

The Effect of Cost Stickiness on Financial Reporting Quality: The Moderating Role of Financial Constraints

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Submit: 2025/02/10 Accept: 2025/04/04

Abstract

Objectives: This study examines the impact of cost stickiness on financial reporting quality, considering the moderating role of financial constraints. By investigating this relationship, the research aims to highlight how financial constraints can exacerbate the adverse effects of cost stickiness on financial reporting quality.

Methodology/Design/Approach: The study employs a causal-correlational research design. The statistical population consists of firms listed on the Tehran Stock Exchange, from which 131 firms were selected using the systematic elimination sampling method. The study covers the period from 2014 to 2023. Financial reporting quality was measured using the modified Jones model, cost stickiness was assessed based on operating costs, and financial constraints were evaluated using the Kaplan and Zingales model. The research hypotheses were tested using multivariate regression analysis.

Findings: The results indicate that cost stickiness negatively affects financial reporting quality. While financial constraints alone do not significantly impact financial reporting quality, their interaction with cost stickiness intensifies the negative effect. In other words, financial constraints amplify the adverse relationship between cost stickiness and financial reporting quality.

Innovation: This study contributes to the literature by providing empirical evidence on the interplay between cost stickiness, financial constraints, and financial reporting quality in an emerging market context. The findings offer valuable insights for firms seeking to enhance financial reporting transparency by managing cost behavior and financial constraints effectively.

Keywords: Cost Stickiness, Financial Reporting Quality, Financial Constraints.

1. Introduction

Financial reporting is the process of communicating a firm's accounting information to its users. According to the Financial Accounting Standards Board (FASB), financial reporting is not limited to the preparation and presentation of financial statements but also includes the methods of presenting and interpreting information that pertains directly or indirectly to financial data (Colleagues, 2018). Cost stickiness refers to the behavior of costs about changes in the level of activity. It indicates that the magnitude of the increase in costs when activity levels rise is greater than the magnitude of the decrease in costs when activity levels fall. Anderson et al. (2003) first described this phenomenon as "sticky costs" (Namazi et al., 2012).

Firms facing severe financial constraints focus on cash flow when making investment decisions. Although all firms may face financial limitations, the degree of such constraints can vary (Dehdarnasab et al., 2015). The quality of financial reporting is an important issue for investors in the capital market, as it serves as the foundation for their decision-making. When these reports lack quality, investors may make poor decisions, resulting in unmet expectations and lower returns. Several factors can impact the quality of financial reporting, leading to deviations. One such factor is the inconsistency between a firm's income and expenses and the variability of sales and associated costs—referred to as cost stickiness. This phenomenon is often more pronounced in firms with financial constraints. Given these issues, there is a clear research gap in the country, highlighting the need to further investigate the relationship between cost stickiness and financial reporting quality.

Theoretical Foundations and Hypotheses Development

Accounting is a data processing activity that transforms business operations into "business language" in the form of financial statements. These reports are shared with both internal and external stakeholders. The financial reporting process involves the collection and analysis of data from different departments, which are

then consolidated into a financial report. The quality of information can be evaluated based on the disclosure content of the financial reports; these statements strongly influence stakeholder decisions, underscoring the need for transparency in financial reporting. Standardized financial reporting has a significant impact on a firm's economic health and serves the role of forecasting and providing foresight, which directly influences operational sustainability. The information in these reports provides interested investors with insights into the risk and uncertainty associated with the firm.

Another key aspect linked to financial reporting is the percentage of a firm's revenue and the behavior of its expenses (Faisal, 2021). Cost stickiness is the asymmetric reflection of economic activity, in which both increases and decreases in sales are reflected differently (Anderson et al., 2003). In simple terms, the increase in costs with rising activity levels is more significant than the reduction in costs when activity levels decline. Anderson et al. (2003) coined the term "sticky costs" to describe this phenomenon. In situations where activity levels change significantly, managers often adjust the firm's cost structure, resulting in changes to the total cost line. Managers are more inclined to adjust costs when activities increase than when they decrease (Balakrishnan et al., 2004).

