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THE IMPACT OF EXTERNAL AUDIT QUALITY CHARACTERISTICS ON EARNINGS MANAGEMENT IN BANKS LISTED ON THE IRAQ STOCK EXCHANGE

Ali Lateef Ayyed

Al-Muthanna University, College Of Administration And Economics, Department Of Business Administration, Iraq

ABSTRACT

Purpose: The current study aims to shed light on the influential role of audit quality in reducing opportunistic management methods in management.

Design/Methodology/Approach: To achieve the objectives of the current study and test the hypotheses from an experimental perspective by reviewing previous studies and relying on them to provide a model that shows the importance of audit quality in reducing earnings management.

Results:

Originality/value: Given that there is a great need to prepare financial statements that are characterized by quality and reliability, this matter requires the availability of an external audit characterized by quality to ensure proper financial reporting for the economic units listed on the Iraq Stock Exchange through the external auditor limiting the means of managing profits that Followed by management.

KEYWORDS: Audit Quality, Earnings Management, Modified Jones Model, Auditor Specialization.



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INTRODUCTION

Audit quality directly affects the accuracy, validity, and reliability of financial statements and financial information. Audit quality refers to the accuracy and validity of the information provided to investors after completing the audit. Hence, this demonstrates the auditor's ability to identify and disclose significant discrepancies and identify any manipulation of net profit. Researching the impact of accounting information users' need for audits.

Financial reports, especially net profit, are considered among the accounting system's most important outputs. According to the First Statement of Financial Accounting Concepts, the primary objective of financial reporting is to provide valuable information to existing and potential investors and other individuals to help them make rational choices about investments, credit, and related matters.

The bankruptcy of prominent companies in the United States, such as Enron and Volcom, and in Australia, Tail One, has raised significant concerns about earnings management, the use of reported earnings, and the ethical dilemmas faced by individuals responsible for preparing and reviewing these earnings—financial reports. As mandated by laws such as the Sarbanes-Oxley Act, US legislatures require bank managers to ensure that financial reporting supports bank governance and enhances auditor independence. This helps reduce earnings manipulation and improve the overall quality of financial reporting. There is room for improvement. Earnings manipulation is essential for a bank's stakeholders, mainly when most revenues are derived from it.

According to agency theory, organizational systems aim to realign the interests of shareholders and managers, reduce conflicts of interest and prevent opportunistic actions. Auditing plays a crucial role in banks by aligning the interests of the manager with those of external shareholders. It acts as a robust control system, preventing managers from manipulating earnings and ensuring financial integrity.

According to this idea, shareholders impose accounting restrictions to prevent managers from manipulating earnings.

Interest in the quality of financial reports and their connection to the quality of auditing has gradually increased over time after the occurrence of scandals involving some banks as a result of accounting manipulation by management. In fact, investors and auditors often prefer to reduce the workload assigned to external auditors. Criticisms arise from the deceptive nature of audited financial statements, which are supported by numerous unique sources confirming intentional lies. The effect of external auditors on reducing earnings management remains uncertain. This study includes an analysis of several aspects of the effectiveness of audit quality in relation to reducing earnings manipulation. Given its distinct dual function, this would ultimately lead to a correlation between audit quality and profit management limitation. From this beginning, the research aims to study the impact of audit quality on earnings management. The research also constitutes an added value to the Iraqi environment by studying the level of audit quality and its impact on reducing profit management, as this is of great importance in supporting the Iraqi stock market, a key pillar of the country's economy.

RESEARCH METHODOLOGY

1.2. The Research Problem

Earnings management is a negative phenomenon that banks use to show that their performance is better than their actual performance, which harms the interests of the relevant parties and creates an environment of asymmetric information among the parties related to the banks. The powers granted to executive managers create an opportunity for them to use accounting methods that allow them to manage bank profits. The mandatory application of international financial reporting standards, which provide flexibility in applying different accounting practices, allows bank management to

manipulate profits. This requires the availability of another tool to work to limit these opportunistic actions of management and control the flexibility provided by international financial reporting standards. Here comes the vital role of quality auditing in detecting manipulation in the financial statements and ensuring the banks' commitment to presenting high-quality financial statements. Therefore, the research seeks to know the effect of the characteristics of the quality of external auditing on reducing profit management in banks. Therefore, the research problem is to answer the following questions

- Do Iraqi banks care about the quality of their external audit?
 - Do Iraqi banks practice earnings management?
 - Is there a relationship between the quality characteristics of external auditing and profit management in Iraqi banks?
- Do the quality characteristics of external audits affect earnings management?

2.2. Research objective

- 1- Measuring the level of audit quality in the banks sampled in the research.
- 2- Measuring the level of profit management in the banks in the research sample.
- 3- Determine the nature of the relationship between audit quality and profit management for the banks in the research sample.

3.2. The importance of research

The importance of the research lies in shedding light on the reality of the quality of auditing in Iraqi banks and the extent to which the quality of auditing is affected in reducing profit management, as the quality of external auditing is one of the essential matters that gives reliability to the accounting information included in the financial reports. It is one of the most critical factors in attracting investments, so this study came. The study aims to identify the reality and trends of Iraqi banks in terms of paying attention to the quality of auditing and determining the level of profit management in Iraqi banks. Because of this, it is of great importance to current and prospective shareholders to assess the extent to which they can rely on accounting

information to predict the performance of banks. This topic also represents the importance of financial markets by knowing the effect of audit quality in reducing profit management. Thus, this is positively reflected in the stability of those markets.

4.2. Research Hypothesis

The research is based on two primary hypotheses:

- 1- There is a statistically significant relationship between the characteristics of the quality of external auditing and profit management in Iraqi banks. The following sub-hypotheses branch out from this hypothesis:

There is a statistically significant relationship between the size of the external audit office and profit management in Iraqi banks.

There is a statistically significant relationship between the reputation of the external audit office and profit management in Iraqi banks.

There is a statistically significant relationship between the specialization of an external audit company or library and profit management in Iraqi banks.

