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Corporate Governance and Audit Factors as Predictors for Accrual Earning Management among Palestine Listed Companies

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Abstract: **Palestine exchange market is one the developing market in MENA area, but it has some unique features associated with continuous struggles to survive. With these condition the possibility of financial reporting quality specially in relation to earning management become questionable. However, studies in developed countries revealed that there are relations between corporate governance and audit quality in accrual earning management. Understanding the factors of improving the quality of earning management in Palestine is important to provide an insight of how to develop the PEX market. Therefore, this study is an exploration into the Palestinian exchange market to increase the knowledge regarding the accrual earning management behavior and its antecedents. This study design has some characteristics, which formulate its design and include; scientific research, deductive research; quantitative research, and secondary data research. The model is composed of nine variables; the highest outcome variable (dependent variable) is firms' performance; Seven independent variables from corporate governance category and audit quality category; and accrual earning management as a mediator. The data collected from secondary data reports published by the Palestinian stock exchange agency (PEX) or by the companies in its official websites. The dataset have 320 records that related to 32 companies in 10 years and model relations analysis are based on OLS regression models. Three relations are accepted and four relations are rejected. The relations from variables; Concentrated Ownership, Managerial Ownership, Institutional Ownership, and CEO Duality are rejected. The highest predictor is external audit (Beta = -0.327). The second predictor is board independence (Beta = -0.212). The third predictor is audit committee (Beta = -0.122). From the five corporate management variables, only board independence has significant relationship with accrual earning management. Similar evidence from previous studies can be found but in relation with earning management and in different environment, in Malaysia [1], and in Indonesia [2]. External audit relation with earning management is mapped with previous studies in different environments; in Indonesia [2]; in Jordan [3]; and in UAE [4]. And audit committee relation with earning management is mapped with previous studies in different environments; in Iran [5], in India [6], and in Pakistan [7].**

Keywords: **Palestine Exchange Market, PEX, Accrual Earning Management, External Audit, Audit Committee, Corporate Governance.**

I. INTRODUCTION

The dependability and precision of the economic details given is required in the business setting in order to be able to perform and make decisions evaluation. Profits are considered the major source of details and would modify any decision [8]. This elevated the demand to establish regulations to regulate the performance and assist by enhancing the high quality of the monetary reporting and to make sure the openness of the financial info [9]. Despite this, accrual basis of accountancy urges managers to participate in earnings administration. This is conveniently detected from the discontinuity in the circulation of revenues. Previous researches have specified the techniques and methods supervisors carry out to manage their incomes [10]

Incomes management is identified as either accrual or real depending upon the nature of manipulation. Accrual control consists of moving the timing of expenditure and earnings recognition between periods like meeting earning thresholds by postponing expense recognition and advancing earnings recognition. Similarly, genuine tasks can be adjusted by reducing the optional expenditures like advertising and marketing and maintenance expenditure or by holding off or lowering research and growth expenditure. Firms that adjust revenues do so to reveal financial coverage that does not match with actual efficiency [11]. The end results of revenues monitoring techniques are assurance unhealthy; they lower business value, its online reputation and its business image [11]. On the other hand, it provokes the misery of stockholders, investors and various other companions and triggers a rise in advocacy and observation by regulative authorities and interested teams [12].

Different scholars make a recent exploration of issues and measures related to the Palestinian exchange (PEX) market stated that the market in Palestine is different because of the continuous struggling to survive and governance-management practices for growth needs to be explored to increase the knowledge of PEX market [13], [14]. Studies have shown that the performance of Palestine exchange market entities is quite low, and this unfortunate development has led to a decrease in the level of financial reporting quality and the loss of the reputation of a financial statement, which consequently jeopardises the confidence of shareholders and investors in the shareholding firms [15]. The low-level of firm performance has also led to the liquidation of many firms, and several others have collapsed prematurely. Analysis form Palestine market, which conducted by Companies Control Department (CCD) statistics shows that 44 firms encountered bankruptcy situation, and similar results were found in the twin market in Jordan [16]. PEX market has some unique features associated with continuous struggles to survive, which increase the possibility of inaccurate financial reporting quality specially in relation to earning management. This practical gap is the main aim of this study to reveal the role of accrual in financial reporting in PEX market [17].

