Analysing the Relationship Between Financial Reporting Quality and Cost of Capital in Iraqi Banks

Abstract

This study examined the impact of financial reporting quality on the cost of capital among listed Iraqi banks, recognizing the cost of capital as a vital determinant of financial stability, investment decisions, and economic growth. The research focused on how faithful representation, timeliness, and value relevance influence financing costs. The investigation adopted *ex-post facto* research methodology as the utilized data was pre-existing and not intended for alteration. The study encompassed a population of 43 listed banks in Iraq. The sample size was 43 banks, determined through census sampling techniques. The research spanned from 2015 to 2024. Panel regression analysis was conducted and the FGLS regression model was used to examine the relationship between the variables studied. The findings revealed that both faithful representation and timeliness have a positive and statistically significant effect on the cost of capital, suggesting that greater financial transparency may expose underlying risks, leading investors to demand higher returns. However, value relevance had a negative but statistically insignificant effect, indicating that although decision-useful information could lower capital costs, this relationship lacks strong evidence in the Iraqi context. The results showed how different dimensions of financial reporting quality affect investor perceptions and capital costs in a developing financial market. This study concludes that faithful representation and timeliness significantly increase the cost of capital, potentially due to enhanced risk awareness among investors in a volatile environment. In line with the findings of this study, it was recommended that regulators and financial institutions should invest in programs that improve investor understanding of financial statements to foster better use of disclosed information in pricing decisions.

Keywords: Cost of capital, financial reporting quality, faithful representation, timeliness, value relevance

JEL Classification Codes: D24, M40, M41

1. Introduction

The cost of capital represents the minimum return required by investors to compensate for the risks associated with an investment (Agoraki et al., 2024; Modigliani & Miller, 1958). In banking, capital structure decisions and financial reporting integrity are crucial as banks rely heavily on external financing. The cost of capital is a critical factor influencing financial stability, investment decisions, and general economic growth, particularly in banking institutions (Qi et al., 2025). In Iraq, the banking sector faces significant challenges related to high financing costs,

limited access to external funding, and weak financial infrastructure. According to the World Bank (2023), the average cost of equity in emerging markets, including Iraq, remains high at approximately 15-18% compared to 8-10% in developed economies. Similarly, the cost of debt in Iraqi banks is elevated due to high-risk premiums, inadequate credit ratings, and macroeconomic instability (Al-Fadly & Hassan, 2023). These challenges make it difficult for banks to secure low-cost funding, leading to increased lending rates and reduced financial intermediation efficiency.

One of the primary issues contributing to the high cost of capital in Iraq is the poor financial reporting quality and weak enforcement of International Financial Reporting Standards (IFRS). While IFRS adoption is progressing, studies indicate that Iraqi banks still exhibit low levels of financial transparency, increasing information asymmetry and investor risk perception (Ahmed et al., 2022). The Iraq Securities Commission (ISC) reported in 2023 that over 60% of listed financial institutions failed to meet timely financial disclosure requirements, leading to a 5–7% increase in their cost of equity. Moreover, inadequate corporate governance, earnings management practices, and inconsistent financial disclosures further exacerbate the problem, discouraging foreign direct investment (FDI) and limiting access to global capital markets (Bhuiyan & Hu, 2025; Hassan & Jassim, 2023).

Furthermore, geopolitical instability and currency fluctuations significantly affect the cost of capital in Iraqi banks. The Iraqi dinar depreciated by over 10% in 2023 due to political uncertainty and oil price volatility, leading to increased borrowing costs for businesses and financial institutions (IMF, 2024). Higher perceived country risk raises required returns for both debt and equity financing, placing additional strain on banking operations. Without significant improvements in financial reporting quality, governance mechanisms, and regulatory oversight, the cost of capital in Iraqi banks will remain a major barrier to financial sector development and economic growth. This study seeks to address these concerns by examining the relationship between FRQ and the cost of capital, providing empirical insights into how enhanced transparency and compliance can mitigate financial risks and lower financing costs in Iraq's banking industry.

Financial reporting quality (FRQ) plays a crucial role in determining the cost of capital for financial institutions, as it directly affects investor confidence, risk perception, and capital allocation efficiency (Adewara et al., 2024; Falana et al., 2025). High-quality financial reporting

reduces information asymmetry between firms and investors, leading to lower equity risk premiums and reduced borrowing costs (Awotomilusi et al., 2024; Ball et al., 2023; Chen et al., 2023). In contrast, poor financial disclosure practices contribute to market uncertainty and increase the cost of both equity and debt financing (Francis et al., 2022). According to Ahmed and Wasiu (2022), banks with higher financial reporting quality experience a 7–10% reduction in their cost of equity due to enhanced transparency and investor trust. Similarly, a study by Hassan and Jassim (2023) found that Iraqi banks with weak financial disclosure practices face higher interest rates on debt financing, ranging from 2–5% above industry averages, as lenders demand higher compensation for perceived risks. These findings suggest that financial reporting quality serves as a key determinant of the cost of capital, as it influences creditworthiness, investor sentiment, and access to financial markets.

