

-RESEARCH ARTICLE-

TESTING THE IMPACT OF EARNINGS QUALITY ON STOCK RETURNS: AN ANALYTICAL STUDY IN A SAMPLE OF ARAB FINANCIAL MARKETS

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—Abstract—

This study delves into the correlation between earnings quality and stock returns within Arab financial markets. Through an examination of data encompassing 115 companies listed on the stock exchanges of Iraq, Saudi Arabia, Kuwait, Qatar, Bahrain, and Dubai over the period spanning 2010 to 2021, and employing the weighted least squares method, the study investigates how six metrics of earnings quality impact stock returns. The findings we have arrived at underscore the pronounced significance of earnings quality as reflected in the financial reports of companies. This influence has a bearing on investor confidence levels and, consequently, stock returns. Enhanced transparency in accounting practices can contribute to mitigating the volatility of stock returns, thereby bolstering the appeal for long-term investors. Moreover, the availability of dependable insights into forthcoming performance assumes a pivotal role in shaping investment decisions and the evaluation of companies. As a result, this research forms a foundational basis for making well-informed investment selections grounded in accurate earnings quality data. It sheds illuminating insights on the intricate interplay between earnings quality and the dynamics of stocks within the context of Arab financial markets.

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INTRODUCTION

In the ever-evolving realm of global financial markets, a collective pursuit is underway by investors and researchers to unearth the pivotal determinants that sway stock returns. Amid these influential factors, earnings quality has risen to prominence as a gauge and marker for evaluating a company's financial health and illuminating its potential for enduring expansion (Francis, Olsson, & Schipper, 2008). Consequently, comprehending the intricate interplay between earnings quality and stock returns has garnered pronounced attention from both the academic realm and industry practitioners alike (Perotti & Wagenhofer, 2014). In light of this backdrop, the current analytical study sets out to meticulously examine the correlation existing between earnings quality and stock returns, with a specialized focus on the Arab financial markets. This region has recently witnessed notable strides in growth and development within its financial markets, drawing the keen interest of domestic and international investors who are on the lookout for prospects within these burgeoning economies. Despite the heightened curiosity surrounding Arab financial markets, empirical research ventures delving into the relationship connecting earnings quality and stock returns in this specific geographical context remain notably scarce.

The concept of earnings quality pertains to the level of transparency, dependability, and materiality associated with a company's disclosed results (Francis, Nanda, & Olsson, 2008). The presence of high-quality earnings in a company signifies its capacity to generate consistent profits, efficiently handle risks, and deliver precise and timely financial information to its stakeholders (Dechow, Ge, & Schrand, 2010). Conversely, earnings of inferior quality may indicate the possibility of accounting manipulation, inadequate corporate governance, or a dearth of financial stability (Barth, Landsman, & Lang, 2008; Al-tae & Flayyih, 2023). Hence, this research will employ an analytical methodology, utilising a sample of companies listed in the Arab financial markets, specifically Iraq, Kuwait, Saudi Arabia, Dubai, Bahrain, and Qatar. The objective is to investigate the correlation between the quality of earnings and stock returns. This study endeavours to elucidate the potential correlation between earnings quality and stock returns in the examined markets by means of analysing financial data and performance criteria. The examination will span a wide array of industries and companies of varying sizes in order to offer a full comprehension of the subject matter.

Consequently, the outcomes of this research are anticipated to provide substantial ramifications for diverse stakeholders within the Arab financial markets. Investors can derive advantages from comprehending the influence of earnings quality on stock returns, hence facilitating the development of more resilient investment strategies and portfolios. Furthermore, regulatory organisations and policymakers have the opportunity to utilise the knowledge acquired from this research in order to establish

guiding principles and implement effective frameworks that promote transparency and instill trust in financial reporting practises. Moreover, it is imperative for companies that operate inside Arab financial markets to develop their corporate governance practises and financial reporting in order to raise the quality of their earnings. This, in turn, would make them more appealing to investors who are interested in long-term value creation. The findings of this study have the potential to enhance decision-making processes and promote a more knowledgeable and effective financial ecosystem inside the Arab markets.

As a result, the study has been partitioned into six distinct portions. The initial portion of this study focuses on the conceptual framework that underlies the relationship between earnings quality and stock returns. The subsequent half is dedicated to reviewing the existing research on this topic. The third section is designated for the formulation of hypotheses, while the fourth section will be dedicated to outlining the chosen technique. Lastly, the fifth section will encompass the execution of tests and the subsequent discussion of the obtained results.

The Conceptual Framework of Earnings Quality and Stock Returns

Earnings Quality

The concept of earnings quality pertains to the degree to which the financial statements of a corporation provide an accurate representation of its underlying economic success and overall financial well-being (Dechow & Dichev, 2002). The term "financial reporting quality" can be alternatively characterised as the extent to which financial information possesses reliability, transparency, and accurately reflects the operating circumstances of the organisation (Leuz & Verrecchia, 2000). In contrast, the capacity of publicly reported earnings to consistently forecast future cash flows and corporate success has been examined by Kothari, Leone, and Wasley (2005). Furthermore, the assessment of profits quality can function as a metric to evaluate the consistency and durability of a firm's profitability throughout a period, so indicating its ability to endure adverse economic circumstances (Lang & Lundholm, 1996).

Earnings quality refers to the state of financial reporting integrity, characterised by the absence of earnings management practises and manipulation. According to Roychowdhury (2006), earnings quality pertains to the level of precision in the disclosure of a company's income statement, which reflects its true earnings. The concept of consistency between accounting choices and economic reality is crucial to eliminating information asymmetry between a corporation and its stakeholders (Francis et al., 2004; Hadi et al., 2023). The concept of earnings quality is closely linked to the principle of prudence in financial reporting, since it enables a more expedited assessment of losses and potential risks in comparison to expected gains (Basu, 1997).

Stock Returns

Stock returns are a measure of the percentage fluctuation in the price of a stock within a designated period of time, reflecting the financial gain or loss experienced by investors (Fama & French, 1992). Moreover, the returns on stocks serve as an indicator of the comprehensive profitability associated with holding the stock, encompassing both capital appreciation and income derived from dividend payouts (Jensen, 1968). Stock returns can be interpreted as the remunerations, bonuses, or deficits acquired by investors as recompense for the hazards linked to investing in a specific stock (Sharpe, 1964). Furthermore, Campbell and Shiller (1988) observed that stock returns, which signify alterations in the market value of stocks, are influenced by market sentiment, firm performance, and macroeconomic variables. Stock returns are a metric used to assess the relative performance of a stock in relation to a benchmark index or market index. They provide insights into the stock's capacity to either outperform or underperform (Jensen, Black, & Scholes, 1972).

LITERATURE REVIEW

Prior research investigating the correlation between the quality of earnings and stock returns has produced inconsistent findings. There is evidence demonstrating a positive correlation between improved earnings quality and higher stock returns (Sloan, 1996). This implies that investors place a significant value on financial information that is transparent and dependable. The findings of these studies indicate that firms characterised by superior earnings quality possess a greater ability to attract investors and secure a premium in the securities market (Fatma & Hidayat, 2019). In contrast, some scholarly investigations (Ball, Kothari, & Robin, 2000; Francis et al., 2004; Givoly, Hayn, & Katz, 2017) have reported a tenuous or inconsequential correlation between the quality of earnings and the performance of stocks. These studies indicate that several factors, including macroeconomic conditions, industry-specific characteristics, and market sentiment, may exert a more substantial influence on stock returns in comparison to the exclusive consideration of earnings quality. Numerous scholars have utilised diverse approaches to assess the quality of earnings, encompassing models grounded in accruals, cash flow-based models, and discretionary accruals. Furthermore, other financial indicators, including earnings persistence, earnings predictability, earnings management, and accounting conservatism, have been employed in these research to evaluate distinct aspects of profits quality (Francis et al., 2004).

