Audit Committee Characteristics, External Audit and Earnings Management among Jordanian Listed Companies: Proposing Conceptual Framework

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Abstract

In fact, regulators and investors often criticize both audit committees and external audit about doing a poor job because the audited financial statements have been proved to be false and misleading due to recent high-profile earnings management cases in the world. However, the concern about the quality and integrity of accounting information is increasing over time and resulted in a drop in investor confidence following the collapse of some firms as a result of accounting manipulation by managers. This has made companies need to achieve significant progress to the corporate governance perform in order to recuperate the investors' confidence in financial reporting quality. This paper proposes a conceptual framework to investigate the role of audit committee characteristics and external audit on earnings management using a sample of industrial companies listed on the Amman Stock Exchange (ASE). Evidence from prior studies suggested that audit committees and external auditors play a central role in ensuring the integrity of financial reporting process. The audit committee is perceived as a liaison between the external auditor and the board, an audit committee bridges the information asymmetry between them. While the external audit is perceived as an effective third party which helps mitigate information asymmetry and conflict of interests between management and investors.

Keywords: Audit committee characteristics, External audit, Earnings management, Jordan.

1. Introduction
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The last two decades have witnessed a series of recent corporate accounting scandals across the United States, Europe and East Asian (e.g. Enron, HealthSouth, Parmalat, Tyco, WorldCom, and Xerox). These accounting scandals have brought a major awareness to the need for an investigation into the quality of financial reports and for more transparency and credibility in order to protect shareholders and stakeholders alike, either through legislative or through other standards related to disclosure (Glaum et al., 2004; Fearnley et al., 2004). The central issue of those scandals center was earnings management (Goncharov, 2005). Studies on earnings management are becoming the subject of many recent researches in financial economics (Jouber and Fakhfakh, 2011). Moreover, it has been a great and consistent concern among practitioners and regulators and has received substantial consideration in the accounting literature (Ali Shah et al., 2009).

Agency theory suggests that the monitoring mechanisms are supposed to align interests of both managers and shareholders and mitigate the conflict of interests and any opportunistic behavior resulting from it (Jensen and Meckling, 1976). Therefore, opportunistic earnings management practice produces less reliable accounting earnings, which do not reflect a firm’s true financial performance. Earnings management is likely to reduce the quality of reported earnings and its usefulness for investment decisions through the selection of accounting methods and treatments that serve the managers’ interests rather than the ones that reflect the truthful financial position of the firm, thus reducing investor confidence in the financial reports and obscures facts that stakeholders ought to know (Loomis, 1999).

In the wake of recent financial failures of some large companies resulting partially from accounting manipulation has raised serious questions about the role of different monitoring devices presumed to protect investors’ interests and control managerial opportunistic behavior. It is widely believed that accounting earnings information provides relevant and useful information to investors and other decision markets. Thus, as part of corporate governance, the audit committee and external audit have recently become of prominent importance in corporate governance (Anderson et al., 2004; Zhang et al., 2008); due to it play important role at overseeing the quality of the financial reports, and at acting as a deterrent to management override of controls and management fraud (Carcello and Neal, 2000; Cohen et al., 2004; Vafeas, 2005; Johl et al., 2007).

This paper proposes a conceptual framework to examine the association between audit committee characteristics, external audit and earnings management among industrial companies listed on Amman Stock Exchange (ASE). The remainder of the paper is organized as follows: Introduces the background of the study in section 2. Literatures review in section 3, the conceptual framework and hypothesis development presented in section 4. Summaries and concludes this paper in section 5.

2. Background

Jordan is an Arab Muslim country and it is situated in southwest Asia, at the meeting point of Asia, Africa, and Europe and a gateway to the Middle East. Jordan is a developing country with a centralized state system. It is very attractive for foreign investments, due to several reasons such as safety, political stability and its central location in the Middle East despite the on-going conflicts in the Middle East region. It seeks for afford a safe environment for its listed securities at the same time as protecting the rights of the investors. Jordan has a mixed economy. It consists of a private and public sectors. The socio-economic development in Jordan is characterized by an on-going cooperation between the public and private sectors. The industrial sector today is seen as one of the major potential economic sectors that Jordan should develop to achieve better economic growth (Central Bank of Jordan, 2007).

