

Financial Reporting Quality (FRQ) as a Determinant of Bank Resilience Based on the CAMELS Model: An Applied Study in the Iraqi Union Bank

Ahmed Taher Kadhimi Al-Anbagi

Middle Technical University

Technical College of Management– Baghdad

<https://orcid.org/0000-0002-7692-1063>

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Abstract

This research aims to evaluate the quality of financial reports issued by local companies (using Union Bank as a case study) using the CAMELS model. This model assesses bank performance and serves as a monitoring tool through the use of several indicators. This study is unique in linking the CAMELS model to the quality of financial reports in the Iraqi context. To achieve the research objective, Union Bank's financial statements (balance sheet and income statement) for the years 2021-2024 were used, and CAMELS model indicators were applied. The relationship between the quality of financial reports and the model was then determined through accurate disclosure of capital, asset valuation, loan provisions, expense recognition, internal controls, profit transparency, and liquidity reporting. The research reached several conclusions, the most important of which is that Union Bank's CAMELS indicators for the period 2021-2024 demonstrate strong capital and liquidity adequacy, supported by improved management efficiency. However, the quality of earnings remains modest, indicating limited sustainability of profitability. The reliability of these indicators depends largely on the quality of financial reporting, as transparent reporting that complies with International Financial Reporting Standards enhances the accuracy of CAMELS assessments of the bank's strength and performance.

Keywords : *Financial Reporting Quality; CAMELS model; Capital adequacy; Asset quality; Management quality; Earning ability; Liquidity; Sensitivity to Market Risk.*

1. Introduction

Due the challenges facing economic entities and the need for fair, transparent, and timely information by users, both internal and external, the focus has shifted to the quality of financial reporting. The objective this research id to examines how financial reporting quality (FRQ) affects bank resilience and performance, using the CAMELS model, which represents capital adequacy, asset quality, management efficiency, earnings quality, liquidity, and sensitivity to

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market risk, as an assessment framework, And to measure the relationship between financial reporting quality and bank resilience, and also To examine how FRQ affects each component of CAMELS.

Banking crises often reveal weaknesses in the transparency of financial statements issued by companies and in supervisory assessments. To assess banks, the following will be used If published financial statements are of poor quality, CAMELS indicators may give a false picture of the bank's true condition, affecting regulators, investors, and management decisions.

2. Financial Reporting Quality (FRQ):

emphasize that reporting is not just an end product; the quality of this process depends on every component, including disclosure of the company's transactions, information about the selection and application of accounting policies, and knowledge of the judgments made. This makes the financial information issued by a company an essential resource for any market participant, as it provides a lower degree of information asymmetry among managers, investors, regulatory bodies, society, and other stakeholders. Therefore, one of the key questions surrounding the quality of financial reporting is its impact on subsequent company performance—that is, how the market evaluates this higher perceived quality (Jonas and Blanchette :2000).

According to previous evidence, firms with better financial information quality are associated with higher subsequent performance. This is due to the fact that the market favors firms that are more committed to providing quality information to shareholders and other stakeholders, with the goal of reducing or avoiding information asymmetries among market participants (García-Lara et al., 2010; Ahmed and Duellmand, 2011; Bushman and Smith, 2001; Bens et al., 2002; Gunny, 2005). Furthermore, managers' discretionary decisions and behavior impact firm performance through the strategic management process. Therefore, it is essential to understand managers' actions, decisions, and behavior, as well as the firm's strategy and accounting policies, among other things, to shed light on and identify the causes of firm performance. In light of the above arguments, this paper examines the consequences of financial reporting quality (FRQ) on firm performance, using three proxies for FRQ: (i) earnings quality; (ii) accounting conservatism; and (iii) accruals.

In relation to FRQ, let us first note that the goal of financial reporting is to provide useful information for decision making. However, even though companies may generate financial statements in accordance with generally accepted accounting principles, these statements may present differing levels of quality (Choi and Pae, 2011). FRQ can be defined as the faithfulness of the information conveyed by the financial reporting process. According to the leading authorities on the evaluation of financial reporting (such as the FASB, the SEC or the Jenkins committee), the main characteristics required are relevance, reliability, transparency and clarity (Jonas and Blanchet, 2000; Lu et al., 2011). It has been asserted that high quality accounting information is a valuable means of counteracting information asymmetry (Chen et al., 2011). FRQ requires companies to voluntarily expand the scope and quality of the information they report, to ensure that market participants are fully informed in order to make well-grounded decisions on investment, credit, etc. This high quality information facilitates greater transparency and this greater transparency reduces the information asymmetries and satisfies investors and stakeholders' needs. Numerous advantages of providing high-quality information have been cited: FRQ reduces information risk and liquidity (Lambert et al., 2007), prevents managers from using discretionary power for their own benefit and helps them make efficient investment decisions (Chen et al., 2011).

