which has the power to analyse the significance of changes in a four-fold table of frequencies for the sample cases in which the samples are related. It is particularly applicable to 'before' and 'after' situations, as required in this study. Other non-parametric tests such as the Chi square were rejected as they require large expected frequencies in each cell.

The remainder of this paper discusses the current OFR requirements and the findings of the study. For each section of the OFR, the disclosure requirements are first presented, followed by the results of the classification scheme on the sample, and finally the results of the frequency analysis are explained.

OPERATING REVIEW ANALYSIS

Operating Results

One would expect this to be the best disclosed part of the OFR since it involves a discussion of changes in turnover, profit margins and the way in which the reporting entity has adapted itself to changing market conditions.

In three reviews, a 100% disclosure was discovered for Category A items but, even within the whole sample, the average disclosure was as high as 66%.

The frequency of disclosure, as expected, was not as high for Category B items with only three companies displaying a 60% record, which could, of course, be partially explained by certain trigger events not occurring during the period. It is noticeable that the three entities providing the most disclosures had all provided a stand-alone OFR.

Two of the sample noted a Category C disclosure.

Table 1 displays a reasonable, if not statistically significant, increase in nearly all disclosures since the advent of the OFR. Particularly noticeable is the additional information available to the reader on new products and services being developed by reporting entities (from 30% to 37%) and the design of new products/services to protect current earnings (3% to 17%).

However, **Table 1** also reveals that, for all 10 operating results, there was no significant P value for any of the disclosures at either the 5% or 10% level.

Table 1: Operating Review – Operating results

	Category A	Category B	Category C	Category D	Observed % frequency of disclosure Post-OFR	Observed % frequency of disclosure Pre-OFR	McNemar Tests P-value
Changes in market conditions	*				70%	63%	0.7539
New products/services		*			37%	30%	0.7539
Changes in market share	*				20%	13%	0.7266
Material acquisitions expectations realised		*			7%	3%	1.0000
Changes in turnover	*				87%	77%	0.4531
Changes in trading margins	*				90%	87%	1.0000
Design of products/services to protect/enhance earnings			*		17%	3%	0.1250
Seasonal factors		*			10%	3%	0.6250
Special factors		*			17%	10%	0.6875
Discontinued factors		*			3%	7%	1.0000
	4	5	1	0			

Dynamics of the business

Most of the items were regarded as category C – they represent on-going disclosure of events that have already occurred. Has an advertising campaign taken place? What effect will it have on future profits? What about the refurbishment of the premises, etc? Most of the disclosure (43%) was directed at a broad discussion about exchange rate fluctuations which was fairly bland and already available to readers from other sources. There was virtually no information on the more controversial and commercially sensitive disclosures relating to such aspects as scarcity of raw materials, skills shortage or dependence on major suppliers/customers. However, these may not have been disclosed because they did not exist in those specific entities.

In comparison with the pre-OFR period, also, there has been relatively little increase in the volume of disclosure. This is obviously an area that will have to be investigated further by the ASB as the voluntary arrangement does not seem to have succeeded in achieving any additional disclosure. Additional information on these issues should enhance the quality of information available to readers but it would require a more proactive approach from the ASB to persuade reporting entities to develop this further.

Under the McNemar Test, there was no significant change at all in the volume of disclosure.

Table 2: Operating Review – Dynamics of the business

	Category				Observed % frequency of disclosure		McNemar Tests P-value
	A	B	C	D	Post-OFR	Pre-OFR	
Scarcity of raw materials			*		3%	3%	1.0000
Skill shortages			*		–	–	1.0000
Patents, licences and franchises			*		–	–	1.0000
Dependence on major suppliers/customers			*		–	–	1.0000
Product liability			*		–	–	1.0000
Health and safety			*		3%	7%	1.0000
Environmental protection costs			*		23%	23%	1.0000
Self-insurance			*		–	–	1.0000
Exchange rate fluctuations		*			43%	43%	1.0000
Rates of inflation		*			3%	–	1.0000
	0	2	8	0			

Investment for the future

The OFR requires some discussion about future investment. Companies should disclose the amount of monies expended on capital expenditure. This should be an annual event since all entities are involved in some form of reinvestment or expansion. As such it is categorised as A. Only 53% of companies, however, mentioned the topic in their review. However this is 20% up on the previous year's figures and is statistically significant under the McNemar Test.

As regards the amount of monies spent on revenue investment (expenditure which fails to meet the definition of an asset but is spent to improve future rather than current performance), only six entities made any attempt to disclose such information. One company in the sample, however, Waterford Foods Plc, did disclose three of the possible seven topics in this section. That entity was also only one of eight companies which decided to prepare a stand-alone 'Operating and Financial Review' document. These topics have all been categorised as B in the analysis as they are, to an extent, largely discretionary. Most reporting entities, however, are involved in expenditure on marketing their products, on training their staff and on maintaining and refurbishing their buildings. Without this expenditure, entities are unlikely to succeed in the long-term and shareholders should be made aware of their company's commitment to this type of 'revenue investment' expenditure.

