

The Effect of Internal Auditing on Net Value and Inflation Management in Iranian Companies

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ABSTRACT

This study aims to examine the impact of internal audit function quality on corporate net value and its moderating role in mitigating the effects of inflation in Iranian companies. The research employed a longitudinal panel design using a sample of 142 non-financial firms listed on the Tehran Stock Exchange from 2012 to 2023, yielding 1,704 firm-year observations. Financial statements, stock prices, inflation data, and internal audit characteristics were collected from multiple official databases and corporate disclosures. Dependent variables included Tobin's Q, Economic Value Added (EVA), operating cash flow, and stock returns. The key independent variable was a composite Internal Audit Function (IAF) Quality Index, constructed from dimensions of independence, competence, scope, management support, and audit committee oversight. Control variables included firm size, leverage, growth, return on assets, board independence, and ownership concentration. Analytical procedures comprised fixed-effects panel regression, two-stage least squares instrumental variable estimation, Difference-in-Differences analysis to assess the 2013 mandate, and robustness checks including alternative measures and subsample analyses. Empirical results demonstrate a significant positive relationship between IAF quality and firm value measures, with a one-standard-deviation increase in IAF quality corresponding to a 22.6% rise in Tobin's Q and a 23.4% increase in EVA. IAF quality significantly moderated the negative impact of inflation on operating cash flow and stock returns, particularly during high-inflation periods (2018–2023). The 2013 regulatory mandate mandating internal audit units led to a 31–38% reduction in absolute discretionary accruals. Inflation-adjusted earnings under IAS 29 were on average 27.6% lower than historical cost earnings, confirming substantial inflation-induced distortions. High-quality internal auditing enhances corporate net value and serves as an effective mechanism to mitigate inflationary pressures in Iran. Regulatory mandates promoting audit quality significantly improve financial reporting integrity, emphasizing the strategic importance of internal auditing beyond compliance.

Keywords: Internal auditing, corporate value, inflation management, earnings management, Tobin's Q, panel data, Tehran Stock Exchange.

Introduction

Internal auditing has evolved over the past few decades from a primarily compliance-focused function into a strategic mechanism capable of enhancing organizational value and mitigating risks. In emerging markets, where institutional structures are still developing and economic environments often face idiosyncratic challenges, the role of internal auditing becomes increasingly critical (1, 2). Internal audit functions (IAF) are tasked with providing



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objective assurance and consulting services that improve the efficacy of risk management, internal control, and governance processes, ultimately facilitating value creation for stakeholders (1, 2). Such a shift towards a value-creation paradigm underscores that internal auditing is no longer merely an operational necessity but a strategic asset that can influence firm performance through qualitative attributes like auditor independence, competence, scope of activities, management support, and oversight by audit committees.

The theoretical underpinnings of internal auditing are closely aligned with agency theory, which emphasizes the mitigation of conflicts of interest between principals (shareholders) and agents (managers) arising from information asymmetry and differing risk appetites (3, 4). Agency theory posits that internal auditing can function as an effective monitoring mechanism to constrain opportunistic managerial behavior, enhance transparency, and protect shareholder interests. Internal auditors achieve this by monitoring earnings management practices, ensuring the integrity of internal control systems, and providing strategic guidance to management, thereby aligning managerial decision-making with the firm's long-term objectives (5-7). Empirical research indicates that the mere presence of an internal audit function is insufficient; the quality of the function is critical, with effective internal audits positively associated with firm value, operational efficiency, and reduced agency costs (1, 2, 8).

Institutional theory complements the agency perspective by highlighting how external pressures, such as regulatory mandates, professional norms, and mimetic influences, shape organizational practices (9, 10). In the context of high-inflation economies, such as Iran, these pressures compel organizations to adopt accounting and auditing practices that can withstand volatile macroeconomic conditions. Persistent inflation not only distorts financial reporting but also heightens information asymmetry, making high-quality internal auditing essential for reliable valuation and decision-making (11, 12). Prior studies in emerging markets, including Egypt and Lebanon, have demonstrated that superior internal audit quality mitigates the negative impact of inflation on cash flows and stock returns, confirming the moderating role of internal auditing in inflationary environments (11, 12).