There is a statistically significant relationship between customer retention periods and profit management in Iraqi banks

- 2- There is a statistically significant effect between the characteristics of the quality of external auditing in profit management in Iraqi banks. The following sub-hypotheses branch out from this hypothesis:

There is a significant, statistically significant effect between the size of the external audit office and profit management in Iraqi banks.

There is a significant, statistically significant effect on the reputation of the external audit office in profit management in Iraqi banks.

There is a significant, statistically significant effect between the specialization of the external audit company or library in managing profits in Iraqi banks.

A significant, statistically significant effect exists between client retention periods in profit management in Iraqi banks.

Search Limits

Spatial Limits: The study was conducted in a

sample of Iraqi banks on the Iraq Stock Exchange.

Temporal limits: The study data related to the financial statements of the banks in the research sample for the years 2017-2022.

3. Theoretical background

1.3. The concept of audit quality

The concepts of audit quality have varied depending on the experiences that have occurred at the global level, meaning that it is possible to achieve audit quality when the auditor's opinion on the financial statements is based on sufficient and appropriate audit evidence through knowledge, experience, and adequate time allocated to performing audit work and applying a strict audit process. By providing valuable reports promptly, audit quality is usually related to the auditor's ability to identify material errors in the financial statements. It is also concerned with the auditor's willingness to disclose an unbiased audit report based on the result (Suseno, 2013, p. 89).

(377 2011; YE) believes that audit quality occurs when the auditor issues a report appropriate to the current circumstances. In this study, we define audit quality as an audit conducted by a highly specialized independent auditor who issues a correct opinion based on appropriate evidence. Auditing companies play an essential role in the economy as they ensure financial statements' quality, integrity, and transparency. They are the agents responsible for discovering and examining the integrity of a company's financial statements.

As known, audit quality is the possibility of the auditor's requirement to discover gaps and errors in the accounting system, disclose information in the report he issues, and reduce the risk of its presence in the company's financial statements (Davis, 2017, p. 411). It is also known as an integrated approach led by the auditor in order to achieve high levels of financial performance through discovering fundamental errors, manipulation, and violations in the financial statements and disclosing them in reports with the legal obligation of the auditor (Eskanari et al., 2014, p. 82). He defined it (Muchugla, 2018, p. 3) as

the auditor's discovery of the extent of the audit's efficiency in discovering fundamental errors, reporting them, and reducing information asymmetry. Between management and shareholders, thus helping to protect shareholders' interests.

As Sudarmadi (2020:348) pointed out, audit quality is the auditor's probability of identifying and reporting an error or fraud in the accounting system. It is also defined as the accuracy of the information reported by the auditor in accordance with the auditing standards used by the auditor, including information on accounting irregularities in the client company's financial statements.

As also defined by Tandiotong (2016: 80), audit quality is the probability that the auditor will identify and report an error or fraud in the client's accounting system. Accordingly, audit quality is the probability that the auditor will find an error or manipulation in the financial statements to give an impartial technical opinion that ensures that the auditor adheres to the standards of ethical conduct for auditing.

2.3. The importance of audit quality

Audit quality produces qualitative financial reports, which in turn prevent financial crises from the point of view of (2020:484), (Yousef, 2020). Audit quality guarantees that financial statements do not contain fundamental errors through extrapolation, and the reliability of financial statements is also reflected in the audit quality practices adopted in their preparation. The audit quality is necessary because it determines the credibility of the audit reports. In addition, the audit quality, when considered in conjunction with the auditor's independence, influences the level of confidence the users enjoy of the financial statements in the financial reports (Al Khaddash et al., 2013, p. 208). Low confidence in earnings reports when issuing qualified opinions. They found that if auditor quality is compromised, audit reports provide a lower level of assurance to users of financial statements.

Auditors must be careful when providing audit services to ensure that the information in their

reports is high quality, adequate, and reliable. In the views (Yousef, 2012, p. 484), high audit quality is expected to lead to high-quality financial reporting, which acts as a tool to avoid a financial crisis. Since auditing aims to confirm the financial statements, the reliability of the financial statements is reflected in Audit Quality.

In the face of rapid developments in information and communications technology, banks' ability to compete more efficiently, be sustainable, and increase stakeholder expectations has increased. High audit quality increases the reliability and quality of financial reporting (DeFond & Zhang, 2014, p. 275). While high audit quality increases the quality of financial reporting and supports informed investment decisions and financial stability, it also serves as a monitoring mechanism that reduces information asymmetry between managers and shareholders (2012:150.), Arens et al. Audit quality helps banks obtain credit from the most reputable creditors and attract potential partners to invest in the bank. Quality involves reliability in audit activities to be completed per pre-defined standards and regulations and the application of quality control procedures. An independent and unbiased auditor plays a vital role in increasing public confidence in the capital markets by providing better Information and confidence in the reliability of financial statements and the accountability reported by management. Thus, audits help increase economic well-being.

Audit Quality Objectives

The auditing profession has faced increasing pressure and continuous criticism in recent years, due to the presence of cases of fraud and fundamental misrepresentation in the financial statements that led to an increase in lawsuits filed against practitioners of the profession, especially after many large American institutions were exposed to failure and even though their financial statements were subject to audit by the most prominent offices. Auditing, as many of these banks, suffered financial losses, which distorts the auditing profession's reputation and made improving the quality of the profession's work a

necessary goal and objective (Masoudi, 2019, p. 153).

