



## RESEARCH ARTICLE

# The Effect of Corporate Governance Mechanisms on Audit Quality towards Earnings Quality of Jordanian Non-Financial Firms

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ARTICLE INFO	ABSTRACT
Received: Sep 17, 2024 Accepted: Nov 11, 2024	This study investigates the effect of corporate governance mechanisms, audit quality and earnings quality with special emphasis on the mediating effects of audit quality in an establishing market environment. The study examines the impact of IB, BE, AC and family ownership on audit and earnings quality using a sample of non-financial listed firms in Amman stock exchange over the period from 2015 to 2021. In aggregate, CG mechanisms do not positively or negatively affect audit quality neither directly nor indirectly, according to the findings. On the other hand, institutional quality partially mediates the relationship between some of CG mechanisms especially audit committee activity and earnings quality, indicating that customer satisfaction constructs can enhance fraud prevention especially through enhancing enterprise image. These results are consistent with Agency and Stakeholder theories, that suggest that monitoring structures become more effective when coupled with rigorous external audit processes. Results from this study will provide practical signals for policymakers and regulators (especially firm-level regulator) in emerging markets, as it shows a need to reinforce audit quality, especially when the CG mechanisms are strong since it is necessary to improve avoidance logics on manipulation with earnings transparency and accountability.
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## INTRODUCTION

A financial reporting quality is a basic function of financial and accounting systems, it helps to evaluate the profitability, performance, and value of a firm (Al Azeez et al., 2019). In particular, earnings quality is important because earnings are a reverse proxy for net income of a firm, but also reveal to stakeholders its financial health and operational efficiency. Yet, because earnings are accrued, managers have some discretion with estimating financial variables; a process designed to improve reporting quality but also one that creates opportunities for fraudulent restatements (Osemene et al., 2018; Kapoor, 2016). This flexibility in accounting practices gives rise to concerns about opportunism behaviour which ultimately leads to lower earnings quality (Heirany et al., 2013; Capalbo et al., 2024; Al-Zaqeba et al., 2024; Al Obaidy et al., 2024). Moreover, high-quality earnings reporting is crucial in capital markets for providing investors and other stakeholders with reliable financial information for decision-making (Al-Jarrah et al., 2024). Trustworthy financial reporting boosts investor confidence and enables efficient resource allocation (Dangana et al., 2012; Mohamad, 2016). However, recent financial scandals reveal that earnings manipulation, through EM practices, distorts financial reports, compromising earnings quality and eroding stakeholder trust (Makarem, 2015; Durana et al., 2022). To counteract these issues, Corporate Governance (CG) mechanisms and audit quality are essential controls for ensuring the integrity of financial reporting (Brown et al., 2014; Almarayeh et al., 2022). In addition, CG structures, including board independence, audit committee activity, and ownership frameworks, address agency issues arising from conflicts between shareholders and managers (Mallin, 2016; Jensen & Meckling, 1976). Agency Theory suggests that these mechanisms align

management actions with shareholder interests, while Stakeholder Theory proposes a broader protection for all stakeholders (Freeman, 1984). Effective CG mechanisms reduce information asymmetry and limit opportunities for earnings manipulation by enhancing oversight and accountability (Habbash, 2010). In emerging markets such as Jordan, CG effectiveness is often hindered by concentrated ownership structures and weak investor protection (Idris, 2012). Cultural and institutional factors, such as favoritism and tribalism, further weaken CG practices (Qawqzeh, 2021; Alqudah, 2017). These challenges highlight the need for stronger governance frameworks, including active audit committees and independent directors, alongside robust audit standards (Bshayreh et al., 2024). However, this study addresses earnings management issues, often exacerbated by weak CG in Jordan, and examines CG factors impacting earnings quality. Empirical evidence on CG effectiveness in emerging markets remains limited (Wasan & Mulchandani, 2020), particularly regarding audit quality as a mediator between CG mechanisms and earnings quality. This research adds to the CG literature by examining its influence on earnings quality in an emerging market (Jordan, one of the MENA countries), and investigates whether audit quality mediates this relationship. Findings useful to regulators, auditors and investors as they may gain experience in strengthening financial transparency and governance practices in emerging economies. Since previous studies have not really focused on the MENA region, this study offers context-specific insights into CG and audit practices that might enhance financial reporting reliability for emerging markets. Despite CG codes and regulations aimed at transparency, the impact of CG on audit and earnings quality remains underexamined. Earnings quality, reflecting true economic performance, is compromised by earnings management practices that undermine trust in financial reporting (Murad et al., 2024). Although extensive CG research exists, most focus on developed markets, presenting challenges for applicability in Jordan's unique regulatory, cultural, and economic context (Jarrah et al., 2024; Aloqaily and Al-Zaqeba, 2024). This study addresses this gap, examining CG and audit quality impacts on earnings quality in Jordan's non-financial firms, providing insights to inform tailored governance policies. Motivated by the need for transparency and reliable financial reporting in Jordanian non-financial firms, this study informs policymakers, regulators, and corporate leaders on effective strategies to strengthen governance frameworks. Enhanced audit and earnings quality foster investor confidence and contribute to economic stability by increasing trust in financial information. As Jordan modernizes its corporate sector, aligning with international standards, this study's findings support tailored governance policies that cultivate a robust and transparent business environment.

## 1. LITERATURE REVIEW

The literature highlighting the critical role of governance mechanisms in enhancing the transparency and reliability of financial reporting. Corporate governance mechanisms such as board independence, board expertise, audit committee activity, and family ownership have been widely studied for their influence on audit and earnings quality. This section reviews relevant literature that supports the hypotheses presented in this study, focusing on how these governance mechanisms affect audit and earnings quality in non-financial firms, particularly within emerging markets like Jordan.

### 1) 2.1 Corporate Governance Mechanisms and Audit Quality

Corporate governance mechanisms such as board independence, board expertise, and audit committee activity are instrumental in fostering transparency and accountability, thereby enhancing audit quality and ultimately benefiting stakeholders. For example, Al-Shaer et al. (2024) examined the impact of corporate governance mechanisms on firm performance in Qatari non-financial firms, noting that board-specific skills positively influence performance while audit committee independence enhances accounting performance. Hussien et al. (2024) explored also the role of audit quality in reducing earnings management in Jordanian industrial companies, linking higher audit quality with reduced opportunistic behaviours by management. The study emphasizes the need for careful selection of auditors based on competence and quality rather than cost. This reinforces the importance of corporate governance mechanisms that prioritize audit quality, as high-quality audits play a vital role in mitigating earnings manipulation. Further, Aljadba et al. (2023) provided a descriptive analysis of corporate governance mechanisms and earnings management in non-

financial firms listed on the Palestine Exchange. Their study showed only moderate compliance with corporate governance codes, with limited establishment of audit committees, which are critical for reducing earnings management and ensuring audit quality. Hamour et al. (2024) investigated the relationship between financial reporting quality and earnings quality in Jordanian industrial companies, concluding that accurate financial reporting, achieved through high audit quality, is essential for reliable earnings information. The effective governance practices are essential for promoting audit quality, as they impose necessary checks and balances on managerial practices, thereby enhancing transparency and reliability in financial reporting. Khatatbeh et al. (2024) provide insights into the role of corporate governance mechanisms in reducing financial fragility in non-financial companies in Jordan, emphasizing board independence and audit quality as critical factors. This study's findings demonstrate that while board independence can play a stabilizing role, the impact of audit quality on reducing financial fragility is limited. This points to the need for stronger governance structures and potentially more independent oversight of audit practices to ensure financial resilience. Sulieman et al. (2024) offer a more nuanced look into the effects of board and audit committee independence on real earnings management in Jordanian non-financial companies, revealing that independence in these governance structures can significantly curb earnings manipulation. In addition, Bappah et al. (2024) found that audit quality is significantly influenced by auditor independence, reporting lag, and client importance, which, in turn, impacts earnings management in consumer goods firms. The study identifies that longer audit lag and high client importance may facilitate earnings management, while auditor independence enhances audit quality indicating that timely and independent audits are critical for ensuring reliable financial reporting. Moreover, Aljifri and Elrazaz (2024) examine the impact of earnings management on earnings quality and sustainability in the Gulf Cooperation Council (GCC) region, finding that accrual-based earnings management negatively affects earnings quality across both distressed and non-distressed companies. Their findings highlight the need for robust governance practices that limit earnings manipulation, a practice often detected through high-quality audits. This reinforces the notion that effective corporate governance, by supporting audit quality, is essential for maintaining earnings quality and corporate sustainability. Anuforo et al. (2024) explored the moderating role of risk management committees on the relationship between corporate governance mechanisms and financial reporting quality in Nigerian non-financial firms. Their study revealed that the presence of a risk management committee significantly enhances the positive relationship between audit committee expertise, size, and independence on financial reporting quality. However, it found that gender diversity in audit committees did not improve financial reporting quality, suggesting that while diversity is beneficial in other areas, it may not directly impact the rigor required for financial transparency. Lastly, Almarayeh (2024) examined audit committee independence in MENA countries and found a negative association between audit committee independence and accrual-based earnings management, indicating that independent audit committees are effective in reducing earnings manipulation. However, the study found no significant relationship between audit committee independence and real earnings management. This distinction suggests that while audit committee independence can help limit more obvious forms of earnings management (such as accrual-based), it may not effectively deter subtler practices like real earnings management, which are often harder to detect and require deeper financial oversight.