The literature on firm accrual earning management determinants in emerging markets is somewhat limited; most of the empirical studies were evidently carried out in the USA and other developed nations [18], [19]. However, the impact of accrual earning management in firms' performance can be different from market to another based on complex geo-economic factors and to reveal that there are a need to explore different relations of accrual earning management and financial analysis of listed firms in stock market [20], [21]. There is a theoretical gap related to knowledge of how accrual earning management can affect firms' financial performance and this study is an exploration to resolve this gap.

Studies conducted to investigate listed companies in Palestinian Exchange market within the last five years are limited; the investigation from different indexes can show up to 10 studies. Studies are associated with different topics include financial performance [22], corporate social responsibility [23], audit quality [24], and corporate governance [25]. None of the studies explored the issues related to earning management especially accrual earning management. Therefore, exploring the connections between corporate governance, audit quality, and accrual earning management have never been conducted in Palestinian context.

II. THEORETICAL FRAMEWORK

A. Palestine Exchange (PEX)

The Palestine Exchange (PEX) was established in 1995 to promote financial investment in Palestine as a personal shareholding firm and transformed into a public shareholding business in February 2010 reacting to principles of transparency and good governance. The PEX was completely automated upon establishment- the very first totally automated supply exchange in the Arab world and the only Arab exchange that is openly traded and totally had by the exclusive market [26].

On 31 December 2016, the PEX listed 48 companies with a total market capitalization of some US3.39$ bn. Listed companies are divided into five sectors: banking and financial services, insurance, investment, industry, and services. Shares and bonds trade in Jordanian dinars and US dollars [26].

In view of the evolution of trading activity of Palestine Exchange, It is noted the extent of fluctuation in trading activity from year to year, since the establishment of Palestine Exchange till 2000, it is recorded a consecutive increases in trading values and volumes. Then due to Al-Aqsa Intifada the trading activity continued to decrease for 3 years till 2004 when trading values began to improve and reached the maximum trading value of 2 billions USD in 2005. Between 2006 and 2008 the trading value fluctuated increasing and decreasing due to the political division between West Bank and Gaza Strip, which reflected the general economic performance in the Palestinian Territories and the confidence of investors and increased the uncertainties regarding the future of the national economy. From 2009 till 2012 the trading value decreased as it is influenced by the global financial crises and the political situation in Palestine and the surrounding Arab countries. Eventually between 2013 and 2016 the trading value and volume has increased [27].

B. Accrual Earning Management

Earning management by business has actually long been documented in the scholastic literature. Administration of reported incomes is a significant audit worry both for academic community in addition to sector [28]. In earnings monitoring, the issue of determining the results of managers' usage of accountancy discretion in bookkeeping approach options is unavoidable. There are two techniques generally identified to control incomes: accrual adjustment or actual activity control [29].

Accumulations disparity between cash flow and earnings that are a standard part of company‘s businesses. For further elaboration, previous studies revealed that if company sold commodities on credit when sale is part of income no matter whether the cash was received or not, this brings about the establishment of what is received that can be canceled when cash is collected from buyers in the future[28]. Therefore, the practices of accounting allow the managers to discrete in the financial information provided. Managers should recognize his by exploring the incomes before been earned or suspend identification-incurred expenditures resulted from in accrual/accumulations [28].

