

## The Moderating Effect of Audit Quality on Audit Committee Characteristics-Earnings Management Practices Relationship

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### Abstract

*The current study aimed to investigate the relationship of Audit Committee (AC) Characteristics with Earnings Management (EM), and effect of external Audit Quality (AQ) on this relationship. Through employing a panel data of the listed non-financial firms in ASE for the years (2015-2021), findings showed that AC activity and AC expertise possess a significant and negative influence on the EM practices (measured by discretionary accruals levels). The findings indicate that these mechanisms restrict the managerial opportunistic behaviour through prevent the EM practices within the Jordanian context. While AC independence found to possess a significantly and positive influence on the EM practices. Regarding the moderating effect, outcomes showed that external AQ moderates the relationships of AC activity, AC expertise with EM practices. Outcomes of this study add to the ongoing debate regarding the role of AC characteristics in mitigating EM practices in the developing markets (Jordan) through taking into account the external AQ as a moderating variable. Outcomes of this research may be generalized on the similar developing economics, which have same contextual characteristics.*

**Keywords:** Earnings Management, Audit Committee, Audit Quality, Discretionary Accruals, AC activity, AC Expertise, AC Independence

## INTRODUCTION

Preparing of the financial statements is regarded as one of the most important steps for the outcomes of the financial systems, with one of its primary goals being to provide the essential statements and information to assess the firm's profitability and its performance (Ishak et al., 2018). Such information in the financial statements need to be presented in a way that the related-parties can assess the firm's previous profitability and performance, as well as anticipate and evaluate its future performance and profitability. Net profit in the provided reports is regarded as one of the most important pillars in evaluating the firm's value, performance, and profitability; however, because net profit is calculated on an accrual basis, it is influenced by estimates and various accounting methods, and it is possible to manipulate the reported profit. As a result, one of the most important research topics is the quality of the earnings in financial statements (Heirany et al., 2013; Al-Othman & Al-Zoubi, 2019).

In recent times, corporate governance (CG) mechanisms have been incorporating various tools to monitor top management effectively. This is done with the aim of protecting the wealth of owners and attracting foreign investments. Previous research has consistently highlighted the crucial monitoring role played by the audit committee in CG. The audit committee serves as a key entity in controlling and overseeing managerial practices. By fulfilling its monitoring function, the audit committee can contribute to enhancing the quality of financial reporting and reducing audit risk. As a result, it plays a vital role in improving the accuracy and reliability of reported earnings. These findings emphasize the significance of a robust and effective audit committee in corporate governance structures (Mardessi, 2021).

Management involving in the EM practices to overstate the earnings in order to achieve the needed targets, because the management's incentives are rely on achieve the targets. In addition, management use EM practices

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to manipulate outcomes to achieve such targets (Leuz & Wysocki, 2016). Such manipulation is unsustainable, and it can be explored in near future (Sae-Lima & Jermisittiparsertb, 2019), through several mechanisms, such as effective audit committees and external audit quality.

The worth of any company is related to the reported retained earnings in the final statements, which lead to creating various pressures on the management in involving in the EM practices (Sae-Lima & Jermisittiparsertb, 2019). In this regard, if the company needs to enhance its financial reporting to increase the earnings quality, the shareholders have to establish an effective audit committee, and empower its role (Sarkar, 2016). However, the relationship of AC characteristics, audit quality, and earnings quality in the developing countries, such as Jordan remains unexplored.

However, while several prior studies show evidence that the conditions of the general macroeconomic lead to affect companies' earnings quality, empirical literature on the impact of audit committee characteristics on companies' EM behaviour is still limited in the developing countries, and the outcomes inconclusive. This research is the first of its kind, to the authors' knowledge, in providing up to date evidence regarding the effectiveness of the AC characteristics and external audit quality, and their role in constraining the EM practices in the Jordanian context.

The outcomes of this study will provide valuable insights for professional accountancy bodies and governments to underscore the importance of addressing earnings management in order to protect the integrity of financial information and preserve owners' wealth. The findings will also contribute to enhancing the characteristics of audit committees and improving audit quality, ultimately leading to enhanced earnings quality. By recognizing the significance of these factors, policymakers and professional bodies can implement measures and regulations that promote transparency, accountability, and the reliability of financial reporting practices, especially in context of the developing countries. To the best knowledge of the authors, this is the first study of its kind to examine the relationship of AC characteristics and EM practices, and the moderating effect of external AQ on this relationship. Mollik et al. (2020) found that companies have high levels of EM practices during the Financial Crisis, and audit quality, (measured by Big4), does not constrain EM practices.

