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A proposed framework for disclosing credit risks and its implications on the quality of banks' financial reports "an applied study"

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Abstract:

This study aimed to develop a proposed framework that explains the impact of credit risk disclosure on the quality of financial reports, with the aim of meeting the requirements of users of financial reports. This was done by determining the value of the provision for loan losses, the percentage of non-performing loans, the liquidity ratio, capital adequacy, financial leverage, the size of the bank, and the extent to which these items affect the assessment of the bank's efficiency and profitability. This is intended to reduce credit risk.

The study was conducted on a sample of commercial banks in Libya, which included 10 commercial banks, and the study continued from 2019 to 2022. Data was collected through the financial statements of the concerned commercial banks. The necessary statistical analyzes were conducted to test the study hypotheses.

The results of the study showed, through statistical analyzes of the data, that there is a fundamental impact of the disclosure of credit risks on the quality of financial reports.

Introduction :

The economy is considered the backbone of any country, and the strength of a country is often measured by the effectiveness of its economy. Since banks constitute the backbone of the economy and submit annual reports that reflect their work, these reports must be transparent,

comprehensive, and clearly reflect the work. This concept is known as the disclosure principle. The principle of disclosure plays an important role in preparing accounting data, and receives great attention from professional and regulatory bodies.

Disclosure of credit risk is essential because it is an essential part of banking activity. Banks must disclose the nature and characteristics of the risks associated with their banking activities, which include lending, investment, cash management, and others. This helps in reducing the impact of risks and evaluating the future performance of the bank. Transparency in risk disclosure enhances investor confidence and contributes to determining stock prices and directing investments.

Previous studies have shown that providing good information about the bank's position and the risks it faces directly affects stock evaluation and directs investors towards good investments.

Disclosure of credit risks is considered necessary as it is an inherent part of the nature of banking activity, as there was a need to disclose the nature of this important part in the annual financial reports of banks by disclosing it, its nature and characteristics, which covers all banking activities including lending operations, trading, Investments, cash and liquidity management, and asset management, in order to limit or reduce the expected effects of risks and thus lead to a better assessment of the bank's performance in the future. Managers also benefit from transparency regarding the risks inherent in its strategic objectives (Moumen, 2020, Hussainey, Othman). Many studies have also shown at the global and local levels that the availability of good information about the bank's conditions and the risks it is

exposed to or the possibility of being exposed to has a direct impact on Determine stock prices,
As well as predicting the returns of those stocks, thus directing investors towards good investment (Bashar, Muhammad 2020,).

the study Problem:

It is true that credit risks are not only theoretical concepts, but rather they are realistic and an integral part of the work of banks. Banks must be prepared to deal with these risks and manage them effectively. Although credit risk cannot be completely eliminated, it can be reduced and better managed through good risk management practices.
The bank's loss of expected return is possible as a result of credit risk, and this could result in a negative impact on the bank's profits and the confidence of shareholders and the bank's customers. An increase in default rates forces the bank to increase its provisions for default, which affects the bank’s profits and financial performance in general.
Credit risk management requires periodic assessment of these risks, application of strategies to reduce them, and identification of policies and procedures that reduce the bank's exposure to these risks. Striking a balance between generating profits and reducing risks is a constant challenge for banks.
We often find that credit risks, whatever their type, are summarized in the following:
The bank's loss of the expected return, or these risks may extend to include the asset that was liquidated from the investment process and thus the loss of a portion of customer deposits.
Increasing default rates leads to an increase in the provisions that banks create and charge to profits, which affects the

bank's profits by decreasing and thus negatively affects the bank's shareholders.
The exacerbation of bad debts and the possibility of converting them into bad debts may expose the bank to the risk of a lack of liquidity, and over time the situation may develop into a problem of financial insolvency.
Understanding risks and disclosing them accurately and transparently is crucial in the banking sector. Proper disclosure of credit risks helps investors and decision makers understand the challenges banks face and can make smarter investment decisions. Banks must adhere to specific standards and regulations for risk disclosure, which contribute to improving the quality of financial information and credibility.
The gap in disclosure of credit risks is a recognized problem, and this requires improving disclosure standards and their careful implementation. It is necessary to incentivize banks to provide more transparent financial information and improve continuous monitoring and assessment of risks.
In addition, regulators and supervisors must play an active role in monitoring and evaluating compliance with disclosure standards and guiding banks to improve their practices. Achieving understanding and awareness of the importance of good disclosure of credit risks can contribute to enhancing the stability of the financial system.
Therefore, the study problem can be summarized in the following main question:

- What is the impact of disclosing credit risks on the quality of banks' financial reports?

The research problem can be addressed by answering the following sub-questions:
What is the impact of credit risk disclosure on the growth rate of banks?

