# *Activating the Role of Audit Committees and Boards of Directors in Restricting Earnings Management Practices: a Perspective of Auditors in Jordan*

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***Abstract:***

*The study objects for investigating the possibility of activating both of audit committee and board of directors for restricting the practices of earnings management phenomenon. To achieve this objective, a questionnaire had been developed and self-administered for a selected sample consists of 123 auditors working in Jordan based on the simple random sampling method.. The study hypothesizes in its first hypothesis that audit committee can be activated in a form to restrict earnings management practices, while it hypothesizes in its second hypothesis that boards of directors can be activated in a form that restricts earnings management practices. The last hypothesis states that activating both of audit committees and boards of directors together will restrict the practices of earnings management. One sample t-test, in addition to descriptive statistics had been used in data analysis and hypotheses testing. The study finds that audit committee, boards of directors, and both of audit committee and board of directors together can be activated to restrict earnings management practices*

***Key words*** *: Audit committees ،Boards of Directors ،Earnings management.*

***ملخص:***

تهدف الدراسة بشكل رئيس إلى اختبار إمكانية تفعيل دور لجان التدقيق ومجالس الإدارة في تقييد ممارسات إدارة الأرباح.

ولتحقيق هذا الهدف، فقد تم تطوير استبانة، ووزعت مباشرة عل عينة مكونة من 123 مدقق حسابات يعملون بالأردن، تم اختيارهم بناء على طريقة العينة العشوائية البسيطة. وتفترض الدراسة في فرضيتها الأولى أنه يمكن تفعيل لجان التدقيق بشكل يقود إلى تقييد ممارسات إدارة الأرباح، فيما تفترض في فرضيتها الثانية، أنه بالإمكان تفعيل دور مجالس الإدارة لتقييد ممارسات إدارة الأرباح.

وتنص الفرضية الثالثة للدراسة أن كلا من لجان التدقيق ومجالس الإدارة يمكن تفعيلها لتقييد ممارسات إدارة الأرباح. ولقد تم استخدام أسلوب اختبار ت للعينة الواحدة وبعض مقاييس .الإحصاء الوصفي في تحليل بيانات الدراسة واختبار فرضياتها. ووجدت الدراسة أن تفعيل لجان التدقيق ومجالس الإدارة ولجان التدقيق ومجالس لإدارة معا من شأنه أن يؤدي إلى تقييد ممارسات إدارة الأرباح.

***الكلمات المفتاحية***: لجان التدقيق، مجالس الإدارة، إدارة الأرباح.

## *1. Introduction*

Since the starting of the current century, the term of corporate governance acquired the attention of different interested groups of people such as academics, accountants, auditors, investors, and creditors. This attention can be mainly attributed to the scandals of several corporations all around the world, especially in US, where large corporations collapsed there, such as WorldCom and Enron. This does not mean that corporate governance, as a term, was unavailable before that, it was available many years before, but the need for more applications of this term appeared because of different scandals.

The current study doesn't take with consideration the different elements of corporate governance, but focuses on two important aspects of this term, specifically, boards of directors and audit committees, because we believe that activating these two elements will enhance financial reporting issues, and therefore, restrict the different practices of earnings management phenomenon.

In 2003, the Security Exchange Commission (SEC) approved several rules of corporate exchange, as a response to scandals (Klein, 2003). The Sarbanes-Oxley Act, can be also considered a response to the scandals occurred by the starting of the current century. In addition, the global financial crisis that appeared and influenced the economy of most countries can be attributed to the lack adoption of corporate governance rules.

Board of directors is selected by common shareholders to manage the firm on behalf of these shareholders. Using other words, the board represents all shareholders in managing the firm. It set the strategies, policies, plans, and procedures, which are supposed to ensure the best possible manner of management, to achieve the objectives of the firm. On the other hand, audit committee is important for the purposes of objective, and reliable financial reporting. It consists of selected members among the board, based on the expertise, knowledge, and ability to direct and supervise internal auditors and the internal control system of the firm. Members of audit committee differ, in their number, from country to country, and may differ from firm to firm in countries where the regulations permit.

A weak in the board of directors and audit committee, or in their members, may lead to more and more of earnings management practices. Earnings management phenomenon, when exists, will result to an inappropriate financial reporting. As a result of inobjective financial reporting, investors, creditors, and other stakeholders will be in a position to take incorrect or inappropriate decisions. Therefore, a correct forming of the board of directors and audit committee should be given more attention, and should be based on correct useful rules.

When adequate incentives to manage earnings are available, the management of the firm may exercise the phenomenon of earnings management to receive more rewards and compensation, or to report lower income tax expense. In more details, management may take actions to reveal higher or lower income than the actual when it has enough incentives such as rewards, compensation, or contract renewal.

The problem of the study seems clear. It is an attempt to investigate the role of both the board of directors and audit committee on the practices of earnings management phenomenon. This problem can be better expressed through two questions. First, is there a role that the board of directors can play in restricting the practices of earnings management phenomenon? Second, Can audit committee restrict the practices of earnings management phenomenon? The study attempts to provide a reasonable answer for each of these two questions. To perform that, the related data should be collected from its available resources.

The study stems its importance from the important results that the practices of earnings management may lead for. Therefore, determining the tools and procedures that can be used to reduce and restrict these practices is more important, because decision makers can take effective actions to restrict these practices. In addition, the study is important because it can provide users with useful information in their perception to the mechanisms that the boards and audit committees can use to prevent or restrict such these practices. The importance of the study increases because of financial crisis that takes place in USA, Europe countries, and some Arab States, especially in Jordan where small investors lost a large, if not all, of their wealth, as a result of practicing several forms of earnings management.