## LITERATURE REVIEW

This section of the research reveals literature review of the study, related previous studies, most significant CG mechanisms (namely; AC activity, AC expertise, and AC independence), external audit quality, and the association of these mechanisms with EM practices. In addition, this section of the research reveals the developed hypotheses according on the agency theory.

### Audit Committee

The main function of the AC is to control, monitor, examine, review and adopt the financial practices and ensure that there are a compliance and commitment in the internal systems (Ittonen et al., 2020). Recently, existence of the effective audit committees has become very important to enhance quality of the financial reporting. Various prior studies revealed that the FRQ and earnings quality are considered as a reflection of expertise and effectiveness of the auditors and the monitoring activities by the audit committees (Wu et al., 2016; Subramaniam & Anandasayanan, 2018; Qawqzeh, 2021).

The audit committee assumes a critical role in overseeing and monitoring a company's management practices, with the primary objective of safeguarding the interests of the owners. One of the key responsibilities of the audit committee is to provide recommendations regarding the appointment and potential changes of the external auditor. However, its role extends beyond this specific function. The audit committee also has a broader scope, which includes monitoring the actions of managers and reviewing the company's internal control system. By fulfilling these responsibilities, the audit committee contributes to ensuring transparency, accountability, and effective governance within the organization (Kallamu & Saat, 2015; Mardessi, 2021).

The Agency Theory is based on the inherent and philosophical assumption that individuals are self-interested and may not always act in the best interests of others, such as the owners or shareholders of a company. This theory acknowledges that conflicts of interest can arise in principal-agent relationships, where principals

(owners) delegate decision-making authority to agents (managers) to act on their behalf. In this context, the Agency Theory recognizes the importance of monitoring mechanisms, such as audit committee characteristics to mitigate potential agency problems (Jensen & Meckling, 1976).

The effective AC prevents the management's activities in involving the EM practices through its role in examining all activities conducted by the management, which in turn lead to high levels of earnings quality (Sae-Lima & Jermisittiparsertb, 2019). Mollik et al. (2020) argued that the regulators and policymakers are encouraged to pay more attention to the well-functioning ACs, comparing to their attention to quality of the external audit. Sae-Lima and Jermisittiparsertb (2019) argue that the effective audit committees possess a significant role in enhancing of the earnings quality. Therefore, the various firms are highly encouraged to having independent members in their ACs, due to the significant role played by such members (Mollik et al., 2020).

## **AC Activity**

Several previous studies focused on various effective qualities of the audit committee, such as its independence, members' knowledge, and activity, due to the monitoring effectiveness and competency of these characteristics in improving the quality of financial statements. Furthermore, such traits result in a more effective audit committee performance (Ghafran & O'Sullivan, 2013; Inaam & Khamoussi, 2016; Bajra & Čadež, 2018; Zalata et al., 2018).

Previous literature suggests that the AC, when it convenes regularly, can play a crucial role in overseeing and managing a company's financial matters, including the preparation of financial statements and the reporting of relevant information. However, the existing body of literature presents varying findings regarding the relationship between AC meetings and activities related to earnings management. Miettinen (2008) revealed that there is a negatively and significantly influence of AC meetings on the EM practices. Ayemere and Elijah (2015) revealed that AC activity has a significantly inverse influence on EM practices. Studies of (Inaam & Khamoussi, 2016), (Albersmann & Hohenfels, 2017), (Alzoubi, 2019) and (Kapkiyai et al., 2020) indicate that the AC meetings have a negatively significant effect on EM. Setiawan et al. (2020) revealed that there is a positive influence of AC activity on the EM practices. Mardessi (2021) showed that AC meetings have insignificant influence on the discretionary expenses. Mardessi (2022) showed that there insignificant influence of AC meetings on the real EM practices. Nikulin et al. (2022) revealed that AC activity is associated with high levels of EM practices.

