

The Role of Bank-Affiliated Directors in Monitoring Earnings Management and Improving Financial Reporting Quality: Evidence from Banks Listed on the Iraq Stock Exchange

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Abstract: The primary objective of this study was to examine the monitoring role of bank-affiliated directors (BAFD) in relation to earnings management (EM) and financial reporting quality (FRQ) among banks listed on the Iraq Stock Exchange. To this end, panel data from 15 banks covering the period from 2015 to 2023 were analyzed, yielding 135 bank-year observations. The research hypotheses were tested using panel regression models and the estimated generalized least squares (EGLS) method, incorporating cross-sectional weights and random effects, as appropriate. Diagnostic procedures included panel unit root tests, the Chow F-test, the Hausman test, multicollinearity assessment, and heteroskedasticity tests. The findings indicated that the presence of bank-affiliated directors had a significant negative effect on earnings management, suggesting that a greater representation of such directors reduces earnings manipulation in banks. This variable also had a significant positive effect on financial reporting quality, thereby improving the transparency and reliability of financial information. However, the moderating effects of bank size and free cash flow on the relationship between bank-affiliated directors and earnings management were not supported. Among the control variables, bank size had a negative effect on earnings management, whereas return on assets had a positive effect on financial reporting quality. Overall, the results indicate that the presence of bank-affiliated directors can function as an effective corporate governance mechanism for improving financial reporting quality and constraining opportunistic managerial behavior in emerging markets.

Keywords: bank-affiliated directors, earnings management, financial reporting quality, corporate governance, Iraqi banks, panel data, EGLS, emerging markets

1. Introduction

Financial reporting is a central component of corporate governance because it reduces information asymmetry, supports contracting, facilitates capital allocation, and enables shareholders, creditors, regulators, and other stakeholders to evaluate managerial performance. The usefulness of financial statements depends not merely on compliance with accounting rules but also on the extent to which reported earnings faithfully reflect underlying economic performance. Accounting information affects firm valuation because earnings and book values provide fundamental inputs for assessing expected future cash flows and equity value [1]. Nevertheless, the informational value of financial statements may weaken when

managers exercise accounting discretion opportunistically or when reported numbers fail to capture relevant economic conditions [2]. The persistence, predictability, smoothness, conservatism, value relevance, and accrual quality of earnings have therefore become important dimensions of financial reporting quality because these characteristics influence investors' assessments of risk and expected returns [3]. High-quality reporting also strengthens debt contracting and governance by allowing external parties to monitor managerial decisions and enforce contractual restrictions more effectively [4]. In banking institutions, the importance of credible reporting is particularly pronounced because banks operate with high leverage, complex financial instruments, extensive regulatory obligations, and substantial informational asymmetry between insiders and outside stakeholders. Weak reporting quality in this sector can conceal asset deterioration, distort assessments of profitability and solvency, and undermine confidence in the broader financial system.

Earnings management represents one of the most significant threats to financial reporting quality. It generally arises when managers use judgment in financial reporting or structure transactions to modify reported accounting outcomes, either to mislead stakeholders regarding economic performance or to influence contractual consequences. The distinction between legitimate managerial discretion and opportunistic manipulation remains conceptually difficult because accounting standards necessarily allow judgment in estimating provisions, impairment, loan losses, and accruals [5]. Early empirical research developed models for estimating discretionary accruals as proxies for earnings management. The Jones Model sought to separate normal accrual changes associated with economic activity from discretionary adjustments potentially attributable to managerial intervention [6]. The Modified Jones Model subsequently refined this approach by adjusting for changes in credit sales and has become one of the most widely applied methods of detecting accrual-based earnings manipulation [7]. However, research design choices, model specification, measurement error, and the economic determinants of accruals can materially affect the validity of earnings-management estimates [8]. For this reason, earnings management should be interpreted in conjunction with the institutional setting, governance arrangements, managerial incentives, and financial characteristics of the firms under examination.

The consequences of earnings management extend beyond temporary distortions in accounting figures. Accruals contain information about anticipated cash flows, but their discretionary components may be less persistent and more susceptible to estimation error than cash-flow components of earnings [9]. Managers may exploit this distinction by accelerating revenues, postponing expenses, adjusting loan-loss provisions, or altering other estimates to achieve targeted earnings outcomes. Evidence concerning earnings momentum suggests that managerial reporting choices may contribute to patterns in earnings persistence and investor expectations [10]. Moreover, managers can shift between accrual-based and real earnings-management techniques in response to regulatory and monitoring pressures. Following major regulatory reforms, firms may reduce discretionary accrual manipulation while increasing real operational actions, such as altering expenditures or transaction timing, to achieve earnings targets [11]. In emerging banking markets, the persistence and detection of earnings management remain particularly important because institutional weaknesses and limited enforcement may permit manipulation to continue over multiple periods [12]. These concerns highlight the need to identify governance mechanisms capable of restricting opportunistic reporting while preserving the informative role of managerial judgment.

Financial reporting quality is broader than the absence of deliberate manipulation. It also reflects the degree to which accounting numbers are reliable, timely, relevant, comparable, and supported by accruals that accurately map into cash flows. The accrual-quality framework developed by Dechow and Dichev emphasizes the extent to which working-capital accruals correspond to past, current, and future operating cash flows, with larger estimation

errors indicating lower reporting quality [13]. Conservative accounting can also improve the timeliness with which economic losses are incorporated into earnings relative to gains, thereby limiting delayed recognition of adverse information [14]. Effective internal-control regulation further contributes to reporting quality by constraining procedural weaknesses, improving the reliability of accounting systems, and enhancing managerial accountability [15]. At the same time, external assurance matters because higher-quality auditors are generally more capable of detecting and constraining aggressive accounting choices [16]. Financial reporting quality therefore emerges from the interaction of accounting standards, internal controls, external auditing, market discipline, and corporate governance rather than from any single institutional mechanism.