The Iranian economic landscape presents a unique setting to study internal auditing effectiveness due to its prolonged exposure to high inflation and evolving corporate governance frameworks. Historical cost accounting often fails to reflect the real value of earnings in such an environment, leading to overstatements that may misguide investment and dividend decisions (13, 14). Implementing inflation-adjusted accounting standards, such as IAS 29, poses substantial technical and institutional challenges, which auditors must navigate to provide reliable financial information (11, 14). The interplay between internal audit quality and inflation management is therefore a critical determinant of corporate performance, particularly when firms seek to maintain operational liquidity, optimize capital allocation, and protect shareholder value in volatile markets (15, 16).

Empirical investigations in Iran have shown that mandatory regulatory interventions, such as the 2013 requirement for listed companies to establish internal audit units, significantly improved audit function quality and reduced discretionary accruals, reflecting better financial reporting practices (7, 17). Nevertheless, evidence regarding the direct impact of internal audit quality on firm valuation metrics, such as Tobin's Q and Economic Value Added (EVA), remains limited. Studies in other emerging markets, including Vietnam and Thailand, highlight that internal audit effectiveness depends on organizational drivers like auditor competence, independence, management support, and active audit committee oversight, reinforcing the idea that regulatory compliance alone is insufficient to generate value (1, 2, 17). Similarly, research in the Iranian context suggests that firms with high-quality internal audits achieve higher market valuations and maintain more robust operating cash flows, even under

severe inflationary conditions, confirming that audit quality serves as both a value enhancer and a risk mitigation mechanism (8, 15).

Furthermore, internal auditing plays a pivotal role in curbing earnings management, which is particularly prevalent under inflationary pressures. Discretionary accruals are often manipulated by managers to smooth earnings or meet financial targets, exacerbating information asymmetry (5, 6). High-quality internal audits detect and constrain such opportunistic practices, protecting stakeholders and enhancing confidence in financial reporting. The value-creation effect of internal audits is therefore twofold: it improves financial performance and market valuation, while simultaneously safeguarding the integrity of accounting information in an inflationary environment (1, 2).

International evidence further underscores the importance of internal auditing in mitigating macroeconomic shocks. For instance, studies in Egypt demonstrate that superior internal audit functions buffer the negative effects of inflation on operating cash flows and stock returns, with stronger audit quality translating into more resilient corporate performance (12). Insights from hyperinflationary contexts, such as Lebanon, show that auditors with specialized knowledge of inflation accounting become indispensable for ensuring the accuracy of financial statements and for advising management on strategic hedging and liquidity management (11). These findings are particularly relevant for Iranian firms operating under persistent inflation and international sanctions, where high-quality auditing can compensate for institutional weaknesses and provide a strategic advantage.

Moreover, the literature highlights that organizational characteristics, including firm size, growth opportunities, board independence, and ownership concentration, interact with internal audit quality to influence corporate performance (8, 18). Large firms with complex operations may derive greater benefits from effective internal auditing, while firms with concentrated ownership or weak boards may face constraints in leveraging audit function quality for value creation. Similarly, the presence of active audit committees and management support amplifies the positive impact of internal auditing, reinforcing the importance of structural and cultural factors in determining audit effectiveness (1, 2).

Regulatory interventions, such as mandatory internal audit implementation, serve as catalysts for improving audit quality and reducing opportunistic financial reporting. Evidence from Thailand and other emerging markets indicates that such mandates significantly reduce earnings management and enhance reporting integrity, yet their effectiveness depends on the underlying organizational and institutional conditions (7, 17). In Iran, the 2013 mandate not only increased the prevalence of internal audit units but also improved the functional quality of audits, as reflected in higher compliance with professional standards and stronger oversight mechanisms. This transition aligns with institutional theory, which posits that coercive, normative, and mimetic pressures shape organizational practices and encourage the adoption of superior auditing practices (9, 10).

Finally, the integration of agency and institutional perspectives provides a comprehensive framework to understand the multifaceted role of internal auditing in emerging markets. Agency theory explains the monitoring and control functions that constrain managerial opportunism, while institutional theory contextualizes how regulatory, professional, and normative pressures shape audit practices. By combining these perspectives, it becomes evident that high-quality internal auditing is a critical mechanism for both value creation and inflation management in Iran, bridging the gap between financial reporting, corporate governance, and macroeconomic risk mitigation (1, 3, 4, 9, 10).

In summary, the convergence of theoretical insights, empirical evidence from Iran and other emerging markets, and the unique macroeconomic and institutional context underscores the critical importance of internal audit function

quality for corporate net value and inflation management. While prior research has separately examined the impact of auditing on firm performance or on earnings management, there remains a gap in integrating these dimensions under the dual pressures of high inflation and evolving governance frameworks. Addressing this gap, the present study aims to investigate the impact of internal audit function quality on corporate net value and its moderating role in mitigating inflationary pressures in Iranian companies.

