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Effect of the economic performance of financial statements on raising levels of accounting conservatism

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Abstract

The financial reports released by the Khartoum Stock Market (KSE) banks provide details on the levels of conservatism in accounting of financial information, especially in the sense of an uncertain economic environment, over 11-year time series for the period from 2008 to 2019.

The objective of the investigation is to Specify the relation between the causes of economic instability (liquidity, exchange rate, inflation, and Gross Domestic Product), and

conservatism in accounting.

The outcome of the research support that in the financial reports there is a proportionally intimate priority between accounting conservatism, and economic fluctuations, these variables have a direct and significant impact on accounting conservatism, which makes these reports able to predict the future, and reduce risks, and make investment decisions consistent with investment conditions surrounding.

Keywords: Accounting Conservatism, Economic Fluctuation, Exchange Rate, GDP, Liquidity, and Inflation

Introduction

Businesses may take a more negative view of the global future. The trust of investors already rattles by tremendous uncertainty in the economies that have posed concerns about the consistency of financial statements. Compliance with the concept of accounting conservatism is a defining trait of companies in terms of the openness of their financial accounts and a criterion for categorizing countries in the waves of cynicism over financial performance according to accounting standards. (Hamdan, 2011a) [21]

Sudan has vibrant genetic means, including oil, and has the potential to become a significant producer of agriculture. Nevertheless, it remains one of the world's least developed economies. Despite the sanctions, the Sudanese economy was one of the strongest in the league before the global financial crisis. Due to these economic catastrophes triggered by lower global oil prices, its financial health seems to be very weak, and its foreign debt is over \$40 billion.

At the curve of the millennium, the idea of accounting conservatism was divisive, and is still there till now. Despite criticism of this theory, it also plays a critical function in accounting procedures (Watts, 2003) [41], we will try to explain the effect of these global fluctuations on accounting conservatism on financial reporting in this analysis (GDP, exchange rate, inflation, and liquidity).

Significance, and objectives of the study

Such research may trace this tenacity in firms operating on the Khartoum Stock Market to something like the link between economic uncertainty and conservatism in accounting, particularly in an unpredictable economic circumstance. The study intends to investigate the impact of economic volatility in those financial reports released between 2008 and 2019 on advancing accounting conservatism principles.

Issue of the study

This study's issue articulated after defining and answering the following questions: what is the impact of economic volatility upon this degree of traditional accounting in the financial statements disclosed? What is the extent of accounting conservatism in the Khartoum Stock Exchange (KSE) banks' financial accounts?

Accounting Conservatism

The adage translates in the scientific literature as reflecting "the propensity of the accountant to dem, and a greater degree of proof to consider good news as benefits than to recognize poor news as losses" Basu (1997) [9]. Bliss (1924) [11], "anticipate no profit, but anticipate all losses" is a widely used term for conservative accounting.

Accounting conservatism seeks to discourage the overestimation of properties, and profits because overestimation is more detrimental than an understatement to lenders, creditors, etc. Watts (2003) ^[41]. Expressly, conditional, and unconditional accounting conservatism are the concepts of two types of accounting conservatism are addressed in Ball (2005) ^[8]. Unwavering conservatism characterizes as an accounting tendency against the presentation of stockholder equity with low book values. Conditional conservatism, but from the other end, stresses the timeliness of accepting defeats. The fall in accounting earnings is a contemporary economic failure under budgetary conservatism. It is not exacerbated via early recognition of expenditure, overdue taxes, or regulated inadequate earnings or book value.

Economic fluctuations

In the present study, the four selected Gross Domestic Product (GDP) indicators describe the overall economic value (Central Bank of Sudan) of the finished goods generated by inhabitants of the country's economic unit over a given period. Inflation in the essential cost of goods and services is a constant and unruly raise (Esfandabad & Jahanshahi Report, 2018) ^[1]. Exchange rate; the rate of the currency is the amount of one country's currency versus the money or economic area of another state. Liquidity, as established by the Central Bank of Sudan (2016) ^[14], includes public currency, dem, and deposits, and quasi-money (margins on documentary letters of credit, guarantee letters, time deposits, and investment deposits).

