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Management Commentary and the Value Relevance of Earnings: The Accreditation Role of Independent Auditors

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Abstract

A management commentary is a descriptive report on the various aspects of a company's operations that can provide useful information to investors. According to the regulations of the Securities and Exchange Organization of Iran, the companies' board of directors has been mandated since 2017 to prepare and submit management commentary. This report has been designed as an essential element in offering information to the capital market and improving the usefulness of the information companies provide. The present study, therefore, aims to investigate the effects of issuing regulations for management commentary on the value relevance of earnings. Considering that these reports must be audited and disclosed at specific intervals, the present study also examines the interactive effect of audit quality and the issuance of regulations for management commentary reporting on the value relevance of earnings. The statistical population of this study includes companies listed on the Tehran Stock Exchange (TSE) and Iran Fara Bourse (IFB) from 2012 to 2023. A linear regression model was used to test the study hypotheses. The results show that issuing regulations to present management commentary has increased the value relevance of companies' earnings. In other words, after these regulations were issued, the quality of companies' earnings increased. Based on the results obtained, audit quality also enhances the effect of issuing rules for management commentary reporting on the value relevance of earnings; that is, when the audit quality is higher, issuing regulations for management commentary reporting has a more significant potential to improve the earnings quality.

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1. Introduction

Following the financial scandals of past years, investors' confidence in financial statements and reports has dwindled, and the quality of financial reporting has emerged as a key factor in determining the credibility of the figures reported in financial statements. In recent decades, significant fluctuations due to financial crises at the global level have underscored the importance of high-quality and reliable financial reporting, further emphasizing the importance of improved quality of earnings and financial statements. Improving the quality of earnings is critical to accountants for sound financial and economic decision-making and gaining greater confidence at the global level. Financial reporting quality is also important to users of financial statements, market participants, regulators, and accounting researchers. High-quality accounting information is also imperative for companies to facilitate access to debt markets. According to Schipper and Vincent (2003), the importance of financial reporting quality can be explained by two approaches, including contractual and investment strategies (Schipper and Vincent, 2003). Based on the contractual approach, low-quality financial reports can lead to unintended wealth transfers. For instance, companies that base their managers' bonuses on earnings will, in practice, receive disproportionately high bonuses if the earnings are overstated. Based on the investment approach, low-quality financial reports are problematic because they can mislead investors when allocating resources (Myers et al., 2003; Schipper and Vincent, 2003). High-quality financial reporting enhances the attractiveness of stocks for investors, strengthens market liquidity (Young and Guenther, 2003), reduces capital costs (Khalifa et al., 2018; Leuz and Verrecchia, 2000; Salvato and Moores, 2010), improves the evaluation of past and current company performances, forecasts future positions (Ismail et al., 2021), and enhances capital allocation in the market (Ha and Feng, 2018; Biddle et al., 2009; Bushman et al., 2011).

Various indicators have been proposed in research to measure earnings quality. Kernel and Landsman divided the measurement indicators of earnings quality into three categories: Value relevance indicators, information content indicators, and predictive indicators. Francis et al. (2004) divided the measurement indicators of earnings quality into two categories: Market-related and accounting-related indicators. They introduced the value relevance of earnings as one of the most significant market-based indicators. They argued that the value relevance of earnings is a criterion that indicates the qualitative attributes of relevance and reliability (Francis et al., 2004). The value relevance of earnings has been defined as the ability of earnings to explain the behavior of stock returns. More precisely, when earnings can better explain the stock returns, they have a higher value relevance. Thus, based on the abovementioned research, the present study has used the value relevance of earnings as an indicator to measure financial reporting quality.

In recent years, capital market regulators, including the US Securities and Exchange Commission (SEC), have become concerned about the quality of financial reporting by companies. These professional regulatory bodies have compiled various financial disclosure and reporting laws to address these concerns. One of the most important regulations is the Sarbanes-Oxley Act, ratified by the US Senate in 2002. This act aimed to reduce future misdemeanors and regain investors' confidence in companies' financial reports and statements. It introduced significant changes in issues related to the reliability of company information disclosure and corporate governance quality. The changes include the development of mechanisms to regulate the accounting profession and revising the regulations regarding auditor independence, corporate governance standards, and banking investment regulations. Also, additional criminal penalties for violating stock exchange rules were introduced by this act.