Within the realm of the importance of earnings quality, a scholarly investigation conducted by Francis and Schipper (1999) delved into the value of financial information, specifically earnings quality, within the capital market. The researchers have identified a significant positive link between the quality of earnings and financial

data, emphasising its importance as a critical determinant for investors when evaluating the worth of a company. Therefore, the research has provided insights into the continued significance of profits quality within the contemporary capital market. In a similar vein, the study conducted by [Beneish \(1999\)](#) examined the correlation between the quality of earnings and the fines incurred as a result of profit overstatement that contravenes the Generally Accepted Accounting Principles (GAAP). According to Beneish, companies characterised by lower earnings quality, indicating a higher likelihood of engaging in earnings manipulation, are susceptible to regulatory penalties and may encounter adverse stock returns. This study highlights the importance of earnings quality in mitigating regulatory infractions and upholding investor trust. Therefore, the research undertaken by [Chan et al. \(2006\)](#) aimed to investigate the correlation between the quality of earnings and stock returns. This investigation utilised a sample of American companies. The researchers have identified a positive association between earnings quality and future stock returns, suggesting that investors assess high-quality earnings favourably. The study highlights the significance of earnings quality in shaping investor expectations and market values. In a similar vein, the research conducted by [Dechow and Dichev \(2002\)](#) sought to examine the correlation between the quality of accruals, earnings, and stock returns within the United States market. The researchers discovered a positive correlation between accrual quality and profits quality in organisations, resulting in increased stock returns. The study emphasises the significance of precise assessment of accruals in the context of financial reporting.

The research conducted by [Francis et al. \(2005\)](#) employed a market-based approach to assess the quality of accruals. The researchers discovered a positive correlation between accrual quality and stock prices, suggesting that investors tend to value companies that offer more dependable and transparent financial data. The study places significant focus on the economic ramifications of accrual quality in relation to firm valuation. Furthermore, the research undertaken by [Kongkaew \(2021\)](#) investigated the influence of earnings quality on the under-pricing phenomenon observed in initial public offerings (IPOs) across global marketplaces. The researchers discovered that initial public offerings (IPOs) of companies exhibiting better levels of earnings quality are associated with reduced under-pricing. This finding implies that the quality of earnings has a significant impact on investor perceptions and pricing determinations within the IPO market. The research conducted by [Ball, Robin, and Wu \(2003\)](#) placed significant focus on the comparison between managerial incentives and accounting standards in their investigation of the correlation between earnings quality and stock returns. Therefore, the primary objective of this study was to examine the correlation between accounting income attributes, such as earnings quality, and their impact on stock returns. The present study centred its attention on four East Asian countries, namely Hong Kong, Malaysia, Singapore, and Thailand. The researchers have demonstrated a positive correlation between earnings quality and stock returns, highlighting the importance of earnings quality as a determinant of investor choices in these markets. In a similar vein,

the research conducted by [Aboody, Hughes, and Liu \(2005\)](#) aimed to investigate the influence of earnings quality on both the cost of capital and stock returns. The study revealed that firms exhibiting superior earnings quality experience reduced capital expenses, suggesting that the market places a premium on earnings of high quality and consequently bestows these companies with elevated stock returns.

In accordance with the previously mentioned, the preceding research offers a wide range of perspectives on the correlation between the quality of earnings and stock returns. The significance of earnings quality as a factor influencing stock prices and investor choices is underscored in both developed and developing markets. The findings highlight the importance of honest financial reporting and precise accrual estimates in the evaluation of companies and the formulation of investment strategies.

Hypothesis development

The process of formulating hypotheses entails the generation of a verifiable explanation or forecast for a phenomenon or issue, drawing upon preexisting knowledge or observations within the realm of scientific inquiry. Hypotheses are constructed as tentative explanations that are open to experimental investigation in order to ascertain their validity or potential for refutation ([Creswell, 2014](#)). Consequently, the procedure of formulating hypotheses encompasses the identification of a research question or issue that necessitates attention, followed by an extensive examination of the scholarly literature and preexisting research pertaining to the subject matter in order to ascertain potential answers or theories. Consequently, it is imperative that hypotheses are firmly rooted in established theoretical frameworks. This entails ensuring that a sound hypothesis aligns with preexisting theories or serves as a foundation for the formulation of novel theoretical constructs. This practise aids in guaranteeing the theoretical rigour of the research and its contribution towards the advancement of knowledge within the respective subject ([Babbie, 2020](#)).

The investigation into the direct influence of earnings quality on stock returns is a fundamental starting point for examining the significance of earnings quality in the formation of a skilled investment portfolio. There has been a significant amount of scholarly attention directed towards examining the correlation between the quality of earnings and the performance of stocks. The notion of earnings quality, in broad terms, pertains to the dependability and durability of earnings that accurately represent the continuous activities of a corporation, as opposed to non-genuine occurrences or breaches of accounting principles. High-quality profits are generally perceived as being more valuable and carrying lower levels of risk in comparison to low-quality profits.

The theoretical underpinning of this association may be traced back to the Efficient Market Hypothesis (EMH), a concept positing that stock prices incorporate all pertinent

information pertaining to a company, such as its earnings (Fama, 1970). Investors are more inclined to invest in a company and subsequently increase its stock price if they perceive the company's earnings to be of high quality and indicative of its continued operations. On the other hand, in the event that investors hold the perception that the firm's earnings possess worse quality, it is more probable that the company would encounter stock selling and, as a result, a decline in its market price. Moreover, the underlying principles of examining the correlation between earnings quality and stock returns can be ascribed to agency theory, a theoretical framework positing that managers may be motivated to manipulate earnings in order to attain certain objectives or optimise their own remuneration (Jensen, Black, & Scholes, 1972). Investors are more inclined to place trust in a company's management and make investments in its stocks if they have the belief that the company's earnings are both dependable and enduring.

The association between the quality of earnings and stock returns may exhibit variability contingent upon the specific qualities of a company. For example, certain research indicate that the correlation may exhibit greater strength in the context of smaller enterprises as opposed to larger ones. The rationale behind this phenomenon is that smaller companies typically possess less resources for the oversight and regulation of their financial statements, thereby amplifying the importance of their earnings' integrity for potential investors. In their seminal work, Dechow and Dichev (2002) conducted a comprehensive examination on the significance of earnings quality in relation to investors. Their investigation yielded compelling data indicating that the association between earnings quality and stock returns exhibits more strength in the context of smaller firms, as opposed to bigger ones. In a study conducted by Chen, Chen, and Cheng (2008), an investigation was undertaken to examine the correlation between family ownership and the quality of earnings in the United Kingdom. The findings of the study revealed that family-owned businesses tend to demonstrate inferior profit quality. Nevertheless, it is worth noting that the inverse correlation between the quality of earnings and stock returns has more strength in the context of smaller family-owned businesses. Additionally, Francis et al. (2004) conducted a study that investigated the correlation between the quality of earnings and the expense of equity, which functions as a substitute for stock returns. The researchers observed a more pronounced correlation between variables in smaller organisations as opposed to larger ones. Moreover, it has been found that a reduction in the level of disclosure policy and an increase in financial reporting opacity contribute to an increase in information asymmetry regarding a company's performance. Consequently, this leads to heightened volatility in the stock price (Rajgopal & Venkatachalam, 2011). According to Moradi, Jabbari Nooghabi, and Rounaghi (2021), an escalation in information risk is associated with an elevation in stock price volatility. The occurrence of information risk might be observed in the form of either information asymmetry or substandard earnings quality (Leuz, Nanda, & Wysocki, 2003). Hence, this study utilises a methodology that involves the examination of six indicators of earnings quality, including accurate quality,

persistence, predictability, smoothness, value relevance, and conservatism, in order to assess their correlation with stock returns.