Table 3: Operating Review – Investment for the future

	Category				Observed % frequency of disclosure		McNemar Tests P-value
	A	B	C	D	Post-OFR	Pre-OFR	
Capital expenditure	*				53%	33%	0.0703/ <0.1
Revenue expenditure:							
Marketing/advertising		*			7%	7%	1.0000
Training		*			7%	7%	1.0000
Refurbishment		*			–	–	1.0000
Research		*			10%	7%	0.6875
Development		*			3%	–	1.0000
Technical support – customers		*			–	–	1.0000
	1	6	0	0			

Statistically the only significant increase in disclosure at the 10% level was that of amounts expended on capital investment.

Operating Review – Miscellaneous

This section should have been popular with preparers since it basically incorporates straightforward disclosures about earnings per share, changes in wealth and overall returns to shareholders. In addition, it should also discuss the link between profits earned and dividends paid and the adoption of any sensitive accounting policies.

The overall level of disclosure for category A was 27% with one company, the Kerry Group, providing 100% as well as one of the two category B items. The most popular item was a discussion on earnings per share (EPS).

Apart from the Kerry Group, only six other entities noted category B items. These related mainly to the disclosure of changes in accounting policies and, in particular, the implementation of FRS 3 for the first time.

However there was a substantial increase since the pre-OFR period, particularly in relation to EPS and the linkage between profit generation and dividends paid. EPS was also the only statistically significant increase in disclosure, at the 5% level.

Table 4: Operating Review – Profit, STRGL, EPS, dividends and policies

	Category				Observed % frequency of disclosure		McNemar Tests P-value
	A	B	C	D	Post-OFR	Pre-OFR	
Overall review	*				20%	23%	1.0000
Changes in wealth	*				–	–	1.0000
Significant gains/losses not in P&L account		*			3%	–	1.0000
Link dividends and profits	*				17%	3%	0.2188
EPS	*				67%	43%	0.0391/ <0.05
Sensitive accounting policies		*			17%	3%	0.2188
	4	2	0	0			

Operating Review – Overall summary

For the 30 companies in the sample there were 192 actual disclosures representing some 19% of the maximum possible total. The reporting entity achieving the highest level of disclosure was that of the Kerry Group Plc with 13 in total (40%).

The results represent an overall increase of 27% (151 to 192) since the publication of the OFR. However the increase has been confined to mainly bland statements on changes in market conditions, how EPS has altered and the amounts expended on capital investment.

The results, also, are statistically only significant for two of the 33 possible disclosures clearly indicating that the OFR has not resulted in substantially increasing the volume of disclosure overall.

There is still a lack of commitment to publish more forward-looking information or provide data which could be regarded as commercially sensitive. This could be due to its voluntary nature but is more likely to represent an attitude of mind which financial directors may hold in being prepared to provide only the bare minimum in the Annual Report, for obvious confidentiality reasons.

In summary, the implementation of the OFR has had a minimal impact for most companies to date in their presentation of operating information and it is therefore unlikely that the quality of information provided has improved.

Table 5: Operating Review – Overall summary

	Post-OFR disclosures			**Pre-OFR disclosures**		
Category	**Max**	**Actual**	**%**	**Max**	**Actual**	**%**
A	270	128	47%	270	106	39%
B	450	51	11%	450	36	8%
C	270	13	5%	270	9	3%
D	0	0	0%	0	0	0%
	990	192	19%	990	151	15%

FINANCIAL REVIEW ANALYSIS

Capital Structure, Treasury Policy, etc.

The best disclosed aspect of the Financial Review was the section dealing with the overall capital structure of the reporting entity. This section was designed to ensure full disclosure of the debt profile of the entity, how it manages its interest rate and exchange rate exposure and basically how the company operates its treasury policy in general.

Most of the items were classified as category B and, of these, only 17% were discovered in the sample. Almost exclusively, disclosures were by those companies in the sample which had deliberately implemented a stand-alone document – either a combined OFR or a separate Financial Review.

Guinness Plc, for example, provided information on all five category A items in a very comprehensive review but three other companies – the Kerry Group Plc, NIE Plc and James Crean Plc – also provided more than half the requirements.

One-third of the survey sample now provide detailed information on the types of capital instruments that they have adopted (formerly 10%). This was also the only statistically significant increase in disclosure at the 5% level. The increase in disclosure of the effect of interest costs on profit was statistically significant at the 10% level.

Overall, there was a rise from 4% to 12% in total disclosure, accounted for mainly by the rise in category B items (from 5% to 17%).