In Iran, the Securities and Exchange Organization (SEO) is the regulatory body for the capital market. One of the main strategies of SEO is to promote public trust and the transparency and flow of sound information in the capital market. According to the Securities Market Act of the Islamic Republic of Iran (ratified on 22 Nov. 2005 by the Islamic Consultative Assembly), companies must prepare and issue their financial statements according to the accounting standards, guidelines, and regulations of the SEO. The executive regulations for the disclosure of information by companies registered with the organization, approved by the Board of Directors on 25 July 2007 (last amended on 5 Aug. 2019), outline the policies and procedures of the SEO on the disclosure of information by companies, including the type of information to be issued, the disclosure timeline, and the consequences of non-compliance with the guidelines. It must be noted that the executive regulations for disclosing information have been revised several times by the said organization since their ratification. One of these revisions occurred through memo 122/29386 on 20 Dec. 2017. An important change of guidelines in this memo was the exemption of listed issuers from disclosing their earnings per share (EPS) predictions while obliging them to publish management commentary. More precisely, according to Clause 5 of the said memo, "Given the absence of issuing EPS prediction following the provisions of the executive regulations for the disclosure of information by companies registered with the organization, listed issuers of TSE and IFB are required to prepare and disclose their management commentary along with interim financial statements for 3, 6, and 9-month periods and their annual financial statements. The companies must also present their auditor's opinion on the management commentary and their 6-month interim and annual financial statements ...". In addition, based on Clauses 1, 3, 4, and 5 of the said guidelines, listed issuers of TSE and IFB are required to present an audited annual management commentary, interim management commentary, audited 6-month interim management commentary, and an unaudited annual management commentary. Subsequently, on 25 Dec. 2017, The SEO Board of Directors approved the regulations for preparing management commentary as a mandatory framework for listed issuers of TSE and IFB. According to these regulations, the management commentary, the responsibility for the preparation and presentation of which lies with companies' boards of directors, is a descriptive report that provides a basis for interpreting the financial position, financial performance, and cash flows of the business unit. This report also allows managers to set their objectives and strategies for achieving them. The report is considered a significant item in informing capital markets and a supplementary and complementary of the financial statements. The report aims to enhance the usefulness of the information provided by business units that are presented along with the financial statements and, therefore, help users make better decisions about resource allocation to the business unit. The management commentary consists of information on the nature of the business, management objectives and strategies to achieve these objectives, key resources, risks and relationships, operational outcomes and prospects, and the key performance indicators and criteria that the management uses to evaluate the performance of the business unit against the stated objectives (Securities and Exchange Organization, 2017). Since the regulatory body claims that management commentary enhances the usefulness of information and facilitates investors' decision-making, it seems that the publication of this report can improve the quality of financial reporting and consequently enhance the value relevance of information. Nevertheless, the potential of management commentary in enhancing the quality of information and financial reporting of companies has not been extensively studied in research in this field. The present study, therefore, aims to investigate whether the quality of financial reporting has improved with the ratification and communication of regulations for presenting management commentary by listed issuers. As mentioned previously, the value relevance of earnings is used in this study to measure the quality of financial reporting. Therefore, the study first investigates the effects of issuing regulations to present management commentary on the value relevance of earnings. Then, the findings of this study can be used by the SEO of Iran to assess and improve management commentary.

The quality of audit services is one of the main factors affecting the quality of financial reporting. Auditors can help increase the accuracy and integrity of financial reports by reducing information asymmetry. They can thus provide stakeholders with more reliable information by reducing information asymmetry and managers' ethical risks (Ismail, 2020). Audit quality has different definitions. From the perspective of financial reporting quality, audit quality means the accuracy of the information provided by auditors to investors to enable them to make exact assessments of the company's value (Titman and Truman, 1986). In the accounting research literature, various studies have focused on the consequences and impact of audit quality on earnings management, financial reporting quality, value relevance, cost of capital, and investment decision-making (Ismail, 2020; Lee and Lee, 2013). The quality of financial reporting is a critical consequence of audit quality. Many studies have also investigated the effects of audit quality on the value relevance of earnings and shown that the value relevance of earnings, an indicator used for measuring earnings quality, increases significantly as audit quality increases (Heydari, 2015; Zakaria and Daud, 2013). Furthermore, Alkali et al. (2018) showed that audit quality statistically affects the earnings response coefficient (ERC) (Mirtaheri and Darabi, 2018; Alkali et al., 2018). Considering the abovementioned, audit quality can improve the value relevance of earnings. Also, the disclosure of management commentary can enhance the value relevance of earnings by improving the usefulness of the information; the present research investigates the interactive effects of audit quality and the issuance of regulations for presenting management commentary on the value relevance of earnings. This study examines whether or not a higher audit quality for management commentary can improve the value relevance of these reports.