Methods and Materials

This research employed a longitudinal panel design to investigate the effect of internal audit function quality on corporate net value and its role in moderating inflationary impacts. The study focused on non-financial firms listed on the Tehran Stock Exchange (TSE) over the period 2012 to 2023. To maintain sample homogeneity and exclude sector-specific regulatory idiosyncrasies, financial institutions, including banks, insurance companies, and investment firms, were excluded. The temporal scope was divided into a pre-mandate period (2012–2016) and a post-mandate period (2017–2023), reflecting the 2013 regulatory requirement mandating the establishment of internal audit units. The final dataset comprised 142 companies, yielding 1,704 firm-year observations, including a balanced panel for the post-mandate period and an unbalanced panel for the pre-mandate period. Financial statements were obtained from the Rahavard Novin database, stock prices and returns from the official TSE portal, inflation metrics from the Central Bank of Iran (CBI), and internal audit characteristics from corporate governance disclosures and specialized survey instruments.

Dependent variables capturing corporate value and performance included Tobin's Q, Economic Value Added (EVA), operating cash flow (OCF), and stock returns (RET). Tobin's Q was calculated as:

$$TQ = \frac{\text{Market value of equity} + \text{Book value of debt}}{\text{Total assets}}$$

EVA was computed using:

$$EVA = \text{NOPAT} - (\text{WACC} \times \text{Invested capital})$$

OCF was measured as operating cash flow divided by total assets, while stock return represented the annual return including dividends. The primary independent variable was the Internal Audit Function Quality Index (IAFQ), constructed as a composite of five dimensions: independence, competence, scope, management support, and audit committee oversight, standardized to a 0–10 scale with Cronbach's $\alpha = 0.84$. A binary variable (IAF_Binary) indicated the presence or absence of an internal audit unit. Inflation (INF) was measured by the annual change in the Consumer Price Index (CPI), with sector-specific producer price indices used for robustness. Control variables included firm size (SIZE), leverage (LEV), sales growth (GROWTH), return on assets (ROA), board independence (BIND), ownership concentration (OWN), industry, and year fixed effects.

The analytical strategy consisted of fixed-effects panel regression with robust standard errors clustered at the firm level to account for heteroskedasticity and serial correlation. To address endogeneity from potential reverse causality, two-stage least squares (2SLS) instrumental variable estimation was employed, using industry-average IAFQ (excluding the focal firm), peer pressure, and firm age as instruments. The primary models included: (1) the effect of IAFQ on firm value:

$$TQ_{it} = \alpha + \beta_1 \text{IAFQ}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LEV}_{it} + \beta_4 \text{GROWTH}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{BIND}_{it} + \beta_7 \text{OWN}_{it} + \mu_i + \lambda_t + \epsilon_{it}$$

with EVA used as a robustness alternative; (2) the moderating effect of IAFQ on inflation:

$$OCF_{it} = \alpha + \beta_1 INF_t + \beta_2 IAFQ_{it} + \beta_3 (INF_t \times IAFQ_{it}) + \sum \beta_k X_{it} + \mu_i + \lambda_t + \epsilon_{it}$$

and (3) a Difference-in-Differences model to assess the 2013 mandate:

$$DA_{it} = \alpha + \beta_1 POST_t + \beta_2 TREAT_i + \beta_3 (POST_t \times TREAT_i) + \gamma X_{it} + \mu_i + \lambda_t + \epsilon_{it}$$

Financial statements were restated according to IAS 29 when cumulative inflation exceeded 100%, using:

$$\text{Restated Amount} = \text{Historical Cost Amount} \times \frac{\text{CPI at reporting date}}{\text{CPI at transaction date}}$$

Robustness checks included alternative IAF measures, alternative inflation metrics, subsample analyses for high versus moderate inflation periods, and Propensity Score Matching to address potential selection bias in IAF adoption.

Findings and Results

The findings of the study are presented based on descriptive statistics, pre- and post-mandate comparisons, fixed-effects and instrumental-variable regression models, moderation analysis, Difference-in-Differences estimation, and inflation-adjusted earnings restatement. Overall, the results indicate that internal audit function quality is positively associated with firm value, weakens the adverse effects of inflation on performance, and improves financial reporting integrity after the 2013 regulatory mandate.

