



## Earning opacity and Bank stability: Evidence from the Iraqi Banking Sector

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### Abstract

This study aims to investigate the impact of earnings opacity on banking stability in the Iraq Stock Exchange. The extent that earnings opacity exists is measured by the discretionary portion of loan loss provisions, and bank stability is captured through the Z-score as an overall measure for probability of financial distress. By employing panel data regression models with several control variables, we find that earnings opacity has a positive and significant effect on bank stability. This result implies that the use of accounting flexibility can serve as a risk-taking instrument in less informationally efficient and more institutionally unstable banking markets. The findings also support the positive and significant impact of profitability on improving bank stability. This paper contributes to the available literature as we empirically demonstrate, using evidence from an emerging market, that the effect of earnings opacity on stability varies significantly with institution-specific and country-specific conditions.

**Keywords:** Earnings Opacity; Bank Stability; Loan Loss Provisions; Z-score

### 1. Introduction

Banking sector stability has received increasing attention in the economic and financial literature, reflecting the pivotal role banks play in supporting economic growth, channeling financial resources, and safeguarding the efficiency of the financial system. Recurrent banking crises have demonstrated that instability within the banking sector extends beyond individual institutions, often generating systemic spillovers that can disrupt the broader financial system



and impair macroeconomic performance. Such risks are particularly pronounced in developing economies, where regulatory frameworks tend to be weaker and uncertainty is more pervasive, thereby amplifying the vulnerability of the financial system to shocks (Laeven & Valencia, 2018; Riahi-Belkaoui & AlNajjar, 2006).

Within this context, the quality of accounting information and the degree of financial transparency emerge as critical determinants of banking stability. Prior research emphasizes that financial reporting constitutes a primary channel through which banks communicate with key stakeholders, including investors and regulatory authorities. When transparency deteriorates or earnings opacity increases, stakeholders may face greater difficulty in accurately assessing banks' underlying risk profiles and financial conditions (Ryan, 2018). Earnings opacity refers to the extent to which accounting information fails to clearly reflect a firm's economic performance, often arising from managerial discretion in financial reporting, limited voluntary disclosure practices, or the institutional environment in which firms operate (Bhattacharya et al., 2003; Riahi-Belkaoui & AlNajjar, 2006).

Result between earnings opacity and bank soundness remains inconclusive both theoretically and empirically. On one hand, there is some empirical evidence that greater opacity increases informational asymmetry and undermines market discipline which in turn can weaken financial stability. Conversely, a related literature argues that opacity can be an equilibrium phenomenon in some cases, especially those found in emerging market economies, as it allows banking sectors to cushion shocks and limit over-reaction (Dang & Huynh, 2024; Sowerbutts et al., 2013). This discrepancy calls attention to the role of institutional and economic environments in determine the effect of earnings opacity on banking stability.

Based on the above gap, this paper tries to investigate the influence of ignorance of earnings toward bank stability in Iraq. The sample of the study includes banks listed on Iraq Stock Exchange for a period of 10 years and annual published financial reports are used. The study anticipates an association between the level of earnings opacity, as measured by



discretionary loan loss provisions, and bank stability as proxied by Z-score. This relationship may account the behavior of banking sector in developing countries, where accounting opacity can be used as a risk management tool and a cushion towards economic shocks and is not purely destabilizing issue.

This research contributes to several aspects of accounting/banking literature. First, it presents a new empirical testing on the effect of earnings opacity on bank stability in an emerging market that has not been explored by previous literature, thereby adding to and broadening existing evidence beyond context-sensitive prior results. Second, the paper relies on a state-of-the-art empirical method to estimate earnings opacity with discretionary loan loss provisions that follows recent advances in the literature. Third, anticipated results are relevant to the current discussion on the two-way nature of banking opacity: as a potential fuel of risk and as an instrument for stabilization in institutional environments made fragile. Finally, the study has practical implications for both Iraqi policy makers and regulators who should give due importance of accounting transparency and supervisory policies towards strengthening banking stability in Iraq.

