# Narrative Conservatism

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# Research Question and Contribution (I)

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  - Is narrative disclosure conservative?

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- **Definition**
  - Narrative conservatism: narratives that reflect bad news in a more **complete**, **news-consistent**, and **timely** manner than good news.
- **Findings**
  - Using 8-K and 10-Q data (1994-2019), we find evidence of narrative conservatism.
  - Narratives are **longer**, **more tone-consistent** (content sentiment agrees with sign of news), and **timelier** (shorter time lag) in reaction to bad news than to good news, where news is measured by returns as in Basu (1997).

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  - Initial evidence narrative conservatism complements conditional conservatism.
- **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 narrative properties of SEC filings.

# Theoretical Framework: Conservatism

- **Accounting Conservatism**
  - Recognition (Beaver and Ryan, 2005; Ball and Shivakumar, 2005)
    - *Conditional*: ex post or news dependent, "higher degree of verification to recognize good news as gains than to recognize bad news as losses," (Basu, 1997, 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.

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  - What role narrative disclosure?
    - Prior work focuses on recognition, little is known about conservative disclosure (Kothari et al., 2009, p.243).
    - A "committment to timely disclosure of bad news need not come exclusively through financial statement recognition" (Guay and Verrecchia, 2018, p. 73-74):

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  - Disclosure: possibility to *timely* convey information that fails to meet certain recognition criteria
    - Displays in the notes and supporting schedules that accompany financial statements (Schipper, 2007); but also:
    - 10-Qs, 8-Ks, press releases, conference calls, social media, etc.

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- **Narratives may not be conservative:**
  - Strategic disclosure and bad news hoarding/smoothing (e.g., Kothari et al., 2009; Segal and Segal, 2016; Chapman et al., 2019).
  - "Full disclosure," (Guay and Verrecchia, 2018) may imply greater timeliness and completeness of good news disclosure, if all bad news are recognized.

# 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 (Diamond and Verrecchia, 1991; Diamond, 1985; Leuz and Verrecchia, 2000)
  - Good news disclosure may be completer, relative to bad news, to boost performance (Teoh et al., 1998; Lang and Lundholm, 2000).
  - Bad news disclosure may be more complete, relative to good news, to avoid litigation risk (Skinner, 1994, 1997; Marinovic and Varas, 2016).

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**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 (Davis et al., 2012; Li, 2010; Huang et al., 2014).
  - Firms may deploy a uniformly positive tone in both good and bad news disclosure, resulting in higher news-consistency in good news disclosure
    - "A careful manager might use 90% positive words in dismissing an employee." (Loughran and McDonald, 2016, p.1206)

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**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 (Chambers and Penman, 1984; Niessner, 2015; Segal and Segal, 2016; Brockbank and Hennes, 2018).
  - Managers may accelerate good news disclosure to increase insider profitability (Khalilov and Osma, 2020).

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**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.

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- **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 of 8-Ks (N8K)

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  - Good and Bad News (RET): stock returns (Basu, 1997).

# 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.

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

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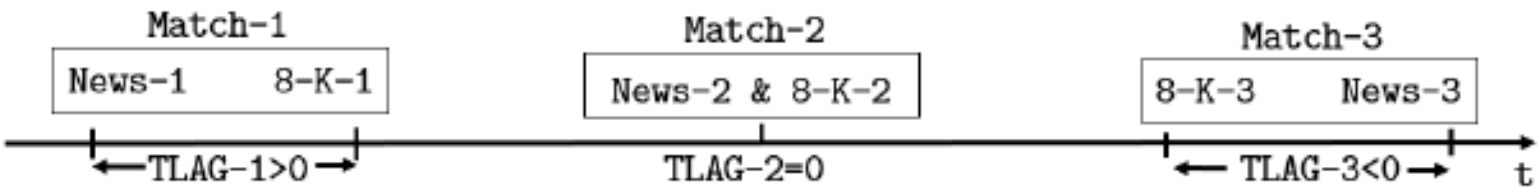
  - $\Delta DRET$ is change in daily returns
  - BN is bad news day, 1 if $\Delta DRET$ is three times larger than average change in DRET.

