

Narrative Conservatism

Juan Manuel García Lara, Beatriz García Osma, Fengzhi Zhu

Universidad Carlos III de Madrid

Queen Mary University of London

December 1, 2020

Research Question and Contribution

- **Research Question**
 - Is narrative disclosure conservative?

Research Question and Contribution

- **Research Question**

- Is narrative disclosure conservative?

- **Findings**

- Using 8-K and 10-Q data (1994-2019), we define and find evidence of narrative conservatism.
- Narratives reflect bad news in a more **complete**, **news-consistent**, and **timely** manner than good news.

Research Question and Contribution

- **Research Question**

- Is narrative disclosure conservative?

- **Findings**

- Using 8-K and 10-Q data (1994-2019), we define and find evidence of narrative conservatism.
 - Narratives reflect bad news in a more **complete**, **news-consistent**, and **timely** manner than good news.

- **Contribution**

- Extend literature on accounting conservatism by defining and documenting the existence of narrative conservatism.
 - Explore the links between recognition and narrative disclosure.
 - Add to the debate on whether managers withhold bad news.
 - Add to the broader literature on the informativeness of SEC filings.

Theoretical Framework: Conservatism

- **Accounting Conservatism**

- Recognition (??)

- *Conditional*: “higher degree of verification to recognize good news as gains than to recognize bad news as losses,” (? , p. 7) leading to earnings that recognize bad news in a timelier and more complete manner than good news.
 - *Unconditional*: ex ante or news independent. Aspects of the accounting process (measurement and recognition criteria at the inception of assets and liabilities), leading to a persistent understatement of net assets.

Theoretical Framework: Conservatism

- **Accounting Conservatism**

- Recognition (??)

- *Conditional*: “higher degree of verification to recognize good news as gains than to recognize bad news as losses,” (?, p. 7) leading to earnings that recognize bad news in a timelier and more complete manner than good news.
 - *Unconditional*: ex ante or news independent. Aspects of the accounting process (measurement and recognition criteria at the inception of assets and liabilities), leading to a persistent understatement of net assets.

- What role disclosure?

- Prior work focuses on recognition, little is known about conservative disclosure (?, p.243).
 - A “commitment to timely disclosure of bad news need not come exclusively through financial statement recognition” (?, p. 73-74):

Theoretical Framework: Recognition and Disclosure (I)

- **Recognition and Disclosure (?)**

- Recognition: depictions in numbers with captions on the face of the financial statements
- Disclosure: display in the notes and supporting schedules that accompany financial statements

Theoretical Framework: Recognition and Disclosure (I)

- **Recognition and Disclosure (?)**

- Recognition: depictions in numbers with captions on the face of the financial statements
- Disclosure: display in the notes and supporting schedules that accompany financial statements

- **Reporting Requirement (FASB, IASB)**

- Recognition: an economic event can be recognized if it satisfies *all*:
 - Definition criterion
 - Measurability criterion
 - Relevance criterion
 - Reliability criterion

Theoretical Framework: Recognition and Disclosure (I)

- **Recognition and Disclosure (?)**

- Recognition: depictions in numbers with captions on the face of the financial statements
- Disclosure: display in the notes and supporting schedules that accompany financial statements

- **Reporting Requirement (FASB, IASB)**

- Recognition: an economic event can be recognized if it satisfies *all*:
 - Definition criterion
 - Measurability criterion
 - Relevance criterion
 - Reliability criterion
- Even if criteria are met, annual reports are *still* annual (low frequency and lack of timeliness)
- Disclosure: can be deployed to disclose information that fails to meet certain recognition criteria

Theoretical Framework: Recognition and Disclosure (II)

- **Role of Narratives**

- *“Although financial statements have essentially the same objectives as financial reporting, some useful information is better provided by financial statements and some is better provided, or can only be provided, by notes to financial statements or by supplementary information or other means of financial reporting.” (FASB 1984, par.7)*
 - Supplement information that cannot be recognized
 - Explain/complement/provide details of recognized line items

Theoretical Framework: Recognition and Disclosure (II)

- **Role of Narratives**

- *“Although financial statements have essentially the same objectives as financial reporting, some useful information is better provided by financial statements and some is better provided, or can only be provided, by notes to financial statements or by supplementary information or other means of financial reporting.” (FASB 1984, par.7)*
 - Supplement information that cannot be recognized
 - Explain/complement/provide details of recognized line items

- **What role narratives in conservative accounting?**

- Strategic disclosure and bad news hoarding (e.g., ?).
- Timely bad news disclosure ameliorates litigation risk, also associated with narratives (e.g., ???).