The study attempts to achieve several objectives. First, it attempts to determine how the board can be activated to own the required abilities that can restrict the practices of earnings management. Second, it also attempts to identify how the audit committee can be used to restrict the practices of earnings management. Third, the study also adds more to the literature of corporate governance, board of directors, audit committee, and the term of earnings management, in addition to the relations available among these terms. Finally, the study objects for determining whether the guidance of Jordanian corporate governance is appropriate, or it needs for amendments in its elements regarding the board of directors and audit committee.

Different studies had been carried regarding corporate governance as a whole and its relation with the phenomenon of earnings management, or regarding some principles of corporate governance, but few studies investigated the role of the board of directors and audit committee in restricting the practices of earnings management. In Jordan, and based on the authors' knowledge, there were no scientific previous investigations to this subject. The study is also completely distinguishable in its place, time, methodology, and data collection.

The remainder of the study is structured to be as follows. Where section 1 is an introduction to the study, section 2 presents the related literature and prior related researches. Section 3 shows the hypotheses of the study, whereas section 4 introduces its methodology. Section 5 lists the data analysis and results, while section 6 provides the conclusions.

## *2. Literature Review and Prior Researches*

### 2. 1 Literature Review

Many people hear with the term of corporate governance, but few of them perceive the actual meaning of this term, and the benefits of its applications. Therefore, introducing brief and clear definitions to this term seems necessary.

The issue of corporate governance appears when two issues are present; (1) the agency problem, and (2) transaction costs (Hart, 1995). The most widely used definition of corporate governance is "the system by which companies are directed and controlled" (Gadbury Committee, 1992). The Organization for Economic Co-Operation and Development (OECD) defines corporate governance as, "a group of relations, that organizes the framework among executive management, board of directors, stockholders, and other related individuals". Corporate governance is also defined by the Internal Institute of Auditing (IAA) as "The processes through which procedures are used by stakeholders to provide an appropriate oversight on risks, managing risks by the management of the firm, and controlling these risks, and ensuring restrictions of these risks in a form that leads to objectives achievement of the firm".

A group of principles are available for corporate governance. We perceive that this is not the most appropriate location to illustrate them; instead, these principles can be listed. OECD identifies six principles that should be available in corporate governance framework. These principles are as follows (OECD, 2004):

1. Promoting transparent and efficient markets, be consistent with the rule of law, and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2. Protecting and facilitating the exercise of shareholders' rights.
3. Ensuring the equitable treatment of all shareholders, including minority and foreign shareholders, and ensuring that all shareholders should have the opportunity to obtain effective redress for violation of their rights.
4. Recognizing the rights of stakeholders established by law or through mutual agreements and encouraging active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
5 Ensuring that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
6. Ensuring a strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and shareholders.

Section 202 of Sarbanes Oxley defines audit committee as "a committee or an equivalent body established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer, and if no such committee exists with respect to an issuer, the entire board of directors of the issuer" (Gorman, 2009). Based on this definition, each business entity is required to establish an audit committee among the members of the board of directors, otherwise, the board itself is required to carry the duties and responsibilities of this committee.

The Sarbanes-Oxley Act acquires two basic requirements regarding the composition of audit committee. The first is that each member of the committee should be independent, whereas the second is that a member of the committee who is a financial expert. New York Stock Exchange (NYSE) requires the listed firm to include a committee of at least three members, in addition to an internal audit function. Each member in the audit committee should have certain basic qualifications, in addition to a basic knowledge of financial matters. Moreover, NYSE requires that each member in this committee must be independent.

Based on NYSE requirements, the committee member is not independent if he or she: (Gorman, 2009)

1- Employed by the firm or by its subsidiaries during the last three years, or an immediate family member within the last three years as an executive officer in the firm.
2- Receives directly more than $120,000 in any year within the last three years.
**3-** Is a current partner or employee of a firm that is the internal or external auditor; the director has an immediate family member who is a current partner of such a firm; the director has an immediate family member who is a current employee of such firm and personally works on the issuer's audit; or the director or an immediate family member was within the last three years a partner or employee of such firm and personally worked on the issuer's audit within that time.
4- The director or an immediate family member is or has within the last three years, employed as an executive officer of a company where any of the issuer's present executive officers at the same time served on the compensation committee.
5- The director is a current employee or an immediate family member is a current executive officer of a company that has made payments to, or received payments from, the issuer for property or services in an amount which, in any of the last three years exceeds the greater of $1 million or 2% of the other company's consolidated gross revenues.

Financial reporting quality is influenced by the monitoring role that the audit committee exercises (Carcello and Neal, 2000). The committee bridges the information asymmetry between the external auditor and the board of directors. Therefore, audit committee practice an important role of monitoring the related issues to financial reporting. Kalbers and Fogarty found that larger audit committees, when it is delegated enough legitimate power by the board of directors will be more effective in exercising its power.

Jordanian Guide of Corporate Governance Rules states that audit committee should be composed of at least three members among the board nonexecutive members, two of them are independent members in the board, so one of them should be the head of the committee. This committee is required by the board to set written work procedures, and its decisions are based on the rule of majority. The decisions and recommendations of the committee should be filed in the annual meetings of the board with shareholders. Underline the Jordanian Guide of Corporate Governance Rules, audit committee is authorized to acquire any needed information from all employees whatever their locations or administrative level in the firm. In addition, it can acquire legal, financial, or administrative consultation from outside consultants, and the firm should pay the determined cost of these consultations. (Jordan Securities Commission, 2003)

The Jordanian Guide of Corporate Governance Rules identifies several tasks to be accomplished audit committee. The most important task of the committee is to oversight and monitor on accounting and auditing activities of the firm. Moreover, the committee contributes in the process of selecting the external auditor, and reviews the external auditor's communications with the firm. Additional tasks are required to be performed by the audit committee in Jordanian firms, including issues related to internal auditors (Jordan Securities Commission, 2003).