According to [Chan et al. \(2006\)](#), the concept of accrual quality is regarded as an integral aspect of earnings, independent of cash flows. The relationship between accrual quality and information risk is established, as evidenced by the occurrence of earnings manipulation throughout the accrual estimation process ([Francis et al., 2004](#)). Hence, in the event of inaccuracies in these predictions, the reported profitability of the organisation may become distorted. There is an anticipation that the quality of accruals will exhibit a positive correlation with the volatility of stock returns. In addition, it is worth noting that persistent earnings, which denote profits that can be maintained over time, have the effect of decreasing the level of uncertainty associated with the reported earnings of a company ([Dechow, Ge, & Schrand, 2010](#)). Hence, the concept of earnings persistence is linked to the notion of information risk, wherein greater persistence serves to mitigate information risk. A study by [Lipe \(1990\)](#) defines predictability as the "ability of past earnings to predict future earnings." According to [Francis et al. \(2004\)](#) and [Dichev and Tang \(2009\)](#), companies with more predictable earnings experience lower forecast errors, enabling financial analysts to make more precise evaluations of the company's value. If the presence of predictability in financial earnings improves the quality of those earnings, then it may be inferred that earnings predictability is indirectly associated with the level of information risk. Results smoothness, which is achieved by managerial modifications to mitigate fluctuations in reported results, is widely recognised as a manifestation of earnings management ([Tucker & Zarowin, 2006](#)). Hence, it may be inferred that the presence of earnings smoothness is expected to diminish the overall quality of results, as managers deliberately engage in earnings manipulation with the aim of obtaining a favourable position in the capital market. This observation suggests a lack of earnings quality ([Leuz, Nanda, & Wysocki, 2003](#)). As a result, it becomes difficult to differentiate between stability that arises from the appropriate implementation of accounting practises and smoothness that is a consequence of earnings management. Therefore, it is anticipated that the smoothness of profits will have a direct effect on the level of information risk and, as a result, on stock returns. Companies that exhibit more earnings smoothness are more likely to encounter elevated levels of information risk in comparison to companies with lower earnings smoothness. Value relevance pertains to the suitability of accounting figures in the context of making investment decisions. Consequently, it is anticipated that earnings of superior quality will possess value-relevance, so establishing a correlation with the variability of stock returns ([Barth, Li, & McClure, 2023](#)). Accounting conservatism, which is distinguished by the adoption of cautious estimating and judgement techniques ([Basu, 1997](#)), is anticipated to heighten information risk and hence augment stock return volatility for firms that employ conservative accounting practises. Based on the above discussion, the following hypotheses were formulated:

Hypothesis 1: *A statistically significant negative correlation exists between the quality of accruals and stock returns.*

Hypothesis 2: *There is a statistically significant positive association between earnings continuity and stock returns.*

Hypothesis 3: *Earnings predictability is positively correlated with stock returns in a statistically significant manner.*

Hypothesis 4: *There is a statistically significant negative relationship between earnings smoothness and stock returns.*

Hypothesis 5: *Value relevance is positively linked to stock returns in a statistically significant manner.*

Hypothesis 6: *Accounting conservatism demonstrates a statistically significant negative relationship with stock returns.*

METHODOLOGY

Measurement of Study Variables

The study variables have been classified into three distinct categories, namely the dependent variable, explanatory variables, and control factors, in the following manner:

Measurement of the Dependent Variable

Stock returns pertain to the monetary profits or losses derived from the act of owning and engaging in transactions involving stocks. The calculation of annual stock returns for the companies in the study sample can be derived through the utilisation of the subsequent mathematical equation (Elton et al., 2009):

$$R_t = \frac{P_t - P_{t-1}}{P_{t-1}} \times 100 \quad (1)$$

Where: R_t = Return for year t. P_t = Closing price for year t. P_{t-1} = Closing price for year t-1.

Measuring the Explanatory Variables

The study utilised six explanatory factors that are indicative of the quality of earnings (accrual quality, persistence, predictability, smoothness, value relevance, and accounting conservatism) as follows:

Accrual Quality

The study measured accrual quality based on the model proposed by Dechow and Dichev (2002), as represented in the following equation:

$$\frac{TCA_{j,t}}{Assets_{j,t}} = \beta_0 + \beta_1 \frac{CFO_{j,t-1}}{Assets_{j,t}} + \beta_2 \frac{CFO_{j,t}}{Assets_{j,t}} + \beta_3 \frac{CFO_{j,t+1}}{Assets_{j,t}} + \varepsilon_{j,t} \quad (2)$$

Equation (2) demonstrates the relationship between the variables in question, where (TCA) symbolises total current accruals, (CFO) represents operating cash flows, and (Assets) means total assets. The aforementioned equation is grounded in theoretical principles, aiming to effectively incorporate historical, present, and future operating cash flows that are linked to the whole current accruals. Furthermore, the explanatory power of the independent variables in the equation is evaluated by means of beta coefficients. The residuals in the regression equation represent the estimation error, which encompasses accruals that are unrelated to actual cash flows. The measurement of accrual quality is represented by the standard deviation of these residuals. According to [Kim and Qi \(2010\)](#), an elevation in the standard deviation signifies a reduction in the quality of accruals, which consequently leads to a deterioration in the quality of earnings. The aforementioned model was implemented on every company within the sample of the study in order to calculate the standard deviation of residuals derived from the model. For every individual company, a total of 48 quarterly observations were conducted.

Earnings persistence and Predictability

The following regression equation was employed to measure earnings persistence:

$$\frac{Earnings_{j,t}}{Assets_{j,t}} = \beta_0 + \beta_1 \frac{Earnings_{j,t-1}}{Assets_{j,t-1}} + \varepsilon_{j,t} \quad (3)$$

Equation (3) represents a simple linear regression model, which serves as a time series model where the value of the variable "Net Earnings Before Extraordinary Items" ($Earnings_{j,t}$) for the current year is a result of a linear relationship with the variable "Net Earnings Before Extraordinary Items" ($Earnings_{j,t-1}$) for previous years, in addition to the estimation error ($\varepsilon_{j,t}$). The parameter values (β) represent the level of earnings persistence, with values closer to or exceeding one indicating a high degree of persistence, while values approaching zero suggest lower earnings quality due to the inclusion of temporary elements such as earnings derived from non-recurring activities of the company ([Francis, Nanda, & Olsson, 2008](#)). The researchers applied this model to every company included in the study sample in order to measure profits persistence. Each company was observed on a quarterly basis, resulting in a total of 48 instances. In addition, the measurement of predictability is determined by the variance of residuals, also known as estimate errors, obtained from Equation (3). This equation indicates the portion of the data that is not accounted for by the explanatory variable ($Earnings_{j,t}$). Thus, the measure of predictability is adopted using the square root of the variance of the estimated error ($\varepsilon_{j,t}$) according to the following equation ([Francis et al., 2004](#)):

$$Predictability_{t,j} = \sqrt{\sigma^2(\varepsilon_{j,t})} \quad (4)$$

Smoothness

smoothness is measured as an indicator of its quality according to the following equation:

$$Smooth_{j,t} = \frac{\sigma(NIBE_{j,t})}{Total\ Assets_{j,t-1}} / \frac{\sigma(CFO_{j,t})}{Total\ Assets_{j,t-1}} \quad (5)$$

Equation (5) illustrates that ($Smooth_{j,t}$) represents earnings stability (smoothing), while $\sigma(NIBE_{j,t})$ stands for the standard deviation of Net Income Before Extraordinary Items, $\sigma(CFO_{j,t})$ is the standard deviation of Cash Flows from Operations, and ($Total\ Assets_{j,t-1}$) represents total assets in the previous year. The determination of a company's earnings smoothing extent is contingent upon the outcome of the equation. An upward trend in the ratios signifies greater volatility in net income before extraordinary items in relation to the variability of cash flows from operations. Thus, an upward trend in the smooth indicator is associated with reduced earnings quality, whereas a downward trend in the smooth indicator suggests increased stability and, hence, improved earnings quality (Francis et al., 2004). The aforementioned model is employed in the analysis of the sample companies included in the study, in order to assess the level of earnings smoothness. Each individual company in the sample is observed on a quarterly basis, resulting in a total of 48 observations per company.

Value Relevance

Value relevance is measured according to the following equation:

$$RET_{j,t} = \delta_{0,j} + \delta_{1,j}EARN_{j,t} + \delta_{2,j} \Delta EARN_{j,t} + \varepsilon_{j,t} \quad (6)$$

Equation (6) illustrates that ($RET_{j,t}$) represents the company's stock return at the end of period (t), and ($EARN_{j,t}$) represents an explanatory variable denoting the earnings before extraordinary items of company j in period t, divided by the market value at the end of period t-1. Meanwhile, ($\Delta EARN_{j,t}$) indicates the change in earnings before extraordinary items of company j in period t, divided by the market value in period t-1. The coefficients ($\delta_{1,j}$) and ($\delta_{2,j}$) represent the model parameters, and ($\varepsilon_{j,t}$) denotes the residuals. The measurement of value relevance is based on the explanatory power of the adjusted determination coefficient (adjusted R^2), derived from equation (6). A greater adjusted R^2 value signifies a more robust capacity of accounting earnings to elucidate fluctuations in stock returns, hence suggesting a superior quality of accounting earnings (Francis et al., 2004). The aforementioned model is employed on every organisation

inside the sample of the study in order to ascertain the value relevance of the said model. The total number of observations conducted on a quarterly basis amounts to 48.