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
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- 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 |
| $\Delta$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*** | 0.029** | -0.279** | 0.335** | -0.081 | -0.318*** |
| | (3.23) | (2.21) | (-2.04) | (2.58) | (-0.78) | (-2.72) |
| NEG | 0.006 | 0.007 | -0.113** | -0.116** | 0.027 | 0.039 |
| | (1.29) | (1.45) | (-2.20) | (-2.31) | (0.73) | (1.03) |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| QRET×NEG | -0.145*** | -0.075*** | 2.103*** | 0.760*** | -0.771*** | -0.189 |
| | (-6.05) | (-3.36) | (6.67) | (2.82) | (-4.07) | (-1.04) |
| SIZE | | 0.035*** | | 0.469*** | | -0.135** |
| | | (3.79) | | (5.57) | | (-2.06) |
| MTB | | -0.007*** | | 0.077*** | | -0.023** |
| | | (-5.53) | | (4.34) | | (-1.98) |
| LEV | | 0.332*** | | -1.260*** | | 0.748** |
| | | (9.76) | | (-2.77) | | (2.16) |
| Additional controls | Included | Included | Included | Included | Included | Included |
| Firm FE | Yes | Yes | Yes | Yes | Yes | Yes |
| Year FE | Yes | Yes | Yes | Yes | Yes | Yes |
| Observations | 91,606 | 91,606 | 91,606 | 91,606 | 91,606 | 91,606 |
| Adjusted R-squared | 0.649 | 0.653 | 0.557 | 0.570 | 0.613 | 0.616 |

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

# 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*** | 13.298*** | 13.407*** | 13.697*** |
| | (21.59) | (21.73) | (18.50) | (18.74) |
| QRET | -1.001 | -0.471 | 8.889 | 11.146 |
| | (-1.49) | (-0.74) | (0.82) | (1.03) |
| NEG | 0.012 | 0.028 | -0.597 | -0.597 |
| | (0.05) | (0.11) | (-0.14) | (-0.14) |
| *(Pred. Sign)* | (-) | (-) | (?) | (?) |
| QRET×NEG | 3.686** | 2.341* | -37.674* | -43.311* |
| | (2.52) | (1.66) | (-1.66) | (-1.92) |
| NW×NEG | | | 0.067 | 0.068 |
| | | | (0.14) | (0.14) |
| QRET×NW | | | -1.093 | -1.285 |
| | | | (-0.91) | (-1.07) |
| *(Pred. Sign)* | | | (-) | (-) |
| QRET×NEG×NW | | | 4.568* | 5.045** |
| | | | (1.81) | (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 |
|---|---|---|---|---|---|---|
| ΔDRET | 0.062 | 0.050 | -1.064** | -0.873** | -13.495*** | -13.883*** |
| | (1.61) | (1.30) | (-2.57) | (-2.15) | (-12.06) | (-11.96) |
| BN | 0.007 | 0.007 | -0.091 | -0.082 | 0.211 | 0.194 |
| | (1.16) | (1.07) | (-1.31) | (-1.20) | (1.13) | (1.02) |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| ΔDRET×BN | -0.129** | -0.108** | 2.175*** | 1.837*** | 20.112*** | 20.817*** |
| | (-2.53) | (-2.12) | (4.07) | (3.49) | (13.37) | (13.21) |
| SIZE | | -0.010* | | 0.139*** | | -0.496*** |
| | | (-1.80) | | (2.88) | | (-5.15) |
| MTB | | 0.003*** | | -0.008 | | 0.017 |
| | | (2.92) | | (-1.14) | | (1.06) |
| LEV | | 0.043 | | -0.938*** | | -1.867*** |
| | | (1.40) | | (-3.60) | | (-3.57) |
| Constant | 7.242*** | 7.279*** | -6.359*** | -6.934*** | 30.063*** | 33.047*** |
| | (32.57) | (33.42) | (-3.68) | (-3.99) | (7.20) | (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 |

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

# 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 |
|---|---|---|---|---|
| ΔDRET | 0.221*** | 0.222*** | 1.076*** | -0.944*** |
| | (4.27) | (4.45) | (6.73) | (-7.63) |
| BN | 0.011 | 0.011 | 0.061 | 0.107*** |
| | (1.23) | (1.24) | (1.44) | (3.82) |
| *(Pred. Sign)* | (-) | (-) | (-) | (+) |
| ΔDRET×BN | -0.318*** | -0.321*** | -1.358*** | 1.436*** |
| | (-4.63) | (-4.86) | (-6.43) | (8.75) |
| Controls | Included | Included | Included | Included |
| Observations | 119,615 | 119,615 | 119,615 | 40,700 |
| Adjusted (Pseudo) R-squared | 0.126 | 0.126 | (0.006) | (0.009) |
| Year-month FE | YES | YES | NO | NO |
| Firm FE | YES | YES | NO | NO |
| Industry Clustered SE | YES | YES | NO | NO |

