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Original Research

External Financing and Earnings Quality: Moderating Role of Enterprise Risk Management

Habib Ansari Samani[1]
Department of Economics, Yazd University, Yazd, Iran

Zohre Arefmanesh
Department of Financial Management and Accounting, Yazd University, Yazd, Iran

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Abstract

Accounting information plays a crucial role in the decision-making process of lenders. They pay special attention to the income statement and its quality when making decisions. Consequently, financial statements must meet the minimum required standards. Adopting a comprehensive risk management approach can enhance earnings quality, ensuring effective reporting and compliance with laws and regulations. Therefore, this study aims to examine the impact of external financing and the moderating role of risk management on earnings quality. The research hypotheses were analyzed and tested using a multivariate regression model with panel data. The study's statistical population consists of firms listed on the Tehran Stock Exchange. The findings demonstrate a positive and significant relationship between a firm's external financing and earnings quality. This suggests that risk management plays a moderating role in the relationship between external financing activity and earnings quality. External financing and risk management contribute to improving the quality of financial information. Investors can evaluate the reliability of a firm's accounting data based on the level of external financing and enterprise risk management components. Thus, these findings have implications for managers and regulators to enhance the quality of financial information and promote the use of a comprehensive risk management approach to build creditor trust.

Keywords: Earnings Quality, Enterprise Risk Management, Financing.

[1] *Corresponding author's Email: h.samani@yazd.ac.ir*

Introduction

External financing is one of the most desirable options for managers to finance the firm. Creditors examine financial statements, especially reported earnings, and their quality to assess the borrower's possibility of paying debt and interest. But what has caused the creditors to worry about the use of accounting earnings is the calculation of this figure using the accrual approach. According to this approach, profit is recognized when revenues are realized and expenses are incurred, regardless of the time of cash exchange. Therefore, forecasts and estimates are used in the calculation of earnings, which makes it possible to manipulate the earning by the management and casts doubt on the quality of the reported earnings, that is, the ability of the earnings to predict future cash flows. If the earnings predict the cash flows more accurately, the lenders will have less risk. Therefore, lenders demand more quality information, especially high-quality earnings and away from any manipulation, to evaluate borrowers' credit.

Earnings quality has different aspects hence different definitions and different criteria have been proposed to measure it. Different research has pointed two important characteristics in defining it decision making and economic benefit. In other words, high earnings quality means the usefulness of earnings information for decision-making and its proximity to economic benefit.

(Ghosh & Moon, 2010) different perspectives were discussed. First, there's the direct linear view. According to this view, as debt levels increase, earnings quality also increases. Creditors require audited financial statements for credit, and the better the information provided, the easier it is to secure financing. In this way, creditors have significant control over recipients' credit and receive accurate information. On the other hand, the reverse linear view suggests that managers manipulate the firm's financial information to portray a more favorable situation. Consequently, as debt levels increase, the quality of information decreases.

The nonlinear view acknowledges the merits of both previous perspectives. It recognizes that a stable linear relationship cannot be established between debt financing and earnings quality due to various influencing factors. However, it posits the existence of a parabolic relationship, combining aspects of both direct and reverse linear perspectives.

Previous research has indicated that embracing enterprise risk management (ERM) can improve the performance of company executives, enhance the reporting quality, and increase the overall value of the firm (((Fraser et al., 2021); (Beasley et al., 2008), (Wang et al., 2018). Furthermore, (Olojede & Erin, 2021) demonstrated that corporate governance and risk management mechanisms can mitigate fraudulent accounting practices and enhance the accuracy of financial information. This highlights the crucial role played by regulatory bodies in effective corporate governance practices and risk reduction.

The author's studies have shown a lack of research on the impact of external financing on earnings quality and the potential moderating role of enterprise risk management. This

study aims to address this research gap and contribute to the literature in this field. The main objective is to examine how enterprise risk management moderates the relationship between earnings quality and external financing, specifically for listed firms in the Tehran Stock Exchange.