## **2. Literature Review**

The literature on earnings opacity emerged from an earlier stream of research concerned with the quality of accounting information and its implications for market efficiency. More recent studies suggest that earnings opacity reflects the limited ability of financial reports to faithfully represent firms' underlying economic performance, thereby increasing information asymmetry between issuers and investors. As transparency declines, pricing mechanisms and market discipline tend to weaken, undermining overall market efficiency. In this regard, Bhattacharya et al. (2003) provide compelling evidence that higher levels of earnings opacity are associated with increased costs of capital and reduced market efficiency, arguing that opacity constitutes a real economic cost borne by less transparent economies. Similarly, Riahi-Belkaoui



& AlNajjar (2006) emphasize that earnings opacity is shaped not only by accounting practices, but also by broader social, economic, and institutional factors, which constrain the cross-country generalizability of empirical findings unless institutional contexts are explicitly taken into account.

As the literature progressed, scholarly attention shifted from defining earnings opacity toward examining its key antecedents, particularly the role of accounting standards and corporate governance mechanisms in mitigating or amplifying opacity. A growing body of evidence indicates that weak governance structures such as ineffective boards of directors and low-quality external auditing create conditions that facilitate greater managerial discretion and higher levels of earnings opacity, especially in emerging market settings (Shemshad, 2024; Yeung & Lento, 2020). In contrast, some studies suggest that the adoption of International Financial Reporting Standards may enhance transparency and reduce opacity; however, these effects are neither uniform nor automatic. As Takamatsu & Fávero (2017) note, the impact of IFRS adoption is highly contingent on the strength of the legal environment and enforcement mechanisms. This divergence in findings implies that formal accounting reforms alone may be insufficient to curb earnings opacity in the absence of deeper institutional and governance improvements.

In addition to its antecedents, the market consequences of earnings opacity have been explored in an emerging stream of the literature relating to investor reaction and asset pricing. Chen et al (2018) show that greater opacity of earnings is associated with larger price discounts in closed-end country funds, suggesting that foreign investors punish for low transparency. In a similar spirit, Nguyen et al (2024) illustrate that firms can use other practices such as corporate social responsibility activities manifestations of the effects that opaque financial reporting. Such findings indicate that the effects of earnings opacity spread beyond financial statements to impact firm investment decisions and more general corporate conduct.

In the banking sector, earnings opacity is particularly pronounced due to the central role banks play within the financial system and the extensive managerial discretion embedded in



certain accounting practices, most notably loan loss provisions. Prior empirical evidence indicates that credit loss provisioning constitutes the primary source of earnings flexibility in banks, as it grants managers considerable discretion in estimating expected credit losses, which may be exploited for opportunistic purposes (Bikker & Metzmakers, 2005). Furthermore, Bushman (2016); Ryan (2018) argue that forward-looking provisioning designed to smooth earnings dampens discipline over risk-taking, consistent with diminished transparency inhibiting outside monitoring. In contrast, forward-looking provisioning reflecting timely recognition of expected future loan losses is associated with enhanced risk-taking discipline.

Note however, that this traditional perspective where opacity and the gap it creates are seen as a destabilizing tool is being programmed against in later literature: there appears to be no one-way view of how to deal with opacity. Sowerbutts et al (2013) argue that the relationship between disclosure and financial stability may be non-linear because more transparency can lead to excessive market response in some situations. In this vein, Dang & Huynh (2024) offer empirical evidence from an emerging market of the positive relationship between earnings opacity proxied by discretionary loan loss provisions and bank stability proxied by the Z-score. Their results suggest that earnings management is more important for the financial stability of smaller banks. Further, the effect of financial information disclosure on bank stability is strengthened by unfavorable macroeconomic conditions, particularly economic downturns, the global financial crisis and uncertain times in banking..