The quality of financial reporting, as defined by Penman (1996), is based on the current earnings information, which helps predict future profits. Penman believes that investors use previous period profits to forecast future profits, thus aiding their investment decisions. As a result, the financial reports serve as support for purchasing decisions. According to research, the quality of financial reporting is the ability of financial statements to convey relevant information about a firm's operations, particularly in forecasting expected future cash flows for investors. This aligns with the notion that accruals improve earnings' informational value by reducing the impact of unstable fluctuations in cash flows (Nikbakht et al., 2018). The quality of financial reporting can also be understood as the extent to which financial statements are useful to

investors, creditors, managers, and other stakeholders (Mehrvavar & Kargar, 2019).

Studies show that when cost stickiness occurs in firms, managers may adjust resources and manipulate events to achieve specific goals. This behavior often leads to revenue management, which compromises the quality of financial information in reports (Poursiadeh et al., 2019). When a firm's costs do not align with its sales and revenue, managers may manipulate financial reports to maintain the firm's image (Faisal, 2021). This leads to the first hypothesis of the study:

H1: Cost stickiness has a significant negative effect on the quality of financial reporting.

In the modern global economy, financial constraints have become a critical issue for firms. However, financial constraints should not be confused with economic pressure or the risk of bankruptcy, although these factors are often related (Lari Dashtbayaz et al., 2018). Firms with financial constraints are more likely to emphasize cash flow when making investment decisions, especially when they face both internal and external financial costs. On the other hand, manipulation of financial statements, fraud, and the resulting degradation of financial reporting quality often occur when managers attempt to mislead shareholders or influence contractual outcomes (Nosrat & Badavar Nahandi, 2018).

Financial constraints refer to situations where firms cannot secure financing for desirable investments due to factors such as poor credit conditions, an inability to obtain loans, or a lack of access to capital markets. While financial constraints can lead to economic pressures, they are distinct from financial pressures or bankruptcy risks. According to Dehdarnasab et al. (2015), firms facing severe financial constraints are more likely to focus on cash flow in their investment decisions. Cost management is essential for daily business operations, and considering cost behavior is a key element in maximizing profits through effective cost management. This behavior creates an asymmetric relationship between changes in business activity and costs, referred to as cost stickiness (Anderson, 2003).

Although cost adjustment is helpful for explaining cost stickiness, firms need sufficient financial resources to offset these costs. Financial constraints that limit access to financing can further exacerbate cost stickiness. Maintaining additional resources is more effective than rebuilding resources after they are depleted, and it aids in quickly resuming production and profits. However, holding onto excess resources ties up liquidity and increases financial risks. Therefore, access to capital plays a critical role in determining cost stickiness, and easing financial constraints can help moderate costs. This insight leads to the second hypothesis:

H2: Financial constraint intensifies the relationship between cost stickiness and the quality of financial reporting.

Research Background

Min Oh (2022), in a study titled *Cost Adhesion and Investment Efficiency*, presented the results of her research, which predicted cost asymmetry as a determinant of investment efficiency and empirically examined it using a sample of 4,328 annual observations from Korean firms during the period 2011-2017. The results indicated that firms with cost stickiness are less efficient in their investments than those without cost stickiness. In other words, cost stickiness is an empirical outcome that supports previous research on cost decision-making from the perspective of managers seeking private interests. By demonstrating that managers' decisions regarding cost behavior impact investment efficiency, this concept provides a foundation for efficient capital management mechanisms.

Tang et al. (2022), in their study *Cost Stickiness and Stock Price Crash Risk*, argued that sticky costs increase the diversity of performance and uncertainty within firms. Investors, considering the expected information and concerns, view fixed costs as indicative of a firm's capacity and risk. The study observed a negative relationship between fixed costs and stock price crash risk. This relationship is particularly evident in firms with younger CEOs, high competition in the

product market, low financial risk, poor performance, and higher, more concentrated government ownership. Overall, the results suggested that cost stickiness reduces the risk of stock price crashes, with implications for corporate governance and strategy.

Ibrahim and Al-Matari (2022), in their study *The Impact of Applied Controls of Governance Laws and Applied Controls Based on Accruals on the Quality of Financial Reporting*, emphasized that governance and its applications significantly influence performance excellence and social development. They found that the application of governance rules—promoting values such as justice, equality, the rule of law, anti-corruption, and transparency—helps improve public budget management and overall performance. A total of 348 questionnaires were distributed, with 242 returned. Structural equation modeling was used to test the hypothetical model, confirming that governance laws and accrual-based controls positively impact financial reporting quality at Jouf University.

