

The effect of the tone of management commentary on the relevance of risk information in stock price valuation

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Abstract

The research aims to develop a two-dimensional analytical framework to analyze the content of narrative disclosure in financial reports, focusing on management comments and their tone, as well as their relationship to the appropriateness of the value of information about financial risks. The study sample comprised 12 banks listed on the Iraq Stock Exchange for the period from 2012 to 2021, resulting in 120 observations. The level of reporting on management comments was measured by analyzing the narrative content of management comment reports and applying the Ohlson (1995) model to calculate the appropriateness of the value of information about financial risks. The study employed multiple linear regression analysis to examine the explanatory and interactive relationships between the tone of reporting on management comments and the appropriateness of the value of information regarding financial risks. The study reached several conclusions, the most important of which is the existence of a statistically significant relationship between the tone of reporting on management comments and the appropriateness of accounting information related to financial risks.

Keywords: Reporting tone, Management comments, Information value relevance

General Framework of the Research

First: Background of the Study

This study evaluates the tone of management commentary reporting by examining the relevance of information value. If the relationship between earnings, cash flows, book value of stocks, and financial risk changes with the market value of stocks, on the one hand, the tone of management commentary reporting is likely to be an essential means of assessing the effectiveness of unit-investor relationships by examining their usefulness to capital providers in the market.

The efficiency of financial markets is based on several factors, including the availability of accurate and timely information. Perhaps one of the significant challenges facing financial markets and affecting their efficiency arose from the lack

of sharing helpful information between informed and uninformed parties, which impacts the relevance of information value to stock prices. Many attempts and efforts have been made to mitigate and address this problem, as well as to support and enhance the relevance of information value.

The International Commission for Administrative Reform (ICAR) states in its framework that it aims to "improve the quality of information available to providers of financial capital to enable more efficient and productive capital allocation" (ICAR, 2013). Furthermore, the framework emphasizes the importance of the concept of materiality—reporting on issues that impact an entity's ability to generate value—and the need to explain the interconnectedness and interdependencies between these issues. Narrative reporting has become more prominent, in part, as a response to ethical, social, and environmental issues affecting a diverse set of stakeholders, who are key players in delegating their resources to agents responsible for providing information about the value created over the long term. As a result, numerous initiatives have been established worldwide to provide a platform for narrative reporting. The International Accounting Standards Board (IASB) has worked on a practice statement for reporting management comments in the context of its activity to organize the reporting process by identifying useful information to external parties, including potential investors, in a modern manner to meet their needs for helpful information about the economic unit's business model, strategies, operating environment, risks to which it is exposed, and information about performance, financial position, and stages of progress to demonstrate to informed parties its efficiency in protecting the interests of shareholders, which helps reduce the imbalance in sharing information and enhances its good intentions to investors (Eidan, 2020).

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One of the primary motivations for reporting management comments is to enhance the value of the information. As Deloitte (2016) emphasizes, the information provided through unit reports must be relevant to decision makers. However, this information becomes valuable when the reports are provided by units at the right time and with the right content to be helpful in the decision-making process. Stakeholders, especially investors, require valuable and relevant information. Since the traditional financial reporting system has been criticized for lacking sufficient information, it has become necessary to obtain a more comprehensive picture. Units' ability to measure and communicate what matters is an increasing demand from investors and other information users. The investor relations framework is expected to enable units to communicate the value creation journey more clearly, both today and in the future.

Furthermore, the information content perspective suggests that linguistic tone may convey additional information related to future earnings. Still, it is not fully captured by concurrent quantitative details due to the limitations of accounting figures, which are subject to generally accepted accounting principles (GAAP) (Li et al., 2019, p. 2906). Indeed, previous studies have documented that the linguistic tone of unit reporting has informational value (e.g., Li, 2012; et al., 2012) and that market participants, including investors, analysts, and auditors, interact with the information contained in qualitative text. Therefore, the linguistic tone of reporting can be viewed as potentially providing insights into the informative role of management's tone in information reporting, which may seek to conceal poor performance or, in other

words, to follow strategies to manage the impression of users of that information, through which it can influence the prediction of future financial performance and risk assessment.

Second: Presentation of the study problem

In the context of value relevance studies, the concept of value relevance has gained importance in both academic and practical fields. It has been incorporated into business models and narrative reporting. The idea of value relevance was first introduced in the work of Paul and Brown (1968), who proposed that the dynamic change in the market value of stocks reflects the flow of information to the market. Thus, the relevant adjustments in stock market prices upon earnings announcements convey the relevance of this information to investors. The consideration of "relevance" as a characteristic of helpful information is also emphasized in the "Qualitative Characteristics of Useful Financial Information" in the Conceptual Framework of International Financial Reporting Standards. Financial information with relevance is defined as "capable of making a difference to the decisions made by users" (IFRSF, 2018).

The interdependence between the various capitals that companies use to generate value is crucial. Therefore, if we assume that information improves, its relevance should increase. In other words, the effectiveness of the reporting tone in management commentary will be demonstrated by its ability to influence the decisions of its users. Therefore, understanding the role of information in investor behavior depends primarily on the need for this information in the first place or the agency problem. The importance of the concept of relevance within regulatory bodies and its subsequent application by reporting entities has stimulated academic research to measure and identify the factors that contribute to its enhancement. Therefore, the study's question can be formulated as follows:

Is there a relationship between the tone of reporting management comments and the relevance of the value of financial risk information for the banks in the study sample?

