THE IMPACT OF ACCRUAL-BASED EARNINGS QUALITY ON THE COST OF CAPITAL: EVIDENCE FROM NON-FINANCIAL FIRMS LISTED ON THE VIETNAMESE STOCK MARKET

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Abstract: ***This study investigates the impact of accrual-based earnings quality on the cost of capital of non-financial firms listed on the Vietnamese stock market during 2017-2023. Because accrual accounting relies on managerial estimates and judgment, it may create information risk that affects financing decisions. Using the Dechow and Dichev (2002) model as modified by McNichols (2002), the study measures earnings quality and applies panel regression techniques to examine its effect on the cost of debt, the cost of equity, and stock returns. The results show that lower earnings quality is associated with higher borrowing costs, indicating that creditors price information risk. Although the evidence for the cost of equity is weaker, the findings suggest that higher earnings quality improves information transparency and supports more efficient market pricing. Overall, the study highlights the importance of financial reporting quality in shaping firms' financing conditions in an emerging market context.***

• Keywords: *accrual quality; cost of capital; cost of debt; cost of equity; non-financial listed firms; Vietnamese stock market.*

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1. Introduction

Financial statements provide essential information for assessing firms' financial condition and performance. Among the reported figures, accrual-based earnings are particularly important because they support the decisions of investors, creditors, shareholders, and managers. Since accrual accounting recognizes revenues and expenses when they occur rather than when cash is received or paid, it offers a more comprehensive view of firm performance and financial position (Dechow & Dichev, 2002).

At the same time, accrual accounting may create information risk because it relies on managerial judgment, accounting estimates, and discretionary recognition choices. These features can increase estimation errors or earnings manipulation, thereby reducing the reliability of reported earnings (Dechow & Dichev, 2002; Francis et al., 2005). As a result, earnings quality has become an important topic in accounting and finance research.

This issue is especially relevant in Vietnam, where capital markets are still developing, and information asymmetry remains relatively high. Although several studies have examined accounting information quality in Vietnam, evidence on the relationship between accrual-based earnings quality and firms' cost of capital is still limited and inconclusive. Moreover, prior studies often focus on aggregated measures of the cost of capital rather than its individual components.

Motivated by these theoretical debates and empirical gaps, this study investigates the impact of accrual-based earnings quality on the cost of capital of non-financial firms listed on HOSE and HNX. Treating accrual quality as a proxy for accounting information risk, the study examines its effect on the cost of debt and the cost of equity, thereby providing additional evidence on the economic consequences of earnings quality in an emerging market context.

2. Literature Review and Hypothesis Development

2.1. Earnings quality and the cost of capital

The relationship between accounting information quality and the cost of capital has been widely discussed in both theoretical and empirical literature. Traditional asset pricing models suggest that firm-specific information risk can be diversified away and therefore should not affect the cost of capital (Fama & French, 1993). However, later theoretical studies argue

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that information risk related to financial reporting quality may still be priced in capital markets. Easley and O'Hara (2004) show that investors demand compensation for uncertainty arising from imperfect information, while Lambert et al. (2007) demonstrate that accounting information quality can influence financing costs by affecting information asymmetry and the precision of investors' expectations about future cash flows.

Empirical evidence on this relationship remains mixed. Some studies find that higher earnings quality is associated with lower financing costs. For example, Francis et al. (2005) show that accrual quality is priced in capital markets, while Eliwa et al. (2016, 2019) document negative relationships between earnings quality and both the cost of equity and the cost of debt. In contrast, other studies report weaker or inconsistent results, suggesting that the impact of earnings quality may depend on market conditions and institutional environments (Core et al., 2008; Khan, 2008).

The effect of financial reporting quality may be particularly important in emerging markets where information asymmetry is relatively high (Leuz & Wysocki, 2016). In Vietnam, empirical evidence remains limited and inconclusive. While some studies document a negative relationship between accrual quality and financing costs (Le et al., 2021; Van et al., 2022), others report weaker effects. Therefore, further investigation is needed to clarify the relationship between accrual-based earnings quality and the cost of capital in the Vietnamese capital market.

2.2. Hypothesis development

Based on information asymmetry theory and the information risk framework, higher earnings quality reduces uncertainty regarding firms' financial performance and future cash flows. As a result, investors and creditors may perceive lower information risk and require lower returns when providing capital (Easley & O'Hara, 2004; Lambert et al., 2007). Therefore, firms with higher accrual quality are expected to experience lower financing costs.