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

# 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 (Loughran and McDonald, 2016);
  - including controls for conditional conservatism and managerial incentives;
  - excluding 8-K items on results of operations that contain quarterly or annual financial statements (Segal and Segal, 2016);
  - using an alternative 8-K reporting time lag definition (Carter and Soo, 1999; Niessner, 2015; Chapman et al., 2019);
  - excluding a priori bad news 8-K items (Segal and Segal, 2016);
  - 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*** | 0.022 | 0.542*** | 0.451 |
| | (2.60) | (1.08) | (2.94) | (1.39) |
| NEG | 0.015*** | 0.010 | -0.132* | -0.038 |
| | (3.28) | (1.56) | (-1.87) | (-0.41) |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) |
| QRET×NEG | -0.062** | -0.026 | 0.773** | 0.453 |
| | (-2.33) | (-0.78) | (1.98) | (0.87) |
| SIZE | 0.037*** | 0.011 | 0.476*** | 0.986*** |
| | (3.53) | (0.71) | (2.60) | (5.17) |
| MTB | -0.003** | -0.004** | 0.039 | 0.044 |
| | (-2.20) | (-2.12) | (1.54) | (1.50) |
| LEV | 0.226*** | 0.360*** | -0.459 | -1.043 |
| | (4.91) | (5.09) | (-0.61) | (-1.22) |
| EARN | -0.444* | -0.789*** | 17.948*** | 13.412*** |
| | (-1.78) | (-4.21) | (4.89) | (5.34) |
| STD_RET | 0.222*** | 0.068 | -3.637*** | -1.011 |
| | (4.67) | (1.44) | (-6.91) | (-1.22) |
| STD_EARN | 0.418*** | 0.808*** | -6.150*** | -5.435* |
| | (2.59) | (5.30) | (-3.20) | (-1.68) |
| AGE | -0.123*** | -0.055** | 0.912*** | 0.093 |
| | (-5.82) | (-2.24) | (2.99) | (0.19) |
| BUSSEG | 0.062*** | 0.026 | 0.170 | -0.241 |
| | (2.99) | (1.18) | (0.56) | (-0.62) |

# Additional Analyses: Voluntary and Mandatory Disclosure

**Table 6. Narrative Conservatism in Voluntary and Mandatory Disclosure**

| Dep. Variables | NW | | TONE | | TLAG | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Disclosure Type | VD | MD | VD | MD | VD | MD |
| ΔDRET | 0.128*** | -0.036 | -1.247** | -0.813 | -15.607*** | -6.471*** |
| | (3.10) | (-0.32) | (-2.41) | (-0.65) | (-8.20) | (-4.32) |
| BN | 0.011* | -0.004 | -0.025 | -0.093 | 0.431 | 0.150 |
| | (1.69) | (-0.26) | (-0.38) | (-0.49) | (1.64) | (0.56) |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| ΔDRET×BN | -0.221*** | 0.003 | 2.818*** | 1.294 | 25.375*** | 9.292*** |
| | (-3.87) | (0.02) | (3.15) | (0.98) | (9.38) | (5.36) |
| SIZE | -0.003 | -0.021** | 0.080 | 0.148 | -0.631*** | -0.050 |
| | (-0.38) | (-2.08) | (1.42) | (1.63) | (-5.16) | (-0.32) |
| MTB | 0.001 | 0.005*** | -0.005 | -0.007 | 0.003 | 0.037 |
| | (0.99) | (3.17) | (-0.51) | (-0.44) | (0.10) | (1.47) |
| LEV | 0.103** | -0.056 | -1.135*** | -0.681 | -1.475** | -2.310* |
| | (2.47) | (-1.02) | (-3.70) | (-1.08) | (-2.39) | (-2.08) |
| Constant | 6.806*** | 8.426*** | -4.453** | -10.788*** | 30.627*** | 39.368*** |
| | (34.89) | (15.03) | (-2.40) | (-2.65) | (6.25) | (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 |

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

# 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 |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| QRET×NEG | -0.024 | -0.068*** | 0.469 | 0.475 | -0.109 | -0.093 |
| | (-1.21) | (-2.71) | (1.50) | (1.08) | (-0.44) | (-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 |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| QRET×NEG | -0.065 | -0.075** | 0.710 | 0.048 | 0.336 | -0.029 |
| | (-1.56) | (-2.45) | (1.53) | (0.10) | (1.15) | (-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 |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| QRET×NEG | -0.113** | -0.128*** | 1.891*** | 0.391 | 0.158 | -0.343 |
| | (-2.29) | (-2.61) | (3.29) | (0.63) | (0.32) | (-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 |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| QRET×NEG | -0.084 | -0.216*** | 0.225 | 0.654 | -0.427 | -0.702 |
| | (-0.96) | (-2.97) | (0.29) | (0.89) | (-0.68) | (-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 |
| *(Pred. Sign)* | (-) | (-) | (+) | (+) | (+) | (+) |
| QRET×NEG | -0.107*** | -0.058** | 1.017*** | 0.691* | -0.290 | -0.026 |
| | (-3.11) | (-2.34) | (3.00) | (1.92) | (-1.05) | (-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.

