

**Managerial Discretion in Loan Loss Provisioning
under IFRS 9: Evidence from MENA Banks**

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**A thesis submitted for the degree of
Doctor of Philosophy in Accounting**

**Essex Business School
University of Essex**

April 2026

Abstract

This thesis examines the influence of the accounting change from IAS 39 to IFRS 9 on the discretionary reporting of loan loss provisions. Using 1,043 bank-year observations from 139 Islamic and conventional banks across 14 MENA countries over 2010–2022, the study develops a panel-based empirical design that estimates the discretionary LLPs and regresses them on the variables of interest in a two-stage regression model.

The findings show that IFRS 9 is associated with higher discretionary provisioning, indicating greater scope for managerial discretion under the ECL model of IFRS 9. The study also provides evidence that discretionary LLPs are associated with increased regulatory capital management practices under IFRS 9 than under IAS 39. In contrast, the earnings management results show that the association between discretionary LLPs and the earnings management indicator weakens under IFRS 9, suggesting that IFRS 9 dampens traditional incentives for earnings management through LLPs. Moreover, the findings demonstrate that discretionary LLP reporting under IFRS 9 is weaker in countries with higher religiosity, highlighting the role of religiosity in constraining bank managers' behaviour. In contrast, organisational religiosity, proxied by Islamic-bank status, shows only weak and inconsistent evidence of a moderating effect, mainly because Islamic-bank observations are small in the study sample. Finally, discretionary reporting of LLPs under IFRS 9 decreased during the COVID-19 pandemic, consistent with the notion that forward-looking LLPs under IFRS 9 mitigate the impact of shocks.

Overall, the thesis contributes to the literature by demonstrating how IFRS 9 reshaped discretionary provisioning among MENA banks, shifting managerial focus from earnings to capital management. Additionally, the thesis extends the literature by integrating informal institutional constraints, particularly religiosity. The study therefore contributes to a more comprehensive understanding of how accounting standards, managerial incentives, and institutional constraints interact in shaping banks' provisioning behaviour.

Acknowledgements

First and foremost, I would like to express my deepest gratitude to my PhD supervisors, Dr John Malagila, Dr John Azure, and Dr Hao Lan. Your unwavering support, insightful guidance, and constant encouragement have been invaluable throughout this journey. You have not only helped shape this thesis but have also contributed significantly to my development as a thinker, researcher, and scholar. I feel truly fortunate to have had the opportunity to learn from each of you throughout this PhD journey.

My heartfelt thanks go to my father, mother and wife, and my beloved family, whose love, encouragement, and unwavering belief in me have sustained me throughout this demanding journey. I am especially grateful for your patience and understanding of the long hours, pressures, and sacrifices that pursuing a doctorate requires. This achievement would not have been possible without your support.

I would also like to extend my sincere appreciation to my friends and colleagues in the PhD room at EBS, who shared this journey with me. Your encouragement, kindness, and support have meant a great deal throughout this period. Whether through words of motivation, shared moments of relief, or simply being present when needed, you helped make this experience more manageable and far less solitary.

I am also deeply grateful to the Central Bank of Iraq for its support and encouragement. Your support has played an important role in enabling me to pursue and complete this doctoral journey.

Finally, I would like to thank everyone who, in one way or another, supported me along the way. Completing this thesis represents a significant personal and academic milestone, and I remain sincerely grateful to all those who contributed to making it possible.

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Chapter 1: Introduction

1.1 Introduction

This chapter sets the foundation for the thesis by introducing the research topic, outlining its motivation, and establishing its theoretical and empirical context. The chapter highlights how the accounting change from IAS 39 to IFRS 9 has changed the scope of managerial discretion in loan loss provisioning. Although IFRS 9 was introduced to improve the timeliness of loss recognition, its greater reliance on forward-looking estimates and managerial discretion raises an important academic question: whether the new standard influences loan loss provisioning and whether it influences earnings and capital management practices through LLPs. In addition, this chapter introduces two contextual dimensions that may influence the managerial incentives for earnings and capital management practices. The first is religiosity, which may operate as an informal institutional constraint on opportunistic behaviour by shaping ethical norms, monitoring expectations, and managerial attitudes toward discretion. The second is the COVID-19 pandemic, which provides a severe stress environment in which the practical operation of the IFRS 9 model can be observed under heightened uncertainty and credit risk. Examining LLP behaviour under such conditions helps reveal whether the expected credit loss framework operates as a mechanism of prudent loss recognition or remains vulnerable to opportunistic use when banks face high uncertainty conditions. The chapter further outlines the research objectives and questions and discusses the study's motivation and importance. Finally, it provides an overview of the thesis structure and situates this research within the broader literature on banking regulation and financial reporting quality.

1.2 Background

The accounting for loan loss provisions (LLPs) involves a degree of accounting discretion in the measurement, estimation of losses, and reporting. The subjective nature of LLPs is seen as a dynamic factor that enables management to build timely LLPs, given that management may have sufficient indicators to estimate the loans' health (Wall and Koch, 2000). However, this same subjectivity also means that LLPs can become a channel through which managers exercise discretion in ways that do not always reflect underlying credit risk. The level of discretion allowed under accounting standards for LLPs has been argued (Bushman and Williams, 2012; Curcio et al., 2017; Tran et al., 2020) to provide bank managers with room to make opportunistic accounting choices¹. In this regard, bank managers may use LLPs as one of the discretionary tools in meeting managerial objectives such as compliance with regulatory capital requirements and avoiding regulatory interventions by delaying loss recognition or reporting fewer LLPs (Ahmed et al., 1999). Therefore, LLPs have been at the centre of a longstanding policy debate because of their effect on financial reporting transparency, regulatory capital, and bank stability (Ahmed et al., 1999; Bushman and Williams, 2012; Morris et al., 2016; Jutasompakorn et al., 2021; Taylor et al., 2025). Because LLPs affect both reported performance and prudential ratios, the accounting treatment of credit losses is not merely a technical issue, but a central issue in banking stability and market discipline.

¹ Opportunistic accounting choice is widely defined as the deliberate utilisation of accounting discretion for purposes of artificially distorting measures of financial results and financial position to achieve desired financial reporting outcomes (Christie and Zimmerman, 1994; Stalebrink and Donatella, 2021).

Existing evidence on the effects of LLPs during the 2008 financial crisis from Morris et al. (2016) and Bischof et al. (2021), show that the IAS 39 Incurred Loss model (hereafter, IAS39IL Model), which requires objective evidence of impairment² to recognise LLPs, allowed bank managers to delay the LLP recognition. These delays in LLP recognition were utilised by bank managers to engage in excessive risk-taking, which weakened market discipline over banks' risk-taking (Beatty and Liao, 2014; Morris et al., 2016). Moreover, IAS 39 was criticised for amplifying procyclicality during the financial crisis by provisioning incurred losses, ignoring future expected losses until impairment became evident, which can risk banks' financial stability during stress times (Wheeler, 2019; Bischof et al., 2021; Yang, 2022). Thus, the main criticism of IAS 39 was not only delayed recognition at the firm level, but also the broader macro-financial consequences of delayed provisioning during downturns.

In response to these shortcomings, the International Accounting Standards Board introduced the IFRS 9's Expected Credit Loss model (hereafter, IFRS9ECL Model) which replaced the IAS39IL Model. The IFRS9ECL Model was designed to improve the timeliness of LLP recognition. Specifically, the IFRS9ECL model is intended to address the main criticisms of the IAS39IL Model in three ways. First, it addresses the "too-late" criticism of the IAS39IL Model by requiring banks to account for the expected loan losses from the first day they lend money or invest in financial instruments. Second, under the IFRS9ECL model, the "too little" criticism of the IAS39IL Model is addressed by requiring banks to account for all information, including forward-looking estimations, when measuring LLPs. Finally, departing from the single stage of the IAS39IL model, the IFRS9ECL model requires banks to classify

² Under IAS 39 loss loan losses may be recognised only when there is objective evidence of impairment; however, the determination of impairment is subject to management's discretion, as it varies depending on the loan risk assessment and agreed arrangements.

loans into three stages based on their risk criteria and to recognise ECL based on that classification.

Nevertheless, the accounting change from the IAS39IL to the IFRS9ECL, despite its improvements in the timeliness of LLP recognition and the inclusion of forward-looking provisions, comes at the cost of more discretion in the ECL part that opens new doors for opportunistic reporting. Unlike the IAS39IL model, which tied LLPs to objective evidence of loss events, the IFRS9ECL model gives management latitude in determining what constitutes a significant credit risk increase and how optimistic or pessimistic future forecasts of ECL are. This latitude could be exploited opportunistically. Indeed, positive accounting theory (hereafter, PAT) predicts that if a new accounting regime offers flexibility, self-interested managers will use it to maximise their utility (e.g., through bonus attainment or regulatory cost avoidance) unless constrained. Under the IAS39IL regime, numerous studies documented that banks managed LLPs for earnings management and capital management motives (Anandarajan et al., 2007; Pérez et al., 2008; Krüger et al., 2018). Recent literature has raised concerns about the possible utilisation of IFRS9ECL for opportunistic purposes. For example, Oberson (2021) argued that the higher degree of discretion granted under IFRS 9 might lead to opportunistic behaviour. These concerns are mainly driven by worries about the consequences of such behaviour at the bank level on the bank's financial stability, and on the macro level, where it may lead to significant economy-wide effects during economic downturns and crises (Krüger et al., 2018; Bischof et al., 2021; Kim, 2022).

With the higher degree of discretion under the IFRS9ECL model, it can be argued that the discretionary LLPs reported under the IFRS9ECL model may also be utilised opportunistically for capital management. Since LLPs are the largest accrual in banks' financial statements (Beatty and Liao, 2014), an increase in LLP would have a negative

effect on regulatory capital adequacy and could require an increase in the bank's capital. This makes it important to examine discretionary LLP reporting not only as an accounting issue, but also as a prudential one, because the effects of the IFRS9ECL model depend partly on how accounting discretion interacts with regulatory capital incentives.

The extent to which such discretion is exercised is unlikely to be determined by accounting rules alone. Its consequences depend on the broader institutional and supervisory environment in which IFRS 9 is implemented. It is well established in the literature that management has incentives (when they can) to create discretionary LLPs that meet managers' excessive risk-taking needs and to meet the regulatory capital requirements (Bushman and Williams, 2012; Beatty and Liao, 2014; Bushman and Williams, 2015; Curcio and Hasan, 2015; López-Espinosa et al., 2021; Kim, 2022). This suggests that the effects of IFRS 9 cannot be understood in isolation from the institutional and supervisory environment in which the standard is implemented. Bischof et al. (2021) demonstrate that management incentives were an important factor influencing the delay in loss recognition during the 2008 financial crisis. Leuz et al. (2003) and Leuz and Wysocki (2016) show that cross-country differences in the enforcement of rules can reduce managers' incentives to mask bank performance, affecting earnings management among banks. Overall, discretionary LLPs can be utilised opportunistically to manage regulatory capital depending on the room for discretion allowed under the accounting rules. Additionally, this opportunistic behaviour can be incentivised by regulatory capital requirements and related rules (Li, 2017; Danisman and Demirel, 2019; Mahieux et al., 2023). The potential negative impact of IFRS 9 arises from the fact that the objectives of regulatory bodies differ from the objectives of accounting standard-setting bodies. While accounting standards aim to provide a "true and fair" image of the firm's financial condition, regulatory

bodies prefer accounting rules that are consistent with financial stability requirements (Borio, 2019). Moreover, the opportunistic reporting of LLPs could cause a decline in the quality of regulatory capital, given that LLPs are permitted to be used as add-backs in bank regulatory capital. Ng and Roychowdhury (2014) find that the add-back of LLPs enabled banks to be less restrictive in lending despite the fact that their loan quality is deteriorating, creating the illusion of non-declining financial health, which permits banks to delay the required actions to mitigate the credit risk. The opportunistic use of discretionary LLPs on bank level can threaten the financial system's stability, especially during economic downturns when a bank faces greater loan losses and has insufficient LLPs to absorb them (López-Espinosa et al., 2021; Kim, 2022). Thus, despite the centrality of the issue, whether the IFRS9ECL model can be used opportunistically to manage regulatory capital using LLPs remains an open question, especially with the lack of empirical evidence on this matter.

Constraining the discretionary behaviour of bank managers requires an effective set of constraints, while governance systems and regulatory oversight are the traditional constraints for managers' behaviour. Informal institutions can provide support, and could be more effective in constraining bank managers' behaviour in some regions where such institutions are widely respected. In the Middle East and North Africa (MENA) region, religiosity is prominent and can provide a constraining influence on the behaviour of bank managers. Evidence shows that religiosity can play a constraining role that affects managers' choices (Farook et al., 2014; Abdelsalam et al., 2016; Leventis et al., 2018; Abdelsalam et al., 2021). Yet, there is no evidence on the influence of personal or organisational religiosity on the use of discretionary LLPs under the IFRS9ECL model. Against this background, this study examines both personal and organisational religiosity under the IFRS9ECL model.

Additionally, despite the greater room for discretion, the framework of the IFRS9ECL model has a prominent feature that can help banks to change their attitude from opportunistic reporting to risk aversion during stress periods. That feature is the forward-looking ECL that front-loading LLPs and early recognition of future credit losses, which I argue could help bank managers to utilise these extra provisions from the pre-COVID-19 period to face the increased credit risks during the pandemic, in a temporary departure from their traditional discretionary LLP reporting.

Taken together, the background highlights the implications of the accounting change from the IAS39IL to the IFRS9ECL on the discretionary LLPs, under the IAS39IL model, the concern centred mainly on delayed recognition, whereas under IFRS9ECL model the concern extends to how forward-looking discretion may be utilised for opportunistic purposes. It also highlights the role of institutional context, and crisis conditions in influencing the discretionary LLPs.

1.3 Research Objectives

Following the above background information and discussion, three research objectives will be addressed in this study in the context of MENA banks:

RO1: To determine whether the application of the IFRS9ECL Model is associated with bank managers' opportunistic behaviour in accounting for LLPs.

RO2: To investigate whether religiosity moderates opportunistic behaviour in accounting for LLPs under the IFRS9ECL Model.

RO3: To investigate whether the shock of COVID-19 is associated with a change in bank managers' opportunistic behaviour in accounting for LLPs under the IFRS9ECL Model.

1.4 The Research Questions

To achieve the above research objectives, this study seeks to answer the following four research questions:

RQ1: Does the accounting change from the IAS39IL model to the IFRS9ECL model affect the extent of discretionary loan loss provisioning by banks?

RQ2: Does the application of the IFRS9ECL model affect the discretionary use of LLPs for earnings management and capital management purposes?

RQ3: Does religiosity moderate the impact of the IFRS 9 ECL model on the opportunistic use of LLPs?

RQ4: Did the shock of the COVID-19 pandemic change the opportunistic use of the IFRS 9 ECL model?

1.5 Overview of the Methodology

This thesis employs a quantitative empirical research design using an unbalanced panel of 139 Islamic and conventional banks from 14 MENA countries over the period 2010–2022, yielding 1,043 bank-year observations, of which 861 relate to conventional banks and 182 to Islamic banks. Consolidated bank-level financial data are obtained from the BankFocus database, while macroeconomic and institutional variables are collected from the World Bank. Country-level religiosity is measured using data from the World Values Survey (WVS), with the religiosity construct derived from indicators capturing religious affiliation, the importance of religion, and participation in religious services. To identify the effect of the IFRS9ECL more

precisely, the study measures adoption at the individual bank level using actual reported ECL data in BankFocus, rather than imposing a uniform post-2018 dummy indicator. This accommodates differences in the timing of the IFRS9ECL implementation across the sample.

The empirical analysis adopts a two-stage modelling approach following recent literature on discretionary LLP (e.g., Beatty and Liao, 2014; Kanagaretnam et al., 2015; Tran et al., 2020; Salem et al., 2021; Olszak and Kowalska, 2022). In the first stage of the model, LLPs are regressed on their principal non-discretionary financial determinants to isolate the discretionary component. The absolute value of the resulting residuals is then used as the measure of discretionary LLPs in the second-stage regressions, which examine the effects of the IFRS9ECL adoption, earnings management, regulatory capital management, personal and organisational religiosity, and COVID-19. The models incorporate bank- and country-level control variables, together with bank and year fixed effects, while standard errors are clustered at the bank level. In addition to the main panel regressions, a staggered difference-in-differences design and event-study analysis are employed to assess the effect of the IFRS9ECL adoption and to distinguish it from broader contemporaneous economic developments.

1.6 Motivation and Importance of The Study

An open question is whether the IFRS9ECL model has, in practice, increased or merely reshaped bank managers' ability to engage in opportunistic accounting with LLPs. This big question has received attention from the literature on LLPs accounting even before the application of the standard in 2018, with early concerns raised in (Novotny-Farkas, 2015; O'Hanlon et al., 2015; Gebhardt, 2016; Novotny-Farkas, 2016). However, the evidence in this regard remains rare and mixed. In particular,

whether the greater discretion under the IFRS9ECL model increases opportunistic reporting of LLPs is still under discussion, partly because the standard has only a short period of application and the available post-adoption evidence is still developing. Novotny-Farkas (2016) was one of the first to examine how the new standard interacts with bank regulation and supervision, and concluded that the IFRS9ECL model might increase the volatility of regulatory capital and provide more room for managerial discretion. Nnadi et al. (2023) using a sample of 100 commercial banks in Europe, find that non-listed banks in the EU engage in earnings management through LLPs under the IFRS9ECL model. On the contrary, recent evidence suggests that the IFRS9ECL model promotes transparency and reduces earnings management. Using a sample of 58 European banks, Proença et al. (2024) find that after IFRS 9 adoption, discretionary LLPs used for earnings management significantly decreased, implying that the new ECL model constrained directors' discretion in manipulating earnings and suggesting that IFRS 9's requirements led to more conservative and better provisioning, thereby improving earnings quality. Accordingly, the central empirical motivation of this study is to clarify whether the IFRS9ECL model intensifies discretionary LLPs' use or instead diminishes bank managers ability to utilise the discretion allowed in the standard for opportunistic purposes. Furthermore, having concrete evidence on the implications of the IFRS9ECL model application, specifically regarding earnings management and capital management, is critical for stakeholders such as regulators, investors, and financial institutions.

Additionally, evidence on the role of religiosity in constraining LLPs' opportunistic reporting under the IFRS9ECL model is missing. To my knowledge, this is the first study to investigate the influence of personal religiosity and organisational religiosity on discretionary LLPs use under the IFRS9ECL model. In particular, existing research

has not established whether personal and organisational religiosity constrain the additional accounting discretion associated with the transition from the IAS39IL model to the IFRS9ECL. This unresolved issue provides important motivation to extend earlier evidence on religious social norms and LLP reporting to the IFRS9ECL setting. By revealing the role of religiosity in restraining opportunistic reporting of LLPs under IFRS9ECL, this research provides insights into the effectiveness of informal institutions in safeguarding against the exploitation of the increased room for discretion under the new ECL model.

To investigate all these aspects together, this study uses data from the MENA region. That choice is motivated by the desire to test the IFRS9ECL model in settings that can reveal all the potential of the new model. This region can provide that to a great extent because it combines the weak rule of law, which would encourage incentivised managers to engage in opportunistic practices, and at the same time, the region is characterised by a strong influence of religious rules on individuals' behaviour (Ben Othman and Mersni, 2014; Elnahass et al., 2014; Abdelsalam et al., 2016; Salem et al., 2021; Elnahass et al., 2021, 2022). Moreover, the MENA context presents an interesting setting to investigate the effect of the IFRS9ECL model on the opportunistic behaviour of LLPs for the following reasons: First, it represents a high-risk environment, due to the high fluctuations in oil prices and GDP, geopolitical instability, and exchange rate fluctuations (Smales, 2021). Second, because capital markets in this region are still underdeveloped, banks play a crucial role as a major source of financing and, further, in supporting the stability of the financial system (Omran et al., 2008; Arezki and Senbet, 2020). Third, the region has a unique dual banking system in which both conventional and Islamic banks coexist under different rules and regulatory requirements that may influence their LLPs' opportunistic behaviour. Fourth, the strong influence that religion has on the banking sector, as

MENA has the highest concentration of Islamic banks in the world with 74% of the world's total Islamic finance assets (Refinitiv, 2022). The effect of regulatory rules on the MENA banks is more pronounced for Islamic banks than for conventional banks. This can be attributed to the strictness of the Islamic rules applied to those banks, which serve as an additional control mechanism to traditional ruling rules in conventional banks, which can discipline risk-taking in Islamic banks. Abdelsalam et al. (2016) show that Islamic banks are more conservative, thus tend to recognise more LLPs and are less likely to manage earnings than conventional banks in Middle Eastern countries, as they are established based on strict religious principles, which are expected to be considered in management decisions. The MENA region therefore offers a setting in which formal incentives for opportunistic reporting may be relatively strong, while informal and organisational religious constraints may also be unusually salient. However, despite a large body of literature on the opportunistic use of LLPs (e.g., Bushman and Williams, 2012; Bushman, 2016; Morris et al., 2016; Aristei and Gallo, 2019; Tran et al., 2020; Jutasompakorn et al., 2021; Hou et al., 2021; Mahieux et al., 2023), little is known about such behaviour in the MENA region. These earlier studies have shown the determinants of earnings management using LLPs in MENA. However, there are no studies that focus on the opportunistic use of LLPs in MENA, especially under the new IFRS9ECL model. Therefore, this study focuses on the MENA region due to the scant knowledge about discretionary LLP reporting under the IFRS9ECL model in MENA banks.

Additionally, the outbreak of the COVID-19 pandemic in 2020 provides a unique context to assess IFRS 9's real-world effectiveness in terms of discretionary LLP reporting and managers' behaviour under extreme stress. The pandemic caused abrupt economic downturns worldwide, which raised credit risks and uncertainty about future loan losses (Duan et al., 2021). High COVID-19 infection rates and disease severity

amplified fear and uncertainty around the globe, causing a pronounced surge in aggregate risk aversion and uncertainty (Bekaert et al., 2022). Banks faced a surge in their non-performing loans and their expected credit losses, which may change the behaviour of bank managers towards LLP reporting (Park and Shin, 2021; Chen et al., 2025). The pandemic is therefore a useful setting to examine whether the discretionary use of the IFRS9ECL model in LLP reporting intensified, weakened, or changed under extreme uncertainty and regulatory measures.

Moreover, this study examines the influence of COVID-19 on discretionary behaviour in IFRS 9 LLP reporting during the pandemic. Overall, the study contributes by jointly examining three issues rarely analysed together: whether IFRS 9 changes discretionary behaviour in LLP reporting, whether religiosity constrains that behaviour, and whether discretionary behaviour in LLP changed during the COVID-19 period. Investigating the incentives and informal constraints on opportunistic behaviour is important for accounting standard-setting bodies, as it provides insights into bank managers' discretionary choices and the quality of reported LLPs under the IFRS9ECL model.

Lastly, on a personal level, my motivation to investigate the discretionary reporting of LLPs is grounded in professional experience. Following my MSc study, I worked within the Central Bank of Iraq, monitoring banks' financial reporting. During this period, I periodically examined patterns in LLPs and compared reported provisions with subsequent realised credit losses. These analyses deepened my understanding of the pivotal role of LLPs in safeguarding financial stability. A notable shift occurred with the adoption of IFRS 9 in 2019 (implemented with a one-year deferral for Iraqi banks). Under the preceding regime, the Central Bank of Iraq applied a threshold-based provisioning framework that mandated specific LLPs rates based on loan

quality³. In contrast, the IFRS 9 expected credit loss (ECL) model introduced greater managerial discretion through forward-looking ECL. In practice, I began to observe reported LLP deviating from the previously expected rules-based patterns (for instance, some banks reported lower LLPs than their actual credit losses), consistent with the increased room for discretion under the IFRS9ECL model. Therefore, I thought that further research in such IFRS9 reporting problems would satisfy my inquisitive mind and serve to enhance my academic skills in the relevant fields. It is my interest now to find out whether bank managers do engage in opportunistic reporting of LLPs under the IFRS9ECL model, and what are the actual purposes of such behaviour. It would be interesting to know how this type of behaviour can be constrained by institutions other than traditional formal ones, and how crises and uncertainty could shift the behaviour patterns of bank managers. By researching all these topics, I believe I would get scientific answers for real-world problems that are currently facing the users of banks' financial reports and the regulatory bodies that monitor these financial reports.

1.7 Overview of Key Findings and Study Contributions

The empirical findings of this thesis provide evidence that the transition from the IAS39IL model to the IFRS9ECL model has materially changed banks' discretionary LLP reporting in the MENA region. First, the results show that IFRS9ECL adoption is associated with significantly higher discretionary LLPs and indicating that the greater reliance of the ECL model on forward-looking estimates and managerial

³ for example: a 2% provision for sound, performing loans; 10% for loans past due by <90 days; 25% for loans past due by around 180 days; 50% for loans past due up to 12 months; and 100% for loans in default for more than 12 months

judgement has increased the scope for discretion in provisioning decisions. Importantly, this finding does not imply that all additional discretionary LLPs reported under IFRS9ECL model are necessarily opportunistic; rather, it establishes that the IFRS9ECL model has widened the discretionary component of provisioning, which can be utilised opportunistically.

The results further show that the consequences of this increased discretion differ across managerial incentives. The interaction between IFRS9ECL and earnings before taxes and provisions (EBTP) is negative, indicating that the use of LLPs for earnings management weakened following the IFRS9ECL model adoption. In contrast, the interaction between IFRS9ECL and regulatory capital is positive and significant, indicating a greater use of discretionary LLPs in relation to regulatory capital management. Taken together, these findings suggest that the IFRS9ECL appears to have reshaped the purposes for which provisioning discretion is exercised, with the balance shifting away from earnings management and towards regulatory capital management. This represents one of the principal empirical conclusions of the thesis.

The findings also demonstrate that the exercise of discretion under the IFRS9ECL is conditional on the institutional environment. Personal religiosity significantly moderates the relationship between the IFRS9ECL and discretionary LLPs, indicating that informal institutional and normative pressures can constrain the use of accounting discretion. By contrast, the evidence for organisational religiosity, proxied by Islamic-bank status, is weak and sensitive to model specification. This distinction indicates that the informal institutional influence of religiosity is more evident through personal or societal religious norms than through the formal organisational classification of a bank as Islamic. The COVID-19 analysis additionally shows that the interaction

between IFRS9ECL and pandemic severity is negative, indicating that discretionary LLP behaviour associated with IFRS9ECL model declined under the exceptional conditions of the pandemic.

The thesis makes several related contributions. First, it provides post-implementation evidence from the under-researched MENA banking context on how the IFRS9ECL model changed discretionary LLP behaviour, moving the debate beyond the earlier question of whether the IFRS9ECL model merely provides greater managerial discretion to showing how that discretion is actually used. Second, the thesis identifies an important change in managerial reporting incentives: weaker earnings-management behaviour but stronger regulatory-capital-management behaviour. This provides a more nuanced understanding of the consequences of the transition from incurred-loss to expected-loss provisioning than an assessment based solely on whether discretionary LLPs increased or decreased. The study also contributes to the literature stream (e.g., Bushman and Williams, 2012; Beatty and Liao, 2014; Bushman and Williams, 2015; Casciello et al., 2024) by providing evidence on the main incentives for the opportunistic use of discretionary LLP reporting.

Third, the thesis extends the literature (e.g., Kanagaretnam et al., 2015; Abdelsalam et al., 2016; Salem et al., 2021; Elnahass et al., 2022) by incorporating informal institutional constraints, particularly personal religiosity, into the analysis of discretionary LLP reporting under the IFRS9ECL. The findings show that accounting discretion cannot be understood solely through managers' economic incentives; it is also conditioned by the institutional and ethical environment within which managers operate. In theoretical terms, the thesis therefore integrates Positive Accounting Theory, which explains managers' incentives to exercise accounting discretion, with Institutional Theory, which explains how formal and informal institutional pressures

may constrain that behaviour. Finally, the analysis of COVID-19 extends the study beyond normal economic conditions by demonstrating that the use of discretion under the IFRS9ECL model is also sensitive to periods of extreme uncertainty and regulatory intervention.

1.8 Structure of the Thesis

This thesis consists of seven chapters. In Chapter 1, I provide a brief background on the study's context, discuss the research objectives and questions, and outline the study's motivation and importance.

Chapter 2 reviews the study's institutional background and the contextual characteristics of the banking sector in the MENA region. Focusing on the regulatory environment, capital requirements, the adoption of IFRS 9, and the role of religiosity in the banking sector and its implications for opportunistic behaviour.

Chapter 3 describes the theoretical framework that explains the opportunistic behaviour in discretionary LLP reporting. The theoretical framework is built on the insights of the PAT, which is the main theoretical framework for explaining bank managers' opportunism. The chapter also built on the institutional theory to provide an explanation of the constraints of opportunism.

Chapter 4 discusses the literature stream that has addressed opportunistic provisioning practices and how the transition from IAS39IL Model to IFRS9ECL Model affects incentives and constraints of discretionary reporting of LLPs. Finally, the chapter discusses the impact of COVID-19 on the discretionary reporting of LLPs during the pandemic. This chapter presents the hypotheses of this research, following the literature review for each topic.

Chapter 5 outlines the research methodology of this thesis. It considers the research design and approach of this thesis. It explains how the sample was chosen and how each variable is measured.

Chapter 6 presents the discussion of the results of the study in line with the theoretical and empirical frameworks developed for this research.

Chapter 7 provides the conclusion of the current investigation, linking findings to the developed research questions. It also outlines the implications of the current research as well as its limitations and contributions to the relevant field of knowledge. The chapter concludes a series of recommendations for related future research.

1.9 Summary

This chapter has established the background, motivation, and theoretical foundations of the study. It highlighted how the shift from the IL model under IAS 39 to the ECL model under IFRS 9 has significantly changed the dynamics of loan loss provisioning, introducing greater managerial discretion and, consequently, the potential for opportunistic reporting. The chapter also highlighted the importance of the MENA region context in this study, where differences in regulatory environments, institutional quality, and cultural characteristics create a distinctive context for understanding banks' financial reporting behaviour. Moreover, the discussion outlined the study's main objectives and research questions, which focus on assessing whether the IFRS 9 ECL model has influenced discretionary LLPs practices and how religiosity and the COVID-19 pandemic could play a moderating role in this relationship. By grounding the analysis in theoretical explanations of managers' incentives, the chapter positioned the study to contribute both theoretically and empirically to the literature on IFRS 9 reporting quality, earnings management, regulatory capital management, and ethical influences in banking accounting.

Chapter 2: Background Information

2.1 Introduction

This chapter provides an institutional and regulatory overview of the banking sector in the MENA region. Focusing on the regulatory environment, capital requirements, the adoption of IFRS 9, and a comparative analysis of banking regulations between MENA and other world regions. This background is essential to this study because managerial discretion in LLPs is largely shaped by the strength of institutional enforcement, supervisory effectiveness, and the broader governance environment that determines the extent to which accounting discretion can be exercised opportunistically. The MENA context is particularly relevant because of relatively weak regulatory enforcement, varying institutional quality, and bank-centred financial systems, which may create a high-discretion environment in which the forward-looking and discretion-intensive requirements of IFRS 9 provide greater scope for discretionary reporting behaviour. Additionally, this chapter explores the role of religiosity in the banking sector and its implications for discretionary behaviour, as religiosity may theoretically moderate accounting discretion by strengthening ethical constraints, social norms, and reputational concerns that discourage opportunistic financial reporting.

2.2 Overview of the MENA Banking Sector

The MENA region covers a vast geographical area stretching from Morocco to Iran and Turkey. The region has become the focus of the world due to the significant role that oil has played in the political, economic, power, and control interests at both local and international levels (Smith, 2016). Approximately 56% of the world's oil reserves and 45% of the gas reserves are located in the region (Aoun, 2013). For almost a

century, the MENA region has encountered persistent political and economic challenges, including the Palestinian-Israeli conflict (1948-2026), Gulf Wars (1980–2003), which caused significant damage to the region, in addition to conflicts in Iraq, Libya, Yemen, Syria, and Lebanon (Al-Shboul et al., 2020). The instability across the region has led to significant political changes. For instance, following the escalation of the Arab Spring in 2011, public protests broke out in several countries across the MENA region to challenge existing political regimes, leading to regime changes in Yemen, Libya, Egypt, Tunisia, and Syria (Belkhir et al., 2017). The implications of these conflicts and political instability are affecting the financial sectors across the region and disturbing bank stability (Al-Shboul et al., 2020). Variations in the political and economic conditions across MENA countries have affected the size and development of their banking sectors. However, despite variations in banking sector size and development among MENA countries, there are common characteristics of the region's financial systems. Mainly, the high concentration of ownership, the dominance of government-owned banks in the region, and monopolistic competition (Naceur and Omran, 2011).

2.2.1 The Importance of The Banking Sector

The banking sector is a central component of modern economic systems. Through the mobilisation of deposits and the allocation of financial resources to productive investment, banks facilitate capital formation, support business expansion and contribute to economic development. An efficient and competitive banking sector can therefore improve the allocation of funds and financial investments, thereby strengthening both the financial system and the wider economy (de Guevara and Maudos, 2011; Banya and Biekpe, 2017). The economic importance of banks has

become even more pronounced as technological innovation and the emergence of new financial services have intensified competition within the financial sector. These developments have compelled banks to enhance their operational efficiency, service quality and overall financial performance to maintain their competitive position (Baffour Gyau et al., 2024).

In the MENA context, banks control a substantial proportion of regional financial flows and hold a significant share of total financial-system assets (Naceur and Omran, 2011). In this region, banks play a vital role in the economy, as they serve as the principal channel through which financial resources are allocated to governments, businesses and households (Hakimi et al., 2023). Accordingly, the performance, stability and resilience of banks have become central concerns for researchers, regulators and policymakers. Conversely, banking-sector instability can disrupt credit provision, weaken investment, and adversely affect economic growth (Anginer and Demircug-Kunt, 2014; Bischof et al., 2021). This highlights the importance of sound accounting practices and the reliable application of accounting standards in the region, especially the IFRS9ECL model, which has direct implications for financial stability (Boolaky et al., 2018; Awuye and Taylor, 2024). Greenwood et al. (2013) estimate that global output could increase by approximately 53% if countries adopted the world's best financial practices. Similarly, Levine and Zervos (1998) demonstrate that the development of both banking systems and stock markets is a significant predictor of subsequent economic growth, highlighting the complementary roles of financial intermediaries and capital markets in supporting long-term economic activity.

2.2.2 Ownership Structure

In terms of the high ownership concentration, Family-owned banks controlled by major shareholders are dominant in the MENA region, since many MENA countries are still under monarchy rule (Bahrain, Jordan, Kuwait, Morocco, Qatar, Saudi Arabia, the United Arab Emirates (U.A.E.), and Oman), and these monarchy families exert significant influence over the business environment in the region, whereas the rest of the countries in the region have switched to republican regimes after gaining independence in the 20th century (Lassoued et al., 2023). Irrespective of whether it is a republic or a monarchy, the banking sector remains largely controlled by specific families (Naceur and Omran, 2011). High ownership concentration has been linked in the literature to poor investor protection and greater opportunistic use of accounting discretion, as it may redirect accounting discretion towards the preferences of controlling owners, especially where provisioning choices are difficult for outsiders to verify. La Porta et al. (1998) find that ownership concentration negatively influences investor protections. This arises when controlling shareholders get involved in decision-making within the firm, as the conflict of interest shifts from management versus shareholders to majority shareholders versus minority shareholders, given that majority shareholders have incentives to maximise their own benefits even if that could negatively affect other shareholders. Under such conditions, internal governance policies may be ineffective at constraining agency conflicts, as controlling shareholders elect representatives to the firm's board to act in their own interests. Likewise, Omran et al. (2008) find that high ownership concentration is an endogenous response to the poor legal protection of investors in several MENA countries, and that it significantly affects firm performance. In the banking context, Bouvatier et al. (2014) show that banks with high ownership concentration exhibit greater income smoothing using LLPs.

2.2.3 State Dominance

The current financial systems in MENA countries reflect the state's excessive influence on the economy. Significant government ownership is a key characteristic that seems linked to the previous point, as government-owned banks account for a significant share of the banking sector in many MENA countries (La Porta et al., 2002; Naceur et al., 2009; Cull et al., 2017). In the GCC countries, despite the fact that there is no state banking sector, Awartani et al. (2016) report that state ownership in the private banking sector ranges from 21% in Saudi Arabia to 70% in the UAE. Moreover, other MENA countries such as Iraq, Libya, Syria and Yemen have state banks dominating the entire banking system. Algeria, Egypt and Tunisia have a significant portion of their banking sectors owned by the state. The only exception can be seen in Lebanon and Morocco, where there are no state-owned banks or state shares in private banks (Arezki and Senbet, 2020). The dominance of state-owned banks and the blurred boundary between the public and private sectors are conducive to a disproportionate share of non-performing loans (NPLs) on bank balance sheets (Arezki and Senbet, 2020). According to Shleifer and Vishny (1997), state ownership of banks might be justified on social welfare grounds and to address monopoly power and distributional concerns. Otchere (2005) suggested that state ownership in the financial sector benefits countries with underdeveloped institutions. However, state control can be subject to greater agency conflicts for the banks in countries with weak legal and regulatory institutions (Haw et al., 2010). The highly concentrated banking sector in MENA is making the banks less profitable and more inefficient, negatively impacting the competitiveness of the banking sector (González et al., 2019). Likewise, government ownership leads to inefficiency due to conflicts between social objectives and political interests, bureaucracy and corruption, and high levels of interest group politics in the MENA region. These conditions, created by state dominance over banks,

could lead to more opportunistic reporting, benefiting from the greater room for managerial discretion allowed under the IFRS9ECL model.

2.2.4 Market Concentration

The banking sector in MENA is also characterised by high concentration and relatively weak competitive pressure. The region demonstrates low levels of financial inclusion and possesses the highest loan concentration ratio in the world, indicating a tendency for lending to large, established corporations and avoiding lending to young and small businesses (Rocha et al., 2011). The financial sectors are mainly composed of traditional banking institutions with some presence of non-banking financial institutions; the insurance sector is relatively small, and external financing channels such as leasing, factoring and access to other funding sources from outside the firm are generally limited. In some parts of MENA, lending practices are also shaped by Islamic financing practices, which are closer in nature to relationship banking rather than broad market financing practices. These practices are more prevalent in more developed countries in the region (Wood and Yang, 2016). Naceur and Omran (2011) find that market concentration and institutional factors significantly affect bank performance in the MENA region. In such a setting, banks are less exposed to the disciplining effects of capital markets and active institutional investors. As a result, managers may face fewer external constraints when exercising accounting discretion.

2.2.5 Financial Market Development

The financial systems in the MENA region are largely skewed toward the banking sector relative to other financial services, such as stock and bond markets, because these capital markets are relatively underdeveloped (Wan Yusoff, 2015; Arezki and

Senbet, 2020). The financial sector in the region is characterised as non-diversified, non-competitive, and concentrated (Wood and Yang, 2016).

The banking sector development levels vary between the region's countries, as economic and political factors play a major role in shaping the banking landscape, such as oil wealth, economic diversification efforts, and varying levels of political stability. The Gulf Cooperation Council (GCC) countries have the most efficient banking sectors in the region (Al-Jarrah et al., 2017). These oil-rich countries are accelerating the process of financial liberalisation and deregulation plans to transform their economies from oil-based to market-based (Elfeituri and Vergos, 2019). According to the World Bank (2021), the hydrocarbon exports of GCC countries are the largest contributor to these countries' GDP as it contribute to around 42%. The banking sector is the second-largest contributor to the GCC countries' GDP (Ali et al., 2022). However, the banking sectors in other MENA non-GCC countries are less developed due to the regional turmoil and the underdevelopment of some of the MENA region's countries, especially in unstable countries such as Iraq and Lebanon (World Bank, 2018; Maroun and Fromentin, 2024). The exchange rates in many non-GCC countries are controlled by the state, and they are overvalued, which negatively affects the quality of bank lending and hampers the development of the financial system (Arezki and Senbet, 2020).