Theoretical Framework: Asymmetric Completeness

- **Completeness**

- Completeness implies that disclosure includes all necessary information for a user to understand the underlying economic event.
 - Disclosure reduces information asymmetry: lowers CoC and increases liquidity ???
- Good news disclosure may be completer, relative to bad news, to boost performance (??).
- Bad news disclosure may be completer, relative to good news, to avoid litigation (??).

Theoretical Framework: Asymmetric Completeness

- **Completeness**

- Completeness implies that disclosure includes all necessary information for a user to understand the underlying economic event.
 - Disclosure reduces information asymmetry: lowers CoC and increases liquidity ???
- Good news disclosure may be completer, relative to bad news, to boost performance (??).
- Bad news disclosure may be completer, relative to good news, to avoid litigation (??).

H1: Asymmetric Completeness

Narrative disclosure is more complete in response to bad news than to good news.

Theoretical Framework: Asymmetric News-consistency

- **News-consistency**

- News-consistency implies that disclosure agrees with the underlying economic event in content sentiment.
- Tone influences how information is perceived or processed, and thus it can be employed both to inform or mislead (???).
- Firms may deploy a uniformly positive (negative) tone in both good and bad news disclosure, resulting in higher news-consistency in good (bad) news disclosure.

Theoretical Framework: Asymmetric News-consistency

- **News-consistency**

- News-consistency implies that disclosure agrees with the underlying economic event in content sentiment.
- Tone influences how information is perceived or processed, and thus it can be employed both to inform or mislead (???).
- Firms may deploy a uniformly positive (negative) tone in both good and bad news disclosure, resulting in higher news-consistency in good (bad) news disclosure.

H2: Asymmetric News-Consistency

Narrative disclosure is more news-consistent in response to bad news than to good news.

Theoretical Framework: Timeliness

- **Asymmetric Timeliness**

- Timeliness implies that disclosure is made *in time* to be able to influence users' decisions.
- Managers may delay bad news disclosure to mitigate its negative economic consequences (????).
- Managers may accelerate bad news disclosure due to litigation concerns (??).

Theoretical Framework: Timeliness

- **Asymmetric Timeliness**

- Timeliness implies that disclosure is made *in time* to be able to influence users' decisions.
- Managers may delay bad news disclosure to mitigate its negative economic consequences (????).
- Managers may accelerate bad news disclosure due to litigation concerns (??).

H3: Asymmetric Timeliness

Narrative disclosure is timelier in response to bad news than to good news.

Research Design: Proxies

- **Narrative Disclosure Corpora**

- Corpora: 10-Q and 8-K filings because they (a) are more credible, (b) have higher reporting threshold and (c) are more timely than other corporate communication channels.
- Heterogeneity between 10-Q and 8-K: (a) 10-Q is more diversified in content (b) 8-K is more timely.

Research Design: Proxies

- **Narrative Disclosure Corpora**

- Corpora: 10-Q and 8-K filings because they (a) are more credible, (b) have higher reporting threshold and (c) are more timely than other corporate communication channels.
- Heterogeneity between 10-Q and 8-K: (a) 10-Q is more diversified in content (b) 8-K is more timely.

- **Proxies for Textual Properties (TEX) and News**

- Completeness (NW): natural logarithm one plus total number of words of SEC filings, also number items (NITEMS) and number of 8-Ks (N8K)

Research Design: Proxies

- **Narrative Disclosure Corpora**

- Corpora: 10-Q and 8-K filings because they (a) are more credible, (b) have higher reporting threshold and (c) are more timely than other corporate communication channels.
- Heterogeneity between 10-Q and 8-K: (a) 10-Q is more diversified in content (b) 8-K is more timely.

