
**THE IMPACT OF DEBT RATIO ON ACCRUALS QUALITY: EVIDENCE
FROM IRAQI COMPANIES**

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ABSTRACT

An examination of the relationship between debt ratio and the accruals of accruals in Iraqi companies. The study aims to furnish actual evidence regarding the impact of debt financing on the quality of accounting information, as assessed by accruals quality.

The study employed a quantitative design utilising panel data from four businesses listed on the Iraq Stock Exchange (ISX) for the years 2022 to 2024, yielding 12 firm-year observations. The Modified Jones Model was employed to assess accrual quality, while the Debt Ratio was utilised to delineate the debt ratio. Descriptive statistics, correlation analysis, and fundamental linear regression analysis were conducted utilising Microsoft Excel.

The results show a moderate inverse correlation between Debt Ratio and Accruals Quality ($r = -0.523$). The regression analysis showed a negative coefficient (-0.481) which implies that the higher level of debt financing is associated with lower accruals quality. The association was not statistically significant at the 5% level ($p = 0.081$). The model explained around 27.3% of the variance in accruals quality ($R^2 = 0.273$).

The study concludes that the debt ratio may have an effect on the accrual quality and the evidence is not sufficient to demonstrate a statistically significant effect among the sampled Iraqi firms. The findings contribute to the literature on financial reporting quality in emerging markets and provide useful information to investors, creditors and regulators.

KEYWORDS: - Debt Ratio; Accruals Quality; Financial Leverage; Accounting Information Quality; Financial Reporting Quality; Iraq Stock Exchange (ISX).

1.0 INTRODUCTION

Debt finance is an important source of external cash for firms, and it is a prerequisite for corporate operations and expansion. The structure of corporate debt has been the focus of much interest in accounting and finance research because financing choices can influence managerial

behaviour and the quality of financial reporting. Lenders often use accounting information to assess the creditworthiness of businesses and to monitor their financial performance. Therefore, the integrity of accounting information has become a significant problem in debt contracting and financing decisions [1], [2].

Accruals quality is considered an important measure of financial reporting quality as it reflects the extent to which accounting accruals match the underlying economic performance of an organization. The better quality of accruals enhances the reliability of financial reports and the reduction of the information asymmetry between the company and the outsiders. The low quality of accruals might be a symptom of earnings management and low transparency of reporting. The prior literature provides evidence that the quality of accounting information influences debt contracts, the cost of borrowing and the assessment of corporate risk by lenders [7], [9].

The association between debt and accrual quality has attracted growing interest in accounting and finance literature. Some studies have demonstrated that debt can increase monitoring and reduce opportunistic managerial behaviour, hence improving the quality of reporting. However, some studies suggest that enterprises under higher financial stress may have more motive to manipulate accounting data to meet creditor expectations or to escape financial constraints. Empirical evidence indicates that accruals quality and earnings management behaviours are significantly affected by debt maturity structure and financing conditions [5], [6], [8].

Despite the growing literature on the Debt Ratio and accounting quality around the world, there is still a lack of real information from emerging economies especially in Iraq. The corporate environment in Iraq is characterised by dynamic financial reporting rules and specific financing situations that might affect the relationship between debt financing and the quality of accruals. Hence, the study of this relationship in Iraqi organisations may provide significant information for investors, creditors, regulators and other users of financial statements. Moreover, most of the prior studies have been conducted in the context of industrialised economies, while there is very little data from emerging and developing economies [3].

This study investigates the impact of debt ratio on accruals quality for sample of Iraqi enterprises listed in Iraq Stock Exchange (ISX). The study contributes to the current literature on accounting quality and firm financing decisions in emerging economies by investigating the association between loan financing and financial reporting quality.

2.0 PROBLEM STATEMENT

The quality of accounting information is important in improving the reliability and openness of financial reporting, especially in emerging nations with emerging financial markets. Quality of

accruals is a significant measure of the quality of accounting information, and it reflects the extent to which reported earnings are derived from real economic performance rather than from discretionary accounting changes [7], [9].