2.3 Banking and Financial Institution Regulatory Environment in MENA

Economic and political factors play a major role in shaping the banking environment, such as oil wealth, economic diversification efforts, and varying levels of political stability (Aliyu et al., 2023; Wu et al., 2026). The MENA region has faced multiple conflicts and political instability for decades, which have negatively affected economic activity (Gatti et al., 2025). The banking sector in the region has faced numerous

challenges that necessitate significant reforms at both the sectoral and individual bank levels to tackle these issues (Rocha et al., 2011; Haque and Brown, 2017). In addressing these issues, most MENA countries have implemented economic and financial reforms since the early 1990s under the guidance of international organisations such as the World Bank, the International Monetary Fund (IMF), and the Bank for International Settlements. Although the reform programmes have varied in terms of depth and comprehensiveness, they have all been designed to facilitate further financial liberalisation and deregulation in the financial systems (Elfeituri and Vergos, 2019; Lassoued et al., 2023). The main objective of these reforms is to establish adequate regulation, regulatory oversight, and transparency in the banking industry, ultimately limiting the risk-taking and enhancing the efficiency of banks. In particular, these reform initiatives focus on key aspects, including regulatory capital adequacy, risk management, financial disclosures, corporate governance, and prudential supervision, with support from the Basel Committee, which provides a structural framework for these initiatives (OECD, 2009). Policymakers and central banks are obligated to implement reform strategies, policies, and effective tools, which may involve enacting new laws and regulations or revising existing ones, to achieve these goals. The issue of financial stability has prompted numerous initiatives that emphasise the necessity for improved governance and more strict regulatory requirements (Mondher and Lamia, 2016). Consequently, regulatory authorities in several MENA countries turned their focus towards formulating new regulations to develop banking practices and implementing a framework for better governance. However, concerns have been raised regarding the potential implications of these reforms on bank lending as they contain more strict regulatory requirements (Awdeh and EL-Moussawi, 2021).

In this regard, several governments reduced barriers to entry that align with World Trade Organisation entry requirements. For instance, the Iraqi banking sector witnessed a major reform after the political change in 2003. A new banking law issued in 2004 permitted more freedom in the banking sector and allowed foreign banks to work in Iraq. These reforms have led to an increase in the number of working banks in Iraq from 21 to 70. However, despite the major reforms, state banks have maintained their domination as they still occupy (81.3%) of the total assets of the banking sector (Looney, 2005; CBI, 2023). In Egypt, many mergers and acquisitions have taken place since 2005, resulting in increased participation of foreign investors and a reduced role of the state. Similarly, in Jordan, the government privatised many state banks and further liberalised the nation's banking system in 1997 (Bdour and Al-khoury, 2008). Lebanon had a well-developed banking sector that served as the main financial centre in the region, and since 1995, the liquidity and capital adequacy of Lebanese banks have met the standards set by the Bank for International Settlements (BIS) (Naceur and Kandil, 2013). However, the governmental debt default in 2020 and the currency devaluation hit the banking sector severely, as Lebanese banks were investing heavily in Lebanese sovereign debt (Maroun and Fromentin, 2024).

Furthermore, banking regulatory bodies in MENA countries have focused on improving regulatory capital requirements since these requirements are considered a major requirement of the Basel Accords, from the perspective that banks' capital adequacy is an important element of prudential regulations (Mateev et al., 2022). Hence, their impact on bank risk-taking behaviour can determine the financial stability in these countries (Mateev et al., 2023). The literature indicates that banks in the MENA region are continuously adjusting their capital adequacy, liquidity, and risk management practices to comply with the requirements of the Basel III framework. For instance, Prasad et al. (2016) reveal that countries in the MENA region, in general,

and GCC countries, in particular, have made substantial progress in the implementation of Basel III accords by imposing tighter regulatory capital and liquidity requirements, establishing “effective early warning systems and regular assessments of systemic risks as integral parts of macro-prudential policies” (Prasad et al., 2016, p.22). These improvements in bank regulation, in general, and in regulatory capital requirements, in particular, can influence discretionary LLP reporting, given that these requirements are among the main incentives for opportunistic reporting of discretionary LLPs.

However, despite the regulatory reforms, the banking sector in the region is still facing challenges stemming from factors such as weak law enforcement and the limited political power of central banks, which lead to weak oversight and poor enforcement of regulatory requirements (Rocha et al., 2011; Haque and Brown, 2017). The independence of central bank supervision in some countries is constrained by weak political independence, combined with the Ministry of Finance's dominant role over state-owned banks. Rocha et al. (2011) highlighted the weak supervisory power, poor enforcement of regulatory guidelines and limited supervisory expertise in several central banks of the region. Moreover, several MENA countries (e.g., Iraq, Lebanon, Libya, and Yemen) suffer from high levels of political instability and corruption, weak governance and government effectiveness, and moderate levels of economic and financial freedom (Karam and Zaki, 2019). These persistent weaknesses could have negative implications for newer accounting standards that allow greater discretion, such as the IFRS9ECL model, given that such discretion may incentivise opportunistic reporting of discretionary LLPs that benefit from the weak regulatory environment.

2.4 The Accounting Change From IAS39IL Model to IFRS9ECL Model

IFRS 9 introduced a fundamentally different approach to accounting for LLPs compared to its predecessor, IAS 39. The change was largely motivated by criticisms of the incurred loss model under IAS 39. IFRS 9 was developed as a response to the concerns that were raised against IAS 39 regarding delayed and inadequate recognition of credit losses. The financial crisis of 2007-2009 demonstrated vulnerabilities inherent in IAS 39, which relied heavily on historical data and its incurred loss (IL) model. Under the IAS39IL model, banks recognised impairment losses only when objective evidence of a loss event, such as default, had already occurred, thus restricting banks' ability to establish timely and sufficient loan provisions. This approach was criticised for being exacerbating procyclical behaviour of LLPs during economic downturns (López-Espinosa and Penalva, 2023; Taylor et al., 2025). The development of IFRS 9 was a joint effort between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) of the United States during the period from 2009 to 2012, intending to issue a unified accounting standard for financial instruments applicable in all jurisdictions that require IFRSs application. At later stage, the FASB withdrew from the development of the IFRS 9, to work on the development of a US CECL standard. The CECL standard is applicable in the US from 2023 (Novotny-Farkas, 2015).

The application of the IFRS9ECL model in 2018 fundamentally changed the rules for loan loss provisioning. The new accounting standard does not rely on strict rules for the estimation of expected losses within LLPs; instead, it requires banks to build their own ECL models in order to provide more flexibility. The ECL model under IFRS 9

is designed to address the “too little, too late”⁴ issues that IAS 39 faced. The IAS39IL was arguably criticised for limiting banks’ ability to create sufficient and timely loan loss provisioning. Laeven and Majnoni (2003), documented that banks worldwide often deferred LLPs until economic conditions deteriorated sharply; this observation was made before the financial crisis. Indeed, the financial crisis revealed that under IAS39IL, banks had overstated asset quality by not accounting for lower losses during good economic periods (Hashim et al., 2019).

In contrast, the IFRS9ECL model is prospective and forward-looking, as it requires banks to rely on early forecasts of future default risk to create forward-looking ECL provisions, which should increase the timeliness of LLPs through the economic cycle (Buesa et al., 2023; Botha et al., 2025). The forward-looking LLPs under the IFRS9ECL model are found to be more adaptive to credit risks, López-Espinosa et al. (2021) find that LLPs under the IFRS9ECL become more predictive of future risk and more credit-risk relevant to debt markets. Yet, the IFRS9ECL forward-looking LLPs also expand managerial discretion, potentially opening new avenues for opportunistic reporting of LLPs. Bushman and Williams (2012) warned that if forward-looking elements in provisioning are used primarily to smooth earnings rather than to recognise actual expected losses, it diminishes transparency and can dampen market discipline on risk-taking.

The accounting change from the IAS39IL to the IFRS9ECL brings a double-edged sword in this context. On the one hand, by mandating earlier loss recognition based on the ECL model, IFRS 9 should improve the timeliness of LLPs. And on the other hand, this improvement comes at the cost of more discretion that opens doors for opportunistic reporting.

⁴ The delay of losses recognition is specifically stated in paragraph 59 of IAS 39: “Losses expected as a result of future events, no matter how likely, are not recognised.” (IASB, 2011)

2.5 Adoption of IFRS 9 in MENA

MENA countries have gradually adopted the International Financial Reporting Standards (IFRS) (IFRS Foundation, n.d.). The transition from local Generally Accepted Accounting Principles (GAAP) to the IFRS in MENA countries has been a complex process influenced by internal coercive and institutional factors such as the governance quality, the freedom of trade and openness to the international economy (Klish et al., 2025). These pressures have necessitated the harmonisation of financial reporting to enhance comparability and transparency in the global market (Nurunnabi et al., 2022). Klish et al. (2021) find that the adoption of IFRS has enhanced the reporting quality and reduced earnings management across IFRS adopters relative to local GAAP adopters.

However, there is a lack of uniformity in the adoption of IFRS across the MENA region. While most MENA countries have fully adopted IFRS, some countries have not yet converted to the IFRS application (e.g., Algeria and Tunisia)(Elhamma, 2023). Iraq and Libya have adopted IFRS only in the banking sector, while non-banking institutions still use local GAAP (IFRS Foundation, n.d.). Egypt hasn't adopted the International Financial Reporting Standards (IFRS) for accounting. Egypt follows the Egyptian Accounting Standards (EAS), which are based on the IFRS with some local specifications (Ebaid, 2016).

Despite variation in the adoption of IFRS standards across MENA countries, IFRS 9 has received special attention from banking regulatory bodies in the region. Some countries needed to delay their adoption date to allow time for the transition arrangements. Although IFRS 9 was issued in 2014 and became mandatory effective from 1 January 2018, with early adoption permitted, Banking regulatory bodies in some MENA countries have postponed the mandatory application, such as Iraq and

Egypt, where the mandatory application was postponed to 1 January 2019 instead of its original date (CBE, 2018; CBI, 2018). IFRS 9, in its original form, provides general specifications of what the ECL number must reflect, such as the probability-weighting ECL, time value of money, and reasonable and supportable forward-looking information (IFRS Foundation, 2014). However, the standard does not prescribe a definite single modelling approach or a uniform definition of staging thresholds. This leaves room for accounting choices and managerial discretion, particularly in areas that affect the ECL calculation, such as defining and evidencing a significant increase in credit risk (SICR) and selecting macroeconomic scenarios and their weights in the final ECL amount.

To avoid the ambiguity and variations in applying IFRS 9, central banks across the MENA region have issued specific instructions and guidelines for banks that have supplemented the original IFRS 9 version with prudential overlays in different ways, including enhanced model oversight, transitional arrangements, additional reserves, and minimum provisioning requirements (Caruso et al., 2021). These instructions and guidelines shaped the pace and financial consequences of the transition from the IL approach of IAS 39 to the ECL under IFRS 9 through transitional arrangements. In Iraq, the central bank released the IFRS 9 instructions in 2018 that have set the requirements for ECL calculations, the SICR triggers that banks have to follow in transitioning debts from the 12 months ECL under stage one to the lifetime ECL under stage two and stage three, with specific characteristics for each stage (CBI, 2018). Additionally, they allowed banks to distribute the quantitative effect of IFRS9ECL over 5 years (IFRS Foundation, 2020). The central bank of Egypt has also introduced prudential reserve mechanisms to smooth the transition. An IFRS 9 risk reserve equal to 1% of total weighted credit risks has been required to be maintained by banks during the transition period to absorb transition effects (Arab Republic of Egypt, 2020). In

GCC, central banks released guidelines and additional provisioning requirements of IFRS 9, for example, in the UAE, the central bank introduced IFRS 9 guidance and a prudential filter for capital adequacy and has retained authority to impose a provisioning floor above 1.50% of credit risk-weighted assets (CBUAE, 2024). In Jordan, the central bank also issued instructions that shaped IFRS 9 ECL calculations. The ECL for Jordanian banks is measured as a minimum, with any additional supervisory impairment provisions added on top (CBJ, 2024). The IFRS 9 application regulations and transition rules could have an influence on the discretionary reporting of LLPs. While there is no available evidence on MENA banks, Dong and Oberson (2022) revealed that transition rules in the EU allowed more discretionary choices to banks to report discretionary LLPs while benefiting from reduced capital requirements without committing to decrease their risk-taking. Additional regulatory relief measures were introduced after the COVID-19 outbreak to relieve the IFRS9ECL model's impact on regulatory capital.

However, there is no clear evidence on whether the instructions and prudential overlays across MENA countries have effectively constrained or increased the discretion allowed under the IFRS9ECL model or limited its impact on regulatory capital.

2.6 Comparative Review of the Banking Regulations in MENA versus Other Regions

Comparing the banking regulatory environment in MENA with other regions is important for understanding the development level of the regulatory framework in the region and how it may impact IFRS 9 application in light of other regions' regulatory frameworks. According to Masciandaro and Romelli (2018) countries in the same region tend to follow the same banking regulations. This pattern is in line with evidence from 102 countries indicating that a country is more likely to implement

reforms in financial sector supervision if neighbouring countries have undertaken such reforms (World Bank, 2019). In fact, evidence shows that these regional reforms offered greater stability and higher capital requirements in the MENA region. It is noteworthy that since the announcement of Basel III in December 2009, a significant transformation of banking regulations has been made. Banks have adjusted their operational and reporting strategies in light of the new framework (Hendricks et al., 2023). This might be attributed to the implementation of stricter capital requirements and enhanced oversight (Barth and Miller, 2018). Therefore, it's expected that the discretionary behaviour toward LLPs might change since the regulatory requirements have changed.

Moreover, further differences in emerging economies from their developed counterparts exist in various banking features, such as the strength of regulatory institutions and regulatory frameworks, that are expected to influence bank managers' incentives toward using LLPs for capital management (Pandey et al., 2022). Rocha et al. (2011) reported that the adoption of international regulatory standards has brought some degree of regional convergence in the banking supervision framework, although there are divergences among MENA countries, depending on the level of sophistication of a country's financial system. When compared to other emerging markets, MENA countries have more stringent disclosure requirements in place. More than two-thirds of countries in the MENA region reported using Basel III, which is almost the same percentage as the South Asia region. By contrast, the adoption of Basel standards has been slow in Latin America and the Caribbean and Sub-Saharan Africa regions, where close to half of the countries are using Basel I (World Bank, 2019). These findings contradict the common notion that MENA financial systems are less regulated than those in other regions.

The literature shows that the reporting benefits associated with IFRS adoption depend heavily on enforcement strength rather than standards alone (Christensen et al., 2013). Earnings management tends to be more widespread in settings characterised by lower-quality legal enforcement (Leuz et al., 2003). In banking, this is particularly important given that LLPs are among the most discretion-sensitive accruals and have long been linked to both earnings management and regulatory capital management (Beatty and Liao, 2014; Ozili and Outa, 2017). This would suggest that the development level of the regulatory framework in this region could have an impact on the discretionary reporting of LLPs under the IFRS9ECL model.

2.7 Discretionary Reporting and Regulatory Challenges in the MENA Region

Institutional conditions may increase incentives for managers to engage in discretionary financial reporting to maximise their own benefits rather than those of stakeholders (Alareeni, 2018; Lassoued et al., 2018). In the MENA, this discretionary behaviour is largely attributed to the institutional voids present in the region's countries, specifically, the weak regulatory environments that characterise these developing countries compared to developed countries (Gill et al., 2014). Despite the implementation of regulatory requirements aligned with international standards, such as the adoption of international accounting standards and the application of Basel accords, governance and accountability in MENA countries remain significantly lower than those of their peers in other regions.

In the same regard, Wood and Yang (2016) argue that World Governance Indicators (WGI) scores for MENA countries are much lower than the scores of other countries and significantly less than the scores of upper-middle and high-income countries in five out of the six governance indicators. Moreover, among the six WGI indicators, MENA countries perform the worst in "Voice and Accountability", given their level

of development. Ball et al. (2003), argue that the incentives of the managers responsible for financial reporting tend to be the driver of financial reporting quality in environments where the political forces that enforce accounting standards are weak. As high-quality standards such as IFRS can not compensate for weak legal institutions.

Firms in MENA countries have not achieved full compliance, particularly with respect to corporate governance, and require improvements and reform (Farah et al., 2021). Without these monitoring mechanisms functioning effectively, top managers retain their ability to exploit the discretion allowed in accounting. This concentration of power allows them to manipulate accruals to mask poor performance or smooth earnings. Cahan et al. (2008) emphasise that even when accounting standards are identical across borders, the application of those standards varies based on the institutional environment. In the banking context, these institutional issues may have a larger effect on the financial reporting quality, given that LLPs are the largest accruals in banks and can be manipulated for opportunistic purposes such as earnings management and regulatory capital management (Bushman and Williams, 2012; Beatty and Liao, 2014; Danisman et al., 2021).

Consequently, although the MENA region has theoretically adopted high-quality accounting frameworks such as IFRSs, the persistent weaknesses in governance and regulatory enforcement mean that reported financial statements likely possess lower value relevance for their users. Moreover, new standards that allow more room for discretion, such as IFRS 9, combined with weak regulatory enforcement, create significant opportunities for provisioning manipulation in banks.

2.8 Religiosity in the Banking Sector and Implications for Discretionary Reporting

Because of persistent conflicts, political instability, and weak regulatory supervision in the MENA region, religiosity may serve as an informal governance mechanism in the MENA banking environment. When the rule of law becomes less effective, informal institutions may complement formal institutions (North 1994). Accordingly, religions can play a significant role in shaping moral values and promoting ethical conduct. The exploitation of one's fellow human beings is consistently condemned by various religions (e.g., Islam, and Christianity). The presence of an anti-manipulative ethos within these religious contexts serves as a compelling argument against the practice of opportunistic behaviour (Callen and Fang, 2015).

In this regard, Anginer and Demirguc-Kunt (2014) argue that the banking system is more fragile in countries with weak supervision and greater state ownership of banks. High religiosity is one of the main characteristics of the MENA region, as it holds a higher level of religiosity compared to the world's other regions (Badaoui, 2023). Moreover, Islam, the second largest religion in the world with over 1.8 billion Muslims, is the dominant religion in the region with 91.2% of the population being Muslims (Pew, 2009). According to Leventis et al. (2018) high religious regions can influence corporate behaviour around role expectations. The presence of a high concentration of religious individuals within a given territory could translate into a high proportion of religious individuals at different stages of an organisation, which in turn translates into a general alignment of corporate attributes and decisions to reflect the prevailing social norms of the local community (Hilary and Hui, 2009). Moreover, religious adherent staff can play a role in whistleblowing on irregular and unethical practices perpetrated by the firm. Firms are highly likely to refrain from such unwarranted and unethical practices for fear of being exposed by religious adherent

individuals within the firm because such exposure could be costly (Callen and Fang, 2015). According to (Badaoui, 2023), the strong position of religion and the degree of individual religiosity merit greater attention in MENA countries. Thus, religion serves important and diverse functions in this region, including serving as a substitute for the rule of law and political ties (Grinin et al., 2019). However, religion does not necessarily neutralise self-interest or constrain opportunistic behaviour in banks. Weaver and Agle (2002) reveal that religion does not serve as a universal neutralising force against organisational misconduct, as it depends on the religious identity salience and the underlying motivations.

In addition to high religiosity in the region at the country level, organisational religiosity is also apparent in the region's banking industry. The banking sector in MENA countries is characterised by a dual banking system where Islamic and conventional banks operate side by side. Hence, Islamic banks' presence could influence the stability of the whole banking system. However, Islamic banks are not free from managerial interests that can trigger opportunistic reporting and manipulation. Islamic banks are subject to significant profit pressures as a result of their unique non-interest business model, such as maximising the returns for investment account holders or ensuring the competitive distribution of profit-sharing margins (Chong and Liu, 2009). Despite the ethical constraints imposed by Shari'ah principles, the structural separation of ownership and management in Islamic banks still gives rise to traditional principal-agent conflicts driven by the need to maintain financial targets (Safieddine, 2009).

Therefore, in the context of IFRS 9's forward-looking ECL framework, with the weakness of formal institutional settings in the MENA region, discretion allowed under the IFRS9ECL model may be exploited. religiosity may operate as an informal

monitoring mechanism that constrains excessive managerial discretion in loan loss provisioning decisions.

2.9 Summary

This chapter provides a detailed overview of the banking sector in the MENA region, focusing on its institutional and regulatory landscape. The chapter outlines the region's banking sector, characterised by the high ownership concentration significant state influence, and underdeveloped financial markets. Moreover, this chapter discussed the regulatory framework in the region and the national reforms that aimed to improve financial stability. However, issues such as weak supervision, political interference, and corruption continue to hinder these efforts. This chapter also outlines the adoption of IFRS 9 across the region. Furthermore, this chapter provides a comparative analysis with other regions, revealing that, while MENA countries have made steps in adopting international standards like Basel III, their governance and accountability remain significantly lower. Additionally, the chapter highlights the role of religiosity in the MENA banking sector. religiosity influences corporate behaviour, potentially reducing opportunistic actions by bank managers through the imposition of ethical and religious constraints.

Chapter 3: Theoretical Framework

3.1 Introduction

This chapter discusses the theoretical framework that explains the discretionary behaviour in LLP reporting under the IFRS9ECL model. The discussion begins with the incentive-based logic of Positive Accounting Theory (PAT), which provides the main theoretical lens for explaining how bank managers may use accounting discretion allowed under the IFRS9ECL model for opportunistic purposes such as earnings and capital management. The chapter then complements this perspective with Institutional Theory, which explains how managerial behaviour is shaped, constrained, or moderated by the wider institutional environment in which banks operate. By combining these two perspectives, the chapter develops a broader explanation of discretionary LLP reporting, in which managerial incentives are understood to operate within a wider formal and informal institutional setting.

The chapter mainly discusses capital regulation as one of the formal institutions that influence bank managers' discretionary decisions in their LLPs. In this respect, the chapter explains how regulatory capital requirements create strong incentives for managers to use accounting discretion strategically, especially when provisioning decisions affect prudential ratios and the risk of supervisory intervention. The religiosity at the personal and organisational levels is discussed as a main informal institution that could influence opportunistic use of the discretion allowed under the IFRS9ECL model. This is especially relevant to the context of this study, given that the MENA region has a high level of religiosity and also has clear representation for both conventional and Islamic banking models. The chapter, therefore, clarifies how formal institutions, such as accounting standards and capital regulation, interact with informal institutions, such as religiosity, in shaping banks' financial reporting

behaviour. In addition, this chapter establishes the conceptual foundation for the hypotheses developed later in the thesis. It explains why the shift from IAS 39 to IFRS 9 is expected to alter the scope for discretionary LLP reporting, why earnings management and regulatory capital management are treated as the main incentive channels, and why religiosity is expected to moderate these behaviours. It also justifies using a combined theoretical framework rather than relying on a single theory, given that discretionary provisioning under the IFRS9ECL model reflects both self-interested managerial motives and the constraining influence of the surrounding institutional environment. Accordingly, this chapter provides the theoretical basis for the empirical model and for the interpretation of the results presented in the subsequent chapters.

3.2 Incentive-based Explanations: PAT

PAT, as suggested by Watts and Zimmerman (1978, 1990), provides an economic explanation for managers' accounting choices based on self-interested incentives that drive managers to make discretionary accounting decisions. This study adopts the PAT framework because it is consistent with empirical results that focused on incentive-based behaviour. However, despite PAT's recognition of the influence of institutions, I note that it does not provide a comprehensive explanation of how institutions act as inhibitors, curbing opportunistic behaviour and mitigating the tendency toward self-interest. Therefore, this study follows Collin et al. (2009) by supplementing PAT explanation with the institutional theory to provide a comprehensive framework for discretionary reporting. Laughlin (1995) argue that there is no single theory that can provide a full representation of accounting reality, thus the intellectual borrowing from other theories in accounting research can enhance the phenomenon's interpretation. Thus, many studies (e.g., Oswick et al., 2011; Mayer and Sparrowe, 2013; Modell,

2015; Modell et al., 2017) have encouraged the adoption of mixed theories in which the theoretical combination can vary from selective borrowing (incorporating elements of one theory within another leading theory) to full-fledged merging of theories in an attempt to found “new” theories. As long as the theories being combined are not sufficiently different in their ontological and epistemological premises, all forms of combination can be significant sources of theoretical rejuvenation (Gioia and Pitre, 1990; Mayer and Sparrowe, 2013). In accounting choice studies, this stream can be seen in a number of studies (e.g., Mezas, 1990; Neu and Simmons, 1996; Collin et al., 2009) that have used mixed theories to explain accounting choice. The use of PAT and institutional theory together allows for a more dialectical approach to scientific development, in which different theories can be integrated into a single explanatory endeavour, reconciling the main theories to develop a critical stance (Collin et al., 2009).

3.2.1 The Opportunistic Perspective

PAT is an expression of neo-classical economic theory and builds its assumptions fundamentally on the economically rational behaviour of individuals. Economic behaviour here is materialistic self-interest, concentrated and representing the basis for all economic activity. Therefore, in PAT, self-interest is the reason for the choice of accounting methods and reporting decisions. Based on rational economic principles of agency theory, the optimisation of self-interest and opportunistic behaviour stems from the assumed information asymmetry between corporate agents (managers) and principals (shareholders) (Jensen and Meckling, 1976). This emphasises the necessity of establishing formal corporate governance structures, incentive systems, and control mechanisms to reduce managerial opportunism and self-serving conduct.

The theoretical explanation for opportunistic accounting choices in PAT takes the nexus of the contracts view of a firm. Contracts are necessary in order to get self-interest-seeking individuals to agree to collaborate in order to maximise the wealth of the owners (Jensen and Meckling, 1976). This theory identifies the actors involved in accounting decisions. Accounting here is considered as a part of the contract between the principal and the agent where the two parties voluntarily agree on the set of accounting choices that can be used and that agreed set will be reviewed by an external auditor to ensure the adherence of the contract (Watts and Zimmerman, 1990). It is further assumed that there is such a significant separation between the agent and the principal that necessitated the assignment of making the accounting choice solely under the agent's discretion. This contractual view is directly relevant to LLPs under IFRS 9 because impairment measurement is no longer based solely on the IL model of IAS 39, but on a forward-looking ECL approach under IFRS 9. In making the ECL model assessments, managers must rely on reasonable and supportable forward-looking information, including macroeconomic condition assessment and forecasts, which makes LLPs estimation inherently judgment-intensive. From a PAT perspective, these judgment points create opportunities for managers to influence accounting numbers when earnings or regulatory costs are contractually important (Dong and Oberson, 2022; EBA, 2023).

Therefore, PAT seeks to understand accounting choices by interpreting the incentives of the various contracting parties (Watts and Zimmerman, 1978). Moreover, (Watts and Zimmerman, 1990) argues that the objective of PAT is to describe, explain and predict managers' accounting practices using contracting nexus. This contracting approach to studying accounting has led to the discovery of important empirical regularities (Holthausen and Leftwich, 1983; Lys, 1984; Holthausen, 1990) and continues to broaden our understanding of accounting phenomena today (Hanlon et

al., 2022). The opportunistic behaviour in PAT view rises from an economic standing point where all decision-makers are *Homo economicus* (i.e., an economic being who is self-interested with well-defined preferences) who will make the same choice for a given situation by optimising, and formal institutions (e.g., regulations, rules, laws) and informal institutions (e.g., norms, culture, religion) govern the interactions between decision-makers and constrain the opportunistic behaviour (Hanlon et al., 2022).

One fundamental assumption of PAT is that “managers choose accounting methods to transfer wealth to themselves at the expense of another party” (Watts and Zimmerman, 1990, p.136). Under this assumption, managers' opportunistic behaviour is the cornerstone of most accounting choice studies. The opportunism occurs when a manager's decision increases the manager's wealth but does not produce a net increase in aggregate wealth. The contracting parties: Managers, owners, and lenders make their economic decisions based on their expectations that formed at the time contracts are negotiated, which include a definition of the accepted set of accounting methods, and the prices paid for the claims. As new information about firms' circumstances arrives, contracting parties revise both their assessments of the firm-value-maximizing decisions and their expectations of total managerial opportunism, given the existing contracts and enforcement mechanisms. Therefore, opportunism is the difference between the value effect of the decision made by a manager and that expected by shareholders at the time the decision is made (Christie and Zimmerman, 1994).

In this assumption, managers would act opportunistically because they are assumed to be rational, wealth-maximizing individuals who will slyly seek their own self-interest. The assumption that managers' incentives are universal and generally motivated by the same desires and react to situations, in the same way, simplifies modelling their

behaviour (Williams, 1989; Neu and Simmons, 1996). Managers control the reported results because of explicit contracts given to them which are tied to accounting numbers. These accounting numbers are considered to be a vital part of contracts in a firm. When managers choose accounting methods to be adopted in a firm, they will act in an opportunism way, and they will maximise their personal benefits by choosing specific accounting numbers which can be used to increase their wealth (Holthausen, 1990; Christie and Zimmerman, 1994). Apparently, the opportunistic perspective does not aim to increase the stakeholder and the firm's benefits, but the managers themselves. According to Watts and Zimmerman (1990), managers as agents, will make accounting choices that (1) increase their compensation, (2) increase their discretion through relaxing debt lending agreements, and (3) lower the risk of facing regulator interference. However, agents' behaviour is not solely based on self-interest, but rather it is more complicated than that, thus PAT, acknowledges that the agent's behaviour is constrained by formal and informal institutions (Collin et al., 2009). These institutions serve to construct the subjectivities of the agent, encouraging certain behaviours and discouraging others which eventually shape the agent's behaviour following to his adherence to these institutions.

3.2.2 The Efficiency Perspective

From the efficiency perspective, managers can also make discretionary choices for other than opportunistic purposes; in fact, the efficiency perspective of the PAT perceives accounting discretion as an efficient mechanism to optimise internal control and the decision-making process. The value maximisation of a firm would require selecting accounting methods that jointly optimise internal control and decision-making (Christie and Zimmerman, 1994). This perspective suggests that accounting choices in financial reporting are motivated by efficient contracting purposes, that aim

to minimise agency costs amongst the contracting parties of the firm. This optimisation would result in maximising the value of the firm (Holthausen, 1990).

In the case of setting compensation contracts and lending contracts, owners/lenders will anticipate managers' incentives to report opportunistic discretionary accounting numbers to distribute wealth between contracted parties. owners/lenders consider the effects of managers' opportunistic behaviour in the value of contracts that they offer to managers/firms. According to Christie and Zimmerman (1994), owners/lenders expected such managerial opportunism, and they already encompassed it into efficient contracting, thus only the unexpected managerial opportunism is considered inefficient from this perspective. Therefore, accounting discretion can be preserved as a managerial mechanism to reinforce the contracting efficiency in a firm.

Consistent with this perspective, (Subramanyam, 1996) finds that accounting discretion improves the ability of earnings to reflect the economic value of the firm and signal future firm's prospects. According to the study, discretionary accruals are opportunistic in general, thus managers tend to behave opportunistically through accruals reporting in a way that increases earnings persistence.

From the banking context, the efficiency perspective can explain the managers' opportunistic behaviour in reporting discretionary accruals (e.g., LLPs, allowances) as a behaviour to reinforce the contracting efficiency through managing these accruals to leverage risk-taking and capital management which is expected to maximise the value of the bank and minimise the agency cost (Kanagaretnam et al., 2005; Tran et al., 2020).

Accordingly, under the IFRS9ECL model, the wealth-transfer logic of PAT extends beyond the broad accounting method choice to the discretionary components of ECL

estimation itself. Managers may have incentives to apply less conservative SICR thresholds, adopt more favourable macroeconomic assumptions, overlays or validate models in ways that reduce current period provisioning when higher LLPs would depress earnings, weaken regulatory capital positions, tighten lending constraints, or increase the likelihood of supervisory intervention (EBA, 2023). In this sense, the IFRS9ECL model does not remove opportunistic behaviour; rather, by embedding greater forward-looking and model-based judgment into provisioning, it changes the channels through which opportunism may be exercised (Novotny-Farkas, 2016). This is consistent with empirical evidence that discretionary LLPs' reporting is largely driven by opportunistic managerial targets, such as earnings and capital management (Ahmed et al., 1999; Curcio et al., 2017; Danisman et al., 2021). All of that can indicate that earnings and capital management incentives can materially shape LLPs' reporting under the standard, benefiting from the standard's increased space for accounting discretion.

Thus, within the IFRS9ECL setting, the efficiency perspective must be interpreted alongside the possibility that the same discretion used to incorporate private information into LLPs may also be used opportunistically through SICR assessment, macroeconomic forecasting, overlays, and validation choices that the ECL model requires.

3.3 Earnings and Capital Management Through LLPs

Earnings management and regulatory capital management are widely seen as the main incentives for the opportunistic use of discretionary LLPs (Ahmed et al., 1999; Anandarajan et al., 2007; Casciello et al., 2024). Under the IFRS9ECL model with the introduction of forward-looking ECL and judgment-based SICR, the room for

discretion has increased, which theoretically provides further room for opportunistic reporting of discretionary LLPs (IFRS Foundation, 2014; Novotny-Farkas, 2016).

3.3.1 Earnings Management

Bank managers (agents) may exercise discretion over LLPs, informed by private knowledge of loan quality and banks' profitability, to maximise their personal utility (e.g., bonuses, job security), potentially in line with shareholder (principal) interests (Jensen and Meckling, 1976). One prevalent managerial practice identified under this framework is earnings management, defined as the deliberate manipulation of accounting figures to achieve specific financial reporting objectives (Healy and Wahlen, 1999). Based on the PAT framework of Watts and Zimmerman (1978, 1990), banks choose LLP levels to meet earnings targets for bonuses, avoid violating debt covenants tied to earnings or capital, or reduce the political visibility associated with high profitability.

The earnings management hypothesis posits that a manager strategically undertakes actions to augment reported earnings during periods of low income and decrease them during periods of high income (Fudenberg and Tirole, 1995). This practice aligns with the "capital market motivation", which suggests that stable earnings streams reduce perceived risk, lower capital costs, and enhance firm valuation. Banks achieve smoothing primarily through discretionary LLP adjustments: increasing provisions during high profitability periods (creating hidden reserves) and releasing them during low profitability periods (Allini et al., 2025). LLPs represent charges against profits, intended to anticipate potential loan defaults. Due to the inherent estimation required in setting LLP levels, managers possess considerable discretion in determining these provisions (Ahmed et al., 1999). Consequently, LLPs can be strategically utilised to smooth earnings, boost reported profits, or manage regulatory capital positions

(Bushman and Williams, 2012). This highlights that earnings management is contingent upon a firm's economic circumstances (Kanagaretnam et al., 2005). Bank managers engage in this type of behaviour, whereas artificial income smoothing in bank financial reporting entails the manipulation of loan loss provisions.

The implications of IFRS 9 for earnings management are therefore mixed. On the one hand, the ECL model is designed to make loan loss recognition earlier and more timely than under the IL model in IAS 39, thereby reducing the traditional form of earnings management based on delaying provisions until credit deterioration becomes evident (Buesa et al., 2023; López-Espinosa and Penalva, 2023; Proença et al., 2024). On the other hand, because the standard relies heavily on forward-looking estimation and staging judgements, it may not eliminate earnings management but instead shift it earlier in the reporting process, into the measurement of stage one and stage two ECLs rather than later realised-loss recognition (Hashim et al., 2019; Nnadi et al., 2023). Therefore, within a PAT framework, IFRS 9 is best understood not as removing managerial discretion over LLPs, but as relocating opportunistic potential from delayed recognition toward forward-looking ECL estimation.

3.3.2 Regulatory Capital Management

From an opportunistic perspective, Watts and Zimmerman (1990) suggest that the existence of regulatory institutions that impose regulatory requirements and frequent investigation, creates incentives for managers to influence their financial reporting in ways that meet the regulatory requirements. In other words, the accounting choice of firm managers under regulatory supervision would differ from their accounting choice in the absence of such regulatory constraints. Thus, managers may have the desire to surpass the threshold in order to decrease the probability or invasiveness of supervisory visits or administrative measures (Kim and Kross, 1998). In the banking context, bank

managers' incentives can be used to explain the relationship between regulatory capital requirements and LLPs through the effect of information asymmetry. Bank behaviour towards risk-taking (lending) may create agency problems that can eventually affect LLPs. This can occur when bank managers face an increase in their loan risk that requires an increase in regulatory capital; bank managers may discretionarily report lower LLPs to reflect a healthy financial position. Bank managers may choose to report discretionary LLPs to satisfy capital requirements rather than pursue legitimate options like increasing capital or shifting risk when they believe regulatory intervention is unlikely (Moyer, 1990; Mahieux et al., 2023). Given that legitimate options such as injecting more capital from shareholders would be costly option. Likewise, selling loans (substitution/risk-shifting) to replace high-risk loans in order to reduce the need for more capital may also be costly for the bank. This can occur if the loan is sold at a hefty loss or when the bank that sells loans is paid to continue monitoring borrowers for the new owners, which would dilute existing ownership and adds a moral hazard problem (Besanko and Kanatas, 1996). As a result, banks will be more prudent with their LLP reporting to avoid costly increases in their capital ratio. A recent study by Bischof et al. (2021) argue that regulatory monitoring increases the reporting quality as it reduces the banks' managers' incentives to use discretionary accruals.

Therefore, Meeting the regulatory capital requirements is one of the main concerns for bank managers, given that failure to meet these regulatory requirements would trigger regulator intervention that forces banks to inject more capital or sell/substitute riskier assets (Mahieux et al., 2023). Thus, bank managers are keen to avoid such costly interventions by fulfilling the regulatory capital requirements. Regulatory capital consists of Tier 1 and Tier 2 capital normalised by credit risk-weighted assets (RWA). Hence, banks can manage regulatory thresholds by either directly increasing Tier 1 or Tier 2 capital or liquidating assets to decrease implied risk weights. While injecting

fresh capital is generally considered a costly option, and selling riskier assets can cause a direct loss (Moyer, 1990; Ryan, 2017). A third, unchallenging option arises from the discretionary part of LLPs, bank managers would be able to exercise accounting discretion to create discretionary LLPs (Anandarajan et al., 2003). The mechanism that induces the incentives to use LLPs opportunistically lies in the fact that retained earnings are part of Tier 1 capital, while general LLPs are included within Tier 2 capital up to 1.25% of credit risk-weighted assets (RWA). Given this set of rules, LLPs have multiple effects on Tier 1 and Tier 2 capital (BIS, 2020, p.34). On the one hand, an increase in LLPs reduces retained earnings and raises the implied risk weights, which reduce the overall Tier 1 capital; on the other hand, that increase in LLPs raises Tier 2 capital to a limited amount due to the mentioned 1.25% threshold, which reduces the capital adequacy ratio. Moreover, any write-off of loan losses would reduce Tier 2 and may reduce Tier 1 (retained earnings) if the loan loss reserves are insufficient.

In addition to the pattern mentioned above, shareholders may also have incentives to encourage managers to engage in discretionary LLP reporting to fulfil regulatory requirements. Given that violation of regulatory capital requirements would incur regulatory costs which can add incentive to manipulate regulatory capital (Anandarajan et al., 2003). In this regard, majority shareholders would most likely incur the costs of not meeting regulatory capital requirements (Berger, 1995). Thus, banks that face higher costs of violating regulatory capital requirements would have greater incentives to engage in opportunistic capital management to avoid such costs (Ahmed et al., 1999).

With the recent accounting change in LLPs from the IAS39IL model to the IFRS9ECL model, bank managers' room for discretion has increased. This would give bank managers more flexibility to utilise LLPs for regulatory capital management.