The board of directors is considered the highest level of administration of shareholding companies, whatever the location or country of the firm. It is already known to most people, that the corporation's shareholders select the members of the board, and mostly it is required to perform two main functions: (1) setting the Chief Executive Officer's (CEO) pay, and (2) overseeing the financial reporting process, in addition to other less important functions (Christian and Volker, 2007). The board can delegate some of its functions to different committees it performs. Based on Jordanian Guide of Corporate Governance Rules number of the board committees should be composed of at least five members up to maximum of 13 members. It represents the firm shareholders to manage the firm for four years starting from the date of its election. At least one third of its members must be independent.

In Jordan, the Guide of Corporate Governance Rules states the assigned tasks to the board. It is not the most appropriate location to list all of these, but stating the most important tasks, especially those are strongly related to the subject of the study, is preferable. Similar to the rules of corporate governance, the Jordanian rules states that the board is required to set the strategies, policies, and procedures which are expected to fulfill the objectives of the firm, and the behalves of its shareholders. Moreover, the board has to establish the appropriate procedures which ensure that all shareholders receive their rights, whether the shareholder is Jordanian, or not, and which achieves fair and equity among those shareholders. The board also sets the procedures which enforce the firm to follow the active legal that ensure the firm compliance to these rules and regulations. In addition, the board of directors in Jordan is also required to set the risk management policy, and to arrange the financial and accounting affairs. The board appoints the executive manager of the firm, as it ends his or her services. The most related task related to the subject of the study, is that the board also initiates the policy of disclosure based on the related regulations. The last issue is the needs to be mentioned here is that establishing a separate organizational unit for internal control and audit (Jordan Exchange Commission, 2003).

Earnings management is defined as "purposeful intervention in the external reporting financial process, with the intent of obtaining some private gain" (Schipper, 1989). The definition of Healy and wahlen (1999), is reasonable, where they define earnings management as "earnings management occurs when managers use judgment in financial reporting in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company to influence contractual outcomes that depend on reported accounting numbers".

To be considered an earning management practice, the activity should be intentional, that the intent to mislead some parties is already available on advance to the action. Moreover, earnings management practices are opportunistic and harmful that is used to mislead at least some stakeholders. The most common items that are subject to practices of earnings management are those which depend on judgment, where estimation of their values is necessary such as useful life of tangible assets and bad debt provisions. In addition, judgment that goes beyond strictly accounting decisions is classified under earning management practices. Moreover, earnings management can occur through shifting expenditures between accounting periods. Other forms of earnings management can occur based on income before extraordinary items and net income, where an extraordinary gain or loss may be classified as a regular and continuous. Disclosure may be also used as an earnings management practice. Accounting method choice and timing is important to be used for earnings management. For instance, capitalizing the cost of an intangible asset may be considered as an earnings management practice. Actually, practices of earnings management may occur in more and more forms or practices, but mentioning some of these forms may be considered enough in this location.

The authors of the study believe that the practices of earnings management phenomenon can be restricted by through activating the rules of corporate governance, especially those rules of board of directors and audit committees, because of the authorities and tasks assigned to these two bodies. Based on ideas mentioned above, both the board of director and audit committee play an important role over financial reporting and over the procedures relating to accounting records and financial information.

**2.2 Prior Researches**

Boards of directors and audit committees, as key components of corporate governance, acquire the interests of researchers, academics, and other interested people these days. Board of directors is the highest administrative position, so it can take strategic and important decisions, while audit committee is a technical and professional committee. In Jordan and in all Arab countries two groupings had not been given enough attention, despite their possible influence on financial reporting based on studies carried outside the Arab world. Therefore, the researchers find that these two elements of corporate governance deserve more importance and attention by researchers.

Baxter and Cotter, (2005), investigated the association between audit committee and the phenomenon of earnings management for a sample of Australian listed companies prior to the introduction of mandatory audit committee requirements of 2003. Two known measures of earnings quality were used in this study based on first Jones (1991) model, and Dechow and Dechiv (2002) model. The study found that the formation of audit committee reduces intentional earnings management, while it doesn't reduce accrual estimation errors. The study also concluded that there are differences between audit committee accounting expertise and two earnings quality measures. The most important finding of the study is that other audit committee characteristics are not significantly related to the quality of earnings management.

Lin and Hwang (2010), investigated the relationship between audit and corporate governance on one hand, and earnings management on the other hand. The authors identified 12 relationships by integrating 48 prior studies. Among the findings of the study is that the independence and expertise of board of directors have a negative relationship with earnings management practices. The study also demonstrated an existence of a negative relationship between the independence, size, expertise, and number of meetings of audit committee and the phenomenon of earnings management. In addition, it revealed a positive effect of audit committee's share ownership on earnings management phenomenon.