Agency theory provides a fundamental explanation for why governance mechanisms are required to protect reporting integrity. The separation of ownership and control creates agency conflicts because managers may pursue private benefits that are inconsistent with shareholders' interests [17]. These conflicts become more pronounced when managers control substantial discretionary resources, particularly free cash flow that can be invested in unprofitable projects, consumed through organizational slack, or used to reinforce managerial power [18]. The association between free cash flow and major ownership or restructuring decisions demonstrates that excess internal liquidity can materially affect managerial incentives and governance outcomes [19]. Firm-level investment decisions may also be shaped by idiosyncratic risk and managerial exposure to firm-specific outcomes, potentially influencing the willingness of managers to undertake value-enhancing but risky investments [20]. In this context, managers may use financial reporting discretion to conceal inefficient investment, smooth volatile performance, protect compensation, satisfy debt covenants, or avoid regulatory intervention. Governance mechanisms that improve monitoring and reduce informational advantages are therefore essential for limiting both inefficient resource allocation and opportunistic reporting.

The board of directors occupies a central position in this monitoring structure. Board members are expected to supervise senior management, review strategic decisions, oversee internal controls, and protect the interests of shareholders and other stakeholders. Empirical evidence indicates that board composition is associated with the likelihood of financial statement fraud, with more effective outside representation generally reducing the risk of fraudulent reporting [21]. Audit committee independence and effectiveness are likewise associated with lower levels of earnings management because independent directors may be better positioned to challenge accounting judgments and managerial pressure [22]. Broader evidence on corporate governance confirms that ownership structures, board characteristics, and monitoring institutions influence managerial accounting discretion [23]. A meta-analysis of the governance literature further demonstrates that board independence and ownership concentration are important, although their effects vary across institutional contexts, measurement approaches, and legal environments [24]. Evidence from Latin American firms similarly indicates that corporate governance mechanisms influence earnings management, but their effectiveness depends on country-level investor protection and organizational characteristics [25]. These findings suggest that the monitoring contribution of directors cannot be evaluated independently of the institutional environment in which they operate.

The effectiveness of governance is especially contingent on legal protection, enforcement quality, and the development of capital-market institutions. Strong investor-protection regimes can constrain expropriation by insiders, improve corporate transparency, and strengthen the disciplinary effects of governance mechanisms [26]. In emerging markets, however, concentrated ownership, weak enforcement, political connections, limited disclosure, and underdeveloped markets may reduce the effectiveness of conventional independent directors. Corporate networks and interorganizational ties can therefore become alternative channels through which

information and influence are transmitted across firms and financial institutions [27]. Such network relationships may create governance benefits by improving access to information and external expertise, but they may also generate conflicts of interest, excessive dependence, or coordinated private benefits. Accordingly, affiliated directors represent a theoretically ambiguous governance mechanism. Their institutional relationships may strengthen monitoring through superior information and financial expertise, yet affiliation may also compromise independence and encourage the protection of connected institutions rather than the interests of all stakeholders.

Bank-affiliated directors are board members who have employment, ownership, professional, or institutional relationships with banks or other lending institutions. Their governance role can be understood through the theory of financial intermediation and delegated monitoring. Financial intermediaries reduce the duplication of monitoring costs by collecting information and supervising borrowers on behalf of dispersed investors and depositors [28]. Banks may also develop reputational capital through repeated lending and monitoring activities, enabling them to influence borrower behavior more effectively than arm's-length creditors [29]. The distinction between informed insiders and outside financiers suggests that banks can obtain private information that improves oversight but may also create informational monopolies and borrower dependence [30]. In relationship-based financial systems, close bank-firm ties may therefore alleviate information problems while simultaneously allowing banks to extract rents or influence corporate policies. The representation of bank-affiliated directors on boards extends this monitoring relationship directly into corporate decision-making, potentially providing lenders with timely access to operational, investment, and reporting information.

The Japanese main-bank system offers an influential theoretical and empirical foundation for understanding these relationships. Main banks historically performed monitoring, restructuring, liquidity provision, and governance functions, particularly when client firms experienced financial distress [31]. Close bank relationships were also associated with corporate liquidity and investment behavior, suggesting that informed banks could reduce financing constraints and support investment when external capital markets were imperfect [32]. More recent evidence indicates that bond investors may rely on the monitoring activities of main banks, effectively delegating part of their own oversight responsibilities to informed banking institutions [33]. These findings reinforce the proposition that bank-affiliated directors may possess informational and monitoring advantages that conventional outside directors lack. Their familiarity with credit risk, cash-flow evaluation, covenant compliance, and financial distress may enable them to identify aggressive accounting assumptions, challenge weak internal controls, and demand more conservative recognition practices.

Empirical studies provide considerable evidence that bank-affiliated directors influence corporate financial policies and reporting choices. The presence of affiliated bankers on boards has been associated with more conservative accounting, particularly where banks face significant credit exposure and therefore benefit from the timely recognition of economic losses [34]. Bank-appointed directors also affect corporate cash-holding decisions, indicating that their influence extends beyond passive monitoring to the management of liquidity and financial policy [35]. Their presence may alter chief executive officers' incentives because bankers can influence financing conditions, risk-taking, compensation arrangements, and managerial discipline [36]. Bank ownership has also been linked to earnings quality, suggesting that bank involvement in governance can enhance the reliability of reported accounting outcomes under certain institutional conditions [37]. More recently, bank-affiliated directors have been shown to influence accounting-policy decisions such as corporate tax avoidance, confirming that their monitoring role affects a broad range of financial reporting and compliance choices [38]. Collectively, these studies imply that bank-affiliated directors may shape both the incentives and opportunities associated with earnings management.

Nevertheless, the effect of bank affiliation is not necessarily uniform. Bank-affiliated directors may pursue the interests of creditors by encouraging conservative reporting, restricting managerial risk-taking, and protecting debt repayment. However, their institutional ties may impair objective judgment, particularly where banks maintain multiple commercial relationships with the firms they monitor. The effectiveness of their oversight may also depend on bank size, organizational complexity, free cash flow, ownership concentration, and the strength of market regulation. Larger banks may possess more sophisticated internal-control systems, greater analyst coverage, and stronger regulatory scrutiny, which can either complement or substitute for board-level monitoring. Conversely, size may create operational complexity and opaque transactions that increase opportunities for earnings management. Free cash flow may also moderate the effectiveness of affiliated directors because excess liquidity increases managerial discretion and agency costs. The risk–return framework underlying financial decision-making further suggests that governance and reporting choices should be evaluated in relation to systematic and firm-specific risk [39]. Thus, the influence of bank-affiliated directors on reporting outcomes is likely to depend on the interaction between governance structures and firm-level financial conditions.

