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JDM AT THE CORE OF ACCOUNTING

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Abstract
The purpose of this research is to look into the qualifying effect of capital structure components on the accounting-related quality of judgement and decision-making (JDM). The framework is used to study the variation in JDM quality by taking the practical significance of the study in an applied field. The study found evidence that different capital structures having both secured and unsecured loans have an impact on accounting-related JDM quality by studying the transformation in the net worth as a result of the volatility of earning and the economic consequences of 3 C dimensions on earnings are analyzed to measure the JDM quality. This study documents a variation in the quality of the informativeness of the treated firm's financial reports. As a research method, we undertook the one-way Annova The study concluded that the Hybrid and high debt capital structures with both secured and unsecured loans influence the adoption of aggressive accounting practices and, as a result, a reduction in the informativeness of firms' financial reporting.
Keywords: Judgement and Decision making, compensation, complexity, circumstances, audit

JEL Classifications: M4, M40, M41, M42

I. Introduction

Accounting is fundamentally concerned with the judgement and decision-making abilities of individuals such as investors, managers, and auditors. However, poor-quality JDM in accounting has serious consequences for the individuals making the decisions, their firms, and third parties who primarily use the information for their work. (Bonner S. E., 2007). The scope of the study is to determine the difference in judgement and decision-making quality of different capital structure components. It delimits the study by not considering the factors which improve the accounting-related JDM quality.

The framework for the logical progression of the research study is created to comprehend the relationship between the different capital compositions on the quality of judgement and decision-making in accounting-related JDM tasks. In the framework, a few important questions

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are developed to serve a few key purposes. The study's first goal is to identify the variation in the quality of judgement and decision making (JDM) in accounting-related tasks due to different capital compositions of the total borrowings in the capital structure. The second purpose of the study is to determine the Accounting related JDM task and its complexity in financial decisions. The third purpose is to measure the JDM quality by identifying the 3 C’s JDM quality dimensions i.e the compensation of a group of people involved in the performing of the Accounting related JDM task, the complexity of the task and the circumstance in which the task is performed.

To gain insight, The study ascertains a few questions in our framework that lead to examining the impact of accounting-related Judgement and decision making (JDM) on financial reporting through dimensions of the JDM quality by measuring the practical significance of the high complexity and low-complexity of accounting-related JDM task, circumstances in which the accounting-related JDM task are performed and the compensation of key individuals who are involved in performing tasks. To support the Hypothetical framework, this study managed to gather a few sample data of financial statements, auditor's reports, and vital ratio analysis statements from secondary sources for 12 companies in the automobile industry with varying capital compositions from the fiscal years 2018 to 2020. This study also shows a consistent relationship between the various capital structure components and a few changes in reporting practices. The research concluded that different capital structure components responded to variations in the quality of judgement and decision-making in the accounting-related task by changing the way their financial conditions were reported to investors. Taken together, these findings add to the literature on integrated reporting, particularly the ongoing discussion on improving the quality of judgement and decision-making in financial disclosure.

II. Literature Review

The current study is a part of the Accounting standards and Finance literature, which has focused on the relationship between judgement and decision-making quality in financial reporting, and different capital composition by identifying accounting-related JDM tasks. Our research is also linked to the accounting literature on International Financial Reporting Standards, In general, IFRS-based accounting systems give reporting firms more flexibility since they are based on principal based standards (Sacer, 2016) and was confirmed in the research that Judgement is subjective as a result, earnings and the impact of the difference in estimation will be seen on the volatility of financial conditions and performance of the company. However, a few studies point out that the mandatory adoption of IFRS provides greater managers flexibility in classification shifting (Baik, 2016) and also it is observed that change in net worth of the companies related to changes in accounting policies and practices or early adoption of IFRS (Hamdani, 2021). In the summary paper, (Ball, 2016) explains that fair value accounting will lead to managerial judgement and discretion, resulting in a wide range of options available for the firm to try to influence the values within accounting standards parameters.

A few studies observed and recommended that corporate governance impacts financial disclosure policies. so the policymakers have to consider corporate governance issues and should give more importance to the interest of stakeholders. (Gurusamy, 2021). The more efficient Firms are, the more Earning management will be executed. In the bonus plan hypothesis, managers can act in personal interest by maintaining positive results to attract more investors, normally the managers prefer inflating profits rather than maintaining sustainability in

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the development. (Nguyen, 2020) also it is explained how dividend policy impact earning management and Judgement and decision-making qualityin the reporting.