More broadly, the literature on banking regulation and supervision emphasizes that the role of transparency in promoting financial stability cannot be viewed in isolation from the effectiveness of supervisory and regulatory frameworks. Prior studies demonstrate that weak legal and institutional capacity significantly undermines the ability of financial information to enhance market discipline and stability (Barth et al., 2004; Bushman & Landsman, 2010). Moreover, evidence from banking crisis analyses suggests that inadequate transparency has often contributed to the severity of systemic failures by delaying corrective actions and obscuring the



buildup of risks within the financial system (Georgescu & Laux, 2007; Laeven & Valencia, 2018). Taken together, this body of research indicates that the impact of earnings opacity on banking stability is deeply embedded within a broader institutional context and cannot be fully understood independently of regulatory and supervisory conditions.

Nevertheless, notwithstanding the expanding literature, empirical evidence from Arab banking systems characterized by underdeveloped markets and low market efficiency remains limited, particularly in the presence of distinct regulatory and institutional settings. Additionally, conflicting findings found in previous research implied that the effect of earnings opacity on bank stability might be contextually specific rather than universally existent. Therefore, there is both a requirement and an opportunity for empirical research that explores this link in other institutional settings like the context of Iraq's banking industry to better understand the role played by earning opacity in bank stability.

### **3. Theoretical Background and Hypotheses Development**

#### **3.1 Information Opacity in the Banking Sector**

The banking industry has been often cited as among the most information opaque relative to other industries of business, thus emphasizing transparency in accounting and financial research. This lack of transparency is because banking business is unique. Banks engage in financial intermediation by turning short-term deposits into long-term loans and investments, creating a complex risk structure that is not easily discernible to outsiders. In this context, Morgan (2002) characterizes banks as opaque institutions in themselves, because of the difficulty of appraising their asset quality and the riskiness of their loans relative to non-financial enterprises.

This opacity is further reinforced by banks' heavy reliance on loans and other financial assets that lack readily observable market prices. The valuation of such assets depends largely on forward-looking assumptions regarding borrowers' repayment capacity rather than transparent



market signals. Unlike physical assets, financial assets are therefore more closely tied to uncertain expectations about future economic and credit conditions, which widens information asymmetry between bank managers and external stakeholders. Consistent with this view, Adrian & Ashcraft (2012) argue that the opacity inherent in banks' asset structures represents a fundamental source of fragility in the financial system, particularly during periods of economic stress.

Moreover, accounting discretion is the main element contributing information opacity in banking sector. Banks have extensive judgment in using accounting estimates, such as beneficiaries for expected losses, financial asset values and revenue recognition. While it is commonly believed that this flexibility will enable firms to more closely mirror the underlying economic environment in their financial reports, it can also be used with the purpose of earnings management or income smoothing over time and therefore reduce the transparency of financial statement information (Bikker & Metzmakers, 2005; Bushman, 2016). Beatty & Liao (2014) also argue that credit loss provisions represent one of the most judgment-sensitive accounting measures and, therefore, there is significant variation in the quality of reported numbers across banks.

Banking information opacity is not only related to accounting procedures, but also determined by regulatory and supervisory rules affecting banking activity. While more heavily regulated than nonfinancial institutions, banks may be affected by adverse consequences from regulation such as reduced incentives to voluntarily disclose or to undertake actions that reduce risk or take other risks that might catch supervisory notice and lead promptly to intervention (Bushman & Landsman, 2010). Furthermore, poor efficiency in financial markets a common trait of most emerging economies undermines the market's role in bringing accounting opacity to light and disciplining non-transparency behavior.

In sum, information opacity in the banking industry is a multifaceted result of the interaction between banking activities, structure of financial assets, discretion in accounting



practices and collateral settings. These inter-related factors form the theoretical base on which modern research analyses the effects of bank opacity on banking behavior and systemic stability in general.

### **3.2 Earnings Opacity and Loan Loss Provisions**

The degree of earnings opacity in the banking industry is linked to loan loss provisions, which are known in the academic literature as one of the most discretionary accounting factors. The purpose of loan loss provisions is to take account for expected credit losses that may result in connection with borrower defaults, although estimating said losses entails a high degree of ambiguity. The one factor which causes this uncertainty is the forward nature of provisioning that it relies on expectation for macroeconomic conditions, credit portfolio standards, and behavior of repayment in case of borrowers.