C. Corporate Governance

Corporate governance is an extremely broad concept, it is watched and analyzed in a different way by each component of the neighbourhood and the organization. Stakeholders watch it as the standards that safeguards their rights, while monitoring views it as their code of service conduct. This plainly results that company administration does not have a shared interpretation in literature and it is not simple to explain [30] Sternberg (1998) specifies it: "Company Administration explains methods of making certain that company activities, representatives and assets are directed at attaining the company objectives established by the company's investors" [31]. It is likewise defined as "the system whereby organisation corporations are routed and regulated" [32]. The OECD Principles of Corporate Governance (2011) gives one of one of the most previously owned wide interpretations given that it serves as a recommendation for all OECD member nations: "Business Governance specifies a set of relationships in between a firm's administration, its board, its investors and various other stakeholders. Corporate Governance also provides the framework where the purposes (i.e. strategy) of the company are established, and the ways of obtaining those purposes and keeping an eye on performance are figured out" [33].

Great business governance enables the firm to work smoothly due to the presence of a clear level of accountability and communication amongst the company, in addition to individuals comprehending what their roles and obligations are. Responsibility, being one of one of the most vital characteristics in bookkeeping practitioners, will certainly clarify all included celebrations' obligations and legal rights, through improving expert values [30] To properly recognize and make use of business administration, it is required to comprehend and use its crucial ideologies. The general concepts of CG are normally associated with the investors, board of supervisors, and stakeholders. Along with that, business administration places a solid focus on the behavior of the corporation and the information it reports openly [32].

Corporate governance systems differ around the planet. This's because in some instances, corporate governance emphasis on the website link between the shareholders and the company, additional versions of corporate governance concentrate on job of the panel of directors plus board methods, while in some instances the emphasis will be on the social duties of the business [30]. You will find two primary versions, which are typically cited, in previous literature associated with the idea of business governance, which is outsider plus insider governance models. These basic versions typically labelled as Anglo Saxon as well as Continental European versions in prior governance literature [34]. Each model reflects the planet where businesses run plus the method of corporate governance that is in position. Corporate governance could include many measures related to management and ownership structure, and for this study the model of corporate governance includes the following:

- Concentrated Ownership,
- Managerial Ownership,
- Institutional Ownership,
- Board Independence
- CEO Duality

D. Audit Quality

The framework of audit quality are concerning two types of audit, internal audit that ministered by audit committee and external audit. An important external corporate governance mechanism is the external auditing. Theoretically, an independent examination of the books of account of a company by an auditor reduce agency problem by preventing the insider (controlling shareholders or managers) from engaging in discretionary accounting practices and estimates [35]. Extant studies showed that market participant react positively to companies audited by reputable audit firms. This is because reputable audit firms deploy more time, skill and resources during audit engagement. A few studies examined the role of quality external monitoring mechanism in reducing the agency problems that emerges from the separation of ownership from control. These studies argued that external monitoring by high quality auditor improves the credibility of financial reporting [36], [37].

Openly traded firms have to keep a qualified audit committee in order to be provided on a stock exchange. Board members should be made up of independent outdoors directors, including a minimum of one individual that certifies as a monetary specialist. The audit committee's role consists of the oversight of economic coverage, the tracking of accountancy policies, the oversight of any kind of exterior auditors, governing conformity and the discussion of risk administration policies with administration [38], [39].

E. Conceptual Framework and Hypotheses

The model is composed of eight variables; the highest outcome variable (dependent variable) is accrual earning management; and Seven independent variables from corporate governance category and audit quality category. The model has 7 main hypotheses and Figure 1 shows the proposed model and research framework. The model formulation is affected by the assumption from three different theories; Agency Theory; Stewardship Theory; and Stakeholder theory.

Agency theory is made use of to comprehend the relationships between principals and representatives. The agent represents the principal in a certain service purchase and is expected to stand for the most effective interests of the principal without respect for self-involvement. The various passions of agents and principals might come to be a source of conflict, as some agents might not perfectly act in the principal's best interests. The resulting miscommunication and dispute may lead to numerous issues and disharmony within firms. Inappropriate wishes may drive a wedge in between each stakeholder and create inefficiencies and monetary losses. This results in the principal-agent problem. These theory ideas relate to business administration and audit management [40], [41].