Furthermore, the IFRS9ECL model is expected to induce these incentives given that it could increase the volatility of regulatory capital for poorly capitalised banks and provide more room for discretion (Novotny-Farkas, 2016). This could be amplified during an economic downturn, as loan loss risk increases with the worsening of economic conditions, forcing banks to face the dilemma of increasing LLPs and increasing capital or selling bad debts in a bad economic situation (Beatty and Liao, 2014; Bushman and Williams, 2015; López-Espinosa et al., 2021; Kim, 2022).

The following sections will discuss the institutional constraints that influence bank managers' discretionary behaviour, and how external formal institutional pressures, namely regulatory capital requirements, could lead to discretionary behaviour in an attempt to avoid the consequences of the failure to meet the regulatory requirements.

3.4 Institutional Constraints on Opportunism

Sociologically oriented institutional theory offers, in certain aspects, a complementary explanation to PAT (Collin et al., 2009). The explanation of institutional factors that influence managers' behaviour is important for identifying how certain institutions may limit managers' incentives to distort firms' financial reporting processes.

Institutions are human-created constraints that structure individuals' interactions. Institutions can be either formal constraints (e.g., regulations, rules, laws, constitutions) or informal constraints (e.g., norms of behaviour, conventions, religion), and they differ in their enforcement characteristics. While both types of institutions limit the choices that people make, informal (constraints) institutions can have a wider influence that shapes people's preferences and beliefs. People usually make choices that do not maximise their self-interest when those choices harm others (North, 1994).

While PAT assumes that agents may act in an opportunistic manner, institutional theory views that the social aspect may temper that opportunistic behaviour, assuming that the social forces have an influence on agents' choices (Neu and Simmons, 1996). "Institutional theory views organisations as operating within a social framework of norms, values, and taken-for-granted assumptions about what constitutes appropriate or acceptable economic behaviour" (Carpenter and Feroz, 2001, p.565). Institutional theory explains managers' behaviour through institutional pressures on accounting choices, which can be normative, coercive, or mimetic. Institutional theory appears to be a viable lens for understanding the sociological and behavioural drivers of bank managers by linking the various institutional pressures that shape agents within the institutional environment (Lubatkin et al., 2005).

Institutional theory evolved in the 1980s, with the work of (DiMaggio and Powell, 1983; DiMaggio, 1988) that addressed institutional environments as generally stable and homogeneous organisational domains, which are shaped by processes of institutional isomorphism rather than deliberate human agency. Institutional theory nowadays emphasises the notion of agency and the impact of substantial pre-existing institutions on agency (Modell et al., 2017). DiMaggio and Powell (1983) identify a list of institutional mechanisms: coercive, mimetic, and normative. The coercive mechanism is mainly a resource-dependency explanation. The coercive mechanism forms an institutional isomorphism, driving organisations to behave in a way that conforms to other powerful organisations' (external stakeholders') expectations. These external stakeholders (e.g., governmental bodies, regulatory agencies, powerful non-governmental organisations) can put pressure on the principal organisation to behave and structure itself in a certain way; otherwise, the principal organisation will face sanctions or fail to gain the necessary resources. Coercive pressure can shape the legislative mandates of the organisations. It also forces the principal organisation to

conform to the cultural expectations of the greater society, even if it does not necessarily align with the organisation's internal values or preferences to avoid negative consequences (DiMaggio and Powell, 1983). The mimetic mechanism is primarily an explanation of herd behaviour. Facing uncertainty, risk, and competition, a principal organisation tends to imitate other organisations it perceives as more legitimate or successful in its industry (DiMaggio and Powell, 1983). Citing Granlund and Lukka (1998), Collin et al. (2009) argue that this mechanism may lead the principal organisation to adopt the industry's best practices even without fully realising their context, attempting to mimic the others' behaviour. Touron (2005, p.856) suggested that "the managers of companies facing situations of uncertainty are more likely to adopt the behaviour of organisations with which they would like to be assimilated. The benchmark firms are either companies exercising the same activity (the sector) or the most talented companies (leaders)". It seeks, through this behaviour, to achieve successful operations and to be seen as legitimate, since it acts in accordance with other organisations' prevailing norms (Barreto and Baden-Fuller, 2006). The normative mechanism mainly stems from professional groups' pressures to promote their competence in society. These groups include suppliers, customers, associations like companies' trade unions, the media, and other social entities. It can also be expanded to include all normative pressures on individuals. When confronted with normative pressure, agents tend to adopt the opinions, making them evident rather than prone to choice, i.e., the norms and views will be taken for granted (DiMaggio and Powell, 1983).

At this degree of institutional influence, institutions incentivise the individual's preferences and cognition, shifting preferences from an exogenous to an endogenous element. This indicates that institutions influence not just human interaction in establishing legitimacy, but also the shaping of human preferences (Granovetter,

2011). Human interest is not entirely an inherent inclination but is formed in part by the environment in which humans exist; consequently, rationality has constraints in both extent and direction. Institutions under this mechanism are imprinted or unconsciously incorporated through tacit beliefs. This mechanism enables a society to spread explicit collective beliefs or patterns of behaviour, allowing it to repeat practices that previously led to positive outcomes (Lubatkin et al., 2005).

3.5 Religiosity as an Informal Institutional Constraint

This section presents religiosity as an institutional factor that constrains opportunistic behaviour within the PAT framework, drawing on insights from institutional theory. Religion represents an informal institution that is embedded in society. Informal institutions denote social norms of behaviour that are typically upheld through sanctioning mechanisms that empower some behaviours and constrain others (North, 1990). These institutions are “socially shared rules, usually unwritten, that are created, communicated and enforced outside officially sanctioned channels” (Helmke and Levitsky, 2006, p.5). Informal institutions play a vital role in shaping individuals' interactions, decision-making, and responses to various situations (Denzau and North, 1994; Williamson, 2000). In order to explain the constraining role of religion as an informal institution within the framework of PAT, the agents' behaviour must be seen in an extended view that takes into consideration the social aspect of agents' economic behaviour. Thaler (2016) uses the term “behavioural economics” to refer to evidence-based economics that views agents as “*Homo sapiens*” (i.e., a human being) in a real economy rather than “*Homo economicus*” (i.e., self-interested individuals consistently rational with infinite willpower and cognitive abilities) that make optimal choices in an abstract economy. This view of agents extends traditional PAT to acknowledge that

agents' behaviour is more complicated than being driven solely by economic incentives and available information, but it would also be motivated by personal preferences, prevailing norms, experiences, and social aspects such as religion. This new behavioural view of agents provides an extended explanation of the constraints that structure agents' interactions by including informal institutions (e.g., norms, conventions, religions) that enable us to characterise the optimal behaviour and predict the actual behaviour of agents, the bank manager in my case (Hanlon et al., 2022).

Religion's influence on opportunistic behaviour may vary following multiple factors that affect the role that religion can play on the individual and organisational levels (Guiso et al., 2003). Therefore, in order to provide an adequate explanation, this study will use two variables to measure religion's influence on opportunistic behaviour, religiosity (at the country level) and organisational religiosity (at the organisational level), as follows:

3.5.1 Manager-level Religiosity

According to Noreen (1988), compliance with certain social moral rules such as religion can promote efficiency and constrain undesirable behaviours. North (1994) notes that informal institutions serve as a supplement to conventional formal institutions such as laws and regulations, mainly when these legal rules become less effective. Religiosity can be defined as “the degree to which an individual is committed to a certain religious group” (Zamani-Farahani and Musa, 2012, p. 803). Religiosity is an individual's degree of commitment to his/her religion – in other words, it is “a way of life which results in individual or social values and attitudes” (Aji et al., 2020, p. 6). More clearly, Achour et al. (2016, p. 1,302) mention, “Islamic religiosity is the

commitment to the fundamentals of the Islamic religion empirically and theoretically through the fulfilment of Allah's rights, the protection of the rights of others, following Allah's orders, avoiding bad acts, and performing worship". Accordingly, religiosity reflects customers' commitment to follow their religion and worship according to Allah's orders. Previous studies have revealed that the different aspects of customer behaviour can be identified depending on their religiosity levels (Jamshidi and Hussin, 2016). Some previous studies revealed that religiosity affected an individual's attitudes and behaviour including satisfaction (Joshanloo, 2016), purchasing behaviour (Briliana and Mursito, 2017), trust (Fungáčová et al., 2019) and perceived value (Jamal and Sharifuddin, 2015; Agarwala et al., 2019).

In theory, religion as an informal institution has the potential to serve as an alternative mechanism to formal institutions and exert a substitutive influence on organisational behaviour (Jha, 2019). The reason behind religious support for formal institutions is that religious beliefs and values can provide moral and ethical backup to formal institutions; relying on the belief in an omniscient supernatural being who metes out rewards and punishments neatly resolves the problem of enforcement of the ethical code (Hanlon et al., 2022). On top of that, religious teachings are more readily internalised by individuals than most other institutions, mostly because these teachings in general persist across generations through individual learning that happens in the context of the perceptions shaped by the cumulative experience of a society, as embodied in its language and mental models (North, 1994). This set of institutions are undesigned ecological systems shaped by evolutionary processes and are not primarily guided by constructivism, that is, "conscious deductive processes of human reason" (Smith, 2003, p.467).

Religion can substantially shape moral values and promote ethical behaviour. When religion is central to an individual's self-identity, deviations from the mainstream religion's norms or the defiance of God's laws lead to increased cognitive and emotional discomfort. This discomfort serves as a motivation for adherents to conform their behaviour to align with these role expectations. The powerful influence of religion on behaviour can be attributed to individuals' tendency to conform to their peer group. By doing so, they want to avoid the potential costs or penalties associated with deviating from the accepted standards, values, or beliefs (Weaver and Agle, 2002; McGuire et al., 2012).

Another explanation for religious managers' avoidance of opportunistic behaviour is the tendency toward risk aversion. Anxiety mediates the relation between religiosity and risk aversion. For example, Miller and Hoffmann (1995) and Miller (2000) emphasise the relationship between religion and the fear of uncertainty, suggesting that religion is sought by risk-averse individuals who are trying to reduce their subjective anxiety about risk and uncertainty in their lives. Thus, religious beliefs and values can constrain and discourage opportunistic behaviour in firms. Barro and McCleary (2003) argue that religious managers are less likely to manipulate corporate information flows, as they show a greater tendency to internalise the social norms that are linked to anti-manipulation practices. Dyreng et al. (2012) show that higher levels of religious adherence are associated with both a lower likelihood of financial restatement and less risk that financial statements are misrepresented. Hilary and Hui (2009) argued that higher levels of religiosity decrease bank risk exposure, suggesting that religiosity has a significant influence on corporate investment decision-making. Although managers may not personally adhere to religious beliefs, they can still be influenced by the dominant religious customs within a diocese. Individuals tend to conform to the behavioural norms set by the groups and local culture they are affiliated

with. Some studies (McGuire et al., 2012; Dyreng et al., 2012) suggested that not only individual adherence but also the intensity of location religiosity affects agents' behaviour, suggesting that firms located in strong religious regions would likely experience lower incidences of misbehaviour due to location religious norms' effect on managers, as they are located in religious society, so they would be likely to avoid acting in a manner that violates a social norm or would lead to social sanctions.

The broader impact of religion is evident in countries where it is integral to national identity. In these countries, it is very probable to produce a set of economic attitudes consistent with its dominant religious beliefs. Therefore, a mimetic isomorphism pattern will be followed by both individuals and firms by avoiding any form of behaviour not listed within social norms to avoid social punishment. This wider effect of religion is evident in the MENA region as it holds a high level of religiosity (Badaoui, 2023). Moreover, Islam is the dominant religion in the region (Pew, 2009). This fact holds a special importance for this study context, as for Muslims, Islam provides rules and guidance on daily transactions and business activities. Consequently, business ethics cannot be separated from Muslims' daily life ethics (Abdelsalam et al., 2021). It is, therefore, appropriate to examine the influence of country religiosity (as a proxy for bank managers' religiosity) on opportunistic behaviour.

Based on this context, I can argue that religiosity can modify the utility function of the agent. It alters the perceived costs of opportunism (social, spiritual, reputational) and shifts the focus from pure wealth maximisation to norm-constrained optimisation.

3.5.2 Organisational Religiosity

Organisational religiosity refers to the involvement of religious beliefs, practices, and values in an organisation's structure, policies, and culture, incorporating religious principles into its mission, values, and operations. In the banking industry, Islamic banks are a unique representation of formal organisational religiosity. The involvement of religious values in the formulation and creation of Islamic bank strategies and operations is self-evident and substantial at all levels, as it lies in sacred intentions originating from the divine purposes of Shari'ah (Haniffa and Hudaib, 2010). Prior studies have suggested that organisational religiosity stimulates social norms/informal institutions that constrain the opportunistic behaviour of bank managers (e.g., Weaver and Agle, 2002; Abdelsalam et al., 2016). In religiously oriented organisations, individuals pay more attention to their behaviour in order to avoid the potential sanctions that arise from non-adherence to the prevailing values and beliefs (Weaver and Agle, 2002; Treviño et al., 2006).

Religious-based organisations are generally expected to work under strict ethical and religious constraints that structure the work settings of such organisations' business operations and enhance their organisational morality (Abdelsalam et al., 2016). Previous research suggests that well-defined moral guidelines improve individual moral behaviour within corporations (Kaptein, 2011; Ha-Brookshire, 2017). Moreover, the theological notion of accountability in Islamic banks is held to extend beyond standard accountability measures to a wider range of religious liabilities that include the bank's broader stakeholders' best interests, together with protecting and maximising the investments of the bank shareholders and depositors (Beekun and Badawi, 2005; Belal et al., 2015). Working with such moral rules fulfils managers' religious duty of trust, which requires them to shape their behaviour in accordance

with the Islamic principles of fairness, balance, and good behaviour (Beekun and Badawi, 2005).

“Shari’ah” principles of moral accountability are embodied in the business model and organisational structure of Islamic banks. From the business model aspect, Islamic banks are founded on a self-constrained business model of banking that forbids usury, getting interest/gain from lending money, excessive uncertainty, and speculation. This model promotes a fair share of earnings, losses, and risks between the bank and its borrowers and depositors. (Abdelsalam et al., 2016). Regarding the organisational structure, Shari’ah accountability forms an essential part of Islamic banks' governance framework under the name of the Shari’ah Supervisory Board (hereinafter SSB). The SSB serves as an internal control and extra governance body that has to ensure that all transactions comply with Islamic rules, which increases Islamic banks' credibility (Rammal, 2006). SSB also provides religious guidance to managers to ensure conformity with Shari'ah and ensures managers' behaviour is in line with the Islamic moral code to avoid religious disputes during decision-making. Additionally, the SSB collaborates with the board to improve the managerial behaviour (Safiullah et al., 2022). SSB also provides religious monitoring which enriches the soundness of the governance system as well as validates the religious and ethical legitimacy expected by the Islamic bank stakeholders (Bougatef, 2015; Ullah et al., 2018). Additionally, the issuance of an annual report on the religious compliance of the banks' operations is under the responsibility of the SSB (Tomkins and Karim, 1987; Karim, 1990; Maali et al., 2006; Ullah et al., 2018). It is worth noting that regulations do not require managers of Islamic banks to be Muslims, as the responsibility for ensuring that management decisions are consistent with Islamic rules is the responsibility of the SSB. The SSB should be composed of specialised jurists in Islamic commercial jurisprudence (Fiqh Al-Mu’amalat). However, it may include a members other than

those specialised in Islamic commercial jurisprudence, but they should be an expert in the field of Islamic banking and with knowledge of Islamic commercial rules (AAOIFI, 2015).

Hence, it can be argued that the existence of SSB and Shari'ah principles in banks can limit managers' opportunistic behaviour, as this type of behaviour violates the Shari'ah principles and may put managers under the SSB sanctions associated with such non-adherence. SSBs are unique to Islamic banks as they are not available in conventional banks, which makes it interesting to study the influence of its existence on the opportunistic behaviour of bank managers. In fact, many studies have highlighted the role of SSBs in providing assurance of bank religious compliance, reporting quality in Islamic banks and impeding management opportunistic behaviour (e.g., Tomkins and Karim, 1987; Haridan et al., 2018; Almutairi and Quttainah, 2020).

Therefore, it is expected that Islamic bank managers, as actors in religiously based organisations, prioritise ethical choices in their financial reporting and avoid LLPs' opportunism. In other words, the moral accountability constraints on Islamic banks' managers are expected to lead to lower opportunistic behaviour in these banks in comparison with conventional counterparts, given that this moral accountability is prominent and rooted in Islamic banks' business model and governance system, which discourages or mitigates opportunistic behaviour.

Based on the previous discussion, religion can constrain managers' opportunistic behaviour through personal and organisational religiosity. By studying these constraints, this study seeks to provide insight into the role of religion in shaping bank managers' behaviour towards LLP reporting under the IFRS9ECL Model.

3.6 Regulatory Capital as a Formal Constraint

Regulations represent one of the main formal institutional factors that structure human interactions. According to North (1990), formal institutions are officially established and accepted sets of rules and regulations introduced to structure economic interaction and govern various aspects of individuals' behaviour that aim to protect contractual rights for principals and agents. Formal institutions can influence both individuals and firms to behave in strict compliance with pre-defined contracts, created and enforced by recognised authorities (Mallor, 2013). By providing authoritative rules of behaviour, formal institutions enable the formation of behavioural expectations (Scott, 2008). Thus, the presence of powerful formal institutions is anticipated to result in higher levels of compliance, since firms have an incentive to adhere to regulations in order to avoid sanctions. According to Holmes et al. (2013), regulatory and economic institutions are seen as significant formal institutions to managers as they establish and outline the order of their business operations. Each institution is formed mainly by the actions of governments, based on the sovereign authority to design legal and control systems that establish rules, monitor adherence to these rules, and sanction misbehaviour (Covaleski and Dirsmith, 1988).

Accounting standards themselves may be understood as part of the formal regulative framework that shapes organisational behaviour by specifying acceptable rules and compliance expectations (North, 1990; Scott, 2008). The accounting change from IAS 39 to IFRS 9, with its direct implication on bank capital, changes the institutional channel through which capital regulation affects bank managers' behaviour. The regulatory environment has an influential role in the decision-making process, that bank managers undergo, including the decisions on accounting choices (Boolakay et al., 2018; Ozili, 2021). The regulatory requirements are imposed by supervisory bodies

in order to limiting banks from engaging in excessive risk-taking (Mahieux et al., 2023). In theory, imposing restrictions on bank activities is likely to have a positive or negative impact on bank risk-taking and overall performance. From the public interest perspective, imposing restrictions on a bank's activity is intended to decrease moral hazard and control any excessive risk-taking that may arise from such an activity. This, in turn, may diminish the financial activities that may cause the rise of excessively large banks that are difficult to supervise and effectively too big to discipline (González, 2005; Barth et al., 2013). On the one hand, the 'private interest view' of bank regulation posits that increased restrictions on banking activities diminish banks' ability to utilise their resources and limit them from providing services to their customers (Laeven and Levine, 2009; Barth et al., 2013). Furthermore, some have argued that large banks advocate for highly complex and model-driven bank regulations, as they have the resources to implement such models that are relevant to their scale of size. This creates significant compliance costs that excessively burden smaller banks and effectively shield large banks from competition (Cyree, 2016). Moreover, regulatory requirements can be structured to give regulators discretion, thereby increasing their leverage and capacity for rent-seeking (Djankov et al., 2002). On the other hand, the 'public interest view' posits that proper regulatory measures that constitute the disclosure of reliable and accurate information on risk-taking and other banking activities are likely to decrease information asymmetry and improve bank efficiency (Beck et al., 2006; Barth et al., 2008). Regulatory requirements here serve as the supervisor's primary tool to mitigate this moral hazard. Quintyn et al. (2007) argues that placing capital regulation in the hands of independent, technocratic agencies is a deliberate, public-interest strategy to insulate financial stability from short-term political pressures. Furthermore, on the public interest rationale, Mendicino et al. (2020) highlight that the regulatory capital requirements can make banks safer in

the long term, and smooth out the macroeconomic shocks, prioritising long-term real-economy stability over short-term bank profitability.

However, as discussed earlier in this chapter, the regulatory capital requirements serve as an incentive for discretionary reporting of LLPs, whereas the regulation here is a formal institution that is supposed to constrain such discretionary behaviour. The fear of the consequences of failing to meet the regulatory requirements triggers the opportunistic behaviour (Moyer, 1990; Ahmed et al., 1999). The capital management hypothesis posits that bank management is incentivised to utilise LLPs to manage capital due to the regulatory costs linked to violations of capital requirements (Olszak et al., 2017). In bank regulation, banks are required to maintain the specified regulatory capital ratio benchmarks, and that requires limiting their risk-taking activities within the safe limit that does not negatively affect the capital ratio; noncompliance may result in regulatory intervention (Anandarajan et al., 2005). The mechanism is especially visible in the treatment of LLPs, because provisioning directly affects both earnings and capital ratios. Ozili and Outa (2017) explain that where regulatory capital rules create binding thresholds, managers have incentives to influence LLPs' estimates so as to remain above the minimum capital requirements, and they explicitly note that managers' awareness of the costs of violating minimum capital requirements strengthens incentives to use discretion opportunistically. Consistent with this logic, Lim and Yong (2017) argue that anticipated tightening under Basel II induced greater income smoothing and less timely recognition of loan loss provisions in low-capital banks, highlighting that even expected regulatory pressure can distort reporting behaviour.

From an institutional perspective, regulatory requirements constitute coercive pressures that compel organisations to maintain the appearance of compliance and

stability to preserve legitimacy. North (1990) argues that institutions create the incentive structure within which organisations operate, and Scott (2008) institutional approach similarly treats regulation as a coercive mechanism that shapes organisational behaviour. However, where compliance is judged through accounting numbers that still require managerial estimation and judgment, such coercive pressure does not necessarily eliminate discretion; instead, it may redirect discretion toward the strategic presentation of compliance. In banks, this means that the stronger the expected consequences of regulatory failure, the greater the incentive to use subjective accounting estimates opportunistically to protect legitimacy, avoid sanction, and postpone intervention. Banks may structure their compliance with regulatory requirements in response to institutional pressures as implied by DiMaggio and Powell (1983). These pressures are coercive, imposed by law and regulations. In the same vein, drawing on Fashola (2014) Burdon and Sorour (2020) argued that banks are subject to coercive pressures stemming from their institutional context, as these are likely to convey social privileges from their stakeholders. Ajibade Adisa et al. (2025) highlight that there are discrepancies between the ethical values promoted by banking institutions and the actual practices implemented, suggesting that the pressure and consequences of failing to meet regulatory requirements and bank targets could force bank managers to engage in opportunistic behaviour. Furthermore, the dynamics of corruption, weak supervision and rationalisation of opportunistic behaviour can incentivise bank managers to meet the regulatory requirements and adhere to these formal institutions by using unethical or opportunistic means (Beck et al., 2006; Aguilera and Vadera, 2008).

From this perspective, discretionary behaviour is not merely a matter of personal bias; it is a rational response to the institutional pressures in which breaching regulatory requirements carries measurable consequences, and in which accounting discretion

can be used to mitigate that risk. Thus, I argue that in the context of banking LLPs, the formal institution of capital requirements does incentivise banks to utilise the ECL model under IFRS 9 to adhere to the regulatory requirements to achieve compliance with formal institutions.

3.7 Conclusion

This chapter discussed the theoretical framework for discretionary behaviour in light of the PAT with insight from IT. According to this theoretical framework, firms' agents (e.g., Bank managers) are motivated to report discretionary financial results to maximise their benefits. The two central incentive drivers discussed in this chapter are earnings management and capital management. Earnings management creates incentives for managers to use discretionary LLPs to smooth reported performance, reduce earnings volatility, and present a more stable financial position. Capital management creates incentives for managers to adjust LLPs to meet regulatory capital requirements or reduce the risk of supervisory intervention. Together, these incentives provide the core theoretical explanation for bank managers' opportunistic behaviour towards the discretion allowed in the IFRS9ECL model and discretionary LLP reporting.

However, discretionary behaviour, like any human behaviour, is constrained by institutional forces that shape the behaviour based on their influence on the agents. Two key constraints were identified. First, religiosity represents an informal institutional force that may restrain opportunistic conduct by strengthening moral norms, ethical accountability, and sensitivity to socially embedded expectations at both personal and organisational levels. Second, regulatory capital requirements operate as a formal institutional force that can both discipline and pressure managerial

behaviour. On the one hand, regulation constrains reporting choices through monitoring, prudential rules, and the threat of supervisory intervention; on the other hand, when capital thresholds become binding, the same regulatory framework may intensify incentives to manage accounting numbers. Accordingly, this thesis conceptualises discretionary LLPs' behaviour as the outcome of the interaction between incentive forces that motivate discretion and institutional forces that constrain or moderate that discretion. Thus, I argue that opportunistic behaviour under the IFRS9ECL model can be defined by both the incentives and the constraints that have a dominant influence on bank managers.

The next chapter presents prior empirical research on discretionary reporting of LLPs. By doing so, the gap in the literature on discretionary behaviour is identified, and then hypotheses are formulated based on what is discussed in the present chapter and the next chapter.

Chapter 4: Empirical Literature and Hypotheses Development

4.1 Introduction

Building on the theoretical framework developed in Chapter 3, this chapter reviews empirical evidence on opportunistic use of the discretionary loan loss provisioning under different accounting regimes and develops testable hypotheses concerning the IFRS9ECL model, earnings incentives, regulatory capital, religiosity, and COVID-19. In doing so, it links the theoretical arguments of the previous chapter to the existing empirical literature in order to identify the specific research gaps that this thesis addresses.

The chapter also examines the main incentives for the discretionary LLPs' reporting and how these may be changed following the adoption of IFRS 9. Particular attention is given to the implication of the shift from the IAS 39 incurred-loss model to the IFRS 9 expected credit loss model, and to whether this accounting change altered the scope, timing, and channels of managerial discretion in provisioning decisions. Then the chapter delves into the impact of personal and organisational religiosity on discretionary behaviour. In this respect, it reviews the literature on religiosity as an informal institutional constraint and considers whether ethical and normative pressures at the individual and organisational levels can moderate the use of accounting discretion under the IFRS9ECL model. Finally, it discusses the impact of COVID-19 on the discretionary reporting of LLPs during the pandemic. This part of the chapter considers whether the severe economic stress, heightened uncertainty, and crisis-period regulatory responses during COVID-19 changed the incentives or opportunities for discretionary provisioning under the IFRS 9 regime. Following the discussion of each section, the hypotheses of this research are presented.

4.2 IFRS9ECL Model and IAS39IL Model

Before examining the discretionary implications of IFRS 9 in this chapter, it's important to note that prior to the implementation of IFRS 9, a robust body of empirical literature documented the deficiencies of the IAS 39 IL model (Bushman and Williams, 2012; Beatty and Liao, 2014; Gebhardt, 2016; Hashim et al., 2019). The empirical literature shows that the shift from the IAS39IL model to the IFRS9ECL model represents a trade-off between verifiability and relevance. While IFRS 9 effectively mitigates the "too little, too late" LLPs problem by incorporating forward-looking expectations in the ECL, it simultaneously introduces complexities related to the discretionary implications of the ECL model. One of the main differences between the IAS39IL model and the IFRS9ECL model is that discretion is no longer concentrated primarily in the recognition trigger, but increasingly in the estimation process itself (Novotny-Farkas, 2016; Awuye and Taylor, 2024).

4.3 Use of the IFRS9ECL Model and Bank Discretionary LLPs

LLPs are the main accounting tool for managing credit risks by booking an estimated amount for the future expected credit losses that would result from the default of some of the bank's debtors. LLPs are important for the external users of accounting information such as investors and regulators, as they use it for the assessment of the overall bank stability. Therefore, LLPs are critical accounting figures and the largest accrual in banks' financial statements; thus, LLPs' accounting methods and choices greatly affect banks' performance and results (Beatty and Liao, 2014).

LLPs represent one of the largest fields of accounting discretionary reporting, due to the nature of LLP estimates which are directly subject to management's judgment (Aggelopoulos et al., 2023). The opportunistic use of discretionary LLPs can be linked to the well-established literature on accounting discretion (e.g., Anandarajan et al.,

2003; Bushman and Williams, 2012; Beatty and Liao, 2014; Tran et al., 2020; Mahieux et al., 2023) according to which bank managers resort to discretionary LLPs for regulatory capital management and other earnings management purposes. The accounting for LLPs in banking literature decomposes LLPs into discretionary and non-discretionary. While the nondiscretionary LLPs are measured based on the occurrence of actual default and therefore do not have room for opportunism. The discretionary LLPs are the major concern as it reflect the efficiency, transparency and behaviour of management (Lobo, 2017).

The literature stream on the discretionary reporting of LLPs is mainly built on the IAS39IL model, which was applicable until 2018, with the exception of some recent contributions (e.g., López-Espinoza et al., 2021; Pastiranová and Witzany, 2022; López-Espinoza and Penalva, 2023). In a cross-country study, Bushman and Williams (2012) examined the effect of accounting discretion on LLPs across 27 countries. The study shows that discretion in LLPs depends mainly on the way managers exploit available discretion to shape LLPs. The use of LLPs for opportunistic purposes dampens disciplinary pressure on risk-taking, reducing bank transparency and inhibiting monitoring by outsiders. Farook et al. (2014) also, find consistent evidence. This earlier IAS 39-based literature therefore establishes the benchmark that LLPs discretion can be used opportunistically; the central question under IFRS 9 is whether the forward-looking ECL framework constrains such behaviour through earlier loss recognition or instead widens the scope for managerial discretion. The literature on the opportunistic utilisation of the IFRS9ECL model remains scant and provides mixed evidence regarding its role. The literature suggests three related strands. First, some studies indicate that the IFRS9ECL model may expand managerial discretion and thereby preserve, or even intensify, the opportunistic use of discretionary LLPs. Kund and Neitzert (2020) examine whether banks use discretionary LLPs for earnings

management and regulatory capital management using annual data from European Banking Authority stress tests. Their analysis is particularly relevant because stress-test settings create strong incentives for banks to present themselves as financially resilient. They find evidence of earnings management and proactive regulatory capital management, indicating that banks continue to use LLP-related discretion strategically even when the accounting framework changes. Oberson (2021) examines the consequences of IFRS 9 for income smoothing using a sample of 69 international banks over the 2014–2019 period. The study finds that managerial discretion in estimating LLPs is used more aggressively to smooth earnings following the IFRS9ECL adoption. This evidence suggests that the forward-looking nature of the ECL model does not necessarily eliminate opportunistic reporting; rather, the additional judgement involved in ECL estimation may provide managers with greater flexibility to adjust provisions in response to reported earnings. These studies therefore provide empirical support for the concern that the discretion embedded in the IFRS9ECL model can continue to facilitate strategic LLP reporting.

Second, another strand of the literature suggests that the IFRS9ECL model improves the timeliness and informational relevance of loan loss recognition, even though it relies more heavily on managerial estimates. Bischof et al. (2022) examine the information and verification consequences of forward-looking ECL estimation. They show that although forward-looking estimates can produce more timely and precise recognition of expected defaults, these estimates are generated through banks' internal models and managerial assumptions and are therefore considerably more costly for outsiders to verify than the relatively coarse estimates under the IAS39IL model.

The literature also documents why earlier loss recognition can be economically beneficial. Bushman and Williams (2015) examine the relationship between delayed

loss recognition, lending behaviour, and market discipline. They find that delayed recognition can reinforce the procyclicality of bank lending and weaken market discipline over bank risk-taking, thereby increasing vulnerability during economic downturns. Similarly, Bertay et al. (2015) and Meriläinen (2019) examine the cyclical behaviour of LLPs under the incurred-loss framework and find that LLPs are negatively associated with real GDP growth, providing evidence of procyclical provisioning. They further show that ownership structure matters, with the procyclical effect being weaker in government-owned and cooperative banks, where stronger oversight and more conservative behaviour can reduce managerial discretion.

Beatty and Liao (2014) review and evaluate the banking literature on loan-loss accounting and show that moving away from an incurred-loss framework towards more forward-looking loss recognition can improve banks' ability to recognise anticipated credit deterioration. At the same time, they emphasise that earlier recognition is likely to increase the level of provisions and the role of managerial judgement in determining those provisions. Jiménez et al. (2017) provide complementary evidence from the Spanish dynamic provisioning system. Using the Spanish experience with dynamic provisioning, which required banks to accumulate additional provisions during favourable periods, they show that earlier provisioning can smooth bank lending cycles, support bank performance during downturns, and strengthen capital buffers. Their findings demonstrate that forward-looking provisioning can have prudential benefits even though it changes the timing and magnitude of reported LLPs. These findings show that ECL provisioning can address some of the weaknesses associated with the earlier incurred-loss approach.

Furthermore, focusing on managers' personal incentives, Hou et al. (2021) examine whether managers' compensation arrangements are associated with discretionary LLP

behaviour. Their findings show that compensation linked to bank share prices provides an incentive for managers to exercise LLPs discretion strategically. This evidence demonstrates that the discretionary reporting of LLPs is partly shaped by managers' personal economic incentives rather than by accounting standards alone.

Third, the literature also points to mixed or transitional effects rather than a uniformly positive or negative consequence of the IFRS9ECL model. In other words, the same forward-looking discretion that can improve early loss recognition can also be exploited for earnings smoothing, capital management, or delayed impairment recognition, depending on managerial incentives and monitoring conditions. This mixed evidence is important because it suggests that the effect of IFRS 9 cannot be inferred simply from the amount of discretion embedded in the standard; it is necessary to examine the managerial incentives that determine how that discretion is actually used. Under the IFRS9ECL model, the use of the ECL forward-looking LLPs requires banks to define the triggers of the Significant Increase in Credit Risk (SICR) that financial assets may face, which includes setting a clear definition of the "Default". However, IFRS 9 did not set a specific definition of "default", leaving the freedom for each bank to define it in accordance with the internal objectives of credit risk management of financial instruments, though IFRS 9 set a general threshold as a rebuttable presumption that "the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due"; this threshold is generally used as a trigger to transfer the loan from stage 1 to stage 2. IFRS 9 also mention a second threshold (which is used by Basel III as a definition for default) that an exposure that is more than 90 days past due is in default, this serves as a trigger to transfer the loan from stage 2 to stage 3 (IASB, 2014, Para 5.5.11; Para B5.5.35). The freedom allowed by IFRS 9 for each bank to define its SICR criteria and related estimates represents one of the major challenges to IASB and

regulatory bodies in terms of limiting the discretion practices, especially with the existence of a parallel standard in the United States free of SICR (O'Hanlon et al., 2015; Botha et al., 2025; Kyiu and Tawiah, 2025). The SICR criteria require the management to define in-stage loan movements and to address a range of possible outcomes and estimate the probability of those outcomes' occurrence. This involves a degree of subjectivity and can result in different estimates of expected credit losses. Accordingly, managerial discretion arises not simply because IFRS 9 is forward-looking, but because managers must decide when credit deterioration is sufficiently severe to justify movement across stages and recognise higher provisions. This sophisticated decision-making process to estimate impairment, combined with extensive discretion, may result in varied LLPs for identical assets under the same conditions. Gebhardt (2016) provides evidence from Greek bonds that the complicated impairment calculation and managerial discretion permitted under IFRS 9 may result in delayed and lower LLPs compared to the fair value losses. Novotny-Farkas (2016) suggested that if bank management fails to promptly identify SICR, substantial 'cliff effects' are possible when banks' loans switch from Stage 1 to Stage 2, that is, when they transition to lifetime loss recognition. thereby creating scope for managers to postpone transfers across stages and delay the recognition of higher LLPs.

In contrast to the studies documenting increased discretionary use, López-Espinosa et al. (2021) examine the initial implementation of IFRS 9 and test whether the new standard increased discretionary LLP reporting for earnings management or regulatory capital management. They didn't find a correlation between IFRS 9 and the increase in the use of discretionary LLP reporting to manage earnings or to meet regulatory capital requirements in the first year of implementation of IFRS 9. These finds limited to the first year of implementation. However, they suggested that the effect of IFRS 9 could vary over time as a result of learning or other dynamics.

Despite these growing insights, the evidence remains limited in MENA banking settings, where institutional conditions may shape whether IFRS 9 discretion is used primarily for timely recognition or for discretionary LLPs management. This leaves an important research gap on the behavioural consequences of IFRS 9 in the MENA context.

In summary, the ECL model can be used opportunistically as a discretionary tool by management to recognise LLPs to foster risk-taking ability and capital adequacy. In sum, the above analysis leads to the following questions: Do bank managers use the IFRS9ECL model to report more discretionary LLPs than they did under the IAS39IL model?

In order to answer this question, I propose the following hypothesis:

H₁: IFRS9ECL model adoption is associated with higher discretionary LLPs relative to IAS39IL model.

4.4 Use of the IFRS9ECL Model for Earnings Management

The discretionary nature of LLPs allows bank managers considerable flexibility in timing expense recognition (Beatty et. al, 1995). Consistent with the incentive-based arguments developed in Chapter 3, managers may use this discretion to smooth reported earnings, signal financial stability, or meet regulatory thresholds. Banks are generally incentivised to manage earnings due to banks' governing strict regulations and the informational asymmetry between insiders and outsiders (Ahmed et al., 1999). According to Healy and Wahlen (1999), bank managers adjust LLPs to smooth reported earnings, signalling financial stability or meeting regulatory thresholds. Earnings management through LLPs results in financial statements that deviate from

a firm's true state of profitability and risk provisioning. Subsequent deterioration of information quality may, in turn, inhibit outside monitoring and scrutiny over the bank's risk-taking. Regulators have made it clear that although managers' judgment for setting the loan loss allowance is acceptable, managers should not use their discretion to manipulate earnings or mislead investors (Kanagaretnam et al., 2003). As explained in Chapter 3, the earnings-management mechanism operates through the relationship between pre-provision earnings and discretionary LLPs. Conversely, when pre-provision earnings are relatively low, managers may reduce or release discretionary provisions to support reported earnings. Consequently, a positive association between pre-provision earnings and discretionary LLPs is interpreted in the banking literature as evidence consistent with income-smoothing behaviour. This provides the conceptual basis for the earnings-management test employed in this study. The transition to the IFRS9ECL model potentially changes the strength of this relationship. Under the IAS39IL model, managerial discretion was constrained by the requirement that impairment losses generally be recognised after objective evidence of deterioration became observable. The IFRS9ECL model moves discretion earlier in the provisioning process because managers must form forward-looking expectations of credit losses, assess future macroeconomic scenarios, determine significant increases in credit risk, and update expected losses before default occurs. Therefore, consistent with the PAT argument, the new standard may enlarge the opportunity set through which managers can respond to earnings-management incentives. If managers exploit this additional judgement for income smoothing, the positive association between pre-provision earnings and discretionary LLPs should become stronger under the IFRS9ECL model than under the IAS39IL model. Under the IFRS9ECL model, therefore, earnings management is less confined to the delayed recognition of incurred

losses and becomes more closely linked to how expected losses are estimated, modelled and updated over time.

Several papers examine how changes in accounting and banking regulation affect earnings management via LLPs. Taken together, this literature suggests that smoothing under IFRS 9 remains possible, but it is likely to become more subtle and model-based than under the incurred-loss regime. For example, Balla and Rose (2015) examine how banks react to changes in accounting regulation in the United States (US). They find that in the long run, the relationship between LLPs and earnings has weakened for publicly traded and privately held banks. However, in the short run, it has weakened only for publicly traded banks. Other studies provided evidence of incentives for the opportunistic use of LLPs in income smoothing. Morris et al. (2016) point out that the smoothing incentive is an important factor in reporting LLPs that are consistent with investors' expectations. Given that investors are valuing smoothed earnings from those banks that are performing better than their peers during economic upturns. However, these investors value conservatively calculated earnings during bad times. Oberson (2021) argues, based on a sample of 69 banks worldwide for the period 2014 – 2019, that under IFRS 9, the managerial discretion over the estimation of loan loss provisions is used more aggressively to smooth earnings.