The present research can strengthen the existing literature on financial reporting quality from two different aspects. First, in this research, the value added of the management commentary on the company's financial reporting chain has been investigated by examining the effect of the management commentary on the quality of financial reporting (the value relevance of earnings). In this regard, it should be mentioned that Taherinia and Darbandi Farahani (2022) showed in the result of their research that the simultaneous disclosure of management commentary and earnings forecasts by managers reduces information asymmetry and increases the quality of investment (Taherinia and Darbandi Farahani, 2022). In other words, in their research, the value added of the management commentary on the predicted earnings has been investigated. At the same time, this study has examined this issue from the perspective of actual (historical) earnings. Also, that research measured the reduction of information asymmetry through the bid-ask spread. In contrast, the criterion for determining the quality of financial reporting in this research is the value relevance of earnings. Finally, the period investigated in this research is 2012 to 2023, while that research period is from 2017 to 2019.

Second, according to the accreditation requirement of the management commentary by independent auditors at 6-month and yearly intervals, this research examines whether a higher quality audit can improve the value mentioned earlier. Previous research has yet to be found in this field.

2. Literature review

2.1 Financial reporting guidelines and the value relevance of earnings

Companies utilize different methods to disclose their information and reports. The literature on disclosure has shown that annual financial reports are one of the most important mechanisms companies use to provide information on their position. Research has also shown that investors and other users have higher confidence in companies' financial statements compared to other information sources. Additionally, the volume and content of information and reports disclosed by companies vary in different countries, depending on the level of economic development, the reporting rules and regulations, the accounting standards, and the degree of financial market development of each country. Company disclosures may be based on enforceable laws and standards or be optional over the requirements. Rules and regulations indicate the minimum required disclosures, and companies may issue helpful complementary information to facilitate investor decision-making (Haddad et al., 2017). Thus, the requirements, standards, and rules of reporting following the economic, financial, cultural, and business context of companies and business units can affect the quality of the final product of financial reporting, i.e., their financial statements, and lead to improved financial reporting quality.

Cohen et al. (2008) investigated the effects of the Sarbanes-Oxley Act on accruals management and earnings management in companies, showing a rising trend for accruals management from 1987 until the law was enacted in 2002. At that time, a decreasing trend started, while earnings management had a decreasing trend due to manipulating actual activities before the enactment of this law. After that time, a rising trend started. In other words, based on the findings of this study, the Sarbanes-Oxley Act has shifted companies from accrual-based management to real earnings management (Cohen et al., 2008). Alfraih and Alanezi (2015) also investigated the relationship between the degree of improvement in financial disclosures and the value relevance of their accounting information in the Kuwait stock exchange (Boursa Kuwait), showing a positive relationship between improved financial disclosures, the value relevance of net income, and the book value of companies. They used Ohlson's model (1995) to measure value relevance (Alfraih and Alanezi, 2015). Haddad et al. (2017) investigated the effect of changes in corporate governance and accounting regulations on the disclosure quality of companies in Jordan from 1986 to 2014, reporting a significant relationship between the changes and the quality of company disclosures. They also stated that certain features, such as the company's size and audit quality, can significantly affect this relationship (Haddad et al., 2017). Santos and Coelho (2018) examined the value relevance of risk-related disclosures and company risk management in the reporting of discussions and management analyses, revealing that the disclosures significantly affect company stock returns, therefore boasting a significant value relevance (Santos and Coelho, 2018).