Stewardship theory is a theory that supervisors, left on their very own, will act as responsible stewards of the assets they manage. Stewardship philosophers think that given a choice in between egocentric behaviour and pro-organizational actions, a steward will put greater worth on collaboration than defection. Stepwise theory is directly related to CEO duality and generally related ro corporate governance [40], [41].

The stakeholder theory is a theory of organizational monitoring and organisation ethics that accounts for several constituencies impacted by business entities like workers, distributors, regional areas, creditors, and others. This theory is related to how entities such as owners (owners structure) behave in their managerial and governance matters [40], [41].

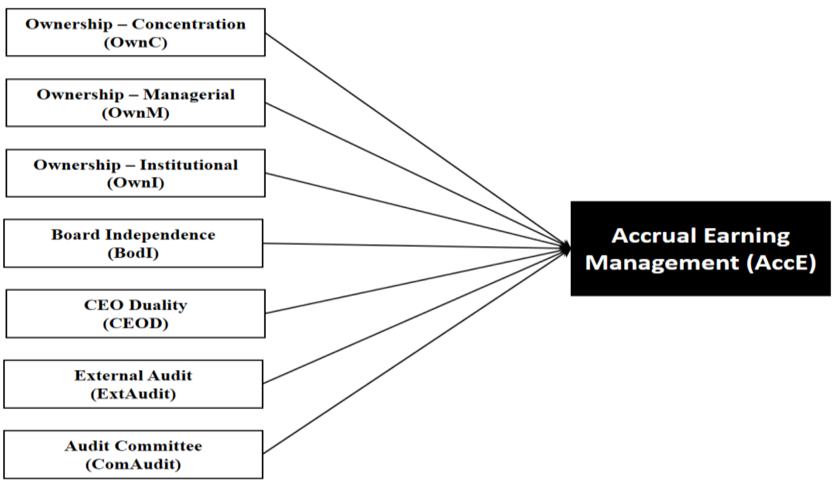

Fig 1: Conceptual Framework and Hypotheses

III. METHODOLOGY

In order to achieve the research objective, a quantitative research approach has been applied whereby the study was conducted based on the analyzed numerical data. The data will be processed into information by analyzing statistical relationship between the variables and the outcome would be conclusive in order to provide a solution to the identified problem in quantitative research. Quantitative research is to quantify the data and typically applies some form of statistical analysis [42]. This study uses quantitative method because it used numerical data that gathered from secondary source from Palestinian stock exchange market and performing statistical analysis to reach a conclusion based in numerical representation.

This study used data from 2008 to 20016 for 32 firms, which means that every firms have same data measures nine times based on annual reports data. Therefore, this study is longitudinal time horizon and the data type is panel data. This particular study is clearly based on secondary data that published by the Palestinian exchange market. That data are based on the annual financial reports published and endorsed by PEX and made available for public either for transparency or for extra analysis and research.

This study is a prediction model for firms' financial performance based on multiple dependent variables; and the numerical data of dependent variable are for true as it is based on the official published data. Therefore, OLS Multiple Linear regression is used to analyses the prediction model [42], [43].

The target population of this study includes the companies listed on the Palestinian stock exchange for the period from 2008 till 2016, which have appropriate data and measures regarding all the proposed variables and its projected scales as discussed in scales design part of this chapter. The desired population is 48 companies. A combination of judgement and convenience sampling was used for data collection. Specific PEX-listed companies were considered, since the annual reports and financial data were conveniently available in a standardized format on PEX official database. A sample was drawn from 32 companies from the 48 companies; researcher used his judgement to include only companies with complete reports during the time horizon from 2008 to 2016.

IV. FINDINGS

This particular analysis is investigating seven set of relations related to the assumption of "there is significant contribution made by corporate governance and audit variables on accrual earnings management". Results in Tables I and II show that variance of accrual earning management can be statistically explained by the seven predictors (F (7.312) = 10.517, p = 0.000). The seven variables can explain 19.1% of the AccE variance. The model is statistically significance at level 1% and the hypothesis is accepted.