Moreover, regulatory compliance with International Financial Reporting Standards (IFRS) has been linked to improved financial reporting quality and lower capital costs in emerging markets, including Iraq. Al-Fadly and Hassan (2023) reported that Iraqi banks that fully adopted IFRS observed a 12% decline in their weighted average cost of capital (WACC) due to greater financial statement comparability and credibility. High financial reporting quality ensures that financial statements accurately reflect a bank's financial health, reducing risk premiums required by investors and creditors (Awotomilusi et al., 2023; Dagunduro et al., 2025; World Bank, 2023). In contrast, financial misstatements and earnings management practices increase perceived investment risks, leading to capital constraints and reduced market efficiency (Dagunduro et al., 2025; IMF, 2024). Given the increasing globalization of financial markets, the ability of Iraqi banks to enhance financial reporting quality through strict regulatory enforcement and governance improvements will be essential in lowering their cost of capital and improving long-term financial sustainability.

Empirical research suggests that higher financial reporting quality reduces the cost of capital by lowering information risk and enhancing investor confidence (Biddle et al., 2019; Barth et al., 2021). In contrast, low financial reporting quality leads to higher required returns by creditors and shareholders due to increased uncertainty regarding future cash flows (Chen et al., 2020). Despite the extensive research on financial reporting quality and cost of capital in developed economies (e.g., Kim et al., 2022; Dechow et al., 2021), limited studies have focused on emerging

markets such as Iraq, where financial systems are undergoing structural reforms. The Iraqi banking sector is transitioning toward greater financial transparency under International Financial Reporting Standards (IFRS) adoption, yet challenges remain regarding regulatory enforcement, corporate governance, and financial disclosures (Al-Fadly & Hassan, 2023). Given the importance of banks as financial intermediaries, understanding how financial reporting quality influences their cost of capital is essential for policymakers, investors, and corporate managers.

Considering this, this study aimed to analyse the effect of financial reporting quality on the cost of capital of Iraqi banks. By employing empirical techniques such as accrual-based measures and cost of equity estimation models, the study seeks to provide insights into whether enhanced financial transparency can reduce financing costs in Iraq's banking sector. Findings from this research will contribute to the broader literature on financial reporting, corporate governance, and banking sector efficiency in emerging economies. Understanding the relationship between financial reporting quality and the cost of capital is vital for improving capital market efficiency and reducing investment risk in Iraq. This study will provide empirical evidence on how improved financial disclosures can enhance investor confidence and lower financing costs for banks operating in high-risk environments.

2. Literature Review and Hypothesis Development

This section provides details on the concepts, underpinning theory and related literature relevant to this study for better understanding and clarity.

2.1 Conceptual Review

This section provides for the definition of concepts used in this study.

2.1.1 Cost of Capital

The cost of capital is a pivotal concept in corporate finance, representing the minimum return a company must make on its investments to satisfy its investors and maintain its market value. Jagannathan et al. (2017) describe it as the rate used to discount future cash flows, ensuring that only projects expected to yield returns exceeding this rate are undertaken to enhance firm value. Vernimmen et al. (2017) defined the cost of capital as the minimum rate of return required to appease both shareholders and debtholders, effectively reflecting the company's total financing cost. Ionici et al. (2011) introduced the cost of capital as the rate used for discounting cash flows in net present value calculations, emphasizing its role in capital budgeting decisions. These

perspectives collectively underscore the cost of capital as a critical benchmark in financial decision-making, guiding firms to undertake investments that are anticipated to generate sufficient returns to justify their associated financial risks.

2.1.2 Financial Reporting Quality

High-quality financial reporting delivers information that is both relevant to users' decision-making needs and faithfully represents the economic phenomena it purports to depict. This includes attributes such as completeness, neutrality, and freedom from error, ensuring the reliability of financial statements (Akinadewo et al., 2023; Renkas et al., 2015). Gaynor et al. (2016) emphasize that financial reporting quality is characterized by the transparency and accuracy of financial statements, enabling stakeholders to gain a clear and precise understanding of a company's financial performance and position. Transparent reporting reduces information asymmetry and builds investor confidence. Ekwueme and Aniefor (2019) define financial reporting quality as the degree to which financial statements adhere to established accounting standards and regulatory requirements, ensuring that the information presented is both credible and legally compliant. According to Jim-Suleiman and Ibiamke (2021), financial reporting quality can be assessed based on the sustainability and reliability of reported earnings. High-quality earnings reflect genuine economic performance and are free from manipulation or aggressive accounting practices, providing a true representation of a company's profitability. Falana et al. (2025) also highlighted that quality financial reporting presents information in a manner that is easily understandable and useful to users, facilitating informed decision-making by various stakeholders.

2.1.2.1 Faithful Representation

Faithful representation refers to the extent to which financial statements accurately reflect the economic substance of transactions rather than merely their legal form. It ensures that financial information is complete, neutral, and free from material errors (Falana et al., 2025; Mora & Walker, 2015). Faithful representation is the quality of financial information that ensures the depiction of real-world economic phenomena in a manner that is reliable and unbiased. It enhances the usefulness of financial reports for investors and other stakeholders by ensuring that the figures reported align with the entity’s actual financial condition (Dechow et al., 2010). Faithful representation in financial reporting means that reported figures truthfully reflect an entity’s

financial position and performance. This characteristic requires that accounting information is verifiable and unbiased, allowing users to make informed decisions based on trustworthy data (Christensen et al., 2013).

2.1.2.2 Timeliness

Timeliness refers to the promptness with which financial reports are made available to users, ensuring their relevance for decision-making. Financial information loses its usefulness if there is a significant delay in its disclosure, as timely reporting enhances transparency and investor confidence (Jim-Suleiman & Ibiamke, 2021). Timeliness in financial reporting quality is the ability of firms to disclose financial statements within the legally required or recommended time frame, allowing stakeholders to make informed decisions. Delayed financial reporting may lead to market inefficiencies and reduced trust in financial statements (Habib et al., 2023). Timeliness is a fundamental attribute of financial reporting quality that ensures financial information is disseminated quickly enough to impact economic decisions. The relevance of financial information is highly dependent on its timeliness, as outdated data may no longer be useful for investors and other stakeholders (Mohammadiyan, 2024).