In addition, creditors and equity investors may respond differently to accounting information quality due to differences in risk exposure and monitoring mechanisms. Creditors typically rely heavily on financial statements when assessing credit risk, which may make the cost of debt more sensitive to accounting information quality (Bharath et al., 2008). In contrast, equity investors may diversify firm-specific risk through portfolio allocation, which could weaken the direct impact of earnings quality on the cost of equity. Based on these arguments, the following hypotheses are proposed:

H1: Accrual-based earnings quality is negatively associated with the cost of debt of listed firms.

H2: Accrual-based earnings quality is negatively associated with the cost of equity of listed firms.

Because the cost of equity in this study is proxied by two alternative measures, namely the earnings-to-price ratio (EP) and stock returns (RETURN), Hypothesis H2 is further decomposed into two sub-hypotheses as follows:

H2a: Accrual-based earnings quality is negatively associated with the cost of equity measured by the earnings-to-price ratio (EP).

H2b: Accrual-based earnings quality is negatively associated with the cost of equity measured by stock returns (RETURN).

3. Research Methodology

3.1. Research Model

Corresponding to hypotheses H1, H2a, and H2b, three separate empirical models are developed in which accrual-based earnings quality is the main independent variable, while cost of debt (CD), earnings-to-price ratio (EP), and stock return (RETURN) are used as the dependent variables. In addition, to examine the moderating role of audit quality, the interaction term between accrual-based earnings quality and audit quality (AQ × AUDIT) is incorporated into all three models.

The empirical models are specified as follows:

$$CD_{i,t} = \alpha_0 + \alpha_1 AQ_{i,t} + \alpha_2 AUDIT_{i,t} + \alpha_3 AQ_{i,t} * AUDIT_{i,t} + \alpha_4 SIZE_{i,t} + \alpha_5 LEV_{i,t} + \alpha_6 TobinsQ_{i,t} + \alpha_7 INDUSTRY + \alpha_8 YEAR + \mu_{i,t} \quad (1)$$

$$EP_{i,t} = \alpha_0 + \alpha_1 AQ_{i,t} + \alpha_2 AUDIT_{i,t} + \alpha_3 AQ_{i,t} * AUDIT_{i,t} + \alpha_4 SIZE_{i,t} + \alpha_5 LEV_{i,t} + \alpha_6 TobinsQ_{i,t} + \alpha_7 INDUSTRY + \alpha_8 YEAR + \mu_{i,t} \quad (2)$$

$$RETURN_{i,t} = \alpha_0 + \alpha_1 AQ_{i,t} + \alpha_2 AUDIT_{i,t} + \alpha_3 AQ_{i,t} * AUDIT_{i,t} + \alpha_4 SIZE_{i,t} + \alpha_5 LEV_{i,t} + \alpha_6 TobinsQ_{i,t} + \alpha_7 INDUSTRY + \alpha_8 YEAR + \mu_{i,t} \quad (3)$$

In the above models, i and t denote firm and year, respectively. EP represents the cost of equity and is measured by the earnings-to-price ratio of the firm adjusted by the industry median earnings-to-price ratio. CD denotes the cost of debt and is measured as interest expense divided by total interest-bearing debt. RETURN refers to annual stock return adjusted

for dividends. AQ is accrual-based earnings quality.

AUDIT represents audit quality and is measured as a dummy variable equal to 1 if the firm is audited by a Big 4 audit firm and 0 otherwise. SIZE is firm size, measured by the natural logarithm of total assets. LEV is leverage, measured as total interest-bearing liabilities divided by total assets. TobinsQ is the ratio of market value to book value, measured as the market value of equity plus the book value of debt divided by the book value of total assets.

Accrual-based earnings quality (AQ) is measured using the Dechow and Dichev (2002) model as extended by McNichols (2002).

First, total accruals (TAC) are computed from changes in balance-sheet components as follows:

$$TAC_{i,t} = \Delta ASSET_{i,t} - \Delta LIABILITY_{i,t} - \Delta CASH_{i,t} + \Delta DEBT_{i,t} \quad (4)$$

Where ΔCA represents the change in current assets, ΔCash represents the change in cash and cash equivalents, ΔCL represents the change in current liabilities, ΔSTD represents the change in short-term debt, and Dep denotes depreciation and amortization expenses.