Third: Research objectives

Regulators view narrative reporting as key to achieving the desired change in the quality of unit reports. In recent years, accounting researchers have increasingly focused their efforts on investigating reporting, and it is now recognized that there is an urgent need to develop reporting metrics to facilitate research into voluntary disclosure and the relevance of risk information in stock price valuation. This study responds to and contributes to this call by investigating the key factors that influence the relevance of financial risk information and how this is reflected in stock price valuation within the Iraqi context. Therefore, the current study seeks to achieve this goal by addressing the following main objectives:

This research examines the complex concept of financial risk information relevance in stock price valuation and the challenges associated with its measurement. It also presents a concise measure of the relevance of risk information in stock price valuation.

This research aims to investigate the relationship between the tone of management commentary reporting and the relevance of risk information in stock price valuation.

Fourth: The importance of the study

The importance of the study lies in all of the following:

Both current and potential investors and lenders seek useful accounting information to inform their decisions. The current study is expected to help them by providing this information, which has the potential to predict future returns and cash flows, through management feedback. This information enhances the relevance of accounting information and financial risk information to stock prices. Assisting the management of the banks in the study sample and all economic units listed on the Iraq Stock Exchange in identifying useful information that should be reported in a manner that meets the needs of their users. This is achieved by adopting management feedback reporting as a means to support and enhance the relevance of information to stock prices. This reduces the cost of capital, encourages foreign investment, and contributes to the proper evaluation, distribution, and allocation of available financial resources, directing them toward the most appropriate investment areas.

Fifth: Scope of the study

The current study aims to examine the relationship between the tone of reporting management comments and the appropriateness of the value of financial risk information. The context of the study is companies within the banking sector whose shares are listed on the Iraq Stock Exchange. The banking sector is a vital component of Iraq's economic activity. It is one of the most actively traded and active sectors within the financial market. Furthermore, it includes a broad segment of individual investors, as companies in this sector are characterized by private shareholding. The impact of banks on society, the environment, and the economy motivates the desire to identify the factors that influence the valuation of their stock prices in the financial market. The current study population consisted of the 48 banks listed on the Iraq Stock Exchange. The focus then shifted to banks listed on the regular market that have commercial activities (excluding Islamic banks), whose shares were continuously traded and whose data were available during the study period. Twelve banks were selected as a sample for the study. Additionally, the study period spanned ten years, from 2012 to 2021, encompassing a total of 120 observations.

The concept of reporting management comments

Unit reporting encompasses unit reports and management commentary, which are interconnected and include key information such as financial results, corporate governance reports, unit social responsibility reports, and other crucial narrative details reported alongside financial statements to provide a comprehensive understanding of the unit's performance, strategy, market position, and prospects. Therefore, unit reports (and management commentary) should go beyond numbers and seek to narrate and communicate information about the unit's performance to stakeholders. (Tlou, 2012:25-26)

The International Accounting Standards Board (IASB) defines "management commentary" as "information that accompanies the financial statements as part of an entity's financial reporting. It is designed to explain the main trends and factors underlying the development and performance of the unit's business during the period

covered by the financial statements. It also reflects the main trends and factors that are likely to affect the unit's future performance and development." (IASB, 2005:15)

Reporting management comments is an integral part of financial reporting, which accompanies the entity's financial reports. These comments aim to enhance the quality of financial information for users by presenting and analyzing the entity's financial position and its trends from the management perspective (Raluca Sandu, 2007: 237). Therefore, there is a belief that reporting management comments is part of a general movement toward disclosing more qualitative information by entities (Fraser et al., 2010: 11). The International Financial Reporting Standards Practice Statement also explains that "reporting management comments provides a context within which to interpret the financial statements—i.e., the entity's financial position, financial performance, and cash flows—as well as providing an opportunity to understand management's objectives and strategies for achieving those objectives" (IASB, 2010: 3). Some see it as a description of the unit's business model using text, metrics and illustrations, as well as clarifying the trends and key factors underlying the development, performance and position of the unit's business during the period covered by the financial statements and its portfolio of strategic options designed to deal with the processes and relationships that drive value creation at the operational, tactical and executive levels and that ensure the unit's future performance and development (Nielsen, 2011:2). Others see it as often a narrative report that provides information that enables the informed user to obtain an appropriate understanding of the business path, position and expected development of the group and the opportunities and risks associated with it, and that it is a system of information included and associated with the financial report. The evolution of trends reveals the increasing importance of reporting management comments and, to some extent, narrative accounting (Wulf, 2016:6). Reporting management comments can be described as a descriptive report that regulates disclosure processes and enables the entity to identify useful information that uninformed shareholders and potential capital providers need to disclose, and explains information that financial reports cannot explain (Eidan and Al-Jawahri, 2020:31). Therefore, the researcher believes that reporting management comments represents a type of narrative reporting that

enhances the reporting contained in financial reports and provides management with insights into the factors that have impacted the entity's financial performance and financial position, as well as the factors that could impact the entity's ability to create value and generate future cash flows. Reporting management comments provides information about the strategic objectives and business model, which enables investors and other stakeholders to better understand the implications of decisions and events that affect the timing and volume of cash flows, thereby reducing risk and enhancing the entity's value.