Literature Review

(Hong et al., 2023) investigates the relationship between corporate governance, external financing, and earnings management in an emerging market. Using a sample of Vietnamese listed companies in the period of 2010–2020, the results indicate that corporate governance is a useful mechanism to control earnings management. However, when firms engage in external financing activities, corporate governance is not significantly associated with both accrual-based and real earnings management. In addition, the study also examines the role of corporate governance in moderating the effects of earnings management on firm value, and how it is encouraged by external financing needs. The study shows that while good corporate governance lessens the influence of earnings management on firm value, external financing needs only prompts earnings manipulation and have no effect on firm value, directly or indirectly.

(Bashirimanesh et al., 2023) provided a model of regulatory and environmental determinants of firm's risk management and its financial consequences. The results of the research showed that the quality of the information environment and competitive strategy, corporate governance, internal control and management structure as regulatory and environmental determinants of firm's risk management. Based on the developed RAF analysis, it was determined that the quality of the information environment is the most influential risk management factor.

(Islam et al., 2022) investigates the relationship between Earnings quality and financial flexibility and moderating role of corporate governance. The empirical results reveal that poor earnings quality significantly negatively influences the level of corporate financial flexibility. The results also demonstrate that corporate governance can significantly positively moderate the relationship between earnings quality and financial flexibility.

(Arefmanesh & Shokohi, 2022) investigated the relationship between enterprise risk management and firm performance with mediating role of competitive advantage and moderating role of financial literacy in manufacturing firms of Yazd industrial town. The results of 220 completed questionnaires show that the relationship between competitive advantage and firm performance is not statistically significant, but risk management has a positive and significant relationship with competitive advantage and company performance. Also, the relationship between financial literacy and competitive advantage is positive and significant. The mediating role of competitive advantage in the relationship between risk management and firm performance is not confirmed, but the moderating role of financial literacy in the relationship between risk management and competitive advantage is accepted.

(Kuo et al., 2021)examines the relationship between enterprise risk management (ERM) and corporate social responsibility (CSR) and how this relationship is affected by managerial confidence and real activities earnings management (REM). The findings

show that firms with more effective ERM are more willing to engage in CSR behaviors. From the interaction terms of managerial confidence and ERM, they find that when firms with more confident CEOs who engage in real activities manipulation are higher, their CSR inputs are larger. The managerial confidence affects corporate policies, including reducing the effects of overall risk on CSR.

(Olojede & Erin, 2021) Investigates the impact of corporate governance and risk management mechanisms on creative accounting practices and earnings quality in Nigeria after the adoption of the Nigerian Financial Reporting Act with a sample size of 70 companies. The findings show that the effectiveness of corporate governance and risk management mechanisms in improving the quality of financial information and reducing creative accounting practices has improved significantly with the adoption of the Nigerian Financial Reporting Act. This study showed that regulatory interventions contribute to corporate governance and risk management mechanisms that minimize creative accounting. The findings emphasize the role of regulatory institutions, which are very effective in corporate governance activities and reducing company risk.

(Rahmani Noorozabad et al., 2021) investigates the effects of external financing requirement on corporate governance index and the value of firms listed on the Tehran Stock Exchange. The results show that the corporate governance has an insignificant effect on the firm's value. However, the need for external financing has significant effects on both the value of the firms and corporate governance index.

(Asim & Ismail, 2019) examines the impact of leverage on earning management in the manufacturing sector of Pakistan. The findings reveal that a significant positive relationship exists between leverage and earning management activities.

(Sayyadi et al., 2019) investigates how ERM (Enterprise Risk Management) effect on relationship between management ability and investment efficiency. Findings conclude that ERM Techniques alone have no effect on relation between managerial ability and capital investment efficiency, but the study shows interactive effect between ERM Techniques including operation and reporting ERM Techniques and managerial ability can influence on capital investment efficiency.

(Wang et al., 2018) examined the impact of external financing activities on earnings management decisions and further explores the role of enterprise risk management (ERM) as a potential moderating factor in this association. they find that managers use both real-activities and accrual-based earnings management when engaging in equity financing activities. Moreover, when firms have weaker ERM systems, they find that managers are less likely to use real-activities earnings management in their equity financing efforts.