- **Proxies for Textual Properties (TEX) and News**

- Completeness (NW): natural logarithm one plus total number of words of SEC filings, also number items (NITEMS) and number of 8-Ks (N8K)
- News-consistency (TONE): marginal change of tone in response to good vs. bad news. TONE is number of net positive words per thousand words.

Research Design: Proxies

- **Narrative Disclosure Corpora**

- Corpora: 10-Q and 8-K filings because they (a) are more credible, (b) have higher reporting threshold and (c) are more timely than other corporate communication channels.
- Heterogeneity between 10-Q and 8-K: (a) 10-Q is more diversified in content (b) 8-K is more timely.

- **Proxies for Textual Properties (TEX) and News**

- Completeness (NW): natural logarithm one plus total number of words of SEC filings, also number items (NITEMS) and number of 8-Ks (N8K)
- News-consistency (TONE): marginal change of tone in response to good vs. bad news. TONE is number of net positive words per thousand words.
- Timeliness (TLAG): reporting time lag, defined as the number of days elapsed between the news release date and the filing date of the studied disclosure

Research Design: Proxies

- **Narrative Disclosure Corpora**

- Corpora: 10-Q and 8-K filings because they (a) are more credible, (b) have higher reporting threshold and (c) are more timely than other corporate communication channels.
- Heterogeneity between 10-Q and 8-K: (a) 10-Q is more diversified in content (b) 8-K is more timely.

- **Proxies for Textual Properties (TEX) and News**

- Completeness (NW): natural logarithm one plus total number of words of SEC filings, also number items (NITEMS) and number of 8-Ks (N8K)
- News-consistency (TONE): marginal change of tone in response to good vs. bad news. TONE is number of net positive words per thousand words.
- Timeliness (TLAG): reporting time lag, defined as the number of days elapsed between the news release date and the filing date of the studied disclosure
- Good and Bad News (RET): stock returns (?).

Research Design: Model for 10-Q (I)

● Model Specification

- **Form 10-Q:** We explore responsiveness to good versus bad news:

$$TEX_{i,t} = \beta_0 + \beta_1 QRET_{i,t} + \beta_2 NEG_{i,t} + \beta_3 QRET_{i,t} \times NEG_{i,t} + \sum \beta_n CONTROLS_{i,t} + \epsilon_{i,t}, \quad (1)$$

- QRET quarterly market-adjusted stock return
- NEG bad news indicator (1 if QRET negative, 0 otherwise)
- CONTROLS: Size, MTB, Leverage, Age, Complexity, profitability, operating risk, analyst earnings forecast errors, readability

Research Design: Model for 8-K

- **Model Specification**

- **Form 8-K:** we explore responsiveness to good versus bad news.

$$\begin{aligned}
 TEX_{i,t} = & \beta_0 + \beta_1 \Delta DRET_{i,t-tlag} + \beta_2 BN_{i,t-tlag} + \\
 & \beta_3 \Delta DRET_{i,t-tlag} \times BN_{i,t-tlag} + \\
 & \sum \beta_n CONTROLS_{i,t} + \epsilon_{i,t},
 \end{aligned} \tag{2}$$

Research Design: Model for 8-K

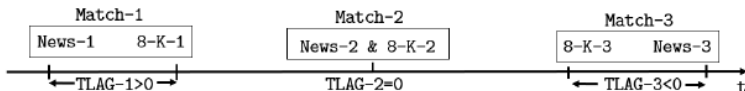
Model Specification

- **Form 8-K:** we explore responsiveness to good versus bad news.

$$\begin{aligned}
 TEX_{i,t} = & \beta_0 + \beta_1 \Delta DRET_{i,t-tlag} + \beta_2 BN_{i,t-tlag} + \\
 & \beta_3 \Delta DRET_{i,t-tlag} \times BN_{i,t-tlag} + \\
 & \sum \beta_n CONTROLS_{i,t} + \epsilon_{i,t},
 \end{aligned} \tag{2}$$

- $\Delta DRET$ is change in daily returns
- BN is bad news day, 1 if $\Delta DRET$ is three times larger than average change in DRET.