The concept of reporting tone

The pivotal role of style in aiding communication has long been understood. Several chapters in Aristotle's Rhetoric (Book III) are devoted to the importance and function of rhetoric in facilitating lucidity (clarity or transparency) and eloquence (effect). Stylistic choices can be made consciously or unconsciously and include a range of devices such as syntax, vocabulary, imagery, and prosody. An essential element of style is tone. Tone is a means by which an author can imbue a narrative with a desired meaning or effect through word choice. Like many elements of style, tone can be deployed to disseminate increasingly useful information or used strategically to influence the reader's perceptions of the narrative topic (Richard et al., 2019, p. 202). It reflects the wording that management uses to report current and future performance to influence users of accounting information positively or negatively when making decisions (Ahmed, 2019: 71). It can be described as a verbal tone that highlights managers' feelings expressed in the report based on the use of words that carry optimistic or pessimistic characteristics. The more words expressing optimistic news than pessimistic news, the more hopeful the tone of the report is, and vice versa (Hussein, 2020: 9-10). The interaction of key individuals with the tone of the report is exciting, given that Narrative reporting offers greater discretion than digital reporting (Martikainen, 2022: 101). Tone is also viewed as the author's attitude toward their audience as well as their attitude toward the narrative subject. This "attitude" can be demonstrated through diction, i.e., the choice of words with equal semantic value (i.e., words with the same literal or dictionary meaning) that can have

different implicit meanings (personal or emotional). Thus, the word choices made in constructing a narrative may combine to create one or more dominant tones, "just as brushstrokes collectively contribute to the texture of a painting." Verbal tone is "a tool people use (sometimes unwittingly) to create distinct social impressions through word choice." Tone becomes more powerful when used repeatedly. Tone can therefore be viewed as "the product of individual word choices that repeatedly accumulate to produce stereotypical expectations that tell the audience something important about their outlook." "The author of things" (Richard et al., 2019: 204). It can represent a strategic performance management tool used by managers to report good news in an optimistic tone or bad news in a pessimistic tone when evaluating the operational performance of the unit, which impacts how stakeholders understand and process information when making decisions (Hussein, 2020: 10). It provides a framework that can influence the perception and understanding of information by financial market participants. The language used in business reports is also a fundamental component of the set of information reported to influence the behavior of its users (Ibrahim, 2022: 18). It represents the use of optimistic and pessimistic language levels in the financial reports of the economic unit, which are determined by several words, nouns, adjectives, or verbs that can help express good intentions and manage the impression of those users of those reports to express the news content (Shalash, 2023: 21).

It is clear from this that researchers in the accounting literature have provided numerous concepts and definitions to determine the meaning of the tone in accounting reporting. However, most of them are similar in that they reflect a feature of narrative reporting based on the use of nouns, adjectives, or verbs to express the feelings of managers and to indicate how to describe the performance of units and their future trends positively or negatively within business reports, which can be reflected positively or negatively on users of the reports when making their decisions. Therefore, the researcher believes that tone reflects managerial sentiments related to the unit's performance, risks, value, and prospects. Managers often seek to report optimistic news more quickly, which includes a set of words indicating good news and sending signals through reporting this news to influence investor and financial market responses. In contrast, a pessimistic tone includes examples of differential expressions

that convey a connotation of pessimistic activity, such as negative, slow, static, and unplanned actions. Expanding on this tone, it is synonymous with "language that supports a person, group, concept, or event, or highlights its negative connotations." This basic type is attributed to a critical view of performance, which negatively affects the perceptions and feelings of information users from interested parties. Managers often prefer to conceal the reporting of pessimistic news, which can gradually decrease with increased exposure to litigation. Still, it can expand with increased managers' tendencies to support stock prices in the financial market and enhance the unit's value.

The concept of relevance of information value about financial risks in stock price valuation

Many countries in advanced, developing, and transition economies experienced banking crises in the 1980s and early 1990s, requiring a comprehensive overhaul of their banking systems (International Monetary Fund, 1998). The scandals and failures of several well-known units in recent decades have led to increased interest in risk disclosure. Furthermore, as the banking sector continues to embrace innovation, the severity and diversity of risks to which users are exposed also continue to increase in tandem with these changes. To ensure that growth in the banking sector does not jeopardize its stability, risk management is of paramount importance. Global concerns about financial risks are growing. In this context, units of all types and sizes are seeking to develop robust financial risk management frameworks that meet compliance requirements, facilitate better decision-making, and enhance performance. Financial units also face critical challenges in finding new and more effective ways to increase core revenues, maintain necessary capital ratios, improve profit margins, strengthen their balance sheets, and enhance operational efficiencies within the unit. Financial risk management has received increasing attention in recent years (Fatemi & Glaum, 2000: 4).

The reasons for financial risk management are the same as those used to implement unit risk management, as financial risk is a subcategory of unit risk. Therefore, commercial banks employ financial risk management practices that do not aim to

prohibit or prevent risk-taking, but rather to ensure that risks are approached consciously and with full knowledge, a clear objective, and a high level of understanding so that they can be measured and mitigated. Allen (2003:1) discovered that unit financial risk management seeks to manage unit exposure to fluctuations in currency prices, interest rates, liquidity, credit, commodities, and other factors driven by the financial market. It should be viewed as an ongoing process that continually evolves as units encounter new and unexpected risks. However, the reality is that many units that have identified various risks in their businesses do not have formal risk policies or strategies to manage these risks within an approved process.

