Journal of Accounting Advances, (2024) 16(2): 243-283
DOI: 10.22099/jaa.2025.51719.2467

Journal of Accounting Advances (JAA)
Journal homepage: jaa.shirazu.ac.ir/?lang=en

Shiraz University

The Effect of World Uncertainty on Earnings Management with the Moderating Role of Institutional Ownership

Reza Malek[1], Hossein Fakhari[2]*

1. MSc, Department of Accounting, University of Mazandaran. Babolsar, Iran.
reza.malek229@gmail.com
2. Full Professor, Department of Accounting, University of Mazandaran. Babolsar, Iran.
h.fakhari@umz.ac.ir

1. Introduction

Political and economic uncertainties, including military threats, war, terrorism, political tensions, and epidemics, are inherent in the environment of organizations and companies (Ahir et al., 2022; Beik Boshriyeh et al., 2022; Mehrani et al., 2013). A literature review indicates that earnings management is a prevalent strategy managers employ in response to environmental uncertainty (Cui et al., 2021; Salem Dezfuli et al., 2019). The literature further reveals that theories such as agency theory, signaling, information asymmetry (Khodadadi et al., 2015; Moshtaq Kahnemoei et al., 2021), behavioral theories, and political cost (Kim & An, 2021; Kim & Yashoda, 2021) explain the motivation for earnings management amid rising uncertainty. Moreover, managerial responses to earnings management are influenced by ownership structure, an external component of corporate governance. The importance of this research lies in its unique context within Iran's capital market, which faces persistent uncertainties. These include periodic international sanctions, domestic and foreign political tensions, war, terrorism, disruptions to agreements like the JCPOA, the COVID-19 pandemic, budget deficits, fluctuations in oil sales, exchange rates, and inflation, as well as regional military threats (Beik Boshriyeh et al., 2022;

Mir, 2020). This study addresses a gap in the earnings management literature by employing the World Uncertainty Index (WUI), which captures sensitivity to political and economic variables (Ahir et al., 2022). Additionally, this is the first study to examine the effect of the WUI on earnings management with institutional ownership as a moderator, marking a novel contribution.

2. Research Hypotheses

H1: The World Uncertainty Index (WUI) significantly affects accrual-based earnings management.

H2: The World Uncertainty Index (WUI) significantly affects real earnings management.

H3: Institutional ownership moderates the effect of the WUI on accrual-based earnings management.

H4: Institutional ownership moderates the effect of the WUI on real earnings management.

3. Research Method

This study was conducted using multivariate regression analysis over an 18-year period from 2005 to 2022. Stata software version 14 was used to analyze the collected data. Continuous data were winsorized at the 1st and 99th percentiles. The statistical population comprises companies listed on the Tehran Stock Exchange, selected via systematic elimination. The independent variable is the World Uncertainty Index (WUI), calculated as the simple average of Iran's three-month WUI values. This quantitative variable ranges between 0 and 1; the closer the number is to 1, the greater the uncertainty (Roshan, 2020). The dependent variables are accrual-based and real earnings management. Accrual-based earnings management is calculated using the modified Jones method. Real earnings management is calculated using the Roychowdhury (2006) model. The moderating variable is institutional ownership, measured by the proportion of shares held by legal persons.

4. Results

The findings indicate that the World Uncertainty Index significantly and positively affects accrual-based and real earnings management. Additionally, institutional ownership negatively moderates the effect of the

WUI on real earnings management. However, institutional ownership does not moderate the effect of the WUI on accrual-based earnings management.

5. Discussion and Conclusion

These findings suggest that increasing World Uncertainty Index (WUI) levels heighten conflicts of interest. Based on agency theory, managers use earnings management (both accrual-based and real) to improve financial statements, aiming to reduce profit fluctuations (Raiszadeh and Ramezani, 2018; Mushtaq Kohnami et al., 2022), conceal managerial and financial weaknesses (Surbakti & Sudaryati, 2021; Salem Dezfuli et al., 2019), meet shareholder and analyst expectations with predictable profits, enhance perceived competence and credibility (Salem Dezfuli et al., 2019), and seek higher rewards. Drawing on information asymmetry, signaling, and behavioral theories, managers reduce information asymmetry through earnings management (Khodadadi et al., 2015; Mushtaq Kohnamoi et al., 2022) and signal the market to neutralize the effects of the WUI (Yang & Root, 2019; Chauhan & Jaiswall, 2020; Surbakti & Sudaryati, 2021; Jain et al., 2021), thereby maintaining the value of shares (Stein & Wang, 2016; Yang & Root, 2019; Mushtaq Kohnamoi et al., 2022) and preventing capital outflow. Additionally, earnings management as a strategy helps managers mitigate shareholder stress and promote rational capital market behaviors. Furthermore, under the political cost hypothesis, earnings management in uncertain conditions reduces legal and political scrutiny (Kim & An, 2021). The significant presence of institutional shareholders in the ownership structure enhances their role in corporate governance. Amid rising conflicts of interest due to uncertainty, institutional shareholders, per the efficient monitoring hypothesis, reduce agency costs by overseeing managerial performance. Since the WUI necessitates earnings management to manage risks (Holzer et al., 2022), institutional shareholders signal accurate information to other shareholders, reducing information asymmetry (Fakhari and Taheri, 2010; Hassas Yaganeh et al., 2008) and diminishing managers' incentives to use real earnings management for risk management.

Keywords: World Uncertainty Index, earnings management, accrual-based earnings management, real earnings management, institutional ownership.