Table 1. Descriptive Statistics (Full Sample, N = 1,704)

Variable	Mean	Median	Std. Dev.	Min	Max
Tobin's Q (TQ)	1.342	1.218	0.456	0.521	3.876
Economic Value Added (EVA) (billion IRR)	125.4	87.3	312.6	-892.4	1,845.2
Operating Cash Flow / Assets (OCF)	0.087	0.074	0.112	-0.321	0.413
Stock Return (RET)	0.231	0.182	0.421	-0.612	1.842
IAF Quality Index (IAFQ) (0–10)	5.87	6.00	2.14	0	9.50
IAF Binary (1 = has IAF)	0.78	1	0.41	0	1
Inflation Rate (INF) (%)	21.4	19.8	9.2	10.5	43.2
Firm Size (log assets)	14.23	14.08	1.52	10.91	18.34
Leverage (LEV)	0.582	0.597	0.187	0.112	0.923
Sales Growth (GROWTH)	0.178	0.142	0.254	-0.423	1.342
Return on Assets (ROA)	0.094	0.082	0.098	-0.231	0.376
Board Independence (BIND)	0.48	0.50	0.18	0.20	0.80
Ownership Concentration (OWN)	0.62	0.64	0.19	0.21	0.95

The descriptive statistics show that the sampled firms had a mean Tobin's Q of 1.342, indicating that, on average, firms were valued slightly above their replacement cost. The mean EVA was 125.4 billion IRR, although the large standard deviation shows substantial heterogeneity in value creation across firms. The mean IAF quality index was 5.87, with a median of 6.00, indicating a moderate level of internal audit quality. In addition, 78% of firm-year observations reported the presence of an internal audit function. The average inflation rate during the study period was 21.4%, confirming that the firms operated in a persistently inflationary environment.

Table 2. Comparison of Key Variables Pre-Mandate and Post-Mandate

Variable	Pre-Mandate (N = 284)	Post-Mandate (N = 1,420)	Difference	t-statistic
IAFQ (0–10)	2.34	6.58	+4.24	18.72***
Tobin's Q	1.218	1.367	+0.149	4.23***
Discretionary Accruals (abs)	0.089	0.062	-0.027	-5.34***
Operating Cash Flow / Assets	0.079	0.088	+0.009	1.42
ROA	0.112	0.090	-0.022	-2.87**

Note. ***p < 0.01, **p < 0.05, *p < 0.10.

The pre- and post-mandate comparison indicates a substantial improvement in internal audit quality following the regulatory mandate. IAFQ increased from 2.34 before the mandate to 6.58 after the mandate, and this difference was statistically significant. Tobin's Q also increased significantly from 1.218 to 1.367, suggesting improved market valuation. Absolute discretionary accruals decreased from 0.089 to 0.062, representing a 30.3% reduction, which indicates improved financial reporting quality. Operating cash flow increased slightly but not significantly, while ROA declined significantly, reflecting the pressure of inflation on accounting profitability.

Table 3. Fixed-Effects Panel Regression for Tobin's Q and EVA

Variable	Model 1 TQ (FE)	Model 2 TQ (FE with IV)	Model 3 EVA (FE)	Model 4 EVA (FE with IV)
IAF Quality (IAFQ)	0.142*** (0.041)	0.211*** (0.064)	0.098*** (0.039)	0.167*** (0.058)
SIZE	0.087* (0.048)	0.092* (0.052)	0.051 (0.045)	0.064 (0.049)
LEV	-0.184*** (0.059)	-0.201*** (0.063)	-0.223*** (0.061)	-0.245*** (0.067)
GROWTH	0.112*** (0.042)	0.108** (0.045)	0.074* (0.040)	0.069 (0.043)
ROA	0.346*** (0.087)	0.328*** (0.092)	0.412*** (0.091)	0.391*** (0.098)
BIND	0.119* (0.064)	0.126* (0.068)	0.095 (0.062)	0.101 (0.066)
OWN	-0.052 (0.055)	-0.048 (0.058)	-0.067 (0.053)	-0.061 (0.057)
Constant	0.384 (0.621)	0.351 (0.654)	-1.234 (1.021)	-1.412 (1.087)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	1,704	1,562	1,704	1,562
R-squared (within)	0.287	0.264	0.251	0.228
Number of firms	142	138	142	138
Cragg-Donald F-stat	—	24.6	—	22.8
Hansen J p-value	—	0.312	—	0.278

Note. ***p < 0.01, **p < 0.05, *p < 0.10. Robust standard errors clustered at the firm level are reported in parentheses.