Conservatism

The Basu model (1997) is widely recognised as the foundational framework for assessing accounting conservatism. This model was utilised by Francis et al. (2004) in their research. The Basu model is widely acknowledged for its utilisation of a reverse regression model, which involves accounting earnings being regressed on concurrent stock returns. This relationship is mathematically represented by the following equation:

$$EARN_{j,t} = \alpha_{j,t} + \alpha_{1,j}NEG_{j,t} + \beta_{1,j}RET_{j,t} + \beta_{2,j}NEG_{j,t}RET_{j,t} + \varepsilon_{j,t} \quad (7)$$

Equation (7) illustrates that ($EARN_{j,t}$) represents the net income before extraordinary items for company j in year t , divided by the market value at the end of year $t-1$. Meanwhile, ($NEG_{j,t}$) denotes a dummy variable that takes the value (1) if the market returns of stock j during period t are negative, and (0) if not. Additionally, ($RET_{j,t}$) signifies the return of stock j after the end of the fiscal year t . If stock returns are positive (good news), the dummy variable (NEG) will be equal to zero. Consequently, the regression equation (7) takes the following form:

$$EARN_{j,t} = \alpha_{j,t} + \beta_{1,j}RET_{j,t} + \varepsilon_{j,t}$$

However, if the stock returns are negative (bad news), the dummy variable (NEG) will take the value of one. Consequently, the regression equation (7) will take the following form:

$$EARN_{j,t} = \alpha_{j,t} + \alpha_{1,j} + (\beta_{1,j} + \beta_{2,j}) \cdot RET_{j,t} + \varepsilon_{j,t}$$

Therefore, ($\beta_{1,j}$) represents the slope coefficient of the estimated returns for positive-sign stock returns, indicating the timing appropriateness of accounting earnings towards positive news. Conversely ($\beta_{2,j}$) represents the slope coefficient of the estimated returns for negative-sign stock returns, indicating the timing appropriateness of accounting earnings towards negative news. Thus, the conservatism in accounting relies on the ratio of the slope coefficient of the estimation for negative returns to the slope coefficient of the estimation for positive returns, as follows:

$$Conservatism = (\beta_{1,j} + \beta_{2,j})/\beta_{1,j}$$

The aforementioned model was employed for each organisation within the study sample to get the accounting conservatism. A total of 48 quarterly data were collected.

Measurement of Control Variables

The existing body of financial and accounting research (Dechow & Dichev, 2002; Domingues, 2016; Francis et al., 2004; Rajgopal & Venkatachalam, 2011) provides insights into several elements that serve as variables to describe a company's operational success and function as controls for stock returns. The variables under consideration encompass business size, leverage, market-to-book ratio, standard deviation of operating cash flows, and return on assets. These variables have the potential to influence fluctuations in stock returns, either positively or negatively. Consequently, the linear regression model employed in this study incorporates these factors. The measurement of firm size was obtained by taking the natural logarithm of the total assets. The calculation of leverage involved determining the ratio between the aggregate amount of debt and the overall value of assets. The growth rate (B/M) was determined through the division of the market value of equity by the book value of equity. Similarly, the return on assets (ROA) was computed by dividing the net income by the total assets. The observations were derived by calculating the averages over the study period.

Sample and Data

The study sample comprised all firms that were listed in six Arab financial markets, namely Iraq, Kuwait, Saudi Arabia, Dubai, Bahrain, and Qatar, throughout the period from 2010 to 2021. As a result, it was necessary for organisations to satisfy a certain set of criteria in order to be included in the sample for the study. The criteria encompassed in these conditions involved the absence of trade suspension throughout the duration of the study, consistent dissemination of financial statements, and provision of the requisite accounting and financial data for the computation of model variables. Consequently, a total of 115 organisations from several industries were included in the study sample, meeting the aforementioned criteria (financial, industrial, services, investment, agricultural). The study collected quarterly observations for each company, yielding a cumulative count of 48 observations per company. The primary data were collected from the official websites of Arab financial markets, regulatory authorities, and the selected companies' public websites. In order to optimise the number of observations, it is noteworthy to acknowledge that the study duration spanned from 2010 to 2021. The investigation encompassed a total of 115 companies, with each variable being computed twice for every company, taking into account the quarterly data. The initial computation encompassed the time frame between 2010 and 2016, whilst the subsequent computation pertained to the interval spanning

from 2015 to 2021. Consequently, two observations were gathered for each variable, resulting in a cumulative total of 230 observations.

Study Model

To test the hypotheses of the study, a multiple linear regression model was employed. The model is as follows:

$$SR_{i,t} = \beta_0 + \beta_1 EQ_{i,t} + \beta_2 Size_{i,t} + \beta_3 Leverage_{i,t} + \beta_4 (B/M)_{i,t} + \beta_5 \sigma(CFO)_{i,t} + \beta_6 ROA_{i,t} + \mu_{i,t} \quad (8)$$

Equation (8) elucidates the variables in play: (SR_(i,t)) symbolizes the yearly return of company (i) during year (t), with ([EQ] (i,t)) capturing the earnings quality of the same company and year. This measure draws from six criteria—namely, receivables quality, persistence, predictability, smoothness, relevance, and conservatism. (Size_(i,t)) pertains to the company's size, calculated by dividing the total assets of company (i) in year (t) by the financial market's market value. ([Leverage] (i,t)) characterizes the financial leverage of company (i) during year (t).

Furthermore, (B/M) (i,t) signifies the ratio of stock price growth for company (i) in the specific year (t), while ([σ(CFO)] (i,t)) captures the standard deviation of operating cash flows for the same company and year. In contrast, ([ROA] (i,t)) denotes the return on assets for company (i) during year (t). The parameter (β) assumes significance as the coefficients within the subsequent model, shaping its outcomes. Lastly, (μ_(i,t)) represents the residuals within the regression equation, signifying unaccounted variations.

Equation (8) demonstrates the relationship between earnings quality, as assessed by its six criteria, and stock returns. It also takes into account the influence of operational performance indicators as controlling factors in the determination of stock returns. The analysis is conducted using a dataset consisting of 230 observations, where each company is represented by two observations. As a result, statistical tests and diagnostics will be employed to evaluate the validity of the model and detect any potential concerns. It is important to acknowledge that Equation (8) was utilised on six occasions, aligning with the hypotheses of the study.

Description of Study Variables

The research encompassed a total of twelve variables, comprising six explanatory (independent) variables, five control variables, and one dependent variable. As detailed in [Table 1](#), the statistical indicators were generated and the cause-effect relationship between the explanatory variables and the dependent variable was analyzed. This analysis was facilitated through the utilization of two software packages: EViews V10 and SPSS V26.

Table 1. Description of Study Variables

Symbol	Variable Code	Description
Dependent Variable		
Y	Stock return	Stock returns are typically measured as the percentage change in the price of a stock over a specific period of time
Explanatory Variables		
X1	Accrual quality	Accrual quality computed as the standard deviation of residual obtained using the modified Dechow and Dechev, 2002
X2	Persistence	Earnings persistence calculated as the slope coefficient of the regression of current earnings on past earnings
X3	Predictability	Earnings predictability computed as the variance obtained from the earnings persistence model
X4	Smoothness	Earnings smoothness calculated as the ratio of standard deviation of operating income divided by cash flow from operation
X5	Relevance	estimated using the Basu, 1997
X6	Conservatism	Conditional conservatism, estimated using the Basu
Control Variables		
W1	Size	The size of the firm
W2	Leverage	The financial leverage of the firm
W3	BTM	Book-to-Market ratio of the firm
W4	$\sigma(CFO)$	Standard deviation of operating cash flows
W5	ROA	Return on Assets

The table, as prepared by the researchers

The Statistical Indicators

To distill the intricate and comprehensive study data into a succinct and comprehensible form, specific statistical indicators have been employed. The intention behind this approach is to aid researchers and readers in gaining a clearer grasp of the presented results and information. A range of statistical indicators has been computed for each variable encompassing the explanatory variables and the dependent variable. These indicators encompass the mean, standard deviation, minimum, and maximum values. For a comprehensive view of these calculated indicators for each variable, please refer to [Table 2](#):

Table 2. Statistical Indicators for Study Variables

variable	Sample Size	Mean	Standard Deviation	Minimum	Maximum
Stock return	230	0.621	1.241	-1.92	6.12
Accrual quality	230	0.644	1.283	-1.74	6.61
Persistence	230	0.657	0.277	-0.09	1.57
Predictability	230	0.177	0.052	0.03	0.37
Smoothness	230	1.081	0.757	0.00	4.08
Relevance	230	0.321	0.050	0.03	0.43
Conservatism	230	0.772	1.287	-3.09	4.04
Size	230	1.516	0.294	1.05	2.04
Leverage	230	0.142	0.207	-0.14	2.09
BTM	230	26.569	8.590	8.15	61.58
CFO	230	1.738	1.299	0.02	6.44
ROA	230	0.713	1.303	-1.61	8.86

Prepared by the researchers based on the results of statistical analysis using SPSS V26

Testing the Normal Probability Distribution of the Data

This test stands as a pivotal initial assessment for the data, with its primary aim being the determination of whether the data associated with the variables under study adheres to a normal probability distribution (referred to as Tests of Normality). The outcome of this test plays a critical role in guiding the subsequent course of action. If the data showcases adherence to a normal probability distribution, conventional techniques such as the Ordinary Least Squares method will be utilized for parameter estimation within the regression model. Conversely, if the data deviates from normality, alternative approaches will be engaged for the purpose of estimation (Weighted Least Squares method, Robust Least Squares method, ... etc).

