تأثير الإفصاح عن تقارير الاستدامة على خفض إدارة الأرباح

: دراسة تطبيقية /استكشافية

Impact of Sustainability Reports Disclosure on Reducing Earnings Management: An Applied -Exploratory Study

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Abstract

The study aims to determine whether accounting disclosure of sustainability reports affects the reduction of earnings management. The study also examines the type of disclosure, whether voluntary or mandatory. Also, do these companies adhere to the rules that qualify them to enter the Islamic Sharia Index and maintain their survival, which would increase investment in these companies and attract a significant group of investors? This was conducted through an empirical study of companies listed on the Egyptian Stock Exchange (EGX33) and an exploratory study to determine the importance of including that accounting disclosure of sustainability reports mitigates earnings management. The study found an inverse relationship between accounting disclosure of sustainability reports and earnings management, i.e., disclosure of sustainability reports reduces earnings management. The study results also proved that mandatory disclosure affects the reduction of earnings management by comparing two years before disclosure with two years after disclosure, and that some companies are eligible to enter and remain in the Sharia Index.

Keywords: Sustainability Reports, Accounting Disclosure, Earnings Management.

المستخلص:

تهدف الدراسة إلى تحديد ما إذا كان الإفصاح المحاسبي عن تقارير الاستدامة يؤثر على تقليل إدارة الأرباح. كما تدرس الدراسة نوع الإفصاح، سواء كان طوعيًا أم إلزاميًا. وهل تلتزم هذه الشركات بالقواعد التي تؤهلها للدخول في مؤشر الشريعة الإسلامية والحفاظ على بقائها، مما من شأنه يزيد من الاستثمار في هذه الشركات وجذب فئة كبيرة من المستثمرين؟ تم إجراء ذلك من خلال دراسة تجريبية للشركات المدرجة في البورصة المصرية (EGX33) ودراسة استطلاعية لتحديد أهمية تضمين أن الإفصاح المحاسبي عن تقارير الاستدامة يخفف من إدارة الأرباح. وجدت الدراسة وجود علاقة عكسية بين الإفصاح المحاسبي عن تقارير الاستدامة وإدارة الأرباح، أي أن الإفصاح عن تقارير الاستدامة يقلل من إدارة الأرباح. كما أثبتت نتائج الدراسة أن الإفصاح الإلزامي يؤثر على تقليل إدارة الأرباح من خلال مقارنة عامين قبل الإفصاح بعامين بعد الإفصاح، وأن بعض الشركات مؤهلة للدخول والبقاء في مؤشر الشريعة.

1. Introduction

As noted on the international scene, the focus on sustainable development in all its environmental, social, and governance aspects has not been far removed from the international scene. Recently, the Arab Republic of Egypt has been keen to focus on environmental practices. Egypt officially hosted the conference regarding climate change at the Conference of the Parties to the United Nations Framework Convention (COP27), as part of the country's efforts to fulfill the Sustainable Development Goals and its vision to achieve these goals by 2030. Within this framework, Egypt has sought to achieve the Sustainable Development Goals, which encourage ethical work and a more just and sustainable society.

Work ethics constitute the fundamental standard for quality of work life. Can you imagine a company where everyone who works there has good morals, no fraud, no sedition, and no profit management? Here's where we begin. Many have debated the ethics of earnings management and whether it violates ethical accountability, or whether there is some flexibility to create a loophole to avoid being considered unethical. Earnings management is a purely ethical issue, and

we will therefore present evidence that earnings management constitutes a type of behavior that is inconsistent with ethical standards and norms of respect for the rights of others.

Some adopt a moderate stance by acknowledging that earnings management exists on a spectrum, ranging from legitimate interpretations of accounting standards to blatant fraud, with numerous accounting decisions residing in a gray region that is neither wholly ethical nor totally unethical (Hamilton et al., 2018).