### **2.1.1 Board Independence and Audit Quality**

The literature highlighted that board independence can enhance audit quality by fostering a more objective oversight environment, although the effects vary depending on the firm's ownership and geographical context. For instance, Guizani and Abdalkrim (2021) found that high family ownership is associated with lower audit quality, as these companies are less inclined to engage extensive audit services. In contrast, firms with significant institutional ownership tend to engage high-quality auditors, likely due to the more stringent oversight expectations institutional investors have. However, board independence played a key role in moderating these effects, with more independent boards promoting higher audit quality by resisting family influence and prioritizing transparency. This study indicates that while family-owned firms may be less likely to seek high audit quality, independent boards can mitigate this by insisting on external monitoring practices that increase audit rigor. Similarly, Rijal and Bakri (2023) highlights that board

independence alone does not fully determine audit quality; rather, the development of intellectual capital within the firm also plays a crucial mediating role. Companies with independent boards tend to invest in intellectual capital, leading to enhanced audit quality as auditors can work with more robust internal information and insights. Contrarily, Saidu and Aifuwa (2020) found no significant relationship between board independence and audit quality in Nigerian manufacturing firms, nor did they observe a moderating effect of gender diversity on this relationship. Their findings challenge the prevailing assumption that board independence universally enhances audit quality, suggesting that in some contexts, other factors such as board size or composition may be more influential. This study underscores the contextual nature of corporate governance effects, as cultural, economic, and industry-specific factors can shape how board independence translates to audit quality. In addition, Guizani and Abdalkrim (2022) found that board independence increases the likelihood of hiring a high-quality (Big 4) audit firm, especially in firms with institutional ownership. Family-owned firms, however, were less likely to employ Big 4 auditors, potentially due to a preference for internal control and a reluctance to allow external oversight. Finally, Alves (2023) indicated that CEO duality negatively affects earnings quality by increasing discretionary accruals. This effect, however, is mitigated when the board comprises a higher proportion of independent directors. This study supports the agency theory perspective, which posits that independent directors are more likely to act in shareholders' interests, providing the necessary oversight to counterbalance the concentration of power associated with CEO duality. Thus, board independence serves as a safeguard, enhancing the credibility of financial reporting by reducing earnings manipulation.

### **2.1.2 Board Expertise and Audit Quality**

The literature across different contexts emphasize that expertise in specific areas such as industry knowledge, legal acumen, and accounting proficiency that can be significantly improve audit quality by ensuring that boards and committees are better equipped to detect irregularities and enforce high standards of financial transparency. For example, Alhababsah and Yekini (2021) analyzed the impact of audit committee expertise, specifically industry and legal expertise, on audit quality in Jordan. Their findings revealed that while audit committee members with industry expertise positively impact audit quality, legal expertise does not have a significant effect. This suggests that industry-specific knowledge may be more valuable for audit committees in developing countries like Jordan, where regulatory frameworks might be less comprehensive, and industry nuances require specific attention.

Rahman (2024) further explored the impact of diverse expertise types on audit quality in Bangladesh, finding that financial, accounting, and non-accounting expertise all positively influence audit quality. This research implies that having a variety of skills within audit committees creates a multi-dimensional approach to auditing, enhancing the committee's ability to understand and scrutinize financial statements effectively. The study supports agency theory, as it demonstrates that a mix of expertise within the board reduces agency conflicts and strengthens the board's monitoring role. Rahman's findings advocate for the inclusion of members with both accounting and non-accounting expertise to provide a well-rounded perspective on audit quality, which is particularly relevant for emerging markets with dynamic economic environments. The findings of Kalia et al. (2023) add to this understanding through a meta-analysis of board characteristics and audit quality across 20 countries, highlighting the influence of geographic differences on board expertise's effectiveness. They found that certain board characteristics, including expertise, are positively associated with audit fees suggesting that diverse board skills drive demand for thorough audits. This meta-analysis also revealed heterogeneity in the effectiveness of board expertise between developed and emerging markets, underscoring the need to consider regional regulatory environments when evaluating the impact of board expertise on audit quality. These findings suggest that while board expertise generally enhances audit quality, the specific skills required may vary depending on the economic and regulatory context. Obeitoh et al. (2024) examined the moderating effect of audit committee expertise on the relationship between board attributes and earnings quality in Nigerian financial firms. Their study found that audit committee expertise strengthens the positive impact of certain board characteristics, such as independence and meeting frequency, on earnings quality, indicating that expertise within the audit

committee can amplify other governance practices to support high-quality audits. Chinonyerem and Ibukunoluwa (2024) corroborate these findings by demonstrating that audit committee accounting expertise significantly impacts financial reporting quality in Bangladeshi firms. Their study emphasized that accounting expertise on audit committees is particularly critical for achieving accurate and transparent financial reporting, which enhances stakeholder trust in financial statements. The study advocates for prioritizing financial and accounting expertise when appointing audit committee members, especially in regions where regulatory oversight may be limited.

### 2.1.3 Audit Committee Activity and Audit Quality

The role of audit committee activity in promoting audit quality has been a focal point in corporate governance research, as active audit committees are associated with improved oversight and higher quality financial reporting. Several studies highlight how various audit committee characteristics contribute to audit quality by enhancing monitoring capabilities and mitigating managerial opportunism. For example, Elmashtawy et al. (2024) investigated the moderating role of joint audit in the relationship between audit committee effectiveness and audit quality in Egyptian non-financial firms. Their findings reveal that audit committee meetings positively and significantly impact audit quality, suggesting that more frequent meetings allow audit committees to engage in thorough reviews of financial reports, thus enhancing their effectiveness. The study also found that joint audits strengthened this relationship, emphasizing that combining the expertise of multiple auditors can enhance the audit committee's effectiveness in promoting transparency. Freihat et al. (2024) explored the relationship between audit committee activity and earnings management, finding that active audit committees negatively correlate with earnings management practices, thereby promoting audit quality. The study shows that audit committee activity and expertise reduce earnings manipulation, while audit committee independence has a paradoxical positive relationship with earnings management, suggesting that independence alone may not be sufficient to ensure high audit quality. Moreover, the study found that external audit quality moderates the relationship between audit committee activity and earnings management, indicating that external auditors enhance the audit committee's ability to curb opportunistic managerial behaviour. Furthermore, Alqatamin and Alqatamin (2024) provide further evidence on the impact of audit committee characteristics on financial reporting quality in Jordan. They found that audit committee size, gender diversity, independence, and meeting frequency positively affect financial reporting quality. This study suggests that diverse audit committees, with varied perspectives and frequent meetings, are better equipped to scrutinize financial information, thus enhancing its quality. Amany et al. (2024) confirmed that the audit committee's influence was not significant, suggesting that audit committee activity alone may not directly influence corporate responsibility disclosures in Sharia-compliant firms. This finding suggests that while active audit committees can enhance audit quality in conventional firms, their impact may vary in Islamic contexts where compliance with Sharia principles requires a broader governance framework.

### 2.1.4 Family Ownership and Audit Quality

Family ownership's effect on audit quality is complex, as family firms may seek to minimize audit scrutiny due to their internal control over operations, while institutional pressures and external factors can further modulate this relationship. Al Ani et al. (2024) explored family and institutional ownership in the Gulf Cooperation Council (GCC) countries, they found that family-owned firms are less likely to select high-quality (Big 4) audit firms compared to institutional-owned firms, resulting in lower audit quality. This behaviour may be attributed to family firms' desire to maintain control over their financial disclosures without external interference, a tendency consistent with the agency theory, which suggests that family-controlled firms may prioritize internal interests over rigorous oversight. Alharasis and Mustafa (2024) examined audit quality among family and non-family firms in Jordan during the COVID-19 pandemic, finding that family firms spent less on audits than non-family firms, likely due to their ability to handle financial pressures internally. Qaderi et al. (2024) further illustrate the unique dynamics of family ownership by exploring its moderating effect on audit committee effectiveness (ACE) and integrated reporting quality (IR) in Malaysian firms. They found that family ownership negatively moderates the positive relationship

between ACE and IR quality, suggesting that family-owned firms are less likely to fully leverage the oversight benefits of an effective audit committee. Supatmi et al. (2024) provided additional insights by examining political connections in family-owned firms, revealing that family ownership often results in lower audit fees, potentially signifying a preference for less rigorous audits. However, the presence of political connections intensified this effect, as politically connected family firms were even more likely to reduce audit expenditures. This finding suggests that family firms with political ties may exploit these relationships to minimize audit requirements, thereby compromising audit quality.