Figure 1: 8-K Matching Process



Research Design: Data

- US firms period 1994-2019
- 8-K and 10-Q files from EDGAR
- Data source: Compustat, CRSP and I/B/E/S
- Exclude regulated and financial firms
- Exclude firms with missing observations

Research Design: Data

- US firms period 1994-2019
- 8-K and 10-Q files from EDGAR
- Data source: Compustat, CRSP and I/B/E/S
- Exclude regulated and financial firms
- Exclude firms with missing observations
- *Final sample 10-Q*: 91,606 observations

Research Design: Data

- US firms period 1994-2019
- 8-K and 10-Q files from EDGAR
- Data source: Compustat, CRSP and I/B/E/S
- Exclude regulated and financial firms
- Exclude firms with missing observations
- *Final sample 10-Q*: 91,606 observations
- *Final sample 8-K*: 119,615 observations
 - If we exclude TLAG over 4 days, sample is 40,700 observations

Results: Summary Statistics

Table 2. Panel A: Summary Statistics 10-Q

	count	mean	std	min	25%	50%	75%	max
Textual Variables								
NW	91606	9.020	0.757	7.120	8.506	9.086	9.547	13.544
nw	91606	10937	10204	1236	4941	8829	13997	752337
TONE	91606	-8.921	7.236	-63.579	-13.127	-7.875	-3.866	24.215
TLAG	91606	39	6	0	36	40	44	52
READ	91606	38.161	42.160	14.580	17.840	20.210	39.660	262.519
Financial Variables								
QRET	91606	0.018	0.253	-1.579	-0.113	0.007	0.130	4.849
NEG	91606	0.483	0.500	0	0	0	1	1
SIZE	91606	6.452	1.772	2.898	5.175	6.317	7.563	11.315
MTB	91606	3.461	3.665	0.416	1.485	2.343	3.902	24.449
LEV	91606	0.192	0.182	0.000	0.011	0.162	0.315	0.705
AF	91606	0.043	0.066	-0.262	0.023	0.049	0.073	0.227
AFE	91606	-0.021	0.067	-0.445	-0.018	-0.002	0.002	0.078
BUSSEG	91606	0.859	0.447	0.693	0.693	0.693	0.693	2.773
GEOSEG	91606	0.898	0.532	0.693	0.693	0.693	0.693	3.045
AGE	91606	8.312	1.033	5.811	7.635	8.420	9.089	10.288
EARN	91606	0.005	0.042	-0.201	0.001	0.012	0.023	0.084
STD_EARN	91606	0.020	0.030	0.001	0.005	0.009	0.021	0.188
STD_QRET	91606	0.089	0.070	0.007	0.040	0.070	0.115	0.379

Results: Summary Statistics Continued

Table 2. Panel B: Summary Statistics 8-K

	count	mean	std	min	25%	50%	75%	max
Textual Variables								
NW	119615	6.093	0.926	4.898	5.553	5.846	6.358	12.486
nw	119615	1339	6398	133	257	345	576	264704
TONE	119615	-0.552	7.424	-97.851	-3.049	0.000	3.677	45.929
TLAG	119615	15	17	0	2	9	21	93
N8K	119615	1	0	1	1	1	1	4
NITEM	119615	2	1	1	2	2	2	16
Financial Variables								
DRET	119615	0.003	0.097	-0.833	-0.039	-0.003	0.041	5.991
Δ DRET	119615	-0.018	0.187	-9.062	-0.121	-0.050	0.100	5.989
BN	119615	0.542	0.498	0	0	1	1	1
SIZE	119615	6.326	1.993	2.122	4.896	6.262	7.664	11.379
MTB	119615	3.741	4.784	0.123	1.366	2.293	4.055	33.434
LEV	119615	0.204	0.192	0.000	0.012	0.171	0.334	0.735