2.1.2.3 Value Relevance

Value relevance refers to the extent to which financial statement information reflects a firm's market value and assists investors in their decision-making processes. Haupt et al. (2024) define value relevance as the ability of accounting information to capture and summarize firm value, indicating its usefulness to investors. Dunham and Grandstaff (2022) describe value relevance as the degree to which accounting information reflects stock prices, serving as an indicator of the information's usefulness in equity valuation. Agbodjo et al. (2021) explain value relevance as assessing the relationship between accounting information and capital market values, providing insights into the impact of financial disclosures on investor perceptions and stock prices. These definitions collectively show the importance of value relevance in evaluating how effectively accounting information reflects a firm's economic value and aids stakeholders in making informed investment decisions.

2.2 Theoretical Framework

This study is rooted in capital market efficiency theory, Eugene Fama is widely recognized as the propounder of the capital market efficiency theory, introducing the concept in his seminal 1970 paper "Efficient Capital Markets: A Review of Theory and Empirical Work" (Fama, 1970). His efficient market hypothesis (EMH) posits that securities prices fully reflect all available information, making it impossible for investors to consistently outperform the market through stock selection or market timing. The theory assumes that investors are rational and maximize their utility, information is freely available to all market participants simultaneously, there are no transaction costs or taxes, investors can borrow and lend at the risk-free rate, and all investors have homogeneous expectations regarding returns (Malkiel, 2003).

Recent studies examining the relationship between cost of capital and financial reporting quality through the lens of capital market efficiency include Li et al. (2021), who documented that higher financial reporting quality leads to lower information asymmetry, thereby reducing estimation risk and cost of capital for firms across multiple international markets. Similarly, Kim and Zhang (2022) found that accounting conservatism, as a component of financial reporting quality, significantly mitigates crash risk and lowers the cost of equity capital by reducing information asymmetry between managers and outside investors. Additionally, Arabzadeh and Aghapour (2023) demonstrated that integrated reporting practices, which enhance transparency and reporting quality, are associated with reduced cost of debt capital particularly in emerging markets where information environments are typically less robust.

The capital market efficiency theory is highly relevant to analyzing the relationship between financial reporting quality and cost of capital in Iraqi banks. In emerging markets like Iraq, where information asymmetry tends to be pronounced, improvements in financial reporting quality can significantly reduce estimation risk for investors. The theory suggests that Iraqi banks with higher financial reporting quality would experience lower costs of capital as investors would demand lower risk premiums due to reduced uncertainty. Furthermore, as Iraqi capital markets continue to develop and integrate globally, adherence to international financial reporting standards could decrease information processing costs for foreign investors, potentially attracting more capital at favorable rates (Al-Janabi et al., 2019).

Applying this theory to the Iraqi banking sector specifically, one would expect that banks with more transparent financial disclosures, fewer accounting irregularities, and higher earnings quality would benefit from lower capital costs. The theory predicts that as regulatory frameworks in Iraq strengthen and enforce higher reporting standards, the overall banking sector should experience a reduction in systematic information risk, leading to more efficient capital allocation and lower financing costs industry wide. This relationship becomes particularly crucial during periods of economic uncertainty or market stress, when information quality differentials among banks may significantly impact their ability to access capital markets (Hassan and Skinner, 2016).

Critics of the capital market efficiency theory include Robert Shiller, who argues that markets exhibit excess volatility inconsistent with the rational expectations model underlying EMH (Shiller, 2003). His behavioral finance perspective suggests that psychological and emotional factors drive investor decisions, leading to market inefficiencies that contradict the theory's fundamental assumptions. Joseph Stiglitz challenges the theory from an information economics perspective, arguing that information asymmetries are pervasive and persistent in real markets, creating enduring inefficiencies that the EMH fails to account for (Stiglitz, 2000). Additionally, Andrew Lo's Adaptive Markets Hypothesis proposes an alternative framework that reconciles behavioral biases with evolutionary principles, suggesting that market efficiency is not an all-or-nothing condition but varies over time and across markets as participants adapt to changing environments (Lo, 2004). References to this theory in the context of financial reporting quality and cost of capital are particularly valuable as they provide a theoretical foundation for understanding how improvements in disclosure practices might benefit Iraqi banks in their capital raising efforts. The theory suggests that as Iraq's financial system continues to mature, banks that prioritize reporting quality will likely gain competitive advantages through reduced capital costs, though the effectiveness of these improvements may be moderated by the institutional and regulatory environment specific to the Iraqi market (Dechow et al., 2010; Easley and O'Hara, 2004).

2.3 Empirical Review

The existing literature provides significant insights into the relationship between financial reporting quality, governance mechanisms, and the cost of capital across different contexts. Bonetti et al. (2023) examined the role of environmental disclosure in mitigating capital costs, highlighting

that firms disclosing carbon emissions experienced a lower increase in the cost of capital post-Fukushima disaster. Their findings suggest that transparency in non-financial reporting influences investor perception and financing conditions. However, their study focused on environmental disclosure rather than the broader spectrum of financial reporting quality.