(Zamani & Sohrabi, 2018) examined the effect of corporate governance and audit quality on bank loan financing in firms in the industries such as production, mining, commerce, and transportation. The results indicated that the corporate governance produces a positive and significant effect on bank loan financing, while audit quality didn't have this effect.

(Ahmad & Alrabba, 2017) examined the impact of capital structure on earnings quality of the Food and Beverages companies listed at Amman Stock Exchange (ASE). The results suggested that the financial leverage of the Food and Beverages companies had a statistically significant direct impact on the earnings quality. The researcher concluded that the capital structure of Food and Beverages enterprises listed at ASE has an impact on earnings quality.

Conceptual Framework

The effect of external financing on earnings quality

Shareholders and creditors typically prefer high-quality information as it allows them to make more accurate assessments of a company's prospects and make informed decisions. Managers may also have incentives to provide better information to reduce financing costs and attract capital. The efficient contracting approach suggests that managers may share private information about the firm's prospects with shareholders and creditors to lower financing costs. By providing reliable information, managers can improve the perceived quality of accounting earnings and mitigate the risk for creditors, potentially leading to lower expected returns. The marking hypothesis suggests that firms with well-established financial reporting credibility can attract capital more easily. Therefore, there may be an economic incentive for firms to voluntarily disclose even bad news, as it helps maintain trust and reduce the risk perceived by investors and creditors. In this context, managers may have a motivation to increase the quality of accounting earnings. It’s worth noting that these hypotheses provide different perspectives on the relationship between debt, earnings quality, and information disclosure. The study you referenced by(Wang et al., 2018) likely delves deeper into these relationships and their implications in the context of financial reporting

However, the opportunistic behavior approach in positive theory suggests that debt can have a negative impact on earnings quality. The presence of information asymmetry between managers and investors, particularly in terms of moral hazard and adverse selection, can result in managers using their accounting authority opportunistically to fulfill contract conditions and reduce the quality of accounting earnings.

In this scenario, managers may increase the use of accruals and compromise the sustainability of earnings to ensure compliance with debt contracts. Consequently, the overall quality of earnings decreases (Lassoued, 2022). Research by (Gordon et al., 2009) indicates that borrowers with limited accounting information often prefer private debt, such as bank loans, over public debt. This preference is due to banks' enhanced access to information and their ability to process it more effectively.

(Asim & Ismail, 2019) further demonstrate a significant positive correlation between leverage (debt) and activities related to earnings management in their investigation of the impact of external financing on earnings management in Pakistan's manufacturing sector.

According to the above, the first hypothesis of the research is formulated as follows:

H_1: External financing of the firm has a significant effect on earnings quality.

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The moderating role of enterprise risk management on the relationship between financing and earnings quality

The proper implementation of ERM not only serves as a risk management tool but also functions as a control system that assists investors in assessing the current operational situation of the firm (Gordon et al., 2009) (Wang et al., 2018)). Effective risk management practices can mitigate earnings manipulation and reduce information risk for financial statement users.

ERM policies necessitate firms to establish robust internal controls, and independent auditors evaluate the effectiveness of these controls by identifying any weaknesses (Wang et al., 2022). The primary objective of these activities is to enhance the accuracy and reliability of corporate disclosures.

Given the connection between external financing and earnings quality, it is plausible that managers may strive to avoid violating loan conditions by opportunistically using their accounting authority. As a result, earnings quality could suffer. However, when ERM is appropriately implemented within the organization, it can curb earnings manipulation and lead to an improvement in earnings quality. In other words, the adequate implementation of ERM establishes a positive relationship between external financing and earnings quality.

Considering these factors, it is expected that the relationship between external financing and earnings quality will be influenced by the moderating role of ERM. This leads us to the formulation of the second hypothesis of the research.

H2: Enterprise risk management has a moderating effect on the relationship between external financing of the firm and earnings quality.