Audit committee characteristics are considered vital monitoring tools within the Agency Theory framework. The presence of an effective audit committee can help address the challenges arising from principal-agent relationships. By having a diligent and independent audit committee, the interests of the owners can be safeguarded. The committee plays a crucial role in overseeing the actions of management, including the financial reporting process, internal controls, and risk management. By providing oversight and guidance, the audit committee helps ensure that managers act in the best interests of the owners, promoting transparency, accountability, and effective corporate governance (Mallin, 2010). Consequently, this study develop the following hypothesis:

*Ha1: AC activity has a significantly and negatively influence on EM practices.*

## **AC Expertise**

The expertise of the members serving on AC is widely recognized as a crucial factor in determining the effectiveness of the committee. In many countries, CG codes stipulate that ACs should comprise individuals who possess a strong level of financial and accounting expertise. This requirement ensures that committee members possess the necessary knowledge and skills to comprehend and elucidate the financial issues faced by the firm (Mardjono & Chen, 2020). By having a diverse range of expertise within the AC, organizations can enhance their ability to effectively oversee financial matters, evaluate financial statements, and provide valuable insights and recommendations to management (Suryanto et al., 2017; Zadeh et al., 2023).

There is a broad consensus regarding the primary role of the AC, which is to review the financial reporting process and ensure the high FRQ. Having members with accounting or financial expertise on the AC can

significantly enhance its efficiency and ability to detect and prevent EM practices. These individuals possess the necessary knowledge and skills to assess the accuracy and integrity of financial information, identify potential red flags, and evaluate the appropriateness of accounting treatments (Juhmani, 2017). Their expertise enables them to ask relevant questions, challenge management, and provide valuable insights during the financial reporting review process. Ultimately, the presence of members with accounting or financial expertise strengthens the AC's ability to uphold the integrity and reliability of the financial statements (Zalata et al., 2018). The relationship of the AC expertise with the EM practices has been a vital issue of the prior studies, but with inconsistent results.

Study of Mollik et al. (2020) found that expertise of the ACs' members has insignificant influence in constraining EM practices. Baxter and Cotter (2009) found that there are differences in the relationship between AC expertise and the various earnings quality measures. Mardessi (2022) showed that there statistically significant influence of AC expertise on the real EM practices. Mardjono and Chen (2020) showed that AC expertise play a significant role in reducing EM practices. Nikulin et al. (2022) revealed that AC expertise is associated with low levels of EM practices. Setiawan et al. (2020) revealed that there is a positive influence of expertise of the AC's members in the financial and accounting issues on the EM practices. Ngo and Le (2021) found that AC expertise is associated inversely with the levels of EM practices. Zadeh et al. (2023) found that AC expertise affect significantly on the EM practices.

The Agency Theory provides the underlying rationale for emphasizing audit committee characteristics and external audit quality in corporate governance regulations. The theory recognizes that agency problems can arise when managers, as agents, make decisions that may not align with the best interests of the owners, who are the principals. In order to address these agency problems, expert members on the AC focus on monitoring and controlling managers' behaviour (Méndez et al., 2017; Chatterjee & Rakshit, 2020; Setiawan et al., 2020). The following hypothesis has been developed:

*Ha2: AC expertise has a significantly and negatively influence on EM practices.*

## **AC Independence**

The Sarbanes-Oxley Act of 2002 places considerable emphasis on the independence of the Audit Committee (AC) to ensure its effectiveness in overseeing financial statements. The act requires that all members of the AC be independent, as the independence of AC members plays a crucial role in their ability to effectively monitor financial reporting (Klein, 2002). By having an independent AC, there is a greater likelihood of accurately presenting the true financial situation of the company. The act recognizes that an independent AC is essential for maintaining transparency and integrity in financial reporting (Mouratidou, 2019). Thus, the AC must possess an independent members in order to perform its unbiased function in developing the firm (Sae-Lima & Jermisittiparsertb, 2019). Several prior studies examined the association of AC independence with EM practices and earnings quality. Ayemere and Elijah (2015) found that there a significantly inverse association between AC independence with EM practices. Likewise, (Inaam & Khamoussi, 2016), (Muda et al., 2018), (Mouratidou, 2019), (Joshi & Pandya, 2020), (Kapkiyai et al., 2020), and (Mursalmina, 2020) also indicated that the high levels of AC independence are significantly reduce EM activities. Such outcomes support the Sarbanes-Oxley Act (2002) in its emphasis on the importance of the AC independence.

Mollik et al. (2020) found that independence of the AC has a significantly influence in mitigating companies' EM practices. Davidson et al. (2005) show that there is a significantly positive association between existence of the AC in the firms with abnormal accruals, also, part of this association is mitigated by AC independence. Baxter and Cotter (2009) show insignificant association between AC independence with EM practices. Kent et al. (2010) revealed a negative but insignificant relationship between EM practices and AC independence

Setiawan et al. (2020) revealed that there is an insignificant impact of AC independence on the EM practices. Mardessi (2022) showed that there statistically significant influence of AC independence on the real EM practices. Mardjono and Chen (2020) showed that independent members on the AC play a significant role in reducing EM practices. Nikulin et al. (2022) revealed that AC independence is associated with low levels of EM

practices. Ngo and Le (2021) found that AC independence has insignificant association with the EM practices. Zadeh et al. (2023) found that AC independence had insignificant association with the EM practices.