The Jordanian government mandated the establishment of audit committees in Jordanian public shareholding companies to facilitate improving the quality of Jordanian financial reporting, the audit committee consisting of three non-executive members from the company’s board of directors, two of them is independent members in the board (see The Jordanian Corporate Governance Codes (JCGC), 2009). Moreover, the development of auditing profession in Jordan has gone along with the
development of the country itself. The auditing profession in Jordan has witnessed tremendous development in the past few decades. This is due to a number of important factors, such as the social and economic development in Jordan, the considerable increase in the volume of investment, the increase in the number of public shareholding companies and the increase in the number of qualified accountants (Abdullah, 1986). In view of the fact that, Jordan is one of the countries where users depend on accounting numbers intended for making decisions, it is of enormous significance to consider the area under discussion of earnings management to protect those users from being misled.

3. Literature Review

Earnings management has been at the core of accounting research for the last two and a half decades. Yusof (2009) indicated that literature on earnings management mostly revolves around agency theory that proposes that managers (agent) would not work at all times in the best interest of their shareholders (principal). Therefore, managers occasionally manipulate earning figures in financial reports for various reasons, thus earnings management is likely to reduce the quality of reported earnings and its usefulness for investment decisions, then reducing investor confidence in the financial reports. Especially, the earnings are a critical factor that influences investment decisions for users of financial reports.

As is well known, one of the objectives of a company’s corporate governance system is to ensure the quality of that company’s financial reporting (Abbott et al., 2004; Klein 2003; Stewart and Munro 2007). The corporate controls are the first line of defense against misstatements in the financial statements, therefore, as part of corporate governance, the audit committees and external audit are expected to provide effective monitoring of earnings management. Furthermore, previous studies showed that higher audit quality (external audit) and audit committee are associated with higher earnings quality (Becker et al., 1998; Francis et al., 1999).

The audit committee is viewed as a monitoring mechanism that can help alleviate agency problems by reducing information asymmetry between insiders (managers) and outsiders board members (Klein, 1998; Chen et al., 2008; Sarens et al., 2009), since its key functions are to review financial information and control management’s conduct of affairs (Fama and Jensen, 1983). A growing body of literature suggests that audit committee is as a delegate body of the board of directors charged with safeguarding and advancing the interests of shareholders (Bedard et al., 2004; Klein, 2002). The board usually delegates responsibility for the oversight of financial reporting to the audit committee to enhance the breadth of relevance and reliability of the annual report. Therefore, the audit committee has been considered as a very important monitoring mechanism of corporate governance for oversight of the company’s financial reporting process (Joshi and Wakil, 2004).

The external audit provides another layer of investor protection by reducing the risk of misstatements (Hoitash et al. 2008). The financial statement audit is a monitoring mechanism that helps reduce information asymmetry and protect the interests of the principals, specifically, stockholders and potential stockholders, by providing reasonable assurance that management’s financial statements are free from material misstatements (Watts and Zimmerman, 1986; Becker et al., 1998; Adeyemi and Fagbemi, 2010) and thus is a valuable method of monitoring used by firms to reduce agency costs (Jensen and Meckling, 1976; Watts and Zimmerman, 1983). In other words, stockholders rely upon the external auditor to provide some assurance that the financial statements of a firm are not misleading.