Furthermore, the uncertainty associated with each type of business activity represents risk (Baldoni et al., 2001:13). Therefore, risk management is the responsibility of all stakeholders. Financial risks are managed to avoid financial distress and the associated costs. Moreover, managerial self-interest in stabilizing earnings or maintaining a constant tax level can serve as a motivation for financial risk management (Dhanini et al., 2007:1). Financial risk management focuses on reducing volatility or avoiding significant losses. Units facing the risk of breaching their debt covenants are likely to choose accounting procedures that can shift future earnings into the current period to avoid default costs, which may lead to earnings management, either upward or downward, to achieve their goal, thus increasing risk (Odoemelam, 2019:9).

Many studies have shown that a unit with high leverage has a greater degree of financial risk and error. Therefore, managers of these units may have an incentive to manipulate earnings to avoid breaching debt covenants. Consequently, it can be argued that for units with high financial leverage, accounting figures should be less favorable to investors. However, lenders have a vested interest in ensuring that they recover from borrowers. Since financial statement information provides them with a measure of such recovery, lenders have an incentive to ensure that the accounting information they receive from borrowers is free of opportunistic earnings management practices. This may lead to a positive association between accounting information and stock prices for highly leveraged units, suggesting that the level of risk

associated with units will affect the relevance of information value. Therefore, financial risk is likely to enhance the relevance of information value (Habib & Azim, 2008: 178).

Furthermore, the study by Acaranupong (2021: 38) revealed that financial leverage plays a crucial role in determining the relevance of information value, a finding consistent with the results of Ertugrul (2021: 247). Financial risks have a significant impact on the relevance of information value for a sample of Turkish entities. However, the effect of leverage on significance is not as simple as a one-sided analysis. Highly leveraged entities may have incentives to manipulate accounting information to avoid violating debt covenants. In this case, accounting figures should be less favorable for highly leveraged entities. Lenders need to ensure that the accounting information they receive from borrowers is free of opportunistic earnings management practices, which can cause a positive correlation between accounting information and stock price (Sousa & Matos, 2021:11). Agency cost theory explains the relationship between leverage and reporting. Increased leverage leads to higher agency costs and is associated with greater reporting compliance, which can help reduce information asymmetry. When the information gap between managers and investors is high, investors face confusion and uncertainty, resulting in increased costs for collecting, processing, interpreting, and utilizing accounting information (analysis costs). This, in turn, can distort the information content. In accounting figures, this weakens the relationship between accounting unit stock prices and their value relevance, as stock prices are an indicator of performance for investors. The market response to reported accounting information is characterized by the coefficient in the regression model, where stock price serves as the dependent variable and accounting measures, such as earnings, book value, cash flows, and financial risk, serve as the independent variables (Ofoegbu & Odoemelam, 2018:1).

Disclosing detailed risk-related information is assumed to help investors, lenders, analysts, auditors, and other users of accounting reports better evaluate entities. Furthermore, risk-related information will be viewed as partial evidence of the effectiveness of the relevance of that information's value and its ability to trigger market reactions in assessing stock prices and returns. (Trang, 2020: 28-29) It is clear

from the above that disclosing risks, including financial risks, can contribute to explaining and enhancing the relevance of information value, as it enables the assessment of future unit values and the prediction of stock returns and prices. Furthermore, it can contribute to adjusting investors' expectations and choices regarding their stock investment decisions, which are followed by changes in those stock prices, due to the stock market's reaction to the disclosure of that information. The relevance of information value is likely to have several advantages for various parties, which should be identified and diagnosed.

Studies that addressed the relationship between the tone of reporting management comments and the relevance of the value of accounting information and financial risks.

The tone of information reporting represents one means by which the information gap between a company's managers and capital providers is bridged. Transparency can lead to a lower cost of capital, support the quality and sustainability of earnings, and enhance corporate market value. The primary feature of information usefulness is its relevance to investor decision-making. The dynamic change in the market value of stocks reflects the flow of information to the market. Consequently, relevant adjustments in stock market prices convey the relevance of this information to investors. Although financial reports are an essential source of information, over time, this information has become insufficient to influence user decisions. A clear need arose to report on issues affecting a company's ability to generate and create value alongside financial information. This has sparked increased interest in narrative reporting in stock valuation and the financial market's response to this information, thereby enhancing its ability to transmit and communicate information efficiently. This has encouraged many researchers to study the nature of the relationship between narrative reporting and the relevance of information value and to conduct further tests in this area. Several studies devoted to this context will be addressed. The study (Jaffar et al., 2019) aimed to achieve two objectives. First, to examine the impact of voluntary disclosure of eight integrated reporting content elements on the value relevance of corporate information in Malaysian companies. Second, to

investigate differences in the value relevance of corporate information between the periods before and after the issuance of the integrated reporting framework. The annual reports of 603 companies listed on the primary market of Bursa Malaysia for the years 2012 and 2015 were examined. The results show a significant difference in value relevance between the periods before and after the issuance of the integrated reporting framework. However, the level of voluntary disclosure of information related to the eight integrated reporting content elements does not significantly affect the value relevance of corporate information.