One way to enhance monitoring and control is through the establishment of effective audit committees. By having competent and independent members on the audit committee, there is a higher likelihood of detecting and preventing managerial misconduct, such as earnings manipulation or fraud (Eriandani et al., 2020; Mardessi, 2022). The audit committee's oversight role, including its review of financial reporting and internal controls, helps ensure that managers act in the best interests of the owners (Mursalmina, 2020; Qintharah et al., 2020). The following hypothesis has been proposed:

*Ha3: AC independence has a significantly and negatively influence on EM practices.*

### **Audit Quality (AQ)**

The main aim of the external auditing is to implement the audit process in order to acquire adequate evidence to enhance opinion of the external auditor regarding the financial reports. Thus, an audit quality practices are required to provide an assurance that financial statements are free of the manipulation and provide an accepted level regarding the faithfulness in the financial reports. Such assurance lead to provide a level of the confidence between all of the related parties regarding the credibility of the company's outcomes (Qawqzeh, 2021).

Studies of Mardessi (2021), and Mardessi (2022) showed that the audit quality is positively moderates the AC characteristics-EM practices relationship. Ngo and Le (2021) found that AC activity has insignificant association with the EM practices.

External audit quality is another important aspect of corporate governance regulations influenced by the Agency Theory. High-quality external audits provide an independent and objective assessment of a company's financial statements. This helps mitigate agency problems by providing assurance to owners and other stakeholders that the financial information is reliable and trustworthy. External audits serve as a mechanism to hold managers accountable for their actions and promote transparency and accountability in financial reporting (Elernes, 2015), (Al-Hajaya, 2019), (Alzoubi, 2018), (Mollik et al., 2020), (Mardessi, 2022). Therefore, the following hypotheses regarding the moderating effect of external AQ have been formulated:

*Hb1: External AQ moderates the AC activity-EM practices relationship.*

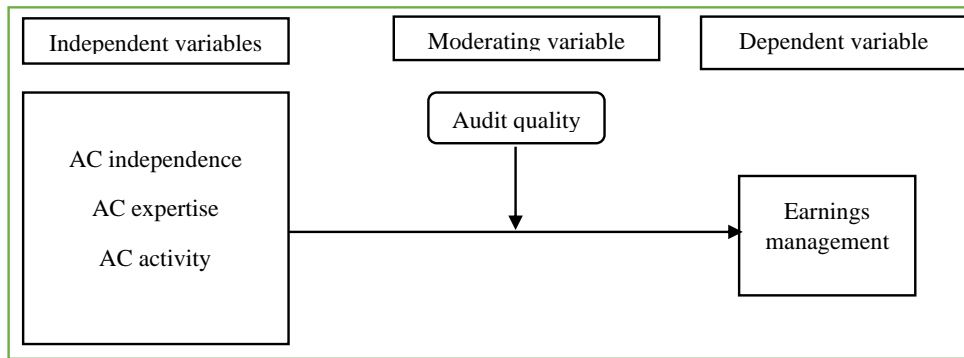
*Hb2: External AQ moderates the AC expertise-EM practices relationship.*

*Hb3: External AQ moderates the AC independence-EM practices relationship.*

Generally, the previous studies related to the CG, the audit quality, and the earnings management indicate that the mechanisms such as the audit committee and the external auditor have a potential and significant role in the credibility and reliability of the earnings quality through preventing the EM practices.

### **RESEARCH METHODOLOGY**

The study's population consist of all listed firms in Amman Stock Exchange (ASE), and the study's period is covers the years (2015-2021). The total listed firms at end of 2021 were 221 firms. While the study's sample involves the non-financial firms, but only the firms that disclosed and reported the fully needed data which associated to the AC characteristics, audit firm size, and earnings management components. In addition, the total non-financial firms in ASE reached 117 firms. The current study excluded the financial firms given that their variances and the special regulations. The listed firms who have missing information also have been excluded. Therefore, the final firms that represent the study's sample reached 94 working firms in the industrial and service sectors over a period of seven years.