The scope of application was selected to be companies listed in the Egyptian Sharia Index, as the Egyptian Stock Exchange launched the EGX33 Sharia Index, which includes 33 companies selected from a pool of companies that comprise the EGX 100 Index. Their activities are consistent with the principles, provisions, and controls of Islamic Sharia, which were approved by a group of Islamic economics experts, Sharia scholars, and financial transaction jurisprudence. These controls are that the company's shares must be ordinary and its activity must be permissible according to Sharia. They allowed that the income generated from non-compliant activities does not exceed 10% of the company's total revenues, and the value of interest-bearing investments must be 33% of the total assets or the average market value of the company during the review period, whichever is greater, as well as the value of borrowed amounts. The value of liquid assets must not exceed 70% of the total assets. The index must be weighted by setting a maximum weight for each company. The percentage invested in purchasing securities of a single company must not exceed 15% of the fund's net assets, and must not exceed 20% of the securities. For this company, and to enable the development of financial products such as index funds, the periodic review of the index should be conducted at the same time as the periodic review of the main stock exchange indices, semi-annually in February and August of each year, and based on the latest available periodic financial statements. (Egyptian Stock Exchange https://www.egx.com.eg/ar/homepage.aspx)

The research problem is represented by the following questions:

1- Does accounting disclosure of sustainability reports affect the reduction of earnings management?

2- Is there an effect between the types of disclosure (voluntary or mandatory) of the sustainable development index on earnings management?

3- Is there an effect between accounting disclosure before and after inclusion in the EGX33 index on reducing earnings management?

2. Theoretical background

Research on corporate social responsibility disclosure often draws on legitimacy theory. Legitimacy theory assumes that corporations must comply with societal norms and expectations. To achieve legitimacy, corporations employ various strategies, such as changing methods, outcomes, objectives, or aspects of social responsibility disclosure, such as political costs. This means that larger corporations may be more likely to use accounting choices that reduce reported profits than smaller corporations, or to engage in other forms of disclosure that mitigate political cost(Ningsih et al., 2023). From an ethical perspective, stakeholder theory suggests organizations that exhibit the highest adherence to stakeholder expectations, such as sustainability issues, have greater incentives to maintain favorable relationships with various stakeholders. Thus, companies that disclose sustainability will experience less earnings management because they are more susceptible to scrutiny by stakeholders and regulators (Alodat et al., 2024).

2.1. Disclosure of sustainability reports

The Financial Regulatory Authority has obliged companies with capital of no less than 500 million to prepare TCFD and ESG sustainability reports.

Financial sustainability is defined as the organization's capacity to produce and maintain diverse resources over for an extended duration, prioritizing the interests of its clients, irrespective of the company's financial resources (Xin et al., 2024).

Environmental, social, and governance (ESG) disclosure is experiencing significant growth as a key factor in corporate sustainability. It is also attracting significant interest from the capital market (Sun et al., 2024).

Wu et al (2024) highlights that companies dedicated to executing ESG practices highlight long-time fundamental processes over short-time cyclical financial

performance. Management that manipulates earnings may adopt ESG activities to protect themselves from stakeholders. ESG engagement is occasionally perceived as a manifestation of managerial misbehavior and a method for obscuring manipulative actions (Almubarak et al., 2023). Organizations exhibiting robust ESG performance and transparency are more inclined to possess effective governance frameworks, clear reporting, and superior internal controls. These reasons may dissuade management from altering financial results (Gavana et al., 2022) on the other hand stakeholders motivate managers to do good by adopting CSR and ESG practices (Prior et al. 2008). The notion of sustainable development posits that superior ESG performance conveys more favorable signals to external stakeholders, hence augmenting the company's worth (Albuquerque et al., 2019).

2.2. Earnings management

Earnings management transpires when managers utilize discretion in the application of accounting methods for financial reporting (accrual EM) or in the timing and structuring of operational, investment, or financial operations (real EM), with the objective of affecting reported results within a designated period. This practice can range from legal and transparent to illegal and misleading (Theodore et al., 2021). Earnings management refers to the manipulation of reported income so that the profit and loss statement does not accurately reflect the actual economic reality of banking activity. One of the most prominent of these practices is earnings smoothing, which aims to reduce the volatility of net income across time periods. To achieve this, managers increase loan loss provisions when initial income is high and decrease them when income is low, with the goal of maintaining relative stability in reported net profits (Suripto, 2023). Earnings management can be defined as intentionally unethical behavior intended to manipulate financial statements for purposes other than professional ones. Creative Accounting – Income Smoothing – Aggressive Accounting: These are the names given to earnings management.