Christian and Volker (2007, examined the effect of board of directors formation on how corporate boards perform the functions of CEO compensation and overseeing the financial reporting process. The study revealed that the use of performance-based pay schemes induces the CEO to practice what is called earnings manipulation. This finding leads to more oversight by the board of directors on the CEO and other positions and procedures occurring inside the company. The study showed that if the whole board is responsible for the both two functions, it will be necessary to provide the CEO with a compensation scheme that it is insensitive to performance, if an actual desire is available in order to reduce the subsequent control, while if the two functions are separated through the a formation of committees, then the compensation committee will be more promoted to choose a higher pay-performance sensitivity as the increased cost of oversight is borne by the audit committee.

An important study had been carried out by Peasnell, Pope, and Young (2005), over UK firms to examine whether the incidence of earnings management depends on outside members of board of directors and audit committee. The most important finding of the study is that the likelihood of managers making income-increasing abnormal accruals to avoid reporting losses and reductions in earnings is negatively related to the proportion of outsiders on the boards. Moreover, the study revealed that the chance of abnormal accruals being large enough to turn a loss into a profit or at least to ensure that profit does not decline is significantly lower in firms with larger number of outside members in the board of directors.

An additional related study to investigate the effect of some audit dimensions, including audit committee on earnings management had been carried out in France by Piot and Janin (2007). The most important finding of the study is that the presence of an audit committee in a firm curbs upward earnings management. One implications, based on authors understanding, of this finding is that the audit committee acts as a device to control the more egregious forms of earnings management, and the monitoring incentive of outside directors may be hampered by the collective board responsibility for financial reporting quality.

Xie, Navidson, and Dadalt (1995), examined the role of board of directors, audit committee, and the executive committee in preventing the practices of earnings management phenomenon. The study finds that the board of directors and the audit committee are related to the likelihood that the firm engages in practicing the phenomenon of earnings management. They add that members of the board and audit committee are associated with firms that have low practices of earnings management. In addition, the authors reveal that the number of meetings of the board members and the audit committee are associated with firms that have smaller discretionary current accruals. The study concluded that board and audit committee activities and their members' financial sophistication is an important factor that constraints the propensity of managers to engage in earnings management practices.

Siregar and Utama (2008), carried out a related study to corporate governance and earnings management. The purpose of the study was to investigate whether companies listed in Jakarta Stock Exchange conduct efficient or opportunistic earnings management, and to examine the effect of ownership structure, firm size and corporate governance on the type of earnings management. The authors used the multiple regression method to analyze the data and test the study hypotheses. As a result, they find evidence that the selected type of earnings by listed firms in Jakarta Stock Exchange tends toward efficient earnings management type. Moreover, the study finds that ownership structure has a significant influence on the selected type of earnings management. The study also shows that family ownership has a significant influence on the type of earnings management the firm selects. Regarding corporate governance, the study finds inconsistent evidence with regard to influence of institutional ownership, firm size, and corporate practices on type of earnings management.

Chtourou, Bedard, and Courteau (2001), carried out a study that investigates the relationship between corporate governance and earnings management. The objective of this study was to investigate whether a firms corporate governance practices affect the quality of its publicly released financial information. In more details, it examines the relationship between audit committee and board of directors characteristics and the extent of corporate earnings management as measured by the level of positive and negative discretionary accruals. The authors of this study used two groups of US firms, the first is of high levels of discretionary accruals, while the second is of low levels. The study finds that earnings management is significantly affected with some practices of governance that the audit committee and board of directors practice. The study actually finds that income increasing earnings management is negatively associated with a larger corporation of outside members who are not managers in other firms. In addition, the study reveals that short-term stocks options held by non-executive committee members are associated with income increasing earnings management.

A study that carried out by Bedard, Chtourou, and Courteau (2004), was specialized with specified characteristics of audit committee and the effect of these characteristics on the phenomenon of earnings management. Specifically, it investigates the expertise, independence, and activities of audit committee on the firm's publicly released financial information. The study also investigates the relationship between audit committee characteristics and the extent of corporate earnings management as measured by the level of income-increasing and income-decreasing abnormal accruals. The authors of the study used two groups of U.S firms, one with relatively high and one with relatively low level of abnormal accruals. The study reached that there is a significant association between earnings management and audit committee governance practices. The study also finds that aggressive earnings management is negatively associated with the financial and governance expertise of audit committee members, with indicators of independence, and with the presence of a clear mandate defining the responsibilities of the committee.

Zhou and Chen (2004), investigated the relationship between audit committee and board of directors on one hand, and the phenomenon of earnings management practices through loan loss provisions in commercial banks. They used a model for loan loss provision, and another model for discretionary loan loss provision. The authors find that banks with more active audit committees, audit committees with greater governance expertise, and more active boards are associated with less practices of earnings management phenomenon. Moreover, the study reveals that the number of audit committee meetings, audit committee members' governance expertise, and board meetings, are negatively associated to earnings management for low earnings management banks, whereas audit committee size, independence, meetings, and board size play an important role in constraining earnings management practices for the high earnings management group of banks.

### *3. Study Hypotheses*

Several incentives encourage managements of firms to practice different forms of earnings management phenomenon. Management exercise to this phenomenon leads investors and stockholders to take decisions based on incorrect, or at least, inaccurate and inappropriate financial information. Therefore, these decisions may lead to bad investing and credit decisions to those decision makers. This study assumes that audit committees and boards of directors can be used in a way to restrict the practices of earnings management.