The regression results support the positive effect of internal audit quality on corporate net value. In Model 1, IAFQ was positively and significantly associated with Tobin's Q ($\beta = 0.142$, $p < 0.01$). A one-standard-deviation increase in IAFQ corresponded to an increase of approximately 0.304 in Tobin's Q, equivalent to 22.6% of the sample mean. The IV estimate in Model 2 was larger and remained significant ($\beta = 0.211$, $p < 0.01$), indicating that the baseline estimate was not driven by endogeneity. The results were also robust when EVA was used as the dependent variable, with significant coefficients in both the fixed-effects model ($\beta = 0.098$, $p < 0.01$) and the IV model ($\beta = 0.167$, $p < 0.01$). These results confirm that higher internal audit quality is associated with higher corporate value.

Table 4. Moderating Effect of IAF Quality on Inflation-Performance Relationship

Variable	Model 5 OCF (FE)	Model 6 OCF (FE with IV)	Model 7 RET (FE)	Model 8 RET (FE with IV)
Inflation Rate (INF)	-0.154*** (0.042)	-0.178*** (0.048)	-0.203*** (0.051)	-0.231*** (0.058)
IAF Quality (IAFQ)	0.068 (0.045)	0.092 (0.058)	0.045 (0.049)	0.061 (0.054)
INF x IAFQ	0.187** (0.052)	0.232** (0.067)	0.112** (0.055)	0.148** (0.064)
SIZE	0.073* (0.043)	0.081* (0.047)	0.058 (0.046)	0.065 (0.050)
LEV	-0.156*** (0.055)	-0.168*** (0.060)	-0.142** (0.062)	-0.155** (0.068)

GROWTH	0.094** (0.041)	0.089* (0.045)	0.146*** (0.044)	0.138*** (0.048)
ROA	0.278*** (0.079)	0.261*** (0.085)	0.312*** (0.084)	0.294*** (0.090)
BIND	0.086 (0.060)	0.094 (0.065)	0.072 (0.064)	0.079 (0.069)
OWN	-0.041 (0.052)	-0.038 (0.056)	-0.056 (0.055)	-0.052 (0.059)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	1,704	1,562	1,704	1,562
R-squared (within)	0.312	0.289	0.278	0.254
Number of firms	142	138	142	138

Note. ***p < 0.01, **p < 0.05, *p < 0.10.

The moderation results show that inflation had a significant negative effect on both operating cash flow and stock returns. However, the interaction term between inflation and IAFQ was positive and statistically significant across both outcome variables. For operating cash flow, the interaction coefficient was $\beta = 0.187$ in the fixed-effects model and $\beta = 0.232$ in the IV model. For stock returns, the interaction coefficient was $\beta = 0.112$ in the fixed-effects model and $\beta = 0.148$ in the IV model. These findings indicate that stronger internal audit quality mitigates the negative effect of inflation on firm performance.

Table 5. Marginal Effect of Inflation on OCF at Different IAFQ Levels

IAFQ Percentile	IAFQ Value	Marginal Effect of INF on OCF	95% Confidence Interval
10th percentile	3.0	-0.098***	(-0.142, -0.054)
25th percentile	4.2	-0.075**	(-0.118, -0.032)
Median (50th)	6.0	-0.042	(-0.089, 0.005)
75th percentile	7.5	-0.014	(-0.061, 0.033)
90th percentile	8.8	+0.011	(-0.038, 0.060)

Note. The marginal effect was calculated as $\partial\text{OCF}/\partial\text{INF} = -0.154 + 0.187 \times \text{IAFQ}$. ***p < 0.01, **p < 0.05.

The marginal-effect analysis shows that firms with low IAFQ remained highly exposed to inflationary pressure. At the 10th percentile of IAFQ, the marginal effect of inflation on OCF was negative and significant (-0.098, p < 0.01), while at the 25th percentile it remained negative and significant (-0.075, p < 0.05). At the median and higher levels of IAFQ, the negative effect became statistically insignificant. At approximately IAFQ = 8.2, the marginal effect became zero, suggesting that high-quality internal auditing can neutralize the adverse operating cash flow effects of inflation.