Table 3. Kolmogorov-Smirnov Test for Testing the Probability Distribution of Data

Variables	Tests of Normality			
	Kolmogorov-Smirnov Test			
	Statistic	df	P-value	Decision
stock return	0.1000	230	0.0000	Reject Null Hypothesis
Accrual quality	0.0980	230	0.0000	Reject Null Hypothesis
Persistence	0.0260	230	0.200*0	Accept Null Hypothesis
Predictability	0.0390	230	0.200*0	Accept Null Hypothesis
Smoothness	0.0830	230	0.0010	Reject Null Hypothesis
Relevance	0.0770	230	0.0020	Reject Null Hypothesis
Conservatism	0.0430	230	0.200*0	Accept Null Hypothesis
Size	0.0850	230	0.0000	Reject Null Hypothesis
Leverage	0.1470	230	0.0000	Reject Null Hypothesis
BTM	0.0970	230	0.0000	Reject Null Hypothesis
CFO	0.1240	230	0.0000	Reject Null Hypothesis
ROA	0.0730	230	0.0050	Reject Null Hypothesis

Prepared by the researchers based on the results of the statistical analysis.

The data presented in [Table 3](#) is rooted in the statistical assessment conducted using the Kolmogorov-Smirnov test. This test scrutinizes the probability distribution characterizing the data. The outcomes displayed in [Table 3](#) point to a distinct pattern: most variables, with the exception of "predictability," "Persistence," and "Conservatism," do not conform to a normal probability distribution. This conclusion is drawn from the fact that the calculated p-values are notably below the significance threshold of 0.05. Intriguingly, these three variables—namely, "predictability," "Persistence," and "Conservatism"—do exhibit a normal probability distribution. This assertion is reinforced by their p-values of 0.200, which surpass the threshold of 0.05. It is worth noting that the hypothesis for the normal distribution test is as follows:

Null Hypothesis: The data follows a normal probability distribution.

Alternative Hypothesis: The data does not follow a normal probability distribution.

Testing the Normality of Residuals

The assessment of the error variable's normal distribution, as depicted in the figures presented in Appendix (A) along with the corresponding tables, stands as a pivotal stage in the decision-making process concerning the utilization of the Ordinary Least Squares (OLS) regression method for effect analysis. Within this context, the Jarque-Bera test emerges as a critical tool for validation. This test hinges on the probability value (Probability) linked to the assessment. This probability value serves as a key metric to gauge whether the error variable aligns with a normal distribution or deviates from it. The hypotheses used for this test are as follows:

Null Hypothesis: The error variable follows a normal distribution. Alternative Hypothesis: The error variable does not follow a normal distribution.

Upon reviewing the six figures provided in Appendix (A), it becomes evident that the error variable within each model deviates from a normal distribution. This conclusion is substantiated by the probability value (Probability) associated with the Jarque-Bera test, which is uniformly calculated as (0.000) across all models. This value is below the significance threshold of (0.05). Consequently, the null hypothesis is rejected in favor of the alternative hypothesis. This outcome implies that the error variable does not conform to a normal distribution.

Testing for Multicollinearity

Numerous techniques are available to identify the presence of multicollinearity, with one of the pivotal methods being the Variance Inflation Factors (VIF) test. This examination becomes crucial, with a key threshold being a VIF value surpassing (10), signaling the potential existence of multicollinearity. The outcomes of this test for each model are comprehensively displayed in [Table 4](#).

Table 4. Variance Inflation Factors (VIF) test for examining multicollinearity.

Variable	Variance Inflation Factors (VIF)					
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Accrual quality	1.020844	1.009858	1.038912	1.008252	1.014050	1.008824
Persistence	1.010871	1.007575	1.006744	1.006813	1.014136	1.007092
Predictability	1.014988	1.017967	1.027074	1.027880	1.016836	1.020184
Smoothness	1.014939	1.003841	1.014577	1.005471	1.002176	1.002531
Relevance	1.016161	1.017398	1.016599	1.015253	1.015687	1.014864
Conservatism	1.031178	1.009389	1.054787	1.016746	1.014974	1.006742

Preparing the researchers, statistical analysis results using EViews V10.

The findings presented in Table 4 demonstrate that in five out of the six examined models, there is no evidence of a multicollinearity issue. This conclusion is substantiated by the Variance Inflation Factor (VIF) coefficients, all of which fall below the threshold of (10).

Autocorrelation

Autocorrelation is a phenomenon that frequently emerges in studies involving time series data and occasionally in cross-sectional data as well. It occurs due to a variety of reasons, including the omission of crucial explanatory variables from the analyzed model, incorrect assumptions about the relationship between the dependent and explanatory variables (assuming linearity when it's not the case, for instance), or the influence of random factors leading to successive error values being correlated. Such situations can arise in contexts like wars, instability, or droughts, where their impacts persist across several consecutive years of observed samples. To discern the presence or absence of autocorrelation, multiple tests are available. Among these, the Arellano-Bond serial correlation test stands out as a significant tool. This test aids in assessing whether autocorrelation is present or not in the analysed data. The hypothesis used for this test is as follows:

Null Hypothesis: There is no autocorrelation among errors. Alternative Hypothesis: There is autocorrelation among errors.

The purpose of this test is to assess the presence of autocorrelation in the errors of the model, which is essential for comprehending the soundness and dependability of the statistical analysis outcomes.

Table 5. for testing autocorrelation

Arellano-Bond serial correlation					
Prob. Chi-Square (2)					
Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
0.439	0.317	0.376	0.231	0.347	0.233

Preparing the researchers

Upon examination of the data presented in [Table 5](#), it is evident that the p-value (Prob. Chi-Square (2)) associated with this particular test exceeds the threshold of significance (0.05) for all values. Consequently, the null hypothesis will be deemed valid, signifying the lack of autocorrelation among errors.

Heteroscedasticity

The issue of heteroscedasticity becomes evident when utilizing the least squares method for regression analysis. Empirical studies have highlighted that in the presence of this problem, we can derive unbiased linear estimates for regression parameters. However, the precision of these estimates is compromised since the dispersion of estimated observations around the regression line is not minimized as effectively as it would be using methods other than least squares. This leads to an inflation of variance, consequently yielding larger standard errors when estimating regression parameters. As a result, the model loses one of the core attributes of the least squares method: the property of minimizing unbiased variance. Numerous techniques are available for detecting heteroscedasticity. These include graphical representations that showcase the variation of error values over time, as well as more rigorous mathematical tests. Notably, the Breusch-Pagan-Godfrey Test stands out as a significant method for identifying heteroscedasticity, particularly within the context of panel data models. The hypotheses for this test are as follows:

Null Hypothesis: Errors have homoscedastic variance. Alternative Hypothesis: Errors have heteroscedastic variance.

Table 6. for testing heteroscedasticity

Breusch-Pagan-Godfrey Test					
Prob. Chi-Square (6)					
Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
0.218	0.357	0.436	0.463	0.554	0.096

Preparing the researchers

Based on the observations made from the data shown in [Table 6](#), it is evident that the p-values (Prob. Chi-Square (6)) associated with this test are all more than 0.05. Consequently, the null hypothesis will be upheld, signifying the lack of heteroscedasticity in the error variance.