Many organizations and professional associations around the world have paid attention to the issue of monitoring the quality of performance in auditing and accounting companies and offices, working to improve the level of professional performance of these offices and trying to improve what serves the public interests. Professional standards are considered guidelines and directives for the auditor's application of procedures, actions, and tasks. These standards contain, in particular, quality control standards, which aim to improve the performance of both auditors and their offices; it is clear that there is a mutual relationship between the quality of the audit and adherence to professional standards, as adherence to professional standards leads to the performance of audit work with high quality, and the performance of the audit process at a level Suitable quality (Hamza, 2020, p. 37)

4.3. Audit quality standards

Auditing quality measures There are many studies that examine the measures and factors that affect audit quality, and using these measures requires consideration of costs and benefits. There is little evidence of the validity of the measures or their descriptive purity in constructing these measures, and these measures need to be evaluated to obtain the ability to make Accurate and detailed advertising forecasts (Zheng & Rajgopal, 2015, p. 190)

Audit quality is multidimensional, cannot be understood by reference to a single factor, and because of its complex and unobservable nature, it is not easily quantified or observed even for participants very close to the audit process. Several metrics have been developed that can help measure audit quality. The most commonly used measure is the size of the investigation company and office, particularly whether a large or small company or audit office audits the bank. The most important goal in choosing audit quality metrics is to use the most appropriate measures. There is usually a more relevant measure to

measure audit quality. However, no single measure has been agreed upon that is capable of drawing a complete picture of audit quality, and we realize that it is only possible to use some measures in one study. (Defond and Zhang) (2013:20) for banks. Audit quality standards are more widely used in the literature and include:

- 1- The size of the audit firm
- 2- The reputation of the auditing company.
- 3- Auditing company fees.
- 1- Sectoral specialization of the auditing company
- 2- The organizational structure of the audit company

5.3. The concept of earnings management

Earnings management in accounting literature is one of the concepts discussed in the field of accounting profit. Such concepts have been shaped in accounting since approximately the beginning of the twentieth century, with numerous studies conducted by accounting scholars. Interest in the issue of earnings management began early when Hepworth (1953) studied the phenomenon of the continuation of a company's declared income. He stated that Management's goal of maintaining the company's regular income is to prevent fluctuations in the declared income and obtain reliable information from parties related to the bank. The financial and accounting literature has focused on many concepts of earnings management, and the following is a presentation of some of these concepts (Minanari & Rahayu, 2020, p. 258).

He defined earnings management as the "manipulation" of earnings toward a predetermined goal that Management may set, request, or expect from a particular group of stakeholders. Or a type of intentional act committed by managers using special tools in accounting to reduce profit fluctuations" (Obaidat, 2017, p. 1).

Some people view earnings management as using flexibility in accounting rules and methods to manipulate reported earnings by changing the number of items in the income statement to achieve other goals that may achieve Management's benefit or give economic benefit as well as the financial position of the unit is stable

over some time (Mahadianto, 2020, p. 23)).

Linking earnings management to the use of personal estimates and experience by executive managers when preparing published financial statements in order to mislead users of these statements or influence the level of performance of the banks they manage for reasons that serve the contractual relationship between them and the owner that arises within the scope of the concept on which agency theory is based. (Adamikova & Sedlakov, 2021:4)

Earnings management is the purposeful intervention of GAAP determinants in the financial reporting process to achieve expected profit levels in relation to its objectives. Earnings management entails increasing, decreasing, or reducing reported profits. For example, if a bank achieves stable profits, then stockholders feel that it is more secure, and because profits are very important, managers always try to manipulate the value of reported profits to achieve their goals. (Bansal, 2021: 266)

He sees earnings management as the process of manipulating accounting numbers by taking advantage of the flexibility of accounting rules, measurement practice options, and the disclosures contained therein to transform financial information that preparers prefer to obtain the desired results from rather than being neutral within a certain range within a specific period of time (AL-Khafaji et al., 2022, p. 324).

These definitions include two different opinions put forward by (Jaya and Narsa, 2020, p. 4). From the first point of view, earnings management is a preferred approach or desirable practice if managers use their judgments to provide more realistic reports. The second opinion may focus on negative or undesirable earnings management practices, where managers use their personal judgments to mislead users of financial information or influence the outputs related to contracts, and the published accounting data depend on these outputs. The most important definitions that will be discussed are two different views of the concepts of earnings management. Earnings management is defined as the accounting policies chosen by managers or

behaviors that affect profits to achieve certain goals of declared profits (Jaya & Narsa, 2020, p. 4).

Based on the above, the researcher believes that earnings management appears as the use of flexibility in accounting rules and methods to manipulate reported earnings by changing the number of items in the income statement to achieve other potentially self-regulating goals. To manage or give an economic unit a stable and sound financial position for a specific period, provided that it does not conflict with the Management's objectives and to maintain the unit's level of operation in the financial markets.

6.3. Motives for using earnings management

Earnings management focused on several distinct drivers, including:

1.6.3. Contractual motives

The agency theory of contractual motives is defined as the relationship between two parties (the agent and the principal) through the work that the first party provides to the second party in exchange for a wage or reward. This contract is drawn up and executed in a way that allows the agent to achieve the highest benefit for the company ((Kusumaningtyas & Yendrawati, 2015: 179), ((TRANet, 2020:390 Accounting data is sometimes used to help formulate a set of bank contracts with stakeholders, which may lead managers to create incentives to manipulate profits in order to complete these contracts in a way that achieves those managers' goals (Rachmawati, 2019, p. 134). Motivations for the contract In the fact that accounting data are used as a basis to rely on to organize certain contractual relationships with others, such as loan contracts that have a significant impact on the distribution of materials corresponding to the costs involved when their remuneration is linked to the improvement of their functional working conditions with the profits earned, there is another incentive that motivates managers to manage profits And to obtain other benefits related to job security and additional benefits when negotiating with unions and others (Scott, 2003, p. 6). There are two types of contractual motives.

2.6.3. Bonus contracts and management compensation:

Many studies have examined management bonuses and compensation contracts to determine managers' motivation, as this is an encouraging incentive for them to manipulate profits to improve their bonuses. These bonuses are often linked to the bank's profits and are expected to be used to increase income (Tanlicha & Kurnia, 2016, p. 4). Others believe that department managers in large international banks postpone revenues when the profit target in their reward program is not achieved and when they are nominated to obtain the maximum rewards agreed upon according to the specific plan. Therefore, reward contracts may prompt some bank managers who manage their profits, on the one hand, to increase their rewards and, on the other hand, to improve their employment situation. Also, if the bank is in financial distress, managers expect their bonuses to be reduced, the possibility of being replaced, and exposure to damage their careers and reputation. Therefore, for conservative Management, managers will seize the opportunity to hide such deteriorating performance by choosing different accounting methods that increase income and can hide the loss. Banks that become bankrupt later but do not appear beforehand engage in practices of manipulating earnings to increase income. (Ghazali et al, 2015: 191).