Literature review

The analysis demonstrates that these factors positively and critically influence unconditional conservatism, exploring the effects of financial performance on macroeconomic conditions and cash supply, according to Crawley's report (2014) ^[17]. Macroeconomic factors have been analyzed in several studies, such as the Esfandabad & Jahanshahi Analysis (2018) ^[1], which examined the effect of different factors (GDP, economic development, flexibility, and rising prices) on unrestricted conservatism in organizations registered upon this Tehran Stock Exchange (TSE). The findings indicate that all positional restraint policies are favorable and closely correlated with economic success, as the survey also found that provisional conservatives are related to a higher level of GDP development. Analysis reveals that GDP forecasts are often more vulnerable to adverse accumulated operating cash results than more wonderful liquidity efficiency statistics. However, the analysis is more resilient to negative aggregate cash flow news (Do, Nabar, 2019) ^[18], looking at conditional aggregate accounting conservatism's macroeconomic implications. Research (Bushman *et al.*, 2011) ^[12] reported that accounting conservatism will encourage economic growth through improving production contraction and growing the capacity for the transfer of productive resources to profitable projects. Managers will better allocate funds from unproductive tasks to productive projects because losses are identified quicker. Kordlouie *et al.* (2014) ^[28] have examined a specific correlation between accounting conservatism and the accuracy of the financial statements of 102 companies listed on the Tehran Stock Exchange from 2006 to 2010. The findings revealed a substantial positive correlation between conservative accounting and financial statements' consistency, using multivariate regression analysis. Organizational efficiency is measured based on ROA, MV, and EPS. A robust economic association within the

management of income and the return on assets and a significantly negative relationship to the return on shares find, and there was no significant impact on the firm's stock value. Chiraz and Anis (2013) ^[16] examine the impact of earnings control on the competitiveness of the IPO on the Paris Stock Exchange.

The accounting conservatism theory has assessed in terms of its benefits and drawbacks by decision-makers and regulators. For example, FASB (2010) has rejected conservatism from the philosophical context because they claim that knowledge asymmetries that affect neutrality will contribute to the conservative approach. Besides, Penman and Zhang (2002) ^[36] address that conservative accounting will contribute to the redistribution of subjective capital and minimize the corporate valuation that influences share pricing. It offers advantages and benefits derived from traditional accounting procedures, including the limitations of conservative accounting, which would not otherwise be considered by decision-makers and regulators (Watts, 2003) ^[41]. Conservative accounting creates conservative accounts that impact the lowering of the wealth of corporate owners, minimizing the possibility of overstated profits. LaFond and Roychowdhury (2008) ^[29] claim that the distinction between corporate ownership and control allows executives to overstate their net worth and profits for their interests. Conservative accounting decreases the cost of borrowing, raises shareholder returns, and increases corporate cash profitability (Li 2015). Besides, some literature suggests that accounting conservatism has a positive effect on financial reporting accuracy (Kordlouie *et al.*, 2014; Penman & Zhang, 2002; Ugwunta & Ugwuany, 2019) ^[28, 36, 40].

In Egypt, the corporate climate has a substantial influence on accounting and financial reporting policies. Therefore, it is essential to research conservatism's tradition in accounting and its impact on corporate success metrics in Egyptian companies. According to the contingency principle, the relationship between conservative accounting and organizational success varies due to the complex structural climate. Based on earlier literature and the above arguments, the results are mixed. Some studies indicate that conservatism restricts managers' opportunistic behavior and enhances corporate performance. While an intensive study in emerging and emerging economies has centered on the relationship between success and accounting conservatism, such as Ugwunta and Ugwuany (2019) ^[40] in Nigeria, Sana'a (2016) ^[39] in Jordan, Chiraz and Anis (2013) ^[16] in France, Chiraz and Anis (2013) ^[16] in Iran, and Chan *et al.* (2006) ^[15] in the UK, there are, however, studies condemning conservatism for the alleged manipulation of facts, its detrimental effects on the distribution of capital, and corporate efficiency.