Several studies that have empirically examined the relationship between audit committee characteristics, external audit and earnings management; but these studies revealed mixed and inconclusive results (e.g., klein 2002; Gul et al., 2002; Bedard et al., 2004; Chen et al., 2005; Abdul Rahman and Ali 2006; Sirayar and Utama 2008; Tsipouridou and Spathis 2012; Habbash et al., 2013; Soliman and Ragab 2014). Also, there has so far been relatively little or lack of research into earnings management practices in Jordan. Therefore, the purpose of this paper is to examine the association between the audit committee characteristics (independence, size, meetings, and financial expertise),
external audit (audit firm size, audit fees) and earning management among industrial companies listed on ASE.

4. The Conceptual Framework and Hypothesis Development

The characteristics of audit committee, external audit and their relation with earnings management are integrated in one conceptual framework. Figure (1) explains the propose framework. In this conceptual framework, audit committee characteristics and external audit are independent variables whereas earnings management is dependent variable. The current study thus attempts to bridge the gap by providing a basis for discerning the impact of audit committee characteristics, external audit on earnings management. Sections 4.1 and 4.2 will discuss the hypotheses that are developed from the conceptual framework.

Figure (1): Audit Committee Characteristics, External Audit and Earnings Management

4.1. Audit Committee Characteristics

4.1.1. Audit Committee Independence

Deli and Gillan (2000) claimed that an audit committee serves as a reinforcing agent to the independence of internal as well as external auditor, audit committees are expected to be more effective in the oversight of financial reporting when they are independent. Xie et al., (2003) mentioned that the more independent audit committee is argued to provide better governance compared to less independent audit committee. In literature less financial misstatements are associated with more independent audit committees (Beasley, 1996; Abbott et al. 2000; Garcia-Meca and Sanchez-Ballesta 2009).

Several research studies have investigated the impact of having an audit committee on financial reporting quality. A common hypothesis is that independent audit committee directors would ensure better financial reporting and the expectation is generally supported by existing empirical evidence (Lin et al. 2006). Specifically, using a sample of 692 publicly traded U.S. firms, Klein (2002) investigates whether earnings management is related to audit committee independence. She showed a negative association between earnings management and the proportion of independent directors on the audit committee.

Furthermore, Bedard et al. (2004) investigate the effect of audit committee characteristics, namely, expertise, independence and activity, on the extent of earnings management based on a sample of 300 U.S. firms for 1996. Their findings reveal that aggressive earnings management is negatively

Recently, a meta-analysis study by Garcia-Meca and Sanchez-Ballesta (2009, p. 607), using the data of 35 empirical studies, and Kent et al., (2010) using a sample comprised of Australian public companies listed on the Australian Stock Exchange in 2004. Both of them supported the notion that the independence of the audit committee constrains earnings management. Additionally, Soliman and Ragab (2014) examine the association between the audit committee effectiveness, audit quality and earnings management practices of more active 50 of Egyptian companies listed on the Egyptian Stock Exchange of the non-financial sector during the period 2007-2010. The results indicated that audit committees independence have significant negative association with earnings management.

In contrast, in the USA, Xie et al. (2003) examine the effect of some characteristics of the audit committee on constraining earnings management and found that audit committee independence is not significantly associated with reduced levels of earnings management. Abdul Rahman and Ali (2006) using Malaysian listed firms, they found an insignificant relationship between independent audit committees and earnings management. Siregar and Utama (2008) using Indonesian companies listed on the Jakarta Stock Exchange to examine the effectiveness of some corporate governance practices on earnings management. Their sample contains 144 firms and covers the periods 1995–1996, and 1999–2002. They failed to detect a relationship between audit committees’ independence and earnings management.

Moreover, Habbash (2011) found an insignificant relationship between independent audit committees and earnings management by using a sample that consists of all companies listed on the Saudi Stock Market and that covers the period of 2006 - 2009. Waweru and Riro (2013) use panel data of 148-firm years obtained from the annual reports of the 37 companies listed on the Nairobi Stock Exchange, the study found that independence of the audit committee is not significantly related to earnings management.