Borrowing

A series of debt covenant terms usually restrict borrowing contracts. When these conditions are violated, the contract may be terminated and the bank will be penalized. The presence of these terms in debt agreements motivates managers to manipulate earnings to avoid violating these agreements. Debt contracts are "the manager's obligation to maintain the terms of the contract and to restrict the manager's actions that benefit the bank's shareholders at the expense of creditors" (Gois & Parente, 2020, p. 128). When the bank requests loans, it must provide financial statements confirming its ability to pay its obligations. Therefore, the bank can resort to accounting means and methods that meet the

requirements for obtaining a loan and demonstrate a solid financial position that demonstrates its ability to repay (Scott, 2003, p. 7). Management's ability to use the bank's assets for personal interests and exploit the bank's assets may be restricted by the presence of external lenders. Since they are concerned about the bank's ability to repay debts, lenders will ensure that Management fully utilizes the available cash in profitable investments. In other words, monitoring activities will be carried out by lenders in order to do so to ensure that the bank embodies the repayment of debts. Lenders will ultimately monitor Management because it is the main factor determining repayment. Previous studies have found that lower bonuses are paid in the long term to the CEO of a highly leveraged bank. This means there is no room for Management to confiscate the bank's cash flow if the lender monitors it. Monitoring by lenders contributes to the bank's profitability and growth. At the same time, previous studies found an insignificant relationship between monitoring by lenders and bank profits (Ghazali et al., 2015, p. 194).

4.6.3. Capital market drivers:

Investors and financial analysts rely heavily on accounting data to help evaluate securities, which incentivizes managers to manipulate earnings to influence the short-term stock market share price performance. There are many motives related to the financial markets that can motivate bank management rather than profit management, including: - (Muhammad, 2017, p. 393), (Abogun et al., 2021: 299

5.6.3. Impact on stock prices

The use of prevailing accounting information by investors and financial analysts to help evaluate the performance of stocks can generate an incentive for managers to manipulate earnings, in an attempt to influence the performance of the stock price, as a decline in the financial values of companies negatively affects their stock prices (Rizeiqat, 2020, p. 533) In an advanced capital market, with the separation of ownership and Management, and a broad shareholder base, earnings management is driven by the desire to

support the bank's share price, as this price is often the primary basis.

These motives may not be relevant in some less developed capital markets for managerial compensation, which may include stock options or other incentive plans (Ding et al., 2007, p. 223). The recent studies on the extreme drivers of the capital market for managed earnings focused on the behavior of receivables and the occasional behavior of unexpected receivables during the accounting period when practicing earnings management. These studies include the period when earnings management revolves around capital market transactions when there is a gap between investor and analyst expectations and unit performance, including the study of earnings management (De Angelo) before a management buyout. He emphasized that profit information is essential for evaluating management acquisitions and assumed that acquisition unit managers are incentivized to reduce profits (Healy & Wahlen, 1999: 371).

6.6.3. Legislative or regulatory motives

The business sector is subject to legislation and laws regulating its work, such as instructions issued by financial markets, central banks, or relevant authorities. Violating these instructions or legislation may result in penalties that may lead to suspending the bank's work in the financial markets. These motives include: - (Majid & Jassim, 2018, p. 616)

1—Tax motives: Management's behavior in adopting alternative accounting methods and policies depends on the potential impact of these methods and policies on the bank's future taxes. The tax imposed on bank profits depends directly on accounting numbers, which requires Management to choose to reduce alternative methods and policies for profits. Taxable (Badr, 2013, p. 52).

2—Legislative and political motives: The political costs imposed by the state on banks, especially large banks with high profits, are among Management's motives for choosing accounting policies and methods that decrease bank profits (Dafaalla et al, 2020:6).

7.3. Quality of audit and earnings management

Adopting opportunistic profit management leads to inaccurate accounting profits, which do not reflect or represent reality or the true and fair vision of the reporting entity's financial performance. This occurrence affects banks and other sectors, reducing investors' confidence in financial reports. Banks have witnessed accounting scandals in the past decade, mostly due to how managers handle details in annual reports. They have the potential to mislead stakeholders by using a variety of accounting options in planning financial statements (KURAWA, 2020&AHMED). The responsibility of the audit mechanism to ensure consistency in reported profits has been a source of concern, leading to questions about the competence of auditors' position in monitoring and managing managerial opportunistic behavior. The audit standard that was presented reflects the auditor's credibility and the quality of the client's revenues. To this end, audit quality and its Impact on earnings management must be considered. Every firm continues to strive to maximize the benefits of audit quality. According to Utami (2017), various techniques are used to achieve audit efficiency.

On the other hand, banks face many challenges that can lead to poor results, financial difficulties, and ultimately bankruptcy, as the bank tries to hide the severe circumstances of its owners. Earnings management is the process of intervening in the processing of external financial data in order to assist stakeholders. Managers have chosen to evaluate accounting standards to process results to achieve this goal. Earnings management is a technique of manipulating financial reports to communicate with management and external parties to the company, and it can reduce the credibility of decision-making (Utami, 2017). The quality of operating performance and audits have led to significant controversies arising from bank fraud in reducing earnings control by banks worldwide (Enofe, 2010). Investors doubt the audit feature's reliability, importance of value, integrity, usefulness, and honesty due to recent bank frauds (Rusmin, 2017). The concern is whether

organizational collapse results from decreased audit quality due to long audit tenure, limited audit rotation period, high audit compensation, loss of freedom, and failure of audit advantage. Many accounting controversies over the past decade involve distorting accounting records by misrepresenting accruals, providing estimated loan losses, and documenting false inventories. Increasing audit efficiency may contribute to or lead to improved quality of recorded revenues (Clement, Adzor 2017). Compared to low-quality auditors, high-quality auditors are aware of questionable accounting procedures and are opposed to submitting and amending the audit report when they are identified. Therefore, banks with lower-quality auditors practice earnings management more than organizations with high-quality auditors. Best (Oladejo, 2020).