The findings revealed that organizational success, leverage, and conservatism in accounting have a substantial positive effect on earnings profitability. Ramadan (2015) ^[37] describes the factors that impact the profit output of manufacturing companies listed on the Amman Stock Exchange. Leverage, corporate efficiency, spending decisions, accounting conservatism, firm's scale, and cash keeping are the continuous independent variables used. In the period 2000-2013, the OLS cross-sectional regression model was applied to evaluate data from 58 companies.

The study findings reinforce the need to follow the required procedures to enable Jordanian insurance companies to adhere to an acceptable, conservative accounting standard. Sana'a (2016) ^[39] explores the influence of accounting conservatism in Jordanian insurance companies on financial performance metrics. As a proxy of results, the ROA, EPS, and MV use. For the time, the data of 12 Jordanian insurance

companies was used (2007-2014). The findings revealed that accounting conservatism substantially affects the Jordanian insurance companies' three success metrics.

The study indicates that Nigerian banks' managers should use conditional conservatism to reduce financial statements' knowledge asymmetry. Conditional accounting conservatism has a positive association with the bank's performance, while unconditional accounting adversely impacts bank performance in Nigeria. The link between accounting conservatism and bank success in Nigeria discuss by Aminu and Hassan (2017) ^[6]. For five years, they used panel regression to evaluate data from 10 banks (2012-2016). As a proxy of bank results, the ROA use. The findings showed a strong correlation in Nigeria between accounting conservatism and bank efficiency.

The outcome indicated a significant positive correlation between conservative accounting and the valuation of shareholders. This result shows that conservatism is an efficient government method to mitigate knowledge asymmetry and disputes between agencies. The relationship between conservative accounting and shareholder capital in Nigerian businesses investigate by Ademola and Moses (2017) ^[2]. Data from 20 companies for the ten years 2006-2015 is analyzed using multiple regression analysis.

They suggested that firms with more conservative financial reporting were quicker to change their capital structure, especially in firms that focused more on external financing. Low leverage companies are a favorable effect of populism on adaptation. It also illustrates that accounting conservatism plays a significant role in promoting changes in low-leverage businesses' capital structure. In a survey of 40,571 U.S. entities listed, Ramalingegowda & Yu (2018) ^[38] explores the relationship between conservative accounting and corporate capital structure changes (1972-2011). Leverage, ROA, market-to-book, net assets, and depletion of total assets, capital assets to total assets, research and development costs to total assets, and a marginal tax rate are the continuous-discrete variables used.

The findings show that accounting conservatism has a negligible positive impact on corporate results. It suggests that Nigerian consumer goods companies appear to be less conservative in financial accounts with low financial reporting consistency. Ugwunta and Ugwuany (2019) ^[40] investigate the relation between conservatism in accounting and success in Nigerian businesses. During 2005-2016, data used from 12 Nigerian consumer products companies. A regression analysis of a panel use. As a proxy of company success, the net profit margin (NPM) use.

This study is contrary to previous studies in estimating the impact of economic uncertainty (GDP, exchange rate, money supply, and inflation) on the degree of accounting conservatism in the accounting information issued by the listed banking industry (KSE) in a competitive and volatile economy due to the combination of factors mentioned above.

Study Hypothesis

The study proposed two null hypotheses and four null sub-hypotheses, and thus their alternative hypothesis revealed a statistically valid correlation among the variables as follows:

H01: There is no reasonable level of accounting conservatism in the listed banks' financial reporting (KSE).

H02: There is no statistically relevant correlation between the level of accounting conservatism in financial reporting released by listed banks (KSE) and the variables of economic fluctuations (GDP, INFL, XR, and M2).

H02.1: There is no statistically significant impact of Gross Domestic Product (GDP) fluctuation on the level of accounting conservatism in the financial report.

H02.2: The exchange rate (XR) fluctuation does not have an apparent effect on the level of accounting conservatism in the financial statements.

H02.3: There is no correlation between inflation fluctuations (INFLs) and the level of accounting conservatism in the financial statements.

H02.4: There is no statistically relevant effect of the liquidity ratio (M2) on the level of accounting conservatism in the financial statements.

Methodology

The research group consists of Sudanese banks listed in (KSE) (10 banks) representing only 43%, during the 11-year time series, from 2008 to 2019, for sampling, the banks with the following characteristics selected.