Audit committee plays an important role in most, if not all issues, of financial reporting. When this committee granted enough authority, it can play the expected role in overseeing the internal audit function, and it can affect different aspects of work. Therefore, the committee when it is activated is expected to play a valid role in restricting the phenomenon of earnings management practices. As a result, the first hypothesis is presented in its null form to be as follows:

***$Ho_1$: Audit Committee cannot be activated to be more useful in restricting the practices of earnings management.***

We expect that board of directors' independence plays a vital role in restricting several practices of earnings management. Board stems its independency from its members' independence. The study also expects that the board size is an important factor that contributes effectively in preventing different forms of earnings management phenomenon. In addition, the board composition may also contribute in restricting the phenomenon of earnings management. Other related aspects to the board of directors are probably affects earnings management. Therefore, the first hypothesis of the study is developed to be as follows, in its null form:

***$Ho_1$: Boards of directors cannot be activated to be more useful in restricting the practices of earnings management.***

Taking the activities of audit committees and boards of directors together may lead to more restriction of the phenomenon of earnings management practices, especially, when a high degree of co-ordination and co-operation between these two bodies exists. Therefore, the third hypothesis is presented in its null form to be as follows:

***$Ho_3$: The phenomenon of earnings management is not restricted through activating both of board of directors and audit committee.***

## *3. Research Methodology*

The population of the study includes all listed firms in Amman Stock Exchange, while the sample consists of only commercial banking industry of Jordan. Data required for the accomplishment of the study had been gathered from different primary and secondary sources, including text books, journals, thesis and dissertation, internet, and so on. Regarding the required primary data, it was collected through using a questionnaire as the tool of the study. This questionnaire had been directed and self-administered for auditors and financial analysts in Jordan.

A questionnaire consisting of three sections had been developed based on the literature review, prior researches, and Jordanian regulations of corporate governance. The first section encompasses 5 items to collect the demographic data of respondents. Specifically, demographic data section includes age, year-experience, gender, education level, and professional certificates that some respondents may hold. The second section of the questionnaire consists of 21 items to collect data regarding boards of directors, whereas, the third consists of 15 items to collect data from respondents regarding audit committees.

The study questionnaire had been developed in English, and translated back to Arabic to be understandable for all respondents. The translation process occurred by a group of English specialized Academics in Universities and by the help of specialized academics in accounting because they have good knowledge with accounting terminology. Thereafter, it was introduced for academics of accounting and auditors to for comments regarding the ability of its items in measuring the different aspects of the study. In addition, a pilot study had been carried out through a primary distribution of the questionnaire for 12 auditors. Comments and recommendations of the experts had been taken with consideration, so it was adjusted to reflect the comments of this group of academics and auditors. At the end, 140 copies of this questionnaire were self-administered for them, among a total of 611 on job auditors in Jordan using the simple random sampling method. Among the total number of distributed questionnaires, 127 were received back, so the response proportion was around 85 percent.

One sample t test method was used in the data analysis based on 95 percent level of confidence, so all hypotheses were tested based on 5 percent (1 – 0.95) level of significance. The decision rule to accept or reject the null hypotheses was the comparison between computed and tabulated t value, where the null hypotheses is accepted if the computed t value is lower than the tabulated one. In opposite, the null hypothesis is rejected, and its alternative one is accepted, when the computed t-value is greater or equal to the tabulated one. To ensure more accurate and correct decisions regarding the acceptation or rejection of study hypotheses, an alternative method was used as a criterion together with the comparison procedure between the computed and tabulated t values. This additional decision rule, is a comparison between the predetermined and computed coefficient of significance, so a null hypothesis is accepted when the computed coefficient is greater than the predetermined one, while it is rejected, when the computed coefficient is the lower.

## *5. Results and Analysis*

### 5.1 Sample Description

At previous location, we mentioned that auditors in Jordan are the respondents to study questionnaire, and a sample of 127 of them responded to it. Based on the consideration of received questionnaires, 4 of them had been excluded because of incomplete answers, or consistency, so 123 were subject and valid to the analysis.

With regard to respondents' age, table (1) shows that greater than 50 percents of respondents are in age range of 35to44 years. The table shows only 3 respondents with less than 25 years, and only 2 of greater than 55.  Based on information available in this table, more than 65 percent of respondents have 35 years or more. This information means that more credible answers were provided by respondents because of their appropriate age.

**Table No. 1**
**Distribution of Respondents' Age**

| Age Range | No. of respondents | Percentage % | Cumulative Percentage |
|---|---|---|---|
| Lessthan 25 years | 3 | 2.4 | 2.4 |
| 25-34 years | 39 | 31.7 | 34.1 |
| 35 – 44 years | 62 | 50.4 | 84.5 |
| 45 -54 years | 17 | 13.8 | 98.3 |
| 55 years or more | 2 | 1.6 | 100 |
| Total | 123 | 100% | |

Regarding the demographic variable of year-experience, table (2) reveals enough information regarding respondents' distribution. The table shows that the range of 10-14 includes the greater number of respondents, where 31.7 percent of respondents have 10-14 year-experience. In addition, 26 of respondents have 15-19 year-experience. In brief, the table shows that greater than 36 percent of respondents have 5 or more year experience. Therefore, year experience is considered high, which also provides more credibility to the study too, because as large as the year-experience, as their respondents are more credible.

**Table No. 2**
**Distribution of Respondents' year-Experience**

| Range of year-experience | No. of respondents | Percentage % | Cumulative Percentage |
|---|---|---|---|
| Lessthan 5 years | 11 | 8.9 | 8.9 |
| 5-9 years | 23 | 18.7 | 27.6 |
| 10-14 years | 39 | 31.7 | 59.3 |
| 15 -19 years | 32 | 26 | 85.3 |
| 20 years or more | 18 | 14.6 | 100% |
| Total | 123 | 100% | |

With regard to respondents' age, table (3) shows how respondents are distributed between males and females. The table shows that only three female respondents in the sample, whereas the remaining are male respondents. This low percentage of female respondents means that the audit profession is unattractive to females. This phenomenon can be attributed to the nature of this profession, where it needs practitioners to move from location to location, and where it needs long working hours. In other words, audit profession is a field profession, so it is more appropriate to male people than female.