Recent research has expanded the analysis of reporting quality by connecting governance to broader organizational and social-performance dimensions. Corporate social responsibility engagement has been associated with earnings-management behavior in emerging markets, indicating that reputational incentives may either constrain manipulation or provide managers with a means of concealing opportunistic conduct [40]. Environmental performance has likewise been linked to earnings management, demonstrating that reporting incentives extend beyond conventional financial contracting to stakeholder legitimacy and sustainability concerns [41]. These developments are relevant to banks because financial institutions increasingly face expectations concerning transparency, responsible lending, digital transformation, and stakeholder accountability. The rapid adoption of financial technology in Arab emerging markets has also altered banks' profitability, operating models, information systems, and risk-management processes [42]. Although fintech adoption may enhance data processing and control, it may also create new reporting complexities and governance challenges. In such an environment, directors with banking expertise may play an increasingly important role in interpreting financial innovations, evaluating reporting systems, and overseeing managerial discretion.

The most directly relevant recent evidence indicates that bank-affiliated directors can improve financial reporting quality in emerging markets by providing specialized expertise, enhanced access to information, and stronger creditor-oriented monitoring [43]. This finding is important because it challenges the assumption that affiliation necessarily weakens director independence. Instead, affiliation may create a form of resource-dependent monitoring in which institutional knowledge and financial expertise compensate for potential limitations in formal independence. However, the generalizability of this relationship remains uncertain because emerging markets differ considerably in legal enforcement, banking concentration, political influence, financial development, and disclosure quality. Moreover, prior research has primarily examined nonfinancial corporations or relatively developed relationship-banking systems, leaving the direct role of bank-affiliated directors within listed banks insufficiently explored. Banks are simultaneously monitoring institutions and monitored entities, which creates a distinctive governance setting. Directors affiliated with banking institutions may possess relevant expertise, but they may also be embedded in interconnected financial networks that complicate independence, accountability, and risk oversight.

The Iraqi banking sector provides an important setting in which to examine these issues. As an emerging banking market, Iraq has experienced institutional reconstruction, regulatory development, technological change, and

increasing pressure to align financial reporting with international standards. Nevertheless, weaknesses in enforcement, concentrated relationships, limited market transparency, and uneven governance practices may continue to create opportunities for earnings manipulation. These conditions increase the importance of board-level monitoring, particularly by directors who possess specialized knowledge of banking operations, credit assessment, financial regulation, and accounting risk. At the same time, the Iraqi context may differ substantially from the settings examined in prior studies, making it inappropriate to assume that bank affiliation necessarily improves reporting outcomes. Bank-affiliated directors could constrain opportunistic behavior through superior monitoring, or their institutional connections could reduce their willingness to challenge management. Empirical analysis is therefore required to determine whether their presence is associated with lower earnings management and higher financial reporting quality in banks listed on the Iraq Stock Exchange.

Accordingly, the aim of this study is to examine the effect of bank-affiliated directors on earnings management and financial reporting quality in banks listed on the Iraq Stock Exchange and to assess whether bank size and free cash flow moderate the relationship between bank-affiliated directors and earnings management.

2. Methodology

Focusing on banks listed on the Iraq Stock Exchange, the present study examines the role of bank-affiliated directors in earnings management and financial reporting quality within an emerging market. The Iraqi banking system provides an appropriate setting for investigating opportunistic managerial behavior because of weaknesses in corporate governance, information asymmetry, regulatory constraints, and the relatively unsatisfactory quality of financial reporting. Although the implementation of International Financial Reporting Standards (IFRS) began in 2016, the available evidence suggests that improving financial reporting quality requires effective monitoring mechanisms, particularly an effective board structure. Accordingly, drawing on recent studies conducted in emerging markets, particularly Jادیappa et al. (2024), the present study investigates the relationships among bank-affiliated directors, earnings management, and financial reporting quality.

This study was conducted within a positivist paradigm and adopted a deductive approach. In terms of purpose, it is applied research; in terms of method, it is correlational; and in terms of implementation, it is a quantitative study based on panel data. The statistical population consisted of banks listed on the Iraq Stock Exchange during the 2015–2023 period. Following the application of the exclusion criteria, 15 banks were selected, resulting in 135 bank-year observations. The data were collected from financial statements, annual board of directors' reports, stock exchange disclosures, and reports issued by the Central Bank of Iraq. Earnings management was measured using the Modified Jones Model, whereas financial reporting quality was measured using the model developed by Dechow and Dichev (2002). The hypotheses were tested using panel data regression models that incorporated moderating variables, namely bank size and free cash flow, and control variables, namely financial leverage, return on assets, and bank age. To ensure the validity of the results, unit root, Hausman, F, t, Durbin–Watson, and other diagnostic tests were also performed. By applying econometric methods, this study provides reliable empirical evidence regarding the role of board structure in improving the quality of financial information reported by Iraqi banks.

3. Findings and Results

Before conducting inferential analyses, the collected data must be organized, screened, and statistically described to provide a clear understanding of their characteristics. Descriptive statistics constitute the first stage of data analysis and provide an initial understanding of the distribution and dispersion of the variables by summarizing the available information. At this stage, the data were classified according to logical criteria, and statistical measures related to central tendency, dispersion, and distributional shape were calculated. These measures facilitate the accurate description of the data characteristics and the preliminary assessment of data quality before econometric analyses are performed. In the present study, descriptive statistics were calculated for the continuous variables before estimating the regression models. Table 1 presents descriptive measures, including the mean and median as indicators of central tendency; the minimum, maximum, and standard deviation as measures of dispersion; and skewness and kurtosis coefficients as measures of distributional shape. The skewness coefficient indicates the degree of asymmetry in a data distribution. A value of zero indicates a symmetrical distribution, a positive value indicates right skewness, and a negative value indicates left skewness. The kurtosis coefficient indicates the concentration of observations around the mean and the height of the distribution curve relative to the normal distribution. According to the results presented in Table 1, the positive kurtosis coefficients for the study variables indicate that their distributions have higher peaks than the normal distribution and that the observations are more concentrated around their respective means. In addition to providing an overview of the statistical characteristics of the data, these indicators establish an appropriate basis for selecting inferential tests and evaluating the assumptions underlying the econometric models.

