Ain Shams University

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The impact of Risk Premium on the relationship between Financial Reporting Quality and Cost of Debt

"An Applied Study on listed Companies on Egyptian Stock Exchange"

A Thesis Submitted in Partial Fulfillment of the Requirements for the Degree of Master of Science in Accounting

by

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2018

In The Name Of Allah, The Merciful, The Compassionate

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جامعة عين شمس

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قسم المحاسبة والمراجعة

رسالة ماجستير

اسم الباحثة: **ريهام محمود فتحى محمود عيسوى**

عنوان الرسالة: **تأثير استخدام علاوة المخاطر على العلاقة بين جودة التقارير المالية وتكلفة الدين "دراسة تطبيقية على الشركات المدرجة في البورصة المصرية".**

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Acknowledgement

I would like to thank **ALLAH** for giving me the opportunity and persistence to accomplish this study.

I would like to thank my thesis supervisor **Dr. Farid Moharam**, Associate Professor of Accounting and the Academic Coordinator of the Credit Hours System Unit, whose office door was always open whenever I ran into a trouble spot or had a question about my study or anything. I would like to express my thanks for his support, feedback, and encouragement. Words can never be enough to thank him.

I would also like to acknowledge **Dr Howida Shehata** as the co-supervisor of this thesis, and I am gratefully indebted to her for her valuable comments on this thesis.

I would like to express my deep thanks to **Prof. Dr. Atef Mohammed El Awam**, Professor of Financial Accounting and Former Vice President of Ain Shams University, for accepting to be the committee chairman, for his valuable time, for giving me the opportunity to learn from his experience and knowledge. I would like to thank him for his support and enriching comments. No words can express how much I am thankful to him.

I would also like to express my deep thanks to **Prof. Dr. Mohamed Hassan Abd EL Azim**, Professor of Financial Accounting and Dean of Faculty of Commerce, Cairo University, for accepting to be a committee member, giving me the chance to learn from his experience and valuable comments.

Also, I must express my very profound gratitude to my family for providing me with continuous support and encouragement throughout my years of study and through the process of researching and writing this thesis. This accomplishment would not have been possible without them.

Finally, my deepest gratitude to my friends and colleagues who have supported me during this thesis.

Dedication

To My beloved

Family

Abstract

This study aims to examine the impact of risk premium (RP) on the relationship between financial reporting quality (FRQ) and cost of debt (CD). This is achieved by developing four hypotheses. The first and the second hypotheses examine the association between FRQ (discretionary accruals, earnings smoothing) and CD directly, while, the third and forth hypotheses examine the relationship between FRQ (discretionary accruals, earnings smoothing) and CD by using RP as a moderate variable.

The study uses Modified Jones Model (discretionary accruals) and earnings smoothing as a proxy for FRQ, the proxy for CD is the quotation between the interest expense on debt to average total debt of the current and previous year. While, the RP is measured by the difference between the stock return of the firm and the risk free rate. The Panel data is used to measure the relation between FRQ and CD and the impact of RP on this relation. The sample consists of 70 firms with 350 observations listed on Egyptian Stock Exchange (i.e. EGX 100) for the period from 2012 to 2016.

The results of the study show that, regarding the first hypothesis there is a positive relation between FRQ (DACC) and CD, while, the second hypothesis shows that there is a negative relationship between FRQ (SMO) and CD. Moreover, the third hypothesis shows that there is no impact of the RP on the relationship between FRQ (DACC) and CD. Finally, regarding the forth hypothesis, there is a negative impact of RP on the relationship between FRQ (SMO) and CD. Therefore, the current study accept H2 and H4, and reject H1 and H3.

Consequently, the current study is of interest for users of financial statements such as regulators. Also, the results are necessary for managers as they have an economic benefit. This study contributes to the literature by showing the impact of RP on the relationship between FRQ (DACC, SMO) and CD, and by giving evidence from the Egyptian Market.

Keywords: Financial Reporting Quality, Discretionary accruals, earnings smoothing, Cost of Debt, and Risk Premium.

Table of Contents

List of Tables

List of Figures