**Table No. 3**
**Distribution of Respondents' 'Gender**

| Gender | No. of respondents | Percentage % | Cumulative Percentage |
|---|---|---|---|
| Male Respondents | 120 | 97.5 | 97.5 |
| FemaleRespondents | 3 | 2.5 | 100 |
| Total | 123 | 100% | |

Table (4) shows the distribution of respondents' level of education. The table shows that around 83 percent of respondents have a bachelor degree, while only 3 have lower than the bachelor. The table also reveals that among respondents, only 12 have a master degree, while 6 have PhD. It is apparent that a round 97.5 percent of respondents have a bachelor or higher degree, which reflects that Jordanian people are highly educated, and audit profession is intellectual in its nature, so it needs for highly educated people.

**Table No. 4**

**Distribution of Respondents'' Level of Education**

| Education Level | No. of respondents | Percentage % | Cumulative Percentage |
|---|---|---|---|
| Diploma or Less | 3 | 2.4 | 2.4 |
| Bachelor | 102 | 82.9 | 85.3 |
| Master | 12 | 9.7 | 95 |
| PhD | 6 | 4.8 | 100 |
| Total | 123 | 100% | |

**Table No. 4**

**Distribution of Respondents' year-Experience**

| Range of year-experience | No. of respondents | Percentage % | Cumulative Percentage |
|---|---|---|---|
| Lessthan 5 years | 11 | 8.9 | 8.9 |
| 5-9 years | 23 | 18.7 | 27.6 |
| 10-14 years | 39 | 31.7 | 59.3 |
| 15 -19 years | 32 | 26 | 85.3 |
| 20 years or more | 18 | 14.6 | 100% |
| Total | 123 | 100% | |

Table (5) introduces information regarding professional certificates that respondents hold. The table reveals that few of respondents have professional related certificates to the profession of audit, such as CPA, ACPA, and JCPA. The total percentage of respondents who hold these types of certificates is around 28 percent. This means that Jordanian audit companies and offices do not send too much auditors for training programs, and no enough fund is assigned for this aspect. Moreover, the table shows that more than half of respondents do not have any professional certificates, which is considered good indicator for low attention auditors receive from the related parties in Jordan.

**Table No. 5**

**Distribution of professional Certificates held by Respondents**

| Range of year-experience | No. of respondents | Percentage % | Cumulative Percentage |
|---|---|---|---|
| No Professional Certificates | 63 | 51.2 | 51.2 |
| CPA | 8 | 6.5 | 57.7 |
| ACPA | 12 | 9.7 | 67.4 |
| JCPA | 15 | 12.1 | 79.5 |
| CMA | 4 | 3.2 | 82.7 |
| Other | 21 | 17 | 100% |
| Total | 123 | 100% | |

### 5.2 Hypotheses Testing

**The First Hypothesis**

It was previously mentioned that 15 items were used in the study questionnaire to measure the first hypothesis. Table (6) shows all of these items, in addition to the one measure of central tendency, and one measure of variation, and the computed t-value for each included item in this section of the questionnaire. The selected measure of central tendency is the arithmetic mean, whereas, the used measure for variation is the standard deviation, each of which is available in the table, for each item.

The table shows that the highest mean equals 4.6423, at standard deviation of 0.61578, and belongs to item number 8, which states "more independence given to audit committee members result of less earnings management practices', whereas the lowest one equals 3.4065, at a standard deviation of 0.87626, and attributed to item number 14 which states that "Less conflict between audit committee members enables the committee for more restriction of earnings management phenomenon". Considering the column of t-value, the table reveals that the highest one equals 29,578, and attributed to the item of the highest mean, while the lowest one equals 5.145 and due to the item with the lowest mean. The mean of the entire group of items used to measure whether audit committee activation leads to earnings management restriction equals 4.1295 at a standard deviation of 0.50465, with 24.824 t-value.

**Table No. 6**

**Items Used in Measuring Whether Activating Audit Committee lead to Earnings Management Restriction**

| Ser. No. | Item | Mean | Standard Deviation | T-Value |
|---|---|---|---|---|
| 1. | Larger number of audit committee members, lead for fewer practice of earnings management phenomenon. | 4.1301 | 1.04771 | 11.962 |
| 2. | When audit committee members have enough knowledge with financial reporting issues, the will have more ability to restrict earnings management practices. | 4.1301 | 0.99143 | 12.642 |
| 3. | More expert members in the audit committee with auditing profession, leads to more ability to constraint earnings management practices. | 4.3984 | 0.90300 | 17.175 |
| 4. | More experienced members in the audit committee enables the committee for more restriction of earnings management practices. | 3.5528 | 0.92509 | 6.628 |
| 5. | When audit committee members ate more knowledgeable with governance rule, they can practice more effective role in restricting earnings management practices. | 4.0569 | 0.98597 | 11.888 |
| 6. | Audit committee members have ability to restrict earnings management practices when they are more educated with the internal control system of the firm. | 4.4797 | 0.69364 | 23.658 |
| 7. | Audit committee members can restrict several practices of earnings management when they are more qualified. | 4.1707 | 0.72097 | 18.009 |
| 8. | More independence given to audit committee members result of less earnings management practices. | 4.6423 | 0.61578 | 29,578 |
| 9. | Audit committee members' ability to constraint earnings management practices is increased, as they | 4.3659 | 0.73850 | |