**Figure 1. Research Framework**

As shown in the Figure. 1, the study's variables include three types of variables, as follows, first: the independent variables, namely; AC characteristics represented by (AC independence, AC expertise, and AC activity). Second: the moderating variable, namely; audit quality. Third: the dependent variable, namely; EM practices. In addition, the current study employed several control variables, namely; Firm Size, Firm age, AC size, loss, and Board size. Therefore, equations of the econometric specification was formulated as follows:

First equation regarding the direct effect of AC characteristics on EM practices:

$$EM = p_0 + p_1ACInd + p_2ACExp + p_3ACAct + p_4Fsize + p_5Fage + p_6ACsize + p_7Bdsiz + p_8Loss + E$$

Second equation regarding the moderating effect of audit quality on the AC characteristics-EM practices relationship:

$$EM = p_0 + p_1ACInd + p_2ACExp + p_3ACAct + p_4ACInd*AQ + p_5ACExp*AQ + p_6ACAct*AQ + p_7Fsize + p_8Fage + p_9ACsize + p_{10}Bdsiz + p_{11}Loss + E$$

Where-

*EM*: Earnings management

*ACInd*: AC Independence

*ACExp*: AC Expertise

*ACAct*: AC Activity

*ACInd\*AQ*: interaction variable

*ACExp\*AQ*: interaction variable

*ACAct\*AQ*: interaction variable

*Fsize*: Firm Size

*Fage*: Firm age

*ACsize*: AC size

*Bdsiz*: Board size

*E*: error term.

### Measurement of the Study's Variables

Measurement of the above variables is shown in the Table 1.

Table 1: Measurement of the variables	
AC independence	% of non-executive AC's members
AC expertise	% of directors who possess accounting or financial experience
AC activity	Number of AC yearly meetings
Audit quality	Audit firm size (Big4)
Earnings management	Discretionary accruals

## Measurement of the earnings management (EM)

Dependent variable in this study is represented by the EM. According to several prior studies, the Performance Matched model which introduced by (Kothari et al., 2005), is considered as the most popular model to calculate levels of discretionary accruals (DACC) in the specific firm. Consequently, this research employed the Kothari model to discover whether the specific firm involve in the EM practices or not through the levels of discretionary accruals. Due to the point of view that the DACC levels can be considered as a reflection of EM practices. It also can be used as an inverse indicator for quality of the firm's earnings (Miettinen, 2008), (Ines, 2017), (Qawqzeh et al., 2020).

The equation of Kothari's model (2005) is formulated as follows:

$$TACC_{it}/TA_{it-1} = \beta_0 + \beta_1(1/TA_{it-1}) + \beta_2(\Delta REV_{it} - \Delta AR_{it})/TA_{it-1} + \beta_3(PPE_{it}/TA_{it-1}) + \beta_4 ROA_{it-1} + \varepsilon_{it}$$

Where -

*TACC<sub>it</sub>*: Total level of Accruals.

*TA<sub>it</sub>*: Total firm's assets.

*ΔREV<sub>it</sub>*: Revenues in the year *t* less revenues in *t-1*.

*ΔAR<sub>it</sub>*: Changes in the Accounts Receivable.

*PPE<sub>it</sub>*: Property, Plant, and Equipment.

*ROA<sub>it</sub>*: Return on Assets.

*ε<sub>it</sub>*: The Residual.

Level of the DACC is a residual of the mentioned equation, it is the difference between the total levels of accruals (TACC) deflated by firm's TA<sub>it</sub> and levels of the non-discretionary accruals which estimated through the fitted values of the mentioned equation. Therefore, TACC can be found through the difference between net income before the firm's extraordinary items and the operating cash flows extracted from cash flows, as follows:

$$DACC = TACC_{it}/TA_{it-1} - [\beta_0 + \beta_1(1/TA_{it-1}) + \beta_2(\Delta REV_{it} - \Delta AR_{it})/TA_{it-1} + \beta_3(PPE_{it}/TA_{it-1}) + \beta_4 ROA_{it-1}]$$

## RESULTS AND DISCUSSION

### Descriptive Statistics

Table 2 below shows the descriptive statistics (DS) regarding the variables under investigation in the current study. As shown in Table 2, mean of the dependent variable (EM) found -0.035, and it varies between Max (0.763), and Min (-0.594). Such results can be considered as an indicator the some of the Jordanian companies in this sample involved in the EM practices, and some not. Mean of the AC activity found to be 3.9 (almost 4), which reflect that most of the audit committees in the Jordanian context hold four meetings per year. In addition, 43% (Mean 0.432) of the audit committees' members in the sample possess accounting or financial experience. 42% (Mean 0.425) of the audit committees in the Jordanian companies consist of independent members. Mean, Med, Max, Min, and S.D of the control variables also have been shown in Table 2.