Similarly, Aggelopoulos et al. (2023) show that bank managers use the LLPs reversals as a direct income smoothing, as they have incentives to meet income targets. Bank managers have a strong incentive to avoid reporting losses due to the characteristics of their banking activities, as they are keen to maintain depositors' confidence and reduce the foreseen bankruptcy risk perceived by investors and regulators. Moreover, Skala (2020) shows that the existence of income smoothing implies that bank managers have discretion over the level of LLPs that the bank creates, and the size of pre-provisioning earnings may affect the level of discretion. These findings are consistent with the PAT

perspective in Chapter 3, earnings management incentives continue to motivate discretionary LLPs' choices, even when the accounting mechanism changes.

As for changes in banking regulation, Ahmed et al. (1999) analyse the change in US capital regulation in 1990 and find no evidence of earnings management via LLPs. Anandarajan et al. (2007) show that earnings management is more acute in the post-Basel period in Australia. Pérez et al. (2008) show that among Spanish banks, the requirement of statistical provisions enacted by the Spanish CB increased the quality of banks' accounting data. Leventis et al. (2011) show that the extent of earnings management by European Union banks declined after IFRS adoption, especially for riskier banks. Consistent with this result, Gebhardt and Novotny-Farkas (2011), on a sample of banks from the EU, show that the mandatory adoption of IFRS reduces discretionary LLPs. Armstrong et al. (2010) find a positive market reaction for EU companies, particularly banks, after adoption of IFRS. Stock market investors apparently view the adoption of IFRS as improving earnings quality in the presence of reduced managerial discretion and reacted accordingly. Barth et al. (2008) using a sample of 21 countries, provide evidence that companies adopting IFRS reduced earnings management.

However, the change from IAS 39 to IFRS 9 and its impact on earnings management require additional consideration. Thus far, some researchers have tried to identify the material impact of the new standard (Giner and Mora, 2019; Gomaa et al., 2019). Gomaa et al. (2019) study the efficacy of shifting from the incurred-loss model of IAS 39 to the IFRS9ECL model. The results show that replacing the incurred-loss model with the IFRS9ECL model facilitates high reserves. At the same time, the resulting increase in earnings management is less than predicted and, consequently, does not outweigh the positive effects of the IFRS9ECL model. However, this study was based

on a test-bed examination, that is, a hypothetical firm, before the issuance of actual reporting by banks under IFRS 9. Hence, the actual post-application effect of the new model on the banking sector was not considered.

Giner and Mora (2019) compare IAS 39 and IFRS 9 in relation to credit-loss models and conclude that unconditional conservatism could be higher under IFRS 9. The authors argued that earnings management may become an issue insofar as impairment losses can be reversed. However, Giner and Mora (2019) do not model or measure earnings management to provide econometric evidence.

Overall, the emerging evidence suggests that the IFRS9ECL model does not remove smoothing incentives; rather, it potentially provides managers with greater opportunity to adjust discretionary LLPs in response to pre-provision earnings. Accordingly, if the additional discretion introduced by the IFRS9ECL model is used for income-smoothing purposes, increases in pre-provision earnings should be associated with a larger increase in discretionary LLPs under the IFRS9ECL than under the IAS39IL model. This implies a stronger positive relationship between pre-provision earnings and discretionary LLPs in the IFRS9ECL period. On this basis, I hypothesise:

H2: The positive association between pre-provision earnings and discretionary LLPs is stronger under the IFRS9ECL model than under the IAS39IL model.

4.5 Regulatory Capital and Bank Discretionary LLPs under IFRS9ECL Model

The traditional capital management hypothesis states that discretionary LLPs can be used by bank managers to maintain their capital within the regulatory ratio to avoid the costs arising from violating capital requirements, a negative correlation being predicted between regulatory capital and LLPs (Beatty et al., 1995; Ahmed et al., 1999). Prior studies document evidence of LLPs' opportunistic reporting to meet

regulatory capital requirements. particularly the banks that hold low capital ratios that almost violate the regulatory capital requirements. Banks are subject to regulators' supervision, which requires them to hold minimum regulatory capital to reduce the need for safety nets from the government (Berger et al., 1995). This situation creates incentives for bank managers to manage LLPs in a way that aims to meet the capital requirements (Moyer, 1990; Ahmed et al., 1999). Moyer (1990) indicated that bank managers may alter accounting figures, specifically the discretionary part of LLPs to manipulate the regulatory capital, with the aim to reduce costs enacted by capital adequacy ratio rules by manipulating the size and the timing of reported LLPs. Her findings align with the hypothesis that bank managers apply accounting adjustments that boost the ratio when the primary capital adequacy ratio falls below the regulatory threshold. Ahmed et al. (1999) provide evidence that US bank managers used LLPs to manage regulatory capital, as they have strong incentives to act opportunistically to maintain capital adequacy ratios within regulatory limits. Bouvatier and Lepetit (2008), using a sample of 186 European banks, show that bank managers in poorly capitalised banks tend to opportunistically use LLPs to manage regulatory capital. In contrast, these incentives are reduced in well-capitalised banks, Bhat and Desai (2020) find that higher bank capital strengthens management incentives to improve loan quality as bank failure is more costly for shareholders of well-capitalised banks. Moreover, the opportunistic behaviour of IFRS9ECL LLPs can be affected by the country's specific regulatory capital requirements, given that these requirements can be one of the main incentives for opportunistic behaviour. (Olszak et al., 2017) suggested that bank managers may use or not use LLPs to manage capital, based on the extent to which retained earnings or LLPs affect capital. Taken together, these studies support the view that regulatory capital pressure can create incentives for

discretionary LLPs' choices, especially when banks are weakly capitalised or close to regulatory capital thresholds.

It's also worth mentioning that some studies have rejected the capital management hypotheses and found no evidence to support the use of LLPs for capital management. For example, Collins et al. (1995) find that banks did not use LLPs to manage their capital. Anandarajan et al. (2007) find no evidence that supports the use of LLPs for regulatory capital management after the implementation of Basel Accord in Australia. Similarly, Pérez et al. (2008) find no evidence that Spanish banks use LLPs to manage regulatory capital. Likewise, using a sample of 91 European banks, Leventis et al. (2011) find no evidence for the use of LLPs for regulatory capital management. Some other studies argued that banks may use discretion in LLPs to enhance bank efficiency rather than meeting regulatory requirements with opportunistic intentions. Bowen et al. (2008) find that managers use accounting discretion in order to optimise the reported earnings for the benefit of stakeholders. Similarly, Jin et al. (2018) find that banks build discretionary LLPs for efficiency rather than opportunistic purposes, as they use proper discretion as a risk management tool to build a buffer for future expected losses. Accordingly, the international evidence is mixed rather than uniform, suggesting that LLPs discretion may reflect either opportunistic capital management or more efficiency-oriented provisioning behaviour depending on the institutional and banking setting.

Under the IFRS9ECL model, the capital management issue becomes more specific because the forward-looking ECL recognition, stage transfers and SICR assessments can affect regulatory capital earlier and more directly than under the IAS39IL model. Bischof et al. (2021) find that despite management incentives' important role in influencing the loan loss recognition during the 2008 financial crisis, the regulators' use of prudential filters led to timely LLPs for the banks that were under the scope of

ECB's asset quality review. Furthermore, (Mahieux et al., 2023) showed that effective regulatory intervention reduces the management incentives to use the ECL model to manage excessive risk-taking to avoid the intervention. The possible explanation for the reduction of using LLPs for capital management is that the subsequent costs of such intervention would be high. Thus, bank managers would avoid reporting discretionary LLPs based on capital management incentives when they find that the consequences of that will outweigh the benefits. As they would take into account the potential impact of LLPs in capital management strategies, especially when their banks are under close supervision (Bischof et al., 2021). or when the bank failure is more costly for shareholders (Bhat et al., 2019; Bhat and Desai, 2020). Recent evidence from López-Espinosa and Penalva (2023) shows that large and small banks in Spain had increased their Tier 1 regulatory capital after the implementation of the IFRS9ECL model to avoid the negative effect of the new standards on regulatory requirements. Moreover, small banks have also reduced lending because these banks have less financial ability than large banks. Focusing on the new ECL models of IFRS 9 and US GAAP, Krüger et al. (2018) performed a counterfactual analysis to study the interaction between loan loss provisioning and capital adequacy by analysing US bonds default and recovery data between 1991 and 2013 using the SICR threshold. Their results show that the provisioning under ECL models reduces the regulatory capital, especially during economic downturns, and in banks with low quality credit portfolios. Their findings reveal that the models increase the procyclicality of regulatory capital, due to the nature of the SICR criterion (the significant increase in the risk of riskier loans usually happens during downturn economic situations) which requires higher capital. Banks with stressed portfolios are more affected by downturns, due to the higher sensitivity of eligible capital. On the other hand, in an economic upturn, the SICR criterion leads to lower loan loss provisioning and capital deduction.

These IFRS 9-specific studies suggest that the interaction between ECL provisioning and capital pressure may intensify managerial incentives, but that this effect may still depend on supervisory strength and bank-specific conditions.

In the MENA context, Bitar et al. (2016) studied the impact of different regulatory capital ratios on bank risk and performance using a sample of 168 banks in 17 countries. The study finds that higher capital adequacy ratios are positively associated with LLPs' size and that higher capital in countries with a proper regulatory environment can influence larger banks' behaviour towards more careful lending activities. However, the study does not differentiate between Islamic and conventional banks in the region. Mateev and Bachvarov (2021) examined risk-taking behaviour in MENA traditional and Islamic banks, and the study finds that the effect of regulatory capital requirements on bank credit risk is insignificant for Islamic banks, whereas it affects traditional banks. The study attributed that to the Islamic banking business model that does not require a large capital base to cushion losses since depositors/equity holders are sharing loan risks and losses between the bank and the borrower. Based on that, it can be assumed that Islamic banks may act differently toward using LLPs for capital management since capital requirements do not affect their risk-taking behaviour, which represents a main driver for opportunistic behaviour. On the contrary, Olson and Zoubi (2014) find that MENA banks do not use LLPs to manage their regulatory capital, suggesting that these banks are well-capitalised and thus, do not need to use LLPs to meet regulatory capital requirements. Similar evidence based on a single country in MENA was also provided. Abu-Serdaneh (2018) finds that there is no positive evidence to support that Jordanian banks utilise LLPs to manage their regulatory capital ratios or engage in pro-cyclical risk-taking behaviour. Overall, the evidence in MENA remains limited and is not specifically centred on the IFRS 9 setting. At the same time, the global literature

provides mixed findings, while the IFRS 9-specific literature suggests that capital incentives may operate differently once discretion shifts into forward-looking ECL estimation. This leaves a clear research gap and indicates the need to test whether regulatory capital pressure moderates discretionary LLP behaviour under IFRS 9.

Based on this discussion, the question of whether country-specific regulatory capital requirements influence the managers' use of the IFRS9ECL model to report discretionary LLPs emerges, and I propose the following hypothesis to answer it:

H3: The association between regulatory capital pressure and discretionary LLPs is stronger under the IFRS9ECL model than the IAS39IL model.

4.6 The Religiosity Influence and Discretionary LLPs

Bank managers' incentives for opportunistic behaviour may be constrained by religious rules. The literature suggests that religion plays a significant role in influencing the economic behaviour of both individuals and firms (Farook et al., 2014; Abdelsalam and El-Komi, 2016; Leventis et al., 2018).

Managers of religiously affiliated organisations are more likely to adopt certain social norms associated with anti-manipulative behaviour. Conroy and Emerson (2004), provide empirical evidence based on the attendance of religious events, indicating that religion is correlated with a decreased tolerance for manipulation of accounting figures. That is due to the influence of local religious norms on the attitudes of managers in a given area. Du et al. (2015) provide empirical evidence indicating that religion provides a set of social norms that can mitigate unethical behaviour such as earnings management, especially in emerging markets, where corporate governance mechanisms are weaker. In the same context, McGuire et al. (2012) find that managers

in highly religious regions would prefer real earnings management over opportunistic earnings management through the manipulation of accruals such as LLPs. Similarly, Dyreng et al. (2012) find that in highly religious regions, the accruals of managers show smaller deviations from expectations. And that high levels of religious adherence reduce the probability of accounting restatements and financial statement misrepresentations. Cantrell and Yust (2018), using data from US private banks, find that higher religiosity is correlated with lower earnings management and better conservatism in financial reporting. Taken together, these studies suggest that country-level or regional religiosity may reduce opportunistic reporting by shaping the broader social norms within which managers operate. However, this evidence is mostly indirect with respect to LLPs discretion in banks and does not necessarily imply that all forms of opportunistic provisioning are constrained in the same way. Some other studies find no correlation between opportunistic behaviour and religiosity. Callen et al. (2011) find using a cross-country analysis, that both religious affiliation and the level of religious adherence do not affect earnings management. Religiosity seems to serve as a personal control mechanism that constrains accounting choices in financial reporting, especially when religion is embedded in the governance and business model of the institution, as is the case in Islamic banks (Callen and Fang, 2015; Abdelsalam et al., 2016). At the individual level, the relevant question is whether the religiosity of managers or board members constrains opportunistic accounting choices. Almutairi and Quttainah (2020) find that bank managers' opportunistic behaviour depends on the corporate religious ethics and morals within boards of directors, and the study suggests that religious values affect how foreign directors influence bank managers' behaviour. Therefore, the impact of religiosity on the agents' (managers') behaviour at the corporate level continues to be an area of ongoing debate. This indicates that the evidence on personal-level religiosity, and religiosity at the societal level may not

always translate into lower opportunistic accounting behaviour at the bank managers' level.

On the organisational level, religion has a formal presence in Islamic banks; these types of banks are founded based on the specific religious rules that affect the behaviour of bank managers and firm performance. For example, Albaity et al. (2022) show that Islamic banks' lending behaviour is more aligned with the economic cycle than conventional banks, due to the governing Shari'ah rules in Islamic banks. According to Mateev and Bachvarov (2021), the strengthened regulatory measures affecting MENA banks' have decreased the profitability of conventional banks more than Islamic banks due to the strength of the Islamic rules applied to those banks that discipline their risk-taking. Elnahass et al. (2018) examine the effect of institutional characteristics of Islamic and conventional banks on capital and earnings management behaviour using LLPs. This study shows that, unlike conventional banks, Islamic banks tend not to use LLPs in either capital or earnings management practices. Suggesting that differences in behaviour are attributed to the constrained business model of Islamic banking, strict governance, and religious orientations. Quttainah et al. (2013) analysed earnings loss avoidance and abnormal loan loss provisions and provide evidence that Islamic banks are less likely to engage in earnings management compared to conventional banks. The study also shows that the existence of SSB does not significantly affect earnings management behaviours in Islamic banks. Suggesting that the Islamic religion does have an important impact on managers' accounting decision-making.

Some studies provided evidence on the influence of organisational religiosity on earnings management. Abdelsalam et al. (2016) tested the effect of organizational religiosity on the earnings quality in MENA listed banks during the period of 2008-

2013. they find that Islamic banks are less engaging in earnings management in comparison to conventional banks due to prevailing religious norms and moral accountability constraints within these banks. Similarly, Elnahass et al. (2022) find that the SSB in Islamic banks can significantly reduce earnings management in comparison with traditional banks. The existence of SSB creates a second layer of governance that is expected to additionally limit opportunities for financial misstatements and consequently moderate the higher agency costs in Islamic banks (Mensah, 2014). Empirically, therefore, the evidence on organisational religiosity in Islamic bank points to lower earnings management in such institutions. This is particularly relevant in the MENA region, where Islamic and conventional banks coexist and where religiosity may operate not only through social norms but also through organisational form.

Conversely, some studies provided evidence that Islamic bank managers also have incentives to use LLPs opportunistically to achieve certain goals. Firstly, given that Islamic banks share profits with their depositors instead of paying fixed interest. They try to avoid reporting negative earnings to maintain the confidence of investors. Secondly, Islamic banks' capital adequacy requirements and liquidity ratios are regulated strictly similarly to conventional banks, which incentivises their managers to use LLPs opportunistically to achieve compliance with such regulations. Lastly, there is a substantial incentive for Islamic bank managers to report discretionary LLPs in order to conceal asset substitution behaviour (Shen and Chih, 2005). Ismail and Be Lay (2002) provide evidence on the extensive use of LLPs for income smoothing by Islamic banks. Similarly, using a sample of 21 Islamic banks in the MENA region over the period 2000-2008, Ben Othman and Mersni (2014) show empirically that Islamic banks use discretionary LLPs for opportunistic purposes mainly to manage earnings and capital. Taktak et al. (2010) find no evidence of income smoothing through LLPs

in Islamic banks. Yet, the study finds extensive use of income smoothing by these banks using other channels such as profit equalisation reserve and investment risk reserve. These findings show that the empirical evidence on organisational religiosity is not uniform. Islamic bank status does not automatically eliminate opportunistic behaviour, and the MENA evidence itself remains mixed.

Based on this discussion, the question of whether religion constrains the managers' use of the IFRS9ECL model to report discretionary LLPs emerges, and I propose the following hypotheses to answer it:

H₄: The positive association between IFRS9ECL model adoption and discretionary LLPs is weaker in countries with higher managers' personal religiosity.

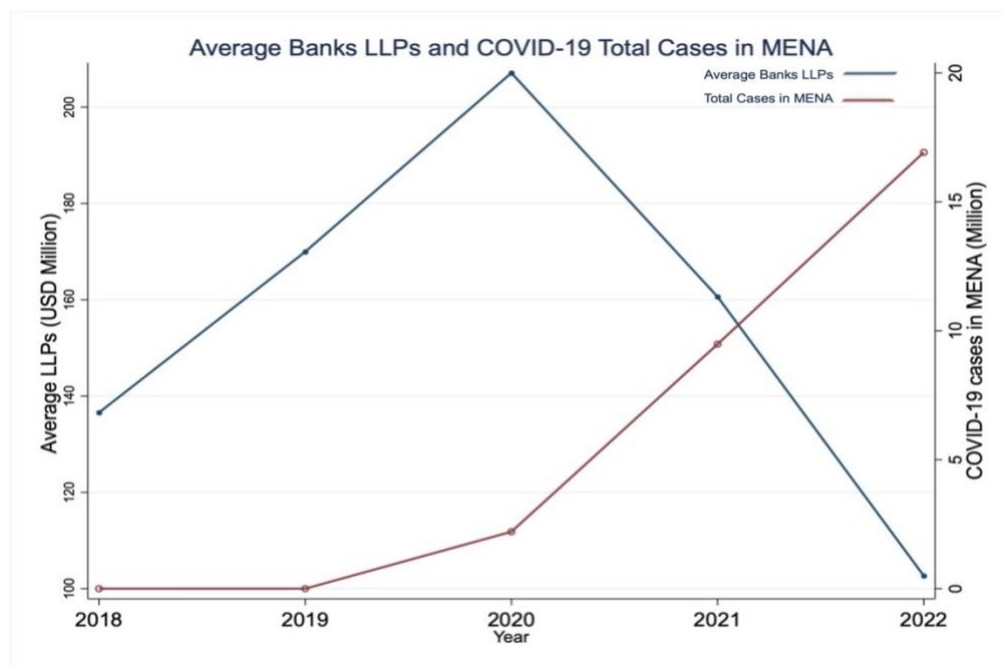
H₅: The positive association between IFRS9ECL model adoption and discretionary LLPs is weaker in Islamic banks.

4.7 Covid-19 and Bank Discretionary LLPs under IFRS9ECL Model

The COVID-19 pandemic constitutes an unprecedented global health and economic shock that was entirely unanticipated and beyond the control of all economic agents, including the banking sector. Unlike typical financial crises triggered by weaknesses in economic fundamentals or financial mismanagement, the pandemic originated from a global public health emergency. Furthermore, its severity and economic implications varied significantly over time and across geographic regions. The rapid outbreak of the COVID-19 pandemic presented an unprecedented shock to banks worldwide, serving as the first major test of the new IFRS9ECL model. In early 2020, MENA banks dramatically increased their LLPs in anticipation of pandemic-related credit deterioration (see Figure 1). The increase was documented in other regions, Beck and

Keil (2022) show that U.S. banks faced increases in LLPs and non-performing loans. These LLPs were intended to cover expected loan defaults amid lockdowns and economic contraction, but they also reflected managerial judgment under extreme uncertainty. Figure 1 illustrates this pattern, average LLPs in MENA banks rose sharply from 2018 to 2020, then declined following a sharp increase in total COVID-19 cases. This suggests that LLP reporting reacted strongly to the uncertainty of the pandemic, and the later path of COVID-19 case numbers.

Figure 1: Average Bank LLPs, and COVID-19 total cases in the MENA Region, 2018-2022



(Source: author's own work).

This behaviour is an expected reaction in LLPs, researchers argue that LLPs can be procyclical in severe, sudden economic downturns such as the recent COVID-19 crisis (Borio and Restoy, 2020; Mora, 2022; Pastiranová and Witzany, 2022). Mora (2022)

argued that the expected loss model of IFRS 9 can reduce the procyclicality effect in controlled, disciplined markets, but it can be more procyclical by its nature than an incurred loss model during a period of crisis. Aggelopoulos et al. (2023) suggested that the IFRS9ECL model is sensitive to the economic cycle, and COVID-19 economic implications demonstrated the importance of strong governance processes to ensure unbiased impairment estimates to limit the IFRS 9 procyclicality effect. Consistent with that, Engelmann and Lam Nguyen (2022) find that Banks' LLPs have increased globally between the end of 2019 and the end of 2020 due to the COVID-19 pandemic; the increase was largely due to SICR, which resulted in a movement of loans and provisions from stage 1 to stage 2. Taken together, these studies suggest that COVID-19 exposed the cyclical sensitivity of IFRS 9 impairment accounting, especially through forward-looking stage transfers and deterioration assessments.

The literature that studies changes in bank discretionary LLPs during the pandemic remains scarce. Taylor et al. (2023) report that earnings management increased significantly during the pandemic period relative to prior years in European banks. However, they do not include the IFRS9ECL model in their analyses to examine whether there are differences between IFRS9ECL-adopting banks and non-IFRS9ECL banks. Supporting this view, Nguyen et al. (2023) in a study of US bank samples conclude that banks used discretionary LLPs to manage regulatory capital during the COVID outbreak.

In contrast, some studies that focused on banks that adopt the IFRS9ECL model reported contrary evidence; López-Espinosa and Penalva (2023) show that the COVID-19 effect was mild in Spanish banks due to the forward-looking LLPs under the IFRS9ECL model, suggesting that IFRS9ECL is likely less procyclical than IAS 39. Especially for large banks, because these banks can reduce the COVID-19 impact

by liquidating foreign assets to maintain capital adequacy, and because large banks are usually more diversified in terms of lending sectors affected by COVID-19. Accordingly, the empirical evidence is mixed: some studies suggest that the pandemic increased discretionary provisioning incentives, whereas others indicate that IFRS 9 may have softened the shock in some banking systems.

Degryse and Huylebroek (2023), show that direct governmental fiscal support reduced banks' LLPs during the pandemic in 37 countries. Furthermore, following the outbreak of COVID-19 in 2020, banking regulatory bodies introduced easing rules to relieve the ECL impact on regulatory capital. These rules aim to mitigate the impact of the ECL estimation, which was pessimistic due to the high uncertainty overwhelming the economic forecast at the time. The easing rules allowed more discretionary choices for banks to report less pessimistic ECL. This may enable bank managers to benefit from the COVID-19 discretionary ECL without committing to decreasing their excessive risk-taking. Devi et al. (2021) revealed that after the implementation of IFRS 9, there was an increase in the formation of loan provisions. This increase can be attributed to increased caution among managers in assessing loan portfolios, especially during the initial implementation phase, which coincided with the pandemic. Overall, the COVID-19 period created an environment in which higher LLPs could reflect both prudent forward-looking provisioning and opportunistic use of discretion. The coexistence of extreme uncertainty, IFRS 9 judgment, and regulatory relief makes the pandemic a particularly important setting for examining whether discretionary LLP behaviour intensified under the new IFRS9ECL model.

Based on this discussion, the impact of COVID-19 on discretionary LLPs' reporting could be positive or negative, depending on the regulatory environment and relief

policies in place at the time. This leads to the following hypothesis, which expects a decrease in discretionary use of LLPs under the IFRS9ECL during the pandemic due to the effect of forward-looking ECL and the relief policies that disincentivises bank managers from engaging in opportunistic reporting of LLPs:

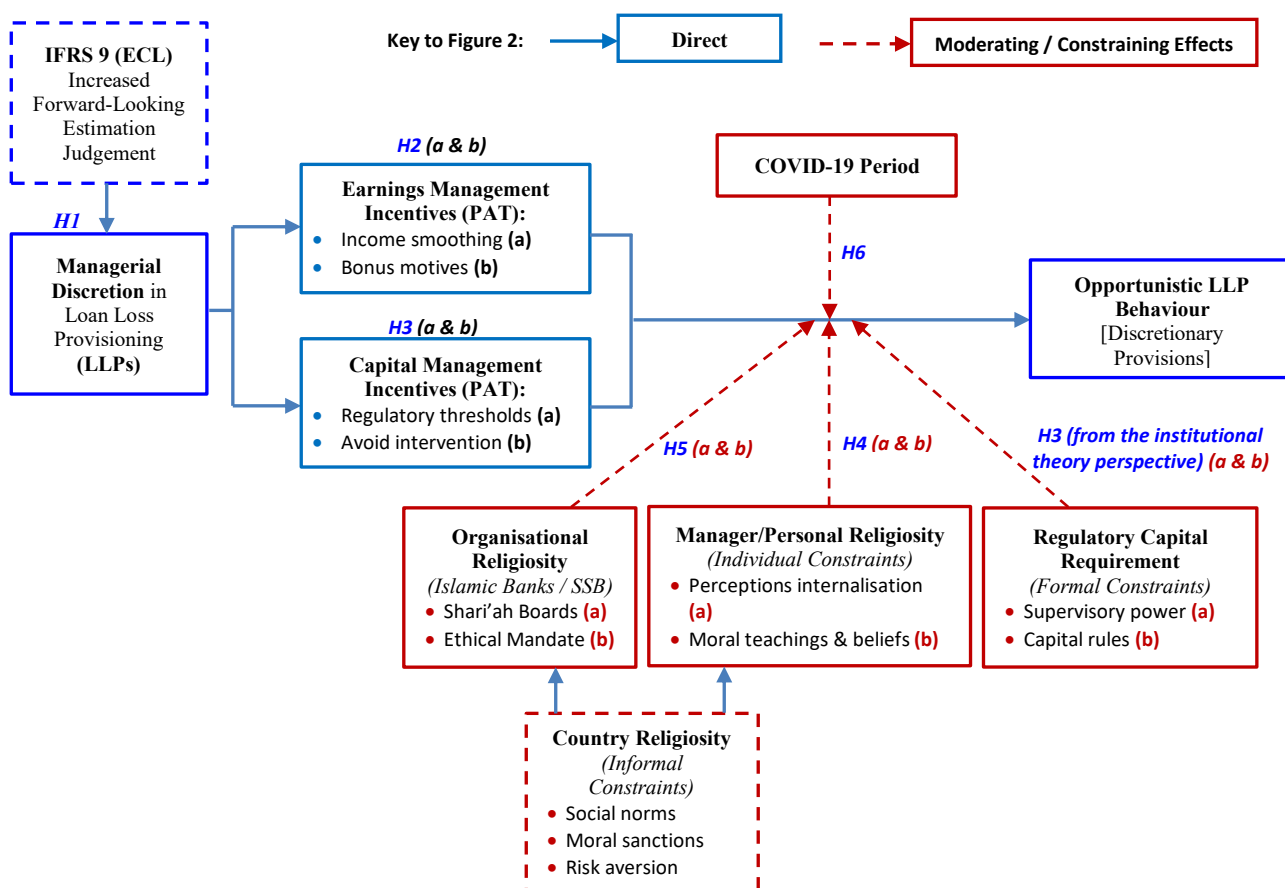
H₆: The discretionary use of LLPs under the IFRS9ECL model decreased during the COVID-19 period.

4.8 Bounded Model of Managerial Discretion Under IFRS 9

Based on the theoretical framework presented in Chapter 3 and the hypotheses developed in this chapter, I build on the theoretical foundations of the “Nationally Bounded Model of Principal-Agent Relationships” proposed by Lubatkin et al., (2005) to portray how incentive and constraint mechanisms operate within the PAT framework. In Figure 2, this study conceptualises a novel bounded model of discretionary behaviour under the IFRS9ECL model, bridging the theoretical foundation of that behaviour with the empirical hypotheses. The framework integrates three complementary perspectives. First, the IFRS9ECL model introduces a more forward-looking ECL model that expands the role of managerial discretion in estimating LLPs. Second, PAT explains why managers have incentives to use that discretion for self-interested reporting purposes, particularly through earnings management and capital management. Third, institutional and bounded agency perspectives suggest that such opportunism does not operate without constraints; rather, it is conditioned by formal and informal institutions. The agent’s opportunistic incentives arise from the self-interest rationale that drives agents to interact in an opportunistic manner. On the contrary, religiosity in this model determines the shape

of the opportunistic attitude. Normative pressure arises from religion's emphasis on social embeddedness when it shapes the bases of behavioural constraints that develop from 'informal' or 'background' institutions.

Figure 2. Bounded Model of Discretionary LLPs Reporting under IFRS 9



(Author's own work, inspired by the theoretical framework of Lubatkin et al. (2005)).

These institutions slowly evolve over centuries and, thereafter, display a great deal of inertia and take on symbolic value with a coterie of true believers. Religion shape manager personal attitudes through the internalisation of perceptions, beliefs, and norms. making it evident instead of subject to choice, i.e., the beliefs will be taken for granted. It also gradually manifests itself in the 'formal' or 'proximate' institutions that compose organisational religiosity. At this level, religiosity has a coercive influence (through the coercive mechanism) on managers' behaviour (i.e., it offers a

set of evident rules that regulate economic interactions and a set of enforcement procedures to identify, prosecute, and penalise persons who violate the defined boundaries) (Lubatkin et al., 2005). It is also shaped inside the contracts by defining contract terms and obliging formal governance rules that structure contracted parties' interactions. Organisational religiosity, as a governance mechanism noticeably reshapes agents' incentives to focus entirely on the ex-ante incentive alignment (Williamson, 2000). At this level mimetic mechanism can be seen when organisational executive agents imitate the structures, rules, and practices in order to conform to governing structures and best practices. Some studies (e.g., Touron, 2005; Rodrigues and Craig, 2007) suggested that in a seek for legitimacy in social systems, mimetic pressures can influence the accounting harmonisation process.

The model further recognises that the COVID-19 period altered the operation of the IFRS9ECL model discretion. The pandemic generated exceptional uncertainty regarding bank operations, macroeconomic forecasts and the probability of credit deterioration. In such circumstances, bank managers' incentives may have changed from traditional earnings management and capital management to maintaining bank stability throughout the pandemic period. Consequently, the COVID-19 period is conceptualised in this framework as a contextual condition that magnified the salience of managerial discretion and potentially changed the balance between incentives and constraints (Salazar et al., 2023).

Taken together, the bounded model in Figure 2 presents the theoretical logic of the hypotheses developed in this chapter. The contribution of this framework is therefore to embed PAT-based reporting incentives within a broader institutional setting, producing a more context-sensitive explanation of discretionary provisioning under IFRS 9.

4.9 Summary

This chapter explores the empirical literature on opportunistic behaviour using LLPs and the transition from the IAS 39 IL model to the IFRS 9 ECL model. The chapter shows how this transition affects incentives for opportunistic behaviour by bank managers, particularly in the context of earnings management, regulatory capital pressure, personal religiosity, organisational religiosity, and the COVID-19 period. The chapter highlights that the IFRS9ECL model, developed to address the shortcomings of the IAS39IL model, introduces a forward-looking approach that increases the discretion available to bank managers in reporting LLPs. This discretion, while intended to improve timeliness and accuracy, can also be exploited for opportunistic purposes, such as income smoothing and capital management. The chapter also considers the influence of religiosity, suggesting that both personal and organisational religious norms may constrain opportunistic behaviour in LLP reporting. Regulatory capital requirements are discussed as a significant factor driving the use of LLPs for capital management, with variations in regulatory environments across countries influencing this behaviour. Additionally, the chapter addresses the impact of COVID-19 on LLP reporting under IFRS 9, noting that pandemic-related regulatory relief may have altered discretionary reporting. Hypotheses are developed to investigate these dynamics empirically. H1 proposes that IFRS9ECL model adoption is associated with higher discretionary LLPs relative to the IAS39IL model. H2 proposes that the positive association between pre-provision earnings and discretionary LLPs is stronger under the IFRS9ECL model than under the IAS39IL model. H3 proposes that the association between regulatory capital pressure and discretionary LLPs is stronger under the IFRS9ECL model than the IAS39IL model. H4 proposes that the positive association between IFRS9ECL model adoption and discretionary LLPs is weaker in countries with higher managers' personal religiosity.

H5 proposes that the positive association between IFRS9ECL model adoption and discretionary LLPs is weaker in Islamic banks. H6 proposes that the discretionary use of LLPs under the IFRS9ECL model decreased during the COVID-19 period. These hypotheses provide the foundation for the methodology chapter, which operationalises discretionary LLPs within a two-stage empirical model to empirically test the hypotheses.

Chapter 5: Research Methodology

5.1 Introduction

This chapter presents the methodological framework employed in this thesis to investigate the opportunistic reporting of LLPs under the IFRS9ECL model for regulatory capital management within the context of MENA countries. It explains the research design adopted to examine whether the accounting change from IAS 39 to IFRS 9 altered the scope for discretionary loan loss provisioning, and how this relationship is shaped by managerial incentives, religiosity, and crisis conditions. The following sections introduce the sampling and data collection techniques, the baseline model, and variable measurement. In addition, the chapter sets out the empirical strategy for estimating discretionary loan loss provisions, explains the two-stage modelling approach adopted in the thesis, and describes the regression specifications used to test the study's hypotheses. The chapter also explains the staggered difference-in-differences and event-study approaches used to identify the effect of IFRS 9 adoption.

5.2 Sampling and Data Collection

The study uses an unbalanced panel dataset of Islamic banks and conventional banks operating in MENA countries, for the period 2010–2022. Consolidated financial data (in U.S. dollars) is collected from the BankFocus database. The country-level control variables and macroeconomic data are collected from the World Bank database. The study period is selected to provide the best representation of the bank data under the IFRS9ECL model, given that IFRS 9 became mandatory only from 2018. This design provides us with 5 years post-IFRS 9's application, which provides a sufficient

timeframe to assess the influence of the IFRS9ECL model on LLPs' opportunistic reporting.

This study uses the MENA region context to examine the use of the IFRS9ECL model for discretionary LLP reporting. There are three reasons for focusing on the MENA countries. First, MENA countries have the highest concentration of Islamic banks relative to other regions in the world; second, the growth of Islamic banking in the past few decades in this region; and third, the region features largely homogeneous cultural characteristics (e.g., Social hierarchy, family structures and history), which enables the comparison of opportunistic behaviour (Elnahass et al., 2014). In terms of sample selection, there is no uniform or single definition of the MENA region, as definitions vary across institutions (Griffiths, 2017). The World Bank defines MENA to include 21 countries, namely, Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Malta, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Syria, Tunisia, the United Arab Emirates and Yemen. Other definitions include other countries, depending on the context, Encyclopædia Britannica lists Turkey within the Middle Eastern countries. Thus, for the purpose of this, I use the World Bank list plus Turkey; adding Turkey is widely used in MENA context studies (e.g., Damar, 2007; Bourgain et al., 2012; Faour and Saad, 2025) due to the shared banking characteristics and geopolitical and religious ties. However, some of the MENA region countries are excluded from the sample for the following reasons. First, countries such as Djibouti, Bahrain, Malta, Oman, Syria, and the United Arab Emirates do not have available data in the WVS database because they were not included in any of the WVS religiosity surveys. Second, Israel is excluded because it does not have Islamic banks and does not share common social characteristics with other MENA countries.

Thus, the final sample for this study comprises 139 banks across 14 MENA countries. The country-level religiosity data have been extracted from four waves of the WVS⁷: Wave 4 (2000–2004), Wave 5 (2005–2009), Wave 6 (2010–2014) and Wave 7 (2017–2022). However, due to the frequency of WVS surveys and the discontinued participation of certain countries in the surveys, religiosity data are available for certain years that cover two to three years for most countries of the sample, with the exception of Kuwait, Palestine, Qatar, Saudi Arabia, and Yemen, which only cover one year of observations. To overcome the issue of missing data, I use linear interpolation/extrapolation to obtain religiosity estimates for each missing sample year (Dyrenge et al., 2012; Chantziaras et al., 2020; Abdelsalam et al., 2021). This methodology allows us to increase the sample years to fully cover the study period, as well as increase the power of the statistical tests (Hilary and Hui, 2009; Leventis et al., 2018).

Islamic windows are excluded from the sample, as these formats are not fully fledged banks; these windows are managed by the same management as the commercial bank that owns the window. Also, because of the differences in capital adequacy requirements for those windows from those for full-fledged Islamic banks (Elnahass et al., 2014). All financial ratios are winsorized at the 1% and 99% percentiles. Hence, the final sample comprises 1,043 bank-year observations, including 861 from conventional banks (114 banks) and 182 from Islamic banks (25 banks). Table 5.1 presents the distribution of banks by country; the highest concentrations of Islamic and conventional banks are in Kuwait, Qatar, and Saudi Arabia, with 13 conventional banks and 13 Islamic banks in each of them.

⁷ WVS perform international survey missions (waves) that last for 5 to 6 years, they survey each country for one year only in each survey.

Table 5.1: Sample Distribution by Country and Bank Type

Country	CB	CB Observations	IB	IB Observations	Full Sample Banks	Full Sample Observations
Algeria	1	1	0	0	1	1
Egypt	6	44	1	1	7	45
Iraq	1	2	0	0	1	2
Jordan	14	148	2	8	16	156
Kuwait	6	62	5	52	11	114
Lebanon	26	173	0	0	26	173
Libya	1	5	0	0	1	5
Morocco	11	63	0	0	11	63
Palestine	4	29	2	8	6	37
Qatar	4	45	5	39	9	84
Saudi Arabia	7	80	4	42	11	122
Tunisia	3	19	0	0	3	19
Turkey	28	185	5	31	33	216
Yemen	2	5	1	1	3	6
Total	114	861	25	182	139	1043

5.3 Research Design

This study employs a quantitative empirical research design to examine banks' discretionary reporting of LLPs under the IFRS9ECL model. The central objective is to investigate whether adopting the IFRS9ECL model significantly influences banks' opportunistic use of LLPs, particularly through earnings management and regulatory capital management, and whether the presence of strong informal constraints, such as religiosity, mitigates opportunistic behaviour in the MENA region. To achieve these objectives and empirically test the discretionary behaviour in LLPs reported under the IFRS9ECL model, the primary empirical strategy of this study is to employ a bank-level panel design with a cross-country sample. The key

methodological benefit of this research design is the greater heterogeneity among determinant variables, such as accounting standards and incentives. This heterogeneity allows tests of hypotheses that are not possible with data from a single country (Dechow et al., 2010). Thus, this will enrich the testing of study variables and add robustness to the study model. The study adopts a robust econometric approach, primarily employing panel data analysis and a staggered Difference-in-Differences (DiD) design. The panel data analysis relies on a two-stage regression model to isolate the discretionary LLPs and test them with the independent variables. The staggered DiD approach allows the treatment effect (IFRS 9 adoption) to be isolated by comparing changes in banks' discretionary LLPs before and after IFRS 9 implementation, controlling for contemporaneous economic shocks and differences across banks. This method specifically addresses concerns of endogeneity arising from omitted variables and simultaneous causality.