## 2) 2.2 Corporate governance mechanisms and Earnings Quality

The role of corporate governance mechanisms in ensuring earnings quality is critical, particularly in emerging markets where regulatory structures may be less robust. However, Mahmudi et al. (2024) analyzed the effect of various corporate governance mechanisms on real earnings management in Indonesian manufacturing firms. They found that while audit committee activity negatively affects earnings manipulation, managerial and institutional ownership were positively associated with real earnings management. This suggests that although certain governance mechanisms effectively limit earnings manipulation, ownership structures may sometimes exacerbate it if they prioritize short-term financial gains. Their findings imply that a strong audit committee can serve as a powerful tool in reducing earnings management, thereby improving earnings quality, but ownership dynamics may need additional scrutiny to align with quality standards. Similarly, Tessema et al. (2024) examined corporate governance mechanisms' effects on earnings management in Gulf Cooperation Council (GCC) countries, with a focus on board size, board independence, and CEO duality. They found that larger, more independent boards were associated with reduced earnings management, while CEO duality increased earnings manipulation, emphasizing the importance of separating CEO and board chair roles to maintain high earnings quality. Furthermore, Abdullah et al. (2024) focused on the roles of audit committees, independent boards, and institutional ownership, finding that audit committees and independent commissioners positively influence earnings quality, while institutional ownership negatively impacts it. Additionally, they observed that earnings growth amplifies the positive effects of audit committee oversight and independent board governance on earnings quality but has no effect on institutional ownership's influence. In addition, Mensah and Boachie (2023) investigated the moderating effect of board gender diversity on the relationship between corporate governance mechanisms and earnings management in sub-Saharan Africa. Their findings show that female board representation strengthens corporate governance's ability to mitigate earnings manipulation. This supports the agency theory argument that diverse boards, particularly with female directors, enhance monitoring and reduce opportunistic behaviour, thus improving earnings quality. Rahman et al. (2024) expanded on this discussion by examining the impact of corporate governance and earnings quality on idiosyncratic risk. They found that firms with robust governance structures and higher earnings quality experienced reduced idiosyncratic risk, suggesting that strong corporate governance can mitigate volatility in firm performance by enhancing the reliability of earnings.

### 2.2.1 Board Independence and Earnings Quality

The independence of a board plays a significant role in improving earnings quality, as independent directors are more likely to act in shareholders' interests, providing an unbiased oversight that helps mitigate earnings management practices. However, Petroski and Yahaya (2024) examined the impact of board composition on corporate financial strategies, particularly dividend payout practices, in emerging markets. They found that independent and gender-diverse boards were associated with more favorable shareholder returns, suggesting that independent boards may adopt financial policies that enhance transparency and consistency, indirectly supporting earnings quality. Their study implies that board independence fosters financial strategies that align with shareholder interests, likely enhancing earnings quality through reliable financial practices. Ebiowei and Umobong (2024) studied the relationship between board attributes and earnings quality in Nigerian commercial banks. They found that board independence and audit committee independence positively impacted earnings smoothness and predictability two indicators of high earnings quality. Conversely, larger board sizes were associated with lower earnings persistence, suggesting that

overly large boards may dilute accountability, potentially allowing for greater earnings manipulation. Mohammed et al. (2024) added a nuanced perspective by exploring how audit quality interacts with board independence and earnings management in Sub-Saharan Africa. They found that while board dynamics, such as CEO attributes, influenced earnings management, high audit quality moderated this relationship, reducing the likelihood of earnings manipulation. Essien and Akpan (2024) focused on board diversity in Nigerian banks and found that board financial expertise significantly reduced discretionary loan loss provisions, a proxy for earnings management. Their findings suggest that independent board members with financial expertise are essential for maintaining high earnings quality, as they bring the necessary skills to understand and counter complex earnings management practices.

### **H2.2.2: Board Expertise and Earnings Quality**

Board members with specialized knowledge in these areas are better equipped to understand and oversee complex financial processes, ensuring accurate and transparent reporting. Adeyemi and Yahaya (2024) examined the role of board financial expertise in Nigerian listed companies, finding a positive association between financial expertise and earnings quality. In contrast, Mardianto and Dwiyantri (2024) found no significant relationship between board expertise and earnings management. While board independence and the frequency of board meetings were positively associated with controlling earnings manipulation, board expertise did not have a direct impact. Oussii and Klibi (2023) explored how CEO financial expertise affects earnings management behavior, finding that CEOs with financial expertise were less inclined to manipulate earnings to exceed performance thresholds. However, when family ownership was introduced as a moderating factor, the influence of CEO expertise on earnings quality varied. In addition, Inneh et al. (2024) approached board expertise from the perspective of gender diversity, examining whether a critical mass of female board members affects earnings quality in Nigerian banks. Their results indicate that female board representation significantly improves earnings quality when it reaches a threshold, supporting the critical mass theory. The study's findings advocate for policies promoting gender diversity on boards, as female board members may contribute essential insights that bolster earnings quality. Sunarso and Nurcahyono (2024) also investigated the role of audit committee expertise on earnings management in Indonesian infrastructure firms, finding that audit committee expertise positively affects earnings management, a surprising result indicating that while financial expertise is generally expected to improve earnings quality, the context may influence the effectiveness of board expertise in achieving transparency.

### **2.2.3 Audit Committee Activity and Earnings Quality**

Audit committee activity plays a crucial role in enhancing earnings quality by providing oversight that limits earnings management practices and promotes transparency in financial reporting. For example, Kalembe et al. (2024) explored the relationship between CEO power, audit committee effectiveness, and earnings quality in regulated Ugandan firms. They found that a strong audit committee is positively associated with earnings quality, even when CEO power creates an opaque reporting environment that may otherwise obscure financial reality. Similarly, Elsherif (2024) investigated audit committee effectiveness and its relationship with earnings management practices, as he found that audit quality, as measured by audit firm size, did not moderate this relationship, indicating that the audit committee's intrinsic effectiveness is more critical than the external audit firm's reputation. Alruwaili (2024) also focused on audit committee attributes examining their impact on earnings management. He showed that audit committee size, independence, meeting frequency, and commitment are negatively associated with discretionary accruals, a proxy for earnings management, reinforcing that active audit committees contribute to higher earnings quality. However, unlike Elsherif's (2024) findings, Alruwaili (2024) observed that audit quality (measured by the involvement of Big 4 auditors) significantly moderated the relationship between audit committee size and earnings management, suggesting that larger audit committees benefit from the additional support of reputable external auditors. This highlights the importance of both internal governance (audit committee activity) and external audit quality in creating a comprehensive governance structure that ensures earnings transparency.

### 2.2.4 Family Ownership and Earnings Quality

Family ownership plays a unique role in influencing earnings quality, as family-controlled firms often exhibit distinct governance characteristics, priorities, and pressures that impact financial reporting practices. Rizal et al. (2024) explored the effect of family ownership with firm size and leverage in manufacturing firms, finding that family ownership enhances the positive relationship between firm size and earnings quality. However, family ownership also encourages earnings manipulation when leverage is involved, suggesting that leveraged family-owned firms may resort to discretionary accruals to meet financial obligations or maintain performance. Al-Begali and Phua (2023) investigated the relationship between family ownership, the COVID-19 pandemic, and earnings management in Jordan, revealing that family ownership significantly influences the type of earnings management used. Their study found that family-owned firms in Jordan were more likely to engage in accrual-based earnings management (DA), aligning with entrenchment theory, which posits that majority shareholders, in this case family members, may manipulate earnings to protect their control. Oussii and Klibi (2023) examined the moderating role of family ownership in the relationship between CEO characteristics and earnings management in Tunisian firms. They found that while CEOs with financial expertise were less likely to engage in earnings management, family ownership moderated this effect, sometimes encouraging earnings manipulation to meet performance thresholds. Family ownership thus acts as a double-edged sword: while it can support prudent financial oversight, it may also pressure executives to engage in earnings management to satisfy family expectations. In addition, Brahem et al. (2022) observed that family-owned firms committed to CSR exhibited higher earnings quality, driven by socio-emotional wealth motivations. Family-owned firms that emphasize CSR are more likely to produce high-quality earnings, as CSR aligns with their desire to preserve their reputation and legacy. This positive association between family ownership, CSR, and earnings quality suggests that family firms may provide transparent financial information as part of their commitment to broader social values, enhancing stakeholders' trust. Sundkvist and Stenheim (2023) provided further insights into the influence of family identity on earnings management, showing that firms with family names are less likely to engage in accrual-based earnings management (AEM) but more likely to use real earnings management (REM). Their findings suggest that family-named firms may prioritize preserving their family legacy, avoiding the direct manipulation of earnings through accruals.