	EM	Ac_act	Ac_exp	Ac_ind	AQ(Big4)	Bdsiz	Acsiz	Loss	Fage	Firmsiz
Mean	-0.035	3.922	0.432	0.425	0.628	8.021	3.491	0.325	2.523	10.264
Med	-0.024	4	0.4	0.4	1	8	3	0	2.639	10.204
Max	0.763	10	1	0.889	1	14	6	1	3.584	14.394
Min	-0.594	0	0	0	0	4	0	0	0.693	5.979
S. D	0.128	1.689	0.262	0.235	0.484	2.216	0.935	0.469	0.625	1.410
Obs	658	658	658	658	658	658	658	658	658	658

*Table 2: Descriptive statistics*

### Correlation Matrix

Table 3 presents the existed correlation of the dependent, independent, and control variables, with their significance together. According to the prior studies (Qawqzeh, Bshayreh, et al., 2021), (Qawqzeh, 2023), the threshold of a harmful value regarding the multicollinearity is ( $\pm 0.80$ ). Results show that the correlation values are low, and there is no any value bigger than (0.8), thus, there is no any issues regarding the correlation.

	EM	acact	acexp	acind	big4	bdsiz	acsiz	loss	fage	firmsiz
EM	1									
acact	-0.115 <i>0.003</i>	1								
acexp	-0.112 <i>0.004</i>	-0.003 <i>0.930</i>	1							
acind	0.045 <i>0.251</i>	-0.021 <i>0.583</i>	-0.002 <i>0.955</i>	1						
big4	-0.069 <i>0.076</i>	0.011 <i>0.774</i>	0.074 <i>0.057</i>	0.030 <i>0.435</i>	1					
bdsiz	-0.045 <i>0.245</i>	0.178 <i>0.000</i>	0.038 <i>0.326</i>	-0.118 <i>0.003</i>	0.026 <i>0.508</i>	1				
acsiz	-0.036 <i>0.355</i>	0.020 <i>0.604</i>	0.042 <i>0.277</i>	0.050 <i>0.200</i>	0.008 <i>0.845</i>	-0.004 <i>0.927</i>	1			
loss	0.289 <i>0.000</i>	-0.007 <i>0.867</i>	-0.063 <i>0.109</i>	0.022 <i>0.569</i>	-0.063 <i>0.109</i>	-0.033 <i>0.398</i>	-0.063 <i>0.108</i>	1		
fage	0.046 <i>0.243</i>	0.065 <i>0.097</i>	-0.002 <i>0.968</i>	-0.004 <i>0.927</i>	-0.085 <i>0.028</i>	-0.041 <i>0.296</i>	0.056 <i>0.151</i>	-0.066 <i>0.091</i>	1	
firmsiz	-0.018 <i>0.640</i>	0.290 <i>0.000</i>	-0.119 <i>0.002</i>	-0.109 <i>0.005</i>	-0.012 <i>0.750</i>	0.437 <i>0.000</i>	0.049 <i>0.212</i>	-0.169 <i>0.000</i>	0.180 <i>0.000</i>	1

*Table 3: Correlation Matrix*

### Assumptions of Heteroscedasticity and Serial Correlation

As shown in Table 4 below, the current research utilized the Prob. Chi-Square to examine the assumptions of the Heteroscedasticity and the Serial correlation, following to (Hair et al., 2014). The value of Heteroscedasticity found to be insignificant (0.216). In addition, the value of Serial correlation found to be insignificant too (0.138). Therefore, no any issues regarding the Heteroscedasticity and the Serial correlation in the current research.



Table 4: Serial Correlation and Heteroskedasticity Tests		
Test	Serial Correlation	Heteroskedasticity
Result	Prob. Chi-Square (0.138)	Prob. Chi-Square (0.216)

## Multicollinearity

In order to examine the Multicollinearity, the most popular test to examine the Multicollinearity is the Variance Inflation Factors (VIF). According to this test, if the values were less than 10, it can be considered as an indicator that there is no Multicollinearity issue (Gujarati & Porter, 2009). Thus, as shown in the Table 5, all values of the study's variables found to be less than 10.

