**Journal of Multidisciplinary Cases**
**ISSN: 2799-0990**
Vol: 04, No. 06, Oct- Nov 2024
http://journal.hmjournals.com/index.php/JMC
**DOI:** https://doi.org/10.55529/jmc.46.17.28

# Impact of the Accuracy of Accounting Earnings Quality Measures in Determining Credit Risks in the Banking Sector

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**Received:** 02 June 2024 **Accepted:** 17 August 2024 **Published:** 01 October 2024

***Abstract: Accounting earnings quality is one of the topics that has attracted the attention of researchers recently. Although accounting research agrees on the importance of earnings quality, it has varied in terms of the nature of this quality and the nature of its measurement. Accordingly, this research aims primarily to determine the level of earnings quality announced in the financial statements issued by Iraqi banks listed on the stock exchange, in addition to tracking the impact of the quality of announced earnings on the stock prices of these banks. To achieve this goal, the financial statements of a number of Iraqi banks were analyzed over the years from 2016 to 2020 as required by quality measurement models, with the addition of data for the year before and the year after this period, according to the profits used in the current research. A set of results was reached, the most important of which is that there is a discrepancy in the level of quality of accounting earnings announced in the financial statements of companies listed on the stock exchange for accounting earnings quality measurement models. The research also found that the quality of Egyptian accounting earnings as measured using the indicators of earnings continuity, earnings predictability and income smoothing has no significant impact on the stock prices of companies listed on the Iraqi Stock Exchange, while the quality of accounting earnings as measured using the accruals quality index has a significant impact on stock prices.***

***Keywords: Accounting Earnings Quality, Credit Risk, Banking Sector.***

## 1. INTRODUCTION

The quality of current accounts is of great importance to investors, lenders and other users of cases and financiers, as the information of current accounts depends on the evaluation of the company's design and making relevant decisions. Therefore, this information must be of high quality and free from fraud or deception as part of the trend. For this reason, the credibility of

 

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financial amounts allows investors to accurately evaluate the performance and rent ability of companies, which helps in making reliable adverse decisions. Although the concept of quality of accounting results has been widely discussed, it still exists today incomplete about the nature of this quality and the nature of the drug. Accounting standards setters and auditors consider high-quality funds to be a source of agreement with generally accepted schedule principles, but the accreditors take into account high quality when they have a great ability to convert effective flows while doing so. Competitors join high-quality gains that express the real change of managers without any significant impact of their strong control factors (Saleh: 2010, 388). Due to their own perceptions about the nature of inputs, many researchers have provided different definitions of input quality according to the objectives they pretend to achieve through the use of financial information. In a study conducted by (Zhang y Penman, 2002), the quality of inputs was determined on the basis of published revenues (before the exceptional participation) in calculating high-quality results if they are a good indicator of their future input, is the decision, and is high-quality. High-quality earnings are earnings that can be sustained in the future, because if the treatments are expendable and as a result the earnings are not sustainable in the future, they are bad earnings.

In the same direction, one of the studies conducted by (Richardson, 2003) indicated that the concept of earnings quality will be achieved through the way that actual earnings can be sustained over future periods. The longer the profit is sustained, the higher the quality of the same. ganancias. Future benefits. In another direction, the study (Penman, 2003) indicated that earnings quality means that the successes announced by the company express in an honest and realistic way the real and actual successes of the company. In other words, the company's stated advantages include a tangible and effective presence, and they do not contain exaggerations or possibilities. (Hamdan, 2012) This is the direction that the quality of finance depends on the goal of financial analysis, which is to assess the actual design of the company and what the company can trust in order to predict the future planning. Of the company. For this reason, researchers considered that high-quality funds reflect the actual operational design of the company, in relation to the value of the company. For future practical planning and to provide a good means, it was a good indicator. For this reason, you can decide that many definitions of the quality of current account earnings revolve in two directions. One of them considers the quality of earnings as the way in which the earnings that have already been disclosed can express the truth of the company's design, while the quality of earnings that revolves around it is torn in two directions. There is another direction and the quality of earnings as its ability to predict future earnings, which represents the quality of earnings root in the continuity of earnings and its wrong volatility. Despite the important progress that has been produced in the field of medicine from the quality of funds in financial information, there is a lot of controversy in the accounting literature about the error of a single means of the quality of current accounts, if you use different means. The most important things are the following: quality of accumulation, continuity of profits, and the ability to raise funds and monetize income.