Research Methodology

The statistical population of this study comprised all firms listed on the Tehran Stock Exchange for the 6 years from March 2014 to March 2020 and their number is approximately 370.

Sampling was done by systematic elimination, whereby all firms in the statistical population that met the following criteria were included in the sample:

1. Not being or being part of any bank, financial institution, investment firm, holding firm, or leasing firm (because, given the nature of activities of these firms, the studied variables will have unique relationships that cannot be generalized to other firms).

2. Being listed on the Tehran stock exchange before March 2013 and remaining listed from March 2014 to March 2020.

3. No suspension of the stock trade for more than six months between March 2014 and March 2020.

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4. Availability of the firm information for the period between March 2014 and March 2020.

5. No change in the financial Year.

After eliminating the firms that did not meet these criteria, a total of 103 firms were included in the statistical sample. The research hypotheses have been analyzed and tested using a multivariate regression model with panel data.

Research Model

The following models have been used to test the hypotheses:

Model (1) is estimated to test the first hypothesis, followed by Wang et al (2018)

model (1):

$$EQ_{it}=B_0 +B_1\ XFIN_{it}+\beta_2 Opercycle_{i,t}+\beta_3 Size_{i,t}+\beta_4 \delta Sales_{i,t}+\beta_5 Cash\ flow_{i,t} +\beta_6 Losses_{i,t} +\beta_7 Growth_{i,t} +\varepsilon_{i,t}$$

The model (2) is estimated to test the second hypothesis of the following model:

$$EQ_{it} =B_0 +B_1\ XFIN_{it}+B_2\ ABERM_{it}+B_3\ XFIN * ABERM_{it}+\beta_4\ Operating\ cycle_{i,t} + \beta_5\ Size_{i,t} + \beta_6\ Sales\delta_{i,t} +\beta_7\ Cash\ flow_{i,t} + \beta_8\ Losses_{i,t} + +\beta_9 Growth_{i,t} +\varepsilon_{i,t}$$

Table 1. demonstrates variables measuring.

Table 1. Variables definitions

dependent variable	
Equation (1): $Accruals_{i,t}=\beta_0 +\beta_1 Cash\ flow_{i,t-1} +\beta_2 Cash\ flow_{i,t} +\beta_3 Cashflow_{i,t+1} +\beta_4 Revenue_{i,t} +\beta_5 Fixed\ assets_{i,t} +e_{i,t}$ $Accruals_{i,t}$: Changes in accruals of working capital of the firm i between year t and t-1 $Cash\ flow_{i,t-1}$: Net operating cash flows of Firm i in year t-1 $Cash\ flow_{i,t}$: Net operating cash flows i in year t $Cashflow_{i,t+1}$: Net operating cash flows i in year t+1 $Revenue_{i,t}$: Change in sales revenue of i firm between year t and t-1 $Fixed\ assets_{i,t}$: Gross property, machinery and equipment firm i at the end of the year t $e_{i,t}$: The residual of the model is used for i firm in year t, which is the criterion for determining the quality of accruals and in this research is used to measure the earning quality. All	Earnings Quality