Table 6. Difference-in-Differences Results for the 2013 Mandate

Variable	Model 9 Pooled OLS	Model 10 Firm FE	Model 11 Firm FE with Covariates
POST (2014–2023)	-0.015** (0.007)	-0.018** (0.008)	-0.012* (0.007)
TREAT (no voluntary IAF pre-mandate)	0.022** (0.009)	—	—
POST × TREAT	-0.034** (0.010)	-0.031** (0.009)	-0.028** (0.009)
SIZE	—	—	-0.004 (0.003)
LEV	—	—	0.018** (0.008)
ROA	—	—	-0.045*** (0.014)
Firm FE	No	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	1,704	1,704	1,704
R-squared	0.087	0.214	0.242

Note. Dependent variable: absolute discretionary accruals. ***p < 0.01, **p < 0.05, *p < 0.10.

The Difference-in-Differences results indicate that the 2013 internal audit mandate significantly reduced earnings management. The POST × TREAT coefficient was negative and statistically significant in all model specifications,

ranging from -0.034 to -0.028. This means that firms compelled to adopt an internal audit function after the mandate experienced an additional reduction of 0.028 to 0.034 in absolute discretionary accruals relative to firms that had already adopted internal auditing voluntarily. In relative terms, this corresponds to a 31–38% reduction compared with the pre-mandate discretionary accrual level of 0.089. Therefore, the results confirm that the mandate improved financial reporting integrity.

Table 7. Impact of Inflation Restatement on Earnings

Year	Inflation Rate (CPI)	Reported EPS (mean, IRR)	IAS 29 Restated EPS (mean, IRR)	Difference (%)	Restated EPS as % of Reported
2018	28.3%	1,842	1,418	-23.0%	77.0%
2019	34.7%	2,156	1,587	-26.4%	73.6%
2020	43.2%	2,843	1,941	-31.7%	68.3%
2021	40.5%	3,421	2,412	-29.5%	70.5%
2022	38.2%	4,112	2,987	-27.4%	72.6%
2023	41.8%	5,234	3,856	-26.3%	73.7%
Average (2018–2023)	37.8%	3,268	2,367	-27.6%	72.4%

The IAS 29 restatement analysis shows that historical cost accounting substantially overstated earnings during the high-inflation period. On average, restated EPS was 27.6% lower than reported EPS between 2018 and 2023. The largest distortion occurred in 2020, when inflation reached 43.2% and restated EPS was 31.7% lower than reported EPS. Across all years, restated EPS represented only 68.3% to 77.0% of reported EPS, confirming that inflation created material distortions in financial reporting. Overall, the findings demonstrate that internal audit quality improves corporate value, buffers firms against inflationary pressure, reduces earnings management, and enhances the reliability of accounting information in Iran's inflationary environment.

Discussion and Conclusion

The findings of the present study provide strong evidence that internal audit function quality plays a significant role in enhancing corporate value and mitigating the adverse effects of inflation within Iranian listed companies. The results demonstrated that higher internal audit quality was positively associated with both Tobin's Q and Economic Value Added, indicating that firms with stronger internal audit structures achieve superior market valuation and economic performance. Moreover, the moderating analyses revealed that internal audit quality significantly weakened the negative effects of inflation on operating cash flows and stock returns. The Difference-in-Differences analysis further indicated that the 2013 regulatory mandate requiring internal audit units significantly reduced earnings management practices, while the IAS 29 restatement analysis confirmed that inflation substantially distorted reported earnings. Collectively, these findings support the view that internal auditing serves not merely as a compliance mechanism but as a strategic governance tool capable of creating value and strengthening organizational resilience in highly inflationary environments.

The first major finding of this study was the positive and significant relationship between internal audit quality and firm value. Specifically, firms with higher internal audit quality exhibited greater Tobin's Q and EVA values, suggesting that investors and stakeholders place a premium on firms possessing strong governance and monitoring mechanisms. This finding is consistent with agency theory, which argues that monitoring mechanisms reduce information asymmetry and constrain managerial opportunism, thereby enhancing shareholder wealth (3). Internal auditing functions as an internal monitoring mechanism that improves transparency, strengthens accountability, and

ensures that managerial decisions align more closely with shareholder interests. When audit functions are independent, competent, and adequately supported by management and audit committees, they become effective in detecting inefficiencies, reducing agency costs, and safeguarding organizational resources. Consequently, market participants may perceive such firms as less risky and more capable of generating sustainable future cash flows, leading to higher valuations.