In this context, the debt ratio is an important financial characteristic that may influence managerial reporting behaviour. Firms with higher debt dependency may be subject to contractual obligations and lender scrutiny, which could lead management to engage in accruals manipulation to meet financial targets or avoid violating loan covenants. Previous studies have shown that accounting quality has a major impact on debt contracting and creditor decision-making [1], [2].

Although the relationship is theoretically important, actual evidence is rather limited in emerging economies notably in the Iraqi situation. The Iraqi firms operate in an environment characterized by fluctuating regulatory frameworks, limited market efficiency and heterogeneous financial reporting quality that may increase the effect of loan financing on accruals conduct. Moreover, the existing research has been mostly focused on the developed markets, while data from emerging countries are quite scarce [3], [8].

Therefore, the core problem of this study lies in the lack of empirical evidence on how debt ratio affects accruals quality in Iraqi companies. This gap raises the following research questions: To what extent does debt ratio influence accruals quality in Iraqi companies?

3.0 RESEARCH METHODOLOGY

The study uses quantitative research design and analysis of financial statement data of Iraqi firms. This research aims to examine the effect of debt ratio on the quality of accruals as a measure of accounting information quality.

3.1 Research Design

The research follows the quantitative methodology and utilises the panel data approach based on secondary financial data that are collected from the public annual reports of the Iraqi firms. The study aims to identify inconsistencies in financial reporting quality and debt financing techniques using a multi-year investigation of the relationship between a debt ratio and accruals quality.

3.2 Sample and Data Collection

The sample comprises many Iraqi companies listed on the Iraq Stock Exchange (ISX). The duration of the study is from 2022 to 2024. The total sample has 12 firm-year observations. The financial data utilised was sourced from public yearly reports and financial statements, encompassing balance sheets, income statements, and cash flow statements. The data was

employed to compute the Debt Ratio and Accruals Quality variables applied in empirical analysis.

3.3 Measurement of Variables

a. Independent Variable: Debt Ratio

The Debt Ratio is determined by dividing total liabilities by total assets. This ratio quantifies the degree to which a corporation employs debt financing within its capital structure and is frequently utilised as an indicator of financial leverage.

b. Dependent Variable: Quality of Accruals

The Modified Jones Model is employed to assess accruals quality. The approach divides total accruals into discretionary and non-discretionary elements. Discretionary accruals serve as a proxy for accrual quality, with elevated discretionary accruals signifying inferior quality of accounting information.

Total Accruals (TA) are calculated as:

$$TA = \text{Net Income} - \text{Operating Cash Flow}$$

The Modified Jones Model is applied to estimate discretionary accruals.

3.4 Control Variables

The current study does not incorporate additional control factors. The research focuses exclusively on the direct correlation between Debt Ratio and Accruals Quality in Iraqi corporations. This method is employed to assess the influence of debt ratio on the quality of accounting information within the chosen sample.

3.5 Model Specification

A straightforward linear regression model is employed in the research to examine the impact of debt ratio on the quality of accruals. The dependent variable of this study is Accruals Quality (AQ), while the independent variable is the Debt Ratio, which indicates the company's reliance on debt financing.

The regression model is formulated as:

$$AQ = \beta_0 + \beta_1 (\text{Debt Ratio}) + \varepsilon$$

Where:

AQ = Accruals Quality

β_0 = Intercept

β_1 = Regression coefficient of Debt Ratio

Debt Ratio = Total Debt / Total Assets

ε = Error term

The model is estimated using ordinary least squares (OLS) regression to evaluate the direction and significance of the relationship between debt ratio and accruals quality.

3.6 Data Analysis

Data was examined via Microsoft Excel software. Descriptive statistics were utilised to summarise the characteristics of the study variables, including mean, standard deviation, minimum, and maximum values. Correlation analysis was conducted to ascertain the direction and intensity of the link between Debt Ratio and Accruals Quality. A simple linear regression was performed to evaluate the study hypothesis and the impact of debt ratio on the quality of accruals in Iraqi enterprises.

4.0 RESEARCH AIM AND OBJECTIVES

This study aims to examine the correlation between debt ratio and accruals quality in Iraqi enterprises, offering empirical evidence about the impact of debt financing on the quality of accounting information.