Results: Summary Statistics Continued

Table 2. Panel C: Summary Statistics by 8-K Item

Item	# of appearance	% of appearance	nw	TONE	TLAG
Before August 23, 2004					
1: Changes in Control of Registrant	4377	8.21%	1195	-1.22	17.29
2: Acquisition or Disposition of Assets	6773	12.70%	7183	-4.65	22.34
3: Bankruptcy or Receivership	85	0.16%	9920	-4.05	27.89
4: Changes in Registrant's Certifying Accountant	895	1.68%	1128	-9.50	24.71
5: Other Events	14836	27.82%	4431	-3.14	20.49
6: Resignation of Registrant's Directors	84	0.16%	8052	-11.32	27.98
7: Financial Statements and Exhibits	18111	33.96%	5239	-3.48	20.70
8: Change in Fiscal Year	153	0.29%	3322	-0.95	27.59
9: Reg FD	4379	8.21%	571	-1.25	15.56
10: Amendments to the Registrant's Code of Ethics	11	0.02%	353	-2.93	19.64
11: Temporary Suspension of Trading	26	0.05%	309	-3.43	19.31
12: Results of Operation	3608	6.76%	316	-0.61	15.98
After August 23, 2004 (included)					
1: Registrant's Business and Operations	15672	7.95%	797	-3.43	14.96
2: Financial Information	42226	21.42%	449	1.03	12.76
2.02: Results of Operation	35910	18.22%	395	1.97	12.43
3: Securities and Trading Markets	3063	1.55%	1081	-4.10	13.03
4: Matters Related to Accountants and Financial Statements	888	0.45%	779	-10.14	16.54
5: Corporate Governance and Management	26776	13.58%	539	-0.06	15.76
6: Asset-Backed Securities	3	0.00%	211	2.91	14.33
7: Reg FD	15795	8.01%	555	0.29	11.04
8: Other Events	18734	9.50%	567	-0.86	11.66
9: Financial Statements and Exhibits	73982	37.53%	488	0.40	12.82

Results: Is 10-Q Narrative Disclosure Conservative?

Table 3. Panel A: Is 10-Q Narrative Disclosure Conservative?

Dep. Variables	(1) NW	(2) NW	(3) TONE	(4) TONE	(5) TLAG	(6) TLAG
QRET	0.039*** (3.23)	0.029** (2.21)	-0.279** (-2.04)	0.335** (2.58)	-0.081 (-0.78)	-0.318*** (-2.72)
NEG	0.006 (1.29)	0.007 (1.45)	-0.113** (-2.20)	-0.116** (-2.31)	0.027 (0.73)	0.039 (1.03)
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
QRET×NEG	-0.145*** (-6.05)	-0.075*** (-3.36)	2.103*** (6.67)	0.760*** (2.82)	-0.771*** (-4.07)	-0.189 (-1.04)
SIZE		0.035*** (3.79)		0.469*** (5.57)		-0.135** (-2.06)
MTB		-0.007*** (-5.53)		0.077*** (4.34)		-0.023** (-1.98)
LEV		0.332*** (9.76)		-1.260*** (-2.77)		0.748** (2.16)
EARN		-0.653*** (-4.27)		15.058*** (5.93)		-5.455*** (-6.21)
STD_RET		0.110*** (3.54)		-1.921*** (-5.72)		0.844*** (3.38)
STD_EARN		0.672*** (7.42)		-7.792*** (-5.42)		5.217*** (6.20)
AGE		-0.065*** (-4.23)		-0.046 (-0.20)		0.199 (1.32)
BUSSEG		0.015		0.460**		0.094

Results: Are Lengthier 10-Qs Less Readable?

Table 3. Panel B: Are Lengthier 10-Qs Less Readable?

Dep. Variables	(1) READ	(2) READ	(3) READ	(4) READ
NW	13.048*** (21.59)	13.298*** (21.73)	13.407*** (18.50)	13.697*** (18.74)
QRET	-1.001 (-1.49)	-0.471 (-0.74)	8.889 (0.82)	11.146 (1.03)
NEG	0.012 (0.05)	0.028 (0.11)	-0.597 (-0.14)	-0.597 (-0.14)
<i>(Pred. Sign)</i>	<i>(-)</i>	<i>(-)</i>	<i>(?)</i>	<i>(?)</i>
QRET×NEG	3.686** (2.52)	2.341* (1.66)	-37.674* (-1.66)	-43.311* (-1.92)
NW×NEG			0.067 (0.14)	0.068 (0.14)
QRET×NW			-1.093 (-0.91)	-1.285 (-1.07)
<i>(Pred. Sign)</i>			<i>(-)</i>	<i>(-)</i>
QRET×NEG×NW			4.568* (1.81)	5.045** (2.02)
Observations	91,606	91,606	91,606	91,606
Adjusted R-squared	0.461	0.462	0.461	0.462
Controls	NO	YES	NO	YES