Hasibun and Abdul Nasser (2022), in their study *The Role of Firm Characteristics in Financial Reporting Quality*, explored how firm characteristics shape the quality of financial reporting in Indonesia. Using structural equation modeling, the study found that structural, regulatory, and performance characteristics have a positive and significant impact on financial reporting quality. However, performance characteristics alone did not significantly affect reporting quality. The findings suggest that focusing on oversight, structure, and performance can enhance the quality of financial reporting, especially in the current pandemic environment.

Faisal (2021), in a study titled *Analysis of the Effect of Cost Stickiness on the Quality of Financial Reporting*, used data from manufacturing firms in Indonesia for 2018. The study employed documentary methods for data collection, analyzed using statistical and regression tests. The results showed that raw material cost stickiness significantly affects the level of financial disclosure, while stickiness in administrative, sales, and labor costs had no significant effect on disclosure in the production sector.

Li and Lu (2021), in *Product Market Competition and Cost Stickiness: Evidence from China*, found that product market competition reduces cost stickiness in emerging markets. For firms with a differentiation strategy, the impact of product market competition on cost stickiness remains unaffected. For firms with public property rights, however, this effect is significantly weakened. Additionally, financial strength and competitive industry position further diminish the impact of product market competition on cost stickiness.

Chen and Ma (2021), in their study *Financial Constraint, Internal Control, and Cost Stickiness*, indicated that managers believe resource retention is more effective than restructuring resources later. However, financial constraints introduce uncertainty in resource decisions. Their results revealed that financial constraints significantly affect cost stickiness, and low internal control quality exacerbates the relationship between financial constraints and cost stickiness.

Habib and Costa (2021) examined the relationship between debt maturity structure and cost stickiness, finding that despite a decrease in activity, managers continue to expand resources for personal gain. They found that short-term debt limits this opportunistic behavior and limits cost stickiness. The availability of free cash flow, revenue management incentives, and executive compensation structures also influence cost stickiness.

Li et al. (2020), in *Risk Management and Cost Asymmetry: Evidence from China*, demonstrated that managers' risk preferences significantly influence cost management decisions. The study concluded that cost stickiness increases with managers' risk appetite, especially in less competitive industries and regions with lower marketing intensity. The findings suggest that managerial characteristics play a key role in asymmetric cost behavior.

Almatari et al. (2020), in *The Impact of Corporate Governance Mechanisms on the Quality of Financial Reporting*, studied the effects of corporate governance mechanisms under Indian accounting standards using a sample of 97 firms listed on the Bombay Stock

Exchange. The study found that the characteristics of the board of directors and audit committee (except for the audit committee's accuracy) significantly influence financial reporting quality. Foreign ownership did not contribute to reporting quality, but audit quality had a substantial impact.

Dine et al. (2015), in *Weaknesses in Internal Control and Financial Reporting Quality*, explored whether weak internal controls increase the financial risk of fraudulent reporting by managers. Their study highlighted a strong relationship between material weaknesses in controls and future fraud disclosures, suggesting that weak controls provide opportunities for financial manipulation, reducing the quality of financial reporting.

Farnoudi and Qajarbeigi (2021), in their study on financial distress and financial constraints, found that financial distress significantly affects accounts payable and receivable. However, financial constraints only impacted accounts receivable, with no strong evidence that they influenced accounts payable.

Razmanesh and Soori (2021), in *Financial Reporting Quality and Investment Efficiency*, investigated the role of family ownership in investment efficiency. The study concluded that high-quality financial reporting improves investment efficiency by reducing information asymmetry. Family ownership was found to positively moderate the relationship between financial reporting quality and investment efficiency.

Fattahi et al. (2020), in *Cost Stickiness and Credit Risk of Banks*, found a significant positive relationship between cost stickiness and credit risk, suggesting that increased cost stickiness leads to lower asset quality, greater profit instability, and higher credit risk in banks.

Vaghfi et al. (2019), in *a Study of Cost Stickiness Behavior in Tehran Stock Exchange Firms*, observed that the intensity of cost increases is greater than the intensity of cost decreases for the same change in activity levels, indicating cost stickiness behavior in the studied firms.

Pourshyadeh et al. (2019), in *The Effect of Ownership Concentration on the Relationship between*

Cost and Risk Stickiness, found that cost stickiness significantly increases firm risk. Ownership concentration, as a key component of corporate governance, negatively moderates the relationship between cost stickiness and firm risk.