Early research also highlights that loan loss provisions are not only for prudential purposes but could be used to manage earnings over time. In addition, based on the research of Bikker & Metzmakers (2005), banks could be artificially boosting provisions in good times so as to create hidden reserves to allow them then to release these provisions when economic conditions are less favorable and thus manage earnings or their volatility. These practices further increase earnings opacity, as financial statements are less able to provide a reliable reflection of the short-run economic performance of banks.

With the developments in the literature, a discussion on separating non-discretionary and discretionary components of loan loss provisions has been identified as being core to scrutinizing earnings opacity. The non-discretionary part is usually determined by certain factors that are observable and can be justified through such credit demand or problem loan status, while



the discretionary portion reflects managerial actions under incentives associated with earnings management, capital regulation, and regulatory compliance. An expanding literature finds that it is precisely this discretionary part which represents the main driver of earnings opacity in banks since it is not easily observed by investors and regulators (Bushman, 2016; Ryan, 2018).

This concern is all the more relevant in banks operating under conditions of low market efficiency and disclosure, which handicaps market disciplinary mechanisms against discretionary action. In these settings, the earnings opacity linked to loan loss provisions can be considered as a normal consequence of the tension between accounting flexibility and institutional or regulatory pressures. Beatty & Liao (2014) highlight differences in bank-implied estimates of credit losses as illustration of the magnitude of this differentiation in reported financial numbers across banks within a single banking system.

While opacity in the earnings due to the loan loss provisions is typically assumed as a result information asymmetry, studies on more recent will provide further reasons for this relationship being less than straightforward in banking. Some flexibility in accounting, perhaps allowing banks to take on credit shocks and reduce profit volatility over the cycle (not just through pro-cyclical overlays) is for example necessary in times of economic turmoil. Therefore, the link between loan loss provisions and earnings opacity is not necessarily negative, but at least it is context dependent with regard to institutions and system level features of banking.

Taken together, loan loss provisions are a reasonable and commonly used surrogate measure for earnings opacity in the banking industry, as they involve substantial amounts of accounting discretion and directly affect reported financial statements and performance. This foundation has been built on in modern-day empirical work that measures earnings opacity and investigates how it affects bank behavior and financial stability.



### 3.3 Earnings Opacity and Bank Stability

This is quite important but less detail has been given to link earnings obfuscation and bank stability. The connection between best earnings and lean earnings and bank stability has garnered increased consideration in the accounting and finance literatures, there is, however yet considerable theoretical empirical controversy. From a mainstream viewpoint, numerous researches suggest that the higher earnings opacity is, the more serious information asymmetry between bank managers and market participants becomes, leading to a decrease in market discipline and hindering investors and regulators from efficiently penetrating banks' real riskiness. According to this view, less accounting transparency leads to the build-up of hidden risks in the banking system and raises financial-system instability.

This is consistent with evidence indicating that financial opacity especially stemming from accounting discretion generosity masks the need for regulatory intervention and impairs the efficacy of market-based monitoring, further heightening banks' exposure to economic slack or banking crises. In this regard, Bushman & Landsman (2010) suggest that a lack of transparency can limit accounting information's ability to discipline bank behavior, while Ryan (2018) observes that low FRQ increases the mispricing of risk and vulnerability to systemic shocks.

On the other hand, new works do not take a one-way perspective regarding the opaqueness of earnings and bank health, but some complicated frame is expected for this relationship, and that may be subject to differential impacts under institutional settings and levels of market efficiency. The existence of some opacity may be consistent with a cautious attitude that exists in the banking sector, particularly if environments exhibit weak market efficiency and high economic volatility. In such environments, opacity considerations can dampen the market overreactions, and banks can better absorb the shocks (Bushman, 2016; Bushman & Williams, 2012). Conforming to this argument, Dang & Huynh (2024) empirically



report from a frontier market that earnings opacity proxied by discretionary loan loss provisions is positively linked to bank stability.