Tax, funds and liquidity

Two of the items in this section were classified as A i.e. a discussion of year-end liquidity and of the main factors helping to generate cash flow from operations. The overall disclosure was 35% but only four companies provided both types of information. Again only those with stand-alone documents provided category B information. Only one company provided category C information.

Table 6: Financial Review – Capital structure, treasury policy, etc.

	Category				Observed % frequency of disclosure		McNemar Tests P-value
	A	B	C	D	Post-OFR	Pre-OFR	
Maturity profile of debt		*			10%	–	0.2500
Type of capital instruments		*			33%	10%	0.0391/ <0.05
Currency breakdown	*				7%	–	0.5000
Interest rate exposure		*			3%	–	1.0000
Ratio analysis	*				–	–	1.0000
Manner in which treasury operations are conducted	*				10%	3%	0.2500
Hedging		*			23%	10%	0.2188
Extent of borrowing at fixed rates	*				7%	–	0.5000
Effect of interest costs on profits	*				37%	17%	0.0703/ <0.1
Purpose and effect of major finance arrangements up to date of approval of accounts			*		–	–	1.0000
	5	4	1	0			

Overall the disclosure is still fairly minimal and still only represents some 10% of the maximum possible. However this does represent a rise from 6% prior to the implementation of the OFR. None of the increases was statistically significant. There was only one statistically significant increase in disclosure at the 5% level – detail about the main factors affecting operating cash flow.

Table 7: Financial Review – Taxation, funds, liquidity

	Category				Observed % frequency of disclosure		McNemar Tests P-value
	A	B	C	D	Post-OFR	Pre-OFR	
Overall tax charge significantly different to UK tax rates		*			20%	10%	0.5078
Main components tax		*			3%	7%	1.0000
Main factors – Operating cash flow	*				23%	3%	0.0313/< 0.05
Other cash flows, including special features		*			10%	–	0.2500
Segmental cash flow		*			–	–	1.0000
Liquidity at end	*				47%	36%	0.5488
Seasonality of borrowings		*			–	–	1.0000
Maturity profile		*			7%	3%	1.0000
Funding – capital expenditure			*		–	3%	1.0000
Restrictions on the ability to transfer funds			*		3%	–	1.0000
Restrictive covenants			*		–	–	1.0000
	2	6	3	0			

Financial Review – Miscellaneous

The final section of the Financial Review covers a number of miscellaneous items. First, under the Cadbury Report, Finance Directors are required to make a statement that, in their opinion, the company is a going concern. No companies in the sample had disclosed this as yet as the Cadbury Committee (1994) provided guidance on how to comply with that requirement only in November 1994.

The Review also requires companies to provide a commentary on the overall strengths and resources controlled by the company but not recorded on the balance sheet. Two companies in the sample provided such information – Guinness Plc on the value of their brands and NIE Plc on the valuation of the entity on a current cost basis. In both cases, this information was not released to shareholders prior to the publication of the OFR.

Included also in this section is a possible statement of compliance with the OFR. This is not required, but the OFR does state that it would be helpful if the directors could provide some indication as to the extent of compliance to date if the Review was not being fully complied with. No companies in the sample provided that information. The McNemar test failed to disclose any significant changes in disclosure for this section.

Table 8: Financial Review – Going concern, resources valuation, statement of compliance

	Category				Observed % frequency of disclosure		McNemar Tests P-value
	A	B	C	D	Post-OFR	Pre-OFR	
Statement by Directors – Going concern				*	–	–	1.0000
Resources controlled not on balance sheet				*	7%	–	0.5000
Value of resources				*	–	–	1.0000
Statement of compliance				*	–	–	1.0000
	0	0	0	4			

Financial Review – Overall Summary

There are some 25 possible disclosures included within the Financial Review. The overall total of disclosures for the sample of 30 companies was 73, representing less than 10% of the maximum possible total. Even within category A items, the total only rose to 19%.

The figures, however, are an improvement on the position prior to the release of the OFR, when the comparatives figures were only 4% and 12% respectively. It is clear that the Financial Review is only in its infancy but it is to be hoped that, with companies such as Guinness Plc with a 44% disclosure rate leading the way, more Irish companies will be prepared to release information on this important aspect of the Annual Report. Statistically, only three of the 25 possible disclosures revealed significant increases.

Table 9: Financial Review – Overall summary

Category	Post-OFR disclosures			Pre-OFR disclosures		
	Max	Actual	%	Max	Actual	%
A	210	23	11%	210	14	7%
B	300	47	16%	300	15	5%
C	120	1	1%	120	1	1%
D	120	2	2%	120	0	0%
	750	73	10%	750	30	4%

CONCLUSION

The overall conclusion to be drawn from the study is that the OFR has had a minimal impact to date on Irish published accounts and, apart from a few significant exceptions, very little attempt has been made to improve the volume of narrative disclosure at the front of the Annual Report. In only five of the possible 58 disclosures was there a significant increase in the level of disclosure at either the 5% or 10% level. The increase in the amount of Financial Review information has, however, doubled, albeit from a very low base.