Mustapha et al. (2021) investigated the effect of changes in corporate governance regulations in Nigeria in 2011 on the quality of financial reporting by companies. These changes pertained mainly to increased responsibility for board members and the increased number of audit committee members in companies. They reported that the increased responsibility for the board members does not significantly affect the quality of financial reporting, but increasing the number of audit committee members improves the quality of financial reporting (Mustapha et al., 2021). Espahbodi et al. (2022) investigated the effect of enacting the Sarbanes-Oxley Act on accruals management and real earnings management of companies in both the short-term and long-term, reporting that the enactment of this law successfully reduced accruals and real earnings management in the short term. In the long term, however, the accruals management returned to the same levels as before the enactment of the law (Espahbodi et al., 2022).

Binz and Graham (2022) investigated the effect of the 1934 US Securities Act on the information content of earnings disclosures. In this research, a short window around the earnings announcement has been employed to measure the information content of earnings. This research showed that the above law has increased the information content of earnings, which is more prominent in companies governed by more substantial requirements (Binz and Graham, 2022). Benkraiem et al. (2022) investigated the effect of adopting IFRS on information asymmetry. As a result, the earnings quality of companies listed on the French Stock Exchange showed that after applying these standards, information asymmetry and earnings quality increased significantly (Benkraiem et al., 2022). Botica Redmayne et al. (2023) examined the perspectives of shareholders, users, compilers, and independent auditors on management commentary in financial reports in New Zealand, showing that independent auditors believe management commentary reports are less beneficial and require further confidence and trust-building. The responses also revealed that the most critical objectives of management commentary in financial reports include enabling management assessment, evaluating the company's prospects, and evaluating future cash flows. The results also showed that the key principle in preparing these reports is presenting the most important and relevant information (Botica Redmayne et al., 2023). Amin and Cumming (2023) investigated the effect of corporate governance reforms in 2012 in Singapore and Vietnam (mainly related to independent non-executive directors) on earnings management. The result showed that new changes in corporate governance regulations have effectively limited earnings management. Also, based on the result of his research, higher education and longer tenure of these managers will lead to a more reduction in earnings management (Amin and Cumming, 2023). Radwan and Xiongyuan (2024) investigated the value relevance of integrated reporting quality by companies in some Asian countries from 2015 to 2022, demonstrating that investors react to the quality of integrated reporting (Radwan and Xiongyuan, 2024). Xia et al. (2024) following the Sarbanes-Oxley Act and the requirement for companies to use financial experts on their audit committees, the effect of compliance with the new law on various earnings management tactics of American companies from 2003 to 2016 was examined. The result showed that this regulation has significantly reduced various earnings management tactics, including accrual and real earnings management (Xia et al., 2024). Duan et al. (2024) investigated the proceedings of the Shanghai Stock Exchange to implement mandatory disclosure requirements (taken from the US capital market). In this regard, the companies' stock prices reaction to the comment letters published by the Shanghai Stock Exchange in connection with the mandatory disclosure requirements from 2013 to 2018 was analyzed. The results showed that the stock prices had a significant adverse reaction to the said letters (Duan et al., 2024).

Behbahaninia et al. (2021) investigated the effects of the SEO's overseeing independent auditors in listed companies on the audit quality and financial reporting quality of companies (the degree of relevance of the accounting information) from 2001 to 2018, reporting that audit quality and financial reporting quality grew significantly from 2007 onwards, following the start of SEO's supervision of auditors compared to the years before (Behbahaninia et al., 2021). Babaei and Etemadi (2016) investigated the factors affecting the value relevance of companies' earnings, claiming that timely accounting information, quality accruals, sustainability, conservatism in earnings, high predictability of earnings, and low volatility of earnings have significant positive effects on the value relevance of earnings (Babaei and Etemadi, 2016). Setayesh et al. (2015) investigated the concurrent impact of company size and the information environment on the value relevance of earnings and operating cash flow of TSE-listed companies from 2007 to 2012, demonstrating that these variables have a significant effect on the value relevance of earnings both separately and simultaneously, with a higher impact on earnings value relevance compared to operating cash flow (Setayesh et al., 2015).