III. Background of the study

The automobile industry necessitates substantial investment for the manufacture of expensive types of equipment, making automobile manufacturing a capital-intensive sector with elevated capital spending. Likewise, the growing business deviation has resulted in a significant reliance on the international capital market and cross-border transactions. The establishment of common accounting knowledge has become critical to facilitating global transactions. The International Financial Reporting Standards (IFRS) attempt to simplify consistent reporting. On other hand increased scope of judgement and decision making on financial facts in international financial reporting standards (IFRS)/ converged IND AS justifies studying more about the quality of judgement and decision making in reporting, and the fact that such low-quality JDM has serious consequences for the organisation and stakeholders in their decision- making process. Accounting literature, International accounting standards and human psychology have all been intended to make this study more significant. Similarly, this study emphasizes the difference in JDM quality in accounting. This same trying to report quality that results from systematic errors in judgement and decision making (Bonner S. E., 1999).

However, having high financial and operating leverage in the automobile industry results in high risk and uncertainty because any small change in sales leads to a big change in profits and return on investment. Over the period the uncertainty and risk impact on production and investment process. The automobile industry needs to maintain high profitability to give adequate returns on investment. This paper examines volatility in earnings and their impact on JDM quality by including the 3c dimensions to measure JDM quality. Empirical research also has been conducted to examine the effect of changing standards on reporting quality. The international reporting standards have expanded the scope of judgement and decision-making on financial facts from recording to disclosure, which includes the process of recognition, measurement, and subsequent measurement and disclosure of financial facts.

Figure 1- present the study of accounting-related JDM Quality in a natural sequence and conclusion. (Bonner S. E., 2007)The framework includes questions about the JDM quality in financial reporting as a the dependent variable, the accounting-related JDM task, to focus on variation in the JDM of the financial facts, and individuals who are involved in the judgement and decision-making task by considering the practical significance of the task complexity, circumstances and an individual Compensation who are involved in performing of the task on the earnings.

To make the study more precise and narrow down, the accounting-related JDM quality is defined from the perspective of the outcome of the accounting process as a result this study limits the evaluation of quality based on output or judgement and decision-making on the final output.The question-and-answer framework serves the purposes of study, as discussed below the frameworkuses the "Judgement and decision-making quality" as a dependent element of the different capital structure components. However, the framework is used to study the variation in JDM quality by taking the practical significance of the study in an applied field and includes the key accounting-related question on earnings volatility, which requires the process of assessing 3 C dimension factors by using institutional knowledge, skills, ability, relevant information and experience to conclude the financial facts and identifying the measurement of JDM quality by involving and analysing :

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a) The key Individuals who are involved in performing the accounting-related JDM task and theircompensation.
b) The higher complexity of accounting-related tasks resulted in Discretionary accruals and thelower complexity of accounting-related tasks resulted in Non Discretionary accruals
c) The circumstances and conditions influence an individual in performing accounting related tasks

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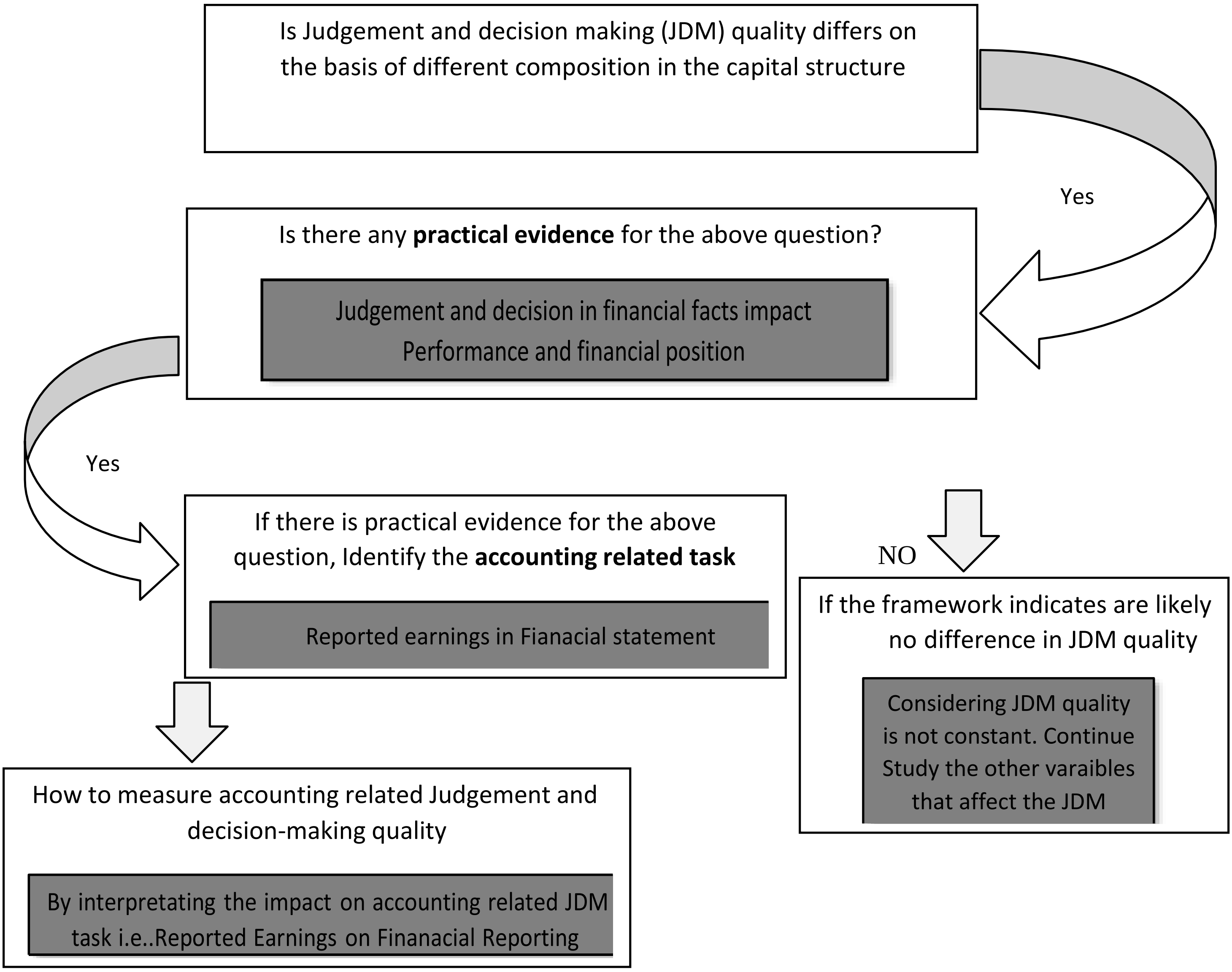
Figure 1: Framework for the transformation in accounting related judgement and decision-making quality