The diverse definitions of earnings management shed light on why it is considered a behavior that may or may not be fraudulent, according to a limited number of previous studies. This variability is due to differences in accounting standards and legal regulations from one country to another, depending on the definitions adopted in each context. Thus, the same practice may be classified

as "earnings management" in one country, while it may be considered "accounting fraud" in another. Earnings fraud constitutes a violation of accounting standards and legal regulations, and its characterization and punishment vary across jurisdictions. This disparity can only be overcome by countries adopting uniform or convergent accounting and disclosure standards. The primary goal of earnings management is to enhance management's image to external parties, but distinguishing between legitimate management behavior and dishonest behavior remains extremely complex (Baskaran, et al. 2020). Accrual earnings management transpires when management strategically utilizes accounting rules to manipulate earnings towards a preferred outcome. Real earnings manipulation transpires when management alters the timing or configuration of operations, investments, or financial transactions. In contrast to accrual earnings management, these operations yield immediate and poor business repercussions (Kjærland et al., 2021). Three main activities are involved in Real Earnings Manipulation (REM): (1) granting credit to higher-risk clients to boost sales, (2) over production of inventories to lower per-unit costs, and (3) reducing discretionary expenditures to enhance income (Davis & Khadivar, 2024). Managers will only be willing to manage earnings if they can reasonably anticipate the benefits (Wagener, 2024). Various constraints and reasons affecting managers may compel them to identify discrepancies in reporting standards. This encompasses managers' expectations throughout the market, individual perceptions of incentives, and the preservation of status within a sector or group. It might be contended that the implementation of effective systems and robust corporate governance processes can alleviate such abuses (Hussaien, 2023). Executives of firms with performance-based remuneration agreements often employ income augmentation in accounting to enhance earnings, choosing accounting methods that reduce income if profits fall below a minimum or exceed a maximum set in the bonus plan. The management compensation theory, known as bonus plan theory, posits that company managers are motivated to use earnings management to improve compensation because management bonuses are often tied to company profits. Company managers are interested in maintaining earnings growth due to its impact on stock prices, and because their compensation is often tied to company profits, they attempt to maintain profits between a minimum and a maximum because this allows them to ensure bonus growth by overstating

reported profits. If reported profits achieve the maximum possible bonus value, managers' incentive will be to accumulate reported profits for further use by taking certain steps that reduce reported profits (Strakova, 2021). Debt covenant motivations exist the "debt covenant" hypothesis posits that companies with a high debt-to-equity ratio tend to have management that employ accounting practices that enhance revenue and profits. According to the debt covenant hypothesis, a company will implement strict earnings management to prevent covenant violations. Earnings management is preferable because the company will face difficulty in obtaining additional financing from creditors, and creditors could threaten the company if they are unable to meet their repayment obligations on time. Therefore, the company is encouraged to increase profit (increase accumulated revenue) to avoid breaching the debt ceiling, Where the higher of the company's leverage, the greater the incentive for managers to manage earnings. Therefore, the extent of a company's debt will motivate management to manage earnings. Managers would prefer an accounting method that suspends reported earnings for the current period to a future period to reduce reported future earnings. The political costs seem substantial owing to the profitability of corporations, which may draw media and customer scrutiny (Marantika, et al., 2021). In numerous countries and areas, policies, rules, and regulations are linked to corporate profitability, and certain industries and corporations manipulate earnings in response to government-imposed laws, regulations, and policies. There exist three kind of regulatory incentives for earnings manipulation: Utilization of earnings management to circumvent industry regulations: Certain sectors, like banking, insurance, and utilities, must adhere to standards directly associated with accounting metrics. Banking regulations mandate that banks maintain capital sufficiency as indicated in their accounting statistics, whereas insurance industry standards necessitate that insurance companies attain a minimum standard of financial health. Given the clarity and specificity of regulations in these businesses, it is unsurprising that managers are more inclined to engage in earnings management to adhere to or circumvent regulatory violations. Banks nearing the minimum capital adequacy criteria exaggerate loan loss provisions, minimize loan write-offs, and report atypical realized gains in their securities holdings. In addition, Petroni provides evidence that financially vulnerable property-casualty insurers, which are close to violating insurance industry

regulations, tend to understate reported loss reserves. This is the second type. This is to reduce the risk of investigation and intervention by antitrust regulators. Other regulations and rules may also prompt firms to manage earnings. For example, firms that comply with antitrust laws always have incentives to underreport earnings. Some firms have claimed that abnormal accruals led to lower income in years under investigation due to antitrust violations. Therefore, firms under investigation have incentives to manage earnings to meet regulations. This is the third type: For tax planning purposes, many firms manipulate earnings for tax planning purposes. When profits are present, there is a tax liability. Many firms may adjust recent corporate earnings to reduce the amount of their final tax payment. On the other hand, capital market motives are linked to the desire to influence stock prices and meet investor expectations. Dechow et al. (2012) highlight that managers may engage in earnings management to portray a favorable depiction of the company's financial status, thereby appealing investors and enhancing stock prices. This strategic application of financial information aligns with the notion that corporations engage in earnings management to convey a particular story about their success.