Mohaimen et al. (2021) also investigated the relevance of accounting information value in the context of integrated reporting (IR) in both mandatory and voluntary settings. A comprehensive review of a wide range of companies across several countries, focusing on the 2011 integrated reporting model, provides detailed insights into the gaps in the IR literature. A multiplier log-linear model is used for measurement. The results show that the relevance of summary accounting information value increases after the implementation of IR in the mandatory setting. In the voluntary setting, the influence of the market and the current reporting model influences the relevance of accounting information value in the context of IR. If the market is large and the current reporting requirements are stringent, the voluntary adoption of IR will have a minimal impact. However, in smaller markets with a less strict reporting environment, the adoption of IR leads to an increased relevance of accounting information value. Compared to traditional models, the results of this thesis demonstrate that capital providers value the information content of IR under specific conditions. Zainy & Temimi (2021) also examined the impact of business model disclosure on the relevance of accounting information value to investors in the Iraqi banking sector. The empirical study was conducted on eight Iraqi banks listed on the Iraq Stock Exchange over the period from 2016 to 2018. This period was characterized by the adoption of international accounting standards and International Financial Reporting Standards, as well as banks' disclosure of their business models. The study yielded a set of results, the most significant of which is that the indicators of the Management Comment Reporting Framework, issued by the International Accounting Standards Board (IASB) in 2010, are the most effective indicators for

business model disclosure in the Iraqi banking sector. Furthermore, business model disclosure enhances the relevance of accounting information value to investors.

The study by Narsa & Permatasari (2021) sought to investigate whether reporting in the form of sustainability reports—which are separate from the annual report—or integrated reports is more valuable to investors, as well as whether integrated reports have value relevance. The study employed the Ohlson model as an approach to assessing value relevance, utilizing a binary variable to distinguish between companies that provide sustainability reports or integrated reports. The study included 922 observations of bond issuers in Europe and Africa between 2005 and 2019. The results showed that sustainability reports had a higher value relevance than integrated reports. However, the results concluded that the interaction of the corporate reporting format with accounting information could also enhance the relevance of accounting information.

Meanwhile, the study by Oliveira et al. (2021) focused on identifying the effect of the tone of narrative risk reporting on a company's market value. The study used a sample of 34 Portuguese non-financial companies traded on the Euronext Lisbon Stock Exchange. A machine analysis of the narrative content of risk communication included in the risk and risk management sections of the 2018 annual reports was performed using DICTION 7 software (Digitext, Inc., Austin, TX, USA) to determine the tone of the communication. The main results indicate that the "activity" tone category is negatively related to the company's market value. This finding also suggests that investors underestimate the risk information communicated to them.

This is also supported by a study by Elshandidy & Zeng (2021), which sought to investigate whether risk-related disclosure, including overall risk disclosure and its tone, including upside and downside risk disclosure, has a relevance value for investors in the UK market. Based on 1,941 observations across the year for non-financial companies listed in the FTSE All-Share Index, the study confirmed that the value relevance of overall risk information is not statistically observable unless its tone is differentiated. Specifically, upside (downside) risk disclosure significantly increases (decreases) stock prices. The results also showed that the value relevance of risk

information exhibits an asymmetric response of stock prices to companies' disclosures of both upside and downside risk. Meanwhile, a study by Pouryousof et al. (2021) examined the relationship between managers' disclosure tone and the trading volume of both small and large investors. Disclosure tone inconsistency and abnormal trading volume generally indicate information asymmetry between managers and investors. However, by separating the abnormal trading volume of small investors from that of large investors, this relationship demonstrates information asymmetry between small and large investors. In this study, the disclosure tone of management discussion and analysis (MD&A) was measured using the finance-oriented dictionaries developed by Loughran and McDonald (L&M), and tone inconsistency was measured using a normative model. Data were collected from 143 companies listed on the Tehran Stock Exchange from 2011 to 2020, with a total of 1,380 annual reports. The results indicate that inconsistency in MD&A tone is positively associated with abnormal trading volume for all investors. Furthermore, MD&A tone inconsistency has a different impact on the trading behavior of small and large investors, and is more likely to mislead the former.

Reichmann (2023) confirms that managers have significant discretion over voluntary disclosures. At the same time, disclosure tone is an essential source of information for investors. Therefore, the study sought to investigate the nature of the relationship between tone management and the risk of future stock price collapses. Consistent with the view that managers use their discretion over disclosure tone to deliberately manage information, the sample period spans 1993 to 2018 for a sample of US firms. The results indicate that tone management in management's discussion and analysis of 10-K filings is, on average, positively associated with the risk of future stock price collapses, even after controlling for quantitative determinants of collapse and financial disclosure readability.

Furthermore, cross-sectional analyses reveal that the effect is more pronounced when managers have greater incentives and are less constrained in manipulating the tone of their disclosures. Taken together, the findings suggest that tone management can have greater and broader consequences for the capital market than previously

documented. The study (Asadi et al., 2024) aimed to investigate the impact of integrated reporting quality on value creation and the relevance of accounting information. The study used a sample of 161 companies listed on the Iranian Stock Exchange from 2017 to 2023. Ordinary least squares regression analysis was used to test the study's hypotheses. The results showed no statistically significant relationship between integrated reporting quality, value creation, and the relevance of accounting information. The researchers attributed these results to the fact that financial and non-financial information are prepared in different reports, regardless of the international integrated reporting framework.

