

THE MEDIATING ROLE OF GEOPOLITICAL RISKS ON THE RELATIONSHIP BETWEEN ECONOMIC VOLATILITIES AND OF ACCOUNTING CONSERVATISM IN FINANCIAL REPORTS

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Abstract

The study aimed to identify the mediating role of geopolitical risks in the relationship between economic volatilities (Gross Domestic Product, inflation, exchange rate, and liquidity) and levels of accounting conservatism in the Financial Reports issued by the banks listed on the Khartoum Stock Exchange (KSE) for the period of 2011 - 2022. The study results showed there is obvious and direct significant impact of the geopolitical risks factors in creating economic volatilities and disturbances in the variables of the study, and these volatilities lead institutions to adopt conservative accounting policies. The study also emphasized the importance of encouraging and implementing an accounting conservatism policy in financial reports during times of economic volatility, as this allows these reports to predict the future, reduce risks, and assist in making investment decisions that are compatible with various investment conditions.

Keywords: Accounting Conservatism, Economic volatilities, Geopolitical risks.

Introduction:

All economic countries go through multiple volatilities and changes in the economy and growth, and often these volatilities are the result of repercussions related to financial crises. There are other factors that affect these volatilities, such as the geopolitical dimensions and their major role in creating economic crises. As usual, investors always resort to searching for safe investment areas that keep them away from risks. The economic sector, as well as the managements of companies and workers in the economic markets, work to provide messages that reassure these investors, and this is what leads us to identify the relationship between the factors that create economic volatilities and the extent of its impact on these investors, and what the companies should be provide it to reassurances to investors through financial reports. Therefore, through this study, the researcher seeks to shed light on the relationship between the political risks, economic volatilities and accounting conservatism in financial reports in the Sudanese banking sector, which is considered a puzzling puzzle for economists, as the country is rich in economic resources and has a strategic location, but suffers from many problems such as geopolitical volatilities , that clearly contribute to creating severe economic volatilities that have crippled the Sudanese economy and prevented it from developing and continuing to grow, Khalid, W.E.O (2021).On the other hand, one of the most essential instruments that corporations may use to alleviate investors' anxieties is accounting conservatism, which is used in financial reports. The concept of accounting conservatism was controversial at the beginning of the last century and remains to this day. Despite criticisms of this principle, it still plays an important role in accounting practices, and the purpose of accounting conservatism is to prevent overestimation of assets and revenues, because overestimation is more harmful to shareholders, creditors, etc., than understatement (Watts 2003a). There are also many factors that affect accounting conservatism, one of the most prominent influential factors is the focus of this study, which is the factors of economic volatilities. Where economic volatilities are used to describe the variation of periods during which the economy grows and then declines, it faces what we also call stagnation (Mubarak, 1982). The most important factors of economic volatilities used in this study are four factors, which is the gross domestic product. Gross domestic product is known as the total monetary value of manufactured products. The final number according to the

economic units residing in the country in a certain period of time (Central Bank of Sudan). Inflation is a permanent and random increase in the general level of prices of products and services, (Study by Esfanabad and Jahanshahi, 2018). Exchange rate; It is the value of one country's currency against the currency of another country or economic region. Liquidity, defined by the Central Bank of Sudan (2019) as consisting of currency held by the public, demand deposits and quasi-money (margins of documentary credits, letters of guarantee, time deposits, and investment deposits).

The significance of this study lies in verifying the mediating role of geopolitical risks in the relationship between an economic volatilities (GDP, exchange rate, inflation and liquidity) and counting conservatism , in banks listed on the Khartoum Stock Exchange (KSE), and studying the role of economic volatilities on enhancing financial performance and knowing about Levels of accounting conservatism in financial reports issued during the years 2011-2022, especially in light of the unstable economic volatilities. This study aims to answer the question - Do geopolitical risks mediating the relationship between economic volatilities and accounting conservatism in the financial Reports?

RESEARCH MODEL

The study model was constructed with geopolitical risk as a mediator variable, mediating the relationship between economic volatility (independent variable) and accounting conservatism (dependent variable).