| | | | | |
|---|---|---|---|---|
| | delegated more power from the board of directors, | | | 20.512 |
| 10. | More meetings of audit committee members lead to more ability of audit committee to restrict earnings management practices. | 4.5772 | 0.68960 | 25,366 |
| 11. | Audit committees having more educated members with responsibilities and duties of internal auditors, will acquire enough ability to constraint earnings management practices. | 4.0976 | 0.69441 | 17.529 |
| 12. | More access between audit committee members and external auditors enables the committee to restrict earnings management practices. | 4.1951 | 0.78572 | 16.869 |
| 13. | Lower outside members in the committee enhances the committee ability in restricting earning management practices. | 3.5285 | 0.80292 | 7,299 |
| 14. | Less conflict between audit committee members enables the committee for more restriction of earnings management phenomenon. | 3.4065 | 0.87626 | 5.145 |
| 15. | Periodic meetings with short time separating each meeting from the next lead to more ability of restricting earnings management restrictions. | 4.2114 | 0.73832 | 18.197 |

The first hypothesis is again presented below:

***$Ho_1$: Audit Committee cannot be activated to be more useful in restricting the practices of earnings management.***

Table (7) shows the related statistics to the group of items used in measuring the audit committee activation can restricts the practices of earnings management. The table shows that the computed t-value equals 24.824, and the computed coefficient of significant equals zero. When the computed t-value is compared with the tabulated one, which equals 1.96, based on 95 percent level of significance, we find that the computed one is greater than the tabulated. Moreover, comparing the computed coefficient of significance with the predetermined one, which equals 0.05 (1 – 0.95 level of confidence), it is apparent the computed is lower than the predetermined. Because the computed t-value is greater than the tabulated, and because the computed coefficient of significance is lower than the predetermined one, the null hypothesis is rejected, so the alternative one which states that activating audit committee restricts earnings management practices is accepted. In other words, the test of the first hypothesis reveals that when audit committee is activated, it will lead to restriction in the practices of earnings management phenomenon.

**Table No. 7**

**Statistics Related to the First Hypothesis**

| | | | | | | |
|---|---|---|---|---|---|---|
| ***No. of Hypothesis*** | ***T-Value*** | ***Degrees of Freedom*** | ***Sig.*** | ***MeanDifference*** | ***Lower*** | ***Upper*** |
| ***$Ho_1$*** | ***24.824*** | ***122*** | ***0.000*** | ***1.12954*** | ***1.0395*** | ***1.2196*** |

**The Second Hypothesis**

We previously mentioned that 19 items were used in the study questionnaire to measure the second hypothesis, which states that activating the board of directors restricts earnings management practices. Table (8) shows all of these items, in addition to one measure of central tendency, and one measure of variation, and the computed t-value for each included item in this group. The selected measure of central tendency is the arithmetic mean, whereas, the used measure for variation is the standard deviation, each of which is available in the table, for each item.

The table shows that the highest mean equals 4.6341, at standard deviation of 0.61761, and belongs to item number 8, which states "The greater the number of the board of directors', the fewer practices of earnings management phenomenon", whereas the lowest one equals 3.2764, at a standard deviation of 0.96071, and attributed to item number 16 which states that " A board that able to set efficient and effective policy for disclosure more ability to prevent several practices of earnings management". Considering the column of t-value, the table reveals that the highest one equals 29.344, and attributed to the item of the highest mean, while the lowest one equals 3.191 and due to the item with the lowest mean. The mean of the entire group of items used to measure whether audit committee activation leads to earnings management restriction equals 4.0672 at a standard deviation of 0.42855, with 27.618 t-value.

**Table No. 8**

**Items Used in Measuring Whether Activating Board of Directors lead to Earnings Management Restriction**

| Ser. No. | Item | Mean | Standard Deviation | T-Value |
|---|---|---|---|---|
| 1. | Monitoring the decision of a firm management by the board of directors may lead to reduction in earnings management practices. | 4.0081 | .88240 | 12.671 |
| 2. | Pursuing the issues of financial reporting by the board of directors can reduce the possible practices of earnings management. | 4.4715 | .88081 | 18.529 |
| 3. | Director's integrity plays an important role in preventing several earnings management practices. | 4.4634 | .79231 | 20.485 |
| 4. | Board of directors' effectiveness helps in restricting some possible earnings management practices. | 4.3902 | .77496 | 19.896 |
| 5. | The way in which the board of directors is composed can eliminate several practices of earnings management. | 4.4228 | .71297 | 22.132 |
| 6. | Number of directors constituting the board of directors has an impact on the directors' ability to restrict many earnings management practices. | 4.4228 | .76831 | 20.538 |
| 7. | The way the board of directors is formed affects its ability to restrict some practices of earnings management. | 4.4390 | .83122 | 19.200 |
| 8. | The greater the number of the board of directors', the fewer practices of earnings management phenomenon. | 4.6341 | .61761 | 29.344 |
| 9. | Larger boards of directors are associated with levels of discretionary, and in restricting the reporting activities that involved some types of earnings management. | 3.8618 | .79264 | 12.58 |
| 10. | The more independent board of directors the more vital role it can play in restricting some practices of earnings management | 4.4553 | .65602 | 24.603 |
| 11. | More outside members on the board of directors lead to more restriction of the possible practices of earnings management. | 4.4878 | .60552 | 27.50 |
| 12. | Firms with larger percentages of independent members in the board have more ability to prevent different practices of earnings management. | 3.7236 | .72768 | 11.028 |