The motivation for the study (Xue et al., 2024) was to investigate the impact of management discussion and analysis (MD&A) on cross-sectional stock returns in the context of Chinese A-share companies. The results indicated a positive and significant relationship between management discussion and analysis and Chinese stock returns after controlling for quantitative financial measures. Moreover, the results confirmed that the management discussion and analysis style provides additional value, enhancing the quality of information in management disclosures, analysis, and market responses. The effect of the textual style is more pronounced in companies with low institutional ownership and low financial transparency, as well as in less competitive market environments. Both the information factor and the emotional factor in the management discussion and analysis style positively impact stock returns. Thus, the results provide compelling evidence that management discussion and analysis narratives can be an effective communication tool for facilitating disclosure and reducing information asymmetry between companies and investors.

Haidar (2024) sought to investigate whether one of the fundamental characteristics of information relevance has improved following the introduction of integrated reporting. To this end, the study sought to examine the effectiveness of integrated reporting by exploring its impact on the value relevance of accounting information. To achieve this purpose, the study employed a quantitative design. It adopted various regression models, including least squares regression, apparently uncorrelated regression, and quantile regression, on a sample from South Africa where integrated

reporting is mandatory. The results indicated that, on average, the implementation of integrated reporting by South African companies did not affect the value relevance of the accounting summary. Further investigations revealed that only medium-sized companies experienced a change in the value relevance of the accounting summary, possibly due to their financial needs. Furthermore, it was found that large companies with experience in international reporting also enhanced the value relevance of their earnings after adopting investor relations.

It is clear from the review of the studies that were addressed that despite the variance in the business model for narrative information reporting, whether represented by integrated reports, management comments, governance reports, and strategy reports, and the extent of its ability to influence the value of companies and the evaluation of the value of their shares in the financial market, and the extent of its ability to influence the suitability of the value of information to evaluate stock prices or their returns, the results revealed by these studies were varied. The results of some of them concluded that narrative reporting had a change in the suitability of the value of information, and the results of others came to indicate that it did not affect the suitability of the value to profits, book value, cash flows, or any other variables, or that its effect was weak. The variance in these results of these studies can be attributed to the difference like mandatory or optional reporting, the nature of the environment in which the tests were conducted, the variance like the units' activity, or the statistical method used to test and analyze the results, in addition to the time series subject to testing and the extent of progress, prosperity, or economic crisis witnessed during the study period. Therefore, it is important to test this relationship in light of the Iraqi environment for a sample of banks (financial activity). The research hypothesis was formulated as follows:

Hypothesis: “There is no statistically significant relationship between the tone of management comments and the appropriateness of the value of risk information.”

Hypothesis Testing and Interpretation of Results

First: Statistical Hypothesis Test Results

To test the hypothesis that "there is no statistically significant relationship between the tone of management's comments and the appropriateness of the value of risk information," the following linear regression model was formulated:

$$VRR_{it} = B_0 + B_1MCT + \varepsilon_{it}$$

Table No. (1) Hypothesis test results

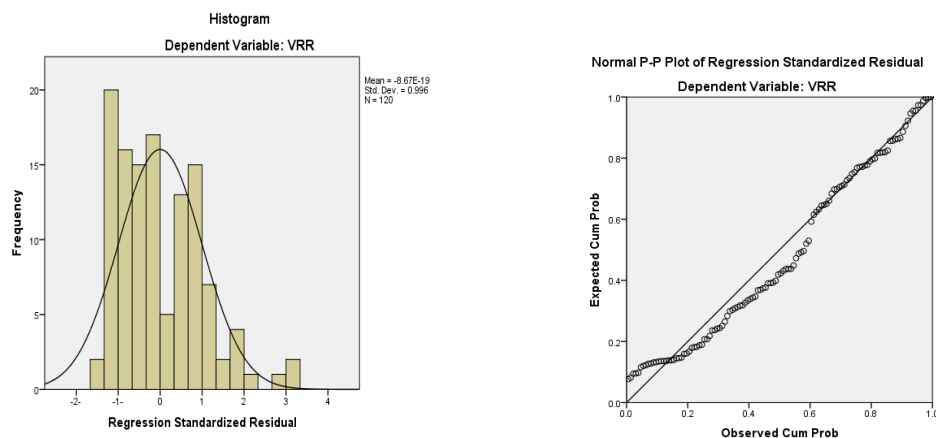
Significance level of the correlation value Sig. (R)	Link value R	Interpretive correlation R Square	Significance level Sig.	Independent variable index T	Effect Amount B	Regression equation variables
.046	.182a	.033	1.000	.000	6.629E-17	Risk Value Appropriateness
			.046	2.013	.182	Management Comment Tone

The table above shows that the correlation value (R) between the variables reached 0.182, which is a statistically low value, and that the value of the interpretation coefficient (R Square) reached 0.033, which means that the independent variable (management's comment tone) explains 3.3% of the variance in the dependent variable (risk value suitability), and that the level of significance of the Sig test reached 0.046, which is smaller than the acceptable error value in the social sciences, which is determined in advance by 0.05, which indicates the suitability of the statistical model used.