The contradictory findings of these various studies are not surprising, because the mere existence of an audit committee, without ensuring its independence and competence, cannot assurance the efficiency of the monitoring process, or its ability to detect and reduce earnings management. Accordingly, based on the above discussion, the following hypothesis is developed:

\[ H_1: \text{The audit committee independence is negatively related to earning management among Jordanian listed industrial companies.} \]

4.1.2. Audit Committee Size

The Blue Ribbon Committee (BRC) report of 1999 released the usefulness of having an audit committee and recommended that an effective audit committee of listed companies should comprise at least three directors. These recommendations reflect the assumption that size is a very important attribute of the effective audit committees and can have a significant effect on the monitoring of earnings management (e.g. Pincus et al., 1989). Although the size of audit committee is affected mainly by the size of the company and its board of directors, if the audit committee size is too small then an insufficient number of directors to serve the committee in occurring and thus decrease its the monitoring effectiveness (Vafeas, 2005). This perhaps because small committee is not capable of fulfilling its duties efficiently as the given assignments is always increasing. Also, when a committee size is too large, the directors’ performance may decline because of the coordination and process problems and hence highlight another reason for weak monitoring (Jensen, 1993; Vafeas, 2005).
The perfect average of the audit committee size is between 3 and 4 members (Abbott et al., 2004; Xie et al., 2003). Evidence from the previous suggested that the firms with large audit committee are more effective in monitoring the management. Baxter and Cotter (2009) found that quarterly earnings management is lower for the firms that have large size of audit committee. This may suggest that having a sufficient number of audit committee members increases the efficiency of its monitoring function in terms of financial reporting integrity.

The findings of prior studies for the effect of audit committee size on earnings management are mixed and inconclusive. Lin et al., (2009) using data from Chinese firms listing in Hong Kong 2004 to 2008, found that an audit committee size is associated with reduced levels of earnings management. Moreover, Kent et al. (2010) found a negative association between audit committee size and earnings management in Australian companies. Lin and Hwang (2010), employing meta-analytic techniques to the data from nearly 48 empirical studies, also found a negative and highly significant association between audit committee size and earnings management.

Xie et al. (2003) found no significant association between the number of directors on the audit committee and earnings management by using a sample of 282 US firms covering the period between 1992 and 1994. Likewise, Bedard et al. (2004), found no significant relationship between audit committee size and aggressive earnings management in US. Abbott et al. (2004) found no impact of audit committee size on earnings restatement. Furthermore, in Egypt, Soliman and Ragab (2014) found no significant relationship between audit committees size and the level of earnings management.

Additionally, Abdul Rahman and Ali (2006) found a positive relationship between audit committee size and earnings management. Siregar and Utama (2008) argue that where there is positive relationship between earnings management and audit committee size it is attributed to efficient rather than aggressive earnings management. In Egypt, Metawee (2013) found that there is a positive relationship between the audit committee size and earnings management by using a sample from corporations listed on the Egyptian Stock Exchange from the years 2008-2010.

Previous studies suggested that audit committee size can have a significant effect on the monitoring of earnings management. Accordingly, based on the above discussion, the following hypothesis is developed:

**H2:** The audit committee size is negatively related to earning management among Jordanian listed industrial companies.

### 4.1.3. Audit Committee Meetings

Effective audit committees meet regularly to ensure that the financial reporting process is functioning properly, and therefore a well-functioning and active audit committee not only reduces earnings manipulation but also improves firm performance since it limits director interaction time (Vafeas 1999). Further, Klein (2002) suggests active audit committees as measured by the number of meetings are positively associated with audit committee independence. An important objective for an audit committee is to provide its members with sufficient time to perform their duties of monitoring their firm’s financial reporting process (Lin and Hwang, 2010).