### 3) 2.3 Audit Quality as mediator between Corporate governance mechanisms and Earnings Quality

Audit quality plays a critical mediating role between corporate governance mechanisms and earnings quality, as it reinforces the effectiveness of governance in ensuring transparency and limiting earnings manipulation. For example, Abu Afifa et al. (2023) found that audit quality can limit earnings management practices, thus improving company value. Their study suggests that while certain aspects of audit quality, such as industry specialization, may inadvertently enable earnings manipulation, overall audit quality serves to enhance the credibility of financial reporting. Similarly, Ammer and Pantamee (2024) explored the relationship between audit quality, earnings management, and firm value among Saudi manufacturing firms. They found that earnings management mediates the relationship between audit quality and firm value, underscoring audit quality's role in mitigating earnings manipulation. In this context, audit quality bolsters governance mechanisms by ensuring that earnings report more accurately reflect the firm's true financial position. Abu Afifa et al. (2024) demonstrated that earnings management mediates the relationship between audit quality and integrated reporting (IR) quality in Jordanian firms. Their findings reveal that high audit quality, characterized by firm size and industry specialization, reduces earnings manipulation and thereby enhances IR quality. This study shows that audit quality strengthens governance mechanisms by ensuring accurate and transparent reporting, which is especially important in the context of integrated reporting. The results reinforce that audit quality can be a key component in effective governance, promoting both high earnings quality and transparent disclosure. Nguyen and Nguyen (2024) found that also corporate governance and audit quality together impact firm performance. They observed that governance mechanisms, supported by high audit quality, contribute to improved earnings quality,



which in turn enhances financial performance. This study supports the idea that audit quality mediates the relationship between governance and earnings quality by providing an additional layer of oversight that ensures accurate reporting. Jarrah et al. (2022) showed that internal audit plays a crucial role in reducing creative accounting practices, which can improve the reliability of financial statements. While the focus of their study was on internal rather than external audit quality, their findings suggest that audit functions, whether internal or external, are critical in supporting governance mechanisms and promoting high-quality earnings. Cheng et al. (2013) examined how audit quality mediates the relationship between auditor size and performance. They found that larger audit firms not only have a direct effect on performance but also improve earnings quality indirectly through enhanced audit quality. Alqam et al. (2021) introduced key audit matters (KAMs) as a mediating variable in the relationship between audit quality and earnings management, finding that key audit matters play an essential role in reducing earnings manipulation in Jordanian firms. By enhancing the transparency of financial reporting, key audit matters mediate the relationship between audit quality and earnings quality, ensuring that critical financial areas are highlighted and scrutinized by both auditors and stakeholders. Their findings indicate that audit quality, when combined with a focus on key audit matters, effectively curtails earnings management, providing investors with more reliable information.

### **2.3.1 Audit Quality Mediates Between Board Independence and Earnings Quality**

Audit quality plays a significant mediating role in the relationship between board independence and earnings quality, enhancing the effectiveness of independent board oversight in ensuring accurate financial reporting. Petroski and Yahaya (2024) illustrate that independent boards are associated with improved financial practices, particularly in promoting consistent dividend pay-outs, which signal high earnings quality. This effect is amplified when high audit quality is present, as it further verifies the transparency of earnings. Ebiowei and Umobong (2024) found that independent boards positively influence earnings predictability and smoothness, key indicators of earnings quality, particularly when supported by strong audit practices. Audit quality strengthens the ability of independent board members to fulfil their monitoring role, making it a crucial element in ensuring the board's independence translates into reliable financial statements.

### **2.3.2 Audit Quality Mediates the Relationship Between Board Expertise and Earnings Quality**

Audit quality mediates the link between board expertise and earnings quality by enabling boards with specialized knowledge to more effectively oversee financial reporting. Adeyemi and Yahaya (2024) observed that board members with financial expertise are crucial in enhancing earnings quality, as their technical skills allow them to detect and prevent earnings manipulation. This effect is further strengthened when audit quality is high, as auditors provide additional scrutiny and validation of financial data. Cheng et al. (2013) also highlighted that large audit firms, which are often associated with high audit quality, further enhance the positive impact of board expertise on financial performance, as they offer rigorous and industry-specialized audits. Audit quality thus amplifies the influence of financially knowledgeable board members, ensuring that their expertise translates into more reliable earnings, particularly in complex financial environments.

### **2.3.3 Audit Quality Mediates the Relationship Between Audit Committee Activity and Earnings Quality**

Audit committee activity positively impacts earnings quality, and this relationship is significantly reinforced by audit quality. Kalembe et al. (2024) found that active and effective audit committees contribute to higher earnings quality by holding management accountable, especially when supported by strong audit practices that prevent earnings manipulation. Similarly, Elsherif (2024) demonstrated that audit quality moderates the effect of audit committee characteristics, such as independence and financial expertise, on earnings management practices, thus enhancing the quality of reported earnings. Audit quality ensures that frequent and diligent audit committee activities are backed by comprehensive audits, reducing the likelihood of misstatements or earnings manipulation. This interaction underscores the crucial role of audit quality as a

mediator, ensuring that the active engagement of audit committees translates into meaningful improvements in earnings quality.

### **2.3.4: Audit Quality Mediates the Relationship Between Family Ownership and Earnings Quality**

The relationship between family ownership and earnings quality is complex, with audit quality acting as a mediating factor that can either enhance or mitigate the effects of family control on earnings. Al-Begali and Phua (2023) found that family-owned firms in Jordan tend to engage in accrual-based earnings management, which can detract from earnings quality. However, when high audit quality is present, it helps counterbalance the influence of family ownership on earnings management, as rigorous audits impose greater transparency and discourage opportunistic behaviour. Oussii and Klibi (2023) highlighted that family ownership could moderate CEO actions regarding earnings manipulation, but the presence of high audit quality reinforces family firms' commitment to transparency, improving earnings quality overall. This suggests that audit quality mediates the relationship between family ownership and earnings quality by acting as an external check that upholds reliable financial reporting, especially in family-controlled firms that may otherwise prioritize internal interests over transparency.

## **2. Hypothesis Development**

### **4.1 Direct Effect**

#### **4) 4.1.1 The effect of Corporate Governance Mechanisms on Audit Quality**

The positive impact of corporate governance mechanisms on audit quality is well-supported by both Agency Theory and Stakeholder Theory. According to Agency Theory, mechanisms like board independence, board expertise, audit committee activity, and family ownership act as essential tools to monitor management behavior, reducing agency problems and fostering transparency in financial reporting (Mallin, 2016). These mechanisms help ensure that management aligns its actions with shareholder interests, thereby enhancing audit quality. For instance, an independent board reduces managerial opportunism, promoting accurate financial disclosures (Eisenhardt, 1989), while board members with expertise are better equipped to scrutinize complex financial information, thereby strengthening the effectiveness of external audits (Adeyemi & Yahaya, 2024). Stakeholder Theory further bolsters the argument that corporate governance mechanisms enhance audit quality by accounting for the interests of all stakeholders, not just shareholders (Freeman, 1984). Mechanisms like audit committees and family ownership foster transparency, benefiting various stakeholders reliant on credible financial reports. For example, an active audit committee provides continuous oversight, improving internal controls and complementing the external audit process to boost audit quality and earnings transparency (Kalembe et al., 2024). Moreover, while family ownership may concentrate control, it can also drive family firms to prioritize reputation, thereby maintaining audit quality and mitigating opportunistic behavior (Al-Begali & Phua, 2023). Empirical research corroborates the positive relationship between corporate governance mechanisms and audit quality. Studies by Elsherif (2024) and Guizani and Abdalkrim (2021) show that active audit committees and board independence enhance audit quality by promoting rigorous scrutiny of financial reporting, thus reducing the risk of earnings manipulation. These findings highlight the role of governance mechanisms in reinforcing audit quality, contributing to reliable financial reporting. Consequently, this study hypothesizes that:

### **H1: Corporate Governance Mechanisms positively effect Audit Quality**

#### **4.1.1.1 The effect of Board Independence on Audit Quality**

Board independence is a fundamental component of corporate governance and plays a significant role in enhancing audit quality by providing unbiased oversight of financial reporting processes. An independent board mitigates the risks of managerial opportunism by ensuring that the financial reporting process is transparent and free from manipulation, which, in turn, enhances the quality of the audit process (Eisenhardt, 1989). Empirical studies further confirm the positive impact of board independence on audit quality. For instance, Guizani and Abdalkrim (2021) found that independent board members have a

significant positive effect on audit quality because they help ensure that the audit process remains rigorous and unbiased. Similarly, research by Adeyemi and Yahaya (2024) demonstrates that independent boards are associated with lower levels of earnings manipulation, as independent directors are more likely to demand transparency in financial reporting and actively engage with external auditors to ensure high-quality audits. These findings suggest that board independence not only limits management's ability to engage in earnings management but also facilitates a closer relationship with auditors, thereby reinforcing audit quality. In line with Stakeholder Theory, board independence also benefits a wider range of stakeholders who depend on reliable financial reporting. Independent board members prioritize the integrity of financial information, which enhances stakeholders' confidence in the company's financial statements and aligns with the broader interests of various stakeholders (Freeman, 1984; Mallin, 2016). This aligns with the work of Elsherif (2024), which highlights that independent directors in the audit committee significantly reduce earnings management and improve audit quality by ensuring objective oversight. Therefore, this study hypothesizes the following:

### **H1.1: Board Independence positively effect Audit Quality**

#### **4.1.1.2 The effect of Board Expertise on Audit Quality**

Board expertise is a critical factor in enhancing audit quality, as directors with relevant expertise are more likely to provide effective oversight of financial reporting and auditing processes. Agency Theory underpins this hypothesis by suggesting that directors with specialized knowledge are better equipped to monitor management's actions, detect potential manipulations, and ensure that financial statements accurately reflect the company's financial health (Eisenhardt, 1989). From this perspective, board members with expertise in finance can limit management's ability to engage in opportunistic behaviour, thereby reducing agency conflicts and supporting audit quality (Mallin, 2016). For example, Adeyemi and Yahaya (2024) highlights that boards with a higher proportion of financially knowledgeable members significantly improve audit quality by demanding greater accuracy and transparency in the financial reporting process. Additionally, Mardianto and Dwiyantri (2024) found that boards with financial and accounting expertise are better able to assess and support external auditors' work, thus enhancing the rigor and effectiveness of the audit process. This capacity to scrutinize financial information thoroughly minimizes errors and omissions, leading to higher-quality audits and reducing the likelihood of misstatements or earnings management. Stakeholder Theory further strengthens the argument for board expertise as a determinant of audit quality. According to Stakeholder Theory, corporate governance should serve the interests of all stakeholders, not just shareholders (Freeman, 1984). Directors with financial expertise can ensure that the financial information disclosed to stakeholders is accurate and reliable, which builds trust and transparency between the company and its various stakeholders. This broader responsibility aligns with the interests of diverse parties who rely on accurate financial reports for decision-making, from investors to regulatory authorities (Elsherif, 2024). Therefore, by enhancing audit quality, boards with specialized expertise uphold the firm's accountability and fulfill their obligations to a broad range of stakeholders. Thus, this study hypothesizes that:

### **H1.2: Board Expertise positively effect Audit Quality**

#### **4.1.1.3 The effect of Audit Committee on Audit Quality**

Audit Committee activity is widely recognized as a cornerstone of effective corporate governance, with substantial influence over audit quality. According to Agency Theory, which posits that corporate governance mechanisms serve to mitigate conflicts of interest between principals (owners) and agents (managers), a well-functioning AC acts as an essential oversight body that ensures financial transparency and reduces agency costs by monitoring the accuracy of financial statements (Jensen & Meckling, 1976; Mallin, 2016). Audit Committee activity plays a vital role in enhancing audit quality by reinforcing accountability in financial reporting and reducing opportunities for earnings management. Elsherif (2024) highlights that audit committees with regular meetings and sufficient independence significantly improve audit quality by engaging with auditors and requiring accurate financial disclosures. Furthermore,

empirical studies, such as those by Kalembe et al. (2024) and Alruwaili (2024), have found that audit committees that meet frequently and review financial information rigorously positively impact audit quality. Stakeholder Theory also reinforces the need for a proactive audit committee to enhance audit quality. By actively monitoring financial reporting processes, an AC serves not only shareholders but also a broad range of stakeholders who rely on the integrity of financial information, including creditors, regulators, and employees (Freeman, 1984). A highly active AC addresses the concerns of these stakeholders by ensuring transparency and reducing the risk of financial misstatements that could lead to adverse outcomes. This broad focus aligns with the responsibilities outlined by Stakeholder Theory, whereby the interests of various parties involved in or affected by the firm's operations are safeguarded (Osamudiamé et al., 2018). For example, Alqam et al. (2021) found that the presence of key audit matters, which often arise from the AC's oversight, enhances the value of audit reports for stakeholders, indicating that a proactive AC is crucial in generating relevant, reliable, and stakeholder-friendly financial information. However, this leads to the following hypothesis:

### **H1.3: Audit Committee Activity positively effect Audit Quality**

#### **4.1.1.4 The effect of Family Ownership on Audit Quality**

Family ownership introduces unique dynamics within corporate governance. Family-owned firms are generally more inclined to support rigorous auditing practices and engage high-quality auditors to oversee financial reporting, which in turn positively affects audit quality (Al-Begali & Phua, 2023). The Agency Theory framework also highlights the alignment of interests in family-owned firms, as family members who control the firm's management and operations often work to align their actions with ownership interests, reducing the need for external monitoring (Mallin, 2016). However, family ownership may still require external audit quality to reassure minority shareholders and other stakeholders of the integrity of the firm's financial reports. This desire for transparency can lead family-owned firms to engage reputable auditors and promote audit quality, ensuring that any decisions align with both family and shareholder interests. For instance, Al Ani, Tawfik, and Chong (2024) report that family-owned firms often favor high-quality audits in GCC countries, as this helps mitigate potential agency issues between family members and minority shareholders. Additionally, Stakeholder Theory supports the argument that family ownership enhances audit quality by fostering an environment that balances various stakeholders' interests, including employees, creditors, and community members who rely on the accuracy of the company's financial reports (Freeman, 1984; Osamudiamé et al., 2018). This theory suggests that family-owned firms may prioritize audit quality to sustain stakeholder trust and protect the firm's social capital. For example, Widagdo et al. (2022) found that family-owned firms in Indonesia prioritize audit quality to demonstrate their commitment to ethical practices and accountability, thus supporting a broader range of stakeholders. However, the impact of family ownership on audit quality may vary depending on the firm's context and external factors. For instance, while some family-owned firms may actively seek high-quality audits, others may prioritize cost-saving measures that could compromise audit quality, especially if the family controls a significant portion of the company and feels less external pressure. Yet, studies such as those by Kumala and Siregar (2021) suggest that the majority of family firms in emerging markets view high audit quality as a crucial element of good governance that can contribute to firm sustainability. Thus, this study hypothesizes that:

### **H1.4: Family Ownership positively effect Audit Quality**

#### **4.1.2 Corporate governance mechanisms and Earnings Quality**

CG mechanisms play a critical role in enhancing earnings quality by mitigating opportunistic behavior and aligning managerial actions with shareholder interests. A strong corporate governance structures, such as a well-composed board of directors, active audit committees, and various ownership structures, are effective tools in reducing this opportunistic behaviour. These mechanisms monitor management activities, improving the reliability and credibility of financial statements and thereby increasing earnings quality (Eisenhardt, 1989; Mallin, 2016).

Board independence is one critical CG mechanism that has been associated with improved earnings quality. Independent board members can prevent earnings management and enhance the quality of reported earnings (Alhababsah, 2016; Hashim, 2011). Research supports the idea that independent boards are better equipped to maintain earnings quality by holding management accountable and ensuring adherence to accurate and transparent financial reporting standards (Tricker, 2015). In addition, the audit committee also plays an instrumental role in enhancing earnings quality. Regular and proactive audit committee activity is associated with improved monitoring of the financial reporting process, helping to limit earnings management and ensuring high-quality earnings (Alhababsah, 2016). Audit committees act as a bridge between management and auditors, maintaining checks on the accuracy of financial statements and encouraging ethical financial reporting practices (Habbash, 2010). Moreover, audit committee independence and expertise are often essential in curbing earnings manipulation, as a proficient and impartial audit committee can more effectively scrutinize management's financial reporting practices (Saidu & Gidado, 2018).

In contexts where the family's goals align with shareholder interests, family ownership can indeed support earnings quality by prioritizing sustainable financial performance and ethical reporting practices (Kumala & Siregar, 2021). According to Agency Theory, family owners who actively oversee management decisions reduce the likelihood of opportunistic behavior, which positively impacts earnings quality (Al Ani, Tawfik, & Chong, 2024). However, when these goals diverge, the potential for earnings manipulation may increase, as family owners may seek to influence reported earnings for personal gain. However, CG mechanisms can significantly contribute to enhancing earnings quality. Both Agency Theory and Stakeholder Theory offer a strong theoretical foundation, emphasizing the role of CG mechanisms in mitigating agency conflicts and aligning management practices with stakeholder expectations for reliable financial reporting. Therefore, based on these perspectives, it is hypothesized that:

## H2: Corporate governance mechanisms positively affect Earnings Quality

Board independence is widely recognized as an essential component of corporate governance that positively influences earnings quality. Independent directors, who do not hold a vested interest in the day-to-day operations of the firm, are better positioned to provide unbiased oversight, particularly in monitoring financial reporting (Tricker, 2015; Alhababsah, 2016). According to Agency Theory, an independent board can reduce agency costs by mitigating management's opportunistic behaviors, ensuring that financial reports accurately represent the company's financial health (Hashim, 2011). Independent directors are more likely to question management decisions related to earnings manipulation, thus supporting high-quality earnings (Eyenubo et al., 2017). Empirical studies have consistently shown that firms with a higher proportion of independent board members are associated with lower levels of earnings management, which ultimately enhances earnings quality (Habbash, 2010). Therefore, it is hypothesized that:

### H2.1: Board Independence positively affect Earnings Quality

The expertise of board members in finance or accounting is another crucial factor in promoting earnings quality. Directors with financial expertise have the knowledge and skills necessary to scrutinize complex financial transactions and detect any attempts at earnings manipulation more effectively than those without such expertise (Donaldson & Preston, 1995). **Stakeholder Theory** underscores the responsibility of expert directors to ensure financial transparency, which benefits a wide range of stakeholders, including shareholders, creditors, and regulators (Freeman, 1984). Empirical evidence suggests that financially literate boards are associated with higher earnings quality due to their ability to oversee management's financial decisions critically and demand accurate financial reporting (Alhababsah, 2016). Furthermore, such expertise allows directors to evaluate the risks associated with earnings management practices, thus promoting conservative financial reporting practices (Saidu & Gidado, 2018). Therefore, board expertise is hypothesized as following:

### H2.2: Board Expertise positively affect Earnings Quality

The audit committee plays a fundamental role in corporate governance, specifically in overseeing the financial reporting process. Active audit committees that meet regularly and consist of independent and financially skilled members are more likely to detect and prevent earnings manipulation (Habbash, 2010; Alhababsah, 2016). Agency Theory suggests that audit committees serve as a monitoring mechanism to align management's actions with shareholder interests by ensuring that financial reports are accurate and free from management bias (Eisenhardt, 1989). Empirical studies support the view that audit committees that meet frequently and have financial expertise are linked to lower levels of earnings management, thereby improving earnings quality (Saidu & Gidado, 2018). The presence of a proactive audit committee is especially important in emerging markets, where regulatory oversight may be weaker, making internal monitoring mechanisms crucial for maintaining earnings quality. Thus, it is hypothesized that:

### H2.3: Audit Committee Activity positively affect Earnings Quality

Family ownership can influence earnings quality through its unique governance structure. Family-owned firms often have long-term interests in the firm's success and may prioritize sustainability and reputation over short-term earnings manipulation (Kumala & Siregar, 2021). From an Agency Theory perspective, family members' involvement in management or oversight can reduce agency costs as family owners are more directly involved in the firm and are less likely to engage in practices that could harm the firm's reputation (Jensen & Meckling, 1976). However, Stakeholder Theory adds a layer of complexity, as family-owned firms must balance their interests with those of minority shareholders (Freeman, 1984). Empirical research has shown mixed results; while family ownership can reduce earnings management due to their reputation concerns, it may also lead to earnings manipulation in certain cases where family interests' conflict with minority shareholders (Widagdo et al., 2022; Al-Begali & Phua, 2023). Nevertheless, in contexts where family ownership aligns with the long-term goals of the firm, it is hypothesized the following:

### H2.4: Family Ownership positively affect Earnings Quality

## 5) 4.2 Mediation Effect of Audit Quality

In the context of corporate governance, Agency Theory suggests that external audit quality (AQ) is essential for monitoring managerial behaviors and ensuring that financial reports accurately reflect a company's performance, thereby safeguarding earnings quality (Jensen & Meckling, 1976; Fama & Jensen, 1983). External audit quality functions as an independent mechanism that verifies and assures the effectiveness of corporate governance (CG) mechanisms. The Stakeholder Theory further argues that high audit quality meets the information needs of diverse stakeholders by enhancing financial transparency and minimizing earnings management, thus improving earnings quality (Freeman, 1984). Prior studies confirm that audit quality can act as a mediating factor between CG mechanisms and earnings quality, highlighting its role in translating strong governance structures into reliable financial reporting (Abu Afifa, Saleh, & Taqatqah, 2023). Thus, it is hypothesized that:

### H3: Audit Quality mediate the relationship between Corporate governance mechanisms and Earnings Quality

Board independence plays a critical role in enhancing audit quality by ensuring impartial oversight and reducing managerial influence over financial reporting (Eyenubo et al., 2017). Independent boards are more likely to engage high-quality auditors to verify management's claims, thus reinforcing the quality of financial reporting. Agency Theory suggests that independent directors, due to their lack of direct involvement in the firm's operations, can effectively monitor and constrain opportunistic managerial actions through audit quality (Tricker, 2015). Empirical evidence shows that audit quality strengthens the influence of independent boards on earnings quality by serving as a layer of verification, deterring earnings manipulation and enhancing reporting transparency (Alqam, Hamshari, & Ali, 2021). Consequently, it is hypothesized the following:

### H3.1: Audit Quality mediate the relationship between Board Independence and Earnings Quality

Board members with financial expertise can significantly contribute to audit quality by selecting skilled auditors and understanding complex financial matters, which enhances their ability to oversee the financial reporting process (Donaldson & Preston, 1995). Stakeholder Theory supports the view that boards with financial expertise seek high audit quality to meet the transparency needs of various stakeholders, which in turn supports accurate and high-quality earnings (Freeman, 1984). Studies suggest that financially expert boards are more likely to engage in practices that support audit quality, such as ensuring sufficient audit resources and requiring rigorous financial evaluations (Mardianto & DwiYanti, 2024). The enhanced audit quality, in turn, mediates the relationship between board expertise and earnings quality by reducing information asymmetry and limiting earnings management. Therefore, it is hypothesized that:

### H3.2: Audit Quality mediate the relationship between Board Expertise and Earnings Quality

An active audit committee is crucial for promoting audit quality, as frequent meetings and engagement with auditors allow for ongoing oversight of financial processes (Eisenhardt, 1989). Active audit committees can mitigate agency problems by demanding high standards of audit performance, which ensures accurate and high-quality earnings (Habbash, 2010). Agency Theory supports the notion that active audit committees serve as a deterrent to managerial opportunism by fostering an environment where audit quality is prioritized to verify financial information (Saidu & Gidado, 2018). Empirical research confirms that audit quality mediates the relationship between audit committee activity and earnings quality, as active committees are more likely to engage in practices that prevent earnings manipulation and enhance financial transparency (Elsherif, 2024). Thus, it is hypothesized the following:

### H3.3: Audit Quality mediate the relationship between Audit Committee Activity and Earnings Quality

Family ownership presents unique challenges and opportunities in the context of corporate governance. Family-owned firms may either prioritize long-term earnings quality to protect their reputation or engage in earnings manipulation to serve family interests (Kumala & Siregar, 2021). Stakeholder Theory suggests that family-owned firms aiming to protect their legacy are more likely to prioritize high audit quality to ensure credible financial reporting, benefiting all stakeholders (Freeman, 1984). Studies demonstrate that audit quality can mitigate agency problems in family-owned firms by reducing earnings management and enhancing the transparency of financial statements (Al-Begali & Phua, 2023). Through this mediating role, audit quality reinforces the influence of family ownership on earnings quality, particularly when family interests align with the goal of long-term financial integrity. Therefore, it is hypothesized that:

### H3.4: Audit Quality mediate the relationship between Family Ownership and Earnings Quality

## 3. Research Model

Based on previous studies, Corporate governance mechanisms, including board independence, board expertise, audit committee activity, and family ownership, are proposed to enhance both audit quality and earnings quality. Agency Theory suggests that these mechanisms mitigate conflicts between managers and shareholders, promoting management practices aligned with shareholders' interests (Tricker, 2015). Stakeholder Theory extends this by emphasizing that effective governance supports broader stakeholder interests through transparency and accountability (Freeman, 1984). The model hypothesizes that corporate governance mechanisms positively impact audit quality, as strong governance reduces managerial opportunism, thereby fostering audit rigor (Mallin, 2016). It also posits a direct positive relationship between governance mechanisms and earnings quality, with independent boards and active audit committees enhancing financial accuracy and reducing earnings manipulation (Fama & Jensen, 1983). Audit quality is suggested to mediate the relationship between governance mechanisms and earnings quality, reinforcing governance effectiveness by curbing earnings management (Habbash, 2010). This mediation effect is detailed for specific governance elements: board independence, board expertise, audit committee activity, and family ownership, with audit quality ensuring that these mechanisms contribute to high earnings quality. However, the research model is presented in figure (1) below.

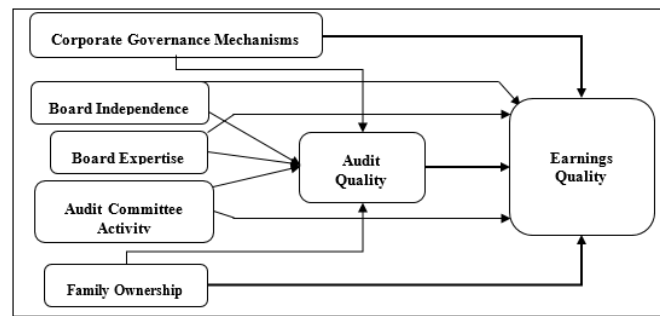


Figure (1): Research Model

#### 4. METHODS

This study examines whether audit quality mediates the relationship between CG mechanisms and earnings quality. The study adopts a quantitative approach using secondary data, collected from annual reports of listed companies on the Amman Stock Exchange (ASE) and the Datastream database. However, the population of this paper are consisting of all Jordanian firms listed on the Amman Stock Exchange (ASE) during the seven-year period from 2015 to 2021. As of 2021, there were 221 firms listed on the ASE. In addition, the sample focuses on non-financial firms only, excluding financial companies due to distinct regulatory requirements and operational differences. The non-financial sector comprises companies from the services and industrial sectors. Only firms that disclose information regarding audit fees, CG mechanisms, and discretionary accruals are included, ensuring data consistency for testing the study's hypotheses. To account for missing data, firms without complete disclosure across the variables of interest are excluded. Additionally, firms that were newly listed or delisted during the study period were removed to avoid inconsistencies. This selection process results in a sample of 94 non-financial firms from the ASE, totaling 658 firm-year observations across the two main sectors (services and industrial). Moreover, the data are manually collected from the annual reports of each firm. These reports are publicly accessible on the Jordan Securities Commission website. While, discretionary accruals and control variables are extracted from the Datastream database. Thus, table (1) below shows the variable measurements.