The table above also shows that the slope of the regression equation for the independent variable (management's comment tone) was 0.182, indicating the effect of the independent variable on the dependent variable (as reflected in coefficient B). A positive coefficient value suggests a direct impact between the dependent and

independent variables. In other words, any one-point increase in the tone of management's comment leads to an 18.4% increase in the appropriateness of the risk value. The significance of the sig t-statistic was 0.046, which is less than the acceptable error value in the social sciences of 0.05. This means that the sample data provided convincing evidence to reject the null hypothesis and accept the alternative hypothesis of a statistically significant effect.

The following figure displays the frequency histogram, which demonstrates the normal distribution of the statistical residuals of the regression equation. It graphically shows the fulfillment of the regression analysis test requirements, illustrating the distribution of points around a straight line. This indicates that the statistical residuals follow a normal distribution, thereby establishing the accuracy of the previously derived regression equation. Figure (1): Frequency histogram and regular distribution of the residuals of the central hypothesis



Second: Interpreting the Hypothesis Test Results

The above analysis reveals a relationship between the tone of management's comments and the relevance of information risks, as indicated by the correlation coefficient and level of influence. Furthermore, the optimistic tone of management's comments demonstrates management's strategies for shaping perceptions and is a signal for understanding how the tone reflects management's intentions. It also explains the biases affecting tone and risk perception. It attempts to influence the

relevance of information through its impact on the decisions made by the parties using that information. Decisions made by stakeholders primarily depend on the reporting of management's comments regarding the nature of the business and its strategic objectives.

The tone of management's comments is a non-quantitative signal that complements risk data. When the tone is consistent with the data (such as expressing cautious optimism with low risk indicators), it sends a reliable signal that enhances the credibility of the information. If the signal is honest (without exaggeration), it reinforces the positive impression without misleading. In an efficient market, the market integrates verbal cues with data to more accurately assess risk. Management recognizes that investors are concerned about high leverage, but it is reluctant to report details that might reveal sensitive risks (such as weak cash flows). Therefore, it uses an optimistic tone as an alternative signal to direct investors' attention toward "growth opportunities" rather than focusing on debt. Formulated optimistically to convey the banks' ability to continue and withstand risks, this information is considered to be of an acceptable level of relevance. In contrast, a pessimistic approach to reporting management comments negatively impacts all stakeholder decisions because these expressions impair the accuracy of future forecasts, particularly regarding debt and the risk of financial failure.

The deliberate phrasing of "exceptional growth opportunities" aims to:

- Create the impression that management is controlling risks through proactive strategies.
- Shift the narrative from "debt problem" to "future success story."

Investors will react to the signal by interpreting it through their biases (according to behavioral theory), as follows:

- Optimism Bias: Investors tend to believe optimistic statements because they satisfy their desire to hear positive news, especially in light of a lack of data.

- Framing Effect: Presenting information within the framework of "growth investing" rather than "risky borrowing" changes their perception of risk.

Thus, market reaction integrates qualitative signals with limited data (efficient market theory). Under semi-strong efficiency, the market notices the increase in leverage, but lacks sufficient data to understand its causes. Therefore, it relies on an optimistic tone as a proxy for future performance. Information becomes "useful" despite limitations (decision utility theory); in the absence of sufficient data, investors rely on tone to build their expectations. With poor reporting, investors increasingly rely on tone, enhancing its value as a decision-making tool.

Management creates a signal to compensate for data gaps, taking advantage of:

- Limited investor attention: Focus on positive aspects.
- The need for narrative reporting: Transforming abstract numbers into a compelling story.

Therefore, investors' interpretation of the signal is not based on complete rationality, but rather on:

- Optimism bias: preferring good news even if it is unsupported.
- Frame-guidance: assessing risks based on how they are presented, rather than their substance.

Thus, financial market interaction, which should not operate in a vacuum, will be a key factor in pricing because:

- Quantitative information is insufficient to make a fully "rational" decision.
- Market participants imitate each other (herd behavior) based on the general tone.

Even incomplete information can be useful if it helps in:

- Making decisions without in-depth analysis.
- Building future scenarios.

The positive relationship between optimistic tone and poor reporting of management comments is not static, but rather the result of a dynamic interaction determined by the following factors:

- 1- Management strategies: Using qualitative signals to compensate for quantitative shortcomings.
- 2- Investor biases: The tendency to selectively interpret information to support their expectations.
- 3- Relative market efficiency: The market's ability to quickly interpret qualitative signals, even if they are inaccurate.
- 4- Practical context: The need for quick decisions in the absence of complete information.