4. Measuring the relationship between audit quality and earnings management

Introduction: To test the research hypothesis, the researcher developed a model to measure the characteristics of external audit quality as independent variables on earnings management using a multiple regression model, which is concerned with studying the effect of quantitative independent variables on a quantitative dependent variable, as it can be referred to through a particular linear function as follows:

$$(EM) = \beta_0 + \beta_1 \text{Size} + \beta_2 \text{Rep} + \beta_3 \text{Exp} + \beta_4 \text{per} + \beta_5 \text{f.size} + \beta_6 \text{Rol} + E$$

where :

Earnings Management EM:

β_0 : Constant

Audit desk size:

I heard the audit office Rep:

Exp company or library specialty:

Customer retention period:

Represents the client's total assets f.size:

Represents the return on investment for the customer Rol:

Random error E:

1.4. Method of measuring research variables:

The research variables were measured as follows:-

1. Independent research variables (measures of external audit quality):

The researcher examined six standards to measure the quality of external audits, which are as follows:

A- The size of the audit company and office: The researcher decided to measure the size of the audit company and office according to the bulletin of licensed auditors for the year 2021, which amounts to a total of (210) companies and audit offices licensed to operate in the year 2021, as the auditors were divided into two categories, namely:

The first category is auditing companies, as (27) have been registered, and each includes several auditors. The second category includes the names of the first and second-class auditors, and their number is (188) auditors. So, the number (1) is given to the first category, and the number (0) The second category measures the size of the investigation company or office because the auditing company consists of the participation of more than one qualified auditor in addition to assistants. In comparison, the second category consists of one qualified auditor and assistants.

B- The reputation or goodwill of the audit company or office: In measuring the reputation or goodwill of the audit company or office, the researcher relied on the share of the bank and the office in the banks listed in the Iraq Stock Exchange to the total number of banks listed in the market after excluding the mixed banks that are owned by the state. A share in their shares because these banks are responsible for auditing their accounts by the Federal Bureau of Financial Supervision and are therefore excluded from the market share of auditing companies and offices, excluding unaudited banks during the years of

research, and calculating a percentage representing their market share in the market.

C- The specialization of the audit company or office in the client's activity: The researcher relied on measuring the specialization of the company or the audit office in the client's activity through the share of the company and the audit office in the banking and industrial sectors to the total shares in that sector and calculating a percentage representing its market share in the sector after excluding the banks. The mixed ones, in which the state has a share in their shares because these banks are responsible for auditing their accounts by the Federal Office of Financial Supervision and are therefore excluded from the market share of auditing companies and offices.

D- Client retention period: The researcher relied on measuring the client retention period, as the number (1) is given in the case of retaining the client for more than two years, and the number (0) in the case of retaining the client for less than this period, because the length of the client retention period leads to increased knowledge and experience. An audit team in the client's industry facilitates the performance of the audit process with high quality and ensures its success.

2- Regulatory variables

A- The client's total assets: The researcher used the bank's total assets as an indication and measure of the size of the client's company.

B- Return on investment: The researcher used the rate of return on investment, which is measured by the bank's net profits/total assets. Table (1) shows the audit quality results of the companies in the research sample.

Table (1) Measuring audit quality

Return on assets for the client	total assets	Custo mer retenti on period	Special ization in client activity	I heard the audit office	Size of the audit office	The bank
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%87	0%	78%	56%	67%	10 0%	Credit
55%	100%	44%	22%	22%	10 0%	Middle East
56%	89%	80%	90%	82%	84 %	Gulf
22%	67%	56%	0%	0%	0%	Commercial
44%	78%	56%	44%	44%	56 %	Elaf
22%	33%	56%	33%	44%	44 %	Al-Mansour
33%	11%	78%	22%	44%	10 0%	Al-Ahly
44%	89%	56%	44%	67%	44 %	Investment
0%	89%	78%	67%	100%	10 0%	Baghdad
44%	89%	67%	78%	100%	10 0%	Assyria

Through Table (1), it is clear to us that the audit quality of the variables, the size of the company and the audit office, the reputation of the company and the audit office, and the client retention period were at reasonable levels in most of the banks in the research sample, as it ranged between 0-100, as it was zero only in (BNOI) Bank, as for the rest of the banks. It was acceptable, ranging between (44% - 100). There is a weakness in the audit quality for the variables specialization in the client's activity, the client's total assets, and the return on assets for the client, as it ranged between (0% - 87%).

3- Dependent research variable: Earnings Management EM:

Earnings Management (EM) is calculated by calculating the total receivables. The Jones model

(1991), modified by Dechow et al. (1995), was used, as most studies indicated that it is considered the strongest among the models used in measuring the quality of profits. The modified Jones model (Jones, 1995) calculates the total receivables

They are then separated into optional accruals (discretionary) and nondiscretionary accruals. Optional accruals express earnings management through the extent of management's influence on manipulating profits, while nondiscretionary accruals express accounting conservatism. The scale is applied through the following steps:

A- Measuring total accruals;

Purpose: To measure total accruals through the difference between net income and adjusted operating cash flow, according to the following

equation:

$TACC_{i,t} = NI_{i,t} - oCf_{i,t}$

Since:

$TACC_{i,t}$: Total accruals of company i in year t

$NI_{i,t}$: net income of company i in year t

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

Table (2): Net income (NI) of companies in the research samples

Average	2022	2021	2020	2019	2018	The bank
16,650	16,016	13,746	25,280	18,532	9,677	Credit
15,169	3,606	20,876	24,282	18,453	8,627	Middle East
30,751	42,753	56,027	36,343	12,470	6,162	Gulf
11,475	10,462	10,689	14,310	7,980	13,934	Commercial
11,498	5,703	7,766	10,746	20,968	12,306	Elaf
18,862	20,596	30,001	19,130	12,557	12,028	Al-Mansour
7,975	6,947	13,874	15,415	2,495	1,142	Al-Ahly
18,389	34,842	31,540	3,417	11,679	10,467	Investment
28,493	32,847	38,797	29,638	24,972	16,211	Baghdad

14,25 5	13,36 7	19,18 6	19,79 6	10,00 6	8,919	Assyria
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Table (2) shows that the highest average net profit was achieved by Al Khaleej Commercial Bank, which amounted to (30,751) million dinars. Al-Ahli Bank also came in last place, reaching (7,975) dinars. It is clear that the banks in the research sample generally had a somewhat acceptable level of profit and did not suffer from a financial deficit.