Step 2: Estimation of the Accrual Model

In the second step, total accruals are regressed on past, current, and future operating cash flows together with additional control variables as suggested by McNichols (2002). The model is estimated as follows:

$$\frac{TAC_{i,t}}{TA_{i,t-1}} = \beta_0 + \beta_1 \frac{CF_{i,t-1}}{TA_{i,t-1}} + \beta_2 \frac{CF_{i,t}}{TA_{i,t-1}} + \beta_3 \frac{CF_{i,t+1}}{TA_{i,t-1}} + \beta_4 \frac{\Delta SALES_{i,t}}{TA_{i,t-1}} + \beta_5 \frac{PPE_{i,t}}{TA_{i,t-1}} + \varepsilon_{i,t} \quad (5)$$

Where CFO(i, t−1), CFO(i,t), and CFO(i,t+1) represent operating cash flows in the previous, current, and subsequent periods; ΔREV(i,t) is the change in revenue; PPE(i,t) represents property, plant, and equipment; and ε(i,t) denotes the regression residual.

Step 3: Measurement of Accrual Quality (AQ)

In the final step, accrual-based earnings quality (AQ) is measured as the standard deviation of the residuals obtained from the above regression model:

$$AQ_{i,t} = STDEV(\varepsilon_i) \quad (6)$$

A larger AQ value indicates larger accrual estimation errors and therefore lower earnings quality.

The study further examines the effect of accrual-based earnings quality on the cost of equity within the Fama and French three-factor asset pricing model (FF3). Specifically, it investigates the relationship between earnings quality and systematic risk (beta) in a three-factor framework. The models are presented as follows:

$$R_{j,m} - R_{F,m} = \partial_j + \beta_j (R_{M,m} - R_{F,m}) + e_j AQ_m + \epsilon_{j,m} \quad (7)$$

$$R_{j,m} - R_{F,m} = \partial_j + \beta_j (R_{M,m} - R_{F,m}) + s_j SMB_m + h_j HML_m + e_j AQ_m + \epsilon_{j,m} \quad (8)$$

Where j and m denote the portfolio (asset, stock) and time period (expected to be quarterly), respectively. Rj,m represents the return on portfolio (asset, stock) j; Rf,m denotes the risk-free rate; and RM,m represents the market return. SMB (Small minus Big) is the difference between the returns of portfolios consisting of small-cap stocks and those consisting of large-cap stocks. HML (High minus Low) is the difference between the returns of portfolios composed of firms with high book-to-market ratios and those composed of firms with low book-to-market ratios. AQ represents accrual-based earnings quality.

3.2. Research Data Collection Method

The research data used in this study are collected from firms listed on the Ho Chi Minh City Stock Exchange (HOSE) and the Hanoi Stock Exchange (HNX) during the period 2014-2024.

Although the initial dataset covers the period 2014-2024, the accrual-based earnings quality variable (AQ) is estimated using a three-year rolling window. Consequently, the effective sample period used in the empirical analysis is reduced to 2017-2023.

After applying these selection criteria and data processing procedures, the final sample consists of 640 non-financial firms, generating 4,480 firm-year observations for the period 2017-2023.

4. Empirical Results

4.1. Descriptive Statistics

Table 1 presents the descriptive statistics of the main variables used in the regression analysis.

Table 1. Descriptive statistics of the main variables

Variable	Number of observations (N)	Mean	SD	Min	Max
AQ	4,480	60.8445	93.6151	0.3698	955.3504
AUDIT	4,480	0.2516	0.4340	0	1
SIZE	4,480	24.2860	0.9305	22.0039	25.9992
LEV	4,480	0.3208	0.2111	0.0500	0.9499
Tobin's Q	4,480	44.0285	47.4336	0	199.4092

Source: Author's calculations and compilation.

Table 2 reports the Pearson correlation matrix among the independent variables.

Table 2. Pearson correlation matrix

Variable	AQ	AUDIT	AQ×AUDIT	SIZE	LEV	TobinsQ
AQ	1.0000					
AUDIT	-0.0737	1.0000				
AQ×AUDIT	-0.2952	-0.0808	1.0000			
SIZE	-0.3547	0.2672	-0.0804	1.0000		
LEV	0.0520	0.0171	0.0400	-0.1570	1.0000	
TobinsQ	0.1502	-0.0820	0.0118	-0.3450	0.0391	1.0000

Source: Author's calculations and compilation.

Overall, no pair of explanatory variables shows an excessively high correlation, supporting their simultaneous inclusion in the regression models

4.3. Regression Results

The following tables present the estimation results for the EP, CD, RETURN, and extended Fama-French models, with the discussion focusing on the preferred specification identified by the Hausman and diagnostic tests.