Previous studies suggested that firms with the higher number of audit committee meetings experience are less likely to be sanctioned for fraud as well as aggressive accounting (Abbott et al., 2000). Abbott et al., (2000) found the negative relationship between meeting frequency and the occurrence fraudulent financial reporting using data 78 firms that were subject to SEC sanctions and 78 matched non-fraud firms in the period 1980 to 1996. Xie et al., (2003) suggested that audit committees that meet regularly during the financial year are associated with effective monitoring. The more frequent they meet can constrain the levels of earnings management.
Doubtless, the effectiveness of audit committees depends, to a large extent, upon their actual operations or activities, such as the frequency, duration, and content of audit committee meetings. Abbott et al., 2004 found audit committees that meet at least four times per year exhibit a significant and negative association with the occurrence of financial reporting restatements through using data 41 firms that issued fraudulent reports and 88 firms which restated annual results in the period 1991-1999.

Furthermore, Ebrahim (2007) examined the relationship between earning management and activity of board of director and audit committee. He selected a sample of US manufacturing companies for two years, 1999 and 2000; results indicated there is a negative relationship between earning management with both board and audit committee independence and he documents that this relation is stronger when the audit committee is more active. Lin et al., (2006) found no implicit evidence to indicate that frequent audit committee meetings will restrain fraud or earnings restatement. In addition, Saleh et al., (2007) found that firms which had more knowledgeable audit committee members and held more audit committee meetings recorded fewer earnings management practices for a sample 561 Malaysian firms in 2001.

Lei (2008) suggested that audit committee meeting frequency shows negative association with income-decreasing earnings management. He uses data of UK-listed companies in the fiscal years 2000 and 2002. Furthermore, Soliman and Ragab (2014) found that audit committee meetings have significant negative association with earnings management. In the same institutional context, Metawee (2013) found also that there is a negative relationship between the audit committee meetings and the earnings management.

In contrast, Bedard et al., (2004) found an insignificant relationship between the number of meetings and earnings management. In the Australian context, Davidson et al. (2005) Baxter and Cotter (2009), the results indicate that a greater number of audit committee meetings do not seem to reduce either earnings management or to enhance earnings quality measures. Moreover, Lin et al., (2009) found that audit committee meeting frequency is not associated with earnings management in Chinese firms.

Effective audit committees meet regularly to ensure that the financial reporting process is functioning properly, and therefore a well-functioning and active audit committee may be able to prevent earnings management. Accordingly, based on the above discussion, the following hypothesis is developed:

\[ \text{H}_3: \text{The audit committee frequency meeting is negatively related to earning management among Jordanian listed industrial companies.} \]

### 4.1.4. Audit Committee Financial Expertise

Knowledge in accounting and finance provides a good basis for audit committee members to examine and analyze financial information. The educational background becomes an important characteristic to ensure audit committees perform their roles effectively. Moreover, audit committees that comprise at least one financial expert have greater interplay with their internal and external auditors (Raghunandan et al. 2001). Many studies argue that audit committees members’ knowledge/expertise or experience is directly associated with effective functioning of audit committees (Bedard et al., 2004; McDaniel et al., 2002; Beasley and Salterio, 2001 and DeZoort and Salterio, 2001).

DeZoort and Salterio (2001) argue that the audit committee’s financial expertise increases the likelihood that detected material misstatements will be communicated to the audit committee and corrected in a timely fashion. Abbott et al. (2004) suggested that the financial expertise of the audit committee is related with a higher financial reporting quality. Choi et al., (2004) show that the presence of at least one member with financial expertise sitting on the audit committee is negatively related to the level of earnings management.
Bedard et al. (2004) found that financial expertise is associated with a significant decrease in earnings management, where show that the presence of at least one member with financial expertise sitting on the audit committee is negatively related to the level of earnings management. In addition, Felo et al. (2003) found the percentage of audit committee members having expertise in accounting or financial management is positively related to the quality of financial reporting and the quality of the financial statement improve. Xie et al. (2003) found evidence that earnings management is reduced with audit committee members which comprise at least one member with a corporate or financial background.

