Earnings Management and Tone Management: Evidence from the UK

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1. Background/ Objectives and Goals

This study investigates, whether earnings management in the audited financial statements is associated with tone management during earnings conference call in the UK.

Earnings management and narrative disclosure are communication strategies used from managers to communicate with investors or other users. Because earnings management and narrative disclosure stem from managers, they can exploit this by doing manipulation in their earnings, and providing narrative information in the earnings conference call as a tone of words, which will affect users' perception, and hence users will be misinformed. The association between earnings and tone management can be explained by the self-serving, through cognitive reference points, theory.

There are few of previous studies that examine the relationship between earnings management and different issues of narrative disclosure. However, no previous study exists to examine the association between earnings management and tone management. This research is motivated to fulfil this literature gap. Moreover, if firms that apply earnings management use tone management to mislead investors, it is beneficial for investors, policy makers, standard setters, or other users to know whether there is an association between earnings management and tone management. Clearly, we believe that this study is fundamental in the accounting context, where it evaluates the communication strategies that are used in firms' financial reports.

2. Methods

The sample period for this study lasts from 2010 to 2015, and the sample comprises all non-financial firms that consider under FTSE 350 during the sample period. A list of words from previous research is used to measure the tone in earnings conference call. Because this study focuses on the managerial strategic choice and the subjective issues that come from management, it uses a number of different discretionary accruals proxies to measure earnings management, where the previous literature suggests that accruals management is a manipulation tool from managers to change the users' perception.

3. Expected Results/ Conclusion/ Contribution

Consistent with prior research, it is expected to find that tone management is positively associated with earnings management. This means that firms that use earnings management have incentives to speak positively during their earning conference call through tone of words, to reflect a good perception for users, which will conceal the earnings management techniques used in their reporting. This suggests that earnings management and tone management are complementary strategies for managers to achieve their self-serving purposes.

Keywords: Earnings management, FTSE 350, Narrative disclosure, Tone management