As mentioned previously, the value relevance of earnings is an indicator used for measuring financial reporting quality. The literature on value relevance investigates the effect of financial variables on users' decision-making and, consequently, company value (Osazevbaru, 2020). Amir et al. (1993) interpreted value relevance as the extent to which accounting data reflect the information used by the investors (Amir et al., 1993). Holthausen and Watts (2001) argued that a financial variable has value relevance when it has a predictive relationship with the market value (Holthausen and Watts, 2001). Brimble (2003) argued that the goal of accounting data value relevance is enabling access to information that reflects the company's performance, thereby also reflecting itself in the company's stock prices as an indicator of investors, return (Brimble, 2003). The value relevance of accounting information depends on its effects on performance analysis and company value, thereby affecting the forecasting of future financial performances (Menike and Prabath, 2014).

2.2 The interactive effects of financial reporting regulations and audit quality on the value relevance of earnings

As discussed previously, the primary objective of financial reporting is to provide financial statements and helpful information for users to make decisions. Financial information provides a transparent and fair view of the financial position and performance of companies, their changes in ownership, and cash flows. Providing incorrect information to users by companies can result in asymmetrical information among intra- and extra-organizational persons. Reducing information asymmetry is only possible with the help of third-party services, such as independent auditors, who can create confidence and trust in the rigor and accuracy of the information. The task of an independent auditor is to provide an independent, professional, and objective opinion on the reported information regarding the financial position and financial performance of the company as an audit statement, which is central to decision-making by investors and leads to added value. Major financial scandals over the past years and significant errors in financial statements have further underscored the critical importance of independent auditors in guaranteeing the quality of financial statements and information. Auditors issue independent, professional, and targeted reports that emphasize the accuracy and rigor of the financial statements and take correct and reliable positions on essential aspects of the financial statements in line with the accounting standards and thus significantly affect investors' perspectives on the company's share (Abdollahi et al., 2020). Investors face various risks in the capital market, including conflicts of interest with managers due to information asymmetry. Auditing is a tool to reduce information asymmetry between the users and the compilers of financial reports. In other words, the independent auditor's statement supports the decisions made by actual and potential investors of the company (Arens et al., 2017).

Furthermore, the value relevance of accounting information is also a significant subject for investors and other stakeholders when making correct investment decisions about investment items. It has remained an important topic of discussion for accounting researchers in the past years. As mentioned previously, the value relevance of accounting information refers to the relationship between accounting information and the company's value. A range of factors, such as audit quality, affect the degree of value relevance of accounting information, including earnings (Tshipa et al., 2018). Independent auditors provide valuable services in eliminating or decreasing asymmetrical information and reducing agency costs; however, this issue depends significantly on the ability of the auditors to limit the managers' opportunistic behaviors for manipulating earnings. A higher audit quality is more likely to reveal incorrect accounting procedures (Becker et al., 1998; Reynolds and Francis, 2000). Lee and Lee (2013) investigated the relationship between audit quality, earnings' value relevance, and the companies' net book value in Taiwan's capital market. In their research, companies that had used big audit firms for their audit services were selected as companies with a high audit quality. They reported that when high-quality audit services are used, earnings' value relevance and assets' net book value are higher (Lee and Lee, 2013). Solikha and Mardijuwono (2020) investigated the relationship between audit quality, the value relevance of earnings, and the book value of equity in companies listed on the Indonesian stock exchange. The measurement criterion for audit quality in the cited study was also the size of the audit firm. The study results showed that audit quality significantly positively affects the mentioned value relevance (Solikha and Mardijuwono, 2020). Dang et al. (2011) reported that companies with failed audits experience lower earnings value relevance (Dang et al., 2011). Jerry and Saidu (2018) investigated the effect of the size of the audit firm on the quality of financial reporting in insurance companies listed on the Nigerian stock exchange. They claimed that the size of the audit firm significantly increases the quality of financial reporting (Jerry and Saidu, 2018). Wahyuni and Herawaty (2018) studied companies listed on the Indonesian stock exchange and reported that audit quality increases the ERC (Wahyuni and Herawaty, 2018). Ismail (2020) surveyed companies listed on the Egyptian stock exchange. He reported that audit quality (i.e., the audit firm's size) significantly affects earnings quality (Ismail, 2020). Verma et al. (2024) investigated the effect of audit quality on the earnings quality of companies listed on the Indian stock exchange in the 20 years from 2001 to 2020. They showed that characteristics such as the auditor's size, audit fee, and auditor tenure have a significant negative relationship. Auditor turnover significantly correlates with earnings quality (Verma et al., 2024).

