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Macroeconomic Instability, Good Governance Indicators and Earnings Management in Iran's Capital Market

Ali Tork Zahrani
Ph.D. Candidate of Accounting, Isfahan (Khorasgan) Branch, Islamic Azad University, Isfahan, Iran, ali_zahrani1989@yahoo.com

Abbas Ali Daryaei*
Associate Professor of Accounting Department, Imam Khomeini International University, Qazvin, Iran, alidaryaii@yahoo.com

Hamzeh Mohammadi Khoshouei
Assistant Professor of Accounting, Isfahan (Khorasgan) Branch, Islamic Azad University, Isfahan, Iran, khoshoei@khuisf.ir

Abstract

Purpose: Examining the status of earnings management by firms in Iran's economic instability, as well as the role of good governance in adjusting this relationship, has remained unanswered so far. The purpose of this study is to investigate the effect of macroeconomic instability on earnings management and the moderating role of good governance indicators in Iran.

Method: To achieve the purpose of the research, the financial information of 163 companies admitted to the Tehran Stock Exchange in the period from the beginning of 2009 to the end of 2022 was used, and to test the hypothesis of the research, the multivariate regression method and combined data were used.

Results: The findings showed that economic instability in Iran's economic environment does not affect real earnings management. However, the findings showed that economic instability in this management environment has increased accrual profit. On the other hand, the findings showed that good governance was able to moderate the relationship between economic instability and real and accrual earnings management. In this way, the interaction of the good governance index with economic instability has caused the real earnings management and accrual earnings management to decrease.

Conclusion: Based on the findings, good governance has a positive effect on adjusting the negative effects of economic instability on earnings management. Accounting researchers can investigate more deeply the role of good governance tools and mechanisms in organizations and provide models that promote the reduce of earnings management in the conditions of economic instability.

Contribution: The findings of this research show a good explanation of the status of earnings management in Iran's economic environment, especially under unstable conditions, and also highlight the important role of good governance in such an environment.

Keywords: Accrual Earnings Management, Good Governance, Real Earnings Management, and Macroeconomic Instability.

Research Article

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Corresponding Author: Abbas Ali Daryaei (alidaryaii@yahoo.com)

Introduction

Financial reports are important sources of information for economic decisions that managers, investors, creditors and other users use to meet their needs. Since information is not provided to users in the same way, information asymmetry is created between managers and investors. This asymmetry allows managers to have exclusive access to a part of the information. Also, incentives such as bonuses, profit smoothing and regulatory avoidance make it possible for managers to apply profit management for their own interests. Therefore, since the preparation of financial statements is the responsibility of the management of the business unit, they may perform profit management for various reasons (Balios et al., 2020). The importance of profit management and its attractiveness have led to many researches in this field (Ashtab & Dehghan, 2023; Nasiri Alamoti et al., 2023). Another fundamental study in the present study is to examine the impact of good governance indicators on the relationship between macroeconomic instability and corporate earnings management based on World Bank statistics on Iran's economic environment, which include accountability and the right to express opinions, political stability and absence of violence, government effectiveness, quality of legislation, rule of law, and control of corruption. Therefore, the goals of these studies were different and showed the influence of various factors on this issue. The purpose of this research is to investigate the effect of macroeconomic instability on profit management and the moderating role of good governance indicators at the level of Iran, which clearly shows how the instability of macroeconomic indicators affects profit management and the role of good governance indicators in Iran as one of the developing countries will analyze.

Materials and Methods

To achieve the purpose of the research, the financial information of 163 companies admitted to the Tehran Stock Exchange in the period from the beginning of 2009 to the end of 2022 was used, and to test the hypothesis of the research, the multivariate regression method and combined data were used. Considering that the purpose of this research is to investigate macroeconomic instability, good governance indicators and profit management in Iran's capital market, it can be said that this research is fundamental in terms of its purpose. The current research is descriptive according to the type of data collection. Because in order to test the hypotheses of the research, the required data have been collected from the available sources, i.e. the financial statements of the companies, the reports of the Tehran Stock Exchange (decisions of the ordinary assembly and the financial statements audited and published through the stock exchange organization), the annual report of the board of directors of the companies and the World Bank. Research data is analyzed through combined data analysis and multivariate regression method. The statistical population of this research is the companies accepted in the Tehran Stock Exchange.

Results and Discussion

The findings showed that economic instability in Iran's economic environment does not affect real profit management. Therefore, it can be argued that Iranian companies have not benefited from the real method of profit management during economic instability and have chosen other methods. However, the findings showed that economic instability in this management environment has increased accrual profit. Therefore, it can be argued that Iranian companies have used the accrual method to manage profits in times of economic instability. Based on these findings, it can be said that the first hypothesis is confirmed. In this way, the lack of economic stability has led to an increase in accrual profit management. In other words, economic instability has increased accrual profit management. On the other hand, the findings showed that good governance was able to moderate the relationship between economic instability and real and accrual profit management. In this way, the interaction of the good governance index with economic instability has caused the real profit management and accrual profit management to decrease. These findings point to the desired results and impact of good governance. Based on this, it can be said that good governance can moderate the negative effects of economic instability on the financial reporting environment. In the specific context of Iran, the persistent economic pressures such as sanctions, fluctuating exchange rates, and high inflation contribute significantly to the decision-making processes of firms. These structural challenges limit companies' ability to use real profit management techniques, which often rely on operational stability. Instead, accrual profit management offers a practical alternative, allowing firms to adapt their financial reporting without the constraints of immediate liquidity. The role of good governance becomes even more critical in this context, as it provides a framework for better corporate oversight and transparency. By fostering strong governance practices, companies can build trust with stakeholders and mitigate the risks associated with economic turbulence. This underscores the importance of policy reforms aimed at enhancing corporate governance standards in Iran, which could ultimately improve the resilience and reliability of financial reporting in the face of ongoing economic challenges.

Conclusions

Based on the findings, good governance plays a critical role in moderating the adverse effects of economic instability on earnings management. By strengthening organizational accountability, transparency, and ethical practices, good governance can reduce managers’ inclination toward manipulating earnings during periods of economic uncertainty. Researchers in the field of accounting can delve deeper into the tools and mechanisms of good governance, such as audit committees, board independence, and internal control systems, to propose practical models that enhance profit management practices under such challenging conditions. Additionally, the effective implementation of national laws is a key factor in reducing corruption and political instability. When legal frameworks are robustly enforced, they constrain the power of politicians and political elites, limiting their potential influence on managers. This, in turn, diminishes managers' susceptibility to external pressures, such as volatile market conditions or political dynamics, which often lead to earnings manipulation. Economic instability heightens the risk of companies engaging in financial report manipulation as they struggle to present favorable outcomes to stakeholders. Thus, the development and refinement of accounting and reporting standards become essential. These standards should be designed to address the challenges posed by uncertainty and ensure the accuracy and reliability of financial information. Researchers can contribute significantly in this area by developing frameworks and guidelines tailored to environments characterized by economic volatility. Such advancements can equip managers with the tools to maintain ethical reporting practices, even in unstable conditions, fostering trust and transparency within the financial ecosystem.

Conflict of Interests

The corresponding author declares that this work has not been previously published elsewhere and has not been simultaneously submitted to another journal. Furthermore, all rights to use the content, tables, figures, and other materials have been assigned to the publisher.

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