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## 2. RELATED WORK (LITERATURE REVIEW)

### 2.1. Concept of Accounting Earnings Quality

Some researchers indicate that the quality of earnings is related to the extent of the continuity of those earnings, and that the greater the correlation between accruals and cash flows, the higher the quality of the earnings. The ability of the earnings published in the financial reports to reflect the real profits of the establishment and the possibility of using them to predict future profits enables the user to judge this quality through the degree of stability of the earnings, their continuity and lack of variability in them, and thus evaluate the financial capacity of the establishment (Gideon, 2016: 66). (Hameed, 2023: 14) believes that the quality of earnings increases the more they are free of earnings management practices, and the lower the percentage of estimating accruals in them, which was confirmed by the study (Raj Gopal, 2011: 3) which explained that high-quality earnings are the most stable and stable earnings that are useful in the decision-making process, and that the main purpose of earnings quality is to analyze the quality of accounting by distinguishing between two types of accounting numbers, which are the numbers resulting from cash flows and the numbers resulting from the accrual basis. The quality of accounting earnings means that earnings have the main characteristics of accounting information, namely relevance and reliability, which meet the main objectives of the financial report in terms of enabling users of financial information, including investors and lenders, to make sound decisions (Olaoye & Adewumi, 2020: 166). Earnings quality expresses the ability of earnings to provide useful information to investors, creditors and other users of financial reports in terms of their basic characteristics and through the degree of their convergence with cash flows from operating activities (Chouaibi, 2024: 116).

Many users of financial statements rely on accounting earnings in making many decisions, and the concept of accounting earnings quality differs according to the users of financial statements. Auditors and regulators of capital market bodies see it achieved by adhering to the generally accepted accounting rules and principles, creditors see it achieved by the ease of converting the announced profits into cash, and shareholders see it achieved when it reflects the company's true performance (Peterson et al., 2015: 5).

In this field, several studies have indicated that the quality of accounting profits is achieved through the continuity of the flow of current profits in future periods, and the ability of current profits to reflect the current and future performance of the company (Beyer, 2019: 79). Continuity means the extent of the company's ability to maintain its profits in the long term, or the ability of current profits to provide a good indicator of future profits (Dang et al., 2020: 66).

### 2.2. Importance of Accounting Profit Quality

Many studies have shown the importance of profit quality for users of accounting information, as financial reports in general and accounting profit information in particular constitute a source of information for users. In a survey conducted on the opinions of investors, it was found that more than 71% of investors believe that accounting profit information is one of the most important factors that affect their investment decisions (Gideon et al., 66). It is noted that high-quality profits are considered to be of great

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importance in developing countries, just like developed countries, whether for users of accounting information or for economic guides as a whole. This is due to two main reasons (Nour & Abaoub, 2016: 18): The majority of investors in developing countries do not have sufficient knowledge about how to analyze and use information, in addition to the low efficiency of the stock market, which requires the availability of good information that helps investors make rational decisions and contributes to increasing market efficiency. The process of economic development in developing countries requires huge investments, which requires high-quality profits that contribute to achieving efficiency in allocating resources to investment opportunities with high returns and attracting national and foreign capital.
The quality of accounting earnings has a direct impact on the stock market, as the study (Bagaeva et al, 2008:36) showed that there are three paths through which the quality of earnings can affect the stock market (Ibrahim et al., 2016:3):

- It helps investors distinguish between good and bad investments, thus reducing the cost and risk of investment.
- It helps investors distinguish between good and bad managers, thus reducing agency costs, and thus the cost of equity.
- The lack of transparency of accounting earnings, meaning the inconsistency between announced earnings and actual earnings, leads to the inability of investors in financial markets to make the right choice for their investment portfolios, which increases the cost of transactions on the stock exchange.

Therefore, it can be said that the quality of accounting earnings represents an important aspect of the financial position of the establishments by many parties. The quality of earnings is important to managers, as the reputation of executives is linked to the quality of earnings, and is not linked to the growth in earnings only, as the growth in earnings in certain years may be due to non-recurring and non-continuous circumstances. As for the quality of earnings, it indicates the continuity of earnings in future periods. Therefore, managers want to achieve profits that are characterized by high continuity and good predictive ability. Such characteristics reflect a good level of earnings quality and at the same time help improve the reputation of managers among financial analysts and investors (Govender, 2010: 65).