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variables in equation (1) were scaled by the average of total assets. the larger the standard deviation of the residuals, the weaker the quality of the earnings, and the smaller the standard deviation of the residuals, the better the quality of the earnings.	
Independent variable	
Equation (2): XFIN = EQUIF +DEBF EQUIF :Net cash flow received from the sale of shares minus the payment of dividends DEBF: Net cash flow received from borrowings minus debt payments. (Bradshaw et al. ,2006)	External financing
Control variables	
The operating cycle of corporate	OPERCYCLE
Natural logarithm of sales	SIZE
The standard deviation of the ratio of sales to assets between years t and t-2	δ SALES
The ratio of operating cash flow to total assets	CFO
If the firm reports a loss, the number 1 is assigned, and otherwise, zero	LOSS
The firm's growth opportunity ((market value of Shareholders' equity + book value of total liabilities)/(book value of total assets))	GROWTH
Moderator variable	
the residual of the following model (e_{it}) indicates deviation from the best-proposed model of Gordon et al. (2009) so that the less the residual of the model, the higher the enterprise risk management. hence, e_{it}- is defined as enterprise risk management. Equation (3): *ERMind it = a0 + a1EUn it + a2ICompe it + a3SIZEit + a4FCom it + a5BDMit + eit* EUn: Environmental uncertainty: To measure environmental uncertainty, the coefficient of sales changes has been used (Berg & Lawless, 1998). ICompe: Industry competition: Industry competition is measured using market share. Higher industry concentration implies that firms within that industry face higher competition. FCom: The complexity of the firm is measured as the ratio of invested capital-to- total assets (Markarian& Parbonetti,2007) BDM: Board of Directors Monitoring: To measure board monitoring following Gordon et al (2009) the number of firm directors divided by the natural logarithm of sales is used. ERMind: Risk Management Indicators. this variable is obtained by summing up the following variables:	Abnormal enterprise risk management

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$$ERMind = star_k + operation_k + Reporting_k + Compliance_k$$

- Star: Represents competitive advantage, $Stra_{i,t}$=($Sales_i$-$IndSA_t$)/σ_{SALEt}

〖Sales〗_i represents the firm's sales, 〖IndSA〗_t represents the average sales of the industry and $\sigma Sale_t$ indicates the standard deviation of the total sales of the industry. The higher the firm's sales compared to industry sales, the better the performance of the firm compared to the average industry and gaining competitive advantage (Gordon et al., 2009).

- operation: represents operational efficiency, is the ratio of asset turnover, and is equal to net sales divided into total assets (Gordon et al., 2009).
- Reporting: indicates the validity of reporting,

$$Reporting = Material\ Weakness + Auditor\ Opinion + Restatement$$

- Material Weakness: By Lin and lee (2016) is with the number of clauses announced in the Independent Auditor's Report.
- Auditor Opinion: If the auditor's report is accepted, the number 1 and otherwise zero.
- Restatement: in case of Re-presentation of financial statements the number 1 and otherwise zero.
- Compliance: represents compliance

Increasing compliance with laws and regulations reduces risk and increases the firm value. complying with accepted audit standards would require audit costs. According to the research (Gordon et al., 2009), the following relationship can be used to measure the Compliance variable.

$$Compliance = \frac{Auditor\ Fees}{TotalAssets}$$

Research Findings

Descriptive Statistics

Table 2. demonstrates Descriptive statistics of variables used in research models

Table 2. Descriptive statistics of variables used in research models

Variable	Mean	Median	Minimum	Maximum	Std. Dev.
Earnings quality	-0.0008	0.0002	-0.561	0.34	0.075
External financing	0.015	0.003	-0.929	0.646	0.092
operating cycle	0.0003	0.0001	-0.007	0.005	0.0007
Firm size	13.987	13.801	9.725	19.566	1.563
std dev of sales to assets	0.11	0.09	0.003	0.588	0.085

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Variable	Mean	Median	Minimum	Maximum	Std. Dev.
Net operating cash flows	0.129	0.117	-0.46	0.624	0.132
Loss	0.116	0.00001	0.000001	1.0001	0.315
growth opportunity	1.704	1.504	0.471	6.113	0.755
Enterprise risk management	0.009	-0.003	-2.326	2.877	0.731

The results of Model (1) to test of the first hypothesis through the weighted or generalized least squares method are shown in Table 3.

The estimated coefficient of external financing indicates a significant relationship between the firm's external financing activities and the quality of the firm's earnings. Therefore, it can be said that there is a significant relationship between external financing activities and earnings quality in listed firms on Tehran Stock Exchange, so the first hypothesis of the research is confirmed.