Table 5: VIF Test	
Variable	Centered VIF
AC_Activity	1.214
AC EXP	1.167
AC IND	1.135
BIG4	1.206
BDSIZ	1.326
AC SIZE	1.152
LOSS	1.226
FIRM AGE	1.042
FIRMSIZE	1.317
C	NA

## RESULTS

Table 6 represents the final main results of the effect of audit committee characteristics on EM, with audit quality as a moderating variable. As shown in the Table 6,  $R^2$  was found to be (0.513) with Prob(F-statistic) significance (0.000). Such results reflect that the independent variables in the current research explain 51% of the variance in the earnings management (dependent variable), that is, the model considered statistically significant.

Regarding the direct effect, namely; the effect of AC characteristics on EM, the findings show that AC activity (AC\_ACT) have a significantly (0.049), and negative (-0.004) influence on the discretionary accruals levels (EM). AC expertise (AC\_EXP) also found to have a significantly (0.076), and negative (-0.023) influence on the discretionary accruals levels (EM). Such results reflect that the mechanisms of corporate governance, namely; AC activity and AC expertise considered as an important tools to restrict the opportunistic behaviour by the management through prevent the earnings management practices within the Jordanian context. These findings are on the same line with the previous studies, like; (Inaam & Khamoussi, 2016), (Albersmann & Hohenfels, 2017), (Alzoubi, 2019) and (Kapkiyai et al., 2020), (Mardjono & Chen, 2020), (Ngo & Le, 2021), (Nikulin et al., 2022). According to the above findings, the developed hypotheses (*Ha1* and *Ha2*), which states that the AC activity and AC expertise have a significantly and negatively influence on EM practices are accepted.

On the other hand, AC independence (AC\_IND) found to have a significantly (0.049), and positive (0.028) influence on the discretionary accruals levels (EM). This finding has been reported by (Davidson et al., 2005), (Setiawan et al., 2020), (S. Mardessi, 2022). Such outcomes can be attributed to the fact that the audit committees in the sample had a low level of the independence among their members. Therefore, the developed hypothesis (*Ha3*) which states that the AC independence has a significantly and negatively influence on EM practices is rejected, and the alternative hypothesis is accepted.

In addition, audit quality (AQ) also found to possess a significantly (0.000), and negative (-0.137) influence on the discretionary accruals levels (EM). More specifically, the outcomes can be attributed to the fact that the high levels of external AQ minimize information asymmetry and then, affect EM practices inversely. This

finding has been supported by several prior studies, like; (Al-Hajaya, 2019), (Alzoubi, 2018), (Mollik et al., 2020), (Qawqzeh et al., 2019), (Qawqzeh, Endut, et al., 2021), (S. Mardessi, 2022), (Qawqzeh, 2023).

Table 6: Moderating Effect of Audit Quality on AC characteristics-EM relationship				
Sample: 2015 2021			Periods included: 7	
Cross-sections included: 94			Observations: 658	
Variable	Coefficient	Std. Error	t-Statistic	Prob.
AC_ACT	-0.004	0.002	-1.973	0.049
AC_ACT*AQ	-0.007	0.003	-2.578	0.010
AC_EXP	-0.023	0.013	-1.780	0.076
AC_EXP*AQ	-0.033	0.017	-1.950	0.052
AC_IND	0.028	0.014	1.971	0.049
AC_IND*AQ	0.026	0.019	1.404	0.161
AQ	-0.137	0.023	-6.037	0.000
BDSIZ	0.001	0.002	0.371	0.710
AC_SIZE	0.002	0.004	0.571	0.569
LOSS	-0.024	0.008	-2.911	0.004
FIRM_AGE	0.002	0.006	0.286	0.775
FIRMSIZE	0.012	0.003	4.077	0.000
C	-0.033	0.035	-0.936	0.350
Mean DV	-0.035	R-squared	0.513	
S.D. DV	0.128	Adjusted R-squared	0.582	
F-statistic	46.744	Prob(F-statistic)	0.000	
DV	EM	Durbin-Watson stat	1.728	
<i>Where-</i> AC_ACT: AC activity. AC_ACT*AQ: interaction variable (AC activity*AQ). AC_EXP: AC expertise. AC_EXP*AQ: interaction variable (AC expertise * AQ). AC_IND: AC independence. AC IND*AQ: interaction variable (AC independence * AQ). AQ: Audit quality. BDSIZ: Board size. AC SIZE: Audit committee size. LOSS: Loss. FIRM AGE: Firm age. FIRMSIZE: Firm size.				