Synn and Williams (2024) analyzed how financial reporting quality affects capital structure optimization, showing that improved reporting mitigates adverse selection concerns, thereby reducing financing frictions and deviations from optimal leverage. Their study primarily addressed the implications of financial reporting for capital structure rather than directly assessing its impact on cost of capital. Similarly, Hasmi et al. (2024) explored corporate governance and ownership concentration in relation to equity costs, demonstrating that stronger governance practices reduce financing costs while high ownership concentration increases it. However, their research was limited to non-financial firms in Pakistan, necessitating further exploration in financial institutions within different economic contexts.

Meneses Cerón et al. (2024) and Agoraki et al. (2024) extended the literature by incorporating climate risk and firm-level exposure to climate change in cost of capital assessments. Their studies underscored that firms with poor environmental credentials encounter increased capital costs and reduced investment opportunities. While these studies emphasize sustainability and financial risk, they do not specifically address financial reporting quality as a determinant of cost of capital. Ernst and Woithe (2024) examined the effect of ESG performance on the cost of capital, revealing that firms with higher ESG scores benefited from reduced costs of equity and debt but saw no direct improvement in their weighted average cost of capital (WACC). The study emphasized the role of sustainability in influencing financing costs, suggesting that firms with strong ESG ratings could access cheaper capital due to lower risk perceptions among investors. However, it also noted that firms with poor ESG scores had a lower WACC due to a higher reliance on debt financing despite their higher associated costs.

Qi et al. (2025) focused on CEO social capital and its impact on the implied cost of capital in Chinese family-listed firms. Their findings indicated that CEOs with strong social networks reduced capital costs by mitigating corporate risk and enhancing information transparency. However, the study found that the effectiveness of CEO social capital varied depending on firm

characteristics, such as family ownership structure and market competitiveness. The study extended the literature by demonstrating that social capital could serve as a risk-reduction mechanism, particularly in environments with economic uncertainty and weak investor protection.

Bhuiyan and Hu (2025) analyzed how corporate donations influence the cost of equity capital, arguing that philanthropic activities enhance corporate reputation and lower firm-specific risk. Using a large dataset covering 44 countries, they found that corporate donations significantly reduced the cost of equity, suggesting that socially responsible behaviors positively impact investor confidence. Their findings remained robust across various sensitivity tests, reinforcing the argument that corporate engagement in social responsibility can serve as a strategic tool for reducing financing costs.

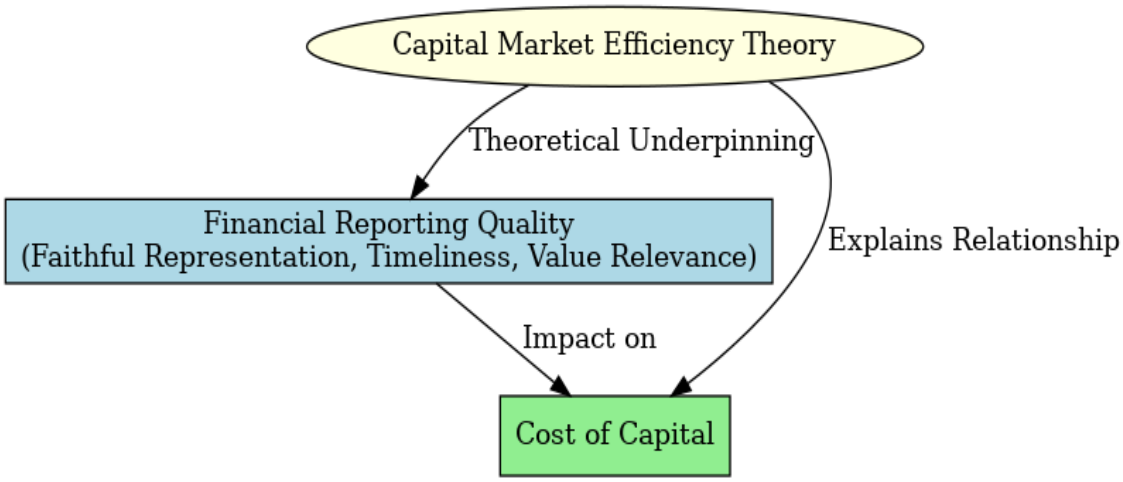
While these studies offer insights into financial reporting quality, ESG factors, and governance mechanisms in determining capital costs, they focus primarily on developed and emerging economies such as China and internationally listed firms. There is a distinct gap in literature addressing the financial reporting quality-cost of capital relationship within Iraq's banking sector, which operates under different regulatory, economic, and institutional conditions. Iraqi banks face unique challenges, including financial instability, weak governance frameworks, and limited transparency in financial reporting. Unlike studies on ESG performance (Ernst & Woithe, 2024) or CEO social capital (Qi et al., 2025), research on the Iraqi financial system must account for regulatory inefficiencies, investor distrust, and high-risk perceptions in determining capital costs. Moreover, previous studies have predominantly examined environmental disclosures (Bonetti et al., 2023; Meneses Cerón et al., 2024), governance structures (Hasmi et al., 2024), and capital structure deviations (Synn & Williams, 2024) separately. However, the interdependence of these factors in a developing banking sector like Iraq’s remains unexplored.

Additionally, previous studies have focused on social and governance factors (Bhuiyan & Hu, 2025) but have not directly examined how financial reporting quality impacts the cost of capital in a volatile banking environment. Future research should explore how improving financial reporting standards, regulatory oversight, and disclosure practices can influence the cost of equity and debt financing in Iraqi banks. This would provide policymakers and financial institutions with data-driven insights to enhance financial stability and capital accessibility.