This integration demonstrates that an optimistic tone is not just "honeymoon talk," but rather a strategic tool that interacts with the complex information environment to create a micro-financial reality, where qualitative signals become part of the game of expectations and perception management. Management used an optimistic tone to conceal poor performance or undisclosed risks, compensating for the lack of reporting on management comments about risks and future growth opportunities. These findings are consistent with the results of a number of related studies, including Connelly et al.'s (2011) study, which confirmed that verbal signals are used extensively in high-risk environments to compensate for a lack of data, especially in startups. Management used tone to craft a narrative aimed at shaping positive perceptions, even if the data were insufficient. They followed several strategies to do so, including justification when explaining negative events with external causes (such as the ISIS incidents in 2014 or the impact of the COVID-19 pandemic in 2020 and 2021), obfuscation by using vague language to avoid reporting details, and other strategies. Therefore, the impact of this strategy is significant. Following these strategies affects investors' perceptions and decision-making, which, according to behavioral theory, can lead investors to overreact to optimistic signals, even in the absence of quantitative support. These findings are consistent with several studies, including those by Brennan et al. (2009) and Hirshleifer et al. (2015), which confirmed that investors place greater weight on verbal cues than on quantitative data in uncertain environments. Under the partial efficiency of the financial market, prices may not reflect all available information, but they react quickly to verbal signals if they are consistent with market expectations. Moreover, in emerging markets, where asymmetric information is widespread, tone becomes a key tool for pricing and evaluating stocks. Therefore, the relationship between reporting tone and the

relevance of risk information was positive, which is consistent with the results of several studies, including Fama & French (2015), Shiller (2019), and Davis et al. (2020), which confirmed that narrative tone is a “key” part of market movements and stock valuation and pricing.

General conclusion

First: Overview

This study addresses a critical issue in the field of reporting and the relevance of information value: the complex relationship between the tone of reporting in management commentary and the value relevance of financial risk information. Given the importance of the local context (the Iraqi environment), the study was applied to a sample of banks listed on the Iraq Stock Exchange for the period from 2012 to 2021.

This study is based on a central problem: the extent to which the information contained in annual reports, particularly that related to financial risks, influences investor decisions and the company's market value (value relevance). The specificity of the problem stems from its focus on the "reporting tone" in the management commentary section—the narrative component that reflects management's position and expectations—as a potential factor influencing how users (especially investors) interpret and perceive the value of quantitative information about financial risks. The fundamental question the study sought to answer was: Does the tone of reporting (whether optimistic or conservative) in management's comments affect the "value relevance" of the information provided about financial risks? If so, what is the nature of this effect?

Second: Presentation of the most important results and conclusions

The most important results and conclusions revealed by the research can be summarized as follows:

The inclusion of management comments in financial reports represents a qualitative shift in reporting. These comments provide management with greater flexibility to express the reality of the unit, the nature of its activities, risks, and prospects, moving away from the traditional quantitative dimension of financial reports. At the same

time, this type of reporting may contribute to the emergence of impression management practices, as management attempts to influence investors and creditors by highlighting positive aspects, downplaying negative aspects, or framing reports in a way that leads readers to more optimistic conclusions than reality. Analyzing the level of reporting, on the one hand, and the tone of reporting, on the other, are two essential ways to understand the objectivity of reports and the extent to which they skew toward exaggeration or conservatism. The relevance of financial risk information is a key pillar of the effectiveness of financial reports, as it is measured by its ability to influence the decisions of investors and other users of financial information. In this context, testing the relationship between a set of accounting variables and stock price represents an effective tool for measuring relevance. Information is not necessarily relevant simply by its availability, but rather when it is capable of influencing users' decisions and market pricing. The tone of management commentary can represent the most prominent element of narrative reporting employed to convey qualitative messages to users of accounting information. It represents a linguistic mix that reflects management's view of the nature of activities, risks, and future expectations. The impact of this variable increases when it is used in an optimistic or pessimistic manner to describe performance, which impacts users' level of risk perception and their ability to make sound decisions. Statistical results indicate a statistically significant relationship between the tone of management commentary and the relevance of financial risk information. A one-point increase in the tone of management commentary leads to an 18.4% increase in relevance.

Third: Presentation of the most important recommendations

Strengthening oversight by enhancing the role of regulatory bodies in reviewing the comprehensiveness and quality of reports, not just financial indicators. Requiring companies to disclose the tone of the risk section separately in annual reports. Establishing a unified platform for publishing financial risk reporting to enhance transparency.

Issuing clear regulatory instructions from the Central Bank of Iraq requiring banks to provide qualitative and comprehensive disclosures, and setting stricter requirements

for management commentary, particularly on objectives, strategies, and the external environment.

Introducing discourse analysis tools, such as sentiment analysis, as part of annual report evaluation tools.

Adopting proactive transparency: Linking optimistic tone to measurable and verifiable performance indicators, and avoiding misleading optimism: Ensure that explicit action plans support claims.

Adopting internal analytical tools: Banks can engage content analysis experts to review reports before they are issued, detecting any exaggerated tone or lack of content. Controlling and balancing tone and reducing rhetoric: Banks should link positive claims to concrete figures or indicators, ensuring greater transparency and avoiding misleading readers.

Provide more precise and more accurate financial information so that the annual report reflects a realistic picture of performance. This includes disclosing potential risks and operational challenges that management may face in its plans.

Encourage banks to use data-backed, analytical disclosure instead of relying too heavily on promotional language. This indicates the need to incorporate sensory and comparative analysis. Using a comparative study between similar companies in the same sector may help uncover any exaggerated variation in reporting tone. Furthermore, analyzing the textual content of reports may reveal the extent to which positive or negative statements are repeated to an unreasonable degree.

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