- We used the pre-2008 banks listed on the Khartoum Stock Exchange.
- These banks did not have business interruptions for more than six months during the specified period.
- Shares shall constitute sale during the time of review.
- The accounting conservatism of their financial statements during the study period was rational.

Study variables

Accounting conservatism as dependent Variable

The researcher relied on the measurement of accounting conservatism on the Book-to-Market (BTM) Approach for Testing the Level of Accounting Conservatism. Many studies referred to (BTM) as one of the indicators of accounting conservatism. The theoretical frame developed by (Beaver & Ryan, 2000) ^[10], used by few studies like those of (Ahmed & Duellman, 2007; LaFond & Roychowdhury, 2008; Jain & Rezaee, 2004; Ahmed *et al.*, 2002; Givoly & Hayn, 2000) ^[3, 29, 23, 7, 20] proposed using BTM to measure conservatism. The Book-to-Market ratio value used to test share value in comparison with the market value.

Economic fluctuations Variables as Independent Variables

Gross Domestic Product (GDP) fluctuation, Inflation fluctuation (INFL), exchange rate fluctuation (EX), and Money Supply (M2) fluctuation, that for the period of 2008 - 2019. In this study, we used smooth of standard deviation for four-year sub-periods (2007-2008-2009-2010-2011-2012 2013- 2014-2015 2016-2017 2018-2019), respectively, So that we get the fluctuations of (GDP), and (M2).

Study models

The research equation presented as follows in the current study for testing hypotheses, and in order to have a more detailed examination, and to explore the effect of each variable.

$$BTM_{it} = \beta_0 + \beta_1 (GDP)_{it} + \beta_2 (INFL)_{it} + \beta_3 (XR)_{it} + \beta_4 (M2)_{it} + \varepsilon_t, i = 1..8, t = 2008- 2019$$

BTM_{it} = Dependent variable, Book-to-Market ratio as an indicator of the level of accounting conservatism of company (i) in the year (t).

β_0 = Constant value.

$(\beta_1-\beta_4)_{it}$ = Slope value of independent variable.

ε_t = the model error term (residuals).

Data analysis, and hypotheses testing

To test hypotheses of the study, the researcher used: BTM approach to measuring the level of accounting conservatism, and descriptive statistics for variables of the study, in addition to multiple linear regression.

First: Measuring the level of the accounting conservatism in the banks Sample Research

After examining the level of the accounting conservatism using a model BTM, because of Table (1), it found that the ratios of the accounting conservatism ranged between 3.78 - 0.28. By testing the null hypothesis according to which there is no reasonable level of accounting conservatism as expressed in the following ($H_0: BV-MV \geq 0$), it found that the financial report showed (BV) is less than (MV), that indicator there is a reasonable level of accounting conservatism. Which means reject the first null hypothesis in opposition to the alternative hypothesis according to that; there is a reasonable level of conservatism.

Second: Descriptive Statistics

Table 1: The Results of the Descriptive Statistics

	N	Min	Max	Mean	Std. Deviation
BTM	100	.28	3.78	1.4171	.74963
GDP	100	1.01	4.00	2.5710	1.04596
INFL	100	11.20	35.90	23.2700	10.07728
XR	100	2.18	8.40	4.8220	1.93707
M2	100	.38	4.31	2.6770	1.21037

For better identification of the nature of the investigated statistical population of the present study, and also a better familiarization with research variables, this table (1) presents descriptive statistics for select aggregate annual time-series data used within this study. The sample period begins in 2008, and ends in 2019; a selection of 10 banks was selected found to have a reasonable level of the accounting conservatism in their financial statements to varying degrees during periods of study.

Regression Equation

Table 4: Regression Equation Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.405	.476		.851	.397		
GDP	.063	.100	.088	.630	.531	.462	2.165
INFL	.000	.009	.006	.050	.961	.577	1.732
XR	.146	.064	.378	2.272	.025	.323	3.095
M2	.050	.085	.081	.586	.559	.472	2.118

a. Dependent Variable

Table 4: Shows that the regression line equation was among the study variables as follows.

$$BTM = 0.405 + .063 \text{ GDP} + .000 \text{ INFL} + .146 \text{ XR} + .050 \text{ M2}$$

Conclusion

It ensures that the veracious accounting policies used, and those skewed in the admission of losses and lower asset prices, mean that the Book Value (BV) is lower than that of the Market Value (MV), that is, assets and earnings with the lowest potential losses and liabilities with the highest possible losses and that the Book Value (BV) is reserved if they emerge in the future. It further noticed that during the years of research, the percentage of banks that applied accounting conservatism hit 35 per cent, most of them (2008-2011). As a result, some results of experiments performed in

Multiple regression analysis

The researcher used multiple linear regressions to measure the variables of the study, according to the following tests.