Moreover, the research design integrates controls for extensive bank-level variables that include bank size, leverage, bank growth, and listing status, alongside macroeconomic indicators that include GDP per capita growth, unemployment rates, political stability, and rule of law. These control variables are consistently incorporated across all study tests to ensure that any observed changes in the results are attributable to the independent variable, rather than to other factors, thereby enhancing the study's internal validity and supporting causal hypotheses by isolating the relationship between the main variables.

Furthermore, the study employs several robustness checks and sensitivity analyses to enhance the precision and reliability of the findings by addressing potential confounding effects.

The methodological rigour provided by this holistic design ensures that the findings effectively capture the implications of the IFRS9ECL model for managerial opportunism in LLPs' reporting, contributing significantly to the accounting literature by highlighting the interplay among accounting standards, managerial incentives, and behavioural constraints.

5.3.1 Modelling Banks' Discretionary LLPs

5.3.1.1 Conceptualising Banks' Discretionary LLPs

The research on LLPs may be complicated by the processes, assumptions, methodologies, and other unobservable factors that bank managers consider when determining LLP estimates. LLP estimation is a function of the accounting system, managerial assumptions and other factors used to determine credit-loss estimates (Ozili and Outa, 2017). Because of their size in banks' financial statements, LLPs play a pivotal role in bank accounting practices and influence management decisions. Discretionary LLPs represent the portion of LLPs driven by managerial discretion rather than economic fundamentals, which provides room for opportunistic financial reporting. Discretionary LLPs are estimated by directly regressing LLPs on observable variables that influence their determination. This approach captures the discretionary component of LLPs. The methodology has been widely adopted in empirical research to analyse the opportunistic use of LLPs for earnings management and regulatory capital management in the banking industry (Collins et al., 1995; Ahmed et al., 1999).

LLP estimates reflect the expected losses of originating and held loans during the period. These estimations are based to some extent on bank managers' discretion; thus, the LLPs' reporting can be vulnerable to opportunism. However, not all LLPs are subject to opportunism, as LLPs can be classified into non-discretionary LLPs and discretionary LLPs. Discretionary LLPs can reflect opportunistic reporting (Kanagaretnam et al., 2010). This proxy is in line with the stream of literature (e.g., (Beatty et al., 1995; Kanagaretnam et al., 2010; Bushman and Williams, 2012; Beatty and Liao, 2014; Abdelsalam et al., 2016; Tran et al., 2020; Jutasompakorn et al., 2021) that uses discretionary LLPs to measure the use of LLPs for opportunistic purposes such as earnings management, income smoothing, and regulatory capital management. The estimation of discretionary LLPs is based on the isolation between non-discretionary LLPs and discretionary LLPs on the notion that non-discretionary LLPs result from the bank's normal operations and are free from management manipulation, as it is based on the normal practice of loan loss accounting. Thus, discretionary LLPs represent the deviation from the normal application of accounting rules. These deviations could either lower reporting quality or reflect managers' private information (Dechow et al., 2010). According to Beatty and Liao (2014), discretionary LLPs are abnormal adjustments to the LLPs based on managerial opportunism.

As highlighted by Zhang and McIntyre (2021), measuring the *DLLPs* is conducted by constructing a prediction model for LLPs, where a group of predictors are regressed against LLPs. The residuals of the fitted model, which represent the unexplained or abnormal portion of the LLPs, serve as estimates of the *DLLPs*. A higher level of unexplained provisions indicates a higher level of *DLLPs*. To estimate the *DLLPs* using a two-stage model, prior studies used different models based on the following baseline model:

$$LLP_{it} = \alpha_0 + \alpha \text{ non-discretionary LLPs Predictors} + \varepsilon_{it}$$

$$\varepsilon_{it} = LLP_{it} - \widehat{LLPs}_{it}$$

The tailored $\widehat{LLPs}$ value from the model captures the notionally normal non-discretionary LLPs. The residuals ε_{it} capture the abnormal discretionary LLPs *DLLPs*. This measure effectively quantifies the opportunistic reported LLPs by bank managers to achieve objectives such as meeting regulatory capital requirements or stabilising earnings.

However, shaping a relevant model with the best predictors to capture *DLLPs* is a challenge, given that there is a lack of agreement on the optimal approach to modelling discretionary LLPs. *DLLPs* models employ various "non-discretionary" predictors. For instance, some studies (e.g., Kim and Kross, 1998; Kanagaretnam et al., 2010; Beatty and Liao, 2014) consider net charge-offs as the non-discretionary element and incorporate them as a predictor in the LLPs model. Other studies (e.g., Beatty et al., 1995; Collins et al., 1995; Bushman and Williams, 2012; Salem et al., 2021) regard net charge-offs as the discretionary element and do not include this variable in the LLPs model. Moreover, the different types of predictor variables and lags used in these studies follow the data availability and other assumptions used in each study. A large strand of recent studies has mainly built either on the model of Kanagaretnam et al. (2010) (e.g., Kanagaretnam et al., 2015; Abdelsalam et al., 2016; Salem et al., 2021; Elnahass et al., 2022) or the model (d) of Beatty and Liao (2014) (e.g., Jiang et al., 2016; Tran et al., 2020; Zhang and McIntyre, 2021; Olszak and Kowalska, 2022). In order to shape a relevant underlying model to capture LLPs' characteristics that fit the available data of MENA banks, I employ Beatty and Liao

(2014) Kanagaretnam et al. (2010) given that it has been used widely to test the discretionary LLPs related to opportunistic purposes (e.g., Kanagaretnam et al., 2015; Abdelsalam et al., 2021; Salem et al., 2021; Haq et al., 2024).

5.3.1.2 Measuring banks' discretionary LLPs

In line with prior research on discretionary reporting of LLPs, the empirical focus is on LLPs, banks' main accrual, which typically explains much of the variability of managerial discretion of their financial reporting (Beatty and Liao, 2014). As evident in the literature, the discretionary use of bank LLPs is embedded in managerial opportunistic behaviour (Anandarajan et al., 2003, 2007; Bushman and Williams, 2012; Abu-Serdaneh, 2018). This necessitated the estimation of the discretionary LLPs model that is capable of explaining the opportunistic reporting of LLPs. Therefore, and based on discretionary LLPs modelling explanations provided in the previous section, the research design of this study adopts a two-stage model to test the impact of IFRS9ECL adoption on banks' discretionary LLPs through the two main channels for discretionary LLPs: earnings management and regulatory capital management in a panel dataset to capture the LLPs' behavioural changes over time (Beatty and Liao, 2014; Tran et al., 2020; Haq et al., 2024). This model is built on prior research examining the use of LLPs in earnings management and capital management in the banking sector (Fonseca and González, 2008; Gebhardt and Novotny-Farkas, 2011; Beatty and Liao, 2014; Kanagaretnam et al., 2010, 2015). While the models used in these prior studies vary in terms of their component variables, I particularly follow those that can be adapted to serve the aims of my analysis in assessing the extent to which the accounting change from IAS 39 to IFRS 9 has influenced the managerial opportunism in LLPs' reporting as well as can be adapted to fit other variables of interests that includes the earnings management,

regulatory capital management, religiosity and Covid-19. Following (Kanagaretnam et al., 2010; Beatty and Liao, 2014; Kanagaretnam et al., 2015; Haq et al., 2024), I regress the following predictor variables on LLPs to effectively isolate discretionary LLPs. The use of non-discretionary LLPs driver variables as a control to estimate the discretionary LLPs, which models the magnitude of LLPs as a function of a set of explanatory accounting variables. The main characteristics of this model's variables are the use of lagged variables for explanatory variables of non-discretionary LLPs and the use of net charge-offs to increase the explanatory power of the model (Beatty and Liao, 2014).

$$LLP_{it} = \alpha + \beta_1 DNPL_{it-1} + \beta_2 ALW_{it-1} + \beta_3 CHO_{it-1} + \beta_4 Loan_{it} + \beta_5 DLoan_{it-1} + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon \dots\dots\dots(1)$$

The explanatory variables are carefully chosen to capture the non-discretionary determinants of LLPs: ***DNPL*** *it-1* represents the lagged change in non-performing loans (NPL), scaled by the bank's total assets at the beginning of period *t*. This variable reflects previous changes in loan performance, which directly influence the level of necessary loan loss provisions (Bushman and Williams, 2012; Beatty and Liao, 2014). ***ALW*** *it-1* indicates the allowance for loan losses carried forward from the previous period, scaled by total assets at the beginning of period *t*. This captures the bank's existing reserve level for anticipated loan losses. ***CHO*** *it-1* measures the lagged net loan charge-offs, scaled by the bank's total assets at the beginning of period *t*. This variable directly represents realized losses and provides historical insight into loan quality. ***Loan****it* denotes the total outstanding loans during the current period, scaled by beginning-of-period total assets. This variable controls for the overall exposure of the bank's portfolio to potential credit losses. ***DLoan*** *it-1*

represents the lagged change in outstanding loans, scaled by beginning-of-period assets. Including this variable allows the model to assess how recent changes in the loan portfolio composition affect loan quality and subsequently LLPs, reflecting banks' incorporation of forward-looking information into their provisioning practices. Including these predictor variables in the model effectively isolates discretionary *LLPs* from the estimation of non-discretionary LLPs (Tran et al., 2020). Bank Fixed Effects and Year Effects are included to control for unobserved heterogeneity across banks and temporal macroeconomic factors, respectively. ε it represents the error term.

Once the model is estimated, I use the regression residual value to estimate the non-discretionary LLPs. The residuals ε_{it} capture the unexplained variance that serves as the proxy for DLLPs used in hypothesis tests of this study. By including the previously identified non-discretionary variables, the equation is a parsimonious model that reflects management's judgment of a non-discretionary component of LLPs and a discretionary component of LLPs.

I use residuals ε_{it} and compute its absolute values, as the focus of this study is on the magnitude of the *DLLPs* and later how that magnitude interacts with other variables of interest. Higher (absolute) values of *DLLPs* indicate that banks exhibit greater discretionary behaviour.

5.3.2 Measurement of Independent and Moderating Variables

5.3.2.1 Measurement of IFRS9ECL Model

To investigate how the application of IFRS9ECL influences banks' LLPs' behaviours. (*IFRS9ECL*) is a dummy variable that indicates whether LLPs are

reported in accordance with the IFRS9ECL model. Despite the fact that 2018 was the first reporting year that IFRS9ECL Model became mandatory in IFRS-compliant countries, the banking regulatory bodies in some MENA countries have delayed the mandatory application due to country-specific regulatory concerns, such as Iraq and Egypt, where the mandatory application was delayed to 2019 instead of 2018 (CBE, 2018; CBI, 2018). To overcome the variation of IFRS9ECL country application dates and bank application dates, I use the actual data of banks' ECL as reported in BankFocus to indicate the actual application of the IFRS9ECL model, which equals 1 if a banks reported expected credit loss under IFRS 9 in a year and zero if otherwise. By measuring IFRS9ECL at the individual bank level via actual financial statement disclosures rather than using a single dummy post-2018 variable, the model exploits cross-sectional and temporal variation in treatment timing. To further mitigate bias from concurrent events, I use controls for time-varying bank characteristics and macroeconomic indicators that directly influence bank LLPs across all the main regression tests. In addition to the identification strategy, I employ a staggered difference-in-differences (DiD) model (see section 5.6), to further isolate the effect of IFRS9ECL adoption from broader contemporaneous developments in the banking environment.

5.3.2.2 Earnings Management

Previous research has indicated the importance of performance effects on LLP reporting. High-performing banks tend to use more conservative accounting, while less profitable banks are expected to engage in discretionary LLP reporting to manage their earnings (Leventis and Dimitropoulos, 2012). I expect that highly-performing banks are less likely to manipulate their accounting numbers as they are less motivated to manage their accounting numbers (Abdelsalam et al., 2016).

Similar to Anandarajan et al. (2007), I use the ratio of earnings before taxes and provisions to lagged total assets (EBTP) and the interaction term $IFRS9ECL*EBTP$ to test the use of LLPs for earnings management during the pre- and post-IFRS9 periods. Prior empirical studies (e.g., Ahmed et al., 1999; Anandarajan et al., 2007; Haq et al., 2024) have relied on the assumption that the motivations for financial reporting discretion are depending on the capital or earnings numbers before the influence of such discretion, and have interpreted the correlation between LLPs and earnings before taxes and provisions as a measure of earnings management (Beatty and Liao, 2014). I expect IFRS 9 to contribute to high earnings management practices by banks. Consequently, I expect a positive coefficient for EBTP if bank managers' decisions on loan loss provisions are motivated by earnings management. The coefficient of the interaction term $IFRS9ECL*EBTP$ (which captures the impact of IFRS 9 on earnings management via DLLPs) is expected to be higher in size relative to the coefficient of the pre-IFRS period.

5.3.2.3 Measurement of Regulatory Capital

To investigate the influence of regulatory capital management banks' LLPs' behaviours, I use (*REG.CAPITAL*) the ratio of lagged regulatory capital (Tier 1 capital) to total risk-weighted assets (RWAs). As it is the most frequently used proxy to examine the use of LLPs for capital management (e.g., Ahmed et al., 1999; Anandarajan et al., 2007; Elnahass et al., 2018). The main effect of LLPs on regulatory capital is through Tier 1 capital (BIS, 2020, p.34). thus, (*REG.CAPITAL*) can allow the capture of the effect of regulatory capital management. Since the reduction of (*DLLPs*) increases earnings and retained earnings and, in turn, expands the regulatory capital, I expect that banks aiming to manage the regulatory capital

upward, through the increase of retained earnings, reduce the (*DLLPs*). In other words, I expect that the regulatory capital requirements pressure to increase high-quality regulatory capital will push banks to engage in opportunistic behaviour in reporting the (*DLLPs*). The managers of low-capitalised firms might have more incentives to manage capital ratio through LLPs in order to avoid sanctions (Anandarajan et al., 2007). The capital management hypothesis posits that managers of poorly capitalised banks have incentives to increase LLPs because primary capital includes loan loss reserve (Ahmed et al., 1999). Prior studies (e.g., Krüger et al., 2018; Ertan, 2021) find that the implementation of IFRS9ECL model implies a reduction of Tier 1 capital. Thus, I expect similar behaviour to (*REG.CAPITAL*).

5.3.2.4 Measurement of Religiosity

Due to the complexity of religion in the context of human behaviour, multiple dimensions should be used to measure religiosity (Parboteeah et al., 2008). Following prior literature (McGuire et al., 2012; Kanagaretnam et al., 2015; Abdelsalam et al., 2021; Salem et al., 2023a), in measuring religiosity, this study defines religiosity by three distinct dimensions (1) the cognitive dimension that measures religious beliefs or knowledge, (2) the affective dimension that represents the feelings of individuals about religion, and (3) the behavioural dimension, which measure the attendance of religious sites, prayer and religion-related donations.

In order to measure religiosity through the three dimensions, this study uses data from the World Values Survey (WVS). In particular, the responses to questions about religious importance to individual life, religious affiliation, and religious events participation. These responses collectively determine adherence to religious norms at a given time for each of the countries in the sample. Therefore, an aggregate

religiosity measure (RELIGIOSITY) of the three religious' dimensions is created by computing the percentage of respondents that indicate that (1) religion is important to them (REL_IMP) to reflect the cognitive dimension, (2) they are affiliated with a religion (REL_MEMB) to reflect affective dimension, and (3) they attend religious services (REL_SERV) to reflect behavioural dimension. The following steps are used to calculate each dimension based on WVS data:

1. **Cognitive dimension:** based on the WVS question “Independently of whether you attend religious services or not, would you say you are: Missing; Unknown; Not asked; Not applicable; No answer; Don’t know; A religious person; Not a religious person; A convinced atheist; other answer”, *REL_MEMB* is calculated as:

$$REL_MEMB = \frac{\text{Respondents who answer "A religious person"}}{\text{All respondents}}$$

2. **Affective dimension:** based on the WVS question “For each of the following, indicate how important it is in your life. Would you say religion is: Missing; Unknown; Not asked; Not applicable; No answer; Don’t know; Very important; Rather important; Not very important; Not at all important”, *REL_IMP* is calculated as:

$$REL_IMP = \frac{\text{Respondents who answer "Very IM" or "Rather IM"}}{\text{All respondents}}$$

3. **Behavioural dimension:** based on the WVS question “Apart from weddings and funerals, about how often do you attend religious services these days? 1: More than once a week; 2: Once a week; 3: Once a month; 4: Only on special holy days; 5: Once a year; 6: Less often; 7: Never, practically never”, *REL_SERV* is calculated as:

$$REL_SERV = \frac{\text{Respondents who attended religious services more than once a year}}{\text{All respondents}}$$

Therefore, religiosity (*RELIGIOSITY*) represents the principal component factor derived from the above three religion variables: (*REL_MEMB*), (*REL_IMP*), and (*REL_SERV*).

5.3.2.5 Measurement of Organisational Religiosity

To investigate how organisational religiosity influences banks' LLP reporting. The type of bank is used as a proxy for organisational religiosity. (*ORG.RELIGIOSITY*) is a dummy variable that equals one if the bank is an Islamic bank, and zero if the bank is a conventional bank.

Islamic banks are a unique representation of formal organisational religiosity. The involvement of religious values in the formulation and creation of Islamic bank strategies and operations is self-evident and substantial at all levels (Haniffa and Hudaib, 2010). The existence of SSBs as an internal control and extra governance body, provides religious guides to managers to ensure conformity with Shari'ah and ensures managers' behaviour. Additionally, the SSB collaborates with the board to improve managerial behaviour (Safiullah et al., 2022). Therefore, it is expected that (*ORG.RELIGIOSITY*) is negatively related to (*DLLPs*) as Islamic banks would avoid the reporting of discretionary LLPs.

5.3.2.6 Measurement of COVID-19

Various sources have been tracking the confirmed infections and deaths by country over time. To investigate the effect of the COVID-19 outbreak in 2020 on the use of LLPs for opportunistic purposes, I use in this study the COVID-19 data from the

World Health Organisation (WHO), which are officially reported by the Centres for Disease Control and Prevention, the Ministry of Health or the equivalent of each country. Following, Feng et al. (2022), I employ COVID-19 death data scaled by population per country. Data on COVID-19 deaths can be more reliable than data on confirmed infections, since infection data are missing for people who have not been tested. Criteria used to determine who is eligible for testing typically require demonstrating symptoms associated with infection or close contact with infected persons. The fraction of untested persons means that the cumulative rate of infection cases has been higher than the reported rate (Manski and Molinari, 2021).

Rahmandad et al. (2020), documented that the estimated cumulative infections across 86 countries through July 2020 are 10.5 times higher than official reports, while the estimated deaths are just 1.47 times higher than the reported values. Findings from other papers (e.g., Lau et al., 2021; Dimpfl et al., 2022) have also provided relevant results supporting this. In other words, data on reported deaths suffer less from underreporting than data on reported infections. Therefore, in my main empirical results, I report only COVID-19 results based on reported deaths, and I provide results based on cases in the additional tests section.

The yearly data used in my sample cover COVID-19 deaths from the first year of the pandemic in 2020 up to the end of 2022, when the pandemic status and procedures were removed across the globe. This variable is employed here to examine whether the opportunistic behaviour using the IFRS 9 ECL model was affected or altered during the pandemic, in order to test the hypothesis (H6). As noted by López-Espinosa and Penalva (2023), COVID-19 was not a typical economic shock that banks can provision for, as it was truly an unexpected shock which may change the

provision practices under IFRS9ECL based on the circumstances that were preserved by the bank managers during the pandemic shocks. Therefore, COVID-19 is measured using the following equation.

$$COV19_{c(i),t} = \frac{\text{Total Covid 19 deaths}_{c(i),t}}{\text{Population}_{c(i),t}} \times 100,000.$$

5.4 Measurement of Control Variables

In order to mitigate the potential issue of omitted variables, the OLS regression incorporates a comprehensive range of control variables. These control variables include proxies for various bank-level and country-level variables as well as bank-fixed effects and time (*Years*) fixed effects. The use of bank and time-fixed effects is consistent with previous literature (Bushman and Williams, 2012; Beatty and Liao, 2014). The bank and country-specific control variables are described below.

5.4.1 Measurement of Bank Control Variables

5.4.1.1 Size

I use (*SIZE*) control for the effect of bank size by using the natural logarithm of the gross total assets book value. Large banks are more visible to the public (Leventis and Dimitropoulos, 2012), and they tend to have more stable operations and a greater ability to diversify risks. Moreover, larger banks are often subject to stricter regulatory scrutiny and have more complex compliance requirements (Beatty and

Liao, 2014). and, therefore, are less likely to engage in aggressive earnings management (Cornett et al., 2009). Thus, I expect large banks to report smaller amounts of *DLLPs*, whereas smaller banks are more likely to report more *DLLPs*. Accordingly, I expect a negative coefficient on the (*SIZE*) variable.

5.4.1.2 Bank Growth

Following Kanagaretnam et al. (2015) and Salem et al. (2021), I control for the effect of bank (*GROWTH*) measured as the change of total assets divided by the lagged total assets.

5.4.1.3 Capital (Leverage)

Following Tran et al. (2020) I employ *Capital* to account for leverage in Model-A, by using the equity ratio, which is the ratio of total equity to gross total assets. Banks with lower equity ratios have more incentives to manipulate their reported figures to mitigate the risk of violating debt covenants (Kim and Yi, 2006). Effectively managing reported earnings can enhance their ability to negotiate reserves by mitigating creditors' perceived risks.

Furthermore, banks that have a high level of leverage are more inclined to exercise discretion in their financial reporting in order to present a more favourable image to current and prospective shareholders (Penman et al., 2007). According to (Barton and Waymire, 2004), banks with high levels of debt are less inclined to effectively manage their accounts because of the higher costs associated with debt agencies.

5.4.1.4 Listing

I also include the dummy variable *LISTED* to control for the influence of listing status. Listed banks are under higher supervision by regulators in comparison to unlisted banks which may put listed bank managers under more pressure to post higher performance and to avoid regulatory intervention (Jensen and Meckling, 1976; Tran et al., 2020).

Moreover, listed banks use the stock market as a source of funds, thus they could have a greater incentive to engage in opportunistic reporting in order to send a message of achievement and reliability to their shareholders. (Beatty et al., 2002; Anandarajan et al., 2007) provide evidence that earnings management behaviour using LLPs by listed banks is greater than unlisted banks.

5.4.2 Measurement of Country Control Variables

5.4.2.1 GDP Per Capita

Similarly to (Kanagaretnam et al., 2015), I use the log GDP per capita ($L-GDP_{perCAP}$) to isolate the influence of personal wealth and financial condition from the opportunistic reporting of LLPs, given that it may influence their utility function and values (Salem et al., 2023a).

5.4.2.2 Unemployment Rate

Following Tran et al. (2020) I include ($DUNEMP_{it}$). ($DUNEMP_{it}$) represents the change in a country's unemployment rate to capture the effects of the macroeconomic dynamics on the quality of loan portfolios, despite that the change in non-performing loans and loan charge-offs partially incorporates the macroeconomic effects (Kanagaretnam et al., 2004).

5.4.2.3 Rule of law

In order to isolate the impact of the variable of interest from the influence of other country characteristics, I follow Berggren and Bjørnskov (2013) by adding a control for the rule of law value (*LawRule*). (*LawRule*) measures ‘perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police and the courts, as well as the likelihood of crime and violence’ (Kaufmann et al., 2008, p.7). Therefore, I use (*LawRule*) data taken from the World Bank’s World Governance Indicators. Demirgüç-Kunt and Detragiache (1998) show that respect for the rule of law, lower corruption levels and strong legal enforcement are crucial for the effective functioning of a financial system. while Hellmann et al. (2000) stress that good political governance ensures that the financial system is regulated and supervised so that savers do not lose their savings in the event of banking failure. Acemoglu et al. (2003) show that the existence of poor political institutions better explains macroeconomic instability across countries than actual macroeconomic policies themselves. Perott (2013) also point out that if weak political institutions fail to restrain the opportunistic behaviour of bank managers and owners, they will increase the risk of financial/banking crises or worsen the consequences. Taken together, these views argue that the presence of, and quality/strength of political economy play a critical role in banking and financial stability. Kaufmann et al. (2011) demonstrate that one important factor that explains differences across countries even when countries have similar legal systems is the political economy differences across countries, that is, the political system through which decisions about economic policies are made.

5.4.2.4 Political Stability

Following Abdelsalam et al. (2016) and Salem et al. (2021, 2023), I control for the potential impact of countries that are experiencing major political unrest or turmoil (*PS*) during the study period. According to the World Bank's yearly lists of fragile and conflict-affected situations, the MENA region has experienced a dramatic increase in violence during the past two decades. According to the World Bank's 2022 list, Syria and Yemen are categorised as high-intensity conflict states, while Iraq and Libya are included in the medium-intensity conflict category, whilst the Palestinian territories and Lebanon are listed in the high institutional and social fragility category of the list (The World Bank, 2022). The widespread violence and political instability across the region have kept the whole region in a fragile state over the years, due to the spillover effect of the multiple conflicts in the region. Devarajan (2016) argued that the failing social contract is one of the main underlying causes of regional instability and conflict in the MENA region. This political instability could have implications for the banking sector and the decision makers. Dai and Zhang (2019) shows that political instability could change corporate behaviour. In the banking context Abdelsalam et al. (2016); Salem et al. (2021, 2023) used a dummy variable encoded 1 if a bank is based in a country experiencing major political instability. I use the World Bank political stability index to capture the effect of political stability that can cause direct or indirect harm to various economic and social aspects. The World Bank Political Stability Index is an international percentile rank that covers all countries in my study sample and may better reflect political stability than dummy variables.

5.5 Empirical Model

To examine the association between the discretionary LLPs proxied by the absolute value of residuals from the LLPs estimation model (*DLLPs*) and (*IFRS9ECL*), (*EBTP*), (*REG.CAPITAL*), (*RELIGIOSITY*), (*ORG.RELIGIOSITY*) proxied by bank type and the COVID-19 effect, the following regression model is used, following prior studies (Kanagaretnam et al., 2015; Abdelsalam et al., 2021; Haq et al., 2024):

$$\begin{aligned}
 DLLPs_{it} = & \beta_0 + \beta_1 IFRS9ECL_{it} + \beta_2 (IFRS9ECL \times EBTP)_{it} + \beta_3 (IFRS9ECL \times \\
 & REG_CAPITAL)_{it} + \beta_4 (IFRS9ECL \times RELIGIOSITY)_{it} + \beta_5 (IFRS9ECL \times \\
 & ORG.RELIGIOSITY)_{it} + \beta_6 (IFRS9ECL \times COV19)_{it} + \beta_7 RELIGIOSITY_{it} + \\
 & \beta_8 REG.CAPITAL_{it} + \beta_9 COV19_{it} + \beta_{10} ORG.RELIGIOSITY_{it} + \beta_{11} EBTP_{it} + \beta_{12} SIZE_{it} + \\
 & \beta_{13} GROWTH_{it} + \beta_{14} Listing_{it} + \beta_{15} LEV_{it} + \beta_{16} PASTLLP_{it} + \beta_{17} LOSS_{it} + \beta_{18} UNEMP_{it} + \\
 & \beta_{19} Political_Stability_{it} + \beta_{20} LAWRule_{it} + \beta_{21} GDPperCapita_{it} + Bank\ Fixed\ Effects + \\
 & Year\ Effects + \varepsilon_{it} \dots\dots\dots(2)
 \end{aligned}$$

where $DLLPs_{it}$ is discretionary LLPs of bank i at time t and is a proxy for LLPs' opportunistic behaviour (see 5.3.1 Modelling banks' discretionary LLPs). I include Bank fixed effects to control for unobservable bank characteristics and include the Year fixed effects to control for time effects, both of which can affect the opportunistic behaviour of banks. ε_{it} is the error term. Since *DLLPs* are likely to be correlated within a bank over time, standard errors used to assess significance are corrected for heteroscedasticity and bank-level clustering.

I expect a positive association with LLPs for the *IFRS9ECL* and between *IFRS9ECL* and *EBTP*, *REG.CAPITAL*, and negative interaction with *RELIGIOSITY*, *ORG.RELIGIOSITY* and *COV19*.

To avoid the statistical issues that may arise from testing different hypotheses together in the baseline model and to demonstrate the stability of the baseline results, I use the following regression models to test each hypothesis separately.

5.5.1 IFRS 9 adoption and discretionary LLPs

H1 predicts that the adoption of the *IFRS9ECL* model is associated with greater discretionary LLPs relative to the IAS 39 incurred loss model. The following model is estimated:

$$DLLPs_{it} = \alpha_0 + \beta_1 IFRS9ECL_{it} + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots (3)$$

5.5.2 Earnings Management

To examine *H2*, which predicts a positive association between the *IFRS9ECL* and the earnings before tax and provision *EBTP*, the following model is employed:

$$DLLPs_{it} = \alpha_0 + \beta_1 IFRS9ECL_{it} + \beta_2 EBTP_{it} + \beta_3 (IFRS9ECL \times EBTP)_{it} + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots (4)$$

5.5.3 Capital Management

To test *H3* that predicts a positive association between regulatory capital pressure and discretionary LLPs under *IFRS9ECL*, I interact the *IFRS9ECL* with *REG.CAPITAL* using the following model:

$$DLLPs_{it} = \alpha_0 + \beta_1 IFRS9ECL_{it} + \beta_2 REG.CAPITAL_{it} + \beta_3 (IFRS9ECL \times REG_CAPITAL)_{it} + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots (5)$$

5.5.4 The Role of Religiosity

To evaluate the moderating effects of personal and organisational religiosity under *H4 and H5*, I interact *IFRS9ECL* with personal religiosity (*RELIGIOSITY*), using the following model:

$$DLLPs_{it} = \alpha_0 + \beta_1 IFRS9ECL_{it} + \beta_2 RELIGIOSITY_{it} + \beta_3 (IFRS9ECL \times RELIGIOSITY)_{it} + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots (6)$$

and I interact *IFRS9ECL* with organisational religiosity (*ORG.RELIGIOSITY*), using the following model:

$$DLLPs_{it} = \alpha_0 + \beta_1 IFRS9ECL_{it} + \beta_2 ORG.RELIGIOSITY_{it} + \beta_3 (IFRS9ECL \times ORG.RELIGIOSITY)_{it} + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots (7)$$

5.5.5 The effect of COVID-19

To test whether the discretionary LLPs under the IFRS9ECL model decreased during the COVID-19 period as predicted by *H6*, I interact the *IFRS9ECL* with *COVID19*, using the following model:

$$DLLPs_{it} = \alpha_0 + \beta_1 IFRS9ECL_{it} + \beta_2 COVID19_{it} + \beta_3 (IFRS9ECL \times COVID19)_{it} + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots (8)$$

5.6 Difference-In-Differences

To test the impact of the IFRS9ECL model on the discretionary LLPs, the study adopts a staggered difference-in-differences (DiD) research approach combined with an event study analysis. Unlike the conventional two-group, two-period DiD design, the staggered design allows banks to enter the treatment group in different years according to their first observed application of IFRS 9. The event study analysis is used to assess the plausibility of parallel trends assumption, which is a critical prerequisite for the validity of the DiD framework, using a pre-treatment comparison (Angrist and Pischke, 2009). The identifying assumptions require the absence of anticipatory effects and parallel trends in untreated potential outcomes between adoption cohorts, conditional on the included controls (Roth et al., 2023). Failure to reject the joint null that the pre-treatment coefficients equal zero is consistent with the parallel-trends assumption. I constructed a relative-year indicator based on each bank's IFRS9ECL adoption year, assigning a hypothetical adoption year (2018) to banks that have never adopted the IFRS9ECL model for analytical consistency. The empirical model utilised a fixed-effects Ordinary Least Squares (OLS) regression, controlling for bank-specific factors and macroeconomic indicators. Standard errors were clustered at the bank level to control for serial correlation and heteroscedasticity and two-way fixed effects (bank + year) with robust standard errors (Bertrand et al., 2004).

$$DLLPs_{it} = \alpha + \sum_{k=-3, k \neq -4}^4 \beta_k \text{rel_year}_{k,it} + \gamma X_{it} + \mu_i + \varepsilon_{it}$$

Where $\text{rel_year}_{k,it}$ denotes the event-time indicators relative to IFRS9ECL adoption, X_{it} represents the control variables of the main regression model, μ_i are bank fixed effects, and ε_{it} is the error term.

After validating the DiD via the parallel trends' assumption test, I employ the staggered DiD. The identifying variation arises from differences in the timing of IFRS9ECL adoption across banks and countries. More specifically, the model compares the within-bank change in DLLPs following IFRS9ECL adoption with the contemporaneous change experienced by banks that have not yet adopted IFRS9ECL or that remain untreated. Consequently, identification does not arise solely from comparing all observations before 2018 with all observations after 2018. Instead, it arises from comparisons between adoption cohorts in the same calendar year, after removing permanent bank characteristics through bank fixed effects and common annual shocks through year fixed effects. This method is appropriate due to the staggered adoption of IFRS9ECL across different banks and years, allowing for the capture of heterogeneous treatment effects over time (Goodman-Bacon, 2021). In studies investigating the impact of accounting standard change, difference-in-differences measures the average impact of accounting change (treatment) by removing unobservable idiosyncratic effects as well as macro effects (Blundell and Costa Dias 2009). The difference-in-differences approach also controls for the underlying economic comparability since the sample requires the same bank pair to have at least one observation before and after the mandatory new accounting standard adoption (Wang, 2014).

Using the same regression model of this study, I add an indicator, *POST*, which equals one for each year that the bank has reported ECL according to the *IFRS9ECL* model based on the actual disclosure data on BankFocus; zero, otherwise. The

coefficient on *POST* captures the effects of the accounting change in the actual adoption year for each bank. Despite that IFRS 9 mandatory adoption was in 2018, the timing of actual *IFRS9ECL* model adoption at the bank level can vary from the mandatory date, reflecting a staggered behaviour. Moreover, the mandatory adoption at the country level also varies across MENA countries (e.g., Iraq and Egypt in 2019 instead of 2018). Including time-varying adopting countries and staggered adoption banks mitigates the likelihood that a single economy-wide trend or development might drive the test results, allowing for better inferences about the impact of the IFRS9ECL model (Kausar and Park, 2024).

$$\begin{aligned}
 DLLPs_{it} = & \beta_0 + \beta_1 IFRS9ECL_{it} + \beta_2 (IFRS9ECL \times POST)_{it} + \beta_3 REG.CAPITAL_{it} + \beta_4 EBTP_{it} + \\
 & \beta_5 SIZE_{it} + \beta_6 GROWTH_{it} + \beta_7 Listing_{it} + \beta_8 LEV_{it} + \beta_9 PASTLLP_{it} + \beta_{10} LOSS_{it} + \\
 & \beta_{11} UNEMP_{it} + \beta_{12} Political_Stability_{it} + \beta_{13} LAWRule_{it} + \beta_{14} GDPperCapita_{it} + \\
 & Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots\dots\dots(9)
 \end{aligned}$$

To reflect the treatment effect, an indicator, *IFRS9ECL*, equals one for banks that applied the IFRS9ECL model; zero, otherwise. The variable of interest is the interaction term of *POST* × *IFRS9ECL*. Via the comparison of interaction terms, I conduct a difference-in-differences analysis that measures the difference between the post-*IFRS9ECL* coefficients and the pre-*IFRS9ECL* coefficients. This test allows for better attribution of any changes in the model's predictive ability of *DLLPs* in the post-adoption period.

5.7 Summary

This chapter has discussed the methodology employed to investigate the influence of the IFRS9ECL model, religiosity, organisational religiosity, and regulatory capital management on discretionary LLPs. Using a sample of 134 banks from 14 MENA countries for the period from 2010 to 2022. The bank-level data have been sourced from BankFocus, and the religiosity data have been sourced from the World Values Survey database. The data on country-level controls have been collected from the World Bank. Regarding model specifications, the chapter identified and addressed two main methodological challenges. The first methodological challenge is estimating discretionary LLPs. This was overcome by using the (*DLLPs*) regression model to proxy for opportunistic behaviour in LLPs, as discussed in this chapter at length. More specifically, the chapter explained the two-stage empirical approach adopted in the thesis, in which discretionary LLPs were first estimated and then used as the dependent variable in the second-stage regressions designed to test the study's hypotheses. The second methodology challenge concerned the availability of religiosity data for MENA countries, as the WVS data are only available for certain years. To overcome the issue of missing data, I use linear interpolation/extrapolation to get religiosity estimates for each sample year. The chapter justified this approach as a practical solution to constructing a continuous annual religiosity series for the panel analysis. The chapter also discussed each variable measurement and its utilisation. Furthermore, the chapter discusses the set of controls added to the empirical model, informed by previous studies. These include both bank-level and country-level controls, which were incorporated to reduce omitted-variable bias and to ensure that the estimated relationships between IFRS 9, managerial incentives, religiosity, and discretionary LLP reporting were not driven by other observable bank characteristics or macro-institutional

conditions. Overall, this chapter established the methodological foundation for the empirical analysis presented in the following chapter.

Chapter 6: Empirical Results and Discussion

6.1 Introduction

This chapter presents the empirical findings of the study. It also discusses the findings with reference to the literature review and the theoretical framework. The findings illustrate the extent to which the opportunistic reporting of LLPs can be influenced by the change from the IAS39IL model to the IFRS9ECL model and by the key explanatory and moderating variables examined in this study, including earnings management, regulatory capital management, personal religiosity, organisational religiosity, and the COVID-19 period. By doing so, this chapter sheds light on the influence of these variables on banks' LLP reporting practices.

6.2 Descriptive Results

This section presents the results of descriptive analysis that explain the main characteristics of the data used in this study.

6.2.1 Summary Statistics

6.2.1.1 Summary Statistics of the DLLPs Estimation Model

Table 6.1 Panel A presents the descriptive statistics for the estimation model of the discretionary LLPs, which will be used as the dependent variable in this study. The dataset constitutes an unbalanced panel dataset comprising 1,776 bank-year observations in this model from 2010 to 2022.

Table 6.1: Descriptive Statistics**A. DLLPs Modelling Components**

	N	Mean	Min	p25	Median	p75	Max	SD
LLPs ₁	1776	.0053	-.0247	.0015	.0043	.0076	.0634	.0057
LOANS	1776	.581	.0284	.441	.613	.721	1.95	.214
DLOAN	1776	.0319	-.411	-.0132	.0252	.0701	1.29	.104
CHO	1776	.0013	-.0809	-.0006	.0002	.0027	.0466	.0068
ALW _{L1}	1776	.025	.000298	.0126	.0209	.0299	.198	.0224
DNPL _{L1}	1776	.0316	.0001	.0115	.0209	.0388	.358	.0377

Notes: This table reports descriptive statistics for the variables used to estimate the discretionary loan loss provisions (DLLPs) model in the first stage. It presents the number of observations, mean, minimum, 25th percentile, median, 75th percentile, maximum, and standard deviation for the dependent variable and its modelling components. See Appendix A for variable definitions.

B. The Model

	N	Mean	Min	p25	Median	p75	Max	SD
DLLPs	1043	.251	0	.0745	.172	.329	4.98	.311
IFRS9ECL	1043	.38	0	0	0	1	1	.486
EBTP	1043	2.25	-4.21	1.53	2.13	2.66	22.5	1.57
REG.CAPITAL	1043	.162	.0355	.123	.147	.175	.77	.0752
RELIGIOSITY	1043	4.44	3.44	4.24	4.46	4.63	6.6	.509
COV19	1043	.943	0	0	0	0	5.27	1.74
ORG.RELIGIOSITY	1043	.174	0	0	0	0	1	.38
SIZE	1043	16.1	10.8	15.1	16.3	17.3	18.7	1.6
GROWTH	1043	.0622	-.427	-.00614	.0505	.117	1.63	.155
Listing	1043	.709	0	0	1	1	1	.455
PASTLLP	1043	.555	-2.95	.149	.409	.772	9.25	.664
LEV	1043	501	21.4	347	457	613	2063	250
GDPperCap	1043	.00319	-.22	-.0151	.00725	.0331	.266	.0485
UNEMP	1043	.44	0	.336	.445	.495	1	.179
P S	1043	.292	0	.0947	.261	.391	1	.24
LAWRule	1043	.595	0	.451	.634	.739	1	.216

Notes: This table reports descriptive statistics for the variables used in the main regressions (second-stage regressions of DLLPs). It presents the number of observations, mean, minimum, 25th percentile, median, 75th percentile, maximum, and standard deviation for the dependent variable, the main explanatory variables, and the control variables. See Appendix A for variable definitions.