Table 1. Descriptive Statistics of the Study Variables

Variable	Symbol	Mean	Median	Maximum	Minimum	Standard Deviation	Skewness	Kurtosis
Earnings management	EM	0.196	0.240	0.240	-0.034	0.066	-1.407	3.892
Financial reporting quality	FRQ	0.821	0.884	1.000	0.108	0.194	-1.073	3.650
Bank-affiliated directors	BAFD	0.352	0.265	0.650	0.100	0.259	0.164	1.127
Free cash flow	FCF	-0.127	-0.119	0.710	-0.890	0.628	0.089	1.466
Bank size	SIZE	18.930	18.961	21.621	16.097	0.895	-0.073	3.250
Return on assets	ROA	0.166	0.026	0.400	0.010	0.178	0.428	1.316
Financial leverage	LEV	0.849	0.898	0.940	0.750	0.092	-0.092	1.055
Bank age	AGE	38.059	22.000	74.000	14.000	26.573	0.416	1.355

The mean, as the most important measure of central tendency, represents the center of gravity of the data distribution and provides a general overview of the study variables. The descriptive statistics indicate that earnings management (EM) had a mean of 0.196 and a standard deviation of 0.066, reflecting relatively limited dispersion across the observations. The mean value of financial reporting quality (FRQ) was 0.821, indicating a relatively favorable level of financial reporting quality among the sampled banks. The mean proportion of bank-affiliated directors (BAFD) was 0.352, indicating that, on average, approximately 35.2% of board members were affiliated directors. The mean value of free cash flow (FCF) was -0.127, indicating that the sampled banks had negative average free cash flow during the study period. Furthermore, the mean values of bank size (SIZE), return on assets (ROA), financial leverage (LEV), and bank age (AGE) were 18.930, 0.166, 0.849, and 38.059 years, respectively. These values reflect the structural and financial characteristics of the research sample.

Following the examination of the descriptive statistics and before testing the research hypotheses, the preliminary relationships among the variables were evaluated through correlation analysis. Because one of the

fundamental assumptions of the Pearson correlation test is the normal distribution of all variables, and the preliminary test results indicated that this condition was not satisfied for all study variables, Spearman's rank-order correlation coefficient was used. Because of its nonparametric nature, this test is more appropriate for data that do not follow a normal distribution and measures the strength and direction of monotonic relationships among variables without requiring the assumption of normality. The results of Spearman's correlation analysis are presented in the following tables. These results provide a basis for examining the preliminary relationships among the study variables and assessing the possibility of multicollinearity before estimating the regression models.

Table 2. Results of Spearman's Correlation Test for the First Main Model

Variable	EM	BAFD	FCF	SIZE	ROA	LEV	AGE
EM	1.000						
BAFD	0.361	1.000					
FCF	0.038	-0.044	1.000				
SIZE	0.114	0.108	-0.149	1.000			
ROA	-0.063	-0.001	0.088	-0.018	1.000		
LEV	-0.041	-0.074	0.045	0.049	0.030	1.000	
AGE	-0.144	0.030	-0.006	-0.143	0.002	-0.004	1.000

Table 3. Results of Spearman's Correlation Test for the Second Main Model

Variable	FRQ	BAFD	SIZE	ROA	LEV	AGE
FRQ	1.000					
BAFD	0.156	1.000				
SIZE	-0.015	0.108	1.000			
ROA	0.225	-0.001	-0.018	1.000		
LEV	0.042	-0.074	0.049	0.030	1.000	
AGE	-0.038	0.030	-0.143	0.002	-0.004	1.000

Before conducting the regression analysis, correlations between the independent and dependent variables were assessed using Spearman's correlation test. It was expected that the regression analysis would produce findings generally consistent with the preceding results. As shown in the tables, none of the correlation coefficients were extremely high or low, particularly close to +1 or -1, to an extent that could adversely affect the regression results.

Table 4. Results of the Hadri Panel Unit Root Tests

Variable	Levin, Lin, and Chu Statistic	Levin, Lin, and Chu Probability	Im, Pesaran, and Shin Statistic	Im, Pesaran, and Shin Probability	Result
EM	-3.306	0.001	-0.321	0.044	Stationary
FRQ	-4.482	0.000	-2.949	0.002	Stationary
BAFD	-3.477	0.000	-1.915	0.028	Stationary
FCF	-7.211	0.000	-2.509	0.006	Stationary
SIZE	-5.221	0.000	-1.913	0.028	Stationary
ROA	-4.441	0.000	-2.375	0.009	Stationary
LEV	-2.456	0.007	-1.051	0.047	Stationary
AGE	-5.116	0.000	-2.339	0.010	Stationary

As shown in Table 4, the probability values for most of the panel unit root tests conducted on all study variables were below the 0.05 significance level. These results provide strong evidence for rejecting the null hypothesis that the variables contain unit roots. It can therefore be concluded that all variables used in the study were stationary at level. Consequently, the subsequent analyses were not subject to the risk of spurious regression.

Table 5. Results of the White and Breusch–Pagan–Godfrey Heteroskedasticity Tests

Model	White Statistic	White Probability	Breusch–Pagan–Godfrey Statistic	Breusch–Pagan–Godfrey Probability	Result
First main regression model	1.679	0.047	2.610	0.028	Heteroskedasticity confirmed
First subsidiary regression model	1.721	0.040	2.688	0.024	Heteroskedasticity confirmed
Second subsidiary regression model	2.295	0.003	2.894	0.016	Heteroskedasticity confirmed
Second main regression model	1.030	0.429	0.764	0.550	No heteroskedasticity

Based on the results of the tests and their associated probability values, the test probabilities for the first main model and the subsidiary models were below the critical significance level of 5%. Therefore, the null hypothesis of homoskedasticity was rejected, indicating the presence of heteroskedasticity in these models. To address heteroskedasticity, the estimated generalized least squares method was therefore applied in the final regression models.

Table 6. Variance Inflation Factors for the Study Models

Variable	First Main Model	Second Main Model
BAFD	1.016360	1.015636
FCF	1.022996	—
SIZE	1.032136	1.022386
ROA	1.013731	1.005065
LEV	1.015578	1.012825
AGE	1.011762	1.011113

As shown in Table 6, all variance inflation factor values were below 5. Therefore, no problematic variance inflation or multicollinearity existed between the independent variable and the control variables.