2.4 Conceptual Framework

Figure 1 illustrates the relationship between financial reporting quality, cost of capital, and the theoretical foundation underpinning this relationship. The independent variable, financial reporting quality, is represented by key attributes such as faithful representation, timeliness, and value relevance, which ensure that financial statements accurately reflect a company's financial position and performance. The dependent variable, cost of capital, is influenced by the quality of financial reporting, as transparent and reliable financial disclosures reduce information asymmetry and investor uncertainty, leading to lower financing costs. This relationship is theoretically supported by the capital market efficiency theory, which posits that well-functioning markets incorporate all available information into asset prices. High-quality financial reporting enhances market efficiency by providing investors with relevant and reliable information, thereby influencing firms' cost of equity and debt.

Figure 1: Conceptual Framework



Source: Authors' Design (2025)

3. Data and Methods

The investigation adopted *ex-post facto* research methodology as the utilized data was pre-existing and not intended for alteration. The study encompassed a population of 43 listed banks in Iraq. The sample size was 43 banks, determined through census sampling techniques. The inclusion of all 43 listed banks in Iraq as the study population and sample was achieved through a

census sampling techniques, which is appropriate when the population size is relatively small and manageable. This approach enhances the accuracy and generalizability of the findings within the Iraqi banking sector, as it eliminates sampling bias and ensures that all relevant institutions are represented (Creswell & Creswell, 2018). The research spanned from 2015 to 2024. The study period from 2015 to 2024 allows for a comprehensive analysis across a full economic cycle, capturing both pre- and post-crisis financial periods, changes in regulatory frameworks, and evolving market dynamics in Iraq. This temporal coverage supports a robust examination of trends and long-term effects of financial reporting quality on the cost of capital. Panel regression analysis was conducted to examine the relationship between the variables studied. The use of Panel regression analysis was due to the longitudinal structure of the dataset, which combines cross-sectional and time-series data. Panel data techniques improve efficiency, control unobserved heterogeneity, and enhance the robustness of parameter estimates (Baltagi, 2021).

3.1 Model Specification

The econometric model for this study was adapted from the study conducted by Petreski et al. (2025), which investigated the reputation effect of repeated green-bond issuance and its impact on the cost of capital of listed Swedish real estate companies. The model was outlined as follows:

$$CoC_{it} = \beta_0 + \beta_1 GBI_{it} + \beta 2 NGBI_{it} + \beta 3 BAS_{it} + \beta 4 TA_{it} + \beta 5 ROA_{it} + \beta 6 DS_{it} + \beta 7 CR_{it} + \mu_i + \varepsilon_{it}$$

where:

CoC_{it} = cost of capital for firm ii in period tt

GBI_{it} = green bond issuance

$NGBI_{it}$ = non-green bond issuance

BAS_{it} = bid-ask spread

TA_{it} = total assets (firm size proxy)

ROA_{it} = return on assets

DS_{it} = debt share (leverage ratio)

CR_{it} = current ratio (liquidity measure)

β_0 = intercept

$\beta_1, \beta_2, ..., \beta_7$ = coefficients of explanatory variables

μ_i = unobserved firm-specific effect (fixed or random effect)

ε_{it} = error term

However, the model was modified by replacing the explanatory variables with faithful representation, timeliness, and value relevance. The modified model was specified as follows:

$CoC = f(FR, TM, VR)$

$CoC_{it} = \beta_0 + \beta_1 FR_{it} + \beta_2 TM_{it} + \beta_3 VR_{it} + \mu_i + \varepsilon_{it}$

where:

CoC_{it} = cost of capital for firm ii in period tt

FR_{it} = faithful representation of financial reports

TM_{it} = timeliness of financial reporting

VR_{it} = value relevance of financial reports

β_0 = intercept

β_1, β_2, β_3 = coefficients of explanatory variables

μ_i = unobserved firm-specific effect (fixed or random effect)

ε_{it} = error term

The *a-priori* expectation is that β_1, β_2, $\beta_3 > 0$, which implies that a positive relationship is anticipated between the explanatory variables and the explained variable.

3.2 Measurements and Descriptions of Variables

Table 1 shows the description, operationalization, and measurement of variables.

Table 1: Operationalization and Measurement of Independent Variables

Variables	Description	Measurement	Source
Cost of Capital (CoC)	The cost of capital represents the required return a company must earn from its investments to maintain its market value and satisfy its investors. It serves as a benchmark for evaluating investment decisions, ensuring that returns exceed financing costs. Companies typically report their cost of capital in the annual report.	This is calculated as the ratio of Earnings Per Share (EPS) divided by Share Price	Damodaran, A. (2012).

Faithful Representation (FR)	Faithful representation is often assessed using financial statement elements such as total assets, total liabilities, and net income. A common proxy for measuring faithful representation in empirical studies is the earnings management index, which captures deviations from expected accruals.	Faithful Representation is calculated by subtracting operating cash flow from net income and then dividing the result by total assets. This measure indicates the extent to which reported earnings reflect actual cash flows, helping to assess the reliability and accuracy of financial statements.	Dechow et al., (2010); Falana et al., (2025).
Timeliness (TM)	Timeliness in financial reporting refers to the promptness with which companies disclose their financial statements to stakeholders. It is a key aspect of financial reporting quality, ensuring that investors, regulators, and other users receive relevant information promptly for decision-making. A delay in reporting can reduce the usefulness of financial statements and increase uncertainty in the market.	This is measured using the financial reporting lag, which is the number of days between the end of a company's financial year and the date the audited financial statements are released.	Habib et al. (2023); Jim-Suleiman and Ibiamke (2021).
Value Relevance (VR)	Value relevance refers to the extent to which financial information disclosed in a firm's annual report influences stock prices or market value. It measures the usefulness of financial reporting in investors' decision-making .	This ratio measures how much of the reported net income is backed by actual cash flows (a key indicator of earnings quality and relevance)	Kim and Kross (2005)

Authors' Compilation (2025)

4. Data Analysis and Discussion of Findings

This section discusses the analysis's findings and consequences. This section explains the variables employed, data analysis, and study results. These statistics summarise how the variable is distributed.