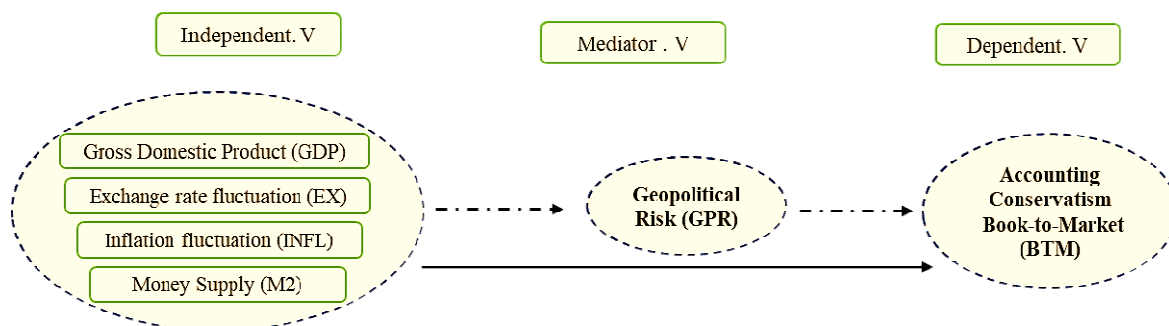


Figure 1. The research Model.

Literature Review and Hypothesis Development:

Many studies have addressed the implications of geopolitical risks on the economy in general. While other studies have addressed the nature of the impact of economic volatilities on financial markets, what is reflected in the reports and financial statements issued by these markets, and the level of accounting conservatism in these lists and reports , the researcher will attempt to review some of the literature relevant to the focus of this study.

To explain the term Geopolitical Risks, Wade 2019¹ pointed out "it's a method of studying foreign policy to understand, explain and predict international political behavior through geographical variables. This also includes area study, climate topography, demography, natural resources, and applied science of the region which is being evaluated. Geopolitical risks occurs when there is a threat to the normal relationships between countries or regions. From an investor perspective, he focused on how shifts in these relationships can impact the economy and create volatility in financial markets". While Khalid, W. E., et al (2023)² mentioned to that any volatilities occur in the

¹- Wade, Keith 2019, Measuring the market impact of geopolitics, <https://www.schroders.com/en/sysglobalassets/digital/insights>

²- Khalid, W. E., Soussi, M. M., & Abdelmajid, R. (2023), The role of the investment actuary in managing financial market risks in light of the repercussions of geopolitical fluctuations. The Seybold report, 18(2).

geopolitical situation, especially at the global level, we find that the anticipation and stimulus are focused on the economy, and the outlook is usually focused negatively, especially on the capital markets, which includes various phenomena such as political instability, military tensions and conflicts between countries, terrorist threats or geographic events that can have regional or global impacts. While Biswal 2016 mentioned that "German geopoliticians used the concept of Geopolitical Risks as military science, And it encompasses the dimensions and effects of geographic factors related to international borders, terrain, climate, natural resources, and interstate conflicts that have an impact on social and economic relations.

In a related context, Lu, Z., Gozgor, et al. (2020) addressed the effect of geopolitical risks on financial development (measured by domestic credit to the private sector) in a panel dataset of 18 emerging markets over the period 1985-2018. The results from the fixed-effects estimations indicate that an increase in geopolitical risks leads to a lower level of domestic credit to the private sector. Further, external imbalances were found to suppress domestic credit in emerging markets. According to the findings from these robustness checks, the negative impact of geopolitical risks on domestic lending is statistically and economically robust, while Wade (2019), Yang (2021) also discussed the effects and repercussions of geopolitical risks on financial markets, a negative effect on equity market returns in all advanced economies and on capital flows. This increases investor anxiety and raises potential risk rates in the event of a development. Conflicts and their continuation will have effect on how well the economy as a whole performs due to economic volatility considerations. While many studies indicated geopolitical risks (GPR), which includes the risk posed by wars, terrorist attacks, and conflicts between states, has a significant role in determining the macroeconomic and financial cycles. Particularly, central bankers and business investors frequently identify GPR as one among the factors influencing investment decisions (Carney, 2016). While Caldara and Iacoviello (2022) have recently created an index of GPR and demonstrated that external changes in GPR can considerably lower economic activity and stock market returns,