| | | | | |
|---|---|---|---|---|
| 13. | More educational diversified members in the board of directors grants the board more ability to prevent different practices of earnings management phenomenon. | 3.6829 | 1.04267 | 7.264 |
| 14. | More independent members in the board of directors enable the board to plays more effective monitoring role which finally leads to reduction in earnings management practices. | 3.6260 | 1.08188 | 6.417 |
| 15. | More qualified members in the board enable that board to set the financial strategies, policies, and procedures that restrict the possible practices of earnings management. | 4.0163 | .96652 | 11.661 |
| 16. | A board that able to set efficient and effective policy for disclosure more ability to prevent several practices of earnings management. | 3.2764 | .96071 | 3.191 |
| 17. | A board that sets clear and appropriate policy for authority delegation will acquire the ability to prevent many forms of earnings management practices. | 3.5285 | 1.18270 | 4.955 |
| 18. | A board of directors has the ability to set practical procedures of corporate governance, will acquire the ability to restrict several practices of earnings management. | 3.6016 | 1.06155 | 6.268 |
| 19. | A board reviews the internal control system of the company from time to time, is able to restrict several earnings management practices. | 3.7642 | 1.04866 | 8.082 |

The second hypothesis states that:

***$Ho_2$: Boards of directors cannot be activated to be more useful in restricting the practices of earnings management.***

Table (9) shows the related statistics to the group of items used in measuring the board of directors activation can restricts the practices of earnings management. The table shows that the computed t-value equals 27.618, and the computed coefficient of significant equals zero. When the computed t-value is compared with the tabulated one, which equals 1.96, based on 95 percent level of significance, we find that the computed one is greater than the tabulated. Moreover, comparing the computed coefficient of significance with the predetermined one, which equals 0.05 (1 – 0.95 level of confidence), it is apparent the computed one is lower than the predetermined. Because the computed t-value is greater than the tabulated, and because the computed coefficient of significance is lower than the predetermined one, the null hypothesis is rejected, so the alternative one which states that activating boards of directors restricts earnings management practices is accepted. In other words, the test of the second hypothesis reveals that when the board of directors is activated, it will lead to restriction in the practices of earnings management phenomenon.

**Table No. 9**

**Statistics Related to the second Hypothesis**

| | | | | | | |
|---|---|---|---|---|---|---|
| ***No. of Hypothesis*** | ***T-Value*** | ***Degrees of Freedom*** | ***Sig.*** | ***MeanDifference*** | ***Lower*** | ***Upper*** |
| ***$Ho_1$*** | ***27.618*** | ***122*** | ***0.000*** | ***1.067184*** | ***0.9907*** | ***1.1437*** |

**The Third Hypothesis**

The third hypothesis takes into consideration the activation of both of audit committee and board of directors. All included items in both sections of the questionnaire were used to measure the role of audit committees and boards of directors in restricting earnings management practices. Because these items and the related statistics are already available in tables (6) and (8), no need to be listed again. The third hypothesis is again presented below:

***Ho$_3$: The phenomenon of earnings management is not restricted through activating both of board of directors and audit committee.***

Table (10) shows the related statistics to the group of items used in measuring the board of directors activation can restricts the practices of earnings management. The table shows that the computed t-value equals 36.386, and the computed coefficient of significant equals zero. When the computed t-value is compared with the tabulated one, which equals 1.96, based on 95 percent level of significance, we find that the computed one is greater than the tabulated. Moreover, comparing the computed coefficient of significance with the predetermined one, which equals 0.05 (1 – 0.95 level of confidence), it is apparent the computed one is lower than the predetermined. Because the computed t-value is greater than the tabulated, and because the computed coefficient of significance is lower than the predetermined one, the null hypothesis is rejected, so the alternative one which states that activating both of audit committee and board of directors will lead to more restriction of earnings management practices is accepted. In other words, the test of the third hypothesis reveals that when audit committees and boards of directors are activated, they will result in more restriction in the practices of earnings management phenomenon.

***6. Conclusions and Findings***

The study hypothesizes that activating both of the audit committee and the board of directors may lead to possible restrictions of earnings management practices. Based on the collected data from auditors working in Jordan, data analysis, and hypotheses testing, the study finds the following:

1- *Activating audit committees leads to less practices of earning management phenomenon, because an activated audit committee will restrict the different methods of earnings management phenomenon. Audit committee can be activated when it is formed and regulated based on the active rules of corporate governance. In more details, audit committee will be able to restrict earnings management practices when it is formed from educated members with financial reporting issues, and when it conducts more meetings. When audit committee is delegated more authority, and when it has more independence will be able to restrict and reduce the different practices of earnings management phenomenon.*

2- *Activating the boards of directors leads to fewer practices of earnings management phenomenon, because an activated board of directors enables the board to restrict several practices of earnings management phenomenon. Boards of directors can be activated through its forming, the abilities of its members, and when it is able to form the required committees. Moreover, a board is activated when is consists of more independent and outside members. In addition, a board that conducts more meetings, and able to set and appropriate strategies, policies, plans, and procedures, and exercise more control monitoring, will be more able to restrict the possible practices of earnings management phenomenon.*

3- *Earnings management phenomenon can be more restricted through activating both of audit committee and board of directors, based on the corporate governance rules.*

*Earnings management practices can be reduced more if co-ordination and co-operation exists between audit committee and board of directors.*

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