First: Operating cash flow (CFO).

To calculate adjusted operating cash flow by relying on the following equation:

$$CFO_{i,t} = NI_{i,t} - (\Delta CA_{i,t} - \Delta CI_{i,t} - \Delta Cash_{i,t} - Dep_{i,t})$$

Since:

CFO_{i,t}: Cash flow from the operations of company i during period t

NI_{i,t}: net income of company i during period t

CA_{i,t} Δ: Change in current assets of the company i during period t

CI_{i,t} Δ: the change in current liabilities of the company i during period t

Cash_{i,t} Δ: The change in cash for the company i during period t

Dep_{i,t}: depreciations of the company I during the period

Table (3): Operating cash flow

Average	2022	2021	2020	2019	2018	The bank
-27,868	-2,922	-18,596	-103,408	157,348	-171,760	Credit
-2,624	19,298	54,779	-45,132	-32,427	-9,640	Middle East
-11,138	-31,796	-26,628	28,804	-47,211	21,142	Gulf
-12,795	-158,740	27,379	6,753	30,450	30,181	Commercial
-582	26,266	-	50,417	-37,379	77,687	Elaf
-129,352	-288,680	-	-18,178	-44,804	-65,797	Al-Mansour
-19,480	-31,841	-76,279	37,165	-14,181	-12,264	Al-Ahly
-10,087	91,474	-52,698	2,362	-52,421	-39,151	Investment
-59,870	-85,118	-	-18,061	1,606	-24,848	Baghdad
23,627	32,051	88,890	-85,507	43,990	38,713	Assyria

Table (3) shows that the highest average operating cash flow was Al-Mansour Bank, which amounted to (80,901) million dinars, and this reflects the bank's operational activity, while the lowest average operating cash flow was from Elaf Islamic Bank's share and amounted to (5,150) million dinars, and this reflects weak activity—the bank's operations.

Table (4) Total dues

	2022	2021	2020	2019	2018	The bank
-10,077	-20,149	150,061	-231,578	18,938	32,342	Credit
-39,249	-93,616	-14,842	-38,189	-15,692	-33,904	Middle East
9,624	-122,972	-33,052	46,942	74,549	82,654	Gulf
41,130	35,842	68,971	-51,677	169,202	-16,689	Commercial
28,160	-80,733	98,516	15,913	-20,563	127,665	Elaf
181,039	196,927	-4,338	144,029	309,276	259,301	Al-Mansour
24,686	-97,004	76,174	15,319	38,788	90,153	Al-Ahly
-517	7,643	-12,433	-25,400	-56,633	84,238	Investment
-65,454	-328,986	95,187	-423,161	117,965	211,725	Baghdad
-29,302	4,355	-33,174	-29,305	-18,684	-69,704	Assyria

The values of the total receivables are extracted by subtracting the operating cash flow from the net profit, and any increase in the total receivables is through an increase in net income over the operating cash flows, which represents a form of profit management. However, if the net income is less than the operating cash flows, this indicates The bank's management tends to be

conservative, and the relationship between total receivables and the quality of financial reporting is an inverse relationship. Through our study of Table (4), it was found that the average total receivables for most banks are negative, which reflects that they are conservative and that there is no manipulation of profits, except for the investment, private, Elaf, and commercial banks.

The average values of total receivables were positive, which indicates the presence of earnings management

B- Estimate the slope $\beta_1, \beta_2, \beta_3$ in the following regression model:

The tendency is estimated for the companies in

$$TACC_{i,t}/A_{i,t-1} = \alpha + \beta_1(1/A_{i,t-5}) + \beta_2\{(\Delta REV_{i,t} - \Delta REC_{i,t})/A_{i,t-5}\} + \beta_3(PPE_{i,t}/A_{i,t-5}) + \varepsilon_{i,t}$$

the research sample over the years of research, that is, estimating the parameters of the model used for the purpose of measuring non-discretionary accruals through the regression equation according to the following model:

where

TACC: Total receivables of banks i in year t

$A_{i,t-1}$: Total assets in banks i in year t-1

$REV_{i,t}$: The change in revenues for banks i between years t, t-1

$REC_{i,t}$: The change in debtors to banks i, between

years t, and t-1

$PPE_{i,t}$: fixed assets of banks i in year t

$\varepsilon_{i,t}$ is the random error and expresses the value of the discretionary receivables of banks i in year t

Table (5) Regression coefficients

β_3	β_2	β_1	γ	The bank
5.046	1.385	29,988,819,874	-0.472	Credit
-0.88	-2.444	-5,381,366,775	0.14	Middle East
1.575	0.135	71,025,062,410	0.049	Gulf
-4.702	-1.084	19,183,253,703	0.179	Commercial
-2.424	-2.492	59,692,406,075	0.201	Elaf
6.071	3.686	-114,710,687,074	-0.2	Al-Mansour
814.281-	-8.312	267,208,441,909	0.223	Al-Ahly
3.203	0.014	-1,462,442,428	-0.143	Investment

-0.396	7.24	18,739,103,358	0.036	Baghdad
-56.588	-7.304	350,619,224,498	-0.23	Assyria

It is noted in Table (5) that the slope values fluctuate between negative and positive, and this has an impact on the estimation of non-optional entitlements, which is subsequently reflected in the optional entitlements.

C- Estimating regular (non-optional) dues.