Table 3. Results of the First Model

$EQ_{it} = \beta_0 + \beta_1 XFIN_{it} + \beta_2\ Opercycle_{i,t} + \beta_3\ Size_{i,t} + \beta_4\ \delta Sales_{i,t} + \beta_5\ Cash\ flow_{i,t} + \beta_6\ Losses_{i,t} + \beta_7 Growth_{i,t} + \varepsilon_{i,t}$					
Variable	Coefficient	Std. Error	t statistic	prob	VIF
C	0.098	0.059	1.651	0.099	
XFIN	0.110	0.031	3.545	0.000	1.130
OPERCYCLE	0.646	0.963	0.072	0.942	1.100
SIZE	-0.005	0.004	-1.319	0.187	1.080
δSALES	0.012	0.027	-0.046	0.645	1.040
CASHFLOW	0.075	0.018	4.051	0.000	1.010
LOSES	0.095	0.003	26.323	0.000	1.130
GROWTH	-0.022	0.002	-7.578	0.000	1.410
AR(1)	0.215	0.043	4.968	0.000	
R-squared	0.449		Durbin-Watson		1.964
F-statistic	3.985		Prob (F-statistic)		0.000
Breusch–Pagan	18.500	0.000	F(Hausman)	14.289	0.026
F (Wooldridge)	10.792	0.002	F(Fixed Effects)	8.377	0.000

In addition, according to the table.2 there is no significant relationship between control variables such as operating cycle, size, and δ Sale and the earning quality. In addition, there is a significant relationship between net operating cash flows, loss, growth opportunity, and earnings quality.

The results of Model (2) to test the second hypothesis through the weighted or generalized least squares method are shown in Table (4)

According to the table (4) the variable of XFIN*ABERM has a significant relationship with the quality of the earnings. Therefore, according to the results, it can be stated that enterprise risk management has a moderating effect on the relationship between Firm

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external financing with earnings quality, so the second hypothesis of the research is confirmed.

$$EQ_{i,t} = \beta_0 + \beta_1 XFIN_{i,t} + \beta_2 ABERM_{i,t} + \beta_3 XFIN * ABERM_{i,t} + \beta_4 Operating\ cycle_{i,t} + \beta_5 Size_{i,t} + \beta_6 Sales\delta_{i,t} + \beta_7 Cash\ flow_{i,t} + \beta_8 Losses_{i,t} + \beta_9 Growth_{i,t} + \varepsilon_{i,t}$$

Table 4. Results of Second Model

Variable	Coefficient	Std. Error	t statistic	Prob	VIF
C	0.055	0.074	0.745	0.456	
XFIN	0.100	0.029	3.400	0.000	3.130
ABERM	0.123	0.051	2.378	0.017	2.080
XFIN*ABERM	0.160	0.021	5.154	0.000	1.900
OPERCYCLE	0.002	0.001	2.545	0.011	1.270
SIZE	-0.002	0.005	-0.562	0.574	1.230
δSALES	-0.005	0.025	-0.224	0.822	1.180
CASHFLOW	0.076	0.018	3.317	0.000	1.010
LOSES	0.093	0.004	23.286	0.000	1.130
GROWTH	-0.022	0.002	-7.792	0.000	1.410
AR(1)	0.214	0.042	5.016	0.000	
R^2	0.533		Durbin-Watson		1.957
F-statistic	2.711		Prob		0.000
Breusch – Pagan	48.410	0.000	F(Hausman Test)	28.895	0.000
F (Wooldridge)	9.717	0.003	F(Fixed Effects)	9.402	0.002

Discussion

In the context of external financing, lenders place particular importance on a firm's ability to repay its debts. They carefully evaluate the profitability and quality of earnings to assess this ability. However, it is worth noting that earnings calculations are based on forecasts and estimates using the accrual approach, rather than reflecting the actual reality. This raises concerns about the reliability of reported earnings and their ability to predict future cash flows. If earnings serve as a more accurate predictor of future cash flows, lenders face less risk. Adopting a comprehensive risk management approach enhances the certainty of cash flows, earnings, and facilitates effective reporting and compliance with laws and regulations. This approach also safeguards firms' reputations and mitigates associated consequences.