What are the obstacles that affect the disclosure of credit risks?
Can it be avoided?
Does increasing credit risk disclosure enhance market discipline and increase the bank's market share?
How can the gap resulting from the value of information contained in traditional financial statements and the value of information resulting from disclosure of credit risks be evaluated?
Does the degree of credit risk disclosure have an impact on the quality of banks' financial reports?
What is the impact of governance on banks' credit risk disclosure?

: Objectives of the study:

The main objective of the study is to develop a framework for disclosing credit risks and its impact on the quality of banks' financial reports. To achieve this goal, the researcher did the following:
Identifying the credit risks facing commercial banks, explaining how to disclose them, and identifying the obstacles that hinder the disclosure process
Methods of measuring credit risk and how to treat it.
Determine the requirements for disclosing credit risks in commercial banks as stated in accounting and international standards
How to improve the quality of financial reporting lists to the required level of credit risk disclosure in accordance with the accounting system derived from international standards and supervisory authorities.
The role of disclosure and transparency about credit risks in reducing profit manipulation
Developing a proposed framework for disclosing credit risks in commercial banks in developing a practical vision for

disclosing credit risks in a manner consistent with the requirements of supervisory authorities.
Testing the impact of the proposed framework for disclosing credit risks on the quality of financial reports.

Previous studies:

Study 1 (2020, Michael Jacobs Jr):
"Supervisory requirements and expectations for portfolio level counterparty credit risk measurement and management".
The study aims to: survey the regulatory requirements and expectations for credit risks. A survey was conducted on credit risks, and various concepts were developed in measuring them, including the prevailing practices therein. Many regulatory requirements and expectations with regard to credit risks were summarized. The study concluded: There are some ideas related to the concept and application of those credit risks that will be considered, which determines uncertainty by measuring the probability distribution, or through repeated experiments.
2 Study: (Randa Al-Mukhtar, 2019):
Titled: “Measurement and disclosure of banking risks in Libyan commercial banks in accordance with international accounting standards and the requirements of the Basel Committee” An applied study on Jumhouria Bank and Sahara Bank. The study aims to: Measure and disclose banking risks in Libyan commercial banks in accordance with international accounting standards and the requirements of the Basel Committee, and in The problem of this study was discussed and its hypotheses were tested. The descriptive analytical method was used to describe and interpret the results of the study and test the hypotheses according to the regression analysis method. The study concluded: The necessity of creating specialized databases for the Libyan commercial

banking sector in general in order to help users of financial statements extract the data necessary for measurement models. Advanced credit risk, market risk and operational risk using simple statistical analysis program (SPSS)...
:(2019, Hamid Salman, Bilal Aziz, Ahsan Nazir) Study 3.
“Financial Credit Risks and Earning Efficiency; Empirical evidence from banking sector Pakistan” The study aims to: determine the long- and short-term impact of financial credit risk and financial control indicators on the profit-earning efficiency of a commercial bank in Pakistan by using the cost of capital. The study concluded: Capital adequacy has a negative impact on the return on shareholders’ equity, which leads to an increase in the risk of financial erosion, which leads to the need for the sincere efforts necessary to build a management specialized in controlling risks that can improve the financial sector’s ability to earn efficiently through... Way to reduce the risk of financial erosion. These empirical results are mainly attractive to senior management in financial institutions and state financial policy makers because they provide assistance in building sound policies regarding credit control management to support the economic development of financial banks by improving their level of attractiveness.

Study methodology:

The researcher follows the following methodology in the study
: -1 The inductive approach: We reviewed theoretical library studies of previous research and writings from scientific theses, Arab and foreign periodicals and books related to the disclosure of credit risks and their impact on financial reports and how to benefit from them in addressing the problem of the study.
-2 The descriptive approach: We identified the scientific and practical aspects to determine the axes of the study and set

the hypotheses and objectives upon which the study's determinants were based, for the purpose of analyzing, comparing, and benefiting from them in linking the theoretical, philosophical, and scientific aspects.

-3 The inferential approach: We analyzed the results of the applied study to reach an inference from the statistical results on the extent of accepting or rejecting the hypotheses and generalizing the results to the relevant banks.

Study assignments

In light of the objectives of the study, the following main hypothesis was formulated:

"There is a statistically significant relationship between the disclosure of credit risks and the quality of commercial banks' financial reports." The main hypothesis is divided into several sub-hypotheses, which are as follows:

The first hypothesis: "There is a statistically significant relationship between credit risk disclosure indicators and the rate of return on assets."

The second hypothesis: "There is a statistically significant relationship between credit risk disclosure indicators and the rate of return on shareholders' equity."

The third hypothesis: "There is a statistically significant relationship between credit risk disclosure indicators and optional accruals."

Statistical analysis of applied study data.