Regarding the moderating effect of audit quality on AC characteristics-EM relationship, the findings show that the interaction variable (AC\_ACT\*AQ) have a significantly (0.010), and negatively (-0.007) influence on the discretionary accruals levels (EM). This finding indicates that the external audit quality (AQ) reduce the levels of discretionary accruals through the AC activity. The interaction variable (AC\_EXP\*AQ) also have a significantly (0.052), and negatively (-0.033). This finding indicates that the external AQ reduce the levels of discretionary accruals through the AC expertise. These findings can be considered as a reflection that the EM practices can be reduced if the Jordanian companies were well-audited. The findings also indicate that the big audit firms play an important role in restricting the EM practices. Consequently, the developed hypotheses, namely; (Hb1), which states that the external AQ moderates the AC activity-EM practices relationship, and (Hb2), which states that the external AQ moderates the AC expertise-EM practices relationship are accepted successfully. While the findings revealed that the interaction variable (AC\_IND\*AQ) have an insignificant (0.161) influence on the discretionary accruals levels (EM). Thus, the developed hypothesis (Hb3), which states that the external AQ moderates the AC independence-EM practices relationship is rejected.

## CONCLUSIONS

The context of the Jordanian companies has been considered as a unique setting and important environment to conducting like this study under investigation given that the various difficulties on the economic level and the several vulnerabilities which had affected the economic situation of the Jordan. For example, such as several of the economics, Jordan faced an accumulation of the debt over the last years, and this led to limit Jordan's ability to invest in the various sectors and the infrastructure, as well as the various development projects. Therefore, the main purpose of the current research is to examine the relationship of audit committee (AC) characteristics and the EM practices, as well as the moderating effect of external AQ on this relationship. AC characteristics in this study are represented by AC independence, AC expertise, and AC activity. Few prior literatures have examined the directly and indirectly relationship between AC characteristics and EM practices in the Jordanian context. In addition, this research has an important contribution in attempting to differentiate

the impact of various corporate governance mechanisms such as audit quality, AC independence, AC expertise, and AC activity on EM practices.

Based on a collective panel data for 94 non-financial Jordanian-listed companies to the period 2015 to 2021, the results revealed that AC activity and AC expertise have a significant and negative influence on the EM practices (measured by discretionary accruals levels). Conversely and surprisingly, findings show the AC independence found to have a significantly and positive influence on the EM practices. This finding can be attributed to the fact that audit committees in the sample had a low level of the independence among their members. On the other hand, the outcomes revealed that external AQ moderates the relationships of AC activity, AC expertise and EM practices. Conversely, the findings show that external AQ did not moderate the relationship between AC independence and EM practices. These findings indicate that the expert members and the active members of the AC in the Jordanian companies avoid EM practices more aggressively compared to other AC characteristics. In addition, the outcomes indicate that the quality of the external audit (through big audit firms) contributes to minimizing and restricting EM practices.

This current research has several implications; for instance, the research recommends that the policymakers in Jordan need to determine additional regulations regarding procedures of the external auditing, particularly in the transitioning economy, which seeks to attract more investments. In addition, Jordanian government have to raise the awareness levels of the earnings quality among the Jordanian companies, through introducing importance of the transparency and disclosures duties, and consequences of engagement in the EM practices, and its influence on the general economy. Moreover, the research indicates that the government in Jordan must review the related fines to the EM practices. In addition, the regulators and the policymakers in Jordan may utilize findings of the current research to address the various EM practices and enhance CG mechanisms.

Beyond the contribution of the current study to the previous studies, it provides an important feedback to the regulatory bodies regarding the EM practices and earnings quality issues. Outcomes of the current research help the investors in their decisions-making, and it provides better understanding regarding the significant role played by the external AQ and AC characteristics in the developing economics. This research extends our understanding regarding the association of external AQ, AC characteristics and EM practices.

This research provides several recommendations for the future research. More research need to investigate whether the various types of CG mechanisms, like board of directors and ownership structures lead to reduce or increase EM practices. Future studies also can focus on consequences of the EM practices. In addition, this study examined the moderating effect of external AQ, future studies may examine the mediating effect of external AQ on the CG mechanisms-EM practices relationship. The limitation of the current research is that its outcomes cannot be generalized on the developed countries, given that the Jordan considered as a developing country. Outcomes of this research may be generalized on the similar developing economics, which have same contextual characteristics.

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All authors are equally contributed in the current study at all stages.

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