Therefore, the objective of this research is to examine the impact of external financing, considering the moderating role of risk management, on earnings quality. The first hypothesis explores the effect of a firm's external financing on earnings quality. The results demonstrate a significant and positive relationship between external financing and earnings quality (Dichev & Skinner, 2002; Zarea et al., 2022). Existing literature suggests that an increase in debt levels enhances earnings quality since creditors require audited

financial statements for credit, and higher-quality financial statements facilitate easier financing. Nonetheless, an opposing view argues that as debt levels rise, managers may manipulate financial information to present a more favorable financial condition, thereby compromising the quality of information. However, this study supports the view that an increase in debt levels corresponds to an increase in earnings quality, consistent with findings from{Ahmad, 2017 #39}{Lin, 2016 #24}{Lassoued, 2022 #25} which indicate a positive and significant relationship between debt financing and earnings management. However, it contradicts the findings of {Asim, 2019 #33}who found no significant relationship between debt and earnings quality.

The second hypothesis investigates the moderating effect of enterprise risk management on the relationship between a firm's external financing and earnings quality. The results illustrate that enterprise risk management positively moderates the relationship between external financing and earnings quality.

In today's dynamic business landscape, organizations face both threats and opportunities that lead to changes in their operations. The ability of organizations to navigate these changes and capitalize on opportunities directly impacts their survival and profitability. Enterprise risk management, with its comprehensive approach to managing threats and opportunities, is essential for organizations to achieve this. Risk management serves as a system designed to mitigate uncertainties and deviations in operations. When managers secure capital through external financing, they provide necessary resources for financing projects with positive net present value. However, numerous factors influence investment decisions, such as capital expenditure, earnings potential, shareholders' expected interest, and the future equity value of the firm. Enterprise risk management is one of these factors, as it influences the selection of investment projects by companies. In essence, risk management serves not only to mitigate losses but also to identify, cultivate, and capitalize on opportunities. Therefore, it can be concluded that enterprise risk management plays a role in influencing the relationship between a firm's external financing and earnings quality. It is worth noting that this particular result cannot be directly compared with findings from other research studies. Based on the authors' review, this hypothesis has not been examined in previous research.

Conclusion

Based on the positive and significant relationship found between external financing and earnings quality in this research, it is recommended that investors give special attention to financing contracts when evaluating the profitability of stocks. Investors should prioritize stocks of firms with high levels of external financing, as these firms tend to report higher earnings quality. Additionally, considering the significant impact of risk management on earnings quality, firms are advised to implement comprehensive risk management procedures. Such procedures not only reduce the firm's risk but also enhance the quality of financial reporting, particularly earnings quality. Based on this, it is suggested that investors prioritize larger firms, which are more likely to report high-quality earnings and higher operating cash flows.

Limitations are an inherent part of any research. Each study is conducted within certain limitations, and the results should be interpreted accordingly. The measurement methods

used for variables in this research impose limitations on generalizing the results. Since there are various methods for measuring earnings quality, external financing, and enterprise risk management in financial and accounting research, the results should be interpreted considering the measurement methods employed in this study. Therefore, future researchers are encouraged to use alternative measurement methods for these variables. Furthermore, this research did not investigate non-linear effects as regression methods have limitations such as linearity. Hence, researchers can explore non-linear effects in their studies. Lastly, this research was not conducted separately for each industry, and it would be valuable for researchers to perform industry-specific analyses in the future.

Author Contributions

Z. Arefmanesh conducted the primary data collection and analysis for the study. This involved designing and implementing surveys, collecting financial data, and analyzing the results. Additionally, she contributed to the development of the research methodology, interpretation of findings, and writing of the manuscript.

H. Samani played a significant role in the conceptualization and design of the research project. He provided expertise in the finance field, contributed to the development of the research questions, and guided the overall direction of the study. Furthermore, he contributed to the interpretation of the data, critical revision of the manuscript for intellectual content, and approving the final version of the paper.

Both authors actively collaborated in the writing and editing process of the manuscript, ensuring the accuracy and integrity of the content presented. Their combined efforts and expertise significantly contributed to the overall quality and outcome of this research in the field of finance.

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