4.1 Descriptive Statistics

Table 2 contains statistics for each variable, as well as details on their distribution and features across datasets. The total number of observations was 140. The average cost of capital was 0.0387 (3.87%). While the median (50%) was 0.0121, this implies that half of the values in the dataset were below 1.21%. The standard deviation was 0.0875. This implies that there was a moderate spread. The skewness was 5.5816. While being strongly positive, this indicates that a few firms have very high capital costs. The Kurtosis of 41.9254 indicates a very leptokurtic distribution, suggesting outliers or extreme values. Overall, most firms have a relatively low cost of capital. In the same vein, the average size of faithful representation was 0.0001. This implies that accruals are near zero, suggesting minimal systematic bias in earnings on average. There is a high variability in FR across firms, indicating that some firms aggressively manage earnings. At a skewness of -7.3042, the distribution is left-skewed. This implies that most firms cluster near zero, but extreme negative outliers exist. The kurtosis of 78.3642 denotes a leptokurtic distribution with extreme FR values.

Similarly, relevance had an average size of -21.6112. This means that earnings depend on accruals/non-cash items while more profits without cash support. The substantial diversity in VR between firms suggests that some organisations aggressively manage earnings. With a skewness of -6.9567, the distribution is left-skewed. This means that most enterprises cluster around zero, but there are extreme negative outliers. The kurtosis of 66.7119 represents a leptokurtic distribution with extreme VR values. Again, the average size of timeliness was 0.5895. This indicates that on average, firms take approximately 59% of the 6 months (106 days) to report. Half of the firms reported within 45% of the window with a median of 0.4505. There is a high variability with a standard deviation of 0.6224. Some firms reported much faster or slower than others. The distribution has a skewness of 1.0737 and is right-skewed. This implies that a few firms took significantly longer to report. The kurtosis of 4.3861 indicates a leptokurtic distribution with some extreme delays exist.

Table 2: Descriptive Statistics

Variable	Mean	Std. Dev.	Median	Variance	Skewness	Kurtosis
Coc	0.0387	0.0875	0.0121	0.0077	5.5816	41.9254
FR	0.0001	0.0766	0.0007	0.0059	-7.3042	78.3642
VR	-21.6112	365.8547	1.0266	133849.6	-6.9567	66.7119
TM	0.5895	0.6224	0.4505	0.3873	1.0737	4.3861

Authors' Computation (2025)

4.2 Test of Variables

Table 3 displays the results of pre- and post-estimation testing to guarantee that the study's findings are reliable and valid. Pre-estimation methods like the unit root test, correlation analysis, and multicollinearity, as well as post-estimation tests like the Hausman and heteroscedasticity tests, were used.

4.2.1 Pre-estimation Test

The following tests were performed to check that the selected model's assumptions were met and that the data used for analysis was adequate. However, unit root was not conducted because the panel was not balanced. If unit root testing was not possible due to the unbalanced panel, according to Elaoud and Jarboui (2017), the first differencing (or higher-order differencing) to convert the data into stationary form becomes sufficient. Therefore, differencing was done.

4.2.1.1 Correlation Analysis

Table 3 shows the correlation matrix with p-values for the correlation coefficients between the variables Coc, FR, VR, and TM. These numbers represent the intensity and direction of the association between pairs of variables. Between Coc and FR, the correlation was 0.0750. While this was very low, this suggests a weak positive relationship between these two variables. This relationship is likely not significant. Also, the correlation between Coc and VR was 0.0309. This was extremely weak, indicating a near-zero relationship between the cost of capital and relevance.

Similarly, the correlation between Coc and TM was 0.3022. This indicates a moderate positive relationship between the cost of capital and timeliness. Conversely, the correlation between FR and VR was 0.1317. While this is weak, it indicates a slightly positive relationship between these two variables. Again, between FR and TM, the correlation was 0.1172. This suggests

a slight positive relationship between faithful representation and timeliness. VR and TM have a correlation of 0.1486, which is also weak and suggests a slightly positive relationship.

Table 3: Correlation Matrix

Variable	Coc	FR	VR	TM
Coc	1.0000			
FR	0.0750	1.0000		
	0.3784			
VR	0.0309	0.1317	1.0000	
	0.7169	0.1209		
TM	0.3022*	0.1172	0.1486	1.0000
	0.0003	0.1677	0.0797	

Authors' Computation (2025)

4.2.1.2 Multicollinearity

The model's estimates and standard errors are influenced by a perfect linear correlation among independent variables. This was assessed using variance inflation factor (VIF) analysis. In this respect, TM and FR have VIFs of 1.03, respectively, while VR has 1.04. This indicates very low multicollinearity. A mean VIF of 1.03 is far below the conservative threshold of 5 (or even 2), suggesting there is no need to drop variables or modify the model.