Mirtaheri and Darabi (2019) investigated the relationship between the emotional biases of investors and the ERC of companies listed on the TSE, as well as the effect of audit quality on this relationship in the timespan from 2013 to 2017, reporting a significant relationship between the emotional biases of the investors and ERC. They also noted that audit quality affects the relationship (Mirtaheri and Darabi, 2019). The significance of the independent auditor's statements on financial information from the perspective of the regulatory body overseeing the Iranian capital market has also been addressed. For instance, Article 7 of the executive regulations for the disclosure of information by listed companies on the SEO requires that listed issuers provide audited 6-month interim and annual financial statements, auditors' statements on the board report, and audited 6-month interim and annual financial statements of subsidiary companies within specific time intervals. Issuers are also required to disclose their 6-month interim and annual management commentary after approval by the independent auditor, which is the topic of the present study.

2.3 Hypothesis development

According to the research literature, changes in accounting requirements, regulations, and disclosure of financial information can affect and improve the quality of financial reporting (which can be measured by various indicators, including the value relevance of earnings). In this regard, due to the change in the disclosure regulations of the SEO as of Dec. 2017, underscoring the necessity to provide management commentary instead of issuing EPS predictions (detailed in the introduction), the initial objective of this research is to investigate the effect of the issuance of new financial reporting regulations by the Securities and Stock Exchange Organization (i.e., the issuing of rules for management commentary) on the earnings quality. Thus, the initial hypothesis of this study is as follows:

H1: Issuing regulations for management commentary has a significant positive effect on the value relevance of earnings.

In addition, according to previous research, independent auditing is considered an important pillar in crediting the company's information and financial statements from the investors' perspective, and investors have always paid attention to the audit quality of companies. So, it seems that auditors' statements on management commentary, which is the main subject of this research, can further reduce information asymmetry between the providers and users of information, significantly affecting investors' responses to accounting information. Hence, the second objective of this study is to investigate the interactive effects of issuing and communicating regulations for financial reporting and audit quality on the value relevance of earnings, and the second hypothesis of the study is therefore as follows:

H2: Audit quality enhances the effects of the issued regulations for presenting management commentary on the value relevance of earnings.

3. Research methodology

This is applied research because its main objective is to find solutions for existing problems under the current circumstances. Usually, secondary data is used for this type of research. In this study, the researcher explains the subject being studied, which is descriptive research. It can also be considered correlational research as it investigates the relationship between variables. Overall, two types of information, i.e., bibliographic and empirical information, are required to conduct every study. This research collected bibliographic and empirical data from specialized Persian and English journals and papers, financial statements, explanatory notes, and existing databases such as “Rahavard Novin” and “Codal. ir”. Finally, all the models in this study were tested in Excel and EViews 10.

3.1 Statistical population and sample

The statistical population consists of all the companies listed on the TSE and IFB from 2012 to 2023. The inclusion criteria for selecting the samples were: Company being listed during the study period, inactive in financial intermediation, banking, insurance, and leasing sector, not having adjusted their fiscal year during the study period, and not having loss.

Based on the above criteria, 182 companies were investigated in this research.

3.2 Research models and variables

To test the first hypothesis of this research, Model 1 (Espahbodi et al., 2022) was used as follows:

Model 1:

$$Pit = \beta 0 + \beta 1EPSit + \beta 2MCit + \beta 3EPSit * MCit + \beta 4Levit + \beta 5Sizeit + \beta 6MBit + \varepsilon it$$

To test the second hypothesis and investigate the effect of audit quality on the relationship between management commentary and the value relevance of earnings, Model 2 (Ismail, 2020) was used as follows:

Model 2:

$$Pit= \beta 0 + \beta 1EPSit + \beta 2MCit + \beta 3AUDQit + \beta 4EPSit * MCit + \beta 5EPSit*MCit * AUDQit + \beta 6Levit + \beta 7Sizeit + \beta 8MBit + \varepsilon it$$

In which:

Pit (dependent variable): The natural logarithm of company stock prices at the end of the fiscal year.

EPSit (independent variable): This is the natural logarithm of the company’s EPS.