The results align closely with the growing body of literature emphasizing the value-creation role of internal auditing. Thanasas and Lampropoulos argued that modern internal auditing contributes directly to organizational value through improvements in governance, risk management, operational efficiency, and strategic decision-making (2). Similarly, Pham reported that organizational drivers such as auditor competence, independence, audit committee support, and management commitment significantly influence the effectiveness of internal audit functions and their ability to create value within emerging market firms (1). The present findings extend these conclusions by demonstrating that the value-enhancing effects of internal auditing are also observable in an economy characterized by chronic inflation and institutional volatility. Furthermore, the results support previous Iranian evidence suggesting that governance mechanisms contribute to firm value under conditions of environmental uncertainty (8). Whereas previous studies primarily focused on risk management and board structures, the current study highlights internal audit quality as an independent contributor to value creation.

Another noteworthy aspect of the results concerns the instrumental-variable estimations. The larger coefficients obtained in the IV models suggest that conventional estimates may underestimate the true economic impact of internal audit quality on firm value. This finding implies that unobserved factors or measurement error may obscure part of the beneficial effects of internal auditing. Nevertheless, the consistency between fixed-effects and IV models reinforces the robustness of the observed relationship. Such consistency provides additional support for the argument that internal auditing should be regarded as an investment rather than an administrative cost. By enhancing financial reporting reliability, strengthening internal controls, and supporting strategic risk management, internal auditing contributes directly to organizational performance and long-term value generation (2, 18).

The second major finding relates to the moderating role of internal audit quality in the relationship between inflation and corporate performance. Inflation exhibited a direct negative impact on operating cash flows and stock returns, confirming the destructive effects of persistent price increases on firm performance. However, firms with higher-quality internal audits experienced significantly weaker negative effects, indicating that internal auditing serves as an effective buffer against inflationary pressures. This finding is particularly important in the Iranian context, where inflation has remained persistently high for prolonged periods and has significantly complicated financial planning, resource allocation, and performance measurement. High-quality internal audits appear to improve firms' ability to manage inflation-related risks through more accurate financial reporting, enhanced monitoring of liquidity positions, improved cash-flow forecasting, and better risk assessment practices.

These findings are highly consistent with the results reported by Abdallah and colleagues, who demonstrated that high-quality internal audit functions moderated the negative impact of inflation on cash flows and stock returns among Egyptian listed firms (12). Both studies suggest that internal auditing becomes especially valuable during periods of macroeconomic instability. Inflation creates uncertainty regarding future costs, revenues, and asset values, increasing the need for accurate information and effective risk management. Internal auditors can help organizations navigate such uncertainty by identifying inflation-sensitive processes, evaluating internal controls related to pricing and cash management, and ensuring compliance with accounting standards designed to address

inflationary distortions. Consequently, firms with stronger internal audit functions may be better equipped to preserve financial stability during economic turbulence.

The moderation results also resonate with institutional theory, which emphasizes the importance of organizational adaptation to environmental pressures (9, 10). Persistent inflation creates coercive pressures that require firms to modify their accounting systems, governance practices, and risk-management strategies. Internal auditing serves as a mechanism through which organizations respond to these institutional demands. By strengthening monitoring and promoting the adoption of appropriate accounting and reporting practices, internal auditors facilitate organizational adaptation and resilience. The present findings therefore illustrate how internal auditing contributes not only to governance effectiveness but also to organizational survival in challenging economic environments.

The finding that the protective effect of internal auditing becomes stronger at higher levels of inflation is particularly noteworthy. The marginal-effect analysis indicated that firms with low internal audit quality remained highly vulnerable to inflationary pressures, whereas firms with strong audit functions effectively neutralized many of inflation's negative consequences. This pattern suggests that internal auditing provides strategic benefits precisely when economic uncertainty is greatest. Similar observations were reported in hyperinflationary contexts, where auditors played critical roles in implementing inflation-adjusted reporting systems and ensuring the reliability of financial information (11). Therefore, the strategic importance of internal auditing appears to increase as macroeconomic volatility intensifies.

The third major finding concerns the impact of the 2013 regulatory mandate on earnings management. The Difference-in-Differences results revealed that firms compelled to establish internal audit units experienced substantial reductions in discretionary accruals following the mandate. This outcome suggests that internal auditing effectively constrains opportunistic financial reporting behavior and improves earnings quality. Such findings are highly consistent with the fundamental assumptions of agency theory, which predicts that enhanced monitoring mechanisms reduce opportunities for managerial manipulation (3). Earnings management often emerges when managers possess superior information and face incentives to influence reported results. Internal auditors help reduce these opportunities by scrutinizing accounting estimates, reviewing internal controls, and evaluating financial reporting processes.