Table 2: Coefficient of determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.386 ^a	.149	.113	.70596

Table2: shows that the value of the coefficient of determination R is 0.386, while the R square parameter is 0.149. It means that 14.9% of the change in the dependent variable (accounting conservatism) is due to the change in the independent variable (economic fluctuations variables), and the rest is due to other factors, This indicates that there is an apparent effect.

Analysis of Variance

The table 3: Shows the results of the analysis of variance test for the regression equation.

Table 3: ANOVA^b

	Sum of Squares	df	Mean Square	F	Sig.
Regression	8.287	4	2.072	4.157	.004 ^a
Residual	47.346	95	.498		
Total	55.633	99			

Table 3: Shows that the value of F = 4.157 at a significant at the 0.01 level, indicates the significance of the statistical model used. It emphasizes the effect of the independent variable (economic fluctuations) on the dependent variable (accounting conservatism). It can state that the H0 rejected in all variables, and acceptance alternative hypotheses of the second central hypothesis, and sub-Hypotheses, that means "there is a statistically significant relationship between the accounting conservatism in the financial reports issued for banks of listed on the Khartoum Stock market, and economic fluctuations variables (GDP, INFL, XR, and M2).

related settings such as the review acknowledge (Ahmed & Duellman, 2007) [3], (Alnajaar, 2014) [5]. The conclusions derived from the series of research and the analysis of the theories revealed that financial statements released by the banks listed on the Khartoum Stock exchange showed a significant amount of accounting conservatism.

It explains the results of the sub-hypothesis, where the first sub-hypothesis test proved that there is significant impact volatility of Gross Domestic Product (GDP) on accounting conservatism in the financial reports. It describes the findings of the sub-hypothesis, although the first sub-hypothesis test indicated that the volatility of Gross Domestic Product (GDP) holds a meaningful effect on accounting conservatism in the financial statements. As a result, it coincides with some findings of studies performed in related environments that

showed that there is a link between GDP volatility and accounting conservatism such as the analysis (Esfandabad & Jahanshahi, 2018)^[1], (Crawley, 2014)^[17], (Do, Nabar, 2019)^[19]. The findings of this study also revealed that exchange rate volatility has a direct impact. This upward trend project to have an opposite impact on financial performance on accounting conservatism in the financial accounts, which in return would implicitly affect the valuation of the shareholders as the exchange rate has been undergoing a continuous rise. Since the decline in the exchange rate will affect the expansion of the trading flow that will ultimately influence (reduce) financial transactions as a result of an adverse exchange rate, this is mirrored in both the market value and the book value, indicating the connection between the exchange rate and the conservatism in accounting. The research also found that there is a correlation between the inflation rate and accounting conservatism in financial statements, which is the third sub-hypothesis, which implies that rising inflation will lead to a rise in the price of monetary assets and the return will have an effect on the value of shareholders, which means that the market value of shares will also improve.

It will finally, in principle, lead to a rise in populism. The research corresponds with such a result. As a result, it agrees with the study (Ademola, Moses, 2017)^[2], (Esfandabad & Jahanshahi, 2018)^[1].

The results of the study shown the economic fluctuations have a direct effect, and on accounting conservatism in financial reports issued from the banks listed on the Khartoum Stock market over the years of study, which makes these reports has a capability of predicting the future, and reduce risks, and make investment decisions consistent with investment conditions surrounding. The findings of the research found that economic volatility and accounting conservatism had a substantial effect over the years of the study on the financial reports published by the banks listed on the Khartoum Stock Exchange, making these reports capable of predicting the future and minimizing risks, and making investment decisions consistent with the relevant investment conditions.

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