MCit (moderator variable in Models 1 and 2): Represents the periods in which management commentary became mandatory by the SEO regulations. Thus, a value of 1 is assigned to this variable from the year 2017 onwards, and 0 is assigned for previous years (note that to test the first hypothesis, this moderator variable is used to examine and compare the relationship between the value relevance of earnings before and after the issuance of regulations for management commentary).

AUDQit (moderator variable in Model 2): Represents the company’s independent audit quality.

The audit quality is measured using the audit firm class index provided by SEO. When the class index of the reporting audit firm is 1 or 2 according to SEO's classification, a value of 1 is assigned to this variable; otherwise, 0 is assigned to it.

Control variables:

Levit: The financial leverage of the company, calculated as the liabilities to assets (L/A) ratio (Espahbodi et al., 2022).

Sizeit: The size of the company, calculated as the natural logarithm of the sum of the company's assets (Espahbodi et al., 2022).

MBit: The market-to-book (P/B) ratio, calculated by dividing the equity market value by its book value (Espahbodi et al., 2022).

4. Research findings

4.1 Results of descriptive statistics

Table 1 presents the descriptive statistics of the variables. A total of 2002 company-years were investigated in this study.

Table 1. Descriptive statistics of the variables

Variables	Mean	Median	Maximum	Minimum	SD
P	3.895	3.848	5.648	2.755	0.488
EPS	2.782	2.847	4.860	-0.134	0.664
Lev	0.499	0.501	1.365	0.013	0.202
Size	14.908	14.662	21.328	10.492	1.684
MB	4.440	2.742	54.686	-49.704	5.978
MC	0.545	1.000	1.000	0.000	0.498
AUDQ	0.620	1.000	1.000	0.000	0.486

As can be seen among the companies investigated in this study, the mean logarithm for EPS is 2.782 (for IRR 1,529), with the maximum being 4.860 (for IRR 72,415) and minimum -0.134 (for IRR 1). The mean financial leverage is 0.499, with a maximum of 1.365 and a minimum of 0.013. in about 62% of observations, independent auditors are positioned in the first or second classes according to the SEO rankings.

4.2 Results of hypothesis 1 testing

Table 2 presents the results of testing hypothesis 1 using the panel regression method with time and a cross-sectional fixed effects model. A probability of F = 0.000 indicates the model's significance. The adjusted R-squared of the model shows that the independent and control variables can explain the changes in the dependent variable by 66.5%. Additionally, a Durbin-Watson statistic of 1.792 indicates independence among the residuals of the model fitting.

Table 2. Results of hypothesis 1 testing

Variables	Coefficients	Standard error	t-statistic	Significance level
C	4.422	0.253	17.469	0.000
EPS	0.220	0.011	20.772	0.000
MC	1.743	0.154	11.287	0.000
EPS*MC	0.374	0.021	17.880	0.000
Lev	-0.043	0.092	-0.466	0.641
Size	0.162	0.015	10.470	0.000
MB	0.047	0.002	22.236	0.000
R-squared		0.678		
Adjusted R-squared		0.665		
Durbin-Watson statistic		1.792		
F-statistic		63.171		
Significance level		0.000		

In the above table, the coefficients of EPS, t-statistics, and its significance level show the value relevance of earnings at a 5% significance level. To investigate the effect of issuing regulations for presenting management commentary on the value relevance of earnings, the coefficient of the EPS*MC variable (i.e., earnings per share*management commentary) was investigated. As shown in the above table, the coefficient of the EPS*MC variable, the t-statistic value, and its significance level suggest a significant positive relationship between this variable and stock prices at a 5% significance level. Thus, the study's first hypothesis is confirmed, indicating that the issuance of regulations for presenting management commentary enhances the value relevance of earnings. Also, investigating the control variables demonstrated a significant negative relationship between financial leverage and stock prices. Additionally, company size and the market-to-book equity ratio significantly and positively correlated with stock prices.

4.3 Results of hypothesis 2 testing

Table 3 presents the results of testing hypothesis 2 using the panel regression method with time and a cross-sectional fixed effects model. A probability of F = 0.000 indicates the model's significance. The adjusted R-squared of the model shows that the independent and control variables can explain the changes in the model's dependent variable by 68.5%. Additionally, the Durbin-Watson statistic of 2.005 indicates the independence of the residuals from the model fitting.