Furthermore, Sowerbutts et al (2013) note that the association between earnings opacity and financial stability may be nonlinear, meaning that too much transparency may exacerbate rather than mute volatility under some conditions. Likewise, Dang & Huynh (2024) study that earnings opacity proxied by discretionary loan loss provisions has a positive sign with bank stability when measured by Z-score in an emerging country. The results are interpreted as indicative of the fact that accounting opacity may allow banks more freedom to manage earnings and risks, thus promoting stability under economic uncertainty.

Notwithstanding these conflicting results, a recurrent pattern in the literature is that repercussions of the relationship between earnings opacity and bank stability cannot be examined in isolation from banks' institutional and regulatory climate. Weak supervisory system, lack of relevant disclosure and financial market being relatively less efficient – characteristics that are common in many emerging markets – and the dependent relationship may be different.

In the presence of such theoretical and empirical anomalies, the relationship between earnings opacity and bank stability over varied banking environments clearly requires closer scrutiny. The examination of the mechanisms by which such externalities occur is necessary for understanding whether earnings opacity acts predominantly as a destabilizing agent or as a buffer against risk in terms of allowing banks to absorb shocks. The persistent argument offers a theoretical basis for the current study's central hypothesis that seeks to assess the effect of earnings opacity on bank stability in Iraqi banks.

### **3.4 Hypotheses Development**

The current theoretical and empirical evidence suggests that the association between opacity of earnings and bank stability is multi-faceted and highly contingent on specific



conditions in different settings. Though conventional wisdom posits a positive relationship between earnings opacity and information asymmetry, market discipline and risk within banks—and thus a threat to financial stability (Bushman & Landsman, 2010; Ryan, 2018) the literature has embraced the possibility of an offsetting effect of opacity under high-information environments like our own in which periodic GDP growth does not lead to increased bank lending. More specifically, in emerging economies with less efficient markets that exhibit less disclosure and more uncertainty, higher levels of account opacity may allow banks to manipulate earnings, maintain lower earnings and absorb a credit shock, not allowing the market to overreact to consternations (Bushman, 2016; Sowerbutts et al., 2013). This view is also supported by empirical evidence from developing countries, which indicates that earnings opacity proxied by discretionary loan loss provisions might be positively related to bank stability (Dang & Huynh., 2024).

Given these mixed findings, the effect of earnings opacity on bank stability remains an empirical issue, leading this study to test the following hypothesis:

***H: Earnings opacity has a significant effect on the stability of banks listed on the Iraq Stock Exchange.***

## **4. Research Design**

### **4.1 Sample Description and Data Sources**

The current study takes a positivistic approach to investigate the impact of earnings opacity on bank stability in the Iraqi banking industry. The study population includes all 21 commercial banks in Iraq those listed the ISX. After controlling for data access and persistence,



a final sample of 18 banks is identified after excluding the banks with incomplete observations or irregular financial reporting during the sample period. The span of ten years studied in this paper is expected to capture both time-series variation and cross-sectional disparity across banks, which contributes to the robustness of our empirical findings. This time period is considered suitable for testing the association between earnings opacity and bank stability under a banking industry context affected by economic and institutional transformation.

All data in this work are from credible secondary sources. Financial data come from the annual financial reports available in the official site of the Iraqi Securities Commission for sampled banks, they are also audited financial statements. Market information – including stock prices and trading volume is obtained from the Iraq Stock Exchange website and annual reports issued by the Iraqi Securities Commission, respectively. Using these official sources helps maintain data quality and trustworthiness.

## 4.2 Measurement of Variables

Table 1 presents the definitions of the variables and their measurement methods.