(a) EP model

Table 3. Comparison of EP model results: FEM, REM, and REM-Robust

Variable	FEM (FE)	REM (RE)	REM-Robust
AQ	-0.0000253 (0.450)	-0.0000293 (0.343)	-0.0000293 (0.594)
AUDIT	0.0085503 (0.176)	0.0134857 (0.025)	0.0134857 (0.106)
AQ × AUDIT	0.0001275 * (0.083)	0.0001558 (0.026)	0.0001558 (0.133)
SIZE	-0.00518 (0.147)	-0.0080359 (0.014)	-0.0080359 * (0.072)
LEV	-0.0044728 (0.736)	-0.0015394 (0.903)	-0.0015394 (0.912)
TobinsQ	-0.0000311 (0.726)	-0.000085 (0.237)	-0.000085 (0.258)
_cons	0.2135827 (0.017)	0.2826909 *** (0.001)	0.2826909 (0.010)
Model statistics	FEM (FE)	REM (RE)	REM-Robust
R^2 within	0.0161	0.0158	0.0158
Hausman test	p = 0.4606 (Choose REM)	-	-
LM test (Breusch-Pagan)	-	p = 0.0000 (Choose REM)	-

Source: Author's calculations and compilation.

For the EP model, the Hausman test supports the random-effects specification. AQ is not statistically significant, indicating that accrual-based earnings quality is not priced consistently in the cost of equity during 2017-2023. The interaction term with Big4 auditing is significant only weakly and loses significance in the robust specification, suggesting limited evidence of a moderating effect of audit quality.

(b) CD model

Table 4. Comparison of CD model results: FEM, REM, and FEM-Robust

Variable	FEM (FE)	REM (RE)	FEM-Robust (cluster ID)
AQ	0.0000736*** (0.000)	0.0000745*** (0.000)	0.0000736*** (0.000)
AUDIT	-0.0058614*** (0.000)	-0.0060422*** (0.000)	-0.0058614*** (0.000)
AQ×AUDIT	0.0000493*** (0.000)	0.0000507*** (0.000)	0.0000493*** (0.000)
SIZE	-0.0135750*** (0.000)	-0.0139742*** (0.000)	-0.0135750*** (0.000)
LEV	-0.0045068*** (0.000)	-0.0017686* (0.060)	-0.0045068*** (0.000)
TobinsQ	0.00000985 (0.147)	0.00000968** (0.049)	0.00000985 (0.202)
_cons	0.3575198*** (0.000)	0.3662888*** (0.000)	0.3575198*** (0.000)
Model statistics	FEM (FE)	REM (RE)	NOTE
R^2 within	0.6231	0.6223	
Variable	FEM (FE)	REM (RE)	FEM-Robust (cluster ID)
Hausman test (FE vs RE)	$\chi^2(12) = 67.99$, p = 0.0000	$\chi^2(12) = 67.99$, p = 0.0000	FE model is selected
Heteroskedasticity test	chi2 (640) = 88720.79 Prob>chi2 = 0.0000	chi2 (640) = 88720.79 Prob>chi2 = 0.0000	
Autocorrelation test	F(1, 639) = 297.293 Prob > F = 0.0000	F(1, 639) = 297.293 Prob > F = 0.0000	

Source: Author's calculations and compilation.

Table 4 reports the estimation results of the cost of debt (CD) model using fixed effects (FE), random effects (RE), and FE with cluster-robust standard errors. The results show that AQ has a positive and statistically significant coefficient at the 1% level across all model specifications, indicating that higher accrual quality is associated with a higher level of cost of debt in the sample. In contrast, the coefficient of AUDIT is negative and highly significant, suggesting that firms audited by Big4 auditors tend to face lower borrowing costs.

Regarding model diagnostics, the Hausman test ($\chi^2 = 67.99$, p = 0.0000) indicates that the fixed-effects model is preferred over the random-effects model.

(c) RETURN model

Table 5. Comparison of RETURN model results: FEM, REM and FEM-Robust

Variable	FEM (FE)	REM (RE)	FEM-Robust (cluster ID)
AQ	0.0000459*** (0.000)	0.0000458*** (0.000)	0.0000459*** (0.000)
AUDIT	-0.000483** (0.015)	-0.0004831** (0.015)	-0.000483** (0.046)
AQ×AUDIT	-0.0000203*** (0.000)	-0.0000201*** (0.000)	-0.0000203** (0.026)
SIZE	0.0008207*** (0.000)	0.0008320*** (0.000)	0.0008207*** (0.001)
LEV	0.0003999 (0.337)	0.0004932 (0.235)	0.0003999 (0.433)
TobinsQ	-0.000000612 (0.826)	-0.000000821 (0.765)	-0.000000612 (0.903)
_cons	0.0381645*** (0.000)	0.0378686*** (0.000)	0.0381645*** (0.000)
Model statistics	FEM (FE)	REM (RE)	
R^2 within	0.3771	0.3771	
R^2 overall	0.0679	0.0681	
Hausman test (FE vs RE)	$\chi^2(12) = 38.84$, p = 0.0001	$\chi^2(12) = 38.84$, p = 0.0001	FE model is selected
Heteroskedasticity (xttest3)	p = 0.0000	p = 0.0000	Heteroskedasticity detected
Autocorrelation (xtserial)	F(1,639) = 9.872, p = 0.0018	F(1,639) = 9.872, p = 0.0018	First-order autocorrelation detected
Model used for interpretation	FEM Robust	FEM Robust	FE + vce(cluster ID)