### 2.3. Credit Risks

Bank lending is the second major and important function of commercial banks to achieve their goals, as credit represents the largest part of these banks' assets and contributes the majority of their operating income (Jefang, 2011: 3). The process of granting credit is a marketing process for the funds available to banks, which leads to achieving profitability and security within sound controls and rules with the availability of guarantees that ensure the flow of funds and their return to the bank and their protection from risks (Brown, 2014: 16). Bank credit by its nature faces many risks that are difficult to predict or protect against with utmost precision, while the bank is always committed to repaying depositors' money when due or on demand. At the same time, borrowers will not be able to repay the value of their loans to the bank regularly or in full, mainly because the credit granted by the bank to borrowers has been invested in various commercial, agricultural and tourism activities that cannot be easily obtained. Recover (Bloom and Over beck, 2016: 14). Therefore, credit risk is

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considered one of the most important reasons that led to the failure of banks and thus the emergence of economic crises in developed and developing countries, as there is almost a consensus among bankers that credit risk is the most common type of banking risk among banks (Ghanimi, 2017: 239). These are the risks that arise from failure to pay in full and on time, which leads to financial loss. Credit risk also arises as a result of the bank resorting to granting loans or credits to natural persons and various economic sectors without being able to recover their rights, represented by the principal and interest of the loan. This may be due to the borrower's inability to repay the principal and interest on the loan on time, or if he has the financial ability to repay but does not wish to do so for one reason or another. Therefore, credit risk is the losses that the bank may incur due to the customer's inability or unwillingness to repay the principal and interest on the loan (Chaibi & Ftiti, 2015: 3). Credit risk is also defined as the risk of customer default, i.e. customers' failure to pay. Inability to repay the principal and interest due on time. Failure to repay results in a complete or partial loss of any amount borrowed or a decrease in the customer's creditworthiness, increasing the likelihood of default (Bussmann et al., 2021: 205).

### 2.4. Sources of Bank Credit Risks

The risks to which loans are exposed can be divided into special risks and general risks. The following are the risks to each of them:

A. Special risks Non-systematic risks: These are the internal risks that are unique to a company or industry under certain circumstances. Examples of these circumstances include weak banking management, administrative errors, labor strikes, and changes in customer tastes as a result of the emergence of new products. Such exceptional and non-market risks can affect the customer's ability and desire to repay his obligations to the lending bank within the agreed term (Alshatti, 2015: 339).

B. General risks Systematic risks: These are all risks that affect all loans regardless of the circumstances of the lending bank, due to economic, political, and social factors that are difficult to control and control. Examples of these risks include risks of changing interest rates, risks of changing customer tastes, risks of inflation, risks of changing foreign exchange rates, and technological changes (Papouskova & Hajek, 2019: 36). In short, specific risks occur as a result of internal factors that affect the bank's ability, which requires it to predict them and anticipate their occurrence in the future. They can be reduced or controlled through diversification, unlike general risks on the market movement as a whole, which are difficult for the bank to control, predict, and confront in the future. Therefore, they cannot be avoided by diversification (Leo et al., 2019: 33). The largest share of total risks is due to systematic

Risks and a portion of unsystematic risks, which can be explained by the following equation:
Total Risk = Systematic Risk + Unsystematic Risk

## 3. METHODOLOGY AND MATERIALS

### 3.1. Research Problem

Accounting literature has provided many indicators that can be relied upon when measuring the quality of accounting profits, the most important of which are the quality of accruals, the

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continuity of profits, the predictive ability of profits, income smoothing, the appropriate value of profits, profit conservation, and the appropriate timing of recognizing profits. However, the majority of studies related to this field have addressed the quality of accounting profits through one of these indicators.
Based on the above, the research problem is represented in the multiplicity of models used to measure the quality of accounting profits, which give different results, and thus the lack of a clear classification of Iraqi banks in terms of their enjoyment of the quality of accounting profits, as well as the lack of an accurate determination of the extent of the impact of the quality of accounting profits on stock prices in the Egyptian Stock Exchange as a reflection of investors' confidence in these profits.
Through the above, the following problem can be raised: To what extent does the use of the quality of accounting profits affect credit risks? And what is the reality of this in commercial banks operating in the Iraqi Stock Exchange?