**Table 1 variables definitions and measurement**

Variable	Symbol	Measurement / Definition	Source / Construction
Bank Stability	Z-score <sup>1</sup>	$Z = \frac{\left(ROA + \left(\frac{Equity}{Assets}\right)\right)}{\sigma(ROA)}$	Constructed following Dang & Huynh, (2024); Laeven & Valencia, (2018)
Earnings Opacity	DLLP	Absolute value of residuals from the loan loss provisions model	Estimated from LLP model

<sup>1</sup> The Z-score is widely used to measure bank stability, as it reflects the distance from insolvency by combining profitability, capital adequacy, and earnings volatility. Higher values of the index indicate greater stability and a lower probability of bank distress, whereas lower values signal increased risk. Due to its ability to provide a comprehensive assessment of banking stability, the Z-score is commonly employed in empirical studies on financial stability.



**Table 1 variables definitions and measurement**

Variable	Symbol	Measurement / Definition	Source / Construction
Loan Loss Provisions	LLP	Loan loss provisions scaled by lagged total assets	Financial statements
Return on Assets	ROA	Net profit divided by total assets	Financial statements
Capital Ratio	CAP	Total equity divided by total assets	Financial statements
Bank Size	SIZE	Natural logarithm of total assets	ln(Total Assets)
Leverage	LEV	Total liabilities divided by total assets	Financial statements
Loan Growth	LG	Annual change in total loans scaled by total assets	Constructed
Loans to Assets	LTA	Total loans divided by total assets	Financial statements

### 4.3 Model Specification

The purpose of this paper is to investigate the impact of earnings opacity on the stability of Iraqi banks cited in the Iraq stock exchange market, applying an econometric model inferred from panel data containing both temporal and sectional aspects. The use of panel data is especially applicable to the nature of the present study since it provides an opportunity to account for within bank differences over time and unobserved heterogeneity that could affect stability in banks.

The Z-score is used as dependent variable as a determinant of the bank stability in the model and earnings opacity is accepted as a crucial independent determinant and it has been proxied by discretionary loan loss provisions. Besides this, the model incorporates some control variables partly because they have been highlighted in previous studies as important factors which determine banking stability and so as to hold constant the other effects on banking stability; such as bank size, financial leverage or profitability, loan growth and the loans-to-assets ratio.

Accordingly, the study model can be specified as follows:



$$Z_{it} = \beta_0 + \beta_1 DLLP_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GR_{it} + \beta_6 LTA_{it} + \varepsilon_{it}$$

where the variables are defined in Table 1.

## 5. Empirical Results

### 5.1 Descriptive Statistics

Table 2 Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max	Obs.
Z	2.60	3.49	0.01	18.08	180
DLLP	0.07	0.10	0.00	0.41	180



**Table 2 Descriptive Statistics**

Variable	Mean	Std. Dev.	Min	Max	Obs.
ROA	0.01	0.02	-0.06	0.09	180
SIZE	27.67	1.02	25.94	30.21	180
LEV	0.87	0.08	0.61	0.98	180
GR	0.02	0.21	-0.62	0.61	180
LTA	0.39	0.15	0.00	0.73	180

The descriptive statistics displayed in the table 1 indicate a considerable heterogeneity in the degree of bank stability, which is indicated by the sample average Z-score of 2.60 and a high standard deviation equal to 3.49 consequence. This suggests there are great disparities among the listed Iraqi banks in terms of loss absorption and risk tolerance. The relatively large maximum of the Z-score (18.08) also indicates that some banks are much more stable than others.

Regarding the magnitude of earnings opacity (DLLP), its mean is 0.07 and its standard deviation is 0.10, which implies heterogeneity in how much banks use-Accounting discretion in recognizing loan-loss provisions. This finding adds further credence to the validity of DLLP as a measure of earnings opacity in the Iraqi banking sector, since it provides evidence that it reflects significant differences in accounting and discretion patterns among banks.

Concerning the control variables, bank size has a rather small dispersion, demonstrating some form of homogeneity over the size for listed banks. Measures profitability (ROA), loan growth, and the loan-to-assets ratio exhibit pronounced diversity that can be attributed to differences in operating tactics and risk exposure from bank to bank. Furthermore, the



comparably high leverage ratios show that Iraq's banks are highly dependent on outside financing.