(Chen et al : 2011) found that FRQ positively affects private firms investment efficiency in emerging markets and that this effect enhances bank financing and decreases incentives to minimise earnings for tax avoidance purposes. There is an extensive agreement among practitioners, academics, investors, regulators, and other agents too on the significance of regulations for the publication of financial information by public firms to increase the quality of financial reporting system. Though, there is a strong debate on whether financial reporting quality has been improving

for last few years and about the capability of numerous proxies to attain the quality information.(Muhammad& . Bilal:2019)

Financial reporting quality varies across companies. The ability to assess the quality of a company's financial reporting is an important skill for analysts. Indications of low-quality financial reporting can prompt an analyst to maintain heightened skepticism when reading a company's reports, to review disclosures critically when undertaking financial statement analysis, and to incorporate appropriate adjustments in assessments of past performance and forecasts of future performance.

Financial reporting quality can be thought of as spanning a continuum. Reporting of the highest quality contains information that is relevant, correct, complete, and unbiased, whereas the lowest quality reporting contains information that is not just biased or incomplete but possibly pure fabrication. Reporting quality, the focus of this module, pertains to the quality of the information disclosed. High-quality reporting represents the economic reality of the company's activities during the reporting period and the company's financial condition at the end of the period.

Managers may be motivated to issue less-than-high-quality financial reports to mask poor performance, boost the company's stock price, to increase personal compensation, and/or to avoid violation of debt covenants. Conditions that are conducive to the issuance of low-quality financial reports include a cultural environment that result in fewer or less transparent financial disclosures, book/tax conformity that shifts emphasis toward legal compliance and away from fair presentation, and limited capital markets regulation. Mechanisms that discipline financial reporting quality include open capital markets and incentives for companies to minimize cost of capital, independent auditors, contract provisions specifically tailored to penalize misreporting, and enforcement by regulatory entities.(cfainstitute.org).

3. CAMELS Model

The Uniform Financial Institution Rating system, commonly referred to as the CAMEL rating, was adopted by the Federal Financial Institution Examination Council on November 13, 1979, and then adopted by the National Credit Union Administration in October 1987. It has proven to be an effective internal supervisory tool for evaluating the soundness of a financial firm, based on identifying those institutions requiring special attention or concern. The reliability of CAMELS analysis depends largely on the quality of accounting information on the one hand and financial reporting (FRQ) on the other. Since all six CAMELS components are calculated from accounting data, such as capital structure, loan quality, income, and cash flows, the accuracy of financial reporting directly affects the validity of the model's conclusions (Bushman and Smith, 2001; Chen, Hop, Lee, and Wang, 2011). High-quality financial reporting provides relevant and accurately representative information (Jonas and Blanchet, 2000), reducing information asymmetry among bank management, regulators, and stakeholders. Conversely, when reporting quality is poor, the CAMELS assessment may misrepresent a bank's actual risk exposure or resilience. Therefore, the quality of financial reporting forms the basis for reliable CAMELS-based oversight and performance analysis. (The United States. Uniform Financial Institutions Rating System 1997, p.1). (Barr et al. 2002, p.19) state that "CAMEL rating has become a concise and indispensable tool for examiners and regulators". This rating ensures a bank's healthy condition by reviewing various aspects of a bank based on a variety of information sources, such as financial statements, funding sources, macroeconomic data, budgets, and cash flows. Nevertheless,(Hirtle and Lopez :1999, p. 4) stress that the bank's CAMEL rating is highly confidential, and only exposed to the bank's senior management for the purpose of projecting the business strategies, and to appropriate supervisory staff.

CAMEL is, basically a ratio-based model for evaluating the performance of banks. It is a model for ranking of the banks. CAMEL is an acronym for five components of bank safety and soundness (Dang: 2011):

- i. Capital adequacy.
- ii. Asset quality.
- iii. Management quality.

iv. Earning ability.