Table 4: Variance Inflation Factor

Variable	VIF	1/VIF
VR	1.04	0.964674
TM	1.03	0.968206
FR	1.03	0.972898
Mean VIF	1.03	

Authors' Computation (2025)

4.2.2 Post-Estimation Tests

The Breusch-Pagan/Cook-Weisberg test was used to homoscedasticity. A higher chi-square test statistic and a significant p-value (p-value < 0.05) indicate heteroskedasticity, otherwise homoskedasticity. The test results revealed a chi-square of 149.99 with a p-value of 0.0000. The null hypothesis of constant variance was thus rejected, revealing substantial evidence of heteroskedasticity in the residuals of the study's model. Again, the Shapiro-Wilk test was employed to determine whether the values followed a normal distribution. The null hypothesis claims that

the data follows a normal distribution, whereas the alternative hypothesis states that it does not. If the p-value is above 0.05, the null hypothesis is accepted; otherwise, it is rejected. The data in this situation is not regularly distributed, as the p-value is 0.0000. Consequently, all variables were transformed. Furthermore, the Wooldridge test for autocorrelation in panel data was carried out. While the null hypothesis states that there is no first-order autocorrelation in the panel data, the alternative hypothesis states that there is first-order autocorrelation. With a p-value of 0.0577, which is slightly above 0.05, the study indicates that there is autocorrelation.

The F-test, on the other hand, determines whether the firm-specific or group-specific effects in a fixed effects model are zero or not. The null hypothesis claims that all individual effects are zero, whereas the alternative hypothesis states that at least some individual effects are not zero. If the p-value is less than 0.05, reject the null hypothesis; else, accept it. The F-test results showed an f-statistic of 1.99 and a p-value of 0.0000, implying that the fixed model is effective. The Breusch and Pagan Lagrange multiplier test was used to compare the accuracy of the random effect model and pooled OLS estimates. The test statistic is 32.46, whereas the p-value is 0.0000. This indicates that the OLS model is more appropriate. The Hausman test was used to determine the optimum model of fixed and random effects. Given that the test result had a probability of 0.9657 and a chi-square of 0.27, the random model was the best fit. Because of the presence of heteroskedasticity and autocorrelation, a robust regression analysis was used.

Table 5: Summary of Post-Estimation Test Results

Test	F-Statistics	P-value
Breusch-Pagan / Cook-Weisberg test for Heteroscedasticity	149.99	0.0000
the Shapiro-Wilk test	10.152	0.0000
Wooldridge test for autocorrelation in panel data	4.405	0.0577
F test that all ui=0: F (45, 549)	4.35	0.0000
Breusch and Pagan Lagrangian multiplier test for random effects	32.46	0.0000
Hausman Test	0.27	0.9657

Authors' Computation (2025)

4.3 Financial Reporting Quality and Cost of Capital

The previous model selection analysis determined that the random-effect model is best suited for this study; however, panel-specific heteroskedasticity and autocorrelation identified in pre- and post-estimation tests require the use of robust regression analysis. In this context, the p-value and coefficients derived from this analysis were used to infer the effect of FR, VR, and TM

on Coc. The overall model significance is indicated by an F-statistic of 7.22 with a p-value of 0.0002. This implies that the model is statistically significant, explaining variation in the cost of capital.

Also, faithful representation has a coefficient of 0.0687 with a p-value of 0.0100. While being statistically significant, a one-unit increase in FR is associated with a 6.87 percentage point increase in the cost of capital, holding other variables constant. This suggests that firms with more earnings manipulation (less faithful reporting) might face higher financing costs. In the same vein, the value relevance coefficient is 0.0000, with a p-value of 0.7950. While this is not significant, changes in the value relevance metric do not have a statistically meaningful effect on the cost of capital in this model. This is unexpected, and this could be due to its indirect effect. Again, the timeliness coefficient is 0.0115, with a p-value of 0.0010. While highly significant, each 1% increase in delay is associated with a 1.15 percentage point increase in the cost of capital. Delayed reporting is likely to increase investor uncertainty, raising financing costs.

Table 6: Robust Regression

Cost of capital	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
FR	0.0687	0.0264	2.6000	0.0100	0.0165	0.1209
VR	0.0000	0.0000	-0.2600	0.7950	0.0000	0.0000
TM	0.0115	0.0033	3.5300	0.0010	0.0051	0.0180
_cons	0.0074	0.0028	2.6800	0.0080	0.0019	0.0129
Number of OBS	140					
F(3, 136)	7.22					
Prob > F	0.0002					

Authors' Computation (2025)

4.4 Discussion of Findings

The cost of capital is a critical factor influencing financial stability, investment decisions, and general economic growth, particularly in banking institutions. Thus, this study aimed to analyse the effect of financial reporting quality on the cost of capital of Iraqi banks. By employing empirical techniques such as accrual-based measures and cost of equity estimation models, the study seeks to provide insights into whether enhanced financial transparency can reduce financing costs in Iraq's banking sector. Specifically, this study assessed the effect of faithful representation, timeliness, and value relevance on cost of capital of listed Iraqi banks. Evidenced from the

regression analysis revealed that both faithful representation and timeliness, two key components of financial reporting quality, have a positive and statistically significant effect on the cost of capital of listed Iraqi banks. This implies that when financial statements are more accurate, complete, and reported promptly, the banks tend to face higher costs when raising capital. This suggests that increased transparency may reveal underlying risks or financial realities that prompt investors to demand higher returns, thus increasing the cost of capital. On the other hand, value relevance showed a negative and statistically insignificant effect on the cost of capital. This means that although more decision-useful information might be associated with a lower cost of capital, the relationship is weak or not supported by sufficient evidence in this context. The findings suggest that, while certain aspects of financial reporting quality seem to increase the cost of capital, others like value relevance do not appear to have a meaningful impact, possibly due to market conditions or investor perceptions in the Iraqi banking sector.