It would appear that the voluntary nature of the OFR may not have succeeded in achieving the objective of improving the volume and, as a consequence, the quality of disclosure in either the Operating or the Financial Review for Irish companies. It could be the case, of course, that it will take several years before good practice from the top companies filters down through other organisations. There is a need, therefore, to carry out a further study in the future to discover whether or not any further improvement may have occurred over a longer period of time.

There are a number of excellent reports, however, of Irish companies which are clearly following the spirit of the statement and it might be in the interests of the ASB if they were to publish some of the best disclosures, as examples of good practice. Generally best practice appears to be found in those companies that have adopted a stand-alone document.

This is probably because they have taken the time to study the OFR in detail and have made a deliberate attempt to follow its requirements. The ASB should therefore change its policy of allowing the information to be incorporated elsewhere in the Annual Report and concentrate its efforts on persuading companies instead to provide a stand-alone document.

APPENDIX: LIST OF COMPANIES IN THE SURVEY SAMPLE

	Year ended
Abbey Plc	30 April 1993 and 1994
Aer Rianta Cpt	31 December 1992 and 1993
Albion Plc	30 September 1993 and 1994
An Post	31 December 1992 and 1993
Ardagh Plc	29 June 1993 and 28 June 1994
Avonmore Creameries Plc	31 December 1992 and 1993
Barlo Group Plc	31 March 1993 and 1994
Bord Telecom Eireann	31 March 1993 and 1994
Clondalkin Group Plc	31 December 1992 and 1993
Coillte Teoranta	31 December 1992 and 1993
Crean, James Plc	31 December 1992 and 1993
FBD Holdings Plc	31 December 1992 and 1993
Golden Vale Plc	31 December 1992 and 1993
Greencore Group Plc	30 September 1993 and 1994
Guinness Plc	31 December 1992 and 1993
Harland & Wolff Holdings Plc	31 December 1992 and 1993
Heiton Holdings Plc	31 December 1992 and 1993
IAWS Group Plc	31 July 1993 and 1994
Inishtech Plc	31 December 1992 and 1993
IWP International Plc	31 March 1993 and 1994
Jefferson Smurfit Plc	31 January 1993 and 1994
Kerry Group Plc	31 December 1992 and 1993
Kingspan Group Plc	31 December 1992 and 1993
NIE Plc	31 March 1993 and 1994
Norish Plc	31 December 1992 and 1993
Powerscreen International Plc	31 March 1993 and 1994
Seafield Plc	31 December 1992 and 1993
Ulster Television Plc	31 December 1992 and 1993
Waterford Foods Plc	31 December 1992 and 1993
Waterford Wedgwood Plc	31 December 1992 and 1993

REFERENCES

Accounting Standards Board (1993). *Operating and Financial Review*, *Accountancy*, August pp. 96-98.

Collins, W., Davie E.S. and Weetman P. (1993). 'Management Discussion and Analysis: An evaluation of practice in UK and US Companies', *Accounting and Business Research*, Spring, Vol. 23 No. 90, pp. 123-137.

Committee on the Financial Aspects of Corporate Governance (1992). *Report of the Committee on the Financial Aspects of Corporate Governance*, London: Gee & Co. Ltd.

Committee on the Financial Aspects of Corporate Governance (1994). 'Going Concern and Financial Reporting', *Accountancy*, Vol. 115, No. 1217, pp. 112-116.

Hooks, K.L. and Moon J.E. (1993a). 'Management Discussion and Analysis: An examination of the Tensions', *Critical Perspectives in Accounting*, Vol. 4, pp. 225-246.

Hooks, K.L. and Moon J.E. (1993b). 'A Classification Scheme to Examine Management Discussion and Analysis Compliance', *Accounting Horizons*, Vol. 7, No. 2, pp. 41-59.

MacArthur, J.B. (1988). 'An Analysis of The Content of Corporate Submissions on Proposed Accounting Standards in the UK', *Accounting and Business Research*, Summer, Vol. 18, No. 71, pp. 213-226.

Schroeder, W. and Gibson, C. (1990). 'Readability of Management's Discussion and Analysis', *Accounting Horizons*, December, pp. 78-87.

Securities and Exchange Commission (1989). *Management Discussion and Analysis of Financial Conditions and Results of Companies: Certain Investment Company Disclosures*, Financial Reporting Release No. 36, SEC.

Weetman, P., Collins, W. and Davie, E.S. (1994). *Operating and Financial Review: Views of Analysts and Institutional Investors*, Edinburgh: Institute of Chartered Accountants of Scotland, 106 pp