Table I: Model Summary of Accrual Earning Management Regression Model

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.437[a]	.191	.173	.0789286
a. Predictors: (Constant), Audit Committee, Board Independence , Ownership Institutional , Ownership Concentration , CEO Duality, External Audit, Ownership Managerial				

Table II: Variance Analysis of Accrual Earning Management Regression Model

ANOVAa						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.459	7	.066	10.517	.000b
	Residual	1.944	312	.006		
	Total	2.402	319			
a. Dependent Variable: Accrual Earnings Management						
b. Predictors: (Constant), Audit Committee, Board Independence , Ownership Institutional , Ownership Concentration , CEO Duality, External Audit, Ownership Managerial						

Table III shows the path coefficient results for the proposed relations in the model. Three relations are accepted and four relations are rejected. The relations from variables; OwnC, OwnM, OwnI, and CEOD are rejected because of the non-fitted P value; significance level of these four variables are higher than the threshold score of 0.05; which shows a non-acceptable relations with theses variables at level of 5%. Board independency, external audit, and audit committee variables have significant relations with accrual earnings.

Table III: Path Coefficient Assessment of Accrual Earning Management Regression Model

Coefficientsa						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.273	.024		11.598	.000
	Ownership Concentration	.004	.019	.010	.198	.843
	Ownership Managerial	.033	.021	.085	1.554	.121
	Ownership Institutional	.030	.016	.093	1.790	.074
	Board Independence	-.069	.017	-.212	-4.128	.000
	CEO Duality	.010	.012	.043	.840	.401
	External Audit	-.046	.007	-.327	-6.339	.000
	Audit Committee	-.019	.008	-.122	-2.249	.025
a. Dependent Variable: Accrual Earnings Management						

The highest predictor and contributor to AccE is external audit (Beta = -0.327, t = -6.339, p = 0.000). Scores show that the increment of one unit of external audit will lead to decrement of 0.327 unit of AccE and the relation is a negative significance at 1% level.

The second predictor and contributor to AccE is board independence (Beta = -0.212, t = -4.128, p = 0.000). Scores show that the increment of one unit of board independence will lead to decrement of 0.212 unit of AccE and the relation is a negative significance at 1% level.

The third predictor and contributor to AccE is audit committee (Beta = -0.122, t = -2.249, p = 0.025). Scores show that the increment of one unit of audit committee will lead to decrement of 0.122 unit of AccE and the relation is a negative significance at 5% level.

Thus, the variance of accrual earning management can be best predicted as the following model equation:

AccE = (0.010 * OwnC) + (0.085 * OwnM) + (0.093 * OwnI) + (-0.212 * BodI) + (0.043 * CEOD) + (-0.327 * ExtAudit) + (-0.122 * ComAudit)

V. CONCLUSIONS

From the five corporate management variables, only board independence has significant relationship with accrual earning management. Similar evidence from previous studies can be found but in relation with earning management and in different environment, in Malaysia [1], and in Indonesia [2]. External audit relation with earning management is mapped with previous studies in different environments; in Indonesia [2]; in Jordan [3]; and in UAE [4]. And audit committee relation with earning management is mapped with previous studies in different environments; in Iran [5], in India [6], and in Pakistan [7].

Suggestions for Further Studies

This research was limited in terms of the nature of firms as the data are from firms belongs to five different categories. Future studies can consider every category of the firms listed at PEX in order to determine whether there are differences in firms' performance practices among firms in different sectors.

The study only considered firm listed at PEX, future studies can expand the study by checking different stock exchange market or by considering regional exchange markets in order to determine whether geographical areas has impact of the firm decision to engage in earnings management.

The proposed model with inclusion of accrual earning management is unique design model; however, scholars are invited to replicate the same model with the same techniques in different environments to contribute is generalizing the model design.

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