. From this perspective, I sincerely believe that all earnings management practices, without exception, are unethical and cannot be classified as anything other than manipulation. Kanungo (2001) believes that an ethical leader should behave well and avoid actions that harm others. His actions should be based on altruistic motives rather than selfish ones. He should also consider the intentions, goals, and behavior of the leader more than normative appropriateness.

3. Literature review and hypothesis development.

3.1. Sustainability Reporting Disclosure and Earnings Management.

Earnings manipulation is frequently linked misrepresentation of public information presented in sustainability reports (Ningsih et al., 2023).

Many studies have addressed the impact of accounting disclosure of sustainability reports, but there is no definitive answer. Does accounting disclosure of sustainability reports affect earnings management? Does

accounting disclosure limit earnings management? Several studies have found that accounting disclosure of sustainability reports in the Egyptian context limits earnings management. Ibrahim (2019) conducted a study on a sample of Egyptian companies from 2014 to 2018. He used accounting disclosure of the sustainability dimensions of ESG reporting and earnings management. The study concluded that disclosure of the environmental and social dimensions positively affects earnings management. Disclosure of governance, the economic dimensions, and employees negatively affects earnings management. Disclosure of the product or service dimensions does not affect earnings management. When examining control variables, it was found that only two factors were influential: company size and return on assets, both of which negatively impact earnings management. Earnings, and Borralho et al (2022) examining how each component of environmental, social, and governance (ESG) disclosure separately affects earnings management in family versus non-family firms, applying it to companies listed in France and Spain from 2009 to 2018, the results showed that the three disclosure components were not equally important in mitigating earnings management, but that family status affects the relationship between ESG disclosure and earnings management. Huang (2021) also studied the relationship between environmental, social, and governance (ESG) disclosure and corporate financial performance, through a literature review of studies that investigated this issue, and found a positive relationship between ESG and corporate financial performance., on the contrary Mao et al (2024) examined the influence of ESG performance on earnings management across varying degrees of divergence in ESG ratings, revealing a negative link between ESG performance and earnings management this is supported by study Velte (2019) where explored the impact of ESG performance on earnings management in German companies and found that it negatively impacts accrual-based earnings management (AEM) but not actual earnings management. When disaggregated, governance performance was found to have a stronger negative impact on accrual-based earnings management than ESG performance. This study also suggests a bidirectional relationship between ESG performance and earnings management. From a dynamic perspective, Study Xiao et al (2024) the study elucidated the influence of ESG rating fluctuations on earnings management in China, revealing that firms in the most polluting sectors exhibit a more significant suppressive effect on earnings management,

akin to mature and heavily marketed companies. As for the obligation of disclosure, it has been study Cui et al (2025) explored the impact of mandatory and voluntary (ESG) disclosure on corporate earnings management.

Jiang (2020) argues that earnings management does not conflict with generally accepted accounting principles, accounting standards, and norms and is part of normal corporate management behavior.

The results revealed that companies' compliance with sustainability disclosure improves their ethical behavior, reducing earnings management practices and increasing the reliability of their financial statements (Alodat et al., 2024)

Found Ajina et al (2019) that participation in corporate social responsibility restricts earnings management practices, indicating that managers will adhere to ethical requirements and meet the interests of stakeholders. The results also show that the impact of CSR on earnings management is particularly strong for boards with more independent directors and a high institutional ownership structure. These corporate governance tools help mitigate managerial opportunistic behavior this is applied on French firms. The results of Hossain et al (2025) demonstrate a favorable correlation between earnings management and company sustainability disclosure. The inclusion of female board members adversely affects this relationship, indicating a reduced likelihood of utilizing sustainability disclosure to obscure earnings management. This improves overall corporate governance. The research endorses Sustainable Development Goal 5 by illustrating that enhancing women's representation on boards can affect policies and leadership, mitigating unethical activities like earnings management, therefore fostering ethical conduct and sustainability.

It found that mandatory ESG disclosure has a negative impact on earnings management, while voluntary disclosure has no impact on earnings management. From the above, hypotheses can be formulated as follows:

H1: There is a significant impact of sustainability reporting disclosure on earnings management.

H2: There are no significant differences between the disclosure of sustainability reports on reducing earnings management before and after the obligation.