Hypothesis Testing and Results Discussion

In [Table 7](#), the outcomes of the analysis concerning the influence of earnings quality on stock returns across six models are presented. The initial model, which examines the first hypothesis, underscores a notable and statistically significant inverse impact of accrual quality on stock returns. For every one-unit increase in the standard deviation of residuals derived from the accrual quality equation, a corresponding decrease of (0.343) is observed in stock returns. This effect's statistical significance is highlighted by the t-test's absolute value, which records a significant value of 6.565, surpassing the critical threshold of 1.96.

This observed inverse correlation between earnings quality and stock returns can be attributed to the practice of earnings management. When accrual quality diminishes due to heightened standard deviation of residuals stemming from the accrual quality equation, it may imply the presence of earnings management activities. Earnings management encompasses the manipulation of accounting decisions to artificially inflate reported earnings. While such actions might initially yield a temporary rise in stock prices, they could erode investor confidence over time, leading to uncertainty surrounding the company's true financial state. As a consequence, as investor scepticism grows about potential manipulation, stock returns may experience a decline.

In the second model, dedicated to examining the second hypothesis, a pronounced and statistically significant positive influence of earnings persistence on stock returns is evident. For each incremental unit increase in earnings persistence (Persistence), there is a corresponding increase of (0.635) in stock returns. This effect attains statistical significance at the 10% level. The observed positive correlation between earnings persistence and stock returns can be attributed to investors' perceptions and anticipations concerning reduced risks. Elevated earnings persistence implies greater consistency in a company's earnings stream over time, which often aligns with a higher level of stability and predictability in the company's financial performance. This, in turn, tends to engender more favourable expectations among investors, as it reduces uncertainty and contributes to their confidence in the company's financial outlook. As a result, investors may view the company as having a lower risk profile, leading to increased stock returns. Companies exhibiting elevated levels of earnings are frequently regarded as possessing greater earnings persistence and a reduced susceptibility to abrupt shocks or unfavorable economic circumstances. This perception tends to foster the perspective among investors that these companies are characterized by enhanced stability and reliability. As a consequence, investor confidence in the capacity for realizing heightened stock returns is bolstered, stemming from the belief that these companies are positioned as steadfast and dependable performers within the market.

In the context of the third model, designed to test the third hypothesis, it becomes apparent that there exists a notable and meaningful influence of earnings predictability (referred to as predictability) on stock returns (referred to as stock return). As the degree of earnings predictability advances by a single unit, there is an associated rise of 3.449 units in stock returns. This influence carries statistical significance at a 10% level. The observed positive correlation between the predictability of earnings and stock returns can be attributed to the reality that enhanced predictability in earnings leads to a more distinct and dependable comprehension of the company's forthcoming financial performance. This, in turn, aids in diminishing uncertainty among investors. When investors possess a more comprehensive understanding of the company's performance outlook, their confidence in making investment choices tends to increase. This heightened confidence has the potential to foster greater demand for the company's stocks, consequently propelling their price upwards and culminating in augmented stock returns.

Table 7. Effect of Earnings Quality on Stock Returns

	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6	
	Estimate	t-stat	Estimate	t-stat	Estimate	t-stat	Estimate	t-stat	Estimate	t-stat	Estimate	t-stat
Intercept	2.286**	5.869	2.066	4.041	1.249	2.229*	2.074	3.975	1.083	1.573	1.616	3.670**
Size	-0.595*	-2.464	-0.039	-0.144	-0.324	-1.132	-0.223	-0.792	-0.095	-0.342	0.001	0.006
Leverage	-0.348	-0.725	-0.585	-1.455	-0.497	-1.295	-0.510	-1.331	-0.502	-1.237	-0.519	-1.002
BTM	-0.030**	-3.296	-0.019	-2.127*	-0.011	-1.064	-0.016	-1.528	-0.020	-2.178*	-0.022	-2.142*
CFO	-0.112	-1.236	-0.154	-2.521*	-0.158	-2.386*	-0.148	-2.261*	-0.151	-2.458*	-0.193	-1.980*
ROA	0.115	1.766	-0.130	-2.107*	-0.142	-2.302*	-0.131	-2.128*	-0.119	-1.913	0.143	2.005*
Accrual quality	-0.343**	-6.565										
Persistence			0.635	2.180*								
predictability					3.449	2.030*						
Smoothness							-0.242	-2.268*				
Relevance									1.998	1.280		
Conservatism											-0.126	-2.200*

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In the context of the fourth model, designed to examine the fourth hypothesis, it becomes apparent that there exists a noteworthy adverse impact of earnings smoothness (referred to as Smoothness) on stock returns (referred to as stock return). With an elevation of one unit in earnings smoothness, there is a corresponding reduction of (0.242) units in stock returns. This impact holds statistical significance at a 10% level. The observed inverse connection between earnings smoothness and stock returns can be attributed to the fact that an elevated degree of smoothness could potentially mask substantial risks inherent in the company's operations. Investors might interpret consistent earnings as an indication of limited transparency concerning the genuine nature of the company's performance. This interpretation might foster the belief that the company is not providing a comprehensive view of its financial position, consequently undermining investor trust and leading to diminished stock returns.

In the context of the fifth model, which aims to assess the fifth hypothesis, an insignificant favourable impact of relevance (referred to as Relevance) on stock returns (referred to as stock return) is observed. The absence of statistical significance in this positive impact could potentially be ascribed to the inefficiencies present in the financial markets within the study sample. If the market operates efficiently and swiftly integrates pertinent information into stock prices, the influence of relevance on stock returns might be limited. Under such circumstances, factors connected to tangible financial performance, the disclosure of information, and macroeconomic conditions could play a more substantial role in shaping stock returns.

In the context of the sixth model, established to examine the sixth hypothesis, a notable

adverse impact of accounting conservatism (referred to as Conservatism) on stock returns (referred to as stock return) becomes evident. With a rise of one unit in conservatism, there is a corresponding decline of (0.126) units in stock returns, and this impact bears statistical significance at a 10% level of significance. The rationale behind this inverse impact can be attributed to the practice of deferring the recognition of profits. Within financial reports, accounting conservatism signifies a cautious methodology, where potential losses or risks are acknowledged more promptly than prospective gains. This approach may lead to a lag in acknowledging positive earnings or gains, consequently causing a reduction in reported profits. Investors frequently exhibit a preference for companies that embrace more transparent and punctual recognition practices. The delay in acknowledgment can result in heightened uncertainty and reduced investor trust, potentially culminating in diminished demand for stocks and ultimately yielding lower stock returns.

Quality Model Evaluation

The assessment of the estimated models' effectiveness requires an analysis of the error values, which signify the disparity between the genuine values and the projected values of the dependent variable. The figures presented in Appendix (B) depict the projected values (referred to as Fitted values), the real values, and the error values (referred to as Residual values) associated with the dependent variable. The findings highlight a convergence between the projected and genuine values, evident from the graphical representation where the line of projected values closely tracks the line of actual values. This alignment serves as substantiation of the calibre of the model.

CONCLUSION

This research delved into the examination and analysis of the influence that earnings quality exerts on stock returns across six Arab financial markets: Iraq, Saudi Arabia, Kuwait, Qatar, Bahrain, and Dubai. The investigation encompassed a dataset of 115 companies and spanned from 2010 to 2021. This extended time frame allowed for a comprehensive and thorough comprehension of the dynamic between earnings quality and stock returns within the context of Arab financial markets. The study's findings indicated the existence of an adverse impact related to the quality of receivables. Specifically, a noteworthy and statistically significant negative effect of receivables quality on stock returns was observed. This observation encompasses the potential scenario in which earnings management practices contribute to artificial inflation of profits, consequently affecting the level of trust derived from company financial reports and, in turn, leaving an imprint on stock returns.

Furthermore, the study unveiled a noteworthy positive influence of earnings persistence on stock returns. This finding can be attributed to investors' tendency to view companies with consistent earnings as possessing lower risk levels and demonstrating greater sustainability in their performance. Additionally, the research identified a significant positive impact of earnings predictability on stock returns. This underscores the significance of stability and the confidence it instils in investors regarding future financial performance. In contrast, the study brought to light a meaningful negative

impact of earnings smoothness on stock returns. This outcome suggests the potential presence of concealed risks beneath the façade of stability, which can undermine transparency and erode trust among investors. The lack of a significant effect of relevance value on stock returns indicates that the study was unable to establish a substantial link between relevance value and stock returns. This could be attributed to various market dynamics or accounting intricacies that may have influenced this relationship. Additionally, the study elucidated a significant adverse impact of accounting conservatism on stock returns. This outcome highlights the consequence of deferred profit recognition and sheds light on how such delays can impact investor trust and investment decisions.