$$READ_{i,t} = \beta_0 + \beta_1 NW_{i,t} + \beta_2 QRET_{i,t} + \beta_3 NEG_{i,t} + \beta_4 QRET_{i,t} \times NEG_{i,t} + \sum \beta_n CONTROLS_{i,t} + \epsilon_{i,t}$$

Results: Is 8-K Narrative Disclosure Conservative?

Table 4. Panel A: Is 8-K Narrative Disclosure Conservative?

Dep. Variables	(1) NW	(2) NW	(3) TONE	(4) TONE	(5) TLAG	(6) TLAG
$\Delta DRET$	0.062 (1.61)	0.050 (1.30)	-1.064** (-2.57)	-0.873** (-2.15)	-13.495*** (-12.06)	-13.883*** (-11.96)
BN	0.007 (1.16)	0.007 (1.07)	-0.091 (-1.31)	-0.082 (-1.20)	0.211 (1.13)	0.194 (1.02)
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
$\Delta DRET \times BN$	-0.129** (-2.53)	-0.108** (-2.12)	2.175*** (4.07)	1.837*** (3.49)	20.112*** (13.37)	20.817*** (13.21)
SIZE		-0.010* (-1.80)		0.139*** (2.88)		-0.496*** (-5.15)
MTB		0.003*** (2.92)		-0.008 (-1.14)		0.017 (1.06)
LEV		0.043 (1.40)		-0.938*** (-3.60)		-1.867*** (-3.57)
Constant	7.242*** (32.57)	7.279*** (33.42)	-6.359*** (-3.68)	-6.934*** (-3.99)	30.063*** (7.20)	33.047*** (7.83)
Observations	119,615	119,615	119,615	119,615	119,615	119,615
Adjusted R-squared	0.447	0.447	0.157	0.158	0.135	0.136

$$TEX_{i,t} = \beta_0 + \beta_1 \Delta DRET_{i,t-tlag} + \beta_2 BN_{i,t-tlag} + \beta_3 \Delta DRET_{i,t-tlag} \times BN_{i,t-tlag} + \sum \beta_n CONTROL S_{i,t} + \epsilon_{i,t} \quad (2)$$

Results: 8-K Items, Filings and Reporting Time Lag

Table 4. Panel B: 8-K Items, 8-K Filings and Reporting Time Lag

Dep. Variables	(1) NITEM	(2) NITEM	(3) N8K_OL	(4) TLAG_OL
$\Delta DRET$	0.221*** (4.27)	0.222*** (4.45)	1.076*** (6.73)	-0.944*** (-7.63)
BN	0.011 (1.23)	0.011 (1.24)	0.061 (1.44)	0.107*** (3.82)
<i>(Pred. Sign)</i>	<i>(-)</i>	<i>(-)</i>	<i>(-)</i>	<i>(+)</i>
$\Delta DRET \times BN$	-0.318*** (-4.63)	-0.321*** (-4.86)	-1.358*** (-6.43)	1.436*** (8.75)
SIZE		0.005 (0.69)	0.103*** (11.72)	-0.160*** (-29.55)
MTB		0.001 (0.88)	-0.011*** (-2.91)	0.006*** (3.14)
LEV		0.068* (1.95)	0.493*** (5.84)	0.096** (1.96)
CUT 1			4.243*** (60.20)	-1.007*** (-22.44)
CUT 2			7.630*** (69.30)	-0.240*** (-5.38)
CUT 3			10.605*** (27.60)	0.348*** (7.79)
CUT 4				1.084*** (23.73)
CUT 5				3.102***

Results: Robustness Checks

- Our evidence of narrative conservatism is robust to
 - employing an alternative tone measure using the positive and negative word list from the Harvard General Inquiry dictionary (?);
 - including controls for conditional conservatism and managerial incentives;
 - excluding 8-K items on results of operations that contain quarterly or annual financial statements (?);
 - using an alternative 8-K reporting time lag definition (??);
 - excluding a priori bad news 8-K items (?);
 - estimating by fiscal year from 1995 to 2020.