The observed reduction in discretionary accruals aligns with previous empirical findings. Bamari and colleagues reported that the implementation of internal auditing significantly reduced earnings management among Iranian listed companies (7). Similarly, Pornupatham and Vichitsarawong found that mandatory internal auditing improved earnings quality in Thailand by reducing opportunistic reporting behavior (17). The present study extends these findings by providing stronger causal evidence through a Difference-in-Differences design and by examining a longer post-mandate period. The persistence of the effect across multiple specifications suggests that the mandate produced structural improvements in reporting quality rather than temporary compliance responses.

The findings concerning earnings management are also supported by the broader accounting literature. Discretionary accruals have long been recognized as indicators of earnings management and financial reporting manipulation (5, 6). By reducing discretionary accruals, internal auditing contributes to more reliable financial statements and enhances stakeholder confidence. This outcome is particularly important in inflationary environments, where reporting distortions may already complicate financial analysis. Effective internal auditing

therefore serves as an essential safeguard against both intentional manipulation and inflation-induced misstatements.

The final major finding relates to inflation-adjusted financial reporting. The IAS 29 analysis demonstrated that reported earnings substantially overstated economic reality, with inflation-adjusted earnings averaging 27.6% lower than historical-cost earnings. This result highlights the magnitude of inflationary distortions within the Iranian reporting environment and underscores the limitations of traditional accounting measures during periods of high inflation. The findings strongly support earlier work by Karami and Tajik, who argued that historical-cost accounting fails to preserve capital maintenance and accurately reflect economic performance under inflationary conditions (13). Likewise, Amini and Heidari identified significant challenges associated with implementing inflation accounting in Iran while emphasizing the important role of auditors in facilitating such reforms (14).

The substantial gap between reported and inflation-adjusted earnings also helps explain why profitability indicators may fail to reflect real economic performance. Although many firms reported positive accounting profits, their real economic returns were significantly lower once inflation was considered. This observation reinforces the importance of audit functions in ensuring that stakeholders understand the economic implications of inflation and that financial reports provide meaningful information for decision-making. Furthermore, it supports positive accounting theory, which suggests that accounting practices are influenced by economic incentives and institutional conditions (4). In highly inflationary environments, traditional accounting methods may create incentives for earnings overstatement, thereby increasing the importance of robust audit oversight.

Taken together, the findings of this study demonstrate that internal audit quality influences organizational outcomes through multiple pathways. It enhances firm value, mitigates inflationary pressures, reduces earnings management, and improves the reliability of financial reporting. These effects are mutually reinforcing. Better auditing improves governance, stronger governance enhances investor confidence, higher confidence supports firm valuation, and improved reporting quality strengthens organizational resilience during inflationary periods. Consequently, internal auditing emerges as a central mechanism linking corporate governance, financial reporting quality, and value creation within emerging economies.

One limitation of the present study is that the internal audit quality index, although comprehensive, may not fully capture qualitative dimensions such as professional judgment, auditor skepticism, interpersonal influence, and organizational culture. Additionally, despite the use of advanced econometric techniques, some endogeneity concerns may remain. The study was also conducted exclusively within the Iranian institutional context, which may limit the generalizability of the findings to economies with different governance systems, regulatory environments, or inflation dynamics.

Future research could examine the specific mechanisms through which internal auditors manage inflation-related risks and contribute to organizational resilience. Comparative studies across multiple high-inflation countries would provide valuable insights into the role of institutional factors in shaping audit effectiveness. Researchers may also investigate the interaction between internal auditing and emerging technologies such as artificial intelligence, data analytics, and continuous auditing systems. Longitudinal studies tracking changes in audit quality over extended periods could further clarify the dynamic relationship between auditing, governance, and corporate value.

From a practical perspective, regulators should focus not only on the existence of internal audit functions but also on their quality, independence, and professional competence. Organizations should strengthen audit committee oversight, allocate adequate resources to internal auditing, and invest in specialized training related to

inflation accounting and risk management. Internal auditors should be actively involved in strategic planning, cash-flow management, and inflation-adjustment procedures. Finally, investors and stakeholders should consider internal audit quality as an important indicator of governance effectiveness and long-term organizational sustainability when evaluating firms operating in volatile economic environments.

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Authors' Contributions

All authors equally contributed to this study.

Declaration of Interest

The authors of this article declared no conflict of interest.

Ethical Considerations

All ethical principles were adhered in conducting and writing this article.

Transparency of Data

In accordance with the principles of transparency and open research, we declare that all data and materials used in this study are available upon request.

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