Journal of Accounting and Social Interests "Scientific Journal" ALZAHRA UNIVERSITY

Alzahra University- Faculty of Social Sciences and Economics
Accounting and Social Interests, VOL. 12, NO. 4, Winter 2022, Pages 11-14

The Effect of Bankruptcy Spillover on Financial Reporting Quality[1]

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Received: 2022/05/30
Accepted: 2022/11/06

Research Paper

INTRODUCTION

In economics, the spillover effect is defined as having an effect that an event in one country can have on the economies of other countries. Recent empirical studies have documented the spillover effects of peers on firm decisions. For example, they have observed significant peer effects on capital structure as well as dividend policy.

In this research, we examine whether the bankruptcy of peers affects the financial reporting quality of other companies in that industry. Accordingly, bankruptcy is considered an attention-worthy event in an industry and it is studied whether the quality of reporting in that industry is affected by this crisis or not. The results of previous studies indicate that the announcement of a company's bankruptcy has negative market effects on other companies within the industry. It seems that companies within an industry that experience peer bankruptcies improve their financial reports to reduce such negative effects in the capital market. Various articles on "peer effects" are seen in foreign studies, but in Iran, there has been little research on this subject and this issue remains unexplored.

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1. DOI: 10.22051/JAASCI.2022.39255.1668

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MATERIALS AND METHODS

This research is of a regression type in terms of method. Library and documentary methods were used to collect data. The source of the data required for this research is the figures available in the financial statements of companies. For this purpose, computerized information banks (Rahavard Novin software) and the Codal website of the Securities and Exchange Organization were used. The four hypotheses of the research included one independent variable and four dependent variables, along with several control variables, which were tested using multiple linear regression analysis with control for fixed effects of year and industry in SPSS software. Finally, 175 companies listed on Tehran Stock Exchange for 28 different industries during the 8 years from 1391 to 1398 were selected as the research sample.

RESULTS AND DISCUSSION

According to the results of the hypothetical test, the bankruptcy of peers has no significant effect on conservatism. In other words, when bankruptcy poses a threat to a company in a particular industry, it does not lead to conservative accounting practices in its financial statements. The findings of this study do not correspond with the results of Delshadi and Magnan (2020, 1). The lack of effect of peer bankruptcy on conservatism can be explained by the fact that in the Iranian capital market, investors do not pay attention to the performance of their peers when making decisions about a company's performance. As noted, this study used the Basu model based on market data to measure conservatism. Therefore, it can be said that stock prices do not change in response to news from peers.

The second hypothesis examines the effect of peer bankruptcy on actual earnings management by firms. According to the results, it is not possible to accept the existence of a significant effect of peer bankruptcy on actual earnings management. According to agency theory, managers are after maximizing their benefits and may not represent an improvement in the actual performance of the firm due to conflicting interests and pursue manipulation of operations for creating profits or in other words, actual earnings management and in some cases accrual-based earnings management. In the

sample firms studied, no effect of peer bankruptcy on earnings manipulation was observed. Thus, it can be said that an event such as bankruptcy in an industry, in Iran, does not lead to earnings manipulation by active firms in that industry. This is while when the model related to testing the second hypothesis was divided into two groups with positive and negative earnings management respectively, results indicated a significant and positive effect of peer bankruptcy on actual earnings management among firms with negative earnings management.

The third hypothesis examines the effect of shareholders' litigation on covenant-based earnings management. The results suggest that shareholders' litigation has no significant effect on covenant-based earnings management. The effect of shareholders' litigation on actual earnings management and the lack of effect on covenant-based earnings management can be explained by the fact that due to regulatory principles such as independent auditing, companies are less likely to manipulate covenants when they receive bad news from shareholders and are more likely to manipulate actual activities since auditors pay more attention to covenants and this manipulation is more likely to reduce earnings.

The results of the fourth hypothesis test indicate that the correlation between peer performance and return response ratio has no significant effect. The lack of effect of peer performance on the return response ratio can be explained by the fact that in the Iranian capital market, investors do not pay attention to the performance of other companies in the same industry when making decisions about a company's performance. This explanation also holds for the result related to conservatism.

CONCLUSION

According to the findings, the bankruptcy of a peer company causes other companies active in that industry to manipulate real activities to reduce profits. The effect of the bankruptcy of peers on real profit management is reduced. Also, its lack of impact on accrual profit management can be justified by the fact that due to the existence of monitoring tools such as independent auditing, companies do not want to manipulate accruals when they receive bad news

from their peers. They are more inclined to manipulate through real activities because auditors' supervision is more on accrual items and this manipulation is more in the direction of profit reduction.

Keywords: Financial Reporting Quality, Peer Firm Bankruptcy, Conservatism, Earnings Management, Earning Response Coefficient.

JEL Classification: M41, M42.

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