# Correlation matrix (I)

**Table 2. Panel D: Correlation Matrix 10-Q**

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|---|---|---|---|---|---|---|---|---|
| (1) NW | | -0.456 | -0.192 | -0.083 | -0.007 | 0.002 | 0.255 | 0.058 |
| (2) TONE | -0.482 | | 0.016 | 0.086 | 0.020 | -0.021 | -0.062 | -0.013 |
| (3) TLAG | -0.263 | 0.021 | | 0.048 | -0.022 | 0.034 | -0.331 | -0.023 |
| (4) READ | -0.252 | 0.169 | 0.125 | | -0.016 | 0.016 | -0.014 | -0.037 |
| (5) QRET | -0.007 | 0.028 | -0.032 | -0.029 | | -0.684 | -0.064 | -0.029 |
| (6) NEG | 0.003 | -0.024 | 0.033 | 0.028 | -0.866 | | 0.000 | 0.014 |
| (7) SIZE | 0.264 | -0.047 | -0.333 | -0.078 | -0.024 | -0.001 | | 0.247 |
| (8) MTB | 0.046 | 0.040 | -0.042 | -0.026 | -0.055 | 0.033 | 0.382 | |
| (9) LEV | 0.014 | 0.076 | 0.000 | 0.075 | 0.003 | -0.004 | 0.143 | -0.111 |
| (10) AF | -0.018 | 0.062 | -0.125 | 0.035 | -0.087 | 0.072 | 0.026 | -0.299 |
| (11) AFE | 0.040 | 0.099 | -0.149 | -0.023 | 0.181 | -0.157 | 0.232 | 0.226 |
| (12) AGE | -0.035 | 0.063 | -0.232 | 0.071 | 0.011 | -0.015 | 0.336 | -0.081 |
| (13) EARN | -0.139 | 0.223 | -0.146 | 0.065 | 0.114 | -0.098 | 0.299 | 0.282 |
| (14) STD_EARN | 0.092 | -0.194 | 0.153 | -0.052 | -0.024 | 0.028 | -0.281 | 0.093 |
| (15) STD_QRET | -0.047 | -0.083 | 0.214 | -0.023 | 0.128 | -0.088 | -0.325 | -0.041 |

# Correlation matrix (II)

**Table 2. Panel E: Correlation Matrix 8-K**

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (1) NW | | -0.425 | 0.133 | 0.154 | 0.164 | 0.021 | -0.015 | 0.011 | -0.024 | 0.042 | 0.075 |
| (2) TONE | -0.414 | | -0.079 | -0.024 | -0.081 | 0.003 | 0.015 | -0.011 | 0.069 | 0.004 | -0.035 |
| (3) TLAG | 0.119 | -0.110 | | -0.041 | -0.055 | -0.016 | -0.037 | 0.038 | -0.093 | -0.006 | -0.036 |
| (4) N8K | 0.206 | -0.043 | -0.059 | | 0.432 | 0.017 | 0.011 | -0.006 | 0.032 | 0.000 | 0.022 |
| (5) NITEM | 0.184 | -0.104 | -0.093 | 0.296 | | 0.009 | 0.006 | -0.004 | 0.014 | -0.005 | 0.027 |
| (6) DRET | -0.001 | 0.009 | -0.019 | 0.006 | 0.003 | | 0.709 | -0.572 | -0.028 | 0.004 | 0.003 |
| (7) ΔDRET | -0.016 | 0.019 | -0.049 | 0.006 | 0.007 | 0.780 | | -0.738 | 0.069 | -0.006 | 0.013 |
| (8) BN | 0.012 | -0.012 | 0.049 | -0.005 | -0.005 | -0.780 | -0.863 | | -0.032 | 0.002 | -0.009 |
| (9) SIZE | 0.029 | 0.075 | -0.113 | 0.032 | 0.024 | 0.025 | 0.080 | -0.032 | | 0.191 | 0.168 |
| (10) MTB | 0.047 | 0.026 | -0.016 | 0.003 | -0.007 | 0.005 | 0.009 | -0.003 | 0.350 | | 0.085 |
| (11) LEV | 0.081 | -0.043 | -0.041 | 0.023 | 0.025 | 0.013 | 0.022 | -0.010 | 0.213 | -0.039 | |