What distinguishes this study?

- The study examines the impact of ESG and TCFD sustainability reporting disclosure on earnings management.

- The study compares accounting disclosure of sustainability reports during the voluntary and mandatory disclosure periods, and whether there is a difference in the impact of accounting disclosure on earnings management. It also compares companies before and after their inclusion in the EGX33 index.

4. Methodology

The research sample was conducted on 33 companies listed on the Egyptian Stock Exchange (EGX33) Sharia Index, which covers 33 companies in 2023. This index has strict controls for selecting listed companies, making it a completely appropriate sample for the research topic. Secondary data were collected from financial statements and data were collected through primary data using a questionnaire directed to the study sample, EGX33 companies. The questionnaire was distributed online to a group of department managers, section heads, and employees in the finance and accounting departments 10 questionnaires were distributed to each company, totaling 330 questionnaires. Three companies were excluded due to unavailability of some data, resulting in a total sample of 30 companies with a total of 300 questionnaires 220 responses were returned, representing 73% of the total, an acceptable response rate for statistical analysis. The questionnaire contains (36) questions, all closed, using a five-point Likert scale. It includes three sections: the first section is dedicated to the independent variable (disclosure of sustainability reports) and consists of 20 questions the second section, which is the dependent variable (earnings management), consists of sixteen questions. The sample spanned the period from 2020 to 2023, as the index was implemented in 2022. Variables measured:

(1) **Independent variables: Disclosure of sustainability reports**, measured using the Calabrese et al. (2021) scale from 1 to 4 for each GRI indicator presented in a company's or bank's sustainability report – TCFD-ESG (1 = "qualitative"; 2 = "quantitative"; 3 = "quantitative time series"; 4 = "quantitative time series and future quantitative target").

(2) **Dependent variables: Earnings management**, using the Miller model.

$MR = (\Delta WC/CFO)_0 - (\Delta WC/CFO)_{T-1}$

Where: MR: Miller's ratio.

Δ WC: Refers to the change in working capital.

Δ CFO: Net operating cash flows.

It means that if earning management is not practiced, there will be=0 It means that if earning management is practiced, there will be=1.

5. Hypothesis Testing

5.1.First Hypothesis Test

There is a significant impact of sustainability reporting disclosure on earnings management.

All effects were fixed, as the Hausman test was used to determine whether the variables were fixed or random. Table No.1 is attached showing the test results.

Variable	Earnings Management
Sustainability	-0.165960***
	(0.006788)
CEO	3.88E-11
	(2.39E-11)
BIG4	-0.140540***
	(0.043140)
Loss	-0.055265
	(0.060019)
ROA	0.006302
	(0.005635)
R^2	0.947987
Adjusted R^2	0.927055
F-Statistic	45.28881***

Variable	Earnings Management

Notes: *** indicate significance at 1%. Standard errors are reported in parentheses. The Hausman test outcomes are used to determine the fixed effects regression model.
EM=sustainability+CEO+BIG4+LOSS+ROA
EM= -0.165960+3.88E-11-0.140540-0.055265+0.006302

By conducting the normal distribution test, it was found that the data is greater than 0.05, so it follows the normal distribution. Therefore, tests will be conducted parametric test.

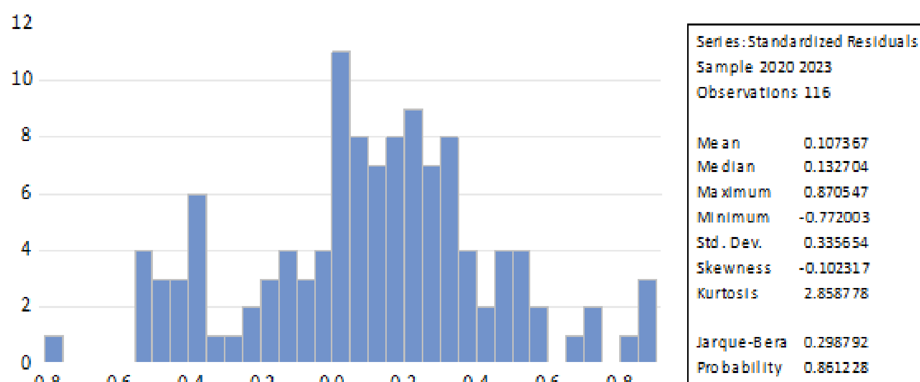

Figure 2: The normal distribution test (author)