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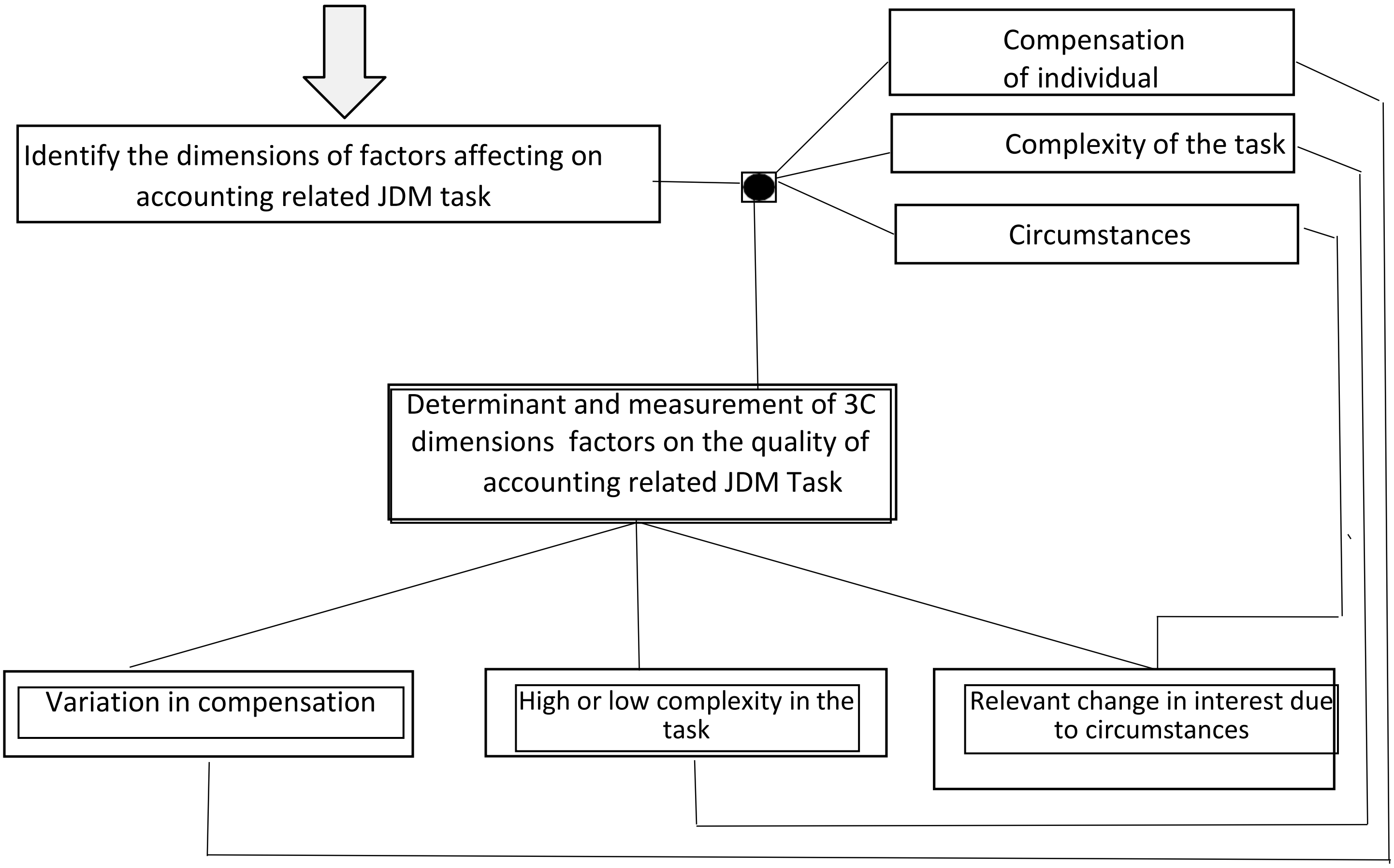