These findings significantly advance our comprehension of the intricate interplay between earnings quality and stock performance within Arab financial markets. They cast a spotlight on the increasing significance of earnings quality within company financial reports and its profound implications on both investor trust and stock returns. The study effectively underscores the critical need to strike a delicate equilibrium between profit generation and upholding rigorous accounting and ethical standards. Moreover, the outcomes emphasize that companies can derive substantial benefits from adopting transparent and dependable financial and managerial practices. This can result in mitigated volatility in stock returns and bolster the attractiveness of these companies to long-term investors. Furthermore, the research underscores the pivotal role of furnishing accurate and comprehensible information regarding future performance expectations and the application of accounting conservatism. Such practices can exert a noteworthy influence on investment choices and the assessments made by investors and financial experts regarding companies.

Notably, the study's results offer a valuable foundation upon which to base more astute investment decisions, grounded in precise data pertaining to earnings quality. This information equips investors with the tools to make well-informed choices and navigate the complexities of the Arab financial markets more adeptly. The study also serves as a catalyst for promoting further research and analysis aimed at uncovering additional factors that could potentially impact the intricate connection between earnings quality and stock returns across diverse financial and economic settings. In a broader sense, this study reaffirms the critical significance of attaining equilibrium among financial goals, ethical principles, and transparency practices. This holistic approach is instrumental in fostering enduring trust and amplifying the value of stocks over the long term. The study's findings reiterate the ongoing necessity for continuous enhancements in company disclosures and financial reporting. Adhering to the utmost standards of precision and quality in these aspects holds the potential to construct more durable and dependable relationships with investors and other stakeholders. This proactive commitment to transparency contributes to the cultivation of sustainable and trustworthy partnerships, serving the best interests of both companies and their associated stakeholders.

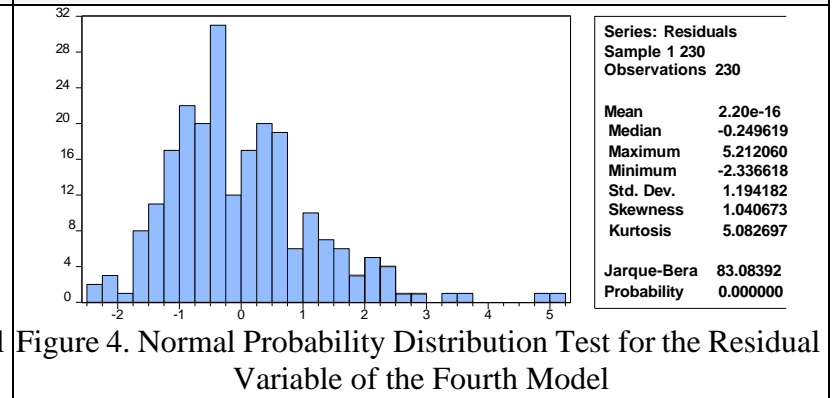
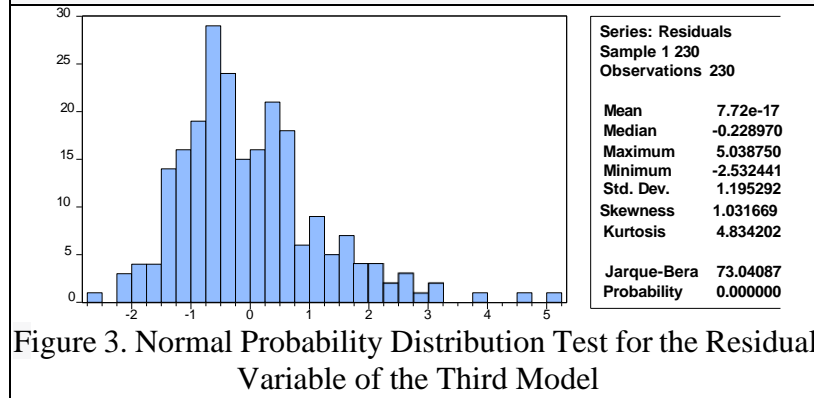
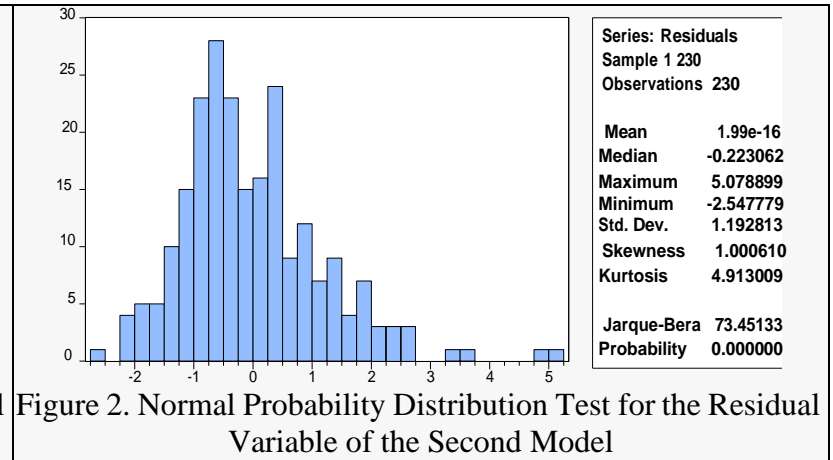
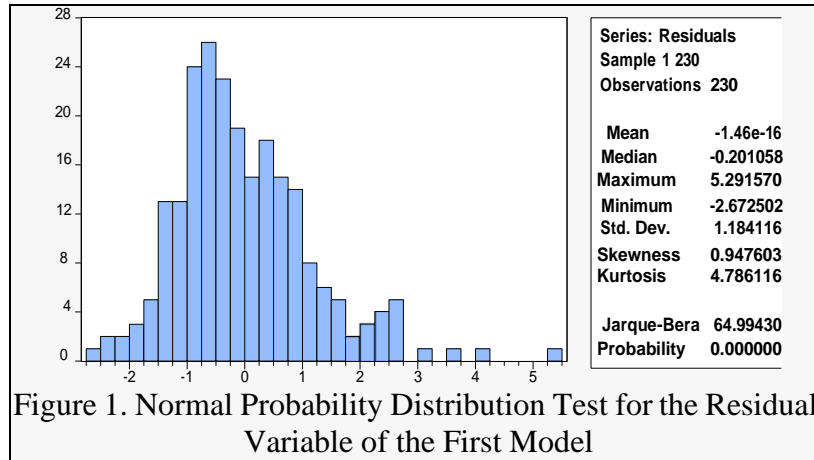
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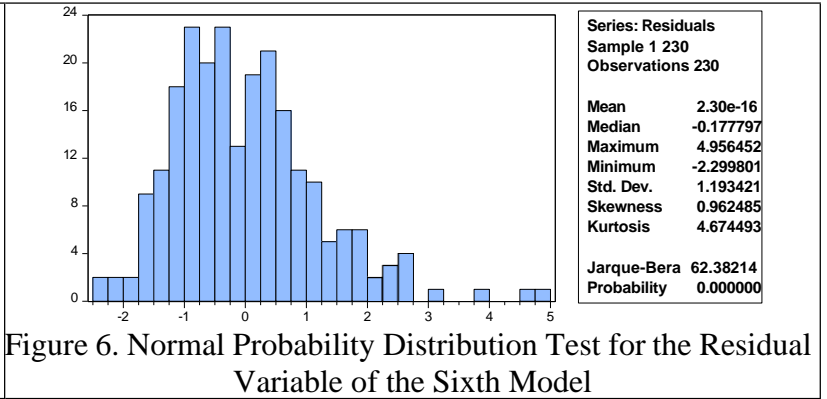
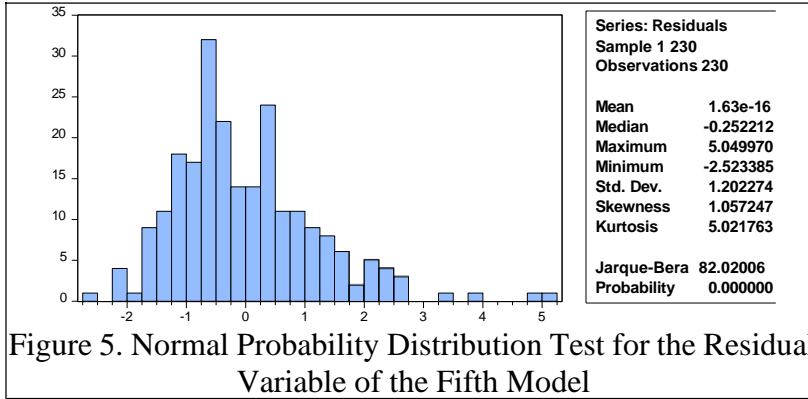
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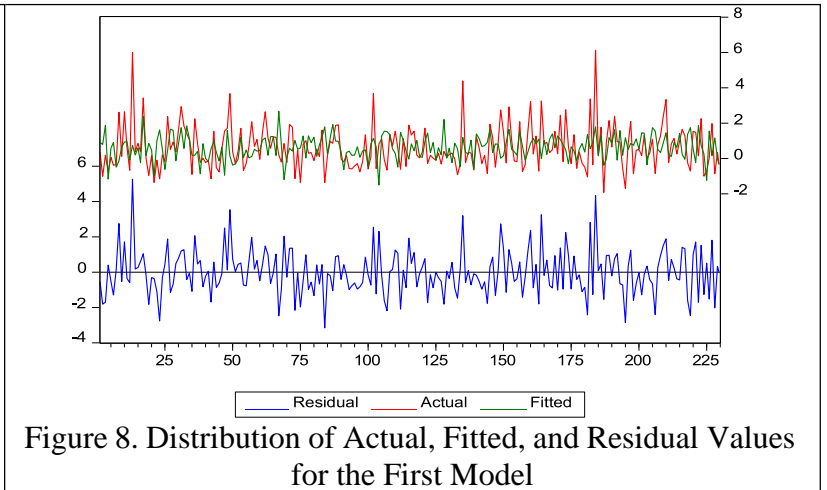
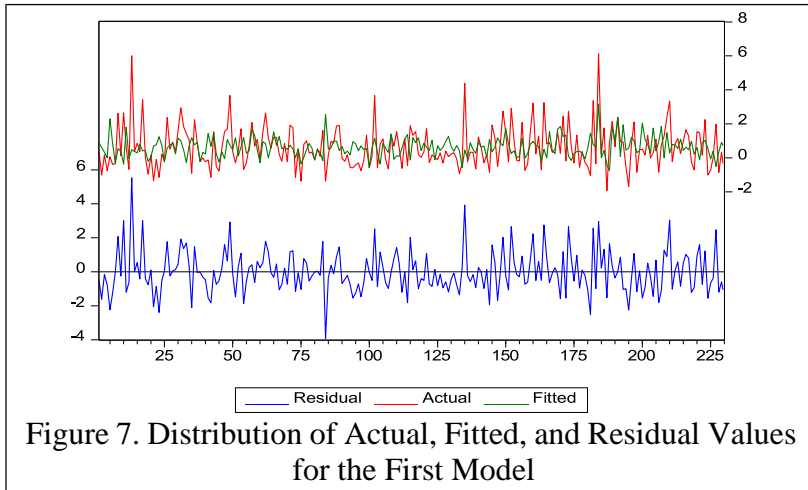
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Appendix (A): Testing the Normality of Residuals