The findings of this study corroborate with findings of Habib et al. (2019) which looked at the effect of adopting IFRS on financial reporting quality and cost of equity in Australian firms. It was found that while financial reporting quality improved after IFRS adoption, the cost of equity also increased. This suggests that greater transparency may lead investors to see more risk and therefore demand higher returns. In a study of MENA countries, Al-Janabi and Hussainey (2023) found that improvements in financial reporting quality, especially faithful representation and timeliness, made investors more aware of risks. This increased risk perception led to higher required returns, raising the cost of capital. Similarly, Francis et al. (2004) examined several earnings attributes, including timeliness and value relevance. It was found that while some aspects of financial reporting quality reduce the cost of capital, others like timeliness may increase it because they make risks more visible to investors. However, the findings contradict the findings of Barth and Landsman (2020) which argued that higher financial reporting quality, including faithful representation and timeliness, reduces information gaps between firms and investors. As a result, investor confidence increases, and the cost of capital goes down. In research on emerging markets, Ahmed and Alabdullah (2022) found that better financial reporting quality, especially value relevance, significantly lowers the cost of capital. When investors receive more useful information, they feel more secure and demand lower returns. Also, Echobu et al. (2017) carried out a study on Nigerian firms found that accurate and complete financial reporting reduces

the cost of capital. When financial statements clearly reflect a firm's position, investors face less uncertainty and are willing to accept lower returns.

According to the capital market efficiency theory, financial markets reflect all available information in asset prices (Fama, 1970; Malkiel, 2021). In an efficient market, timely and faithfully represented financial information enables investors to make more informed decisions, leading to a more accurate assessment of firm risk. In emerging market like Iraq, where market volatility and geopolitical risks may be higher, the revelation of detailed and timely financial disclosures may increase perceived risk, resulting in higher required returns from investors and hence a higher cost of capital (Al-Janabi & Hussainey, 2023). Considering the finding of value relevance which revealed a negative but insignificant effect on the cost of capital suggests that although decision-useful financial information typically enhances investor confidence and should theoretically reduce the cost of capital in an efficient market (Barth & Landsman, 2020), this effect is not strongly observed in the Iraqi banking sector. This could be attributed to limited investor sophistication, weak enforcement of disclosure standards, or a semi-efficient market environment where information is not fully or rapidly absorbed into asset prices (Ahmed & Alabdullah, 2022). Therefore, while the Iraqi capital market may respond to certain dimensions of reporting quality, its efficiency level may moderate the expected benefits of value relevance in reducing the cost of capital.

5. Conclusion and Recommendations

This study investigated the effect of financial reporting quality on the cost of capital of listed Iraqi banks, recognizing that the cost of capital is a crucial determinant of financial stability, investment decision-making, and overall economic growth. Using accrual-based measures and cost of equity estimation models, the study specifically analyzed the influence of three dimensions of reporting quality; faithful representation, timeliness, and value relevance on financing costs. The regression results showed that both faithful representation and timeliness had a positive and statistically significant effect on the cost of capital, indicating that enhanced transparency could reveal underlying risks and raise investor-required returns. In contrast, value relevance exhibited a negative but statistically insignificant effect, suggesting limited influence within the current structure of Iraq's capital market. The findings were aligned with the theoretical framework of the capital market efficiency theory, which posits that financial markets incorporate all available

information into asset prices, although Iraq's market appears to exhibit semi-efficient characteristics. This study concludes that while financial reporting quality influences the cost of capital in Iraqi banks, the effects vary across its components. Faithful representation and timeliness significantly increase the cost of capital, potentially due to enhanced risk awareness among investors in a volatile environment. Conversely, value relevance does not have a significant impact, possibly due to the market's inefficiencies or lack of investor sophistication. These results underscore the need for a nuanced approach to improving financial disclosure, one that considers the characteristics and maturity of the local capital market.

In line with the findings of this study, it was recommended that regulators and financial institutions should invest in programs that improve investor understanding of financial statements to foster better use of disclosed information in pricing decisions. Secondly, regulatory bodies should ensure strict compliance with international financial reporting standards (IFRS), especially concerning timeliness and relevance of information. Lastly, policymakers should focus on deepening market infrastructure and transparency to transition from a semi-efficient to a more fully efficient capital market environment. The study adds to the growing literature on financial reporting quality by providing empirical evidence from a developing market, specifically Iraq, where capital market dynamics differ from developed economies. The research offers insights into how different reporting attributes influence capital costs, helping regulators tailor disclosure policies to encourage market stability and attract investment. The study contributes to accounting theory by illustrating how the capital market efficiency theory operates in an emerging market context, challenging the assumption that enhanced disclosure always leads to reduced capital costs. Future research could explore the role of investor behavior and risk perception in moderating the relationship between financial reporting quality and the cost of capital. Comparative studies across multiple emerging markets could also help generalize findings and examine whether similar trends exist in other semi-efficient capital markets. Additionally, incorporating qualitative insights from investors and financial analysts may provide a deeper understanding of how financial disclosures are interpreted in practice.

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