The value of the regular (non-optional) receivables of the research sample companies is estimated during the research years by using the model processor β_1 , β_2 , β_3 extracted in the previous equation in the following equation.

$$NACCI_{i,t} = \beta_1(1/At-7) + \beta_2(\Delta REV_{i,t} - \Delta REC_{i,t}) + \beta_3(PPE_{i,t})$$

Table (6) Regular (non-optional) dues

max	2022	2021	2020	2019	2018	The bank
-	-	-	-	-	-	Credit
159,585	239,974	157,433	120,217	144,945	135,356	
-	-	-	-94,339	-19,219	13,618	Middle East
129,095	160,189	385,348				
122,989	135,394	103,306	167,366	134,116	74,765	Gulf
-	-	-	-	-	-	Commercial
303,456	282,231	352,601	232,842	318,838	330,768	
81,236	18,626	149,091	62,404	266,526	-90,467	Elaf
-14,931	85,964	-109	-	5,294	-799	Al-Mansour
			165,004			
-60,951	-73,368	-76,144	-64,856	-45,975	-44,413	Al-Ahly
27,627	25,049	30,841	29,835	26,168	26,241	Investment
9,991	40,401	-2,380	68,262	-50,942	-5,385	Baghdad
119,887	151,573	128,047	109,086	110,597	100,133	Assyria

The appearance of optional receivables with a negative value indicates that the bank does not practice earnings management, meaning that the quality of profits is high and vice versa. It is clear

from the table above that the banks that have good quality profits throughout the sample years are all (the National Bank, the Commercial Bank, and the Credit Bank), while there are Three banks

managed profits throughout the years of research: (Assyria Bank, Investment Bank, and Gulf Bank).

D- Calculating the optional (extraordinary) accruals (abnormal accruals or discretionary accruals). The total accruals include optional

accruals and non-discretionary accruals. The optional accruals are the result of following profit management, which are extracted by subtracting the non-discretionary accruals from the total accruals according to the following equation:

$$ANASS_{i,t} = TACC_{i,t} - NACC_{i,t}$$

where:

ANASS i,t represents the extraordinary (discretionary) receivables of banks i in year t

Table No. (7)

Max	2022	2021	2020	2019	2018	The bank
101,766	7,385	142,970	267,188	-47,868	139,155	Credit
165,324	212,659	291,733	191,296	52,287	78,647	Middle East
-169,063	-272,344	-226,279	-141,089	-112,785	-92,817	Gulf
330,663	219,430	388,443	355,085	288,312	402,044	Commercial
-184,940	-131,627	-284,793	-191,964	-115,320	-200,998	Elaf
-183,666	-					
	1,734,335	201,297	6,279	132,287	476,143	Al-Mansour
61,055	263	-20,859	106,190	116,035	103,644	Al-Ahly
-45,791	-33,555	-23,198	-32,856	-52,880	-86,468	Investment
-52,503	111,890	-326,606	311,705	-409,208	49,704	Baghdad
-159,867	-157,215	134,672	281,204	-129,451	-127,771	Assyria

Optional accruals are considered a good indicator for measuring the quality of profits, as the appearance of negative values for optional accruals indicates a high quality of profits and vice versa. It is clear from Table (7) that three banks (Elaf, Al-Khaleej, and Al-Istithmar) achieved good profits throughout the years of the research, while we find that the Iraqi Commercial Bank was managing profits throughout the years of the

research. As for the rest of the banks, their results fluctuated between the quality of profits and profit management during the years of research. By compensating the banks that have quality profits with the number (1) and the banks that do not have quality profits with the number (0), and according to the data of the extraordinary (optional) receivables mentioned in Table (7):

Table (8): Earnings management matrix

2022	2021	2020	2019	2018	The bank
0	0	0	1	0	Credit

0	0	0	0	0	Middle East
1	1	1	1	1	Gulf
0	0	0	0	0	Commercial
1	1	1	1	1	Elaf
1	0	0	0	0	Al-Mansour
0	0	0	0	0	Al-Ahly
1	1	1	1	1	Investment
0	1	0	1	0	Baghdad
1	0	0	1	1	Assyria

Second: Statistical analysis.

The purpose is to measure the impact of the quality of external auditing on the profit management of the companies in the research sample over the years through multiple regression analysis using the statistical program Spss. Audit quality variables were entered, namely the size, reputation, specialization, and client retention period of the auditing companies and offices that audited the banks in the research sample during the years of the research, and the results were The statistics are as follows:

Table 9: Descriptive statistics

N	Std. Deviation	Mean	code	Variables
60	0.452	0.53	E.M	administration Profits
60	0.482	0.71	Size	Size of company and audit firm
60	0.473	0.58	Rep	Reputation of the company and the audit office
60	0.611	0.51	Exp	Allocating a company and an audit office in the client's activity
60	0.428	0.76	Per	Customer retention period
60	0.528	0.48	Size	Represents total assets
60	0.524	0.33	ROI	Represents return on investment

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GoalsAdjust goals
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Writing Help
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PrintCtrl+P
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CopyCtrl+C
PasteCtrl+V
Select allCtrl+A
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Support
What's new

Send product feedback
Privacy policy
Terms of service
It is clear from Table (9) that the mean and standard deviation of earnings management and the average and standard deviation of audit quality variables for the companies and audit offices that audited the banks in the research sample during the years of the research. We note that the average of earnings management profits is (53%), which means most of the banks in the research sample. It practices earnings management and has a high level of earnings management. The averages for the size of the company and the audit office, the reputation of the company and the audit office, as well as the period of client retention, are (71%), (51%), and (76%), respectively, which shows us that most of the sample banks First-level external auditors audit the research and has a good reputation in the market, and the client has been retained for more than two years.
Table (10) Correlation matrix
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		EM	Size	Rep	Exp	Per
Pearson Correlation	EM	1	0.524***	.0.621* *	0.551**	0.452** *
	Size	0.524** *	1	0.121**	0.101*	0.227**
	Rep	0.621**	0.121**	1	0.212**	0.214*
	Exp	0.551**	0.101*	0.212**	1	0.216**

n	Per	0.452** *	0.227**	0.214*	0.216**	1
	F.Size	- 0.546** *	0.262*	0.164*	0.113*	-.204**
	ROI	0.328** *	-.152*	-.124*	-.245*	0.231*

By looking at the subvariables separately, most of them are greater than the test reference significance of (0.00). The correlation was strong between the independent variables and the dependent variable. Which means that there is a statistically significant relationship between audit quality and earnings management, and the relationship was negative, which indicates an inverse relationship, meaning that any increase in audit quality will lead to a decrease in the level of earnings management. Which means that there is a statistically significant relationship for any of the variables (the size of the company or the audit office, the reputation of the company or the audit office, specialization in client activity, and the period of client retention) on profit management, thus proving the sub-hypotheses related to the first main hypothesis. That is, there is a statistically significant relationship between the characteristics of the

quality of external auditing and profit management in Iraqi banks. There is also a negative relationship to the characteristics of the quality of external audit in earnings management, and it was as follows
There is a negative and statistically significant relationship between the size of the external audit office and profit management in Iraqi banks
There is a negative and statistically significant relationship between the reputation of the external audit office and profit management in Iraqi banks.
There is a negative and statistically significant relationship between the specialization of an external audit company or library and profit management in Iraqi banks.
There is a negative and statistically significant relationship between customer retention periods and profit management in Iraqi banks.