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IV. Methodological Procedures

Sample and Development of hypothesis

From 2017 to 2020, our study consists of all 12 automobile companies with varying capital compositions. In the main part of our empirical analysis, We have excluded companies from various industries. To understand the variation in the JDM quality of the different capital compositions, the data is processed in four steps.

Step 1- Interpret the relationship between Capital employed and Net worth

Step 2 - Analysing JDM quality in reported earnings (Proxy for JDM quality with different capital compositions) by measuring the volatility in earnings for three years with different capital compositions.

Step 3 - Identify the 3 C dimensions variables of the JDM quality which influence the judgement and decision-making process in the reported earnings.

Step 4 - Eliminate those items or measurements that contribute to the process of improving JDM quality.

Top academic journals reviewed and found a positive linkage between ownership structure and earning management (Prasetya Margono, 2021) and (Nguyen, 2021). A few empirical studies gave evidence that the Mandatory adoption of IFRS/IFRS converged accounting standards is associated with an increase in the scope of manipulation (Anagnostopoulou, 2021). Based on all those analyses hypotheses are developed.

H0: The different capital compositions do not affect the accounting-related JDM quality in reporting.

The capital structure component does not affect JDM quality. In the viewpoint of the Modigliani-Miller theory, financial decisions have no impact on the performance of the company in such instances accounting-related JDM tasks will become insignificant for the studies. According to MM theory, the capital structure does not affect the performance of the company because it raises funds within the perfect capital market, the interest rate in the market is constant and bankruptcy events will never occur. According to a studies, countries with strong investor protections and tighter debt covenants (Chen, 2016) and (Barzotto, 2022) showed no linkages between the composition of different capital structures and accounting-related JDM quality.

H1: The different capital compositions affect the accounting-related JDM quality in reporting

Capital structure is a combination of equity and debt used by a company for its ongoing operations and to increase the efficiency of the business. A few studies concluded that the high level of debt component (Prasetya Margono, 2021) and tight debt covenants (Hamdani, 2021) force managers to act opportunistically to increase incentives for the company this affects the accounting-related JDM Quality.

It has been also observed that under IFRS or convergence to IFRS regime, the greater flexibility provided in management discretion leads to plenty of opportunities to apply

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accounting estimations and long-term accruals (Baik, 2016) and (Sacer, 2016) as a result of it the financially distressed companies will take an advantage in their reports.

Experimental Design

Figure 2 presents the dimensions of the JDM quality and their Independent variables which are impacting on accounting-related JDM task

Figure 2
Construct the research concerning the Framework

Accounting Related JDM task	Dimension Variables	Measurement
	Compensation	Variable compensation
Earnings	Complexity of task	Discretionary accruals
	Circumstances	High interest

Research Design

In this section, we discuss the 3C dimensions of Judgement and decision-making quality and also the empirical model used for investigating the relationship between JDM quality at the different capital composition structures.

The measure of information quality

The proxy for the JDM quality is earning volatility. Less volatile in reported earnings is expected to be high JDM Quality. The JDM Quality in the volatility of the earnings is measured by the 3C Dimensions factors and the practical significance of the earnings.

The first dimension is compensation. This study suggests that variable compensations should be considered to analyse the practical significance of the compensation on the reliability of the accounting-related task. We measured the volatility of the earnings in comparison with compensation through thestatistical measure that is Coefficient of variation.

The second dimension is the complexity of the task. This model relies on cash flow adjusted through discretionary and non-discretionary accruals in the statement of profit and loss. More discretionary accruals increase the complexity as a result more volatility in earnings can be observed. The practical significance of Less Discretionary accruals decreases the complexity that leads to less volatility in the

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earnings. We have measured the correlation between free cash flows and PBIT. The negative relationship between free cash flows and PBIT is presumed to be more non-discretionary accruals than discretionary accruals which results in the higher JDM quality and no relationship between free cash flows and PBIT are presumed to be more discretionary accruals than non-discretionary accruals which result in to lower the JDM quality.