In Malaysia, Saleh et al., (2007) some of the most important findings of their study are: the companies whose members of audit committee are distinguished for experience, financial knowledge, professionalism, in addition to frequent meetings of the committee have less practices of earnings management when compared to other companies. Additionally, Lei (2008) found that financial expertise of audit committees constrain the level of earnings management. Further, Chang and Sun (2009) use a dummy variable for financial experts if at least one of the audit committee members possesses accounting experience. Their results indicate a marginally significant negative association between the presence of financial experts on the audit committee and earnings management.

Lin et al., (2009) found that an audit committee expertise is associated with reduced levels of earnings management. Lin and Hwang (2010) found a negative relationship between audit committee financial expertise and earnings management. In Egypt, Soliman and Ragab (2014) indicated that experience of audit committee members have significant negative association with earnings management. In the same Egyptian context, Metawee (2013) found also that there is a negative relationship between the audit committee financial expertise and the earnings management.

In different words, both the regulatory concern as well as the experimental evidence suggested that having suitable experience and knowledge, mainly in accounting and auditing, is likely to improve the performance and judgment of the audit committee. Accordingly, based on the above discussion, the following hypothesis is developed:

**H4**: The audit committee financial expertise is negatively related to earning management among Jordanian listed industrial companies.

### 4.2. External Audit

#### 4.2.1. Audit Firm Size (Big4/Non-Big4)

Abundant research indicates higher audit quality mitigates the earnings management (Becker et al., 1998; Francis et al., 1999; Zhou and Elder, 2004; Chen et al., 2005; Francis and Yu, 2009; Jordan et al., 2010). In an early research, Becker et al. (1998) using the Jones model as proxy for earnings management and Big6 auditors (now Big4) as proxy for audit quality, collected a sample of 10,379 Big6 and 2,179 non-Big6 firm years. They reported that companies audited by non-Big6 audit firms have higher earnings management than companies audited by Big6 audit firms. Francis et al., (1999) has shown that Big Four auditors provide a significant constraint on earnings management for public firms.

In addition, Bartov et al. (2001) examined six large audit firms to evaluate audit quality. They hypothesized that these firms possess high audit quality and that companies which are not audited by these firms are trying to present more accruals in order to modify the earnings. Therefore, it is argued that high quality auditors are expected to be more likely to detect the practice of earnings management. A study by Chen et al. (2005) adopting Big5 (now Big4) audit firms and industry specialist auditors for audit quality used a sample of Taiwan IPO firms from 1996-1998. They found that high audit quality plays a pivotal role in constraining earnings management and that Big5 auditors provide high audit quality leading to the constraint of earnings management. Using Chinese data, DeFond et al. (2000) in their study have found that managers are more likely to prefer smaller
auditors because they consider that small auditors allows them to have more flexibility reporting their earnings.

Lin and Hwang (2010) using various factors for audit quality (auditor size, industry specialist auditor, audit fees, auditor tenure), found that only Big4 auditors and industry specialist auditors have a significant negative relationship with earnings management. Moreover, in US Charles et al. (2010) stressed that the manipulation of earnings is less likely to be managed with firms audited by Big4 auditors while clients with non-Big4 auditors show signs of manipulation. Sun and Liu (2011) found that the effectiveness of Big N auditors over non-Big N auditors in constraining earning management is greater for high-litigation-risk-clients than for low litigations risk clients, suggesting that clients’ high litigation risk can force big auditors to perform more effectively.

Gerayli et al., (2011) using a sample of 90 non-financial Iranian listed firms from 2004 to 2009, the results reveal that earnings management are negatively related to auditor size. Overall, this study provides evidence that firms which are audited by high quality auditors are more likely to have less earnings management. In the same context, Zhou and Elder (2003) and Ahsen (2011) found that Big 4 auditors associate with less earnings management in the firms. Indeed, Big 4 audit companies are assumed to have higher audit quality than non-Big 4, because they are less dependent on their clients. Innaam and Khmoussi (2012) in the Tunisian context and using 319 firm-year observations during the period 2000-2010, they found that Big 4 auditors associated with lower levels of accruals earnings management.

