Journal of
Empirical Research In Accounting

Alzahra University, Faculty of Social Sciences and Economics
Empirical Research in Accounting, Summer 2023, V. 13, No. 48, pp.7-10

Measuring the Readability of Financial Reports and Management Obfuscation Hypothesis [1]

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Received: 2022/07/20
Accepted: 2023/03/14

Research Paper

INTRODUCTION

A significant amount of accounting information is provided to users in the form of explanatory and written disclosures. Financial reporting is an integral part of an organization's financial reporting. These disclosures help users of financial information to get management's picture of the company. The literature has pointed out that managers, as the authors of company reporting, have the greatest impact on the writing (qualitative) part of reporting and their readability.

The most important issue that is considered in the understanding of a text is its readability. Readability, in a general sense, refers to the ease of understanding and comprehension of a text by its readers. The intention and purpose of the author of the text are influential in the way it is written so that the readability of the text is completely determined by the author. The definition of readability in financial and accounting literature is different, in this field, readability refers to the ability of investors and analysts to identify valuable information in explanatory notes accompanying financial statements (Loughran and McDonald, 2014).

Readability does not have a fixed and clear structure, and the way it is measured in different texts depends on its definition. Linguistic literature provides many definitions for readability and its meanings. These definitions have been created by various researchers and experts who continuously work in the field of comprehension (Serori et al., 2018).

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The main purpose of this research is to investigate the ambiguity hypothesis of managers and the relationship between the company's performance and the readability of management interpretive reports, using a new model for measuring readability. Although the phenomenon of readability has been studied many times in the literature on financial reporting (Abbaszadeh, Salehi, and Nasim Toosi, 2018), related internal research has two important limitations:

1- Absence of a localized model for measuring the readability of explanatory accounting disclosures;

2- Focusing research on notes accompanying financial statements, which mostly have standard and similar text.

To solve these challenges, the current research has examined the readability of interpretive management reports and for this purpose, it uses a new model that, while emphasizing various aspects of readability, relies on reliable indicators. The mentioned model has not been used in previous research.

MATERIALS AND METHODS

The current research is applied research in terms of its purpose and quasi-experimental research in terms of the method of data collection, which examines the causal relationships between variables in the form of quantitative research and inductively. Historical data has been used in this research, so it is considered "post-event" research. The data required for the research has been extracted from the information contained in the audited financial statements and the interpretive reports of the board of directors about the company's activity and general situation. The research community includes all companies admitted to the Tehran Stock Exchange. The time domain of the research is 2019. In this research, a systematic exclusion sampling method was used for sampling.

RESULTS AND DISCUSSION

First, in the descriptive statistics section, we calculate the central indices, such as the mean, dispersion indices, standard deviation, skewness, and kurtosis. Then, the correlation between variables and data is checked. In the following, regression analysis is performed, which examines the significance of the hypotheses based on the probability value. In the current research, the significance level is 5% and 10%.

Descriptive indices (mean and standard deviation, minimum and maximum, skewness and kurtosis) of the scores of each research variable were calculated and the results are presented in Table 1.

Table 1. Descriptive indices of scores of variables dependent on group separation

Research Variables	No.	Normality indices		Descriptive Statistics		variation range	
		Elongation	skewness	standard deviation	Ave.	Max	Min.
Readability of management interpretive report	78	-0.644	-0.090	0.951	-0.276	1.609	-2.396
Rate of return on assets	78	-0.066	-0.288	0.190	0.269	0.654	-0.246
Operating cash flows	78	0.549	-1.592	0.397	0.808	1.000	0.000
Financial Leverage	78	-0.413	0.271	0.209	0.470	0.995	0.031
Company size	78	-0.085	0.867	0.764	7.031	9.020	5.656
Company age	78	4.775	-2.038	0.319	1.194	1.643	0.000

Using the results of Table 1, which includes central and dispersion indices for different variables, the following results are obtained.

78 research sampling units are related to 78 companies. From the table above, it can be seen that the mean of the dependent variable (readability of management interpretive report) is -0.276, which has a standard deviation of 0.951. Also, the most changes in the readability of the management interpretive report among the investigated companies was 1.609 and the lowest value was -2.396. This variable has negative skewness and negative elasticity. The absolute value of the coefficient of skewness and kurtosis of this variable is less than 2, which indicates that the distribution of the variable is not skewed compared to the normal distribution. The mean of the first independent variable (assets return rate) is 0.269, which has a standard deviation of 0.190. Also, the most changes in the rate of return on assets among the investigated companies was around 654 and the lowest value was -0.246. This variable has negative skewness and negative elasticity. The absolute value of the coefficient of skewness and elongation of this variable is less than 2, which indicates the deviation of the distribution of the variable in comparison with the normal distribution. The mean of the second independent variable (operating cash flows) is 0.808, which has a standard deviation of 0.397. The absolute value of the coefficient of skewness and elongation of this variable is less than 2, which indicates the deviation of the distribution of the variable in comparison with the normal distribution.

CONCLUSION

Based on the regression fitting results of the research model, the significant effect of asset return rate on the readability of management interpretive reports has been supported. The significant effect of operating cash flows on the readability of management interpretive reports is not supported at the 95% confidence level. But if we reduce the confidence level to 90%, operating cash flows affect the readability of management's interpretive reports.

The findings of the current research are consistent with the managers' ambiguity hypothesis and show that the readability of financial reporting has a positive and significant relationship with the company's performance.

According to the results of the research, suggestions for future research are presented as follows:

Since in the current research, only management interpretive reports have been examined, it is suggested that other reports, such as the activity report of the board of directors, be examined and tested by applying the assumptions of this research.

The current research model should be developed and the relationship of variables such as the ratio of market value to the book value of assets and the standard deviation of profit should be investigated with readability.

Keywords: Readability, Management Discussion and Analysis Report, Regression, Corporate Features.

JEL Classification: M41.