Study population and sample:

The study population consists of thirty-seven (37) banks registered with the Central Bank, according to the Central Bank report. A stratified sample of ten (10) commercial banks was chosen from these banks, and the financial statements as well as the supplementary clarifications published for each bank from the study sample were used.

The study period extended during the period from 2019 to 2022, thus the number of observations reached seventy (70). View each variable in the study. The study data were analyzed using the statistical package (SPSS) and dealing with variables.

Study variables and methods of measuring them:

The applied study aims to build a proposed model to study the relationship between credit risk disclosure as an independent variable and the quality of financial reports as a dependent variable. The following is a presentation of the study variables and the relationship between the variables, of course, for the proposed model through the following points:

A- The method of calculating each variable and its purpose in the proposed model
are shown in the table as follows:

Table No. (1): The method of calculating each variable and its purpose in the proposed model shown in the table as follows

The meaning	Calculation method	code	Indicator	variable
Loan recovery efficiency	Non-performing loans/total loans	X1	Non-performing (bad) loans NPLR	The Independent
Absorbing losses before insolvency	Capital and reserves/total assets	X2	Capital adequacy CAR	
Ability to refund deposits upon request	Loans/deposits	X3	Liquidity LAR	
Deposit reserve	Loan loss provisions/total loans	X4	Provision for loan losses LLPR	

Total assets of the bank	The natural logarithm of total assets	X5	BS bank size	
Ability to fulfill obligations	Total Loans / Total Assets	X6	Leverage LEV	
Efficient use of assets	Net profit/total assets	Y1	Return on assets ROA	dependent
Efficiency of future profits	Net profit/shareholders' equity	Y2	Return on shareholders' equity ROE	
Measuring earnings management practices	Industry model Dechow & Model Sloan (1991)	Y3	Return on shareholders' equity ROE	

Main hypothesis test

The relationship between the dependent variables is tested (1Y (rate of return on assets (ROA), 2Y (rate of return on equity (ROE), 3Y) optional benefits (DACC). The multiple regression model was used, which aims to Testing the significance of the relationship between the dependent variables. The results of the statistical analysis were as follows:

Table (2): The relationship between the rate of return on assets (ROA) and the rate of return on equity (ROE) (optional benefits (DACC)).

		ROA	ROE	DACC
ROA	Pearson Correlation	1	.632(**)	0.61**
	Sig. (2-tailed)		.000	.000
ROE	Pearson Correlation	.632(**)		055**
	Sig. (2-tailed)	.000		.000
DACC	Pearson Correlation	0.61**	055**	1
	Sig. (2-tailed)	.000	.000	

**Correlation is significant at the 0.01 level (2-tailed).

It is clear from Table No. (2) that there is a direct, statistically significant relationship between the rate of return on assets and optional entitlements. The value of the correlation coefficient between the two variables is (0.61).

- It is clear from Table No. (2) that there is a direct, statistically significant relationship between the rate of return on shareholders' equity and optional entitlements, and the value of the correlation coefficient between the two variables is (0.55).
- It is clear from Table No. (2) that there is a direct, statistically significant relationship between the rate of return on assets and the rate of return on shareholders' equity, where the value of the correlation coefficient between the two variables is (0.63).

In light of the previous results, the null hypothesis (Ho) is rejected and the alternative hypothesis (Ha) is accepted, which stipulates that there is a statistically significant correlation between the disclosure of credit risks and the quality of banks' financial reports."

2. Testing the first sub-hypothesis of the study: To test the relationship between credit risk disclosure indicators

(independent variables) and the rate of return on assets (dependent variable), multiple regression analysis was used, and Table No. (2/5) shows the results of this analysis. It is possible to interpret the test of the relationship between credit risk disclosure indicators (independent variables) that have the most influence on the rate of return on assets (dependent variable). The results of the statistical analysis using the SPSS program were as follows:

Table (3): Results of regression coefficients to test the relationship between credit risk disclosure variables and the rate of return on assets

Unstandardized Coefficients					
	B	Std. Error	Standardized of Coefficients β	T	Sig.
(Constant)	0.988	0.250		3.95	0.00
X_1	-3.771	0.912	-0.61	-4.13	0.000
X_2	-0.098	.047	-0.25	-2.08	.0410
X_3	- 4.02	0.11	-0.05	-3.81	0.01
X_4	-37.612	0.11714	-0.12	-2.66	0.052
X_5	9.01	.009	0.17	2.51	0.037
X_6	3.44	.125	0.02	2.72	0.035
R =0.776		F = 8.398		Sig. =0.000	
R^2 =0.59297				S.E= 0.7435	

a Dependent Variable: y1

It is clear from Table No. (3) that M

• All regression coefficients are statistically significant at a significance level of 0.05

• All signs of the regression coefficients agreed with economic theory, as the signs of the coefficients of each of the variables were (1X (performing non-performing loans ratio), (2X) capital adequacy ratio, (3X (liquidity ratio), (4X) loss provision ratio). (Loan impairment) all have negative signs, which indicates that increasing these variables leads to a decrease in the rate of return on assets (1Y), which means that there is an inverse relationship between these variables and ROA.