Hajiha et al. (2019), in *The Effect of Managers' Short-Term Attitude on Cost Stickiness*, found that managers' short-term attitudes negatively correlate with cost stickiness, suggesting that earnings management and cost control motivations are influenced by managers' short-term focus.

Bazrafshan et al. (2018), in *The Effect of Managers' Narcissism on the Quality of Financial Reporting*, found no significant relationship between narcissistic traits based on signature size and financial reporting quality. However, a significant relationship was observed between managers' reward ratios and financial reporting quality.

Nikbakht and Khanbeigi (2018), in *The Impact of Corporate Governance on the Quality of Financial Reporting*, concluded that corporate governance positively influences the quality of financial reporting in the Iranian capital market. Their findings suggest that strong governance, particularly in terms of audit and ownership structure, significantly affects reporting quality.

Nosrat and Badavar Nahandi (2018), in *The Relationship between Corporate Governance and Firm Growth*, found that institutional ownership and ownership concentration positively relate to firm growth, while financial constraints do not significantly affect this relationship.

Namazi and Fathali (2018), in *Investigating the Effect of Intellectual Capital and Free Cash Flow on Cost Stickiness in Tehran Stock Exchange Firms*, revealed that there is a significant anti-sticky relationship between free cash flow and costs. The study further indicated that intellectual capital and free cash flow reduce cost stickiness in firms with higher intellectual capital.

Research Methodology

This research is applied in nature, aiming to address practical issues, and follows a causal and post-event correlation design as it investigates relationships after the occurrence of an event. The study focuses on firms listed on the Tehran Stock Exchange, with a research period spanning from 2014 to 2023.

The statistical population includes all firms listed on the Tehran Stock Exchange. To ensure comparability and consistency in the study, certain criteria were applied during the selection process of the final sample:

Financial Year Consistency: The firms in the sample must have a financial year ending in March and have not altered their fiscal year during the study period (2014-2023).

Data Availability: The selected firms must have disclosed all the required information during the study period and must not be involved in significant events

(e.g., bankruptcy, mergers) that could invalidate the research results.

After applying these criteria, 131 firms were chosen as the final sample.

For the data analysis, a panel data approach was used, which enables the study of multiple entities over time. This methodology provides more comprehensive and reliable information. The analysis was conducted using **Eviews 12 software**, with the application of the **robust standard error method** to address potential heteroscedasticity issues and ensure the reliability of the hypothesis testing.

The research utilizes **regression analysis** to explore the relationships between various factors, as regression is the most suitable method for examining causal relationships and testing hypotheses in the current study.

Table 1: How to Choose a Statistical Sample of Research

The statistical population in 2023		536
Lack of Corporate Responsibility	-189	
Firms with stock trading freezes	-31	
Firms that have changed the course of finance	-50	
Firms that entered the stock market during the research period	-92	
Investment Firms, Bank, and Holdings	-49	
Final Sample of Research		135

Operational Definitions of Research Variables

Dependent Variable: Financial Reporting Quality (FRQ)

In this study, accrual quality is used as a proxy for financial reporting quality. The modified Jones model (1995), recognized as one of the most robust models for measuring accrual quality, is employed. The model is formulated as follows:

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_0 \left(\frac{1}{TA_{it-1}} \right) + \alpha_1 \left(\frac{\Delta REV_{it}}{TA_{it-1}} \right) - \alpha_2 \left(\frac{\Delta REC_{it}}{TA_{it-1}} \right) + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}} \right) + \varepsilon_{it}$$

Where:

$TAC_{i,t}$: Total accruals of firm i in year t (calculated as net profit minus operating cash flow for the current period):

$$TAC_{i,t} = E_{i,t} - OCF_{i,t}$$

$E_{i,t}$: Net profit of firm i in year t

$OCF_{i,t}$: Operating cash flow of firm i in year t

$\Delta REV_{i,t}$: Change in sales revenue of firm i between years t and $t-1$

$\Delta REC_{i,t}$: Change in accounts receivable of firm i between years t and $t-1$

$PPE_{i,t}$: Gross property, plant, and equipment of firm i in year t

$TA_{i,t-1}$: Total book value of assets of firm i in year $t-1$

$\varepsilon_{i,t}$: Residual term of the model

To determine the quality of accruals in this study, the absolute value of the model's residuals (ϵ_{it}) is taken and multiplied by -1. This transformation ensures that higher absolute residuals, which indicate greater discretionary accruals and lower financial reporting quality, yield negative values, aligning with the interpretation that lower values represent higher accrual quality.