Table 3. Results of hypothesis 2 testing

Variables	Coefficients	Standard error	t-statistics	Significance level
C	6.696	0.252	26.588	0.000
EPS	0.0.242	0.019	12.981	0.000
MC	1.030	0.112	10.170	0.001
AUDQ	1.590	0.207	7.698	0.000
EPS*MC	0.288	0.025	16.680	0.003
EPS*MC* AUDQ	0.291	0.026	11.040	0.000
Lev	-0.447	0.115	-3.899	0.001
Size	0.045	0.014	3.140	0.002
MB	0.057	0.003	21.769	0.000
R-squared		0.692		
Adjusted R-squared		0.685		
Durbin-Watson statistic		2.005		
F-statistic		11.088		
Significance level		0.000		

In the above table, to investigate the interactive effects of audit quality and issuing regulations for management commentary on the value relevance of earnings, the coefficient of the EPS*MC*AUDQ variable (earnings per share*management commentary*audit quality) was examined. As shown in the above table, the coefficient of the EPS*MC*AUDQ variable, t-statistic value, and its significance level show a significant positive relationship between this variable and the stock prices at a 5% significance level. Therefore, the study's second hypothesis is confirmed, indicating that audit quality enhances the effect of issuing regulations for presenting management commentary on the value relevance of earnings in companies.

5. Conclusion

Based on the results of hypothesis 1 of the study, issuing regulations for presenting management commentary has improved the value relevance of earnings. Based on this finding and the study's theoretical basis, issuing disclosure regulations or changing rules to encourage greater information transparency can enhance the quality of earnings in companies. Thus, the obligation to present a management commentary, which is a comprehensive descriptive report for interpreting a company's financial position, financial performance, and cash flows, aimed at enhancing the usefulness of the information provided to the users, can affect the value relevance of earnings as a measure of earnings quality. Providing descriptive reports on various aspects of a company’s activities has provided more useful information to investors and improved their responses to share prices. These results are consistent with the findings of Espahbodi et al. (2022).

According to the results of hypothesis 2 of the study, higher audit quality can enhance the effect of issuing regulations for presenting management commentary on the value relevance of earnings. According to the rules of the SEO, companies must provide their independent auditor’s statement on their management commentary on a 6-month interim and annual basis. Considering that audit quality varies among audit firms, the study's results suggest that when audit quality is higher, the effect of issuing regulations for presenting management commentary on the value relevance of earnings also grows higher. In other words, the present study confirms the interactive effects of audit quality and issuing regulations for presenting management commentary, consistent with the findings reported by Solikha and Mardijuwono (2020) and Wahyuni and Herawaty (2018).

Based on the outcome of testing the hypotheses of this study, regulatory bodies, such as the SEO, are recommended to focus on the quality of the information provided in management commentary because, according to the results of this study, the disclosure of this information affects investors’ response to accounting information and the financial reporting quality of companies. Given the importance of this information from an investor perspective, it is also recommended that company managers be more rigorous in preparing and presenting management commentary to improve the value relevance of the company's stocks under their management. The present findings also demonstrate that improving audit quality enhances the effect of management commentary on the value relevance of earnings; therefore, shareholders are recommended to pay more attention to quality when selecting an independent audit firm for their company at ordinary general assembly meetings of shareholders and to utilize higher-quality auditors for their independent auditing.

Future researchers are recommended to investigate the effects of issuing and communicating other disclosure regulations by regulatory bodies such as the SEO on the quality of earnings and thus provide appropriate feedback to the relevant authorities. Reviewing this study using other indicators to measure the quality of earnings and audit quality is also recommended.

It should be noted that in this research, to measure the audit quality variable, the data related to the classification of SEO was employed, and due to the lack of access to the details of how to classify, there is a possibility of measurement error in this regard, which is one of the limitations of this research. Also, considering the value relevance of earnings in this research, controlling factors such as institutional shareholders ownership or the percentage of free-floating shares could lead to more accurate results. Finally, in this research, it is not possible to investigate the different reactions of different types of shareholders (institutional, individuals, etc.) to the earnings and analyze the effect of the management commentary on this reaction due to the lack of access to data related to share prices in transactions related to each category of these shareholders.

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