Results: Additional Analyses

- We expect to observe greater narrative conservatism
 - where managers are more able to have discretion over narrative content: in the MD&A section as compared to the footnotes;
 - also, in voluntary disclosures as compared to mandatory disclosures;
 - in settings where managers have incentives to release bad news
 - in firms where recognition criteria may be stringer (less opportunities to recognize bad news).

Additional Analyses: MD&A and NFS

Table 5. Narrative conservatism in MD&A and NFS|

Dep. Variables	(1) NW_MDA	(2) NW_NFS	(3) TONE_MDA	(4) TONE_NFS
QRET	0.031*** (2.60)	0.022 (1.08)	0.542*** (2.94)	0.451 (1.39)
NEG	0.015*** (3.28)	0.010 (1.56)	-0.132* (-1.87)	-0.038 (-0.41)
<i>(Pred. Sign)</i>	<i>(-)</i>	<i>(-)</i>	<i>(+)</i>	<i>(+)</i>
QRET×NEG	-0.062** (-2.33)	-0.026 (-0.78)	0.773** (1.98)	0.453 (0.87)
SIZE	0.037*** (3.53)	0.011 (0.71)	0.476*** (2.60)	0.986*** (5.17)
MTB	-0.003** (-2.20)	-0.004** (-2.12)	0.039 (1.54)	0.044 (1.50)
LEV	0.226*** (4.91)	0.360*** (5.09)	-0.459 (-0.61)	-1.043 (-1.22)
EARN	-0.444* (-1.78)	-0.789*** (-4.21)	17.948*** (4.89)	13.412*** (5.34)
STD_RET	0.222*** (4.67)	0.068 (1.44)	-3.637*** (-6.91)	-1.011 (-1.22)
STD_EARN	0.418*** (2.59)	0.808*** (5.30)	-6.150*** (-3.20)	-5.435* (-1.68)
AGE	-0.123*** (-5.82)	-0.055** (-2.24)	0.912*** (2.99)	0.093 (0.19)
BUSSEG	0.062***	0.026	0.170	-0.241

Additional Analyses: Voluntary and Mandatory Disclosure

Table 6. Narrative Conservatism in Voluntary and Mandatory Disclosure

Dep. Variables	NW		TONE		TLAG	
Disclosure Type	(1) VD	(2) MD	(3) VD	(4) MD	(5) VD	(6) MD
$\Delta DRET$	0.128*** (3.10)	-0.036 (-0.32)	-1.247** (-2.41)	-0.813 (-0.65)	-15.607*** (-8.20)	-6.471*** (-4.32)
BN	0.011* (1.69)	-0.004 (-0.26)	-0.025 (-0.38)	-0.093 (-0.49)	0.431 (1.64)	0.150 (0.56)
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
$\Delta DRET \times BN$	-0.221*** (-3.87)	0.003 (0.02)	2.818*** (3.15)	1.294 (0.98)	25.375*** (9.38)	9.292*** (5.36)
SIZE	-0.003 (-0.38)	-0.021** (-2.08)	0.080 (1.42)	0.148 (1.63)	-0.631*** (-5.16)	-0.050 (-0.32)
MTB	0.001 (0.99)	0.005*** (3.17)	-0.005 (-0.51)	-0.007 (-0.44)	0.003 (0.10)	0.037 (1.47)
LEV	0.103** (2.47)	-0.056 (-1.02)	-1.135*** (-3.70)	-0.681 (-1.08)	-1.475** (-2.39)	-2.310* (-2.08)
Constant	6.806*** (34.89)	8.426*** (15.03)	-4.453** (-2.40)	-10.788*** (-2.65)	30.627*** (6.25)	39.368*** (4.37)
Observations	84,113	35,502	84,113	35,502	84,113	35,502
Adjusted R-squared	0.464	0.522	0.196	0.158	0.140	0.178

$$TEX_{i,t} = \beta_0 + \beta_1 \Delta DRET_{i,t-tlag} + \beta_2 BN_{i,t-tlag} + \beta_3 \Delta DRET_{i,t-tlag} \times BN_{i,t-tlag} + \sum \beta_n CONTROL S_{i,t} + \epsilon_{i,t} \quad (2)$$