Research Independent Variable: Cost Adhesion (CS)

The concept of cost stickiness was first introduced by Anderson et al. (2003). Cost stickiness is a type of cost behavior that reflects how costs respond asymmetrically to revenue fluctuations—rising more when revenue increases but declining at a slower rate when revenue decreases.

To measure cost stickiness, Anderson et al. (2003) employed a virtual regression model, which has been further utilized and refined by Kurdistani (2020). Additionally, Reimer (2018) and Hamburg (2018) proposed similar models to quantify cost stickiness. The following model is commonly used in the literature, with the residual term indicating the degree of cost stickiness:

$$\log\left(\frac{SGAt}{SGAt-1}\right) = \beta_0 + \beta_1 \log\left(\frac{Salest}{salest-1}\right) + \beta_2 Dt \\ * \log\left(\frac{Salest}{salest-1}\right) + e$$

This model helps in assessing how firms adjust their costs in response to revenue changes, providing insights into managerial decision-making and financial flexibility.

In this context, the variables used in the regression model for measuring cost stickiness are defined as follows:

SGA_t: Selling, General, and Administrative (SG&A) expenses in the current year (operating costs).

SGA_{t-1}: Selling, General, and Administrative (SG&A) expenses in the previous year.

Sales_t: Total sales revenue in the current year.

Sales_{t-1}: Total sales revenue in the previous year.

D_t: A dummy variable that takes the value of **1** when the sales revenue of the current year has decreased compared to the previous year (indicating periods of declining sales) and **0** otherwise.

This model allows researchers to examine how firms adjust their operating costs in response to changes in sales revenue, highlighting the asymmetric nature of cost behavior.

Moderating Variable: Financial Constraint (KZ)

Firms are considered financially constrained when there is a gap between the internal and external sources of allocated funds. Based on this definition, all firms experience financial constraints to some extent; however, the severity of these constraints varies. Firms with lower financial constraints typically possess higher liquidity and substantial net assets.

In this study, financial constraint is treated as a binary variable (0 and 1). To measure financial constraints, the **Kaplan and Zingales (KZ) index** is used, which has been localized for the Iranian business environment by **Raei and Hesarzadeh (2009)**. The KZ scores are ranked from the smallest to the largest and then divided into five quantiles. Firms in the **fourth and fifth quantiles** are classified as financially constrained firms.

$$KZ = 17.33 - 37.486 * (\text{Cashholding} / \text{Total Assets}) - \\ 15.21 * (\text{DIY} / \text{Total Assets}) + 3.39 * \text{LEV} - 1.402 * \\ (\text{M/B})$$

Cashholding: Net cash flow of the firm divided by total assets.

Total Assets: The total value of a firm's assets.

Dividend-to-Assets Ratio (DIY): The ratio of total dividends paid to total assets.

LEV (Leverage): Total liabilities of the firm divided by total assets.

M/B (Market-to-Book Ratio): The ratio of the market value of equity to its book value (Nosrat & Badavarnahdi, 2018).

Research Control Variables

- **ROA (Return on Assets):** This variable is calculated by dividing net profit before interest and tax by total assets.
- **SIZE (Firm Size):** This variable is measured as the natural logarithm of total assets.
- **LEV (Leverage):** This variable is computed as the ratio of total liabilities to total assets.
- **MTB (Market-to-Book Ratio):** This variable is calculated by dividing the market value of equity by the book value of equity at the end of the financial year.
- **STATE (State Ownership):** This is a binary variable, where a value of 1 is assigned if the firm's largest shareholder (i.e., the entity or individual holding the highest percentage of shares) is the government or a government-affiliated entity; otherwise, it is assigned a value of 0.

Research Regression Model

$$FRQ_{i,t} = \beta_0 + \beta_1 CS_{i,t} + \beta_2 KZ_{i,t} + \beta_3 (CS_{i,t} \times KZ_{i,t}) + \beta_4 LEV_{i,t} + \beta_5 SIZE_{i,t} + \beta_6 ROA_{i,t} + \beta_7 MTB_{i,t} + \beta_8 STATE_{i,t} + \varepsilon_{i,t}$$

Descriptive findings

The primary central index is the **mean**, which represents the equilibrium point and the center of gravity of the distribution. It serves as a reliable indicator of data centrality. For instance, the **average leverage value** is 0.55, indicating that approximately

half of the observations fall below this value while the other half exceed it.