The objectives of the study are the following:

1. To study the debt ratio of Iraqi enterprises through the debt ratio as a measure of dependence on debt funding.
2. To estimate the accruals quality as a proxy of the quality of accounting information, using the Modified Jones Model.
3. To study the association of debt ratio with accruals quality in the Iraqi enterprises.
4. To investigate if higher amounts of debt financing are connected with lower accruals quality.
5. To give empiric evidence that contributes to understand the factors of accounting information quality in the Iraqi corporate environment.
6. To provide practical implications for investors, creditors, regulators and other consumers of financial statements regarding the impact of debt financing on the quality of financial reporting.

5.0 RESEARCH HYPOTHESES

Based on the research problem and objectives, this study develops the following hypothesis to examine the relationship between debt ratio and accruals quality in Iraqi companies:

H₁: Debt ratio has a significant effect on accruals quality in Iraqi companies.

This hypothesis is tested by examining whether the level of debt financing, as measured by the debt ratio, influences the quality of accruals and, consequently, the quality of accounting information reported by Iraqi companies.

6.0 THEORETICAL FRAMEWORK

The quality of accounting information is a fundamental aspect in supporting economic decision-making, as it improves transparency and reliability of financial reporting. Accruals quality, the primary measure of accounting information quality, gauges the extent to which reported earnings reflect actual economic performance rather than subjective accounting estimations. Higher quality of accruals decreases information asymmetries and promotes the usefulness of financial statements for investors, creditors and other parties [7], [9].

In this respect, debt financing is an important financial factor which may alter the behaviour of managers in financial reporting. Lenders constantly monitor companies that are highly dependent on debt financing and often require them to meet contractual covenants and performance standards tied to their debt. Hence, managers may have the incentive to manage the reported results by discretionary accruals to keep good financial positions and to avoid the possible financing constraints [2], [5].

This relationship can be explained using Agency Theory which assumes that there are conflicts of interest between managers and stakeholders. Managers may use earnings management tactics in the debt financing contracts to increase their own benefits or avoid the negative consequences of loan contracts. Therefore, pressure associated with debt might impact the integrity of reported accounting information [5], [6].

This relationship can be explained by the Signalling Theory. Companies want to send positive signals to external stakeholders through financial reporting. High debt firms may try to signal financial strength and stability by presenting good accounting results, increasing the incentives to apply discretionary accounting methods and affecting the quality of accruals [3], [8].

The debt ratio is expected to have a direct effect on accruals' quality. High debt financing levels might lead to greater use of discretionary accruals and lower quality of accounting information. The purpose of this research is to examine the association between debt ratio and accruals quality in Iraqi companies to shed light on the effects of financial decisions on quality of financial reporting in an emerging economic environment.

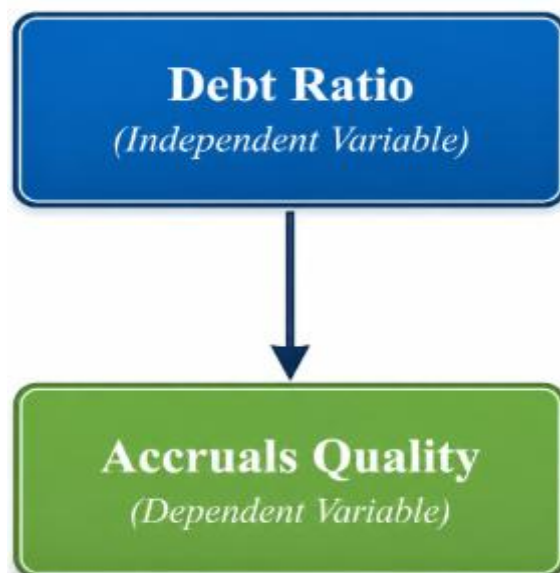


Figure 1. Conceptual Framework of the Study
Source: Prepared by the researcher.

Figure 1 presents the conceptual framework of the study, illustrating the proposed relationship between Debt Ratio as the independent variable and Accruals Quality as the dependent variable.

7.0 LITERATURE REVIEW

The relationship between debt financing and financial reporting quality has been of great interest in accounting and finance literature. The quality of accruals has been the focus of researchers as a significant measure of the quality of accounting information, and as an indicator of the reliability of reported earnings.