The descriptive statistics show that the relatively modest mean of *LLPs* aligns with the literature highlighting limited LLP reporting in MENA (Leventis et al., 2011; Tran et al., 2020). The narrow standard deviation suggests cautious and conservative provisioning behaviour across the sample. *LOANS* represents a

significant portion of total assets for banks, emphasising their importance in provisioning decisions. The observed distribution, with substantial variance (0.211), reflects considerable differences in loan exposure across banks. The modest average change in loans *DLOAN* suggests steady loan growth. The volatility (standard deviation of 0.089) indicates variability in lending practices across MENA banks, which may influence the potential use of discretionary provisions to manage reported income. Tran et al. (2020) suggest that variability in loan growth directly impacts DLLP behaviour, as banks may provision more aggressively during periods of increased lending activity.

Charge-offs *CHO* represents direct losses on loans recognised by banks. The low mean and standard deviation of *CHO* reflect banks' caution in directly writing off loans. The literature (Beatty and Liao, 2014; Tran et al., 2020) suggests banks manage charge-offs strategically to maintain regulatory capital and earnings stability.

The lagged allowance for loan losses *ALW* captures previously set provisions still available to absorb future losses. The moderate mean and variability indicate that MENA banks' LLPs are timelier and more forward-looking. The non-performing loans (DNPLs) significantly influence banks' provisioning behaviours. the mean (0.030) and noticeable variability indicate sensitivity to loan quality deterioration and associated risks.

6.2.1.2 Summary statistics of the study model

Table 6.1 panel B presents the descriptive statistics for the study model. The statistics of the study model show that DLLPs have a mean value of 0.25%, with a minimum of 0, a maximum of 4.98%, and a relatively small standard deviation of 0.31%. These results suggest relatively moderate discretionary provisioning

behaviours among most of the MENA banks, with some high discretionary provisioning behaviours in some of the banks in the sample. The statistics are consistent with the notion that while banks are reporting discretionary LLPs, they generally avoid aggressive manipulation of earnings through LLPs (Kanagaretnam et al., 2010). The relatively small standard deviation indicates that while banks use discretionary provisions, they do so within a restricted and modest range (mainly in estimating ECL using their own discretionary SCIR), likely due to regulatory scrutiny and conservative reporting rules enforced under IFRS 9. The mean LLPs (0.5%) compared to DLLPs (0.25%) indicates that discretionary LLPs represent a large portion of banks total reported LLPs . This proportion aligns with literature emphasising that DLLPs often constitute a significant, yet cautiously managed, segment of LLPs (Beatty and Liao, 2014; Tran et al., 2020).

The IFRS9ECL variable, which indicates whether banks applied the IFRS9ECL model, shows a mean of 0.38 and a median of zero, reflecting staggered adoption of the IFRS9ECL model during the sample period.

The mean earnings before taxes and provisions (EBTP) of (2.25%) indicates generally limited profitability across MENA banks in comparison to other regions such as Europe; Di Fabio et al. (2021) report EBTP mean of (14.87%) across European banks). Low profitability may create potential room for bank managers to manage their earnings by adjusting discretionary LLPs (Tran et al., 2020; Casciello et al., 2024). Moreover, the mean regulatory capital stands at (16.2%) ($\cong 16\%$ of RWA), suggests that MENA banks typically have adequate regulatory capital ratios, either due to higher capital or as a result of managed regulatory capital via LLPs.

The RELIGIOSITY variable has a mean of (4.44), indicating a moderate to high average level of religious adherence across MENA countries. The literature stream strongly supports the role of religiosity in constraining managerial opportunism. Abdelsalam et al. (2021) and Kanagaretnam et al. (2015) find religiosity negatively associated with discretionary LLPs, attributing this to ethical and cultural constraints discouraging opportunistic managerial behaviours.

Control variables such as bank size (SIZE, measured as the natural logarithm of total assets) average 16.1, with a range from 10.8 to 18.7, indicating a broad distribution of bank sizes in the sample. The GROWTH variable, reflecting annual asset growth, shows a mean of 6.21%, but ranges from -42.7% to 163%, capturing both contraction and rapid expansion episodes. The Listing variable, representing publicly listed banks, has a mean of 0.709, indicating that about 71% of the sample banks are listed.

Other control variables, such as past loan loss provisions (PASTLLP), leverage (LEV), loss dummy (LOSS), unemployment rates (UNEMP), and measures of law and order (LAWRule), exhibit substantial variability, reflecting both bank- and country-level heterogeneity. For instance, the mean value of LEV (leverage ratio) is 501% suggesting high loan leverage to the equity, and LAWRule, which captures the rule of law, averages 0.595, indicating moderate institutional quality across the sample. The unemployment variable (UNEMP1) has a mean of 0.44. The political stability variable (PS) averages 0.292, reflecting the substantial instability across MENA countries.

Overall, the summary statistics suggest considerable diversity in bank characteristics, risk-taking, regulatory environments, and macroeconomic

conditions across the sample, providing a solid basis for subsequent regression analyses.

6.2.2 Pearson Correlation Results

Table 6.2 presents the Pearson correlation coefficients for the variables used to estimate non-discretionary LLPs. This analysis is important for validating the expected theoretical relationships between the dependent variable (LLPs) and the explanatory variables, and for detecting potential multicollinearity among the variables that could bias the regression estimates (Gujarati and Porter, 2009).

LLPs exhibit positive and statistically significant correlation with all key non-discretionary LLP drivers. Specifically, the strongest correlation is observed with the lagged change in non-performing loans (DNPLt-1 $r = 0.391$), followed by the lagged allowance for loan losses (ALWt-1, $r = 0.272$). This provides a preliminary indication that LLPs are primarily driven by the deterioration in loan quality. Furthermore, net charge-offs (CHO) are positively correlated with provisions ($P = 0.236$, $r < 0.01$). This is consistent with the notion that banks are continually provisioning to replenish allowances following write-offs. This correlation validates that the variable CHO effectively controls for the retrospective consumption of loan reserves, a necessary control to isolate discretionary behaviour (Liu and Ryan, 2006; Lepetit et al., 2012).

The positive correlation with total loans ($r = 0.263$) confirms the size effect, indicating that larger banks naturally accrue higher absolute provisions (Beaver and Engel, 1996; Kanagaretnam et al., 2010). Accordingly, controlling for total loans is essential when modelling discretionary LLPs, as it attributes a substantial portion of observed provisioning to the non-discretionary, exposure-driven component of loan impairment rather than to managerial discretion.

Table 6.2.1 Pearson correlation for DLLPs Modelling

Variables	(1)	(2)	(3)	(4)	(5)	(6)
(1) LLPs1	1.000					
(2) LOANS	0.263*** (0.000)	1.000				
(3) DLOAN	0.065*** (0.002)	0.548*** (0.000)	1.000			
(4) CHO	0.236*** (0.000)	0.110*** (0.000)	0.017 (0.465)	1.000		
(5) ALW_L1	0.272*** (0.000)	0.239*** (0.000)	-0.070*** (0.001)	0.188*** (0.000)	1.000	
(6) DNPL_L1	0.391*** (0.000)	0.158*** (0.000)	-0.085*** (0.000)	0.154*** (0.000)	0.820*** (0.000)	1.000

Notes: This table reports pairwise Pearson correlation coefficients for the variables used in the first-stage DLLPs estimation model.

Reported p-values appear in parentheses below the coefficients. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

In terms of the multicollinearity, the correlations between independent variables show generally low to moderate coefficients, suggesting that multicollinearity is not a pervasive issue for most variables. For instance, the low correlation between loan growth (DLOAN) and charge-offs (CHO) ($r = 0.017$) implies that these variables capture distinct dimensions of bank performance. However, a notably high correlation is observed between the lagged allowance (ALWt-1) and the lagged change in non-performing loans (DNPL t-1) with a coefficient of 0.820 ($P < 0.01$). This high degree of association is theoretically intuitive, as the allowance level is a stock variable accumulated from past non-performing loan flows. While coefficients above 0.80 can raise concerns regarding multicollinearity, both variables are retained for theoretical completeness. Beatty and Liao (2014) argue that excluding the allowance ignores the extent to which sufficiently high provisions in the past reduce current needs, while excluding NPL changes omits critical forward-looking information regarding LLPs. Therefore, omitting either

variable result in an underspecified model for non-discretionary LLPs. Nevertheless, as the primary objective of the model is to maximise explanatory power to extract an accurate residual (DLLP), rather than to test individual structural parameters, the inclusion of correlated controls remains methodologically sound (Dechow et al., 2010).

Table 6.2.2 presents pairwise Pearson correlation coefficients among the variables used in the study model across the main multivariate tests and robustness regressions. These results provide initial insights into the bivariate associations that underpin the multivariate analyses in subsequent sections.

Table 6.2.2 Pearson correlation for the Model Variables
Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1) DLLPs	1.000															
(2) IFRS9ECL	0.165*** (0.000)	1.000														
(3) EBTp	-0.010 (0.747)	0.015 (0.621)	1.000													
(4) REG.CAPITAL	0.122*** (0.000)	0.008 (0.806)	0.155*** (0.000)	1.000												
(5) RELIGIOSITY	-0.075** (0.015)	0.083*** (0.007)	-0.067** (0.029)	0.011 (0.726)	1.000											
(6) COV19	0.034 (0.266)	0.413*** (0.000)	0.038 (0.220)	-0.025 (0.414)	0.028 (0.359)	1.000										
(7)ORG.RELIGIOSITY	-0.006 (0.846)	0.005 (0.880)	0.062** (0.045)	0.083*** (0.007)	-0.244*** (0.000)	0.030 (0.335)	1.000									
(8) SIZE	-0.169*** (0.000)	0.008 (0.799)	-0.068** (0.028)	-0.353*** (0.000)	-0.196*** (0.000)	-0.114*** (0.000)	0.117*** (0.000)	1.000								
(9) GROWTH	-0.106*** (0.001)	-0.136*** (0.000)	0.137*** (0.000)	0.137*** (0.000)	0.028 (0.370)	-0.064** (0.037)	0.203*** (0.000)	0.021 (0.492)	1.000							
(10) Listing	-0.148*** (0.000)	-0.068** (0.029)	-0.013 (0.677)	-0.129*** (0.000)	0.080*** (0.009)	-0.060* (0.053)	0.150*** (0.000)	0.346*** (0.000)	0.071** (0.021)	1.000						
(11) PASTLLP	0.367*** (0.000)	0.119*** (0.000)	0.040 (0.195)	-0.008 (0.797)	-0.224*** (0.000)	0.119*** (0.000)	0.040 (0.197)	0.006 (0.856)	-0.149*** (0.000)	-0.077** (0.013)	1.000					
(12) LEV	0.075** (0.015)	0.084*** (0.007)	-0.116*** (0.000)	-0.397*** (0.000)	-0.157*** (0.000)	0.222*** (0.000)	0.201*** (0.000)	0.225*** (0.000)	-0.005 (0.883)	0.025 (0.412)	0.288*** (0.000)	1.000				
(13) GDPperCAPITA	-0.014 (0.662)	-0.004 (0.890)	0.087*** (0.005)	0.033 (0.281)	0.004 (0.898)	0.273*** (0.000)	-0.013 (0.682)	-0.003 (0.914)	0.020 (0.513)	-0.058* (0.061)	0.059* (0.055)	0.189*** (0.000)	1.000			
(14) UNEMP	0.026 (0.396)	-0.044 (0.151)	-0.017 (0.581)	-0.022 (0.472)	0.021 (0.490)	-0.254*** (0.000)	-0.077** (0.013)	-0.075** (0.016)	-0.015 (0.639)	-0.059* (0.058)	0.031 (0.314)	-0.045 (0.149)	-0.256*** (0.000)	1.000		
(15) Political_Stability	-0.015 (0.626)	0.053* (0.087)	-0.070** (0.024)	0.085*** (0.006)	-0.386*** (0.000)	0.016 (0.616)	0.247*** (0.000)	0.165*** (0.000)	0.112*** (0.000)	0.184*** (0.000)	-0.019 (0.544)	-0.090*** (0.003)	-0.142*** (0.000)	-0.121*** (0.000)	1.000	
(16) LAWRule	-0.059* (0.055)	-0.130*** (0.000)	0.100*** (0.001)	0.015 (0.632)	-0.063** (0.041)	-0.015 (0.621)	0.282*** (0.000)	0.241*** (0.000)	0.121*** (0.000)	0.538*** (0.000)	0.063** (0.040)	0.109*** (0.000)	0.032 (0.305)	-0.087*** (0.005)	0.351*** (0.000)	1.000

Notes: This table reports pairwise Pearson correlation coefficients for the dependent variable, the main explanatory variables, and the control variables used in the second-stage analysis. Reported *p*-values appear in parentheses below the coefficients. The table is used to assess initial bivariate associations and possible multicollinearity concerns. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

As expected, the results reveal a positive and significant correlation between *IFRS9ECL* and *DLLPs* (*IFRS9ECL*; $r = 0.165$, $p < 0.01$), suggesting that the accounting change from IAS39IL to the IFRS9ECL model may be associated with increased discretion in LLP reporting. This supports the notion that the IFRS9ECL model provides greater room for opportunistic reporting of DLLPs and aligns with the broader literature emphasising that discretionary components of LLPs are informative about managerial discretion and potential manipulation incentives (Kanagaretnam et al., 2010; Beatty and Liao, 2014).

The correlation between *DLLPs* and *EBTP* is negative and insignificant ($r = -0.010$, $p = 0.747$), implying that discretionary LLPs are not directly linked to contemporaneous profitability levels in MENA banks. This lack of significance suggests that the weak relationship between earnings and DLLPs may only emerge under multivariate specifications that control for bank-specific and macroeconomic characteristics.

The positive correlation between *REG.CAPITAL* and *DLLPs* ($r = 0.122$, $p < 0.01$) indicates that banks with higher capital ratios tend to report higher discretionary LLPs, consistent with the capital management hypothesis. These results align with the findings of Leventis et al. (2011), who suggest that banks strategically use provisions to manage capital to meet regulatory requirements.

In line with Kanagaretnam et al. (2015) and Abdelsalam et al. (2021), religiosity (*RELIGIOSITY*) is negatively correlated with DLLPs ($r = -0.075$, $p < 0.05$), reflecting its potential role in constraining opportunistic reporting through ethical and cultural norms (Kanagaretnam et al., 2015; Salem et al., 2023). Although the correlation is statistically significant, its relatively small magnitude suggests that

the direct linear association is modest, and that religiosity's moderating role is better examined in the multivariate regressions.

The COV19 shows a positive and significant correlation with IFRS9ECL ($r = 0.413$, $p < 0.01$), consistent with expectations that the pandemic period heightened provisioning uncertainty and increased managerial discretion in loss recognition (Dursun-de Neef and Schandlbauer, 2021). The ORG.RELIGIOSITY variable is negatively but not significantly correlated with DLLPs ($r = -0.006$, $p = 0.846$), consistent with the notion that religious institutions, such as Islamic banks, would exhibit lower discretionary behaviour. However, the insignificance suggests that organisational form alone does not explain discretionary provisioning behaviour in this sample.

The SIZE variable (log of total assets) exhibits a strong and significant negative correlation with DLLPs ($r = -0.169$, $p < 0.01$), suggesting that larger banks tend to engage less in discretionary LLP reporting, consistent with Beatty and Liao (2014), who argue that large banks face greater regulatory scrutiny and reputational pressures limiting opportunism. GROWTH, capturing annual asset growth, is negatively and significantly correlated with DLLPs ($r = -0.106$, $p < 0.01$), implying that banks experiencing slower or negative growth may increase discretionary provisions, potentially as a precautionary or income-smoothing response. The Listing dummy variable, indicating publicly listed banks, is negatively and significantly correlated with DLLPs ($r = -0.148$, $p < 0.01$), suggesting that listed banks exercise less discretion in LLP reporting. This may reflect stronger disclosure requirements and market discipline. Listing is also positively associated with SIZE ($r = 0.346$, $p < 0.01$), as larger institutions are more likely to be listed. A strong positive correlation between PASTLLP and DLLPs ($r = 0.367$, $p < 0.01$) confirms

banks' tendency to maintain consistency in their provisioning patterns over time, reflecting the persistence of discretionary practices highlighted by Tran et al. (2020).

Leverage (LEV) is positively correlated with DLLPs ($r = 0.075$, $p < 0.05$), although the weak magnitude suggests that leverage alone exerts only a limited influence on discretionary provisioning decisions. Similarly, GDP per capita (GDPperCapita) is negatively but insignificantly related to DLLPs ($r = -0.014$, $p = 0.662$), indicating that macroeconomic development levels do not directly affect provisioning discretion.

Among macroeconomic and institutional controls, unemployment (UNEMP) shows an insignificant correlation with DLLPs ($r = 0.026$, $p = 0.396$), suggesting that variations in unemployment rates do not directly influence provisioning behaviour. The political stability index (PoliticalStability) and rule-of-law index (LAWRule) both show weak negative correlations with DLLPs ($r = -0.015$, $p = 0.626$ for political stability; $r = -0.059$, $p < 0.10$ for LAWRule), implying that institutional quality has a limited direct impact on discretionary LLPs under IFRS 9.

Regarding multicollinearity, most independent variables exhibit low to moderate correlations, indicating that multicollinearity is not a major concern. The highest correlation observed among the key explanatory variables is 0.413 (between IFRS9ECL and COV19), which is well below the conventional threshold of 0.80, often cited as an indicator of serious multicollinearity. Consistent with this, subsequent variance inflation factor (VIF) diagnostics confirmed the absence of multicollinearity issues, and the regression results remained robust when either variable was omitted.

6.3 Regression Results

This section presents the regression results of all the tested models. Given that this study adopts a two-stage regression model, subsection 6.3.1 presents the results of the DLLPs estimation model used in the main study models.

6.3.1 Regression Results of the DLLPs Estimation Model

Before examining the results, it's important to report the regression results used to estimate the dependent of the study *DLLPs*. Table 6.3.1 presents the regression results, which demonstrate a robust fit with an adjusted R^2 of 0.417. This indicates that approximately 42% of the movements in LLPs are explained by the fundamental non-discretionary LLP drivers included in the model. This explanatory power is consistent with prior studies estimating discretionary LLPs in the banking sector (e.g., Bushman and Williams, 2012; Beatty and Liao, 2014). The coefficient for the lagged change in non-performing loans NPL_{t-1} is positive and highly significant ($\beta = 0.058$, $p < 0.01$). This is consistent with the view that non-discretionary LLPs are associated with deteriorating loan quality. As noted by Wahlen (1994), changes in non-performing loans are a primary non-discretionary driver of LLPs, as banks provision for identified deteriorated loans. The total loans (LOANS) exhibit a strong positive and significant association with LLPs ($\beta = 0.895$, $p < 0.01$). This confirms the scale effect that larger loan portfolios require larger absolute provisions, irrespective of managerial discretion. The change in Loans (DLOAN), which represents the coefficient on loan growth, is negative but insignificant (-0.223). While rapid loan growth can lead to higher provisions (risk build-up), it can also dilute the provision ratio in the short term via the denominator effect. Net Charge-Offs (CHO) show a positive and significant relationship with LLPs ($\beta = 0.153$, $p < 0.05$).

Table 6.3.1: Discretionary LLPs Modelling Results

	(1)
	LLPs
LOANS	0.895*** (0.277)
DLOAN	-0.223 (0.416)
CHO	0.153** (0.060)
ALWt-1	-0.023 (0.025)
DNPLt-1	0.058*** (0.019)
Constant	-0.296* (0.157)
Year Fixed Effect	Included
Bank Fixed Effect	Included
Observations	1776
Adjusted R ²	0.417

Notes: This table reports the first-stage estimation results of DLLPs that are employed as the dependent variable in the study model. DLLPs are estimated here as the absolute value of the error term. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

This reflects the retrospective nature of provisioning as banks write off loans, they must simultaneously replenish the allowance for loan losses (ALW) to maintain coverage ratios. This supports the findings of Liu and Ryan (2006), who argue that charge-offs act as a deterministic constraint on provisioning levels. The Allowance ratio (ALW) shows a negative coefficient ($\beta = -0.023$), though it is statistically insignificant. Theoretically, a negative sign is expected due to mean reversion; banks with high existing allowances need to provision less in the current period (Altamuro and Beatty, 2010). These results indicate that the residuals from this estimation model are consistent with the literature and the expected behaviour of the non-discretionary

LLP driver variables to proxy the discretionary LLPs, consistent with prior studies (Kanagaretnam et al., 2004, 2010; Beatty and Liao, 2014).

6.3.2 Regression Results of the Study Models

This section presents the multivariate regression findings. Table 6.3.2 tests the six hypotheses on opportunistic loan loss provisioning (DLLPs) under the IFRS 9 expected credit loss (ECL) model versus the IAS 39 incurred loss (IL) model. Four model specifications are tested and reported: the baseline model, the model with added bank-level controls, the model with added country-level controls, and the full model, which includes all controls. Country-level macroeconomic variables are included because they are at least as important as other discretionary factors (Dichev et al., 2013). I observe that the results are mostly stable in all models. The inclusion of these variables does not appear to significantly alter the magnitude of the relationships between variables of interest and DLLPs.

Overall, the adjusted R-squared improves from 0.33 in the baseline model to 0.41 in the full model, indicating that adding bank-specific and country-specific controls substantially increases the model's explanatory power.

Table 6.3.2: Multivariate Analysis

	Baseline Model	(+Bank Controls)	(+Country Controls)	(Full Model)
	DLLPs	DLLPs	DLLPs	DLLPs
IFRS9ECL	1.077*** (0.377)	0.693*** (0.190)	1.144*** (0.390)	0.636*** (0.196)
IFRS9ECL*EBTP	-5.668 (3.450)	-4.359* (2.286)	-5.560 (3.429)	-4.379* (2.276)
IFRS9ECL*REG.CAPITAL	0.719*** (0.234)	0.967*** (0.261)	0.802*** (0.225)	0.914*** (0.243)
IFRS9ECL*RELIGIOSITY	-0.168*** (0.056)	-0.121*** (0.033)	-0.183*** (0.059)	-0.107*** (0.036)
IFRS9ECL *ORG.RELIGIOSITY	-0.104** (0.050)	-0.025 (0.049)	-0.068 (0.055)	-0.011 (0.051)
IFRS9ECL *COV19	-0.002*** (0.000)	-0.002*** (0.001)	-0.002*** (0.000)	-0.002*** (0.001)
EBTP	3.337* (1.707)	4.518** (2.007)	2.939 (1.784)	4.668** (2.024)
REG.CAPITAL	-0.016 (0.246)	0.217 (0.269)	0.069 (0.236)	0.242 (0.280)
RELIGIOSITY	0.058 (0.051)	0.099* (0.056)	0.054 (0.060)	0.019 (0.047)
ORG.RELIGIOSITY	0.208* (0.109)	-1.200 (0.830)	0.586* (0.335)	-0.306 (0.730)
COV19	0.001** (0.000)	0.002*** (0.001)	0.001** (0.000)	0.002*** (0.001)
SIZE	- -	-0.190 (0.160)	- -	-0.218 (0.170)
GROWTH	- -	-0.010 (0.112)	- -	-0.017 (0.112)
Listing	- -	-0.328*** (0.042)	- -	-0.334*** (0.040)
PASTLLP	- -	0.094*** (0.025)	- -	0.094*** (0.024)
LOSS	- -	0.259*** (0.096)	- -	0.265** (0.102)
LEV	- -	0.001 (0.000)	- -	0.001 (0.000)
GDPperCAPITA	- -	- -	-0.814*** (0.235)	-0.239 (0.275)
UNEMP	- -	- -	-0.044 (0.066)	-0.081 (0.053)
Political_Stability	- -	- -	0.425* (0.227)	0.372* (0.200)
LAWRule	- -	- -	0.325 (0.272)	0.947*** (0.361)

Table 6.3.2: Multivariate Analysis (Continued)

	Baseline Model	(+Bank Controls)	(+Country Controls)	(Full Model)
	DLLPs	DLLPs	DLLPs	DLLPs
Constant	-0.211 (0.243)	0.024 (0.292)	-0.644* (0.380)	-0.606* (0.335)
Year Fixed Effect	Included	Included	Included	Included
Bank Fixed Effect	Included	Included	Included	Included
Observations	1043	1043	1043	1043
Adjusted R ²	0.330	0.410	0.336	0.416

Notes: This 143 presents the main regression results for discretionary LLPs that reported under the IFRS9ECL model. The dependent variable is DLLPs. Columns present the baseline specification, the model with bank controls, the model with country controls, and the full model. Year and bank fixed effects are included in all specifications. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

6.3.2.1 The Accounting Change from IAS39 to IFRS9

Hypothesis H1 posited that the accounting change from the IAS39IL model to the IFRS9ECL model influences the extent of discretionary LLP reporting. In the regressions, the variable IFRS9ECL is an indicator for bank-year observations under the IFRS9ECL model. Across all model specifications, the IFRS9ECL coefficient is positive and statistically significant, suggesting that, on average, discretionary LLPs are higher under IFRS 9. This coefficient is statistically significant in the baseline model ($\beta = 1.077$, $p < 0.01$), and ($\beta = 0.693$, $p < 0.01$), with bank-controls, and ($\beta = 1.144$, $p < 0.01$), in the model with country-controls, and ($\beta = 0.636$, $p < 0.01$), in the full model (standard errors 0.377, 0.19, 0.39, and 0.196, respectively). The positive sign implies that the adoption of IFRS 9 is associated with higher discretionary LLPs relative to the IAS 39 period.

These results provide clear support for *H1*, confirming that the accounting change from IAS 39 to IFRS 9 has indeed influenced the discretionary provisioning

behaviour. The positive direction of the effect, indicating more discretionary provisioning under IFRS 9, is noteworthy. It suggests that bank managers may have taken advantage of the increased discretion and forward-looking estimation allowed under the ECL model to report higher discretionary LLPs. The results demonstrate that bank managers under the IFRS9ECL model have more ability to exercise judgement when estimating LLPs that can be used for opportunistic purposes, consistent with the PAT; managers are assumed to pursue self-interested financial reporting choices (Watts and Zimmerman, 1986), such as income smoothing or capital management, when new standards provide opportunities. From this perspective, the shift from IAS 39 to IFRS 9 did not merely alter the technical method of impairment recognition; it changed the opportunity set within which managers exercise accounting choice. By moving from a model tied more closely to incurred-loss triggers to one that relies heavily on forward-looking estimates, staging assessments, and expectations about future economic conditions, the IFRS9ECL model expanded the discretionary space through which opportunistic behaviour can be expressed. The IFRS9ECL model requires substantially greater managerial estimation of future credit losses, which provides more room for bank managers to exercise judgment in determining ECL (Novotny-Farkas, 2016). These results indicate that overall discretionary LLPs increased with IFRS 9 adoption. These findings are in line with the emerging empirical literature that documents how IFRS 9 reshaped banks' provisioning practices and created scope for model-based discretion. For instance, some studies report higher LLP levels or volatility post-IFRS 9 (e.g., Abad and Suárez, 2017), suggesting that managers exploit the ECL model's subjectivity for strategic provisions. It should be noted that the IFRS9 coefficient's significance weakens to the 10% level in the full model (possibly due to multicollinearity or the inclusion of comprehensive controls), but the positive

sign remains robust across all four models. The additional difference-in-differences test in the next section confirms a significant positive impact of IFRS9ECL, reinforcing the conclusion that IFRS 9 is associated with more discretionary LLPs. These findings are consistent with Hypothesis H1 that IFRS9ECL provides more room for the discretionary reporting of LLPs and provide novel evidence of higher discretionary reporting of LLPs under the IFRS9ECL model than the IAS39IL model.

While these findings support H1 and provide evidence that the IFRS9ECL model is associated with greater discretionary LLPs and, consequently, with greater scope for opportunistic reporting, they should not be interpreted as establishing that all discretionary LLPs under IFRS 9 are opportunistic. The observed increase may encompass both legitimate forward-looking recognition of ECL and strategic adjustments made by management. The interpretation of opportunistic behaviour is consequently based on the combined evidence from H1 and the subsequent incentive-based tests of H2 and H3, rather than on the IFRS9ECL coefficient alone. This evidence therefore supports the central theoretical claim of the thesis: when a new accounting regime enlarges managerial judgement, managers may use that discretion strategically unless constrained by other forces. Tran et al. (2020) and Elnahass et al. (2018) highlight that changes in regulatory accounting frameworks, such as the transition from IAS 39 to IFRS 9, can significantly alter managerial incentives and behaviours. These findings are also consistent with Casciello et al. (2024), who highlight how IFRS 9's expected credit loss approach might lead to strategic, albeit cautious, managerial behaviour in LLPs' provisioning.

6.3.2.2 The Discretionary LLPs and Earnings Management

Hypothesis H2 predicted that the relationship between discretionary LLPs and earnings before tax and provisions (EBTP) (an indicator of earnings management behaviour) is more positive under IFRS 9 than under IAS 39. Under IAS 39, banks often managed earnings by increasing LLPs in high-income periods (and possibly decreasing LLPs in low-income periods) to smooth profits over time. If IFRS 9's forward-looking provisions facilitated even more earnings management, I would expect the interaction of IFRS9ECL with EBTP to have a positive coefficient. The findings, however, contradict H2. The coefficient on IFRS9ECL*EBTP (the interaction between IFRS9ECL and EBTP) is negative in all models, and statistically significant in the bank-controls and full specifications, with ($\beta = -4.359$, $p < 0.10$) in the bank-controls model and ($\beta = -4.379$, $p < 0.10$) in the full model. The magnitude of the results is considerable and suggests that IFRS 9 weakened earnings management through LLPs. Therefore, I reject H2 based on these results. At the same time, the main effect of EBTP remains positive across specifications: ($\beta = 3.337$, $p < 0.10$) in the baseline model, ($\beta = 4.518$, $p < 0.05$) in the model with bank controls, ($\beta = 2.939$, $p > 0.10$) with country controls, and ($\beta = 4.668$, $p < 0.05$) in the full model. This pattern indicates that under the IAS 39 incurred-loss regime, there is a significantly positive association between EBTP and discretionary LLPs, consistent with income-smoothing behaviour during the earlier period. Specifically, the positive EBTP main effect suggests that, for banks not under IFRS 9, higher pre-provision earnings are associated with higher LLPs, supporting the classic income-smoothing incentive (Healy and Wahlen, 1999). The persistence of a positive EBTP coefficient in most specifications further suggests that residual discretion remains in LLP reporting. Similar to prior literature (e.g., Kanagaretnam et al., 2010, 2015; Tran et al., 2020; Haq et al., 2024), the positive

and significant EBTP coefficients across most models suggest earnings management behaviour through the discretionary component of LLPs. This aligns with Kanagaretnam et al. (2015), who note that managers retain some discretion in LLP reporting even under stricter standards.

However, the negative IFRS9ECL*EBTP coefficient means that this positive association is diminished under IFRS 9. In other words, under IFRS 9, the link between earnings and LLPs disappears or becomes far weaker. This suggests that bank managers did not use the greater forward-looking discretion of IFRS 9 to amplify earnings management via LLPs ; rather, the propensity to smooth earnings through provisions was curtailed in the IFRS 9 era. This result runs counter to hypothesis H2 and some expectations from PAT. From the PAT perspective, the prior expectation in H2 was that a more judgment-based impairment framework would enlarge the opportunity set available to managers and therefore strengthen the use of LLPs for income smoothing. As I have expected from a PAT incentive view, IFRS 9's increased discretion would enable greater smoothing (i.e. a more positive EBTP-LLPs relationship as per H2). Instead, the evidence indicates IFRS 9 curtailed the opportunistic use of LLPs for income smoothing. The possible interpretation of these results is that IFRS 9's requirement to recognise credit losses earlier and more systematically may have reduced the need or scope for discretionary end-of-period adjustments to meet earnings targets; managers under IFRS 9 might have less "surprise" profit at year-end to smooth because losses are already provisioned earlier.

This finding supports the argument that IFRS9ECL model constrains traditional income smoothing by reducing managerial discretion over the timing of loss recognition relative to the delayed-recognition structure of IAS 39 (Bushman and Williams, 2012). The implementation of IFRS9ECL model has introduced changes

in loan loss provisioning that may affect earnings management behaviours. These results are aligned with Leventis et al. (2011) those who find a decline in earnings management after the adoption of IFRS. Other research finds no increase or even a reduction in earnings management post-IFRS 9. Mathuva (2025). For instance, finds that banks did not use IFRS 9 LLPs to inflate profits; its results provide evidence contrary to the hypothesis that banks use credit loss reserves to increase their profits. My findings indicate that the IFRS9ECL model did not reinforce earnings management incentives. Accordingly, while the IFRS9ECL model may widen discretion in general, the evidence here suggests that it simultaneously constrains the specific timing-based discretion that had previously enabled income smoothing through LLPs under IAS 39 by enforcing forward-looking ECL. In the context of PAT, this could mean that while managers have discretion under the IFRS9ECL model, other forces (regulatory oversight, the nature of expected-loss accounting, or concurrent economic conditions) kept income-smoothing opportunism in check. Thus, the findings for H2 suggest not the disappearance of opportunism, but a reallocation of opportunistic behaviour away from earnings smoothing and towards other channels, a result that is fully consistent with the broader theoretical argument of this thesis.

6.3.2.3 The Discretionary LLPs and Capital Management

Hypothesis H3 concerns regulatory capital management, hypothesising that the relationship between discretionary LLPs and regulatory capital pressure is more positive under IFRS 9. Bank managers may have incentives to use discretionary LLPs to manage regulatory capital ratios in order to avoid sanctions or intervention by regulatory bodies (Anandarajan et al., 2007). The results strongly support H3.

The interaction term IFRS9ECL*REG.CAPITAL is positive and highly significant in all four models. In the full model, the interaction coefficient is ($\beta = 0.914$, $p < 0.01$). By contrast, the main effect of regulatory capital is small and not significant on its own in any specification, indicating that there is no clear relationship between regulatory capital levels and discretionary provisioning in banks that do not apply the IFRS9ECL model.

This finding suggests that under-capitalised banks might engage in opportunistic reporting by reducing LLPs to conserve capital. The net effect is an opportunistic pattern consistent with capital management incentives. This pattern is in line with PAT's prediction that managers use accounting choices to avoid regulatory costs (Watts and Zimmerman, 1986). Under the IFRS9ECL model, the increased discretion in estimating future credit losses may have enabled banks to time or size LLPs in ways that align with capital planning needs. Banks near the minimum capital constraint might intentionally hold off on recognising discretionary provisions to avoid further capital depletion. The fact that this behaviour intensifies under the IFRS9ECL model relative to the IAS39IL suggests that IFRS 9 allowed more pronounced capital management via LLPs.

The result also contributes to the institutional argument developed in this thesis. Regulatory capital requirements constitute a formal coercive pressure that constrains banks' reporting and operating decisions, while IFRS 9 forms part of the formal accounting environment governing how credit losses are measured. The significant interaction indicates that these two institutional arrangements should not be considered independently: the discretion available under the accounting standard appears to operate differently according to banks' regulatory capital positions. The finding therefore supports the broader theoretical argument that discretionary LLP

reporting arises from the interaction between managerial incentives and the formal institutional structures within which managers exercise accounting judgement.

This evidence is consistent with the prior empirical research noting that capital management incentives influence the LLPs' reporting. This finding is consistent with prior evidence on capital management through LLPs (Ahmed et al., 1999; Elnahass et al., 2018). This underscores the interplay of incentives and accounting standards posited by PAT and highlights the role of institutional pressures.

6.3.2.4 The Personal Religiosity and Discretionary LLPs

H4 proposed that personal religiosity as a cultural/institutional factor measured at the country level moderates the use of discretionary LLPs under IFRS 9. Banks in more religious contexts are expected to engage in less opportunistic behaviour and do not exploit the more discretion under the IFRS9ECL for opportunistic purposes. This expectation reflects the notion that strong internalised religious norms, as informal institutions, impose ethical constraints on managers' opportunistic tendencies (North, 1990; Lubatkin et al., 2005; Scott, 2008). The regression results provide clear support for H4. The interaction term IFRS9ECL*RELIGIOSITY is negative and statistically significant at the 1% level in all models (with coefficients ranging from $\beta = -0.168$ to $\beta = -0.107$, all $p < 0.01$ across specifications). Religiosity therefore reduces the marginal effect of IFRS9ECL by 0.107 log points per index unit, equivalent to an approximate 10.1% differential reduction in DLLPs. This negative and significant coefficient indicates that under IFRS 9, higher levels of societal or personal religiosity are associated with lower discretionary LLPs and reduced opportunistic behaviour. Specifically, in countries with higher religiosity, the adoption of IFRS 9 is associated with lower levels of DLLPs. This implies that religiosity acts as a moderating factor, mitigating the opportunistic use of LLPs that

might arise under the IFRS 9 framework. IFRS 9 introduced a forward-looking provisioning model, which contrasts with the previous IL model under IAS 39 and potentially offers different degrees of managerial discretion. In the full model, the interaction coefficient remains negative and statistically significant, confirming that this moderating effect is robust even after controlling for both bank-level and country-level characteristics. By contrast, the main effect of religiosity, which captures the influence of religiosity under IAS 39, is small and not consistently significant (it is positive in one intermediate baseline model with bank controls at the 10% level but becomes negligible in the full model). This suggests that in the IAS 39 era, religiosity did not have a strong measurable impact on LLP behaviour due to the small room for discretion allowed under IAS 39, but in the IFRS 9 era it became highly influential in restraining discretion. Once the new accounting standard presented opportunities for greater judgment, managers from more religious environments exercised significantly more restraint in exploiting those opportunities compared to managers in less religious environments. This finding aligns well with the theoretical framework of this study that combines the PAT with institutional theory. While PAT explains the incentives for opportunism, the institutional theory in this context provides the theoretical support for these results through the notion of normative pressures and cultural values that constrain behaviour. Religiosity, in this study, is treated as an informal institution that operates through normative pressure, moral socialisation, and internalised ethical expectations. In contrast to formal institutions, which constrain behaviour through codified rules and external enforcement, informal institutions shape behaviour by defining what is socially appropriate, morally acceptable, and personally legitimate (North, 1990; Scott, 2008). These results therefore support the notion that deeply embedded religious norms act as a check on opportunistic financial reporting.

Managers who have internalised strong religious or moral values may feel bound to higher standards of honesty or may fear the social/psychological costs of unethical behaviour, thereby avoiding aggressive LLPs manipulation. Drawing from this, religiosity appears to function as an informal governance mechanism that can restrict managerial discretion and constrain opportunism (Callen and Fang, 2015). The result is also consistent with Lubatkin et al. (2005), who argue that principal-agent relationships are nationally bounded by the surrounding institutional and normative environment. From that perspective, managerial opportunism is not shaped by incentives alone; it is also conditioned by the background social norms within which managers operate. The present finding supports this logic by showing that the same formal accounting regime, IFRS 9, generates less opportunistic provisioning when embedded in a more religious context. Thus, personal religiosity does not eliminate the incentives highlighted by PAT, but it moderates the behavioural response to those incentives by imposing normative constraints on the use of discretion.

