

The Association between Related-Party Transactions and the Existence of Distortions in Financial Statements and the Financial Reporting Quality: The Role of Restatements and Accrual Estimation Errors¹

Majid Rastegar², Hossein Etemadi³, Mansour Momeni⁴

Received: 2023/01/30

Accepted: 2023/04/29

Research Paper

INTRODUCTION

Related party transactions provide controlling shareholders and other related parties who can influence the company with, potential means to secure their interests at the expense of other shareholders and stakeholders (Ryngaert and Thomas 2012). There are two opposing theoretical frameworks concerning related party transactions in prior studies (Ryngaert and Thomas 2012). The first theory, known as efficient contracting, argues that related-party transactions can be used to optimize internal resource allocation and reduce transaction costs (Khanna and Palepu 2000); the second theory, known as agency theory, argues that related-party transactions provide opportunities for majority shareholders, managers, and other related parties to extract resources (Johnson et al. 2000).

1. DOI: 10.22051/JERA.2023.42772.3094

2 Ph.D. Student, Department of Accounting, Tarbiat Modares University, Tehran, Iran. (m_rastegar@modares.ac.ir).

3 Professor, Department of Accounting, Tarbiat Modares University, Tehran, Iran. (Corresponding Author). (etemadih@modares.ac.ir).

4 Professor, Department of Management, Tehran University, Tehran, Iran. (mmomeni@ut.ac.ir).

<https://jera.alzahra.ac.ir>

Controlling shareholders, through managers, need to hide such interests to maintain their control and interests (Leuz, Nanda, and Wysocki 2003). The controlling groups can only obtain these benefits for themselves when it cannot be proven because in this case, the minority shareholders can prepare documents of these benefits and take legal action (Dyck and Zingales 2004). Therefore, managers use their discretion in the field of financial reporting and will try to hide such interests (Leuz, Nanda, and Wysocki 2003). This action affects awareness of financial statements and the quality of financial reporting and will lead to an increase in the possibility of presenting financial statements containing significant distortions caused by fraudulent financial reporting. These reasons have led (Beasley et al. 2010) to claim that transactions with related parties can indicate the existence of fraud risk.

Currently, we do not have enough evidence to use them to conclude whether the association between transactions with related parties and the low quality of reporting was due to opportunistic goals or not, so (Jorgensen and Morley 2017) have suggested that in future research, the relationship between transactions with related parties be examined with the quality of reporting. The main goal of this study is to determine which of these theories is compatible with the transactions made with related parties in Iran.

MATERIALS AND METHODS

The main goal of this study is to answer two questions. First, do transactions with related parties increase the risk of material misstatement in financial reports? Second, whether the effect of transactions with related parties on increasing the risk of significant distortion in financial reports, which was obtained in response to the first question of the research, extends to the criterion of accruals quality provided by Dechow and Dichev (2002) or not, The main purpose of this, in addition to expanding the theoretical literature of the subject, is to strengthen and increase the reliability of the results obtained from the first hypothesis. To answer the above questions, the impact of transactions with related parties on the presentation of financial reports containing distortions and its impact on

the quality of accruals has been investigated. In this regard, the number 134 firms listed on the Tehran Stock Exchange during the years 2016 to 2021 have been investigated. To test the hypotheses of this research, pooled and cross-sectional data were used.

RESULTS AND DISCUSSION

The regression analysis results show a positive and significant association between the amount of related-party transactions and the existence of distortions caused by fraud or mistakes in financial statements. Also, there is a negative and significant association between the number of transactions with related parties and the quality of accruals, which is used as a measure of reporting quality in this research.

The results of this research will help auditors have a more reliable assessment of audit risk and implement more effective audit operations in Iranian companies with a higher level of related party transactions. At the same time, other users and beneficiaries should also make more appropriate economic and investment decisions with special attention to the level of transactions with related parties of companies.

The results of various types of research have shown that different types of related party transactions have different effects on reporting quality, fraudulent reporting, auditor opinion, firm performance, and earnings management (Aharony, Wang, and Yuan 2010; Bailey 2016; Berkman, Cole, and Fu 2009). ; D. Chen, Jian, and Xu 2009; Y. Chen, Chen, and Chen 2009; Fang et al. 2018; Henry et al. 2007; Ming Jian and Wong 2010). Therefore, it is suggested in future research the effect of different types of transactions with related parties (such as purchase, sale, receipt, and payment of loans, etc.) be investigated by researchers on various criteria of reporting quality, auditor's opinion, and presentation of financial reports containing distortions.

CONCLUSION

According to the Findings, it can be concluded that transactions with related parties in Iran are compatible with the theory based on the opportunistic perspective.

Keywords: Related Party Transactions, Accruals, Financial Reporting Quality, Restatements, Distortion.

JEL Classification: M41, G17, G53, C31, C33.

COPYRIGHTS



This is an open access article under the CC BY-NC-ND 4.0 license.