The Third Dimension is the circumstances in which the earnings are adjusted. To study the practical significance of circumstances on earnings the high rate of interest is taken into consideration. Due to the high payment of interest, cash volatility has been observed. Corresponding to high volatility in cash flow, the earnings will be adjusted through accruals. The multi-regression model is used to analyse the influence of accruals on earnings.

V. Data analysis and Interpretation

In the first step, we explore the interplay between the net worth of the company and the capital employed to understand the impact of different components in the capital structure on the net worth generation of automobile Industries.

Table 1 reports that there is a strong correlation between the different capital structure compositions and the net worth generation.

Table 1: Pearson Correlation Matrix

Correlation between Capital and Networth
Zero- debt capital structure

	CAPITAL	NETWORTH
CAPITAL	1	0.9998649
NETWORTH	0.9998649	1

Hybrid capital structure

	CAPITAL	NETWORTH
CAPITAL	1	0.97302025
NETWORTH	0.97302025	1

High debt capital structure

	CAPITAL	NETWORTH
CAPITAL	1	0.83059505
NETWORTH	0.83059505	1

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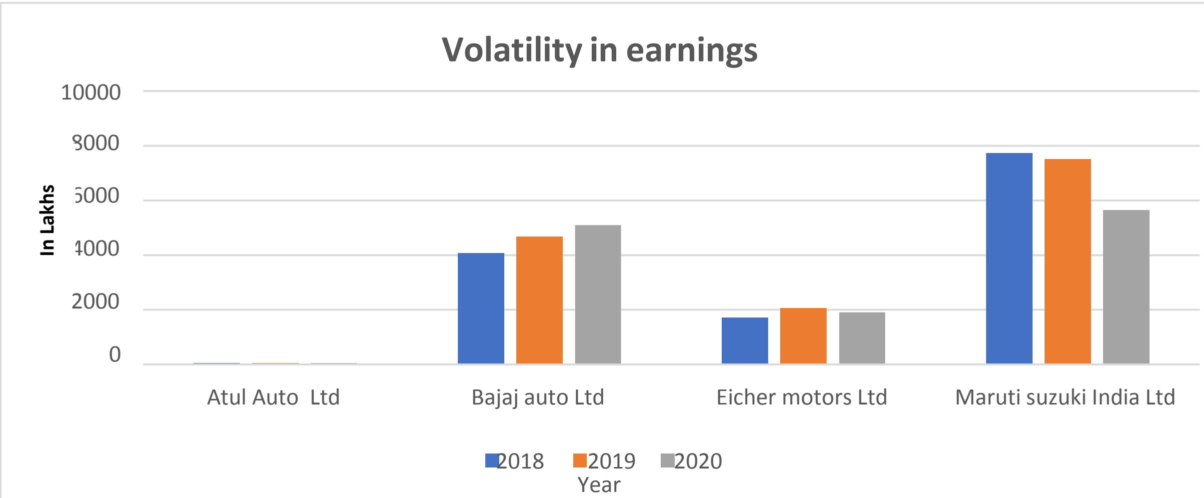
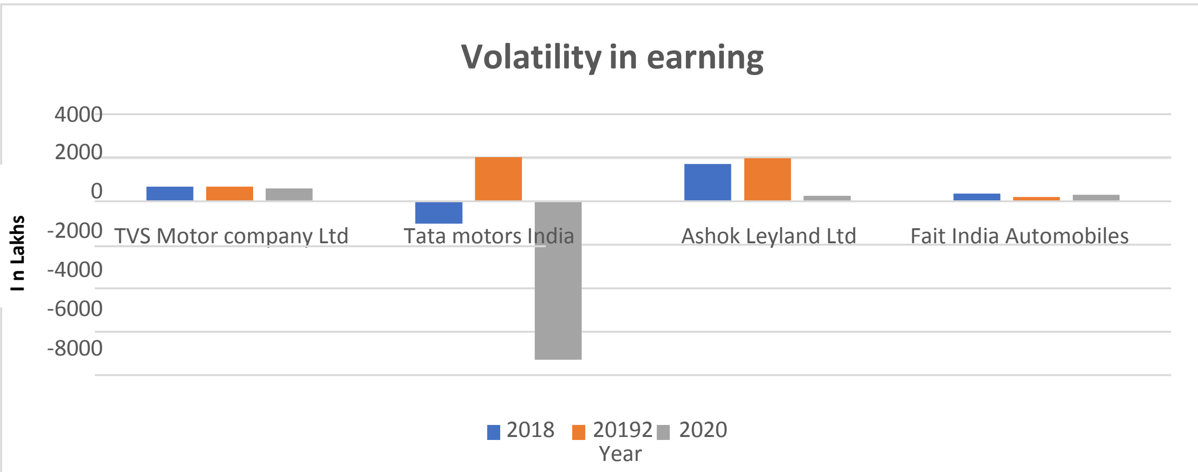
A measure of JDM Quality

The proxy of JDM quality is the earnings with different capital compositions. The volatility of reported earnings measures the degree of quality in earnings at different capital structure compositions. The less volatile in earnings of 3 years presumed to be the high quality of JDM and more volatile in earnings of 3 years presumed to be low quality of JDM. The JDM quality is measured with the practical significance of the 3 C dimensions variable on earnings at different capital compositions. The high practical significance on the earnings will have resulted in a high variance in the earnings and less practical significance will result in less variance in the earnings. Firstly the volatility in earnings is displayed through graphs than practical significance and statistical significance of 3 C dimensions variable on earnings and finally the one-way ANOVA test is performed to conclude the research objective.