Table (2) Correlation matrix between variables

Correlation t-Statistic Probability	EMILLER	SUSTAINABI...	CEO	BIG4	Loss	ROA
EMILLER	1.000000 ----- -----					
SUSTAINABILITY	-0.776269 -13.14760 0.0000	1.000000 ----- -----				
CEO	-0.072500 -0.776127 0.4393	0.050623 0.541204 0.5894	1.000000 ----- -----			
BIG4	-0.095425 -1.023531 0.3082	0.145993 1.575664 0.1179	-0.063409 -0.678388 0.4989	1.000000 ----- -----		
Loss	-0.003648 -0.038949 0.9690	-0.002359 -0.025191 0.9799	-0.280768 -3.123420 0.0023	-0.191670 -2.085139 0.0393	1.000000 ----- -----	
ROA	0.514080 6.399210 0.0000	-0.523100 -6.553295 0.0000	-0.086666 -0.928838 0.3549	-0.112581 -1.209730 0.2289	0.191093 2.078621 0.0399	1.000000 ----- -----

Pearson's correlation matrix shows that there is a strong inverse correlation between the disclosure of sustainability reports and earnings management itself. This is consistent with previous studies. The more sustainability reports are disclosed, the lower the earnings management practices in companies, thus reducing them. This means that the hypothesis that there is a significant effect of sustainability reports disclosure on reducing earnings management is valid

Validity and reliability test

Table (3) Validity and reliability test

Items	Cronbach's alpha	Validity
36	0.956	0.978

Since the Cronbach's alpha coefficient is approximately 96%, which is a high and acceptable percentage for research, the scale has a high degree of validity.

Correlation Coefficient Matrix between Variables

After conducting the Smirnov-Kolmogorov test, it was found that the data did not follow a normal distribution. Therefore, we will use a non-parametric test. Spearman's rank was used to measure the degree of correlation between the variables,

It is clear from the correlation matrix that the degree of correlation between the two variables is high and that there is a direct correlation between disclosure of sustainable development and reducing earnings management where was 802*** at a significance level of 0.000.

Table (4) Regression between variables

Dependent variables	R2	F	Sig
Earning management	.752	661.858	.000

There is significant impact between variables where was F value 661.858 when sig 0.000

5.2.Second Research Hypothesis:

There are no significant differences between the disclosure of sustainability reports on reducing earnings management before and after the obligation.

The years 2022 and 2023 will be compared with 2021 and 2020, as this period is a transitional period in two respects. First, companies transition from voluntary to mandatory disclosure, and second, companies transition to the Shariah Index. Does this have an impact on disclosure levels and the reduction of earnings management? In other words, have disclosure and its impact on earnings management changed before and after joining the Shariah Index? Is there a difference between mandatory and voluntary disclosures? Therefore, a t-test was conducted to test the differences between the averages for two years before joining (2020 and 2021) and two years after joining (2022, the start of implementation, and 2023).

Paired Samples Tes

Table (5) Paired Differences test

		Mean	t	df	Sig.(two-tailed)
Pair 1	x.post – x.pre	-3.433	-20.107	29	0.001
Pair 2	y.post – y.pre	-5.033	-2.756	29	0.010

Table (5) shows a t-test showing statistically significant differences in the disclosure of sustainability reports (x) and earnings management (y) before and after joining the EGX33. Furthermore, companies were required to issue ESG and TCFD sustainability reports in January 2022. This means there is a difference between the voluntary disclosure period (2020 and 2021) and the mandatory disclosure period (2022 and 2023). This means that the disclosure requirement has had an impact on reducing earnings management. The difference between the companies' inclusion in the index before and after joining indicates that these companies possess the behaviors and characteristics that truly qualify them for inclusion, that they were well-selected, and that the hypothesis of differences before and after inclusion is accepted.

6. Results and Recommendations

The study concluded the following:

- Sustainability reporting disclosure impacts earnings management, as an inverse relationship was found between disclosure and earnings management itself, thus mitigating or limiting earnings management.

- Companies selected to be included in the Shariah Index are eligible for inclusion.

- There is a difference between the level of reporting, whether mandatory or voluntary. When companies are required to prepare sustainability reports, they are more concerned about whether they are voluntary.

-When using the t-test, it was found that there is a difference between the pre- and post-measurements.

The study recommends adhering to ethical values and introducing ethical curricula into the early stages of education, teaching ethical accounting at universities should be a priority and amending international standards to close loopholes for anyone who dares to harm others should be encouraged.

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