

The Impact of Corporate Governance Mechanisms on Earnings Management Practices: Evidence from Jordan

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Abstract : This paper aims to examine the impact of two influential internal corporate governance mechanisms, namely board characteristics and ownership structure on the use of real activities-based and accrual-based earnings management by Jordanian public firms. Using panel data from Jordanian public firms after the introduction of the Jordanian Corporate Governance Code (JCGC) in 2009, the study finds both institutional ownership and managerial ownership constrain the use of real and accrual earnings manipulations. On the other side, both independent directors and largest shareholders are found to exaggerate the incidence of using real and accrual earnings management. The study also examines the trade-off between real and accrual earnings management and found that Jordanian firms use a combination of real and accrual-based earnings management to obtain the greatest effect on earnings reporting strategies. For the purpose of this study, three types of real earnings management are considered: sales manipulation, overproduction, and the abnormal reduction of discretionary expenditures. The abnormal discretionary accrual is considered for accruals management. While for the internal corporate governance mechanisms; board characteristics are examined by using board independence, board size, and CEO-duality; and ownership structure is examined by using managerial ownership, institutional ownership, foreign ownership and largest shareholder ownership. To the best knowledge of the researchers, this study is the first to examine the relationship between board characteristics and real earnings management in Jordan. Further, it is the first to examine the relationship between corporate governance mechanisms and discretionary accruals after the introduction of the Jordanian Corporate Governance Code in 2009. Thus, the findings of this study have important policy implications for policymakers, regulators, standard setters, audit professional, and investors in their attempts to constrain the practice of earnings management, whether real or accrual, and to improve the financial reporting quality in Jordan.

Keywords : board characteristics, Jordan, ownership structure, real earnings management

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