Regarding the implications of geopolitical risks in Sudan, we found this country continued to suffer from a number of obstacles and geopolitical issues that shaped the bleak picture of its stability. Although it is a country rich in natural resources, Çınar, H. Y., & Adem, Ö. Z. E. R. (2023) has divided the Issues with a geopolitical dimension in Sudan are attributed to internal and external factors, as the internal factors were: internal power struggles, ethnic divisions, economic disparities, and governance challenges, and external factors that have intertwined and perpetuated cycles of conflict and fragility as Sudan's Foreign Policy Issues, Water Resources, Controversies, Border Disputes, the separation of South Sudan, The policies of regional actors (the Gulf states, Iran, and Turkey) and global actors (Russia, America, and China) on the axis of competition for interests and benefiting from the resources that Sudan enjoys, and the struggle over influence and geopolitical interests to benefit from Sudan's strategic location and the subsequent intersection of interests, and economic sanctions imposed by the United States of America on Sudan for more than 20 years.

On the other hand, when we discussing the economic volatility, we find the several studies have revealed macroeconomic issues, such as the study of (Bushman et al., 2011), showed that accounting conservatism can facilitate economic growth by improving contracting efficiency, and increases the likelihood that economic resources are allocated to productive projects. Because losses are recognized earlier, managers can divert resources from unproductive projects to productive projects faster, according to a study by (Crawley, 2014), investigated the impact of accounting conservatism on macroeconomic factors and money supply, The results showed that GDP measurements are more sensitive to negative aggregate cash flow news than to positive aggregate cash flow news, As observed by Cerqueira, A., & Pereira, C. (2020), there is a close relationship between the economic conditions and the levels of accounting conservatism, also the study revealed a decrease in conservatism trend in the pre-crisis period, followed by a significant increase in the post-crisis period, also the study of (Ademola, Moses, 2017) which investigated the Accounting Conservatism and its Benefits to Shareholders in Developing Capital Market, Which uses variables volatilities of inflation and exchange rate as a control variables, the results show that the volatilities

of inflation and exchange rate have an inverse effect on the financial performance which in return will affect the accounting conservatism and which the shareholders' value. also the study of (Esfandabad & Jahanshahi Study, 2018) investigated the impact of macroeconomic factors (GDP, economic growth, liquidity and inflation) on unconditional conservatism in companies listed on the Tehran Stock Exchange (TSE), the study show that these factors have positive and significant impact on unconditional conservatism, But the study of (Do, Nabar, 2019) which investigated the Macroeconomic effects of aggregate accounting conditional conservatism. The results show that both conditional conservatism measures have a positive and significant association with economic growth, as also the study showed that conditional conservatism is associated with higher level of growth in (GDP). This study differs from previous studies in being to measure Impact of Economic Volatilities (GDP, Exchange rate ,money supply and inflation) on the levels of accounting conservatism in the financial reports issued by banking listed on the (KSE), In a complex and unstable economy due to a combination of factors mentioned earlier.

The study posed two null hypotheses and four null sub-hypotheses are the following:

H1: There is reasonable level of accounting conservation in the listed banks' financial reporting (KSE).

H2: Geopolitical Risk mediates the relationship between Economic volatility and accounting conservation in financial reports issued by the banks listed on the (KSE).

H2.1: Geopolitical Risk (GPR)mediates the relationship between Gross Domestic Product (GDP) volatility and accounting conservation in the financial report.

H2.2: Geopolitical Risk (GPR) mediates the relationship between exchange rate (XR) volatility and accounting conservation in the financial report.

H2.3: Geopolitical Risk (GPR) mediates the relationship between inflation (INFL) volatility and accounting conservation in the financial report.

H2.4: Geopolitical Risk (GPR) mediates the relationship between liquidity ratio (M2) and accounting conservation in the financial report.

Methodology:

The study's sample comprises of Sudanese banks listed in the (KSE) (15 banks) comprise just 90%, during a 10-year time series, from 2011 to 2022, banks with the following criteria were selected:

- We used the banks listed on the Khartoum Stock Exchange was listed before 2011.
- This Banks did not have commercial interruptions for more than six months during the specified period.
- Shares shall be traded during the period under investigation.
- There was reasonable of accounting conservatism in their financial statements during the study period.