Table (11) Correlation coefficient

Mo del	R	R Squar e	Adjust ed R Squar e	Std. Error of the Estimate
1	0.55	0.48	0.014	0.512

As for the model summary of the correlation coefficient values between the independent variables and the dependent variable, we find that the value of the simple correlation coefficient R reached (0.55), which means that the independent variables explain (55%) of the variance in the quality of profits, and that the

value of the standard error reached (51. %), and the value of the coefficient of determination (R^2) reached (48%), which means that these measures affect (48%) of the changes that affect earnings management, while the remaining percentage (52%) is affected by other variables that have not been tested. In the search form.

Table (12) Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.463	4	0.425	31.248	0.000
	Residual	31.235	56	0.417		
	Total	33.698	60			

It is clear from Table (12) ANOVAa that the value of (sig), which shows the effect of the The quality of the combined audit on earnings management reached (0.000), which is less than the level of moral significance of (0.05), which means accepting the alternative hypothesis, which states (the existence of a significant correlation between the quality of the audit on earnings management of the banks in the research sample), and what confirms this is the value The explanatory F of (31.248) and Table (13)

shows the strength of the relationship between the measures of the external audit quality characteristics of any of them individually with earnings management, which is represented by the characteristics of the external audit quality through a decrease in the height of the beta, as most of them reached negative values, and that the strongest audit quality measures have an impact on management. Profits are the reputation of a company or audit firm.

Table (13) Coefficientsa

Prob.	t-Statistic	Std. Error	Coefficient	Variable	
				Variable name	code
0.415	-0.8257	0.167	-0.1379	Fixed limit	C
0.000	-5.752	0.3855	-2.218	The size of the audit firm or office	Size

0.000	-4.762	4.7797	-22.76	The reputation of the company or audit office	Rep
0.000	-4.983	0.0233	-0.1159	Allocating an audit company or office in the client's activity	Exp
0.0019	-3.393	1.369	-4.644	Customer retention period	Per
0.666	0.436	1.471	0.6408	Total assets	F.Size
0.778	-0.285	0.2232	-0.0636	Represents return on investment	ROI

The above table clearly shows that the quality characteristics of external auditing have a statistically significant negative effect on earnings management in Iraqi banks. The attributes of audit quality also negatively affect earnings management.

1-There is a negative and statistically significant effect of the size of the external audit office on profit management in Iraqi banks.

2-There is a statistically significant negative and significant effect of the reputation of the external audit office on profit management in Iraqi banks.

3-There is a statistically significant negative and significant effect of the specialization of the external audit company or library on managing profits in Iraqi banks.

4-There is a statistically significant negative and significant effect between client retention periods and profit management in Iraqi banks.

Therefore, the external auditor's commitment to audit quality will effectively reduce the level of profit management in Iraqi banks listed on the Iraqi Stock Exchange.

Conclusions and Recommendations

Conclusions

Through the results of the research, it is possible

to reach the following conclusions:

1-Earnings management is considered a negative approach whenever it aims to distort accounting information, mislead users of financial statements, hide banks' actual operational activity, unrealize estimates, or achieve managers' interests.

2-The study's results indicated that the banks in the research sample practice profit management. This is evident from the model analysis's positive results in most years of the study.

3-Motivations for managing profits in the bank's sample. The research on managing earnings was often aimed at showing good performance, in addition to the mandatory application of international financial reporting standards, which allow flexibility in applying accounting practices.

4-It became clear that the banks in the research sample were subject to external auditing that was characterized by quality. Most of these banks had specialized auditors with good reputations and large staff, and they were working to change the auditor voluntarily to ensure the quality of the audit.

5-The results of testing the research hypotheses made it clear that the quality of auditing impacts profit management through the negative correlations that appeared in the research results.

This means that any increase in the quality of auditing works to reduce the level of profit practice by the banks in the research sample due to the auditors' commitment to external standards of ethical behavior.

6-The results of testing the research hypotheses made it clear that the quality of external auditing affects profit management and that this effect is negative. This means that any increase in auditing quality will contribute to reducing profit management in the bank's sample of the research.

RECOMMENDATIONS

In light of the conclusions reached by the researcher, she recommends the following:

1-Banks should avoid any means that could lead to the use of earnings management that is inconsistent with ethical behavior that requires management's commitment to it. This includes preventing deliberate interventions to influence bank performance and misleading users of their financial statements.

2- Banks should make more efforts to contract with external auditors whose work is of high quality because of this great importance in reducing profit management, which contributes to generating quality accounting information and reduces the chances of practicing profit management.

3-Intensifying efforts between the relevant authorities represented by the Iraqi Stock Exchange, the Iraqi Accounting and Regulatory Standards Board, and professional organizations to support regulatory activities, follow up on bank management, and monitor them effectively to reduce opportunities to exploit the flexibility available for accounting practices in international financial reporting standards.

4-Banks should make more efforts to contract with high-quality external auditors because this is of great importance in reducing profit management. This contributes to generating quality accounting information and reduces the chances of practicing profit management.

4-Make efforts to educate bank management about the negative effects of earnings

management and that it does not represent an appropriate solution to demonstrate banks' good performance because this solution is not sustainable in the long term, which causes banks to collapse and go bankrupt.

6-Banks must strive to change the auditor regularly over the years to ensure dependence and not be affected by the bank's management through the length throughout.

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