(Barker and Holdsworth :1993) find that the CAMEL system is useful, even after controlling for a wide range of publicly available information about the condition and performance of banks. This composite index further acts as a bank's failure-predicting model. The rating is assigned based on both quantitative and qualitative information of the bank. If a bank's index is less than two, it is regarded as a high-quality bank, whereas institutions with grade four or five are rated to be insolvent (Curry, Elmer, and Fissel, 2009). The up-to-date examination ratings help identify if the banks require increased supervisory attention well before they actually fail. Although (Gaytán and Johnson :2002) argue that the model is only parallel with the performance of the bank at the time of the examination, while variables in banks are highly volatile to market forces, the CAMEL model is still very much popular among regulators due to its effectiveness.

4. Methodology

to achieve the objective of research the Published financial statements of commercial banks (the Iraqi Union Bank) will used and for Period(2021–2024). And will analysis the financial statement throw Compute CAMELS ratios and Measure FRQ indicators which represent accurate Capital Disclosure, Asset Valuation & Loan Provisioning, and Expense Recognition & Internal Controls and Earnings Transparency and finally Liquidity Reporting for the Iraqi Union Bank.

i. Balance sheet for the Iraqi Union Bank for Period(2021–2024)

Items	2021	2022	2023	2024
Cash	48,650,345	49,364,988	72,453,317	54,699,502
Other Bank Balances	622,719	650,644	(653,177)	635,547
Credit Facilities	354,538,616	353,002,902	332,663,823	304,390,562
Financial Assets fair value	843,696	867,209	896,896	930,042
Property and Equipment	23,960,556	21,769,242	21,563,148	43,625,007
Other Assets	63,216,293	97,176,292	94,066,092	132,309,347
Total Assets	491,832,225	522,831,277	520,990,099	536,590,007
Liabilities and Shareholders' Equity				
Liabilities				
Loans Received	51,509,856	65,603,007	58,404,066	56,667,167
Customer Deposits	83,728,868	86,778,493	92,861,245	67,902,291
Cash Margins	80,873,062	87,302,323	85,030,837	85,751,444
Miscellaneous Provisions	4,090,792	4,090,792	4,114,793	5,349,903
Income Tax Provisions	1,058,908	564,044	1,447,720	1,878,188
Other Liabilities	6,009,170	564,044	8,000,998	22,560,207
Total Liabilities and Shareholders' Equity	227,270,655	255,803,185	249,859,658	240,109,200
Share Capital	252,000,000	252,000,000	252,000,000	252,000,000
General Reserves	8,292	8,292	8,292	8,292
Statutory Reserve	4,890,266	5,010,066	5,211,656	5,333,622
Expansion Reserve	4,900,000	4,900,000	4,900,000	4,900,000
Retained Earnings	2,809,950	5,104,393	8,975,465	11,377,044
Accumulated Deficit	(28,766)	000	000	22,793,674
Fair Value Reserve	(18,172)	5,341	35,028	68,175

Total Shareholders' Equity	264,561,570	267,028,092	271,130,441	296,480,807
Total Liabilities and Shareholders' Equity	491,832,225	581,517,415	520,990,099	536,590,007

ii. Income statements for the Iraqi Union Bank for Period(2021–2024)

Items	2021	2022	2023	2024
Interest Income	3,699,856	2,311,552	4,381,931	4,379,952
Interest Expense	(1,987,650)	(4,970,650)	(2,017,429)	(3,057,308)
Net Foreign Exchange Income	1,712,206	2,659,098	2,364,502	1,322,644
Net Commission Income	(436,122)	(90,191)	10,498,237	26,392,442
Total Foreign Exchange and Commission Income	8,203,151	13,368,546	8,739,115	25,868,885
Foreign Exchange Income	7,767,029	13,278,355	377,363	33,619
Other Operating Income	564,898	282,201	816,176	385,534
Net Operating Income	299,437	301,617	12,297,156	28,133,832
Salaries and Wages	10,343,570	11,203,075	3,310,508	3,302,522
Depreciation and Amortization	415,147	424,503	339,730	339,671
Other Operating Expenses	5,179,595	4,546,324	3,807,450	3,989,928
Total Operating Expenses	(9,106,998)	(8,338,851)	(7,481,688)	(25,264,050)
Net Profit Before Tax	1,236,572	2,864,224	4,815,468	2,869,782
Income Tax	(226,256)	(468,215)	(783,676)	(430,468)
Net Profit After Tax	1,010,316	2,396,009	4,031,792	2,439,314

iii. CAMELS RATIO Analysis

Table (1) CAMELS RATIO for the Iraqi Union Bank (2021–2024)