Bharath, Sunder and Sunder (2008) studied the effect of accounting quality on debt contracting. Their results show that firms with better accounting information have better debt contracting conditions and lower knowledge asymmetry between borrowers and lenders. The research pointed out that the precision of accounting is significant in lenders' assessment of corporate risk and their financing decisions.

Ball, Bushman and Vasvari (2008) explored the importance of accounting information for debt contracting. Their study concluded that the quality of accounting information is higher if the knowledge asymmetry between firms and creditors is reduced, hence improving the effectiveness of debt contracting agreements. The results suggest that accounting quality has a major impact on financing decisions and the effectiveness of creditors monitoring.

De Meyere, Vander Bauwhede and Van Cauwenberge (2018) examined the effect of financial reporting quality on loan maturity in private firms. Consistent with their findings, better financial reporting is associated with increased chances of obtaining long-term debt financing and maintaining superior debt structures. It was found that good quality accounting information reduces information asymmetry and increases creditors' confidence in companies' financial accounts.

Fields and Gupta (2007) examine the association between loan maturity structure and accrual quality. Their research demonstrated that organisations with higher amounts of short-term debt tend to have lower accrual quality, signalling higher tendency to use earnings management techniques. The study identified a significant effect of the characteristics of debt financing on managerial reporting practices.

Ilmas, Tahir and Asrar-ul-Haq (2018) studied the effect of ownership and debt structure on discretionary accruals in Pakistani firms. The results indicate that debt structure has a significant effect on discretionary accruals and managerial reporting practices. The research found that the financing decisions can affect the earnings management practices and the accuracy of accounting information.

Rey et al. (2020) investigated the relationship between earnings management and debt maturity. Their study finds that enterprises with high levels of earnings management are less likely to acquire long-term debt financing, emphasising the significance of accounting quality for the financing decisions of creditors.

Qi, Subramanyam and Zhang (2010) examined the relationship between accrual quality and debt outcomes. The study indicated that firms with higher quality accruals had better financing circumstances and lower information risk. The authors contend that reliable accounting information improves the ability of creditors to assess firm risk and improves the efficiency of loan contracting decisions.

Overall, the studies show that decisions about debt financing can affect the quality of accounting information because of their effect on incentives for managerial reporting and on standards for financial reporting.

The relationship between debt financing, earnings management and financial reporting quality has been extensively explored in the literature. However, the current data is not convincing on the direct effect of debt ratio on the accrual's quality. Furthermore, most of the prior studies have been conducted in industrialised economies or in rising markets and the empirical evidence from

Iraq is very limited. Further research is needed due to the peculiar nature of the Iraqi business environment, especially its evolving financial reporting standards and funding mechanisms. This work seeks to fill this gap by investigating the effect of debt ratio on the quality of accruals in Iraqi enterprises and presents empirical evidence from a relatively under-researched emergent market.

8.0 MODIFIED JONES MODEL

In this study, the quality of accruals is measured by Modified Jones Model created by Dechow, Sloan and Sweeney (1995). This model is one of the most commonly used models for estimating discretionary accruals and measuring earnings management. The model is widely used in accounting research as a proxy for the quality of accounting information.

First, we compute total accruals (TA) as the difference between net income and operating cash flow:

$$TA = \text{Net Income} - \text{Operating Cash Flow}$$

Total accruals are then scaled by lagged total assets to control for firm size differences.

The Modified Jones Model is estimated as follows:

$$TA / A(t-1) = \beta_0 + \beta_1(1 / A(t-1)) + \beta_2[(\Delta REV - \Delta REC) / A(t-1)] + \beta_3(PPE / A(t-1)) + \varepsilon$$

Where:

- ΔREV = Change in revenues.
- ΔREC = Change in receivables.
- PPE = Property, Plant, and Equipment.
- $A(t-1)$ = Total assets at the beginning of the period.
- ε = Error term.

The residuals from the model are discretionary accruals (DA), which is a popular indicator of accruals quality. High levels of discretionary accruals suggest a greater opportunity for earnings management and a lesser quality of financial reporting. Conversely, low levels of discretionary accruals indicate a high quality of accruals and reliable accounting information [4].