In general, **dispersion parameters** measure the spread of data points relative to each other or the mean. One of the most significant dispersion parameters is the **standard deviation**, which quantifies variability. In this study, the **standard deviation** for **firm growth (market capitalization to book value)** is 5.37, while for **cost stickiness**, it is 0.09. These values indicate that firm growth exhibits the highest variation, whereas cost stickiness shows the lowest standard deviation.

The results in **Table 4** indicate that the significance level of the **White test** in the research model is below 5%, suggesting the presence of heteroscedasticity in the error terms. This issue was addressed in the final model estimations by employing the **Generalized The Least Squares (GLS)** method. Additionally, the results from the **Godfrey-Brochure test** for serial autocorrelation show that the significance level of the autocorrelation test in the research models is below 5%, implying the absence of serial correlation in the models. Furthermore, the **Durbin-Watson statistic** confirms that there is no substantial autocorrelation among the residuals of the model.

According to the results presented in **Table 5**, the significance level of the variables in the reliability test is below 5%, indicating that the variables are stationary. According to the results presented in **Table 6**, the significance level of the test for the research model is below 5%, indicating the acceptance of the pooled data model.

Table (2): Descriptive statistics of research variables

Variable	Mean	Max	Min	ST.D
FRQ	0.12-	0.004-	0.61-	0.12
CS	0.007	0.30	0.17-	0.099
Kz	0.40	1.00	0.0000	0.49
LEV	0.55	0.96	0.10	0.20
MTB	6.26	16.9	1.02	5.37
ROA	0.14	0.55	0.075-	0.14
SIZE	14.65	19.53	11.64	1.48
STATE	0.41	1.00	0.0000	0.49

Table (4): Results of Variance and Serial Autocorrelation Test

Test Model	Test Statistics	Sig
White Test	237.1	0.0000
The Brush Godfrey Test	0.99	0.60
Comprehensive Research Model (Watson Durbin)	1.97	-

Table 5: Stability Test Quantity of Variables

Variable	Test Statistics	Sig	Results
FRQ	23.6070-	0.0000	Stationary
CS	8.68722-	0.0000	Stationary
LEV	11.2303-	0.0000	Stationary
MTB	19.6820-	0.0000	Stationary
ROA	13.3262-	0.0000	Stationary
SIZE	16.8838-	0.0000	Stationary

Table (6): F-Limmer (Chow) Test Results

Test Model	Test Statistics	Sig
Research Model	0.70	0.66

Table (7): Results of Testing Research Hypotheses

$FRQ_{it} = \beta_0 + \beta_1 CS_{it} + \beta_2 KZ_{it} + \beta_3 (CS_{it} \times KZ_{it}) + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 MTB_{it} + \beta_8 STATE_{it} + \varepsilon_{it}$					
Variables	Coef	ST.D	Statistic t	Sig	VIF
CS	0.66-	0.079	8.33-	0.0000	1.56
Kz	0.007	0.013	0.54	0.58	1.75
CS*KZ	0.73-	0.081	8.94-	0.0000	1.54
LEV	0.020-	0.018	1.11-	0.26	1.65
SIZE	0.0001	0.002	0.076	0.93	1.10
ROA	0.13-	0.029	4.62-	0.0000	1.92
MTB	0.002-	0.0006	3.48-	0.0005	1.61
STATE	0.006	0.006	1.11	0.26	
C	0.061-	0.032	1.87-	0.061	-
R2	0.12				
D.W	1.97				
F	18.45319				
-	0.0000				

The results in **Table 7** show that the cost stickiness variable, with a negative coefficient (-0.66) and a significance level of less than 5% (0.0000), has a significant inverse relationship with the quality of financial reporting. Therefore, the first hypothesis of the research is accepted at the 5% error level. This indicates that as cost stickiness increases, the quality of financial reporting decreases.

For the second hypothesis, the interaction of cost stickiness and financial constraint, with a negative coefficient (-0.73) and a significance level of less than 5% (0.0000), demonstrates an inverse effect on the quality of financial reporting. Since the absolute value of the regression coefficient for the second hypothesis is larger than that of the first hypothesis, it can be concluded that financial constraint intensifies the negative relationship between cost stickiness and the quality of financial reporting. As a result, the second hypothesis is also accepted at the 5% error level.

