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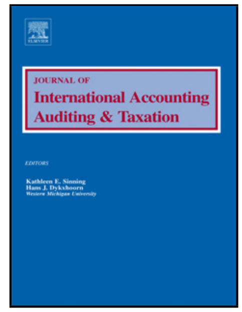

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Audit quality, debt financing, and earnings management: Evidence from Jordan

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Abstract

This paper presents the initial evidence regarding the relationship between audit quality, debt financing, and earnings management in Jordan. The study used the cross-sectional version of the modified Jones model, in which discretionary accruals were employed as a proxy for earnings management. Generalised least squares regression was employed to examine the influence of audit quality and debt financing on earnings management using a sample comprising 72 industrial companies during the selected period from 2006 to 2012. The results suggested that audit quality (auditor tenure, size, specialisation, and independence) and debt financing (low debt) diminish the potential of earnings management, and, in turn, enhance the financial reporting quality. Invariably, high debt would raise earnings management risk. This research raises probable implications for policy-makers in Jordan and other countries to consider in formulating a more comprehensive and reliable audit system.

Keywords: audit quality, debt financing, corporate governance, earnings management, financial reporting quality

1. Introduction

Earnings management is of considerable interest to company stakeholders, especially when earnings are frequently deemed to be suitable forecasters of financial reporting quality (FRQ), since accounting