EARNING VOLATILITYt AT A ZERO-DEBT CAPITAL STRUCTURE



EARNING VOLATILITY AT A HYBRID CAPITAL STRUCTURE



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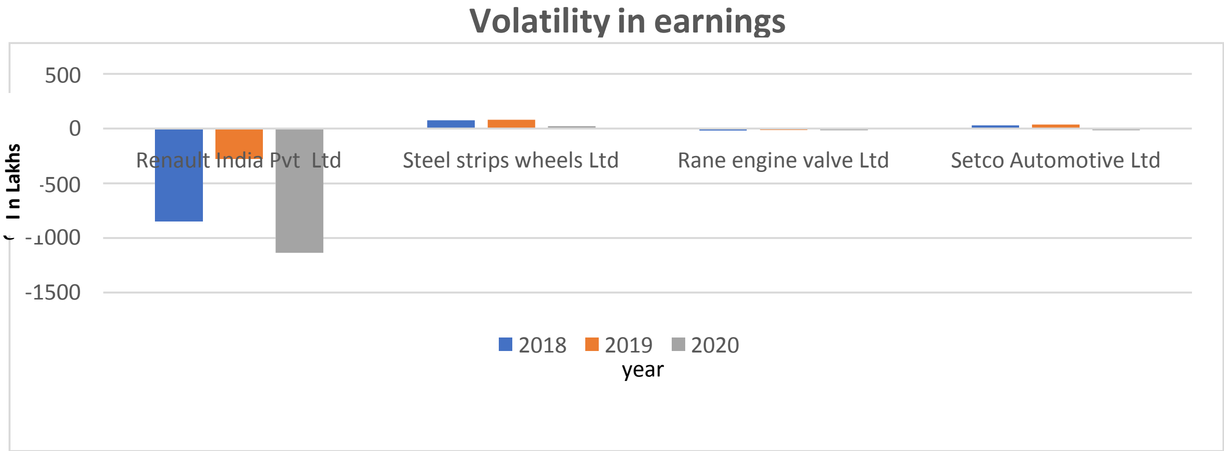
EARNING VOLATILITY AT A HIGH DEBT CAPITAL STRUCTURE



dichotomous scale is used to measure the JDM quality. In this study the variable compensations, discretionary accruals and Interest are used to measure the JDM quality. Less volatility in earnings is assumed to be high JDM quality because of less complexity in tasks, less discretionary accruals, less variation in variable compensation to perform accounting-related tasks, and in circumstances where the companies use less debt financing to avoid high rate of interest.

More earning volatility is assumed to be less JDM quality, because of a more complex task, i.e., more discretionary accruals, more variation in variable compensation to perform the task, and so on. Financial distress companies are expected to use more debt financing and refinancing to meet financial requirements, resulting in lower JDM quality. On the dichotomous scale, less volatility in earnings is measured at 1 and more volatility in earnings is measured at 0.

Influence of variable compensation on the Volatility of earnings

Table 2 confirms the strong Influence of compensation on the earnings volatility of the company.The high influence of variable compensation on the earnings has less JDM Quality. Variable pay ties performance to compensation so that managers can make a genuine effort to manage earnings, (Lee, 2019). We have reported the coefficient of variance based on the samples of 12 automobile companies from 2018 to 2020 and the test results to suggest that considerable changes in earnings over 3 year which are associated with considerable modification of variable compensation.

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Table 2: Influence of variable compensation on the volatility in earnings over 3 years

Name of the company	*CV of Variable compensation*	*CV of volatility in earnings*
Atul Auto Ltd	0	7.53
Bajaj Auto Ltd	13.89	11.39
Eicher Motors Ltd	11.37	9.04
Maruti Suzuki India Ltd	87.36	16.35
TVS Motor Company Ltd	11.60	6.69
Tata Motors India ltd	173.20	-225.85
Ashok Leyland Ltd	173.20	71.53
Fiat India Automobiles Ltd	NA	31.05
Renault India Pvt Ltd	NA	-57.03
Steel strips wheels Ltd	56.70	53.27
Rane engine valve Ltd	NA	-11.77
Setco Automotive Ltd	141.42	167.09

NA Not available

Discretionary accruals measure the quality of earnings

Many accounting principles and rules require the management make judgement and decisions to provide financial facts in financial statements. Many prior works of the literature suggest that management is under pressure to manipulate earnings within the scope of accounting policies and rules to meet the expectations of investors, the market and analysts . For this many key decision-makers receive heavy compensation to make decisions and judgement on financial facts to fluctuate the earning. Some of the techniques are used to manipulate the reported earnings in that accruals are more prone to manipulation because it is based on forecastings and estimations. Accrual accounting is a method where revenue and expenses are recorded when the transaction occurs before payments are issued or received.