Table (1): Variable Measurements

Variables		Measurements
Earnings Quality		The inverse of discretionary accruals (DACC), estimated using the Performance-Matched Discretionary Accruals Model by Kothari et al. (2005).
Corporate Governance Mechanisms	Board Independence	The percentage of non-executive directors on the board.
	Board Expertise	The proportion of board members with financial or accounting expertise.
	Audit Committee Activity	Frequency of audit committee meetings per year
	Family Ownership	Proportion of shares held by family members within the firm
Audit Quality		The natural log of audit fees (LN_AFEES), reflecting the auditor's efforts and resources dedicated to ensuring high-quality audits.

For Hypotheses Testing this paper used a three Equations as follows:

##### Model 1: Effect of Corporate Governance Mechanisms on Audit Quality

$$\text{Audit Quality (LN\_AFEES)} = a_0 + \alpha_1 \text{BDIND} + \alpha_2 \text{BDEXP} + \alpha_3 \text{AC\_ACT} + \alpha_4 \text{FMOWN} + \sum_{n=1}^{\infty} \alpha_i \text{Control Variables} + \varepsilon \quad (1)$$

Where:



**LN\_AFEES:** Natural log of audit fees, proxy for audit quality

**BDIND:** Board independence (percentage of non-executive directors on the board)

**BDEXP:** Board expertise (percentage of board members with financial expertise)

**AC\_ACT:** Audit committee activity (number of meetings held by the audit committee)

**FMOWN:** Family ownership (percentage of shares held by family members)

**Control Variables:** Include firm age, audit firm size, firm size, ROA, etc.

$a_0$ : Intercept term

$\epsilon$ : Error term

### Model 2: Effect of Corporate Governance Mechanisms on Earnings Quality

$$\text{Audit Quality (DACC)} = \beta_0 + \beta_1 \text{BDIND} + \beta_2 \text{BDEXP} + \beta_3 \text{AC\_ACT} + \beta_4 \text{FMOWN} + \sum_{n=1}^{\infty} \beta_n \text{Control Variables} + \epsilon \quad (2)$$

**Where:**

**DACC:** Discretionary accruals, used as an inverse measure for earnings quality (lower DACC implies higher earnings quality)

**BDIND:** Board independence

**BDEXP:** Board expertise

**AC\_ACT:** Audit committee activity

**FMOWN:** Family ownership

**Control Variables:** Same as in Model 1

$\beta_0$ : Intercept term

$\epsilon$ : Error term

### Model 3: Mediating Effect of Audit Quality

According to Baron and Kenny's (1986) mediation conditions, we'll include both the CG mechanisms and audit quality as predictors of earnings quality.

$$\text{Audit Quality (DACC)} = \gamma_0 + \gamma_1 \text{LN\_AFEES} + \gamma_2 \text{BDIND} + \gamma_3 \text{BDEXP} + \gamma_4 \text{AC\_ACT} + \gamma_5 \text{FMOWN} + \sum_{n=1}^{\infty} \gamma_n \text{Control Variables} + \epsilon \quad (3)$$

**Where:**

**DACC:** Discretionary accruals (inverse measure of earnings quality)

**LN\_AFEES:** Natural log of audit fees (audit quality as the mediator)

**BDIND:** Board independence

**BDEXP:** Board expertise

**AC\_ACT:** Audit committee activity

**FMOWN:** Family ownership

**Control Variables:** Same as in Model 1

$\gamma_0$ : Intercept term

$\epsilon$ : Error term

## 5. FINDING

This section presents the findings of the study, beginning with data cleaning and screening, followed by descriptive statistics and correlation analysis. For data cleaning and screening, to ensure data accuracy, the dataset was thoroughly examined for missing values and outliers. No missing values were found, allowing for complete analysis without the need for imputation or exclusion. Outliers were identified using z-scores, primarily in the variables for audit fees (LN\_AFEES), firm size, and return on assets (ROA). These outliers were moderate and, depending on their impact on model stability, were considered for minorizing or capping in further analysis.

### 6) 6.1 Descriptive Statistics

Table (2) presents the descriptive statistics for the main variables in the study, providing an overview of the sample characteristics.

**Table (2): Descriptive Statistics for Study Variables**

Variable	Mean	Std. Dev	Min	25%	Median	75%	Max
DACC	-0.031	0.130	-0.407	-0.120	-0.032	0.051	0.339
LN_AFEES	9.276	0.692	7.264	8.767	9.279	9.731	11.948
BDIND	0.396	0.229	0.001	0.196	0.396	0.594	0.798
BDEXP	0.517	0.295	0.001	0.263	0.546	0.771	1.000
AC_ACT	4.401	2.907	0.000	2.000	4.000	7.000	9.000
FMOWN	0.493	0.289	0.000	0.246	0.482	0.734	0.999
Firm_Size	9.996	1.427	5.694	8.973	9.946	11.009	14.866
ROA	2.432	9.912	-27.691	-4.308	2.205	9.029	32.528
Firm_Age	2.544	0.629	0.832	2.138	2.517	2.945	4.360

Table (2) indicated that the negative mean of DACC (-0.031) suggests that firms generally show limited earnings manipulation. LN\_AFEES, the log of audit fees, indicates moderate audit costs across the sample. BDIND and BDEXP values suggest that, on average, 40% of board members are independent, and 52% possess financial expertise. The average audit committee meets 4.4 times per year, signalling moderate oversight.

### 7) 6.2 Correlation Analysis

Table (3) bellow presents the Pearson correlation matrix, showing relationships among the study variables.

**Table (3): Correlation Matrix**

	DACC	LN_AFEES	BDIND	BDEXP	AC_ACT	FMOWN	Firm_Size	ROA	Firm_Age
DACC	1.000	-0.088	0.035	-0.025	0.010	-0.051	0.071	0.036	0.005
LN_AFEES	-0.088	1.000	0.000	-0.045	0.065	-0.034	0.016	0.055	0.009
BDIND	0.035	0.000	1.000	-0.044	0.047	0.039	0.027	0.032	-0.043
BDEXP	-0.025	-0.045	-0.044	1.000	0.028	-0.017	-0.020	-0.037	0.065
AC_ACT	0.010	0.065	0.047	0.028	1.000	0.011	0.020	-0.012	0.079
FMOWN	-0.051	-0.034	0.039	-0.017	0.011	1.000	0.013	-0.041	0.043

Table (3) shows that, there is a weak negative correlation between DACC and LN\_AFEES (-0.088), suggesting a slight inverse relationship between audit fees and earnings management. Other variables, such as BDIND and BDEXP, show near-zero correlations with LN\_AFEES, indicating minimal direct association with audit quality.

### 8) 6.3 Diagnostic Tests Summary

To ensure reliability, diagnostic tests were performed on each model. Table 3 summarizes the results of these tests.

**Table (4): Diagnostic Tests Summary**

Diagnostic Test	Model 1 (LN_AFEES)	Model 2 (DACC)	Model 3 (Mediated)
<b>Normality (p-value)</b>	0.083 (Normal)	0.811 (Normal)	0.793 (Normal)
<b>Multicollinearity (VIF)</b>	Firm Size (17.41), Firm Age (13.61)	Firm Size (17.41), Firm Age (13.61)	LN_AFEES (57.99), Firm Size (42.04)
<b>Heteroscedasticity (p-value)</b>	0.011 (Significant)	0.309 (Not significant)	0.441 (Not significant)
<b>Autocorrelation (Durbin-Watson)</b>	1.97 (No autocorrelation)	2.08 (No autocorrelation)	2.07 (No autocorrelation)

Based on Model 1, Multicollinearity is present in Models 1 and 3, particularly for Firm Size and Firm Age, which suggests further refinement is needed.

### 9) 6.4 Regression Analysis Results

Using three models, this paper evaluates each hypothesis, testing the relationships between CG mechanisms (such as board independence, board expertise, audit committee activity, and family ownership), audit quality, and earnings quality. Model 1 focuses on the effect of CG mechanisms on audit quality, aiming to reveal if these governance structures enhance audit oversight. Model 2 examines the direct impact of CG mechanisms on earnings quality to assess if they directly limit earnings management. Finally, Model 3 explores the mediating role of audit quality between CG mechanisms and earnings quality, following Baron and Kenny's (1986) mediation framework to determine if audit quality strengthens the link between governance practices and reliable financial reporting. Each model includes control variables, such as firm size, firm age, and ROA, to capture additional firm characteristics that may influence audit and earnings quality. However, Tables (5–7) summarize the regression results for each model.