### 3.2. Importance of Research

#### 32.1. From the Scientific Side

This research deals with the quality of accounting profits in one of the emerging markets, which is the Egyptian Stock Exchange, which adds to the writings that have addressed this quality as one of the important topics in accounting research locally, regionally and globally in recent years.

#### 3.2.2. From the Practical Side

The research classifies companies listed on the Iraqi Stock Exchange according to the availability of accounting profit quality in the published reports of these banks, which contributes to improving investment decisions for many parties that rely on these profits primarily in the process of making various decisions. The research also seeks to determine the extent of the impact of the quality of announced accounting profits on the stock prices of companies listed on the Iraqi Stock Exchange, after classifying these companies according to the degree of availability of accounting profit quality in them.

### 3.3. Objectives of Research

Analysis of the most important models presented by accounting literature to measure the quality of accounting profits. Determining the extent to which the profits declared in the financial statements issued by Iraqi banks registered on the stock exchange enjoy an acceptable level of quality. Tracking the impact of the quality of profits declared in the financial reports on the stock prices of these banks. Identifying the extent to which accounting earnings quality can reduce credit risks. The importance that banks give to accounting earnings quality when making credit decisions. Identifying the availability and suitability of financial information to measure accounting earnings quality.

### 3.4. Research Hypotheses

There are varying levels of quality of accounting profits declared in the financial statements of banks listed on the Iraqi Stock Exchange.

 

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There is a significant impact of the quality of accounting profits on stock prices of banks listed on the Iraqi Stock Exchange.

### 3.5. Research Methodology

The research objectives are achieved by following the theoretical study and applied study methods. The theoretical study depends on analyzing what is included in the accounting literature of research and publications about professional organizations related to the research topic, its main issue and its objectives to identify the different concepts of the quality of accounting profits, with the aim of forming the theoretical framework and setting the study hypotheses.

The applied study measures the quality of profits in the companies included in the study sample in order to determine the extent to which the financial statements issued by the selected companies enjoy an acceptable level of declared profit quality. To determine the extent to which the quality of profits in the declared reports has an impact on the prices of bank stocks, the prices of shares of all banks are tracked, whether the existence or non-existence of profit quality has been proven, within a reasonable period of time that allows highlighting the impact of the quality of declared profits on the share price or not. To this end, the most frequently used models in previous studies were applied.

## 4. RESULTS

4.1. Study Community: The Study Community Consists of a Number of Banks Listed in the Iraq Stock Exchange as Shown in the Following Table

| Bank Name | Date of Establishment | Authorized Initial Capital (Billion Dinars) |
|---|---|---|
| Sumer Commercial Bank | 1999 | 400 |
| Iraqi Credit Bank | 1998 | 200 |
| Iraqi National Bank | 1995 | 400 |
| Middle East Bank | 1993 | 400 |
| Mansour Investment Bank | 2005 | 55 |
| Khaleej Commercial Bank | 1999 | 600 |
| Bank of Baghdad | 1992 | 100 |
| Mosul Bank for Development and Investment | 2001 | 1000 |
| Iraqi Commercial Bank | 1992 | 150 |
| Bank of Economy, Investment and Finance | 2005 | 207 |

### 4.2. Testing the First Main Hypothesis: (There is no Effect of Accounting Earnings Quality Measures in Determining Credit Risks)

To test this hypothesis, the researcher relied on the Francis classification of earnings quality measures as it is the most comprehensive, but the researcher was unable to measure appropriateness, appropriate timing, and accounting conservatism due to the lack of data available to the researcher. Accordingly, seven measures of the most common and

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comprehensive earnings quality measures were used, which are: earnings continuity, earnings predictive ability, receivables quality, absence of earnings management practices, earnings smoothing, approaching cash, and reverse feeding. Accordingly, seven sub-hypotheses were formulated as follows:-

- Achieving continuity in profits does not affect the determination of credit risks
- The predictive ability of profits does not affect the determination of credit risks
- The quality of receivables does not affect the determination of credit risks
- The absence of earnings management practices does not affect the determination of credit risks
- Earnings smoothing does not affect the determination of credit risks
- Approaching accounting profits does not affect the determination of credit risks
- Reverse feeding does not affect the determination of credit risks
- They will be measured according to the following equation:-