Appendix (B): Quality Model Evaluation



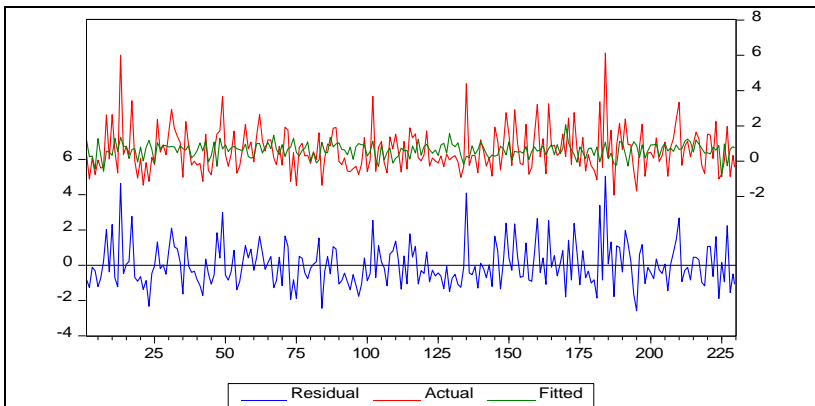


Figure 9. Distribution of Actual, Fitted, and Residual Values for the First Model

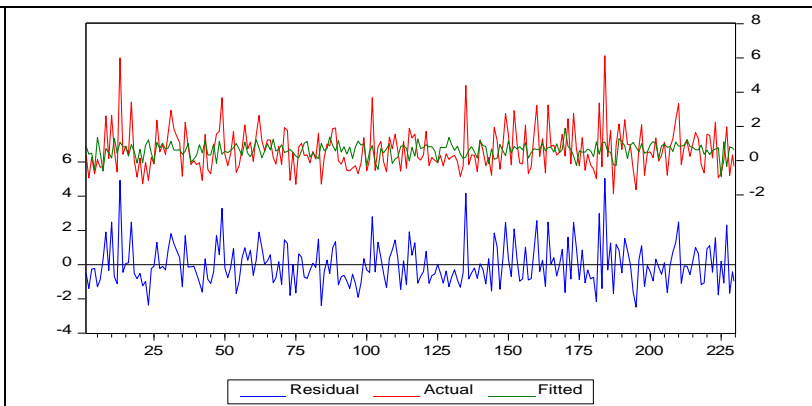


Figure 10. Distribution of Actual, Fitted, and Residual Values for the First Model

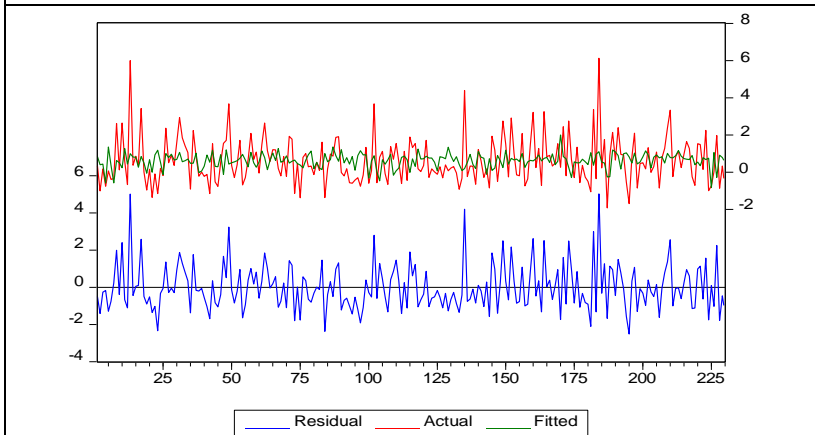


Figure 11. Distribution of Actual, Fitted, and Residual Values for the First Model

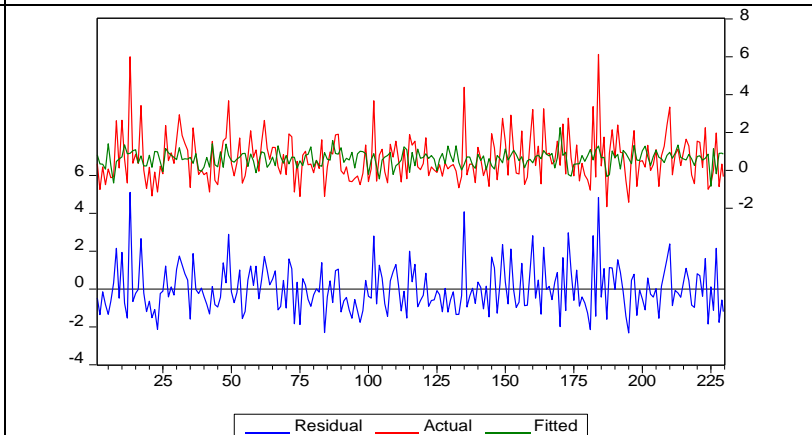


Figure 12. Distribution of Actual, Fitted, and Residual Values for the First Model