The study sample data were obtained from the financial statements published on the websites of e-banks, (KSE)³, Central Bank of Sudan⁴, IMF⁵.

Study Variables:

Accounting conservatism as dependent Variable:

The researcher relied on the measurement of accounting conservatism on the Book-to-Market (BTM) Approach for Testing the Level of Accounting Conservatism. Many studies referred to the (BTM) as one of the indicators of accounting conservatism. The theoretical frame developed by (Beaver & Ryan, 2000), used by few studies like those of (Ahmed & Duellman, 2007; LaFond & Roychowdhury, 2007; Jain & Rezaee, 2004; Ahmed et al., 2002; Givoly & Hayn, 2000, Khalid, W.

³- www.kse.com.sd

⁴- <https://cbos.gov.sd/>

⁵- [https://www.imf.org/en/Search#q=sudan&sort=relevancy&f:type=\[DATA\]](https://www.imf.org/en/Search#q=sudan&sort=relevancy&f:type=[DATA])

E , et al (2023) proposed using BTM to measure conservatism. The Book-to-Market value is used to test share value in comparison with the market value. The presence of a reasonable level of accounting conservatism means that the Book Value (BV) is less than that of the Market Value (MV) through a certain period of time, as the following formula ($BV-MV < 0$) .

Economic volatilities Variables as Independent Variables:

Gross Domestic Product (**GDP**) fluctuation, Inflation fluctuation (**INFL**) ,exchange rate fluctuation (**EX**), and Money Supply (**M2**) fluctuation, that for the period of 2011 - 2022. In this study, we used smooth of standard deviation for four year sub-periods (2011-2012-2013- 2014- 2015 2016 -2017-2018-2019-2020-2021-2022), respectively.

Geopolitical risks variable as a Mediating variable:

To measure geopolitical risks, the researcher relied on (GPR) which includes the risk posed by wars, terrorist attacks, and conflicts between states, internal power struggles, ethnic divisions, economic disparities, and governance challenges, has a significant role in determining the macroeconomic and financial cycles. Additionally this index (GPR) is based on daily and monthly indicators of geopolitical risks (GPR) in newspapers, international and local. Also we find central bankers and business investors frequently identify GPR as one among the factors influencing investment decisions (Carney, 2016).While Caldara and Iacoviello (2022) have recently created an index of GPR and demonstrated that external changes in GPR can considerably lower economic activity and stock market returns,This variable has been used based on many studies, such asHu, W.et al (2023), (Carney, 2016), and Khalid, W. E , et al (2023), Caldara, D., & Iacoviello, M. (2022).

We would like to emphasize that geopolitical risks were used to determine their impact on the study variables rather than to quantify them in and of themselves.

In the present study, for testing hypotheses, and in order to have a more accurate investigation and examine the effect of each variable, the equation of research is presented as following:

$$GPR_{it} = \beta_0 + \beta_1 (GDP)_{it} + \beta_2 (INFL)_{it} + \beta_3 (XR)_{it} + \beta_4 (M2)_{it} + \varepsilon_t, i = 1...15, t = 2011-2022$$

$$BTM_{it} = \beta_0 + \beta_1 (GDP)_{it} + \beta_2 (INFL)_{it} + \beta_3 (XR)_{it} + \beta_4 (M2)_{it} + \beta_5 (GPR)_{it} + \varepsilon_t, i = 1...15, t = 2011- 2022$$

Where:

- GPR_{it}** = Mediating variable
- BTM_{it}** =Dependent variable. The level of accounting conservatism (Book-to-Market ratio) indicator of company (i) in the year (t).
- β₀** = Constant value.
- GDP** = Gross Domestic Product - Independent Variable.
- INFL** = Inflation fluctuation - Independent Variable.
- XR** = Exchange rate - Independent Variable.
- M2** = Money Supply - Independent Variable.
- (β₁-β₄)_{it}** = Slope value of independent variable.
- ε_t** =the model error term (residuals).