**Cost debtj,t= $\alpha_0$+ $\alpha_1$ persistj,t+ $\alpha_2$ predictj,t+ $\alpha_3$ Aqj,t+ α4 managj,t + $\alpha_5$ Smoothj,t+ $\alpha_6$ Closeness to cashj,t+$\alpha_7$ FVt+ ej,t**
**Where:-**
Persistj, t: Earnings persistence.
Predictj, t: Earnings predictability.
Aqj, t: Quality of accounting accruals.
Managj, t: Earnings management.
Smoothj, t: Earnings smoothing.
Closeness to cashj,t= Closeness to accounting earnings
FVt: Feed-back of earnings information.
To show this effect, the researcher used simple regression loading for the following equation:-

### 4.3. Profit Continuity

Table (2) Results of Measuring the Impact of the Continuity of Accounting Profits in Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| -.015 | .115 | .732 | .119 | .004 | .060 |

2- Predictive ability of profits

Table (3) Results of Measuring the Impact of the Predictive Ability of Profits in Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| .020 | .079 | .683 | .170 | .005 | .072 |

From the above, the null hypothesis can be accepted, i.e. there is no effect of the predictive ability of profits in the study sample banks in determining credit risks.

 

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### 4.4. Quality of Accounting Receivables

Table (4) Results of Measuring the Impact of the Quality of Accounting Receivables in Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| -.329 | .128 | .247 | 1.387 | .040 | .201 |

From the above, the null hypothesis can be accepted, i.e. there is no effect of the quality of accounting receivables in the study sample banks in determining credit risks.

### 4.5. Profit Management

Table (5) Results of Measuring the Impact of Earnings Management in Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| -.006 | .101 | .987 | .000 | .000 | .003 |

From the above, the null hypothesis can be accepted, i.e. there is no effect of earnings management in the study sample banks in determining credit risks.

### 4.6. Preparing Accounting Profits

Table (6) Results of Measuring the Impact of Smoothing Accounting Profits in Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| -.075 | .134 | .548 | .369 | .011 | .105 |

From the above, the null hypothesis can be accepted, i.e. there is no effect of smoothing accounting profits in the banks in the study sample in determining credit risks.

### 4.7. Approaching Accounting Profits

Table (7) Results of Measuring the Impact of Approaching Accounting Profits in Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| -.001 | .105 | .475 | .521 | .016 | .125 |

From the above, the null hypothesis can be accepted, that is, there is no effect of approaching accounting profits in the study sample banks in determining credit risks.

### 4.8. Feedback of Earnings Information

Table (8) Results of Measuring the Impact of Earnings Information Feedback on Determining Credit Risks for the Period 2016-2020

| $a_1$ | a0 | sig | F-value | $R^2$ | R |
|---|---|---|---|---|---|
| -1.56 | .105 | .801 | .065 | .002 | .044 |

From the above, the null hypothesis can be accepted, i.e. there is no effect of the feedback of earnings information in the study sample banks in determining credit risks.

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## 5. DISCUSSION

5.1 The profits of the private commercial banks in the study sample enjoy quality through their continuity of accounting profits, the ability to predict future profits, quality in their accounting receivables, smoothing accounting profits, and providing feedback on profit information.
5.2 There is no effect of achieving continuity in the private commercial banks in the study sample in determining credit risks
5.3 There is no effect of the predictive ability of profits in the private commercial banks in the study sample in determining credit risks
5.4 There is no effect of the quality of accounting receivables declared in the statements in the private commercial banks in the study sample in determining credit risks.
5.5 There is no effect of profit management in the private commercial banks in the study sample in determining credit risks.

## 6. CONCLUSION

6.1. Increase interest in the quality of accounting profit results, which may contribute to increasing the validity of the decisions of all parties dealing with the private commercial banks in the study sample in the Iraq Stock Exchange.
6.2. Work to educate investors about the importance of the quality of accounting profits, which helps them make their various decisions.
6.3. Working on relying on the financial statements of private commercial banks when determining credit risk items, as relying on the financial statements in determining loan interest may help to influence credit risks.

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