Table 7. Results of the Chow F-Test

Model	Test Statistic	Probability	Result
First main regression model	4.694506	0.0000	Panel data method
First subsidiary regression model	4.651212	0.0000	Panel data method
Second subsidiary regression model	4.731645	0.0000	Panel data method
Second main regression model	5.030263	0.0000	Panel data method

As presented in Table 7, the probability values of the Chow F-statistic for all study models were below 5%. Therefore, the panel data method was selected for these models. The Hausman test was subsequently applied to determine the appropriate panel estimation specification.

Table 8. Results of the Hausman Test

Model	Test Statistic	Probability	Result
First main regression model	5.736862	0.0332	Fixed-effects method
First subsidiary regression model	5.725533	0.0454	Fixed-effects method
Second subsidiary regression model	5.259792	0.0283	Fixed-effects method
Second main regression model	13.072740	0.0207	Random-effects method

Because the p-values obtained for all models associated with the first main hypothesis were below 5%, the Hausman test results supported the selection of the fixed-effects specification for the first main hypothesis and its

subsidiary models. By contrast, the random-effects specification was considered appropriate for the second main hypothesis.

Table 9. Estimation Results for the First Main Research Model

Variable	Coefficient	Standard Error	t Statistic	p
BAFD	-0.030648	0.011038	-2.776678	0.0064
SIZE	-0.006627	0.003265	-2.029958	0.0447
ROA	0.014397	0.016726	0.860751	0.3912
LEV	0.008543	0.032224	0.265124	0.7914
AGE	0.000100	0.000111	0.902057	0.3689
Constant	0.073200	0.066031	1.108572	0.2699
Model Statistic			Value	
R ²			0.455081	
Adjusted R ²			0.365051	
F statistic			5.054773	
Probability of F statistic			0.000000	
Durbin–Watson statistic			1.885333	

Based on the model estimation results, the probability associated with the F statistic was 0.000, which was below the 0.05 significance level. Therefore, the null hypothesis that the model was not jointly significant was rejected, indicating that the regression model was statistically significant and adequately fitted at the 95% confidence level. This finding indicates that the independent and control variables jointly explained variations in the dependent variable and that the model possessed the statistical validity required to test the research hypotheses.

The adjusted coefficient of determination was 0.36, indicating that approximately 36% of the variation in the dependent variable was explained by the explanatory variables included in the model. The remaining 64% of the variation was attributable to other factors outside the model and random error.

The Durbin–Watson statistic was 1.88, which falls within the conventional acceptable range of 1.5–2.5. This result indicates the absence of first-order autocorrelation among the disturbance terms and confirms that one of the fundamental assumptions of the regression model was satisfied. Overall, the diagnostic test results indicate that the model had an acceptable fit, adequate statistical validity, and sufficient reliability for interpreting the estimated coefficients and testing the research hypotheses.

Table 10. Estimation Results for the First Subsidiary Research Model

Variable	Coefficient	Standard Error	t Statistic	p
BAFD	-0.231018	0.218729	-1.056187	0.2931
SIZE	-0.011197	0.004793	-2.336222	0.0212
BAFD × SIZE	0.010425	0.011424	0.912506	0.3634
ROA	0.018767	0.016148	1.162211	0.2476
LEV	0.000308	0.031569	0.009758	0.9922
AGE	0.000010	0.000111	0.864060	0.3894
Constant	-0.020581	0.096509	-0.213251	0.8315
Model Statistic			Value	
R ²			0.463924	
Adjusted R ²			0.369875	
F statistic			4.932818	
Probability of F statistic			0.000000	
Durbin–Watson statistic			1.862997	

Based on the model estimation results, the probability associated with the F statistic was 0.000, which was below the 0.05 significance level. Therefore, the null hypothesis that the model was not jointly significant was rejected, indicating that the regression model had an adequate fit and statistical validity at the 95% confidence level. This result demonstrates that the independent and control variables simultaneously explained variations in the dependent variable.

The adjusted coefficient of determination was 0.36, indicating that approximately 36% of the variation in the dependent variable was explained by the model's explanatory variables. The remaining 64% was attributable to other factors outside the model and random error.

The Durbin–Watson statistic was 1.86, which falls within the conventional range of 1.5–2.5. This result indicates the absence of first-order autocorrelation among the disturbance terms and confirms that one of the fundamental assumptions of the regression model was satisfied. Consequently, the estimated coefficients can be regarded as having appropriate statistical validity, and the model is suitable for testing the research hypotheses and interpreting the findings.

Table 11. Estimation Results for the Second Subsidiary Research Model

Variable	Coefficient	Standard Error	t Statistic	p
BAFD	-0.032800	0.011282	-2.907332	0.0044
FCF	-0.003022	0.007537	0.400907	0.6892
BAFD × FCF	-0.017935	0.016576	-1.082004	0.2816
SIZE	-0.007809	0.003327	-2.347150	0.0207
ROA	0.020517	0.016762	1.224032	0.2235
LEV	0.013700	0.032348	0.423507	0.6727
AGE	0.000114	0.000112	1.013791	0.3128
Constant	0.056512	0.067066	0.842628	0.4012
Model Statistic			Value	
R ²			0.467303	
Adjusted R ²			0.368307	
F statistic			4.720394	
Probability of F statistic			0.000000	
Durbin–Watson statistic			1.833481	

Based on the model estimation results, the probability associated with the F statistic was 0.000, which was below the 0.05 significance level. Therefore, the regression model was statistically significant at the 95% confidence level, and the explanatory variables jointly accounted for variations in the dependent variable. The adjusted coefficient of determination was 0.36, indicating that approximately 36% of the variation in the dependent variable was explained by the independent and control variables included in the model. The remaining 64% was attributable to other factors outside the model and random error.

The Durbin–Watson statistic was 1.83, which falls within the acceptable range of 1.5–2.5. This result indicates the absence of first-order autocorrelation among the disturbance terms and confirms that one of the fundamental assumptions of the regression model was satisfied. Accordingly, the estimated coefficients possess adequate statistical reliability and validity. Overall, the diagnostic test results indicate that the model had an appropriate fit and was sufficiently reliable for testing the research hypotheses.