These results are also in line with empirical evidence explaining the impact of religiosity through the lens of IT. For example, these findings align with previous results from Barnard and Mamabolo (2022) who find that religiosity influences decision-making frameworks, although the level of that influence varies depending on the strength of the formal institutions. The findings also align with Halabi et al. (2019) who show that religion is at least as strong as formal institutions in determining managers' earnings management choices. I also draw upon recent literature documenting how religiosity functions as a monitoring institution that reduces managerial opportunism and enhances accountability and transparency in financial reporting (McGuire et al., 2012; Dyreng et al., 2012). The results are consistent with prior evidence from McGuire et al. (2012) that firms in more

religious regions exhibit higher financial reporting integrity. These results also align with the results of Kanagaretnam et al. (2015), who find that banks in highly religious countries engage in less earnings manipulation. They also show that higher levels of religiosity are associated with reduced earnings management through abnormal LLPs, driven by ethical norms that discourage managers from engaging in manipulative and opportunistic financial reporting behaviours. Furthermore, these results are consistent with Abdelsalam et al. (2021), who find that religiosity positively affects banks' earnings quality, with this effect more pronounced during periods of economic stress and regulatory change. In this study's context, the effect is particularly pronounced under IFRS 9, a scenario that likely offered greater discretion to exploit. The significant negative interaction indicates that those discretionary possibilities were significantly tempered by personal religiosity. This provides empirical support for H4 and provides novel evidence on the influence of religiosity on LLPs under the IFRS9ECL model. This evidence aligns with the notion that the ethical constraints imposed by religiosity become particularly influential when formal regulatory frameworks, such as IFRS 9, undergo significant transformations. The findings also align Lubatkin et al.'s (2005) claim that religiosity imposes normative constraints on agents' opportunistic attitudes. Under IFRS 9, where opportunistic incentives are present, the "informal" institutional force of religion appears to moderate behaviour by reducing earnings management and capital management by acting as an informal governance mechanism. Abdelsalam et al. (2021) support this notion, showing religiosity's effect is pronounced where formal institutions are weak. Thus, H4's moderating effect of personal religiosity is confirmed; high-religiosity environments see significantly less discretionary LLPs usage, even when the IFRS9ECL model might offer more room for such practices.

6.3.2.5 The Organisational Religiosity and Discretionary LLPs

H5 posited that organisational religiosity, proxied by the bank's type (Islamic bank versus conventional bank), moderates the relationship between IFRS 9 adoption and discretionary LLPs. The expectation is that banks with a religious orientation or governance where formal religiosity is embedded in their organisation would exhibit less opportunistic provisioning under IFRS 9, due to stronger ethical standards and an additional layer of institutional oversight by SSBs that would discourage excessive earnings manipulation. Drawing from Lubatkin et al. (2005) and Abdelsalam et al. (2021) insights, organisational religiosity in this study represents an organisational expression of wider informal religious norms that have been internalised into the bank's identity, values, and monitoring arrangements. In this sense, it reflects the attempt to translate religion, as an informal institution, into organisational practice.

However, my empirical support for H5 is weak. The coefficient on IFRS9ECL*ORG.RELIGIOSITY is negative across all four models, which is directionally consistent with the hypothesis that banks with a religious identity would report lower discretionary LLPs than conventional banks, confirming the notion that Islamic banks, governed by Shari'ah principles emphasising ethical conduct and risk-sharing, are hypothesised to exhibit reduced discretionary LLPs (Abdelsalam et al., 2016). The negative interaction term aligns with the view that organisational religiosity curbs opportunistic financial reporting by fostering ethical norms. In the baseline model, IFRS9ECL*ORG.RELIGIOSITY has a small negative coefficient ($\beta \approx -0.104$, $p < 0.05$), suggesting that, initially, Islamic banks under IFRS 9 might have shown slightly less opportunistic provisioning than their conventional counterparts. However, this interaction is not statistically significant

in the full model and other controlled specifications. Once bank controls are added (model 2) or country controls (model 3) are added, the coefficient loses significance. Essentially, after controlling for other factors, I do not find robust evidence that organisational religiosity significantly constrains opportunistic behaviour under IFRS 9. The possible interpretation is that any effect of an Islamic banking model on LLPs practices is subsumed by other bank characteristics or country factors. Islamic bank status, however, captures a combination of organisational characteristics that extend beyond religiosity and may jointly influence both the incentives and the need to use discretionary LLPs for earnings and regulatory capital management. In addition to religious values and oversight by SSB, Islamic banks differ from conventional banks in their contractual structures, governance arrangements, sources of funding, asset composition and risk-sharing relationships with investment-account holders. The prohibition of interest and excessive uncertainty, together with the use of asset-backed and profit-and-loss-sharing contracts, may produce different patterns of credit risk and loss recognition (Beck et al., 2013; Ben Othman and Mersni, 2014). These characteristics can affect the extent to which managers need to use LLPs to stabilise reported earnings. Similarly, differences in capital structure, risk-weighted assets, regulatory treatment and capital buffers may alter the costs of breaching capital requirements and, consequently, the incentive to use LLPs for regulatory capital management (Boulila Taktak et al., 2010; Farook et al., 2014). Islamic banks may further differ systematically in size, ownership concentration, listing status, product complexity and the regulatory or accounting frameworks under which they operate (Lassoued et al., 2018). Hence, when I include size, listing status, macroeconomic and institutional controls, the unique impact of being an Islamic bank might be diluted. Therefore, the use of bank type as a proxy for organisational religiosity can have

limitations, as it captures the combined effect of religious orientation alongside other Islamic banks' characteristics, such as business-model constraints and risk characteristics. Conversely, the insignificant full-model result may arise because these organisational characteristics exert offsetting effects.

Moreover, these findings may be influenced by the fact that Islamic banks' observations in the study sample account for 17% of the total sample observations, which limits their credibility. Additionally, IFRS 9's phased implementation (post-2018) might obscure its full effects, as banks continue to adapt to ECL's technical demands. From the perspective of informal institutions, this weak result is important. It suggests that the mere organisational labelling of a bank as "Islamic" may not be sufficient to generate a strong and consistent behavioural constraint on opportunistic reporting. Informal institutions are most effective when their values are genuinely internalised by decision-makers; where those values are only partially embedded, formal organisational identity may not translate into materially different accounting choices.

Prior empirical evidence on this question has found mixed results. Quttainah et al. (2013) find that Islamic banks engage in less earnings management through LLPs relative to conventional banks, attributing this to religious principles of truthfulness and risk-sharing. My baseline model's weak significance is directionally consistent with that finding. However, other studies (e.g., Mersni and Othman, 2016) report that the large size of Shari'ah boards in Islamic banks can, in fact, increase discretionary LLPs. This indicates a positive relation between organisational religiosity and discretionary reporting of LLPs. This mixed evidence suggests that organisational religiosity does not operate uniformly across banks, and that its effectiveness depends on how religious governance is implemented in practice rather than on formal religious identity alone.

The full model result therefore leans toward the conclusion that organisational religiosity alone does not significantly moderate IFRS 9 opportunism once other influences are accounted for. The lack of a clear constraint effect from formal religiosity, in contrast to the strong effect from personal religiosity, might imply that cultural/ethical norms internalised by individuals are more potent in curbing opportunism than the formal designation of a bank as religious. It could also reflect that the coercive institutional mechanisms in religious organisations (e.g., Sharia boards) were not strongly effective or were heterogeneous, leading to no detectable uniform impact. In summary, H5 is not conclusively supported, and the moderating effect of organisational religiosity on IFRS 9 discretionary LLPs appears weak and sensitive to model specification. Accordingly, the results suggest that the informal institutional influence of religion is more evident at the personal level than at the organisational level, where formal identity alone appears insufficient to discipline discretionary LLP behaviour under IFRS 9.

6.3.2.6 The COVID-19 and Discretionary LLPs

H6 conjectured that the economic downturn during the COVID-19 crisis had a significant effect on discretionary LLPs' behaviour under IFRS 9. The logic is that bank managers' 2020 provisioning was largely non-discretionary, dominated by genuine expected-loss recognition and supervisory guidance, so the additional "room" IFRS 9 might afford for discretion was crowded out by real-time loss assessment and oversight. Thus, I expected a noticeable shift in discretionary LLP patterns in the COVID period for IFRS 9 banks. The results show a significant effect of the interaction coefficient $IFRS9ECL*COV19$ on discretionary LLP

reporting. The coefficient on IFRS9ECL*COV19 is ($\beta = -0.002$, $p < 0.01$) across all models. This suggests that the forward-looking ECL allowed credit deterioration to be recognised earlier, while pandemic-related regulatory relief and transitional capital arrangements may have reduced the incentives to use LLPs opportunistically. Thus, banks that adopted the IFRS9ECL model reported less discretionary LLPs than other banks. The main effect of the COVID-19 downturn (the variable COV19 without the interaction) is positive and significant across the models, indicating that the banks that had not adopted the IFRS9ECL model continued to report discretionary LLPs during the pandemic. My explanation for that behaviour is mainly due to the fact that these banks did not have forward-looking LLP reserves accumulated in prior years that could be drawn upon to absorb such a sharp increase in credit risk, unlike banks operating under the IFRS9ECL model. The forward-looking provisioning model under IFRS 9 has therefore provided sufficiently early booked LLPs that could serve as a buffer during pandemic-related shocks and help smooth the impact of the crisis on banks' provisioning needs. Overall, these findings support H6.

These results are consistent with López-Espinosa and Penalva (2023). From a theoretical perspective, this finding is consistent with the study's theoretical framework. The COVID-19 shock appears to have altered the incentive environment by making genuine loss recognition more pressing and by reducing the relative benefits of opportunistic discretion. Institutional theory suggests that a severe exogenous shock such as COVID-19 creates strong coercive pressures through economic reality, regulatory scrutiny, and supervisory expectations, which can override or suppress opportunistic managerial behaviour (North, 1990; Lubatkin et al., 2005; Scott, 2008). In this sense, the pandemic did not remove discretion from the IFRS 9 framework, but it appears to have changed the context

in which that discretion operated, shifting managerial behaviour away from opportunistic provisioning and towards prudential recognition of heightened credit risk.

6.4 Difference-in-Differences Results

The results of the difference-in-differences tests provide strong empirical evidence on whether the IFRS9ECL model adoption has influenced the discretionary LLP reporting behaviour.

Table 6.4 presents the results from the DiD event-study analysis. The results strongly support the parallel trends assumption for the DiD test. Pre-treatment coefficients (years -3 to -1) are statistically insignificant, indicating that the trends in DLLPs were not significantly different between treated and control banks before adoption. This supports the validity of the parallel trends assumption, justifying the use of a DiD approach. At the time of treatment (Relative Year 0), the coefficient becomes positive and statistically significant at the 5% level ($\beta = 0.0011$, $p < 0.05$), suggesting an immediate increase in DLLPs following the IFRS9ECL adoption. The effect intensifies in the first post-treatment year (Relative Year +1), with a highly significant increase ($\beta = 0.0021$, $p < 0.001$). Positive and significant effects persist in the second ($\beta = 0.0011$, $p = 0.021$) and fourth ($\beta = 0.0013$, $p = 0.032$) years after adoption, while the effect is not statistically significant in the third year ($p > 0.10$). These findings imply a sustained increase in DLLPs in the years following adoption, suggesting banks may adjust their provisioning behaviour in anticipation of or in response to the IFRS9ECL requirements.

Table 6.4: Event Study Regression Results

Relative Year	Coefficient	Std. Error	z-value	p-value	Confidence Interval (95%)
-3	0.001	0.001	1.44	0.149	[-0.001, 0.001]
-2	0.001	0.001	1.38	0.167	[-0.001, 0.001]
-1	0.001**	0.001	1.91	0.056	[-0.000, 0.002]
0 (treatment)	0.001**	0.001	2.48	0.013	[0.001, 0.002]
+1	0.002***	0.001	4.23	<0.001	[0.001, 0.003]
+2	0.001**	0.001	2.30	0.021	[0.001, 0.002]
+3	0.001	0.001	1.64	0.101	[-0.001, 0.002]
+4	0.001**	0.001	2.14	0.032	[0.001, 0.002]

Notes: This table reports the dynamic treatment effects from the event-study difference-in-differences specification around IFRS 9 adoption. Relative-year coefficients measure changes in DLLPs before and after treatment, with clustered standard errors. Pre-treatment estimates are used to assess the plausibility of the parallel-trends assumption, while post-treatment estimates capture the timing and persistence of the treatment effect. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 6.5 presents the results of the staggered DiD estimation. The coefficient on *IFRS9ECL* is positive and statistically significant at the 5% level. In the basic DID ($\beta = 0.065$, $p < 0.05$), in the full model ($\beta = 0.061$, $p < 0.05$), and the balanced DID model ($\beta = 0.067$, $p < 0.05$), indicating that the adoption of *IFRS9ECL* is associated with an increase in discretionary LLPs, consistent with the hypothesis *H1* that banks exploit the increased subjectivity of the ECL model to engage in more discretionary provisioning reporting.

The DiD estimates corroborate the direction and significance of the principal *H1* result. The findings highlight a significant influence of the *IFRS9ECL* model adoption on discretionary loan loss provisioning, suggesting that the new accounting standard effectively alters banks' provisioning behaviour, implying that banks exercised greater discretion, potentially for opportunistic purposes.

Table 6.5: DiD Analysis

	Basic DID	Full Sample	balanced-sample 2012-2022
IFRS9ECL	0.065** (0.033)	0.061** (0.030)	0.067** (0.032)
EBTP	- -	1.022 (1.708)	0.999 (1.808)
REG.CAPITAL	0.334 (0.311)	0.439* (0.254)	0.390 (0.342)
RELIGIOSITY	- -	-0.060** (0.029)	-0.042 (0.035)
ORG.RELIGIOSITY	- -	0.001 (.)	0.000 (.)
COV19	- -	0.000 (0.001)	0.000 (0.001)
Constant	-0.340 (0.255)	-0.213 (0.264)	-0.267 (0.228)
Controls	Included	Included	Included
Observations	894	1043	894

Notes: This table reports the staggered difference-in-differences estimates of the effect of the IFRS9ECL model adoption on discretionary LLPs. Columns present the basic DiD model, the full model, and the balanced-sample specification. The dependent variable is DLLPs. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

These results align with previous research (e.g., Beatty and Liao, 2011), indicating that accounting policy changes can impact managerial discretion in financial reporting. Prior empirical evidence suggests that the introduction of forward-looking provisioning models can create additional scope for managerial judgment and discretion (Abdelsalam et al., 2021; Haq et al., 2024). Moreover, the finding is consistent with concerns raised by Beatty and Liao (2014) and Gebhardt and Novotny-Farkas (2011), who argue that increased subjectivity under ECL models may lead to greater incentives for earnings management. Furthermore, the findings confirm the theoretical expectation that the IFRS9ECL forward-looking requirements introduce estimation uncertainty, thereby increasing the opacity of

financial statements and enabling greater opportunism (Bushman and Williams, 2012).

6.5 Robustness and Sensitivity Tests

This section presents the robustness and sensitivity tests undertaken to assess the stability and reliability of the empirical results reported in the main analysis. Although the baseline models are designed to capture the opportunistic use of LLPs under the IFRS9ECL framework, the interpretation of the findings may still depend on modelling choices, variable measurement, and the specification of key explanatory variables. It is therefore necessary to examine whether the main conclusions remain valid when alternative empirical approaches and sensitivity checks are applied.

The purpose of these additional tests is twofold. First, they provide reassurance that the results are not driven by a particular construction of discretionary LLPs, a specific proxy, or a narrow specification of the baseline model. Second, they allow for a more careful assessment of whether the estimated relationships among IFRS 9, managerial incentives, religiosity, and crisis conditions are robust to alternative measures and sample structures. In this way, the robustness analysis strengthens the study's internal validity and clarifies the extent to which the main findings can be interpreted as stable rather than specification-dependent.

6.5.1 Individual Effect Analysis

In this test, I run a separate model for each hypothesis. This procedure isolates and clearly identifies the incremental effect of each variable of interest. The purpose is to determine whether the direction, magnitude and precision of each focal coefficient depend materially on the simultaneous inclusion of the other interaction terms. By doing so, the specific contribution of each interaction to the explanation

Table 6.6 Individual Effect Analysis

	(1)	(2)	(3)	(4)	(5)	(6)
	IFRS9ECL	EBTP	REG.CAPITAL	RELIGIOSITY	ORG.RELIGIOSITY	COV19
IFRS9ECL	0.061** (0.030)	0.147** (0.063)	-0.070 (0.064)	0.631*** (0.230)	0.057 (0.035)	0.097*** (0.036)
IFRS9ECL*EBTP	-	-3.587 (2.169)	-	-	-	-
IFRS9ECL*REG.CAPITAL	-	-	0.768*** (0.278)	-	-	-
IFRS9ECL*RELIGIOSITY	-	-	-	-0.103** (0.042)	-	-
IFRS9ECL*ORG.RELIGIOSITY	-	-	-	-	0.022 (0.055)	-
IFRS9ECL *COV19	-	-	-	-	-	-0.002*** (0.001)
EBTP	1.022 (1.708)	4.053** (1.864)	0.987 (1.832)	0.823 (1.842)	1.001 (1.843)	1.247 (1.821)
REG.CAPITAL	0.439* (0.254)	0.384 (0.276)	0.208 (0.270)	0.444 (0.270)	0.389 (0.265)	0.405 (0.271)
RELIGIOSITY	-0.060** (0.029)	-	-	-0.003 (0.040)	-	-
ORG.RELIGIOSITY	0.000 (.)	-	-	-	-0.556 (0.656)	-
COV19	0.000 (0.001)	-	-	-	-	0.002** (0.001)
Constant	-0.213 (0.264)	-0.341 (0.298)	-0.119 (0.315)	-0.483 (0.359)	-0.202 (0.324)	-0.213 (0.324)
Controls	Included	Included	Included	Included	Included	Included
Year Fixed Effect	Included	Included	Included	Included	Included	Included
Bank Fixed Effect	Included	Included	Included	Included	Included	Included
Observations	1043	1043	1043	1043	1043	1043
Adjusted R ²	-	0.401	0.402	0.401	0.396	0.401

Notes: This table compares the separate specifications that estimate each interaction individually. The purpose is to assess whether the individual-effect models yields result consistent with the combined model. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

of discretionary behaviours can be accurately assessed without confounding influences. Furthermore, these tests check the robustness of the model against multicollinearity, given that introducing multiple interaction terms simultaneously into a single regression model can lead to multicollinearity, making it difficult to interpret individual coefficient estimates reliably. Testing separately mitigates this issue, ensuring more precise and statistically robust inferences.

The test results in table 6.6 indicate that the combined model with all variables of interest and their interactions with IFRS9ECL produces results similar to the separate models. These findings confirm that the combined model adequately captures the theoretical and empirical framework of this study.

6.5.2 Alternative Modelling for Banks' Discretionary LLPs

To ensure that the empirical results are not sensitive to the specific functional form used in the primary analysis for estimating discretionary loan loss provisions (DLLPs), this study employs an alternative estimation model proposed by Beatty and Liao (2014). While the primary DLLPs estimation model follows standard literature conventions, Beatty and Liao (2014) highlight a lack of consensus in banking research regarding the optimal modelling of discretionary LLPs. Following (Jiang et al., 2016; Tran et al., 2020; Zhang and McIntyre, 2021; Olszak and Kowalska, 2022), I select Model (d) from Beatty and Liao (2014) as a robustness check because it is the most comprehensive derived from their analysis plus, their results show that Model (d) yields a significantly higher explanatory power (R^2 of approximately 65%) compared to the other models they tested, suggesting it effectively isolates non-discretionary economic determinants. The main characteristics of this model are the use of three periods (lags) of non-performing loans, as well as the use of net charge-offs to increase the explanatory power of the model (Beatty and Liao, 2014). Using such a model allows for isolating DLLPs from the estimation of non-discretionary LLPs (Tran et al., 2020). This model also uses a two-stage approach to estimate the *DLLP*. Beatty and Liao's (2014) model uses more components than Kanagaretnam et al. (2015) to estimate the normal or non-discretionary component of LLPs which results in a smaller number of total DLLPs observations in comparison to the primary model due to the missing data

issue in my MENA sample. Accordingly, this analysis tests whether the substantive conclusions depend on the method used to separate discretionary from non-discretionary LLPs. However, because the alternative DLLPs model requires additional lagged variables and thus yields a smaller sample, differences from the primary results may reflect both the alternative DLLP measure and changes in sample composition. Similar to the main model, at stage 1, LLPs are regressed on bank' non-discretionary components of LLPs, bank controls, and controls for bank-level and country-level effects as well as year effects, using the following model:

$$LLP_{it} = \beta_0 + \beta_1 DNPL_{it+1} + \beta_2 DNPL_{it} + \beta_3 DNPL_{it-1} + \beta_4 DNPL_{it-2} + \beta_5 ALW_{it-1} + \beta_6 CHO_{it} + \beta_7 Size_{it} + \beta_8 DLoan_{it} + \beta_9 DGDP_{it} + \beta_{10} DUNEMP_{it} + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it} \dots\dots(4)$$

In this model equation, $DNPL_{it}$ represents the change in non-performing loans (NPL), normalised to the beginning of the total loans of bank i at time t . ($DNPL_{it+1}$) is the change in non-performing loans from the current year to the next year. Using these changes ($DNPL$) allows the analysis to consider the use of forward-looking information by banks when estimating their LLPs. ($DNPL_{it+1}$) indicates unreported ECL reflecting the loan's future default. in contrast, the concurrent ($DNPL_{it}$) and lagged ($DNPL_{it-1}$) capture previously observed changes in loan performance (Bushman and Williams, 2012; Beatty and Liao, 2014). The change in loans ($Dloan_{it}$) is included to measure the effects of changes in loan portfolios on the quality of loans and non-discretionary changes in earnings.

Table 6.7: Alternative DLLPs Modelling Results

	(1)	(2)
	LLPs	LLPs
	Country and Year FE	Bank and Year FE
DLOAN	-0.147	-0.268
	(0.178)	(0.225)
CHO	0.136***	0.160***
	(0.048)	(0.043)
ALWt-1	-0.043*	0.012
	(0.025)	(0.015)
DNPLt-1	0.050***	0.022
	(0.017)	(0.017)
NPL t	0.053**	0.046**
	(0.021)	(0.020)
DNPLt-2	-0.031***	-0.039***
	(0.011)	(0.009)
DNPL t+1	0.016	0.010
	(0.017)	(0.014)
SIZE t-1	-0.080	-
	(0.100)	(0.019)
DUNEMP t	0.244***	0.224***
	(0.078)	(0.081)
DGDP	-1.168**	-0.874*
	(0.494)	(0.446)
Constant	0.469	0.951***
	(0.313)	(0.138)
Year Fixed Effect	Included	Included
Bank Fixed Effect	Included	-
Country Fixed Effect	-	Included
Observations	1159	1159
Adjusted R ²	0.562	0.370

Notes: This table reports the first-stage DLLPs estimation results under the alternative model. Columns show estimates under bank fixed effects, country fixed effects, and alternative specifications used to derive the discretionary component of LLPs. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

Table 6.7 presents the regression results for the alternative DLLPs Model. The alternative DLLPs model estimates display economically coherent sensitivities to realised credit losses and broader business-cycle conditions. Net charge-offs enter positively and strongly (CHO: 0.136, $p < 0.01$), consistent with banks replenishing

reserves following write-offs and with charge-offs capturing realised credit deterioration that mechanically reduces the allowance stock. Lagged changes in non-performing loans ($DNPL_{t-1}$: 0.050, $p < 0.01$) and the contemporaneous change in NPL ($DNPL_t$: 0.053, $p < 0.05$) are also positively associated with LLPs, indicating that provisions respond to both the flow into non-performance and the stock of impaired exposures. At the same time, $DNPL_{t-2}$ loads negatively (-0.031 , $p < 0.01$), which is consistent with dynamic provisioning, in which earlier credit-quality deterioration has already been incorporated into reserves, reducing the need for provisioning in subsequent years. Macroeconomic variables behave as expected in a fundamentals-based provisioning equation: UNEMP is positive (0.244, $p < 0.01$) and DGDP is negative (-1.168 , $p < 0.05$), implying higher provisioning during labour market weakening and lower provisioning during periods of stronger GDP growth. Collectively, these patterns support the interpretation that the alternative DLLPs model fitted values capture the systematic, non-discretionary component of LLPs comprehensively, as reflected in the high adjusted R^2 (0.562), consistent with the results for Model (d) in Beatty and Liao (2014).

Moreover, to further assess the robustness of the findings, I examine the sensitivity of the DLLP's alternative model results to alternative fixed-effects structures. In the baseline estimation, I employed Bank Fixed Effects to control for time-invariant, bank-specific unobserved heterogeneity. While this is a rigorous approach, it can sometimes absorb meaningful cross-sectional variation in bank characteristics (Zhou, 2001).

6.5.3 Earnings Management Sensitivity Tests

To assess whether the main inferences from the earnings management results are robust, I conduct sensitivity tests on the model. Because earnings management tests can be sensitive to how unobserved heterogeneity is absorbed, I estimate the above model under three parsimonious structures reflected in Table 6.8: (1) country and year fixed effects, (2) year fixed effects only, and (3) pooled OLS without year effects. This triangulation checks whether the earnings management inference is driven by time-invariant cross-country differences (e.g., regulatory regimes, supervisory stringency, provisioning culture), common macro shocks or residual cross-sectional variation (Bushman and Williams, 2012).

Table 6.8 presents the analysis results. Similar to the results of the main model, the interaction term $IFRS9ECL*EBTP$ is consistently negative across specifications (-2.68 to -3.01), indicating that, directionally, the earnings management through DLLPs is weaker under the IFRS9ECL model. However, the interaction is not statistically significant across estimates, implying that the data do not support a sharp inference about the earnings management under the IFRS9ECL model in this sample period. This outcome differs from the main combined model, in which the $IFRS9ECL*EBTP$ interaction is negative and weakly significant at the 10% level. Although the negative direction and approximate economic magnitude remain reasonably stable, the loss of statistical significance indicates that the weak statistical evidence reported in the main model is not robust to alternative fixed-effects structures. The sensitivity results therefore do not support H2's prediction that earnings management increases under the IFRS9ECL model. These results provide directional evidence that the association may have weakened under IFRS 9, but the estimates are insufficiently precise to establish this conclusion definitively.

Table 6.8: Earnings Management Sensitivity Test

	(1)	(2)	(3)
	Country /Year Fixed Effect	Year Fixed Effect	No Fixed Effect
IFRS9ECL	0.133*	0.128	0.12
	-0.078	-0.09	-0.075
IFRS9ECL*EBTP	-3.009	-2.681	-2.972
	-2.556	-2.6	-2.581
EBTP	1.802*	1.586*	2.219**
	-1.071	-0.918	-0.874
Constant	-0.471***	0.151*	-0.02
	-0.146	-0.077	-0.063
Controls	Included	Included	Included
Year Fixed Effect	Included	Included	-
Country Fixed Effect	Included	-	-
Observations	1043	1043	1043
Adjusted R ²	0.237	0.233	0.21

Notes: This table reports sensitivity tests for the earnings-management hypothesis under alternative specifications. It evaluates whether the interaction between IFRS 9 and EBTP remains stable when estimated alongside alternative control structures and related incentive variables. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

6.5.4 Regulatory Capital Sensitivity Tests

To establish that the findings presented in 6.3.2.3 are not an artefact of one metric, I conduct a set of sensitivity tests that re-estimate the baseline model using three alternative measures of regulatory capital and their interaction with the IFRS9ECL. The estimating equation is:

$$\begin{aligned}
 DLLP_{it} = & \beta_1 IFRS9ECL_{it} + \beta_2 (IFRS9ECL_{it} \times REG_CAPITAL_{it}) + \beta_3 REG_CAPITAL_{it} \\
 & + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it}
 \end{aligned}$$

I employ three distinct measures of regulatory capital *REG.CAPITAL* to test the sensitivity of the results. Each measure offers a unique perspective on the bank's solvency and regulatory compliance status. The first measure is the Tier 1 capital, which is the ratio of a bank's core equity capital to its total risk-weighted assets (RWA). The Tier 1 ratio is the standard measure used to assess regulatory capital behaviour relative to regulatory requirements (Beaupain and Braouezec, 2024). The Tier 1 capital is the primary focus of market participants and regulatory bodies during periods of financial stress, which makes its management a primary focus for bank managers (Ng and Roychowdhury, 2014). The second measure I use is the Total Regulatory Capital ratio, which is the total regulatory capital ratio that the bank holds. This defined as the sum of Tier 1 and Tier 2 capital divided by risk-weighted assets. Tier 2 capital includes supplementary capital such as subordinated debt and, crucially, the allowance for loan and lease losses (up to 1.25% of risk-weighted assets)(BIS, 2020). Thus, it captures broader solvency capacity beyond Tier 1. Using the total capital ratio Using total capital is standard in studies examining whether banks manage LLPs to influence overall compliance with risk-based minimum capital requirements, as it helps to check whether the effects are robust when additional loss-absorbing items are included (Ahmed et al., 1999; Gropp and Heider, 2010). The third measure of capital is the *MINIMUM_CAPITAL* which represent the capital buffer over the regulatory floor. Following the literature, I compute the *MINIMUM_CAPITAL* as the Total Capital ratio minus 8%, which is the minimum capital requirement of the Basel Pillar 1 (Ayuso et al., 2004).

$$MINIMUM_CAPITAL_{it} = TotalCapitalRatio_{it} - 0.08,$$

The raw capital ratio may not fully capture the pressure a bank faces. Thus, using the buffer may reveal whether managers who are near breaching the regulatory ratio use LLPs' discretion to maintain a safe distance from the regulatory requirements.

Discretionary LLPs' behaviour can become most pronounced as banks approach the regulatory minimum (Fonseca and González, 2008). Robust effects on the buffer would indicate the findings are economically meaningful relative to regulatory thresholds.

Table 6.9 presents the sensitivity tests on Regulatory Capital to confirm the results of H3. The interaction term (IFRS9ECL* REG.CAPITAL) exhibits a coefficient of ($\beta = 0.768$, $p < 0.01$). In the second test, the interaction term (IFRS9ECL* TOTAL_CAPITAL) shows a coefficient of ($\beta = 0.868$, $p < 0.01$). for the third measure of capital, which is capital buffer over the minimum regulatory requirements, the interaction term (IFRS9ECL*MINIMUM_CAPITAL) is similarly positive and significant, with a coefficient of ($\beta = 0.868$, $p < 0.01$).

The consistently positive interaction coefficients across the distinct Tier 1 and Total Regulatory Capital measures support the robustness of the positive association reported in the main model. The sensitivity results therefore provide qualified support for H3 that discretionary LLPs under the IFRS9ECL model are utilised for regulatory capital management.

Table 6.9: Capital Sensitivity Test

	(1)	(2)	(3)
	REG.CAPITAL	TOTAL_CAPITAL	Minimum Capital
IFRS9ECL	-0.070 (0.064)	-0.104 (0.075)	-0.035 (0.054)
IFRS9ECL*REG.CAPITAL	0.768*** (0.278)	- -	- -
REG.CAPITAL	0.208 (0.270)	- -	- -
IFRS9ECL*TOTALCAPITAL	- -	0.868*** (0.310)	- -
TOTAL_CAPITAL	- -	-0.005 (0.256)	- -
IFRS9ECL*MINIMUM_CAPITAL	- -	- -	0.868*** (0.310)
MINIMUM_CAPITAL	- -	- -	-0.005 (0.256)
Constant	-0.119 (0.315)	-0.084 (0.305)	-0.084 (0.304)
Controls	Included	Included	Included
Year Fixed Effect	Included	Included	Included
Bank Fixed Effect	Included	Included	Included
Observations	1043	1041	1041
Adjusted R ²	0.402	0.402	0.402

Notes: This table reports sensitivity tests for the regulatory capital hypothesis using alternative measures of regulatory capital. The purpose is to assess whether the main capital-management finding is robust to alternative capital definitions. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

6.5.5 Personal Religiosity Sensitivity Tests

To examine the robustness of the inferences from the findings presented in 6.3.2.4, and to overcome the methodological concern that the PCA aggregate religiosity index may obscure which dimension of religiosity drives the moderation effect. Following Abdelsalam et al. (2021) and Salem et al. (2023), I replace in this sensitivity analysis the PCA religiosity index with its three underlying WVS

dimensions: *REL_MEMB*, which represents the Personal Religion affiliation; *REL_SERV*, which represents the Religious services attendance; and the *REL_IMP*, which stands for the importance of religion for the person. The estimating equation is:

$$DLLP_{it} = \beta_1 IFRS9ECL_{it} + \beta_2 (IFRS9ECL_{it} \times REL_COMPONENT) + \beta_3 REL_COMPONENT \\ + Controls + Bank\ Fixed\ Effects + Year\ Effects + \varepsilon_{it}$$

Building on the findings of Abdelsalam et al. (2021) and Salem et al. (2023), I expect the coefficient of (*IFRS9ECL* * *REL_COMPONENT*) to remain negative and statistically significant across all three specifications. This would confirm that the moderation effect of religiosity on reducing the discretionary LLPs under the *IFRS9ECL* is robust to alternative definitions and persists across the cognitive, affective, and behavioural dimensions of religious norms.

Table 6.10 presents the results of the sensitivity analysis; the interaction term for Religious Membership (*IFRS9ECL* * *REL_MEMB*) is statistically insignificant. This suggests that mere religious affiliation, the cognitive dimension, is insufficient on its own to constrain opportunistic behaviour in loan loss provisioning in the MENA context. This finding implies that simply identifying with a religious group without active participation or internalised importance may not translate into the ethical restraint required to constrain opportunistic reporting incentives. Moreover, this can be attributed to the notion that people in MENA usually would identify themselves as a member of a religion regardless of their actual beliefs (Spierings, 2019).

Table 6.10: Religiosity Sensitivity Test

	(1)	(2)	(3)
	Religion Affiliation	Religious Services Attendance	Religion Importance
IFRS9ECL	-0.011 (0.137)	0.252*** (0.082)	1.254** (0.551)
IFRS9ECL*REL_MEMB	0.018 (0.033)	-	-
REL_MEMB	-0.032 (0.024)	-	-
IFRS9ECL*REL_SERV	-	-0.072** (0.030)	-
REL_SERV	-	-0.010 (0.034)	-
IFRS9ECL*REL_IMP	-	-	-0.278** (0.126)
REL_IMP	-	-	0.039 (0.099)
Constant	-0.182 (0.313)	-0.435 (0.352)	-0.465 (0.472)
Controls	Included	Included	Included
Year Fixed Effect	Included	Included	Included
Bank Fixed Effect	Included	Included	Included
Observations	1043	1043	1043
Adjusted R ²	0.396	0.402	0.399

Notes: This table reports sensitivity tests for the personal religiosity hypothesis using alternative dimensions of religiosity, including religious affiliation, religious service attendance, and the importance of religion. The table evaluates whether the moderating effect of religiosity depends on how religiosity is measured. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

In contrast, the interaction term for Service Attendance (IFRS9ECL * REL_SERV) is negative and statistically significant ($\beta = -0.072$, $p < 0.05$). This result supports the "social norm" perspective, in which the behavioural dimension of religiosity effectively constrains opportunistic personal behaviour. As noted by Kanagaretnam et al. (2015) and Salem et al. (2023), frequent attendance at religious services

subjects individuals to peer scrutiny and reinforces shared ethical values through social interaction. The significant negative coefficient confirms that the social pressure and reputational costs associated with active religious participation effectively discourage managers from exploiting discretion allowed under the IFRS9ECL model for opportunistic purposes.

Furthermore, the strongest effect is observed for the Importance of Religion dimension (IFRS9ECL * REL_IMP), with a highly significant negative coefficient ($\beta = -0.278$, $p < 0.05$). This dimension captures the affective, or believing, element that reflects the significance of religion to an individual's identity. The magnitude of this coefficient suggests that internal moral constraints are a primary driver of the observed results. Consistent with McGuire et al. (2012), when religion is central to a manager's self-identity, the cognitive deviation arising from unethical behaviour, such as manipulating LLPs, is heightened, leading to stronger self-regulation and reduced opportunism.

6.5.6 Organisational Religiosity Sensitivity Tests

To validate the robustness of the relationship between the discretionary LLPs under the IFRS9ECL model and organisational religiosity proxied by bank type, this study employs a set of sensitivity analyses, in which I implement two complementary strategies. The first is to use the pooled interaction test by augmenting the baseline model with interaction terms, `ORG.RELIGIOSITY*EBTP` and `ORG.RELIGIOSITY*REG.CAPITAL`, to capture the role of organisational religiosity proxied by bank type in constraining earnings management and capital management.

$$\begin{aligned}
DLLP_{it} = & \beta_1 IFRS9ECL_{it} + \beta_2 (IFRS9ECL_{it} \times \text{ORG.RELIGIOSITY}) + \beta_3 \text{ORG.RELIGIOSITY} \\
& + \beta_4 (EBTP \times \text{ORG.RELIGIOSITY}) \\
& + \beta_5 (REG_CAPITAL \times \text{ORG.RELIGIOSITY}) + \text{Controls} \\
& + \text{Bank Fixed Effects} + \text{Year Effects} + \varepsilon_{it}
\end{aligned}$$

The second strategy uses subsample estimation. I estimate the same fixed-effects model separately for commercial banks and Islamic banks. This avoids imposing common slope coefficients across models and provides a direct check on whether the IFRS9ECL coefficient and control-variable behaviour are qualitatively different across bank types. Across all models, I retain bank and year fixed effects to account for time-invariant bank characteristics. This design is aligned with the dual-banking literature, which emphasises that differences between Islamic and conventional banks are partly structural (business model and governance) and therefore best handled with fixed-effects and explicit sub-sample tests (Elnahass et al., 2018).

Table 6.11 presents the results of the organisational religiosity sensitivity analysis. Similar to the results of the main model, across all the additional sensitivity specifications, the interaction term $IFRS9ECL * \text{ORG.RELIGIOSITY}$ is statistically insignificant. Likewise, in the sub-sample estimations (Columns 3–4), the estimated IFRS9ECL coefficients are not statistically different from zero for either commercial banks or Islamic banks. Taken together, these results imply that the data do not support the specific moderation claim that organisational religiosity systematically weakens the discretionary LLPs reported under the IFRS9ECL model. However, these tests reveal that regulatory capital management is a driver of DLLPs. For commercial banks (Column 3), regulatory capital is positively associated with DLLPs. For Islamic banks (Column 4), the regulatory capital coefficient turns negative and is weaker in statistical precision.

Table 6.11: Organisational Religiosity Sensitivity Test

	(1)	(2)	(3)	(4)
	Full Sample	Full Sample Interactions	Commercial Banks sub-sample	Islamic Banks sub-sample
IFRS9ECL	0.057 (0.035)	0.062** (0.029)	0.044 (0.044)	0.036 (0.080)
IFRS9ECL*ORG.RELIGIOSITY	0.022 (0.055)	-0.072 (0.060)	-	-
ORG.RELIGIOSITY	-0.556 (0.656)	0.090 (0.094)	-	-
ORG.RELIGIOSITY*REG.CAPITAL	-	-0.780* (0.397)	-	-
ORG.RELIGIOSITY*EBTP	-	2.777 (2.111)	-	-
REG.CAPITAL	0.389 (0.265)	0.568*** (0.190)	0.611** (0.285)	-0.217 (0.578)
EBTP	1.001 (1.843)	-0.138 (1.548)	0.576 (1.939)	4.768 (6.382)
Constant	-0.202 (0.324)	0.006 (0.051)	-0.231 (0.354)	-0.388 (0.564)
Controls	Included	Included	Included	Included
Year Fixed Effect	Included	-	Included	Included
Bank Fixed Effect	Included	-	Included	Included
Observations	1043	1043	861	182
Adjusted R ²	0.396	0.208	0.425	0.194

Notes: This table reports additional tests of organisational religiosity using full-sample specifications, interaction models, and sub-sample estimations for commercial and Islamic banks. The purpose is to assess whether the moderating effect of organisational religiosity is robust across alternative specifications and samples. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

In the pooled interactions model (Column 2), the ORG.RELIGIOSITY*REG.CAPITAL term is negative and marginally significant, implying that the capital and DLLPs association is materially lower for Islamic banks than for conventional banks. The most important implication of these tests is that the IFRS9ECL*ORG.RELIGIOSITY interaction remains statistically insignificant in both the principal and sensitivity specifications. The sensitivity

analysis therefore reinforces the main conclusion that H5 is unsupported. The marginally significant `ORG.RELIGIOSITY*REG.CAPITAL` interaction represents secondary evidence of possible heterogeneity in capital-related provisioning. Consequently, the observed capital-related difference cannot be attributed exclusively to organisational religiosity, particularly given the smaller Islamic-bank subsample and its correspondingly lower statistical precision.