The accrual-based reportings are based on the good quality of judgement and decision-making to maintain the transparency and accuracy of the information in reporting. In the discussion of the influential paper (Dechow, 2002) it is concluded that accruals as a modification of cashflows, with a negative correlation between accruals and cash flow statements. This paper shows that only discretionary accruals are highly complex to measure the quality of earnings, on the other hand non-discretionary accruals are less complex because they will be adjusted in a short period. To evaluate the role of discretionary accruals in determining the earning quality the free cash flow and PBIT relation are studied.

Positive relation/ no relations between free cash flow and PBIT are subject to more adjustment toward discretionary accruals and less adjustment towards non-discretionary accrual, which resulted in high volatility in earning. The negative relation between free cash flow and PBIT are less subject to the adjustment toward discretionary accruals and more adjustment towards non-discretionary accrual results in less volatility in earnings adjusts the cash flows.

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This paper shows the characteristics and impact of both discretionary and non-discretionary accruals on earings. The claim rests on two points the first, most of the non-discretionary accruals are recorded independently of the cash flow statement, therefore PBIT is studied to understand the volatility in earnings because these items i.e. interest and tax create a temporary difference in the free cash flow statement and earnings. Such difference can be reversed over a short period. Second, discretionary accruals are used in the process of observing cash flows and then adjusting discretionary accruals. The one-time discretionary accruals create permanent differences therefore discretionary accruals adjust for a longer period. Table 3 summarizes the correlation matrix between the variables to understand the complexity of tasks with discretionary and non-discretionary accruals.

Table 3 : Correlation Matrix Between Free cash flows and PBIT

Name of the company	*Correlation between variables*
Atul Auto Ltd	- 0.34
Bajaj Auto Ltd	-0.45
Eicher Motors Ltd	0.16
Maruti Suzuki India Ltd	0.90
TVS Motor Company Ltd	-0.99
Tata Motors India ltd	0.99
Ashok Leyland Ltd	0.29
Fiat India Automobiles Ltd	-0.98
Renault India Pvt Ltd	0.14
Steel strips wheels Ltd	0.71
Rane engine valve Ltd	-0.94
Setco Automotive Ltd	0.70

The PBIT measures the core business performances so it includes both discretionary and non-discretionary accruals for key decisions on profits. The investors analyse the PBIT to understand the earning potential. PBIT is commonly used by creditors to check the financial ability of the company for paying off creditors and to get an accurate picture of the financial ability. When the free cash flow is negatively correlated to PBIT. Indeed by a simple calculation, a number reconciles the accrual earnings (expenses) with cash flow must be accrual earning (expenses) + or – cash flows and such accruals are mostly expected to be non-discretionary accruals.

PBIT= PROFIT BEFORE TAX (AFTER DEPRECIATION) + INTEREST

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The empirical analysis shows that the negative correlation between free cash flows and PBIT results in less impact on profits. Example TVS Motors PBIT calculated by taking both discretionary accruals and non-discretionary accruals other than tax and interest expenses :

PBIT (2018) = 878.64 (PROFIT BEFORE TAX) + 56.62 (INTEREST)
PBIT (2019) = 960.96 (PROFIT BEFORE TAX) + 80.56 (INTEREST)
PBIT (2020) = 754.41 (PROFIT BEFORE TAX) + 102.19 (INTEREST)

Above PBIT is used as a financial matric by investors and analysts. In analysis, it is found that very less adjustment towards discretionary accruals has been observed in earnings. Let's say the interest cover ratio which is mainly used by creditors to know the ability of the company towards payment of the cost of debts. The simple calculation shows a less complex adjustment is made in the earnings to present theinterest cover ratio.

TVS Motor Ltd, Interest cover ratio is 16.52 (2018), 12.93 (2019) and 8.38 (2020), and the Interest is 56.62
(2018), 80.56 (2019) and 102.19 (2020)…

PBIT (2018) = 16.52*56.62 is 935.36,
PBIT (2019)=12.93*80.56 is 1041.64
PBIT (2020)=8.38*102.19 is 856.35

Discretionary accruals are not included in key decisions. So less discretionary accruals are assumed to be high JDM Quality.

Whereas,…

The positive correlation between the free cash flow and PBIT shows a high impact on earnings.