Table 12. Estimation Results for the Second Main Research Model

Variable	Coefficient	Standard Error	t Statistic	p
BAFD	0.157399	0.055441	2.839050	0.0053

SIZE	-0.009423	0.016196	-0.581840	0.5617
ROA	0.237053	0.080435	2.947137	0.0038
LEV	0.099585	0.156960	0.634460	0.5269
AGE	-0.000725	0.000534	-1.356586	0.1773
Constant	0.847694	0.328567	2.579975	0.0110
Model Statistic	Value			
R ²	0.118862			
Adjusted R ²	0.084709			
F statistic	3.480305			
Probability of F statistic	0.005528			
Durbin–Watson statistic	1.972787			

The regression estimation results indicate that all the main research models had an adequate statistical fit. In all models, the probability associated with the F statistic was below 0.05 and was predominantly equal to 0.000, indicating the overall statistical significance of the models and the suitability of the explanatory variables for explaining the dependent variables. Furthermore, the Durbin–Watson statistics ranged from 1.83 to 1.97, indicating the absence of first-order autocorrelation among the error terms and confirming one of the fundamental assumptions of regression analysis.

In testing the first hypothesis, the adjusted coefficient of determination was 0.365, indicating that approximately 36.5% of the variation in earnings management was explained by the independent and control variables. The results show that bank-affiliated directors had a significant negative coefficient, $\beta = -0.031$, $p = .006$. This finding indicates that an increase in the representation of bank-affiliated directors reduces earnings management and that such directors perform an effective monitoring role in constraining managers' opportunistic behavior. Therefore, the first research hypothesis was supported. Among the control variables, bank size had a significant negative effect on earnings management, whereas return on assets, financial leverage, and bank age had no statistically significant effects.

To examine the moderating role of bank size, the $\text{BAFD} \times \text{SIZE}$ interaction term was entered into the model. Although the model was statistically significant and explained approximately 37% of the variation in earnings management, the interaction coefficient was positive and statistically nonsignificant, $p = .363$. Therefore, no evidence was found that bank size moderated the effect of bank-affiliated directors on earnings management, and the first subsidiary hypothesis, H1a, was rejected. In this model, bank size continued to have a significant negative effect on earnings management.

The second subsidiary hypothesis examined the moderating role of free cash flow. The results indicate that the coefficient of the $\text{BAFD} \times \text{FCF}$ interaction term was negative but statistically nonsignificant, $p = .282$. Accordingly, free cash flow did not significantly affect the relationship between bank-affiliated directors and earnings management, and the second subsidiary hypothesis, H1b, was not supported. Nevertheless, the main BAFD variable continued to have a significant negative effect on earnings management, thereby confirming the robustness of the findings related to the first hypothesis.

In testing the second hypothesis, the results indicate that the regression model was statistically significant, $\text{Prob}(F) = .006$, and that its adjusted coefficient of determination was 0.085. Thus, approximately 8.5% of the variation in financial reporting quality was explained by the variables included in the model. Bank-affiliated directors had a significant positive coefficient, $\beta = 0.157$, $p = .005$, indicating that a greater representation of such directors was associated with improved financial reporting quality. This finding is consistent with the theoretical

foundations of corporate governance and the monitoring role of the board of directors and therefore supports the second research hypothesis. Return on assets also had a significant positive effect on financial reporting quality, whereas bank size, financial leverage, and bank age had no statistically significant effects.

Overall, the findings indicate that the presence of bank-affiliated directors can serve as an effective corporate governance mechanism for reducing earnings management and improving financial reporting quality. However, the results show that bank size and free cash flow do not play significant moderating roles in these relationships. This finding suggests that the direct effect of bank-affiliated directors remained robust and independent of these structural and financial characteristics within the sample examined.

4. Discussion and Conclusion

The findings of this study provide empirical evidence that bank-affiliated directors play a meaningful monitoring role in banks listed on the Iraq Stock Exchange. The first main result showed that the proportion of bank-affiliated directors had a negative and statistically significant effect on earnings management. In other words, banks with a greater representation of directors affiliated with banking institutions exhibited lower levels of discretionary earnings manipulation. This result supports the first research hypothesis and indicates that bank-affiliated directors can operate as an effective corporate governance mechanism in an emerging banking market. The finding is particularly important in the Iraqi context, where information asymmetry, regulatory limitations, concentrated financial relationships, and relatively weak governance structures may increase managerial opportunities to influence reported earnings. Under such conditions, directors with banking expertise and institutional connections appear to strengthen board monitoring and reduce managers' ability to use accrual discretion opportunistically.

This negative association between bank-affiliated directors and earnings management is consistent with the theoretical logic of delegated monitoring. Banks possess specialized capabilities in credit assessment, financial analysis, risk evaluation, and the interpretation of accounting information. Through repeated interactions with borrowers and other financial institutions, banks acquire private information and develop monitoring expertise that may not be available to ordinary outside directors. According to the delegated-monitoring framework, financial intermediaries reduce monitoring costs by collecting information and supervising firms on behalf of dispersed stakeholders [28]. Banks also build reputational capital through continuing monitoring and lending relationships, which can increase their capacity to discipline managers and discourage opportunistic behavior [29]. When individuals with such expertise serve on boards, their access to information and familiarity with financial risk may enable them to identify aggressive accounting estimates, challenge unusual accrual adjustments, and demand more reliable reporting. Therefore, the observed reduction in earnings management may reflect both the technical competence and the monitoring incentives of bank-affiliated directors.

The result also aligns with the literature on relationship banking and the main-bank system. Bank involvement in corporate governance has historically extended beyond the provision of financing to include oversight, intervention, restructuring, and strategic monitoring [31]. Close bank relationships can reduce financing constraints and improve the flow of private information between firms and financial institutions [32]. More recent evidence shows that external investors may rely on the monitoring performed by main banks, indicating that bank oversight can generate governance benefits for parties beyond the lending institution itself [33]. The present findings suggest that a comparable monitoring logic may operate in Iraqi listed banks. Although the institutional structure of Iraq

differs from the Japanese main-bank system, bank-affiliated directors may similarly serve as informed monitors who possess the financial expertise and institutional authority required to constrain managerial discretion.