Results and Discussions:

To test the study hypotheses and understand The Mediating Role of Geopolitical Risk on the Relationship between Economic Volatilities and of Accounting Conservatism in Financial Reports Khartoum Stock Exchange (KSE), the researcher used descriptive statistics for the study variables and multiple linear regression, in addition The BTM approach to measuring the level of accounting conservatism.

Table 1. The Results of the Descriptive Statistics

V	Min	Max	Mean	Std. Deviation	skewness
BTM	.24	4.01	2.4184	.7773	1.366
GDP	1.89	3.98	2.9230	1.10016	0.936
INFL	2.88	12.01	7.7810	3.26389	0.157
XR	2.91	8.70	4.4990	.446871	0.182
M2	.57	4.67	2.9210	1.17345	6.137
GPR	-	-	3.0036	3.12317	0.197

Source: Research Calculations

Table 1 shows descriptive statistics for the aggregate time-series data collected every year used in this study. The time period being studied runs from 2011 to 2022, and a sample of 15 banks was chosen because they demonstrated a reasonable level of accounting conservatism in their financial statements to varied degrees during the study period.

After analyzing the descriptive statistics shown in Table 1 and referring to the financial reports of the study sample to determine levels of accounting conservatism according to the methodology used (BTM), we observed We found that the accounting conservatism rate moved between 3.93 and 0.24. After testing the first hypothesis (There is reasonable level of accounting conservatism) as exhibited in the following (H1: $BV-MV \geq 0$), the financial report revealed that (BV) is less than (MV) , This indicator point out to there is a reasonable level of accounting conservatism, which means used that a certain accounting policies were used and those were biased in admitting loss and lower values of the assets, Which mean accepted the first hypothesis. Such a result it agree with the some results of studies conducted in similar environments like the study of (Ahmed & Duellman, 2007), (Alnajaar, 2014).

Table 2: Correlation Analysis

Variables	BTM	GDP	INFL	XR	M2	GPR
BTM	1					
GDP	.910**	1				
INFL	.760**	.797**	1			
XR	.810**	.882**	.706**	1		
M2	-.740**	.850**	.787**	.760**	1	
GPR	.870**	.862**	.852**	.810**	.706**	1

****.** Correlation is significant at the 0.01 level (2-tailed).

Source: data analysis, SPSS V23 -2023

From Table (2) related to the Pearson correlation Analysis between the variables, we find that they are all variables significantly at the level of significance (0.005). This confirms there significantly of the correlation between the variables.

Multiple Regression Analysis:

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

Table 3: Testing of the hypotheses

Panel A: Coefficient of determination					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	
1	.440 ^a	.193	.159	.66399	
Panel B: Analysis of variance:					
	Sum of Squares	df	Mean Square	F	Sig.
Regression	10.031	4	2.072	5.688	.000 ^a
Residual	41.884	95	.498		
Total	51.914	99			

Source: Survey data, SPSS V23 -2023

Table (3-A) shows that the value of the coefficient of determination R is 0.440, while the R square parameter is 0.193. This shows the effect of the on other variables and that indicate of 19.3% of the change in the dependent variable (accounting conservatism) is due to the change in the independent variable (economic volatilities variables), and the rest is due to geopolitical risks GPR as mediating variable , This indicates that there is a clear effect. As the table (3- B) shows that the value of F = 5.688 at a significant at the 0.01 level, indicates the significance of the statistical model used.

It emphasizes the effect of the independent variable (economic volatility) on the dependent variable (accounting conservatism), and explains that the of Geopolitical risk variable are mediating the relationship between economic volatilities and of accounting conservatism in financial reports ,which mean accepting the second main hypothesis and its sub hypotheses , So as to explain the following :

It can be stated that the results obtained from testing the second main hypothesis showed that the variable of Geopolitical risk is mediating the relationship between economic volatilities (GDP, INFL, XR, and M2) and of accounting conservatism in financial reports, and there is a statistically significant relationship between the accounting conservatism in the financial reports issued for banks of listed on the (KSE) and economic volatilities variables (GDP, INFL, XR, and M2).