Additional Analyses: Intangible Assets and R&D Expenses

Table 7. Narrative Conservatism, Intangible Assets and R&D Expenses

Dep. Variables	NW		TONE		TLAG	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Intangible Assets	LOW	HIGH	LOW	HIGH	LOW	HIGH
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
QRET×NEG	-0.024 (-1.21)	-0.068*** (-2.71)	0.469 (1.50)	0.475 (1.08)	-0.109 (-0.44)	-0.093 (-0.24)
Observations	29,636	29,634	29,636	29,634	29,636	29,634
Adjusted R-squared	0.831	0.798	0.708	0.678	0.654	0.693
Panel B: R&D Expenses	LOW	HIGH	LOW	HIGH	LOW	HIGH
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
QRET×NEG	-0.065 (-1.56)	-0.075** (-2.45)	0.710 (1.53)	0.048 (0.10)	0.336 (1.15)	-0.029 (-0.06)
Observations	22,899	22,898	22,899	22,898	22,899	22,898
Adjusted R-squared	0.623	0.682	0.581	0.635	0.626	0.619

$$TEX_{i,t} = \beta_0 + \beta_1 QRET_{i,t} + \beta_2 NEG_{i,t} + \beta_3 QRET_{i,t} \times NEG_{i,t} + \sum \beta_n CONTROLS_{i,t} + \epsilon_{i,t} \quad (1)$$

Additional Analyses: Managerial Incentives

Table 9. Narrative Conservatism and Managerial Incentives

Dep. Variables	NW		TONE		TLAG	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: SEO	NO	YES	NO	YES	NO	YES
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
QRET×NEG	-0.113** (-2.29)	-0.128*** (-2.61)	1.891*** (3.29)	0.391 (0.63)	0.158 (0.32)	-0.343 (-0.66)
Observations	17,937	17,919	17,937	17,919	17,937	17,919
Adjusted R-squared	0.649	0.678	0.595	0.634	0.632	0.685
Panel B: Option Value	LOW	HIGH	LOW	HIGH	LOW	HIGH
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
QRET×NEG	-0.084 (-0.96)	-0.216*** (-2.97)	0.225 (0.29)	0.654 (0.89)	-0.427 (-0.68)	-0.702 (-1.36)
Observations	11,553	11,552	11,553	11,552	11,553	11,552
Adjusted R-squared	0.456	0.513	0.561	0.623	0.555	0.599
Panel C: Litigation Risk	LOW	HIGH	LOW	HIGH	LOW	HIGH
<i>(Pred. Sign)</i>	(-)	(-)	(+)	(+)	(+)	(+)
QRET×NEG	-0.107*** (-3.11)	-0.058** (-2.34)	1.017*** (3.00)	0.691* (1.92)	-0.290 (-1.05)	-0.026 (-0.10)
Observations	58,945	32,661	58,945	32,661	58,945	32,661
Adjusted R-squared	0.626	0.688	0.532	0.620	0.620	0.611

$$TEX_{i,t} = \beta_0 + \beta_1 QRET_{i,t} + \beta_2 NEG_{i,t} + \beta_3 QRET_{i,t} \times NEG_{i,t} + \sum \beta_n CONTROLS_{i,t} + \epsilon_{i,t} \quad (1)$$

Conclusions

● Conclusions

- We provide evidence that narratives reflect bad news in a more complete, news-consistent, and timely manner than good news.
- Firms report lengthier 10-Qs to clarify rather than obfuscate bad news, and provide more 8-Ks and 8-K items in response to bad news than to good news.
- We document greater narrative conservatism in the MD&A section and in voluntary disclosure. Also, narrative conservatism is pervasive in firms with high conditional conservatism, intangible assets, R&D expenses and proprietary costs.
- We find greater narrative conservatism in settings where managers have strong incentives to disclose bad news.