As a whole, the descriptive statistics reveal that the sample enjoys a sufficiently large amount of variability with no substantial outliers, which justifies using it in its econometric modeling and testing models to examine the effect earnings opacity on stability among Iraqi listed banks.

**Table 3 Correlation Matrix**

Variables	Z	DLLP	SIZE	CAP	LEV	ROA	GR	LTA
Z	1.00							
DLLP	0.08	1.00						
SIZE	0.09	-0.23	1.00					
CAP	0.00	0.03	-0.36	1.00				
LEV	-0.07	-0.13	0.17	-0.08	1.00			
ROA	0.04	0.19	-0.26	0.09	0.05	1.00		
GR	-0.04	-0.12	0.19	0.00	0.08	0.03	1.00	
LTA	0.03	-0.15	0.23	-0.10	-0.10	0.14	0.07	1.00

The values of the correlation coefficients between independent variables and dependent variable (Z) are quite low in the correlation matrix, and no strong linear relationship exists there to which some powerful bias can be attributed about model estimation. Further, the inter correlations among the independent variables also fall within acceptable ranges as absolute values are typically less than 0.40. This indicates that Multicollinearity problem was also absent in the estimated model. In general, these findings justify the adequacy of treating the specified variables together in regression analyses.



## 5.2 Baseline Regression Results

**Table 4 Regression Results: Earnings Opacity and Bank Stability**

Variable	Coefficient	Std. Error	t-Statistic	p-value
DLLP	32.77	17.24	1.901	0.063 *
ROA	3.39	1.18	2.878	0.006 ***
CAP	0.50	2.34	0.202	0.832
LEV	-2.12	1.97	-1.076	0.291
SIZE	-0.09	0.41	-0.230	0.818
GR	0.84	1.25	0.666	0.509
LTA	1.63	1.53	1.065	0.293
Constant	-7.03	3.87	-1.815	0.077 *
N	180			
R <sup>2</sup>	0.52			

There is a positive effect that earning opacity (DLLP) has on the bank's stability; that is to say, it stands at coefficient 32.77 at the 10% level, which is statistically significant. This evidence is consistent with the notion that bank opacity might serve as a protective role in emerging banking markets. It is also in line with threads of the more recent literature that argue accounting flexibility, especially loan loss provisions, will allow banks to absorb shocks and reduce short-term earnings volatility.

The findings further report that profitability (ROA) is positively significant at the 1% level of significance on bank stability. This implies that more profitable banks are in a better position to absorb risks and ensure financial stability. This result is consistent with theoretical



predictions and previous empirical evidence, which confirm the significant contribution of profitability towards improving bank stability.

In contrast, the remaining control variables, such as the capital ratio, financial leverage, bank size, loan growth and loans-to-assets, have no significant relationship with bank stability over the period of study. These findings imply that the influence of these variables may be constrained or mediate in the Iraqi banking environment, or it might coexist with other institutional and regulatory features which are not directly included in our model.

In conclusion, the regression results support that the model is a good explanation for the stability of Iraq-listed banks and partially support this study's main hypothesis and further indicate that both earnings opacity and profitability are fundamentally important in explaining levels of bank stability.

### **5.3 Discussion of Results and Linkage with Prior Literature**

The baseline regression estimates reveal that DLLP is positively related to the stability of listed Iraqi banks with a positive and significant (at 10%) coefficient. This result indicates that the higher degree of earnings opacity using discretionary loan loss provisions as a gauge might even contribute to stabilizing bank health and not just damaging it. Such an outcome can be explained in terms of attributes endemic to the Iraqi banking sector, characterized by very low levels of market efficiency and feeble market discipline. In this sense, accounting opacity might allow banks the flexibility to absorb credit shocks and smooth short-term volatility of earnings.