6.5.7 Covid-19 Sensitivity Analysis

To ensure the robustness of the primary findings, I perform a sensitivity analysis on the COVID-19 influence on IFRS9 and DLLP reporting. This period represents a significant exogenous shock to the global banking system, characterised by extreme economic uncertainty, government interventions, and regulatory forbearance measures (Elnahass et al., 2021). In these tests, I employ an alternative measure of COVID-19 using the Infection Cases (`COV19_Cases`), which represents the severity of the pandemic, measured by the total number of confirmed COVID-19 cases per 100,000 population in a country for the given year. This proxy captures the intensity of the crisis and the varying degrees of economic lockdown across different jurisdictions (Ding et al., 2021).

$$\text{Cov19_Cases}_{c(i),t} = \frac{\text{Total Covid 19 cases}_{c(i),t}}{\text{Population}_{c(i),t}} \times 100,000.$$

Furthermore, to examine if the crisis dampened or amplified opportunistic behaviour, I include interactions with capital and earnings management proxies. I also test the model without year fixed effects to assess the sensitivity of the results. The specification excluding year fixed effects is used only as a diagnostic test of whether the estimated COVID-19 coefficients depend on the absorption of common annual shocks. It is not treated as an equally preferred model because omitting Year

Fixed Effects may leave the estimates exposed to contemporaneous macroeconomic and regulatory developments unrelated to COVID-19.

Table 6.12 presents the results of the sensitivity analysis examining the impact of the COVID-19 pandemic on discretionary LLPs. The results indicate that the main inferences are robust to the explicit modelling of pandemic exposure and intensity. Similar to the results of the main model, across the COVID-19 specifications, the coefficient on IFRS9ECL remains positive and statistically significant, indicating that the discretionary LLPs are higher in the IFRS9ECL regime even after accounting for pandemic effects. The key interaction term IFRS9ECL*COV19 is negative and statistically significant in Columns (1) and (2), implying that the incremental discretionary provisioning associated with the IFRS9ECL is smaller under COVID-19 conditions than in non-COVID conditions. Results are broadly robust to an alternative COVID-19 measure and to crisis-interacted incentives. Under the COV19_Cases model, the direction of results remains consistent. IFRS9ECL remains positive and significant, and the IFRS9ECL*COV19_Cases interaction is negative. This pattern is consistent with the interpretation that more severe pandemic conditions (higher case intensity) dampen the incremental IFRS 9 discretionary effect.

The “with interactions” models further show that allowing incentives to vary during COVID does not materially alter the central conclusion. In particular, the interaction EBTP*COVID is negative (weakly significant), consistent with income-smoothing incentives through LLPs becoming less pronounced or operating differently during the pandemic (Dursun-de Neef and Schandlbauer, 2021). The interaction REG.CAPITAL* COVID is statistically weak, suggesting that crisis conditions do not systematically amplify capital management behaviour through DLLPs (López-Espinosa and Penalva, 2023).

Table 6.12: COVID-19 Sensitivity Test

	(1)	(2)	(3)	(4)	(5)
	COVID- No Year effect	COVID- with interactions	Cases	Cases- No Year effect	Cases with interactions
IFRS9ECL	0.144*** (0.047)	0.096*** (0.036)	0.076* (0.038)	0.140*** (0.050)	0.071* (0.038)
IFRS9ECL*COVID19	-0.002*** (0.001)	-0.002** (0.001)	-	-	-
COVID19	0.001* (0.001)	0.003** (0.001)	-	-	-
REG.CAPITAL*COVID19	-	-0.004 (0.008)	-	-	-
EBTP*COVID19	-	-0.025* (0.013)	-	-	-
IFRS9ECL*COVID19_Cases	-	-	-0.008 (0.006)	-0.012* (0.007)	-0.008 (0.007)
COVID19_Cases	-	-	0.028** (0.013)	0.005 (0.006)	0.024 (0.017)
REG.CAPITAL*COVID19_Cases	-	-	-	-	0.061 (0.062)
EBTP*COVID19_Cases	-	-	-	-	-0.247* (0.126)
REG.CAPITAL	0.418 (0.275)	0.426 (0.270)	0.318 (0.264)	0.448 (0.276)	0.230 (0.286)
EBTP	1.549 (1.932)	2.109 (1.842)	0.827 (1.780)	1.215 (1.917)	1.736 (1.834)
Constant	-0.211 (0.381)	-0.247 (0.317)	-0.102 (0.303)	-0.230 (0.389)	-0.100 (0.294)
Controls	Included	Included	Included	Included	Included
Year Fixed Effect	-	Included	Included	-	Included
Bank Fixed Effect	Included	Included	Included	Included	Included
Observations	1043	1043	1043	1043	1043
Adjusted R ²	0.403	0.400	0.403	0.381	0.403

Notes: This table reports robustness tests for the COVID-19 results using alternative pandemic measures and interaction specifications. It includes models using the main COVID-19 indicator, models without year effects, and models based on COVID-19 case intensity. The table assesses whether the main COVID-19 finding is sensitive to alternative measurement and specification choices. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. See Appendix A for variable definitions.

6.6 Summary

This chapter has discussed the empirical results of this thesis. The overall results, based on the tested empirical models, shed light on the influence of the IFRS9ECL model on banks' opportunistic reporting in LLPs. The findings show that IFRS 9 adoption is associated with higher discretionary LLPs, indicating that the shift from IAS 39 to IFRS 9 increased the scope for opportunistic provisioning behaviour. It also shows that regulatory capital is a major incentive for managers' opportunistic behaviour in relation to LLP reporting. By contrast, the results on earnings management indicate that the opportunistic use of LLPs for income smoothing became weaker under IFRS 9, suggesting that the new standard did not intensify all forms of opportunistic reporting equally. This indicates that IFRS 9 reshaped, rather than uniformly increased, the use of managerial discretion in LLP reporting. In addition, personal religiosity can play a constraining role that reduces the use of extra discretion allowed under the IFRS9ECL model for opportunistic purposes. However, the results for organisational religiosity are weaker and less robust, suggesting that the formal religious identity of a bank does not, by itself, provide a consistent constraint on discretionary LLP reporting once other bank and country level controls are taken into account. Additionally, this chapter reveals the influence of the COVID-19 pandemic shock on the opportunistic reporting of LLPs under the IFRS9ECL model, which was strong enough to alter such opportunistic behaviour. The findings suggest that the crisis environment, together with the forward-looking structure of the IFRS9ECL model and the policy responses adopted during the pandemic, reduced the scope for opportunistic provisioning and shifted reporting behaviour towards more prudent loss recognition. The chapter also presented the difference-in-differences results and a range of sensitivity analyses, which broadly confirmed the direction and robustness of the main findings.

The results of this chapter provide broad empirical support for the thesis's central argument that the adoption of the IFRS9ECL model changed the pattern of discretionary LLP reporting, while also showing that this behaviour is shaped by managerial incentives, informal constraints, organisational characteristics, and crisis conditions. Overall, this chapter has provided the empirical foundation for the conclusions drawn in the thesis's final chapter.

Chapter 7: Summary and Conclusions

7.1 Introduction

This chapter presents a summary of the thesis's findings and draws the overall conclusions that follow from the analysis of discretionary LLPs under the IFRS9ECL model and its interactions with managerial incentives, religiosity, and crisis conditions in the MENA region. The chapter also discusses the thesis's scholarly contributions and outlines the policy implications of the findings, particularly for standard setters, regulators, and banking practice under IFRS 9. The chapter also critically reflects on the limitations of the research in order to clarify the scope of the conclusions drawn and the extent to which the findings can be generalised. Finally, the chapter identifies directions for future research that arise from the thesis's findings, limitations, and unresolved questions.

7.2 Summary of Key Research Findings

This thesis set out to investigate whether the adoption of IFRS 9 in the MENA region altered banks' discretionary use of LLPs and whether this additional discretion was associated with earnings management and regulatory capital management, as two important managerial incentives, while also assessing whether religiosity, as a major informal institution in the MENA region, constrains such behaviour. The empirical analysis yielded several notable findings from which important inferences may be drawn. First, following IFRS 9 adoption, banks exercised more discretionary provisioning than under IAS39, consistent with the view that the forward-looking estimates under the IFRS9ECL model provide management with greater room for discretion. This was accompanied by a decline in earnings management via LLPs in the IFRS 9 period (contrary to H2). These

findings suggest that the new standard curtailed this particular earnings management channel. At the same time, regulatory capital management through LLPs became more pronounced under IFRS 9, thereby supporting H3. Bank managers appear to have utilised the extra discretion under the IFRS9ECL model to influence regulatory capital through LLPs to a greater extent than in the IAS39IL era. This pattern of reduced earnings management but heightened capital-driven opportunistic provisioning highlights a shift in managerial incentives under IFRS 9, and aligns with prior observations that discretionary LLPs have historically been used to manage earnings and regulatory capital (Beatty and Liao, 2014). Overall, these empirical findings provide novel contribution that the purposes for which such discretionary LLPs are used appear to have changed, with the balance shifting away from earnings management and towards regulatory capital management in MENA banks under the IFRS9ECL model.

The second set of empirical results focuses on one of the major informal institutions in the MENA region, namely religiosity. In MENA countries, where formal institutions, such as the rule of law, may be relatively weak, other informal institutions, including social norms and religion, may play a more prominent role in shaping behaviour. The rule of law indicator for MENA is substantially below the global average (World Bank, 2023). In the sample period, the rule of law shows a mean of 0.595 across the MENA region. religiosity can support formal institutions by providing ethical guidance, while also reinforcing compliance through belief systems centred on divine reward and punishment, thereby helping to mitigate weaknesses in formal enforcement mechanisms (Hanlon et al., 2022). The empirical results of this study show that the moderating role of personal religiosity significantly constrains opportunistic provisioning under the IFRS9ECL model, which supports *H4* and provides novel evidence on the influence of religiosity on

LLPs under the IFRS9ECL model. Specifically, banks operating in environments characterised by stronger personal religiosity exhibit lower discretionary LLPs and weaker use of LLPs for earnings and capital management. This result suggests that personal ethical values grounded in religiosity can curb managers' propensity to exploit accounting discretion for self-serving ends. It resonates with prior cross-country evidence that higher societal religiosity is associated with less earnings management by banks (Kanagaretnam et al., 2015; Abdelsalam et al., 2021; Salem et al., 2023a). In this context, the present finding provides bank-level confirmation that the moral guidance from personal faith appears to deter aggressive provision practices, consistent with religiosity serving as a deterrent to earnings manipulations (Kanagaretnam et al., 2015). In contrast, organisational religiosity proxied by bank type, which captures the Islamic banks as institutions with embedded organisational religiosity relative to conventional banks. The results showed only a weak and inconsistent effect on discretionary LLPs use in the baseline model, which constitutes weak support for H5, given that the results were insignificant across all other models. While the initial notion would suggest that an organisation with a formal religious identity or ethos would behave more conservatively, the evidence presented here does not reveal a significant, systematic reduction in LLPs opportunism for such banks. This nuanced result suggests that having an organisational religious affiliation (e.g., an Islamic bank charter) is not, by itself, a guarantee of restrained provisioning behaviour. These findings imply that the mere label of religiosity is less influential than the actual commitment of individuals in charge. However, these results are also constrained by the data in my sample, given the relatively small number of Islamic banks observations compared with conventional bank observations (182 and 861, respectively). Overall, personal religiosity demonstrated a more direct impact on mitigating opportunistic

accounting choices than organisational religiosity in the IFRS 9 era, highlighting the importance of individual ethics over institutional labels in shaping managerial behaviour.

The third set of empirical results concerns the analysis of opportunistic reporting LLPs during the COVID-19 pandemic. The results show strong evidence that the pandemic substantially altered discretionary LLP behaviour under the IFRS9ECL model which supports *H6*. The severe economic stress and uncertainty brought on by COVID-19 diminished incentives for banks to engage in extreme provisioning manipulation under the IFRS9ECL model. There were some increases in discretionary LLPs in non-IFRS 9 banks due to deteriorating credit, as these banks were required under the IAS39IL model to book LLPs when there is evidence of credit deterioration. In effect, IFRS 9 was stress tested by an unprecedented crisis, and the findings suggest it largely functioned as intended by enabling banks to early recognise losses and create sufficient LLPs reserves that could help absorb credit losses during economic downturns. Nevertheless, the pandemic was a unique scenario; the limited opportunistic response observed may reflect temporary measures as well as exceptional regulatory interventions that were in place. The COVID-19 analysis reinforces the conclusion that IFRS 9's introduction was the primary driver of the changes in provisioning behaviour during regular and stress periods.

Taken together, these findings indicate that the IFRS9ECL model did not simply reduce or increase discretion in a uniform way; rather, it reshaped the direction and use of that discretion. While opportunistic provisioning became more pronounced overall, the evidence suggests that this occurred less through earnings management and more through regulatory capital-related incentives. At the same time, the

constraining role of personal religiosity and the altered provisioning behaviour observed during COVID-19 demonstrate that discretionary LLP reporting under the IFRS9ECL model remain sensitive to both informal institutional influences and crisis conditions. Collectively, the results confirm the thesis's central argument that the IFRS9ECL model has provided relatively more room for discretion, but the utilisation of that discretion in reporting LLPs depends on the interaction between the new standards and the managers' incentives, institutional pressures, and the stress context within which it operates.

7.3 Scholarly Contributions of the Thesis

This thesis makes several contributions to the literature on accounting, banking and financial reporting behaviour. First, it is among the first comprehensive empirical studies to document how IFRS 9's ECL model has altered discretionary LLP reporting. The study provides novel evidence that discretionary LLP reporting under the IFRS 9 ECL model has increased compared with the IAS 39 IL model, and that managerial incentives to use discretionary LLPs opportunistically have changed as the focus has shifted from earnings management to regulatory capital management under the new ECL model. IFRS 9 was designed to improve the timeliness of LLP reporting by requiring early recognition of LLPs using the discretionary ECL model, thereby improving transparency and reducing the "too little, too late" problem in loan loss accounting that was identified under the IAS39IL model (Bushman, 2016; Beatty and Liao, 2014; Novotny-Farkas, 2016). However, as suggested by Novotny-Farkas (2016), the complexity and forward-looking nature of the IFRS9ECL model may provide significant room for managerial discretion. My results empirically confirm this concern in the context of MENA banks, as bank managers took advantage of the flexibility to exercise

judgment, leading to higher levels of opportunistic provisions. At the same time, the results show that one form of opportunism, earnings management, appears to have been curtailed under the IFRS9ECL model. This nuanced outcome of reduced earnings smoothing and increased capital management extends prior literature by pinpointing which managerial behaviours were dampened, and which were exacerbated by the accounting change. It complements earlier findings from the IFRS transition under IAS 39, where moving to the international standards was found to reduce earnings management via LLPs (Gebhardt and Novotny-Farkas, 2018). My results suggest that while earnings management using LLPs diminished under the IFRS9ECL model, the incentive to manage capital through provisions remained and even intensified. This insight adds depth to the scholarly understanding of banks' trade-offs in using LLPs under the IFRS9ECL model; the balance appears to have shifted away from smoothing earnings toward managing regulatory capital. Such knowledge is valuable for academics and practitioners alike, as it highlights that accounting changes can have multi-faceted effects on different types of opportunistic reporting behaviour. By documenting these dynamics, the thesis contributes to ongoing discussions in the accounting literature about the effectiveness of forward-looking loss provisioning and its unintended consequences (e.g., Abad and Suárez, 2017; Mora, 2022; Kyiu and Tawiah, 2025). It also answers recent calls (e.g., Cardoso Fontes et al., 2025) in the literature to empirically assess the impact of IFRS 9's adoption and bank behaviour in the post-implementation period.

Moreover, this thesis examines religiosity as a constraint on accounting discretion under IFRS 9. The use of both personal religiosity and organisational religiosity as moderating variables in the holistic model that combines the two main incentives

for LLPs' opportunistic reporting (earnings and capital management) with informal opportunistic constraints is a novel scholarly contribution. A small number of prior studies on earnings management and LLPs have incorporated managers' individual religious ethos into the analysis (e.g., Kanagaretnam et al., 2015; Abdelsalam et al., 2021) and related work has shown that informal institutions and ethical norms may influence reporting behaviour more broadly (North, 1990; Holmes et al., 2013; Hanlon et al., 2022; Barnard and Mamabolo, 2022; Badaoui, 2023); however, to my knowledge, this is the first study to incorporate these factors in relation to the accounting change from the IAS39IL model to the IFRS9ECL model. This study contributes to an emerging stream of literature that recognises how cultural and ethical norms influence financial reporting (Mezias, 1990; Collin et al., 2009; Kanagaretnam et al., 2015; Abdelsalam et al., 2016; Abdelrehim et al., 2017; Halabi et al., 2019; Salem et al., 2023). In particular, the evidence that personal religiosity constrains earnings manipulation adds a new layer to the understanding of governance and ethics in banking.

Furthermore, the study contributes new empirical evidence on the consequences of IFRS 9 in an emerging market setting, namely the MENA region. Most early studies on IFRS 9 and LLPs have concentrated on European banks or other developed-market settings (e.g., Bischof et al., 2021; Awuye and Taylor, 2024; Proença et al., 2024; López-Espinosa and Penalva, 2023; Engelmann and Lam Nguyen, 2022; Salazar et al., 2023), leaving comparatively limited evidence on how the standard operates in jurisdictions characterised by different institutional structures, enforcement environments, and banking systems. To my knowledge, this is the first study to provide evidence on the influence of IFRS 9 on discretionary LLP reporting in the MENA region. By examining the LLP reporting under IFRS9ECL in MENA banks, this thesis responds to calls for more research in under-researched

jurisdictions outside the Western economies (e.g., Caruso et al., 2021; Salazar et al., 2023; Awuye and Taylor, 2024). The MENA focus is especially valuable given the region's distinctive features, such as the coexistence of Islamic and conventional banks, varying levels of enforcement and oversight, and the strong presence of informal institutional factors, such as religiosity. The findings thus extend the generalisability of accounting research and shed light on whether global accounting reforms have similar or different effects in emerging markets (Leuz et al., 2003; Naceur and Omran, 2011; Boolaky et al., 2018; Buesa et al., 2023; Awuye and Taylor, 2024). In doing so, the work complements and contrasts with studies from other regions, enriching the literature with a comparative dimension.

Additionally, this work offers a theoretical contribution by integrating perspectives from PAT and institutional theory to interpret the findings. PAT predicts that managers will choose accounting methods and respond to new standards in ways that serve their own interests to maximise bonuses, meet debt covenants, or avoid political costs (Watts and Zimmerman, 1990). Indeed, my hypotheses were grounded in such incentive-driven behaviour, expecting earnings or capital management motivations to manifest under the higher discretion allowed in IFRS 9. The results largely bear out PAT's predictions, bank managers reacted strategically to IFRS 9 by increasing discretionary provisions and opportunistically utilising the LLPs discretion in line with their incentives. However, the inclusion of religiosity adds an institutional theory lens, recognising that managerial behaviour is embedded in a broader social context of norms and values. Institutional theory suggests that organisations are influenced by more than just economic incentives; they are also influenced by cultural and normative pressures (North, 1990; Scott, 2008). My finding that personal and organisational religiosity can moderate accounting behaviour illustrates this interplay. It shows that financial reporting

outcomes and LLPs choices under IFRS 9 are not solely a product of opportunistic financial reporting, but also of normative constraints, in this case ethical norms rooted in religion. This dual theory approach extends prior literature by demonstrating how both self-interest (per PAT) and institutional/cultural forces shape accounting decisions in banks. In particular, it provides evidence consistent with the notion that normative pressures (such as a societal emphasis on honesty or a religious duty to avoid deceit) can limit the extent of opportunistic accounting, even when formal rules (such as IFRS 9) grant discretion. By blending these theoretical perspectives, the thesis contributes to a more holistic understanding of accounting choice as it validates the economic motivations highlighted by PAT while also emphasising the moderating power of institutional factors that represent cultural ethics in the case of personal religiosity and organisational identity in the case of organisational religiosity on those choices. This approach enriches the academic dialogue on financial reporting behaviour by moving beyond purely economic or purely institutional explanations and showing their intersection in an emerging market context.

Finally, the study addresses specific gaps in the literature and responds to recent research calls. As mentioned, the post-implementation period of IFRS 9 is still relatively recent, and scholars have called for evidence on its real effects, especially outside the core economies. This thesis directly responds to the call for more research on IFRS 9 in diverse settings (Awuye and Taylor, 2024), offering insights from MENA, a region that encompasses both Asian and African emerging economies. It also addresses the gap in examining accounting behaviour in the context of new financial reporting standards and crises. By examining the COVID-19 period, my work provides early evidence on how an expected loss regime functions under extreme stress, contributing to the nascent literature on IFRS 9's

robustness during economic downturns (Abad and Suárez, 2017; Bischof et al., 2021; Mora, 2022; Degryse and Huylebroek, 2023). In doing so, the thesis also connects the literature on financial reporting behaviour with wider debates on resilience, prudence, and the role of accounting in preserving banking stability during downturns.

Overall, the thesis contributes a conditional explanation of discretionary LLP reporting under IFRS 9. It shows that the effects of the IFRS9ECL model cannot be understood solely by examining whether discretionary provisions increase or decrease after adoption. Instead, those effects depend on the managerial purpose for which discretion is exercised, the informal institutional constraints surrounding decision-makers, and the economic conditions under which provisioning judgements are made.

7.4 Policy Implications

Beyond academic contributions, the findings of this thesis carry practical implications for regulators, standard-setters, and banking sector stakeholders, especially in the MENA region.

The findings suggest that although IFRS 9 was introduced to improve the timeliness of credit loss recognition, the greater reliance of the ECL framework on forward-looking judgment has also widened the scope for discretionary LLP reporting. The policy implication is therefore not that IFRS 9 should be reconsidered in principle, but rather its implementation, guidance, and oversight require further refinement to ensure that the objective of timely loss recognition is not undermined by excessive managerial flexibility.

A first implication concerns standard setters, especially the IASB. The findings of this thesis suggest that the IASB should consider whether additional clarification or

refinement is needed in those areas of IFRS 9 where managerial discretion is most open-ended, particularly in periods of economic stress. In particular, the standard setter could strengthen application guidance and disclosure expectations regarding the assessment of SICR, the use of forward-looking macroeconomic scenarios, management overlays, and the justification for major changes in expected credit loss estimates from one period to the next. Such refinements would not require abandoning the principles-based nature of IFRS 9, rather it could reduce the scope for opportunistic interpretation by making key judgements more transparent, more comparable across banks, and more open to challenge by auditors, investors, and supervisors. In this respect, the evidence from this thesis supports a standard-setting response that focuses on greater discipline around judgement, rather than a retreat from the expected loss model itself.

Relatedly, consistent with the observations of (Gebhardt, 2016; Pucci and Skærbæk, 2020; Engelmann and Lam Nguyen, 2022; Awuye and Taylor, 2024) the IASB could usefully consider whether crisis-specific interpretive guidance is needed for the application of IFRS 9 in periods of severe systemic stress. One of the central tensions revealed by this thesis is that the flexibility built into IFRS 9 may be necessary to reflect rapidly changing economic conditions, yet that same flexibility can also make opportunistic provisioning harder to distinguish from prudent judgment. Accordingly, clearer guidance on how banks should incorporate exceptional macroeconomic uncertainty, temporary policy interventions, and abrupt deterioration in borrower conditions would help reduce inconsistent practice across institutions and jurisdictions. A stronger disclosure framework in such periods, for example, requiring banks to explain the basis for scenario weighting, post-model adjustments, and departures from prior provisioning patterns, would also improve the usefulness of financial statements and strengthen market

discipline. Therefore, the recommendation for the IASB is to refine IFRS 9 operational guidance so that timeliness does not come at the cost of reduced comparability and increased opportunistic latitude.

A second implication concerns banking regulators and supervisory authorities. The evidence that discretionary LLPs increased under IFRS9ECL, together with the stronger association between LLPs discretion and regulatory capital management, suggests that supervisors should not assess reported ECL and LLP amounts in isolation. Rather, supervisors should review reported LLPs jointly with reported earnings, regulatory capital ratios, capital buffers, changes in risk-weighted assets, and other related financial-statement indicators in order to identify whether unusually high or low provisioning coincides with particular managerial incentives. The IFRS9ECL model inherently grants management substantial discretion in forecasting macroeconomic conditions and determining whether credit risk has increased significantly (Novotny-Farkas, 2016). While such flexibility may improve responsiveness to changing risk conditions, it also creates room for strategic managerial use of accounting judgement, with the present findings indicating that regulatory-capital incentives are particularly relevant in the MENA setting. Regulators should therefore continue to develop supervisory guidance and review mechanisms that constrain excessive discretion, for example, through closer scrutiny of model governance, conservative challenge of management overlays, benchmarking of provisioning practices across peer banks, and more systematic review of unusually low or unstable provision levels. Especially in emerging markets such as MENA, where enforcement quality may vary, stronger supervisory capacity, technical training, and consistent enforcement remain essential to ensuring that banks comply with the IFRS 9 requirements and the prudential requirements and thresholds for LLPs.

A third implication relates to disclosure and transparency. Greater transparency around the judgments embedded in ECL estimation could serve as an important constraint on opportunistic behaviour. Detailed disclosure of the assumptions, scenario designs, overlays, and sensitivity of LLP estimates to alternative macroeconomic paths would allow external users to better evaluate whether reported provisions reflect underlying risk or managerial incentives. Here, both standard setters and regulators have a role. The IASB can strengthen the reporting architecture by clarifying disclosure expectations within the accounting framework, while regulators can reinforce those expectations through supervisory reporting templates and enforcement. Enhanced transparency would improve comparability across banks and reduce the opacity that often surrounds forward-looking provisioning decisions.

Another implication concerns corporate governance and ethical culture within banks. The finding that personal religiosity is associated with more restrained accounting behaviour under IFRS 9 highlights the importance of managerial values and ethical orientation in shaping the use of discretion. The broader policy lesson is not that religiosity as such should be treated as a governance instrument, but that ethical discipline matters for the quality of financial reporting under discretion-based accounting standards. Bank boards and regulators may therefore draw on this insight by placing greater emphasis on integrity, prudence, and professional conduct in the appointment, evaluation, and oversight of senior executives and finance functions. Ethical codes, internal control cultures, and effective board oversight can complement formal regulation by limiting the tendency to exploit accounting flexibility for short-term reporting objectives. Banks and the central banks as regulators, could implement training programs and codes of conduct that reinforce ethical financial management, perhaps incentivise bank managers to

participate in such training. Additionally, the weak influence of organisational religiosity on its own implies that simply branding a bank as “Islamic” is not enough; what matters is the genuine internalisation of those values in day-to-day decisions. Policymakers overseeing Islamic banking sectors might ensure that governance structures (such as Shariah supervisory boards in Islamic banks) are empowered to scrutinise financial reporting decisions, including LLPs, so that the institution's ethical stance translates into practice. More broadly, encouraging diversity and independence in boards (e.g., independent directors who prioritise long-term firm reputation over short-term earnings manipulation) can complement formal regulations.

The thesis findings also have implications for banking stability and crisis management. The results indicate that discretionary LLP behaviour associated with the IFRS9ECL model was lower during the pandemic than during normal periods. This suggests that the interaction between IFRS 9 and regulatory interventions during the pandemic was reasonably effective in maintaining prudent provisioning, preventing severe distortions in reported loan loss recognition. Policymakers should note that IFRS 9 did not universally lead to a destabilising jump in provisions that some had feared, nor did banks overwhelmingly exploit the chaos to hide losses or build “cookie jar” reserves. In part, this outcome may reflect temporary measures (for example, according to Dong and Oberson (2022), regulators in various jurisdictions allowed banks to use transitional arrangements to spread the impact of IFRS 9 on regulatory capital, and gave guidance to use reasonable judgment in unprecedented circumstances).

Going forward, Policymakers should therefore continue refining the interface between accounting standards and prudential regulation in crisis periods. One

implication is the importance of flexibility in extraordinary periods, having mechanisms such as transitional capital arrangements, temporary supervisory guidance, and countercyclical buffers may provide necessary flexibility. However, such flexibility must be carefully calibrated to avoid recreating the delayed-recognition problems associated with IAS 39. The experience of COVID-19 can inform future policy by highlighting best practices, clear communication from regulators on using forward-looking information objectively, robust oversight, transparent disclosures, and carefully designed flexibility that supports lending and stability without permitting opportunistic delay in loss recognition.

Overall, the policy implications of this thesis point to a shared responsibility between standard setters and regulators. For the IASB, the key recommendation is to refine IFRS 9 through clearer guidance and stronger disclosure expectations in the most judgment-sensitive areas of the ECL framework, especially during economic stress. For regulators and supervisors, the central task is to ensure that this discretion is not abused through weak oversight or uneven enforcement. Taken together, these measures would better align the objectives of timely loss recognition, reporting credibility, and financial stability.

7.5 Limitations of the Study

This thesis has several limitations. First, the panel is unbalanced: some countries, most notably Algeria and Iraq, contribute relatively few bank-year observations because of missing data in some of the key variables, this reduces statistical power. Second, the number of Islamic banks in the sample is small. As a result, the proxy for organisational religiosity based on bank type may lack sufficient cross-sectional variation; the non-significant coefficients for this proxy could therefore reflect

limited statistical power rather than the absence of an underlying effect. This is particularly relevant when interpreting the weaker results relating to H5, as these may partly reflect sample constraints rather than a definitive absence of organisational religiosity effects.

Third, the personal religiosity series derived from the World Values Survey (WVS) is observed only in periodic waves, leaving gaps in intervening years. I address this by interpolating between survey waves. Because religiosity tends to evolve slowly at the population level, interpolation is a reasonable approximation; however, it may diminish variations over time and bias estimates toward zero, and it does not capture the estimation uncertainty introduced by imputation. Accordingly, the results relating to personal religiosity should be interpreted with some caution.

Finally, the heterogeneity in the additional test results may be driven by differences in variable definitions and measurement. Alternative specifications, the construction of bank controls, or country-level institutional indicators could yield quantitatively different coefficients. Relatedly, although the main findings remain informative, some of the sensitivity in the additional analyses suggests that the magnitude of the estimated effects may depend partly on modelling choices and variable construction. These limitations should be borne in mind when interpreting the findings and their generalisability.

7.6 Directions for Future Research

While this thesis has advanced our understanding of discretionary LLP behaviour under the IFRS9ECL model in the MENA region, it also opens several avenues for future inquiry. Many of these avenues follow directly from the limitations identified above and from the broader questions raised by the empirical findings. Future research can examine individual and governance-level characteristics that may

constrain managerial discretion in LLP reporting; board-member characteristics and other individual managerial characteristics could have an influence on discretionary LLPs decisions that need to be addressed to expand our knowledge about the formal and informal constraints that shape bank managers' reporting decisions. Another promising direction is to extend the analysis to other regions and comparative settings. Future studies could examine whether the patterns observed here hold in other emerging markets or in developed markets under IFRS 9 and under different institutional characteristics that have not been fully observed in MENA, such as a strong role of law or different forms of social power that can serve as constraints other than religiosity. A cross-country comparison between MENA banks and those in Europe or North America could illuminate how institutional differences (such as legal enforcement, market discipline, or cultural norms) shape the impact of the IFRS9ECL model on earnings management and capital management. Such research would further test the generalisability of the conclusions of this thesis and potentially identify whether certain regulatory or market environments amplify or dampen opportunistic behaviour under IFRS9ECL provisioning.

Another avenue for research is to investigate the role of religiosity and culture in financial reporting more deeply. My results point to the importance of individual ethics in accounting choices, but many questions remain. For instance, future work could explore other measures of personal integrity or ethical orientation of managers beyond religiosity to see if they similarly constrain earnings management. Psychological traits or values-based leadership assessments might be linked to financial reporting outcomes in interesting ways. Moreover, researchers could study different dimensions of religiosity, for example, comparing the effects of different religions or denominations, or examining religiosity intensity in a more granular

manner to see if the findings hold across various contexts. Qualitative studies, such as interviews or case studies of banks known for ethical versus unethical practices, could also shed light on the mechanisms through which personal beliefs influence accounting decisions. On the organisational religiosity side, since my measure yielded only weak effects, future research might refine this concept. It could be useful to investigate how the presence of religious or ethical oversight bodies (e.g., SSB in Islamic banks) impacts financial decision-making within banks, potentially through a mixed-methods approach. Such work would help clarify whether the weak organisational religiosity effect observed in this thesis reflects measurement limitations or a genuinely limited behavioural influence.

Further research is also necessary to unpack the nuances of earnings management under IFRS 9. This study treated earnings management and capital management as distinct and indeed found divergent trends for them, but in practice, managers may make provisioning decisions while considering multiple objectives simultaneously. Future studies could employ more detailed models to see how banks prioritise among competing goals. The interplay between accounting discretion and regulatory capital requirements remains a fertile field. Investigating how the IFRS9ECL LLPs interact with Basel III regulatory capital rules (such as the treatment of Stage 1 and Stage 2 provisions in capital calculations) would be valuable. Additionally, the question of the procyclicality of IFRS 9 deserves attention: Does the standard's expected loss approach mitigate or exacerbate the procyclicality of bank lending in emerging countries? While this study focuses on managerial opportunism, another consequence to explore is how IFRS 9 affects the availability of credit and banks' risk-taking behaviour over economic cycles. Future research could also examine whether capital management and earnings

management under IFRS 9 operate as substitutes or complements under different regulatory and macroeconomic conditions.

Lastly, given that IFRS 9 is still in its early years of adoption, long-term research would be beneficial. As more data become available over multiple years and through different economic conditions, studies can assess whether the initial effects I documented persist or evolve. It's possible that as banks and regulators gain experience with IFRS 9, some opportunistic behaviours could be reined in through improved oversight or market learning, or new patterns could emerge. Additionally, future shocks beyond COVID-19 could provide further tests of IFRS 9's resilience. Studying how banks using IFRS 9 behave in future downturns or crises will be important for validating or refining the conclusions drawn from the COVID-19 experience. Ongoing research should monitor the dynamic interplay between accounting standards, managerial behaviour, and economic conditions. By doing so, the academic community can continue to inform standard setters and regulators about where IFRS 9 is succeeding and where improvements may be needed to limit unintended opportunistic outcomes.

7.7 Summary

In conclusion, this thesis has examined opportunistic behaviour in loan loss provisioning under the ECL model of IFRS 9 using evidence from the MENA region, highlighting its key theoretical and empirical implications. The results show that while IFRS 9 brought about meaningful changes in banks' accounting practices by introducing the forward-looking LLPs that restrain some forms of earnings management, it also offers new scope for opportunistic utilisation of the ECL

discretion for capital management, and the outcomes of such discretion are significantly shaped by contextual factors like managerial religiosity and institutional environment. More specifically, the thesis has shown that the IFRS9ECL model altered the pattern of discretionary LLP behaviour, strengthened the role of regulatory capital management incentives, demonstrated the constraining effect of personal religiosity, and provided evidence on how provisioning behaviour changed during the COVID-19 period.

The scholarly contributions and policy insights derived from this study have been discussed in this chapter alongside the study's limitations and directions for future research, thereby situating the findings within the broader academic and policy debate on accounting discretion, bank regulation, and financial reporting quality. Accordingly, this chapter has concludes the thesis by summarising its principal contributions, and clarified the implications of the findings for standard setters, regulators, and future scholarship. It is my hope that these conclusions will encourage further research and informed policy that together enhance the integrity and stability of bank financial reporting and improve the implementation and refinement of accounting standards.

Appendices

Appendix A: Variable definitions and measurement

Abbreviation	Name of Variable	Description and measurement
Discretionary LLPs variables		
DLLPs	Discretionary loan loss provisions	DLLPs is a proxy for opportunistic behaviour in LLPs, and is measured as the logarithm of the absolute residual value (ϵ_{it}) generated from the following regression model: $LLP_{it} = \alpha + \beta 1 \times DNPL_{it-1} + \beta 2 \times ALW_{it-1} + \beta 3 \times CHO_{it-1} + \beta 4 \times Loan_{it} + \beta 5 \times DLoan_{it-1} + Bank\ Fixed\ Effects + Year\ Effects + \epsilon_{it}$
Components of DLLP models		
LLPs	Loan loss provisions	Loan loss provisions, scaled by total assets at the beginning of the year
NPL	Nonperforming loans	Nonperforming loans over the year, scaled by total assets at the beginning of the year
DNPL	Change in NPL	Change in NPL over the year (closing less beginning NPL balance), divided by total assets balance at the beginning of the year
LOAN	Loan assets	Total loan assets over the year
DLOAN	Change in loans	Change in total loans over the year (closing less beginning total loans balance), divided by total assets balance at the beginning of the year
ALW	Loan loss allowance ratio	Loan loss allowance as a percentage of lagged total assets
CHO	Adjusted charge-off	Adjusted charge-off as a percentage of lagged total assets
Variables of interest		
IFRS9ECL	LLPs under IFRS9 ECL model	A dummy variable that equals 1 if bank reported LLPs under IFRS9 ECL model at year, and 0 otherwise
EBTP	Earnings before provisions and taxes	Earnings before provisions and taxes during year t scaled by total assets at the beginning of the year.
REG.CAPITAL	Regulatory capital ratio	The bank Tier 1 Regulatory capital ratio

Abbreviation	Name of Variable	Description and measurement
ORG.RELIGIOSITY	The type of bank	A dummy variable that equals 1 if bank is Islamic bank, and 0 if the bank is conventional bank.
COV19	Covid-19 Death cases	The total numbers of Covid-19 death cases during a year, based on the WHO data.
Covid19Cases	Covid-19 confirmed infection cases	The total numbers of Covid-19 confirmed infection cases during a year, based on the WHO data.
RELIGIOSITY	Country religiosity	The principal component of: (a) the percentage of respondents that religion is important to them (REL_IMP), (b) the percentage of respondents responds that they are a religious person (REL_MEMB), and (c) the percentage of respondents indicates that they attend religious services (REL_SERV). Data source: WVS.
Components of RELIGIOSITY		
REL_MEMB	Religion affiliation	The proportion of respondents who indicate they are affiliated with a religion based on the WVS.
REL_SERV	Religious services attendance	The proportion of respondents who indicate they attend religious services based on the WVS.
REL_IMP	Religion importance	The proportion of respondents who indicate the religion is important to themselves based on the WVS.
Control variables		
GROWTH	Bank growth	Growth in total assets from the beginning to the end of the year.
SIZE	Bank size	The natural logarithm of closing gross total assets balance.
LOSS	Dummy loss	A dummy variable that equals 1 if net income is negative, and 0 otherwise.
LEV	Leverage	the ratio of gross loans and advances to total equity.
Listing	Listing status	A dummy variable that equals 1 if the bank is listed in stock exchange, and 0 otherwise.

Abbreviation	Name of Variable	Description and measurement
LAWRule	Rule of law	A percentile ranks for the perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. Data source: World Bank.
Political_Stability	Political Stability	A percentile ranks for political stability and absence of violence/terrorism in each country. Data source: World Bank.
DGDP	Change in GDP	Change in country GDP (growth of country GDP) over the year.
GDPperCapita	Change in GDP per capita	Change in country GDP per capita (growth of country GDP per capita) over the year.
UNEMP	Change in unemployment ratio	Change in country unemployment rates over the year.

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