On the other hand, other studies report no significant relationship between Big 4 audit firms and earnings management. For example, Maijoor and Varstraelen (2006) examine the effect of audit firm quality on earnings management in three European countries (France, Germany and the UK). Their results suggest that Big 4 audit firm do not appear to constitute a constraint on earnings management. Piot and Janin (2007) investigated in the effect of various audit quality dimensions on earnings management in France. The main finding is that the presence of a Big Five auditor makes no difference regarding earnings management activities.

Moreover, using US data, Sun and Liu (2011) report an insignificantly positive relationship between Big 4 audit firms and earnings management. Abdul Rahman and Ali (2006) also found an insignificantly positive relationship between Big 5 audit firms and earnings management for a sample of Malaysian firms. Using a sample of manufacturing industry firms listed on Istanbul Stock Exchange (ISE) for the years 2003-2007, Yasar (2013) found that audit firm size as proxy for audit quality, does not have an impact on earnings management. His results indicate that there is no difference in audit quality between Big 4 and non-Big 4 audit firms for restriction of earnings management in Turkey.

Under the assumption that high-quality audits actually serve as an earnings management constraint, the following hypothesis is developed:

**H5:** Big 4 audited companies are negatively associated with the level of earnings management among Jordanian listed industrial companies.

### 4.2.2. Audit Fees

Several studies that have empirically examined the relationship between audit quality and audit fee; but these studies revealed inconclusive results. Gul et al., (2002) examine the linkages between earnings management and audit fees using a sample of 648 Australian firms show that there is a positive association between earnings management and audit fees. In addition, Alali (2011) examines the relationship between earnings management and audit fees, using a large sample of cross-sectional firms over the period 2000-2006 in USA. She found that there is a positive and significant association between earnings management and audit fees.
Ashbaugh et al. (2003) found no association between firms’ total fees and earnings management; Similarly, Chung and Kallapur (2003) found no association between several audit-fee metrics and their estimate of earnings management. Similarly, Ananthanarayanan (2008) provides evidence between auditors’ fees and earnings management in New Zealand. The results show that audit fee is not related to earnings management. Frankel et al., (2002) examine whether auditor fees are associated with earnings management. They found that audit fees are negatively associated with earnings management indicators.

In a Jordanian setting, large companies tend to operate mainly in the banking and manufacturing sector. Auditing the accounts of companies that belong to these industries arguably requires more time because of the complexity of their operations than that spent on companies operating in other industries. In an emerging economy like Jordan, large sized companies are also more likely to be diligently monitored by the public and expected to incur higher agency costs. Hence, these companies attempt to minimize agency costs by assuring investors as well as creditors by employing a prestigious audit firm that cost more than an ordinary one. In addition, large-sized companies can afford to employ expensive auditors. Accordingly, based on the above discussion, the following hypothesis is developed:

\[ H_6: \text{The audit fees are negatively related to earning management among Jordanian listed industrial companies.} \]

5. Summary and Conclusions

Earnings management is of great concern to corporate stakeholders, practitioners and regulators and has received considerable attention in the accounting literature. More recently, high profile scandals, financial crises, or institutional failures in East Asia, Europe and the United States have brought corporate governance issues to the forefront in developing countries. These scandals shake the integrity of accounting information and resulted in a drop in investor confidence. Thus, as part of corporate governance, the audit committee and external audit have recently become of prominent importance in corporate governance (Anderson et al., 2004; Zhang et al., 2008); due to it play important role at overseeing the quality of the financial reports, and at acting as a deterrent to management override of controls and management fraud (Cohen et al., 2004; Vafeas, 2005; Johl et al., 2007).

The role of audit committees and audit quality in ensuring the quality of corporate financial reporting has come under considerable scrutiny due to recent high-profile earnings management cases in the world. Specifically, this paper intends to investigate the relationship between the audit committee characteristics, external audit and earnings management among industrial companies listed on the Amman Stock Exchange (ASE).

References