Regarding the control variables, firm growth and return on assets both show a significant relationship with the dependent variable at a level of less than 5%. The coefficient of determination is 12%, indicating that the independent and control variables in the model explain 12% of the variance in the dependent variable. Additionally, the value of the Durbin-Watson statistic is 1.97, which suggests that there is no strong serial correlation in the residuals of the model.

Discussion & Conclusion

The main objective of this study is to examine the effect of cost stickiness on the quality of financial reporting, considering the role of financial constraints. The estimated coefficient of the cost stickiness variable, which is negative, along with a calculated t-statistic value below 5%, indicates that the relationship between these variables is inverse and statistically significant at the 95% confidence level.

Financial reporting quality serves as a criterion that differentiates useful information from irrelevant data, enhancing the overall usefulness of financial information. It refers to the extent to which financial statements provide valuable insights for investors,

creditors, managers, and other stakeholders. More precisely, financial reporting quality is defined by the accuracy of financial reports in reflecting relevant information about a firm's operations and cash flows.

Prior research suggests that cost stickiness arises when managers deliberately adjust resources and manipulate events to achieve specific corporate objectives. This practice, often classified as earnings management, compromises the reliability of financial reports. When firm costs do not align with sales and revenue levels, managers may seek to preserve the firm's financial image, leading to distortions in financial reporting. Consequently, an increase in cost stickiness results in a decline in financial reporting quality. The findings of this study's first hypothesis align with the research of Faisal et al. (2021), who also concluded that cost stickiness is associated with lower financial reporting quality.

Furthermore, the estimated coefficient for the interaction between financial constraint and cost stickiness—represented statistically as a multiplicative term—demonstrates a negative value, with a t-statistic below 5%. This result indicates that the relationship between these variables is also inverse and significant at the 95% confidence level. The interaction between financial constraints and cost stickiness further diminishes financial reporting quality.

Cost management is a critical aspect of corporate decision-making, playing a key role in resource allocation and profit maximization. While cost adjustments help explain cost stickiness, firms still require adequate financial support to manage these costs effectively. The financial burden associated with securing external funding often leads to financing constraints, which, in turn, exacerbate cost stickiness.

Preserving resources is generally more efficient than rebuilding them once depleted, as it allows firms to resume production and profitability more swiftly. However, maintaining surplus resources ties up liquidity and increases financial risk, making access to capital a crucial determinant of cost stickiness. When a firm faces cost stickiness, it must secure financing to cover these expenditures. In cases where firms

experience financial constraints, the simultaneous presence of both factors—cost stickiness and financial constraints—can pressure managers to misrepresent the firm's financial condition in financial reports. Consequently, financial reporting quality is further compromised.

The findings of the second hypothesis are consistent with the research of Chen and Ma (2021), who concluded that financial constraints exacerbate cost stickiness.

Practical Research Suggestions

Continuous cost control and alignment with the firm's revenue level are fundamental responsibilities of managers. Since the financial foundation of any business depends on maintaining a balance between income and expenses, managers must implement strategic plans for the sale and procurement of raw materials. By considering market conditions, risks, inflation, and economic downturns, firms can prevent cost stickiness and maintain financial stability.

- **Financial preparedness:** Managers must ensure adequate resources are available to address potential shortfalls in financing. Maintaining a balanced approach to liquidity and investments prevents situations where financial constraints force them to manipulate financial reports.
- **Impact on stock price:** If poor financial reporting quality stems from cost and financing crises and persists undetected, its eventual disclosure could negatively impact investor behavior. A sudden revelation of low-quality financial reports may lead to a sharp decline in the firm's stock price.
- **Investor confidence:** By assessing the financial strength of firms and ensuring the accuracy of financial reports, shareholders can make informed decisions about potential returns and risks, leading to more confident investment choices.
- **Specialized financial management:** Firms should establish dedicated economic teams and

appoint managers with expertise in financial issues, reducing the need for earnings management practices that compromise financial reporting quality.

- **Role of capital market analysts:** Analysts play a crucial role in safeguarding market integrity by conducting thorough evaluations of firms' financial statements and capabilities. Their insights help firms, investors, and the broader capital market make well-informed decisions.

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