Component	Formula / Indicator	2021	2022	2023	2024	Interpretation (Trend)
C – Capital Adequacy	Equity / Total Assets	264,561,570 / 491,832,225 = 53.8%	267,028,092 / 522,831,277 = 51.0%	271,130,441 / 520,990,099 = 52.0%	296,480,807 / 536,590,007 = 55.2%	Strong capital position, improved in 2024 → high solvency.
A – Asset Quality	Credit Facilities / Total Assets	354,538,616 / 491,832,225 = 72.1%	353,002,902 / 522,831,277 = 67.5%	332,663,823 / 520,990,099 = 63.9%	304,390,562 / 536,590,007 = 56.7%	Gradual decline → lower credit exposure, better asset diversification
M – Management Efficiency	Operating Expenses / Operating Income	9,106,998 / 299,437 = 30.4x	8,338,851 / 301,617 = 27.6x	7,481,688 / 12,297,156 = 0.61x	25,264,050 / 28,133,832 = 0.90x	Improved dramatically after 2022 →

						cost control and efficiency gains.
E – Earnings Quality	ROA = Net Profit / Total Assets	1,010,316 / 491,832,225 = 0.21%	2,396,009 / 522,831,277 = 0.46%	4,031,792 / 520,990,099 = 0.77%	2,439,314 / 536,590,007 = 0.45%	Modest but stable profitability → moderate earnings quality.
E – Earnings Quality (ROE)	Net Profit / Equity	1,010,316 / 264,561,570 = 0.38%	2,396,009 / 267,028,092 = 0.90%	4,031,792 / 271,130,441 = 1.49%	2,439,314 / 296,480,807 = 0.82%	ROE peaked in 2023 → slightly declined in 2024.
L – Liquidity	(Cash + Bank Balances) / Customer Deposits	(48,650,345 + 622,719) / 83,728,868 = 0.59x	(49,364,988 + 650,644) / 86,778,493 = 0.58x	(72,453,317 – 653,177) / 92,861,245 = 0.77x	(54,699,502 + 635,547) / 67,902,291 = 0.81x	Liquidity steadily improved → healthy cash position.
S – Sensitivity to Market Risk	Financial Assets (FV) / Total Assets	843,696 / 491,832,225 = 0.17%	867,209 / 522,831,277 = 0.17%	896,896 / 520,990,099 = 0.17%	930,042 / 536,590,007 = 0.17%	Very low market sensitivity → conservative risk exposure.

Source : prepared by researcher

Summary of CAMELS RATIO for the Iraqi Union Bank

- Strong Capital Adequacy** (average ~53%) = low insolvency risk.
- Improved Asset Quality** = reduced loan concentration.
- Enhanced Management Efficiency** after 2022= better cost control.
- Stable but low Earnings Quality** = suggests conservative income generation.
- Improving Liquidity** = strengthened short-term solvency.
- Low Market Sensitivity**= low exposure to market risk.

iv. CAMELS and Financial Reporting Quality (FRQ)

Table (2) CAMELS RATIO and Financial Reporting Quality (FRQ)

Aspect	Connection to FRQ	Effect on CAMELS
accurate Capital Disclosure	Reliable equity and reserves reporting enhances CAR validity.	Strengthens Capital Adequacy .
Asset Valuation & Loan Provisioning	Transparent loan classifications and fair value accounting reduce information asymmetry.	Improves Asset Quality and Sensitivity .
Expense Recognition & Internal Controls	Faithful representation of operating expenses reflects real efficiency.	Supports Management Efficiency .
Earnings Transparency	Lower accrual manipulation and consistent accounting policies produce reliable profitability ratios.	Enhances Earnings Quality .

Liquidity Reporting	Honest disclosure of cash/deposit balances helps evaluate liquidity accuracy.	Strengthens Liquidity Assessment.
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Source : prepared by researcher

5. Conclusions

The CAMELS models that evaluate bank performance on the one hand, and serve as a monitoring tool on the other hand, through several indicators. The CAMELS indicators of Union Bank for 2021–2024 reveal strong capital adequacy and liquidity, supported by improved management efficiency. However, earnings quality remains modest, indicating limited profitability persistence. The reliability of these indicators depends heavily on financial reporting quality, as transparent, IFRS-compliant reporting enhances the accuracy of CAMELS-based evaluations of bank soundness and performance. The FRQ indices significantly enhance the reliability and predictive accuracy of the CAMELS model for corporate financial statements. Furthermore, companies in general, and banks in particular, with higher FRQ ratios demonstrate better capital adequacy, asset quality, and liquidity. Finally, the FRQ ratio is a key determinant of banks' resilience under financial stress or market volatility.

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