The findings are also consistent with prior empirical studies examining the reporting consequences of banker representation on boards. Affiliated bankers have been associated with more conservative accounting, particularly where the timely recognition of losses protects creditors' interests [34]. Bank ownership and involvement have likewise been related to improved earnings quality, indicating that banking institutions can influence the reliability of financial statements through both ownership and governance channels [37]. The current result also corresponds closely with the findings of Jادیappa et al., who reported that bank-affiliated directors improve financial reporting quality in emerging markets by contributing specialized knowledge and strengthening board oversight [43]. In addition, evidence that bank-appointed directors affect corporate cash-holding policies suggests that such directors actively influence financial decisions rather than serving merely symbolic or ceremonial roles [35]. Their presence may also affect managerial incentives and chief executive behavior, thereby strengthening financial discipline and constraining opportunistic reporting choices [36].

The negative association between bank-affiliated directors and earnings management is further supported by the broader corporate governance literature. Effective boards reduce the risk of financial statement fraud by improving managerial accountability and increasing the likelihood that irregular reporting choices will be detected [21]. Independent and effective audit committees have also been associated with lower earnings management because they enhance scrutiny over accounting estimates and financial disclosures [22]. Empirical evidence more generally confirms that board structure, ownership characteristics, and governance quality influence the extent of managerial discretion in financial reporting [23]. A meta-analysis of governance and earnings management similarly demonstrates that stronger monitoring mechanisms tend to constrain opportunistic accounting, although the magnitude of their effects varies across institutional environments [24]. The current findings extend this literature by showing that affiliation with a banking institution does not necessarily weaken board effectiveness. In the Iraqi banking context, specialized institutional expertise may compensate for concerns regarding formal independence and may produce a net monitoring benefit.

The findings can also be interpreted from an agency-theory perspective. Managers may engage in earnings management to protect compensation, avoid covenant violations, conceal poor investment decisions, or maintain the appearance of stable performance. Such behavior arises from the separation of ownership and control and from the informational advantage of managers over outside stakeholders [17]. The problem may become more severe when managers control substantial free cash flow and can allocate resources without adequate external discipline [18]. Bank-affiliated directors may reduce these agency costs by increasing the probability that managerial decisions and reporting practices will be reviewed by individuals who understand financial risk and contractual obligations. Because banks often have incentives to preserve repayment capacity and financial stability, their affiliated directors may prefer more conservative and sustainable reporting policies rather than short-term income inflation. This explanation is compatible with evidence that bank-affiliated directors influence accounting policies such as tax avoidance and therefore shape a broader range of managerial reporting decisions [38].

The second major finding showed that bank-affiliated directors had a positive and statistically significant effect on financial reporting quality. This result supports the second research hypothesis and indicates that increasing the representation of such directors improves the reliability, transparency, and informational usefulness of reported financial data. The positive effect is consistent with the argument that financial reporting is an integral component of governance and contracting. High-quality accounting information reduces information asymmetry, supports

debt monitoring, and allows stakeholders to evaluate managerial performance more accurately [4]. Because bank-affiliated directors are likely to be familiar with credit analysis, impairment recognition, loan-loss provisioning, and regulatory reporting, they may be particularly effective in strengthening the processes through which financial statements are prepared and reviewed. Their expertise can improve the board's ability to question management assumptions, evaluate internal-control weaknesses, and demand more accurate recognition of financial risks.

The improvement in financial reporting quality can also be explained through the concept of accrual quality. Financial statements are more reliable when accruals correspond closely to past, current, and future cash flows and when estimation errors remain limited [13]. Bank-affiliated directors may reduce such estimation errors by closely reviewing provisions, receivables, impairment charges, and other judgment-intensive accounts. Their creditor-oriented perspective may also encourage the timely recognition of bad news and economic losses, consistent with the principle of accounting conservatism [14]. This interpretation is supported by evidence that affiliated bankers on boards promote more conservative accounting policies [34]. By constraining delayed loss recognition and overly optimistic valuation assumptions, bank-affiliated directors may improve the credibility of financial reports and reduce the risk that accounting numbers overstate economic performance.

The positive relationship between bank-affiliated directors and reporting quality is further consistent with the view that earnings quality affects the cost of capital and investor decision-making. Accounting attributes such as accrual quality, persistence, predictability, and value relevance influence the risks perceived by capital providers [3]. High-quality earnings are also more useful for valuation because they allow investors to connect reported performance more accurately with expected future cash flows and book values [1]. Conversely, when financial statements lose relevance or fail to reflect economic fundamentals, their usefulness for market participants declines [2]. The present findings suggest that bank-affiliated directors help preserve the informational function of accounting by improving the quality of the reported data available to investors, regulators, depositors, and other stakeholders.

The result is also compatible with studies emphasizing the role of internal controls and external monitoring in improving reporting quality. Strong internal-control regulation enhances the reliability of accounting systems and reduces opportunities for error or manipulation [15]. High-quality external auditing similarly constrains aggressive accounting choices and reduces discretionary accruals [16]. Bank-affiliated directors may complement these mechanisms by improving communication between the board, audit committee, internal auditors, external auditors, and risk-management functions. Their familiarity with financial institutions may enable them to recognize deficiencies that less specialized directors could overlook. Therefore, their influence may extend beyond direct monitoring of reported earnings to the broader governance infrastructure that supports financial reporting quality.

The result regarding financial reporting quality is especially relevant because earnings management can take multiple forms. Managers may use discretionary accruals, but they may also alter real operating decisions to achieve reporting targets [11]. The conceptual boundary between legitimate accounting discretion and opportunistic earnings management is therefore complex [5]. By strengthening overall reporting systems rather than focusing only on individual accruals, bank-affiliated directors may help reduce both explicit manipulation and less visible forms of reporting distortion. This is particularly important in emerging markets, where the persistence of earnings management may be difficult to detect using a single measurement approach [12]. The positive effect on financial reporting quality therefore indicates that bank-affiliated directors contribute not only to reducing measured discretionary accruals but also to improving the broader reliability of accounting information.

The study further found that bank size had a negative and significant effect on earnings management. This suggests that larger Iraqi banks engage in lower levels of earnings manipulation. One explanation is that large banks are more visible to regulators, investors, auditors, and market participants and are therefore subject to greater scrutiny. They may also possess more advanced accounting systems, stronger internal controls, larger audit functions, and more professional boards. These characteristics reduce the opportunity for managers to manipulate reported results without detection. Greater institutional visibility may also increase the reputational costs of earnings manipulation. However, the absence of a significant moderating effect of bank size indicates that the monitoring influence of bank-affiliated directors does not depend materially on whether a bank is relatively large or small. Their direct effect appears to remain stable across different organizational scales.