Table 1. Descriptive Statistics of Study Variables

Variable	Mean	Std.Dev	Min	Max
AQ	0.403999115	0.282893605	0.060990456	0.94333048
Debt Ratio	0.381500958	0.307649317	0.112708111	0.93043568

Source: Prepared by the researcher based on Excel outputs.

Descriptive statistics of the variables of study are presented in Table 1. The average of accruals quality (AQ) was 0.404, which indicates a moderate level of accounting information quality in the examined Iraqi firms. A standard deviation of 0.283 suggests a large variation in accrual quality between businesses and across time. On average, the Debt Ratio was 0.382, indicating that debt financing forms a significant portion of total assets. The standard deviation of 0.308 is considerable and shows that there are large variances in financing structures across the examined organisations.

Table 2. Correlation Matrix

Variable	AQ	Debt Ratio
AQ	1.000	-0.523
Debt Ratio	-0.523	1.000

Source: Prepared by the researcher based on Excel outputs.

Table 2 presents the correlation matrix among the factors evaluated. The results show that there is a moderate negative correlation between the Debt Ratio and Accruals Quality ($r = -0.523$). The results of this study reveal that organisations with a higher level of debt financing tend to have a lower quality of accruals. The negative correlation may be due to the fact that managers have a greater incentive to alter accounting estimates when the debt commitments are high and the pressure from creditors is great.

Table 3. Regression Results

Variable	Coefficient	P-value
Debt Ratio	-0.48071	0.08118

Additional Statistics: $R^2 = 0.273$; $F = 3.761$; Significance $F = 0.081$

Source: Prepared by the researcher based on Excel outputs.

The results of regression analysis of the effect of debt ratio on the quality of accruals are shown in Table 3. The coefficient of the Debt Ratio is negative (-0.481), indicating that accruals quality worsens as debt financing increases. The model shows the model explains around 27.3% of the variance in accruals quality ($R^2=0.273$). But the p-value (0.081) is bigger than the normal 5% level of significance, therefore the effect is not statistically significant at the 5% level, despite the negative association. Therefore, the study does not give enough data to confirm the significant effect of debt ratio on quality of accruals in the tested Iraqi enterprises.

9.0 RESULTS AND DISCUSSION

This section presents and discusses the empirical findings of the study regarding the relationship between debt ratio and accruals quality in Iraqi companies. The analysis is based on descriptive statistics, correlation analysis, and regression analysis. The results provide evidence on whether debt financing influences the quality of accounting information as measured by accruals quality.

9.1 Descriptive Statistics

Descriptive statistics of the variables of study are presented in Table 1. The average of Accruals Quality (AQ) was 0.404 which indicates moderate level of accounting information quality among the examined Iraqi firms. The standard deviation of 0.283 suggests a moderate level of variation in the accrual quality of the firms and the years. The minimum and maximum scores were between 0.061 and 0.943, showing a considerable variation in accounting quality in the sample.

The average Debt Ratio was 0.382 indicating that debt financing is a dominant part of the companies' capital structure. The standard deviation of 0.308 suggests that there is a considerable variation in debt dependency among the sampled firms. The Debt Ratio ranged from 0.113 to 0.930 indicating that certain firms were very dependent on debt funding while other others had very low debt.

9.2 Correlation Analysis

Table 2 displays the association matrix between Accruals Quality (AQ) and Debt Ratio. The results show that the two variables have a moderate negative association, with a correlation coefficient of -0.523. This result shows an inverse relation between the volume of debt financing and the quality of accruals in the sampled Iraqi enterprises.

The negative relation implies that more debt dependence may induce incentives for management to engage in accounting methods that diminish the quality of the reported accruals. Such behaviour may be a response to pressures from debt commitments, monitoring by creditors, and

financial expectations. Thus, the correlation analysis provides preliminary evidence that debt ratio may alter the quality of accounting information.

9.3 Regression Analysis

Table 3 reports the results of the regression analysis examining the impact of debt ratio on accruals quality in Iraqi companies. The regression coefficient of Debt Ratio was negative (-0.481), indicating that an increase in debt financing is associated with a decrease in accruals quality. This finding is consistent with the correlation analysis, which also revealed a negative relationship between the two variables.