This explains the results of the sub-hypotheses, where the first sub-hypothesis test proved that there is a significant impact volatility of Gross Domestic Product (GDP) on accounting conservatism in the financial reports (negative effect), Such a result it agree with the some results of studies conducted in similar environments of which indicated that there is a relationship between volatility of GDP and the accounting conservatism like the study (Esfandabad & Jahanshahi ,2018) ,(Crawley ,2014), (Do, Nabar ,2019), That shows the impact of Geopolitical risk factors on Gross Domestic Product (GDP), and Which proved that the variable of Geopolitical risks mediates the relationship between Gross Domestic Product (GDP) volatility and accounting conservation in the financial report.

The volatility of exchange rate has a direct affects and on accounting conservatism in the financial reports , that mean when the exchange rate have been experiencing a continuous increase, this upward movement is expected to have an inverse effect on the financial performance ,and that shows the impact of Geopolitical risk factors on exchange rate (ER) volatility and which proved of the variable of geopolitical risks mediates the relationship between exchange rate (ER) volatility and accounting conservation in the financial report. This is reflected in both the market value and book value and thus shows the relationship between the exchange rate and accounting conservatism.

Also the volatility of inflation refers to when there is increase of inflation will lead to the increase of the value of monetary assets and return affect the shareholders' value, so the market value of equity will also increase. And eventually, it will lead to the increase of conservatism. Such a result it agree with the study Such a result it agree with the study (Ademola , Moses, 2017), (Esfandabad & Jahanshahi ,2018). Also that shows the impact of Geopolitical risk factors on volatility of inflation (INFL) and which proved of the variable of geopolitical risks mediates the relationship between volatility of inflation (INFL) volatility and accounting conservation in the financial report.

Additionally the volatility of liquidity ratio mean Money supply affects stock prices through the mechanism of the central bank, which requires commercial banks to deposit a percentage of their reserves. If the bank's policy is directed towards the credit policy of individuals, it reduces its reserve ratio, which increases the liquidity of banks, which reduces the cost of borrowing and interest rate, and encourages the highest investment in shares and then the rise in prices, This in turn could make the market share split higher than book value, suggesting a conservative policy with banks, such a result it agree with the study. (Esfandabad & Jahanshahi, 2018),(Crawley,2014), (Do,Nabar,2019), (Bushman et al,2011). That shows the impact of Geopolitics risk factors on volatility of Money supply (M2), and which proved of the variable of geopolitical risks mediates the relationship between volatility of Money supply (M2) and accounting conservation in the financial report.

CONCLUSION:

The study aimed to identify the mediating role of geopolitical risks in the relationship between economic volatilities and levels of accounting conservatism in the Financial Reports issued by the banks listed on the Khartoum Stock Exchange (KSE) for the period of 2011 - 2022, as the statistical analysis results of this study reflect the impact of geopolitical risks factors and their role in creating economic volatilities and disturbances in the factors The subject of the study, and these volatilities lead institutions to adopt conservative accounting policies. The results of the study also show the effect of volatilities and economic factors in enhancing the levels of accounting conservatism in the financial reports issued by the banks under study. The results of the study were shown there is a reasonable level of accounting conservation in financial reports issued by the banks listed on the (KSE). This means shown assets and profits with the lowest possible values losses and liabilities of the highest possible values and reserves them if they occur in the future, and the study shown there is a relationship between conservatism accounting and economic volatilities (GDP, Exchange rate , inflation and liquidity) in the banks listed in Khartoum Stock Exchange (KSE) , and these economic volatilities has a direct effects and on accounting conservatism in financial reports over the years of study especially in an unstable economic situation, this make the financial reports ability to handle such situations, and a capability of predict the future and reduce risks and help make investment decisions consistent with investment conditions Surrounding.

Also the results of this study reflect the impact of geopolitical risks factors and their role in creating economic volatilities and disturbances in the factors under study. These volatilities lead institutions to adopt conservative accounting policies, and which proved of the variable of geopolitical risks mediates the relationship between economic volatilities and accounting conservation in the financial report. The study also emphasized the importance of encouraging and implementing an accounting conservatism policy in financial reports during times of economic volatility, as this allows these reports to predict the future, reduce risks, and assist in making investment decisions that are compatible with various investment conditions.

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