The nonsignificant moderating effect of bank size may indicate that specialized monitoring by bank-affiliated directors operates independently of the structural complexity associated with organizational size. Although larger institutions may have more sophisticated governance systems, they may also be more complex, diversified, and difficult to monitor. These competing effects could neutralize the moderating influence of size. In smaller banks, bank-affiliated directors may compensate for limited internal resources by contributing expertise and external networks. In larger banks, they may reinforce established monitoring systems but face greater operational complexity. As a result, the direct effect of their presence remains significant, while the interaction between affiliation and size does not produce an additional statistically detectable effect.

The second subsidiary finding showed that free cash flow did not significantly moderate the relationship between bank-affiliated directors and earnings management. This result does not support the hypothesis that the effectiveness of affiliated directors varies with the level of excess cash resources. Agency theory predicts that free cash flow can intensify managerial opportunism because managers may invest in inefficient projects or use discretionary resources for private benefits [18]. Prior research has also demonstrated that free cash flow affects major corporate financing and ownership decisions [19]. Nevertheless, the current evidence suggests that, within Iraqi banks, free cash flow does not materially alter the monitoring impact of bank-affiliated directors. One possible explanation is that banks differ from nonfinancial firms in the meaning and regulation of liquidity. Cash holdings and liquid resources in banking institutions are closely linked to reserve requirements, depositor withdrawals, credit provision, and regulatory capital management. Consequently, free cash flow may not provide the same degree of unrestricted managerial discretion as it does in industrial firms.

Another explanation for the nonsignificant moderating effect of free cash flow is that bank-affiliated directors may monitor earnings management consistently regardless of the level of discretionary liquidity. Their incentives may be connected more strongly to credit risk, solvency, regulatory compliance, and institutional reputation than to the amount of available cash. The direct negative effect of bank-affiliated directors remained statistically significant in the model containing the interaction with free cash flow, indicating the robustness of the main relationship. This suggests that their monitoring contribution is not conditional on excess liquidity and may instead arise from stable professional expertise, access to information, and creditor-oriented oversight.

Among the remaining control variables, return on assets had a positive and significant effect on financial reporting quality. More profitable banks may have less incentive to distort their financial statements because strong underlying performance reduces pressure to meet benchmarks or conceal poor results. Profitable institutions may also possess better governance resources, stronger internal controls, and more advanced reporting systems. Moreover, high profitability can increase the reputational benefits of transparent reporting and reduce the perceived need for aggressive accounting choices. The result is consistent with the view that the economic

characteristics of earnings influence their persistence, informativeness, and valuation relevance [9]. By contrast, leverage and bank age did not significantly affect either earnings management or financial reporting quality, suggesting that these characteristics did not independently explain reporting behavior in the sampled banks after other governance and financial variables were controlled.

Overall, the findings reinforce the view that bank-affiliated directors can provide effective governance in emerging-market banking institutions. Although affiliations are sometimes assumed to undermine director independence, the results indicate that institutional expertise and monitoring capacity may outweigh potential conflicts of interest in the Iraqi context. Bank-affiliated directors appear to reduce earnings manipulation and improve financial reporting quality through informed oversight, creditor-oriented discipline, and greater scrutiny of managerial reporting decisions. These findings are consistent with research showing that bank involvement influences accounting conservatism, earnings quality, corporate liquidity, executive incentives, and other accounting-policy choices [34–38]. They also extend the emerging-market evidence by demonstrating that the monitoring benefits of bank-affiliated directors apply directly within listed banking institutions, where financial reporting quality is critical to market confidence and financial stability.

This study is subject to several limitations. First, the sample consisted of 15 banks listed on the Iraq Stock Exchange over the 2015–2023 period, which limits the generalizability of the findings to unlisted banks, nonbank financial institutions, and banks operating in other institutional environments. Second, earnings management and financial reporting quality were measured using accrual-based models that may contain estimation error and may not fully capture real earnings management, classification shifting, loan-loss provisioning strategies, or other forms of accounting discretion specific to banks. Third, the measurement of bank-affiliated directors was based primarily on their representation on the board and did not distinguish among different types, degrees, or durations of affiliation. Fourth, the study relied on publicly available financial statements and annual reports, which may not fully reveal informal relationships, political connections, director influence, or internal board deliberations. Finally, although the regression models included several control variables, other factors such as board independence, audit committee expertise, ownership concentration, audit quality, regulatory sanctions, political connections, and macroeconomic instability may also influence earnings management and financial reporting quality.

Future research should extend the analysis to a larger sample of listed and unlisted banks and compare Iraq with other emerging and developed banking markets. Researchers should distinguish among different forms of bank affiliation, including current employment, former employment, lending relationships, ownership ties, and interlocking directorships, to determine whether these affiliations produce different governance outcomes. Future studies could also examine director tenure, financial expertise, gender, attendance, committee membership, and the intensity of bank–director relationships. Alternative measures of earnings management, including abnormal loan-loss provisions, real earnings management, income smoothing, and the Miller Index, could be used to evaluate the robustness of the findings. Longitudinal, dynamic-panel, instrumental-variable, and natural-experiment designs may also help address potential endogeneity and reverse causality. Qualitative interviews with directors, auditors, regulators, and senior bank managers could further clarify the mechanisms through which affiliated directors influence reporting decisions.

In practice, Iraqi banks should consider appointing directors with substantial banking, accounting, risk-management, and regulatory expertise while establishing safeguards to preserve objective judgment and prevent conflicts of interest. Nomination committees should evaluate not only formal independence but also the professional competence, institutional relationships, and monitoring capacity of board candidates. Banks should

disclose the nature and extent of directors' affiliations, require conflict-of-interest declarations, and restrict participation in decisions involving connected institutions where necessary. Regulators and the Iraq Stock Exchange should strengthen board-composition requirements, reporting obligations, and governance guidelines concerning affiliated directors. Banks should also integrate these directors into audit, risk, and financial-reporting oversight processes, provide them with timely access to internal-control and audit information, and regularly evaluate their contribution to reporting quality. Particular attention should be given to smaller and less profitable banks, which may benefit most from specialized board expertise and stronger financial-reporting controls.

Authors' Contributions

Authors equally contributed to this article.

Ethical Considerations

All procedures performed in this study were under the ethical standards.

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Conflict of Interest

The authors report no conflict of interest.

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