So-called accruals which impact earnings are expected to be discretionary accruals.

PBIT (2018) = (946.92) (LOSS BEFORE TAX) + 1744.43 (INTEREST)
PBIT (2019) = 2398.93 (PROFITS BEFORE TAX) + 1793.57 (INTEREST)
PBIT (2020) = (7127) (LOSS BEFORE TAX) + 1973 (INTEREST)

Tata Motors Ltd has taken discretionary accruals for key decisions. The below formula will give more clarity about the discretionary accruals. Discretionary accruals are one-time expenses and companies are not obligated toward the payment of such expenses. Such accruals modify the cash flows which havea greater impact on the earnings.

PBIT=PROFIT BEFORE TAX AND INTEREST- DEPRECIATION (–)/(+) DISCRETIONARY ACCRUALS

Tata Motors Ltd, Interest cover ratio is 0.95(2018), 2.34(2019) and

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1.38(2020).
Interest is1744.43 (2018), 1793.57(2019) and 1973(2020)…

PBIT (2018)=1744.43*0.95=1657.20,
PBIT (2019)=1793.57*2.34=4196.95,
PBIT (2020)=1973*1.38=-2722.74
In the above calculation for the interest cover ratio, the earnings are inflated by adding back thediscretionary accruals. So more discretionary accruals are assumed to be low JDM quality.

Circumstances influence JDM quality

A requirement of capital is large for capital-intensive businesses like automobile industries for day-to-day operations. Unsecured loans will be available for a company based on the repayment history and without pledging any company assets at a high rate of interest. The risk associated with the unsecured loan is more compared with a secured loan. The capital-intensive automobile companies have a high interest in expenses due to large amounts of debts to meet long term and short growth of the company.The high rate of interest and circumstances to meet the requirement of capital for operations motivate firm to provide financial information based on polished values within accounting policies and regulatory standards. The profit/loss statement and cash flow statement are key statements for creditors to evaluate the financial ability of the company. Under IFRS/ IFRS converged IND AS gives morescope for management to make judgement and decisions on financial facts and classification shifting incashflow on interest payments for an operational activity to financial activity. (Baik, 2016)

The empirical evidence shows a high rate of interest serves as an influencing factor for JDM quality of financial statements as a result more unsecured loan in the capital structure leads to more volatility in earnings. Under the new accounting standard regime, there is scope for classification shifting of Interest payments from operation activity to financial activity gives a different opinion about cash available from operations to the investors. To meet the capital requirement or shortfall of cash for the capital intensive companies use unsecured loans. The cash volatility has been observed due to the higher cost of capital for accessing debt finance. The corresponding change in the profit/loss statement is adjusted through accruals. The high corresponding change in profit/ loss is expected to be less JDM Quality and the Less corresponding change in profit/loss is expected to be more JDM quality.

In the results, it shows a negative relationship between unsecured loans and earnings, the correlation for 2018 is (-0.82), 2019 (-0.64) and 2020 (-0.75).

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Table 4 : Multiple Regression model of Influence of the unsecured creditors on earning

Variable	Model - Multiple regression model		
	2018	**2019**	**2020**
	Coefficient sig.	coefficient sig.	
coefficient Sig.	Unsecured loan	-0.007 0.0001	
-0.003 0.02	-0.0130 0.004		
R Square	0.672		0.42
0.56			

Volatility in earnings over 3 years

According to analysis, there is an influence of 3c dimensions on the earning proxy for JDM quality of the financial Report. Based on the above findings, the one-way ANOVA test is conducted to check the variability in earnings over 3 years at the different capital structure

Groups	*F Value*	*P-Value*	*F-Critical*
Earnings at different levels of capital structure 2018	2.99	0.10	4.25
Earnings at different levels of capital structure 2019	8.87	0.00	4.25
Earnings at different levels of capital structure 2020	5.47	0.02	4.25

The above result shows that, the proxy for JDM quality at the different capital structures significantly differs in 2019 and 2020. In 2018 not much difference has been observed at all the levels of capital structure.

VI. Conclusion and Recommendation

Much research suggests that JDM quality differs at different levels of composition in capital structure, evaluate the measurement of JDM quality the practical significance of the 3 C dimensions factors is studied, the first C dimension is compensation so the variable compensation has an impact on earnings volatility. The study shows that more volatility in the earnings is associated with variable compensation. The second C dimension factors are discretionary accruals, these accruals are identified as one-time expenses and such accruals adjust the cash flow accordingly, less accrual adjustment in earnings is expected to be high JDM and vice versa. The third C dimension is the circumstance in which high debts with high-rate interest are raised by the companies to meet the financial requirement. It is concluded that a high rate of interest affects the cash flows. To reconcile the cash flow with earnings the short-term or non-discretionary

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accruals are adjusted in the earnings resulting in a short-term impact on the JDM quality
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