. • There is a direct relationship between (5X (bank size), (6X (financial leverage ratio)) and the rate of return on assets (1Y) (which means that increasing the size of the bank leads to an increase in the return and an increase in the market value of the bank, as well as an increase in the financial leverage ratio indicates the ability to... The bank is committed to fulfilling its obligations.

• The value of the multiple correlation coefficient R = 0.77, which indicates that there is a significant relationship between the variable rate of return on assets and the independent variables.

. • The value of the coefficient of determination $R^2 = 0.593$. This indicates that approximately 60% of the changes that occur in the rate of return on assets are responsible for the independent variables.

. • The calculated value of (F) = 8.398 and the corresponding probability (Sig) indicate the significance of the regression relationship as a whole between the dependent variable and the independent variables. On the dependent variable (the rate of return on assets (1Y)) was on • It turned out that the most influential explanatory independent variables are the order: ((1X (non-performing loans ratio)), then ((5X (bank size),

then ((2X) capital adequacy ratio), then ((4X) (loan loss allowance ratio)) then ((3X) liquidity ratio)) Then ((6X (leverage ratio)

. • The available independent variables represent the following: (1X (non-performing loans ratio), (2X) capital adequacy ratio, (3X) liquidity ratio, (4X) loan loss provision (impairment) ratio, (5X) bank size, and (6X) ratio Financial leverage is the most influential variable on the dependent variable (rate of return on assets), as these variables explain approximately 60% of the changes in the dependent variable, which is a relatively high percentage due to the large number of internal and external factors affecting the quality of financial reports, which is reflected in the quality of Financial reports, the efficiency of asset utilization, and the ability to predict the level of bank profitability. The model of the relationship between credit risk disclosure indicators and the rate of return on assets can be formulated in the following form:

$$\mathbf{Y}_1 = 0.988 - 3.711\mathbf{X}_1 - .098\,\mathbf{X}_2 - 0.042\mathbf{X}_3 - 37.612\mathbf{X}_4 + 0.019\mathbf{X}_5 + 0.344\mathbf{X}_6$$

Results of the applied study

In light of the above statistical analysis of the financial data of the commercial banks under study to test the main and subsidiary hypotheses, what resulted from the results of the applied study is “the existence of a statistically significant relationship between the disclosure of credit risks and the quality of the banks’ financial reports,” which can be summarized as follows:

:-1 There is a statistically significant inverse relationship between the rate of return on assets and each of the following:

: • (1X): Indicator of non-performing loans (irregular or bad)

. • (2X): Capital adequacy index.
• (3X): Liquidity index.
• (4X): Indicator for provision for loan losses (impairment).

. -2 There is a direct, statistically significant relationship between the rate of return on assets and each of the following:

• (5X): The size of the bank.
• (6X): Leverage indicator.

-3 There is a statistically significant inverse relationship between the rate of return on shareholders' equity.

• (1X): Indicator of non-performing loans (irregular or bad).
• (3X): Liquidity index.
• (4X): Indicator for provision for loan losses (impairment).

-4 There is a direct, statistically significant relationship between the rate of return on shareholders' equity and each of the following:

• (2X): Capital adequacy index.
• (5X): The size of the bank.
• (6X): Leverage indicator.

5 - There is a significant and statistically significant inverse relationship between optional entitlements and each of the following:

• (1X): Indicator of non-performing loans (irregular or bad).
• (4X): Indicator for provision for loan losses (impairment).

6 - There is a direct, significant and statistically significant relationship between optional entitlements and each of the following:

• (2X): Capital adequacy index.

• (3X): Liquidity index.
• (5X): The size of the bank
. • (6X): Leverage indicator.

Recommendations

Based on the results reached by the researcher, there are a set of recommendations, which are:

1. The researcher presented most of the indicators by which credit risks can be measured in commercial banks, which are an objective basis for measuring these risks and measuring the degree of disclosure through them.
2. Applying the framework proposed by the researcher to disclose bank credit risks in commercial banks.
3. Relying on the results of measuring bank credit risks in commercial banks in the proposed framework for forming credit allocations, so that these allocations are more objective, sound and realistic.
4. The necessity of activating the supervisory role as well as the audit committees in banks to limit the banks' practice of profit management in order to achieve the best quality of accounting information and provide the characteristics of trust and suitability in it.

the reviewer:

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