This result is also in line with the results reported by Dang & Huynh (2024), who provide support for a positive association between bank opacity and stability in an emerging country, suggesting that accounting discretion may serve as a preventive mechanism to overcome incomplete institutional frameworks. It is also consistent with the findings put forward by Bushman (2016); Sowerbutts et al (2013), who posit that the relation between



transparency and financial stability could not be linear but concluded instead that constraining too much the level of information released may lead sometimes to an exacerbation of market reactions which tend to destabilize banking systems, in particular in less efficient markets.

In contrast, this finding contradicts the conventional literature that perceives earnings opacity as a cause of information asymmetry increase and market discipline weakening, and therefore exacerbating financial stability (Bhattacharya et al., 2003; Bushman & Landsman, 2010). This deviation may be due to the institutional setting, since these studies are for developed economies with more efficient financial markets in which opacity would have an even stronger negative effect than in emerging countries.

On the profitability (ROA) side, the findings indicate a significant and positive impact on bank stability at the 1% level of significance. This shows that more profitable banks have a relatively stronger capability to construct sufficient loss-absorbing safety buffers and hence improve their financial soundness. This result validates extant evidence that profitability is a key fundamental aspect enhancing bank stability and minimizing the probability of distress (Ryan, 2018; Laeven & Valencia, 2018).

In sum, the findings of this study add to the current literature on earnings opacity and bank stability by offering evidence from an under-investigated emerging market environment. They also emphasize that the effect of earnings opacity on bank stability is not consistent in all contexts but depends on country-level institutional and economic conditions faced by banks. This also emphasizes the need to empirically assess the role played by earnings opacity for banking stability in alternative settings.

## **6. Conclusions**

This study examines the impact of earnings opacity on the stability of listed Iraqi banks in an emerging country like Iraq, specifically on the Iraqi Stock Exchange market, with panel



data covering 18 banks over ten years. The findings present a positive and statistically significant impact on bank stability in terms of earnings opacity proxied by discretionary loan loss provisions. This result implies that Iraqi banks use their accounting flexibility to act as a preventative mechanism in the Iraqi banking sector of managing credit shocks and short-term earnings volatility.

The findings also show that profitability is an important factor in explaining bank stability; the other control variables are not statistically significant. The results suggest that the effect of earnings opacity on bank soundness is very much context dependent, which highlights the importance of regulatory and accounting standards that take into account particular settings in banking systems in emerging markets.

## **7. Policy Implications and Recommendations**

Several policy Recommendations can be suggested in view of the results of this study. First, Iraqi capital-market regulatory and monitoring authorities responsible for regulation of the country's financial reporting—including its banks—should embrace a mixed/balanced approach to financial-reporting regulation that discourages opacity but also does not discourage the accounting flexibility required vis-à-vis how institutions manage risk and withstand credit shocks in an economy seeking equilibrium from rampant economic instability. Second, the quality of accounting information (and more particularly, estimation of loan loss provisions) should be improved by better regulatory guidance and greater conformity with estimation practices. These kinds of measures would serve to constrain the excessive power of school managers while retaining its cautionary function. Third, profitability is found to be critical in underpinning bank stability, which calls for the need for incentivizing banks to further enhance efficiency and resource utilization. Lastly, the results may help policymakers in formulating a regulatory system that captures the unique features of the Iraqi banking sector and thus supports financial soundness in the medium-to-long term.



## 8. Limitations and Future Research

However, this study has some limitations that should be considered when interpreting the results. The sample is also limited to Iraqi companies listed in the stock exchange, thus, generalization of findings may be constrained. Moreover, the examination further uses voluntary loan loss provisions as a proxy for earnings opacity and the Z-score to represent only one dimension of bank soundness, which may not be able to fully capture all dimensions of these constructs.

Hence, further studies may conduct the analysis using other measures of earnings opacity or bank soundness including risk based market indicators and systemic stability. In addition, further research might extend the sample to address longer time horizons or to bilateral country comparisons and directly test the mediating or moderating effects of institutional and regulatory variables on the relationship between earnings opacity and bank stability.

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