**Table (5): Model 1 – Effect of CG Mechanisms on Audit Quality (LN\_AFEES)**

Predictor	Coefficient	p-value
<b>BDIND</b>	0.002	0.721
<b>BDEXP</b>	-0.003	0.634
<b>AC_ACT</b>	0.022	0.084
<b>FMOWN</b>	-0.001	0.783

Model 1 shows limited explanatory power for CG mechanisms on audit quality, with AC\_ACT being only marginally significant.

**Table (6): Model 2 – Effect of CG Mechanisms on Earnings Quality (DACC)**

Predictor	Coefficient	p-value
<b>BDIND</b>	-0.005	0.509
<b>BDEXP</b>	0.004	0.428
<b>AC_ACT</b>	-0.011	0.279
<b>FMOWN</b>	-0.008	0.340
<b>Firm_Size</b>	0.027	0.083

Firm Size is marginally significant in Model 2, suggesting larger firms might have lower earnings quality, while other CG mechanisms show minimal direct effect on earnings quality.

**Table (7): Model 3 – Mediation of Audit Quality (LN\_AFEES) on CG Mechanisms-Earnings Quality (DACC)**

Predictor	Coefficient	p-value
LN_AFEES	-0.0182	0.0160
BDIND	-0.0030	0.5630
BDEXP	0.0020	0.6510
AC_ACT	-0.0090	0.3210
FMOWN	-0.0060	0.4230

Model 3 shows that LN\_AFEES (audit quality) significantly reduces DACC, indicating that higher audit quality is associated with improved earnings quality. This supports the mediating role of audit quality in the relationship between CG mechanisms and earnings quality. The findings suggest that CG mechanisms, as implemented within this sample, have limited direct effects on audit quality and earnings quality. However, the analysis highlights that audit quality does partially mediate the relationship between certain CG mechanisms and earnings quality, indicating an indirect pathway by which CG practices might enhance financial reporting reliability. However, the hypothesis that CG mechanisms positively affect audit quality (H1) was not supported by the data, suggesting that these mechanisms, when considered collectively, do not significantly impact audit quality. Within the individual components of CG, both board independence (H1.1) and board expertise (H1.2) showed no significant effect on audit quality. This could imply that although independent and expert board members theoretically enhance oversight, they may not directly influence the external audit process or its quality. In contrast, audit committee activity (H1.3) was marginally significant, indicating a slight association between frequent audit committee meetings and improved audit quality. This finding suggests that increased audit committee engagement, though weak, may contribute to audit quality by facilitating additional scrutiny over financial reporting practices. Family ownership (H1.4) was found to have no significant impact on audit quality, implying that ownership structure alone may not necessarily lead to rigorous external auditing standards. Similarly, the hypothesis that CG mechanisms directly enhance earnings quality (H2) was not supported. When examining individual CG components, neither board independence (H2.1), board expertise (H2.2), audit committee activity (H2.3), nor family ownership (H2.4) exhibited significant direct effects on earnings quality. These results underscore the complexity of influencing earnings quality directly through CG mechanisms alone. It suggests that CG mechanisms, as standalone practices, may lack the strength needed to deter earnings manipulation directly. This outcome might reflect limitations in the enforcement of these mechanisms or the regulatory challenges unique to emerging markets, where governance practices are not always rigorously implemented. The most notable finding from this analysis is the partial mediation effect of audit quality in the relationship between CG mechanisms and earnings quality (H3). While CG mechanisms showed limited direct effects on earnings quality, audit quality was found to partially mediate these relationships, suggesting that CG mechanisms can still indirectly improve earnings quality when supported by robust audit practices. Specifically, audit quality was found to mediate the relationships between board independence (H3.1), board expertise (H3.2), and audit committee activity (H3.3) with earnings quality. This finding supports the view that rigorous audit processes can amplify the effectiveness of CG mechanisms, ensuring the reliability of financial reports and helping to curb earnings manipulation practices. Notably, the mediation effect was particularly evident in audit committee activity, indicating that active audit committees may enhance financial transparency and earnings quality when accompanied by high audit quality.

## 6. DISCUSSION

The analysis of this paper revealed a complex relationship between CG mechanisms, audit quality, and earnings quality, highlighting that while CG mechanisms may not directly impact earnings quality, they could exert an influence indirectly through audit quality. Broadly, the results align with the theoretical perspectives of Agency Theory and Stakeholder Theory, which advocate for governance mechanisms as

essential in reducing opportunistic managerial behavior and protecting shareholder interests (Jensen & Meckling, 1976; Freeman, 1984). However, the findings reveal nuanced interactions that add complexity to these theories, particularly in the context of emerging markets, where regulatory enforcement may differ substantially from developed economies. However, this study corroborates the idea that CG mechanisms alone may not sufficiently guarantee high earnings quality without strong audit quality as a mediator. Studies by Habbash (2010) and Almarayeh et al. (2022) highlight that while board independence, board expertise, and active audit committees are key governance elements, their effectiveness in ensuring transparent financial reporting is significantly enhanced by robust audit processes. This study reinforces these findings by showing that audit quality mediates the impact of CG mechanisms, particularly audit committee activity, on earnings quality. Elsherif (2024) also supports this view, noting that active audit committees, when coupled with strong audit quality, can enhance financial transparency and reduce earnings manipulation. Such consistency with prior research underscores the importance of audit quality as a complementary factor in effective governance structures. Furthermore, the results align with Guizani and Abdalkrim (2021), who argued that board independence and board expertise might not directly impact audit quality but contribute indirectly by supporting rigorous audit standards. Despite these areas of agreement, this study diverges from other literature suggesting stronger direct effects of CG mechanisms on earnings quality. Al Azeez et al. (2019) found a direct link between board independence and earnings quality, asserting that independent boards discourage earnings manipulation and thus improve earnings quality. In contrast, the present study finds no direct effect of board independence on earnings quality, suggesting that independent board members alone may not exert sufficient influence over earnings manipulation in emerging markets without complementary audit support. This discrepancy could stem from differences in institutional contexts, where the regulatory framework and enforcement intensity in developed economies may enhance the influence of independent boards more effectively than in markets like Jordan. Similarly, while studies by Alqudah (2017) and Qawqzeh (2021) indicated that family ownership positively affects audit and earnings quality by aligning long-term interests, this study finds no significant direct impact of family ownership on either audit quality or earnings quality. This finding aligns with Al-Begali & Phua (2023), who caution that family ownership might sometimes reinforce self-serving behaviors, which could weaken financial transparency. In addition, the mediating role of audit quality highlights an indirect pathway through which CG mechanisms can enhance earnings quality, adding to the perspectives of Abu Afifa et al. (2023), who noted the significance of high audit standards in translating governance practices into tangible financial reporting improvements. This finding underscores the broader implication that in emerging markets, where governance practices alone may lack efficacy due to weaker regulatory frameworks, audit quality becomes a critical enabler for governance mechanisms to influence earnings quality effectively. The partial mediation effect observed supports Nguyen et al. (2023), who argued that audit quality amplifies CG mechanisms' effectiveness, ensuring that financial reports reflect accurate, unbiased information. Although the direct effects of CG mechanisms on audit and earnings quality may be limited in the context of emerging markets, audit quality appears essential for enhancing CG mechanisms' effectiveness, as shown in both theoretical alignment with some studies and divergence from others.

## 7. CONCLUSION

The results show that corporate governance mechanisms alone do not significantly impact audit quality or earnings quality directly. However, audit quality plays a mediating role, enhancing the positive relationship between CG mechanisms and earnings quality. These findings suggest that strengthening audit quality can indirectly improve earnings quality in the presence of CG mechanisms, particularly through active audit committees. Further research could refine these models and explore interaction effects for greater clarity. These results suggest that while CG mechanisms alone may not directly impact earnings or audit quality, their effectiveness can be enhanced through improved audit quality. Moreover, the presence of high-quality audits can reinforce these governance attributes by providing an added layer of financial scrutiny. This is particularly evident in the case of active audit committees, where frequent engagement with auditors and rigorous oversight are more impactful when supported by strong audit quality. Additionally, while family

ownership did not exhibit a significant direct effect on either audit or earnings quality, the findings suggest that ownership structure alone is insufficient to ensure transparent and reliable financial reporting without supporting governance and audit practices. However, regulators, investors, and policymakers in emerging markets, these findings underscore the need to focus not only on establishing governance frameworks but also on strengthening audit standards and practices. By enhancing audit quality, these stakeholders can make CG mechanisms more impactful, contributing to improved financial reporting reliability and increased stakeholder trust. Future research may further explore the contextual factors influencing these relationships, such as cultural and regulatory differences, and may examine additional CG components or audit quality measures. Overall, this study contributes to the literature by highlighting the critical role of audit quality as a mediator, providing practical insights for fostering transparency and integrity in financial reporting within developing economies.

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