The coefficient of determination (R^2) was 0.273, suggesting that Debt Ratio explains approximately 27.3% of the variation in accruals quality. Although the explanatory power of the model is moderate, it indicates that debt ratio contributes to understanding differences in accounting information quality among the sampled companies.

However, the statistical significance level of the model was 0.081, which exceeds the conventional significance threshold of 0.05. Therefore, the effect of Debt Ratio on accruals quality is not statistically significant at the 5% significance level. Consequently, the study does not provide sufficient empirical evidence to support the hypothesis that debt ratio has a significant impact on accruals quality in Iraqi companies.

These findings suggest that while debt financing may influence accounting reporting behavior, other factors not included in the model may play a more important role in determining accruals quality within the Iraqi business environment.

9.4 Discussion of Findings

The outcomes of this study indicate a negative relationship between debt ratio and the quality of accruals in Iraqi firms. The results of correlation analysis and regression suggest that rise in debt financing is associated with decrease in accruals quality. This result is consistent with Agency Theory which suggests that managers may be driven to manipulate accounting estimates and reporting techniques in the face of growing debt commitments and creditor scrutiny.

These results are in line with the findings of Fields and Gupta (2007) who found that organisations with higher amounts of debt, particularly short-term debt, have lower accrual quality and higher likelihood of earnings management. In the same vein, Ilmas et al. (2018) argued that debt-related pressures may force managers to resort to discretionary accounting approaches thereby reducing the quality of reported accounting information. Rey et al. (2020) also stressed the importance of quality of accounting in making judgements about debt financing

and discovered a significant relationship between earnings management and the structure of the debt maturity.

The results are consistent with found by De Meyere et al. (2018) which said that better financial reporting mitigates information asymmetries between firms and creditors and so allows for more favourable loan arrangements. The results support the claim that the quality of accounting and finance choices are tightly interconnected.

Unlike previous research that documented statistically significant effects of debt-related variables on accounting quality, this study did not find statistically significant effects at the 5% level of significance. This difference can be explained by the small size of the sample, the nature of Iraqi businesses, and the institutional and legal environment within which they operate. This may suggest that factors other than the debt ratio are more important for the quality of accruals in the Iraqi environment.

Preliminary evidence suggests that debt financing may have an impact on accruals quality, although the relationship is weak and not statistically significant at traditional levels of significance. Therefore, the results should be interpreted with caution and may be the basis for future research with larger sample sizes and other explanatory variables.

10.0 CONCLUSION

This study examined the effect of the debt ratio on the quality of accruals in Iraqi companies by using descriptive statistics, correlation analysis and regression analysis. The results showed a moderate negative relationship between the debt ratio and the quality of accruals. This means that companies that finance with a high level of debt generally have poor quality accounting information.

The regression study shows that the debt ratio explains around 27.3% of the variation in accruals quality. The estimated association is negative; however the statistical analysis did not yield enough evidence to indicate a significant effect at the conventional 5% significance level. The study shows that debt financing could impair the quality of accruals, however its effect was not statistically significant in the selected Iraqi company's sample.

The results are consistent to the previous literature that debt-related pressures might alter managerial reporting behaviour and the quality of accounting information. The study adds to the limited empirical evidence on financial reporting quality in Iraq and provides useful insights for investors, creditors, regulators and other financial statement users concerning the relationship between debt financing and accruals quality.

The results should be interpreted with caution given the small sample size and short observation period. Future research should use larger samples, longer time periods, and other explanatory variables to better understand the determinants affecting accruals quality in emerging economies.

11.0 RECOMMENDATIONS

Based on the findings of this study, the following recommendations are proposed:

1. Iraqi companies should strengthen financial reporting practices to improve the quality of accounting information and reduce the potential negative effects associated with high debt levels.
2. Regulatory authorities and market supervisors should enhance monitoring mechanisms to promote transparency and improve financial reporting quality.
3. Investors and creditors should consider accruals quality indicators when evaluating the financial performance and reporting reliability of companies.
4. Future studies should include larger samples and longer time periods to provide more robust evidence regarding the relationship between debt ratio and accruals quality.
5. Researchers are encouraged to examine additional determinants of accruals quality, such as corporate governance, firm size, profitability, and ownership structure, to better understand financial reporting behavior in the Iraqi environment.

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