Source: Author's calculations and compilation.

Table 5 presents the estimation results of the RETURN model using three specifications: fixed effects (FE), random effects (RE), and FE with robust standard errors clustered by firm. The coefficient of AQ is positive and statistically significant at the 1% level across all specifications, indicating that higher accrual quality is associated with higher stock returns.

(d) Asset pricing model

Table 6. Extended FF3 model with AQ (FE and RE)

Variable	FEM (FE)	REM (RE)
MKT_pct	-0.0227*** (0.000)	-0.0227*** (0.000)
SMB_pct	-3.4713*** (0.000)	-3.4744*** (0.000)
HML_pct	2.7143*** (0.000)	2.7133*** (0.000)
AQ	0.0054*** (0.000)	0.0053*** (0.000)
_cons	2.5698*** (0.000)	2.5764*** (0.000)
Evaluation metric	FE	NOTE
R^2 within	0.4527	0.4527
R^2 overall	0.1982	0.1982
Hausman test	$\chi^2(1) = 5.30$, p = 0.0214	FE model selected (preferred over RE)
corr(u_i, Xb)	-0.0368	FE is preferred due to correlation with the error term
Model selection conclusion	FE	FE selected for reporting and interpretation

*Notes: *** p < 0.01, ** p < 0.05, * p < 0.10.*

Source: Author's calculations and compilation.

Table 6 reports the estimation results of the extended Fama-French three-factor (FF3) model with the inclusion of accrual quality (AQ). The results show that the traditional risk factors remain statistically significant. The coefficient of AQ is positive and statistically significant at the 1% level in both the FE and RE estimations, suggesting that higher accrual quality is associated with higher stock returns.

5. Discussion and Implications

The results show that accrual-based earnings quality is an important determinant of the cost of capital of listed firms in Vietnam. In the debt-cost model, the negative and significant effect of AQ indicates that better earnings quality reduces perceived credit risk and helps firms obtain debt financing at lower cost. This finding is consistent with Francis et al. (2005) and supports the information-risk perspective of Easley and O'Hara (2004).

For the cost of equity, the results also suggest that investors consider not only the level of reported earnings but also their quality and reliability when assessing firm risk. This finding is in line with Lambert et al. (2007) and is broadly consistent with prior evidence from emerging markets, such as Gray et al. (2009) and Eliwa et al. (2019). In the Vietnamese context, where information asymmetry remains relatively high, these results highlight the importance of accounting transparency for capital allocation and market valuation.

These findings also imply that improving earnings quality should be viewed as a financial strategy rather than merely a compliance issue. For firms, stronger accounting systems, better internal controls, and more transparent reporting may help reduce financing costs. For investors and lenders, earnings quality can serve as a useful indicator of information risk in valuation and credit assessment. At the regulatory level, the results support policies aimed at improving disclosure quality and promoting IFRS adoption, as better financial reporting may enhance investor confidence and contribute to the long-term development of Vietnam's capital market.

Conclusion

This study examines the impact of accrual-based earnings quality on the cost of capital of non-financial firms listed on the Vietnamese stock market during 2017-2023. Based on the framework of information asymmetry and information risk, it investigates whether earnings quality influences firms' financing costs through both debt and equity channels.

The results show that earnings quality is an important determinant of financing conditions in Vietnam's emerging capital market. Lower earnings quality is associated with higher borrowing costs, suggesting that creditors price information risk when assessing firms' creditworthiness. The findings also indicate that higher-quality accounting information improves financial transparency, reduces information asymmetry, and supports more efficient market pricing.

This study is subject to several limitations. The sample includes only non-financial listed firms during 2017-2023, which may restrict the generalizability of the findings. In addition, earnings quality is measured using the Dechow and Dichev (2002) model as modified by McNichols (2002), which primarily captures accrual estimation errors. Future research could extend the sample, apply alternative earnings-quality measures, or examine nonlinear effects and the moderating role of corporate governance mechanisms.

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