

**CORPORATE GOVERNANCE, INTELLECTUAL
CAPITAL, AND EARNINGS QUALITY: THE
MODERATING ROLE OF POLITICAL
CONNECTION IN JORDAN**

OSAMAH JAMAL DOLAI ALORAYNI

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CAPITAL, AND EARNINGS QUALITY: THE
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CONNECTION IN JORDAN**

by

OSAMAH JAMAL DOLAI ALORAYNI

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LIST OF ABBREVIATIONS

AC	Audit Committee
ASE	Amman Stock Exchange
CG	Corporate Governance
JCGC	Jordanian Corporate Governance Code
IC	Intellectual Capital
EQ	Earnings Quality
DACC	Discretionary Accruals
JSC	Jordan Securities Commission
MV	Moderating Variable
OECD	Organisation For Economic Development

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**TADBIR URUS KORPORAT, MODAL INTELEKTUAL, DAN KUALITI
PEROLEHAN: PERANAN PENYEDERHANA HUBUNGAN POLITIK DI
JORDAN**

ABSTRAK

Pemisahan pemilikan dan pengurusan dalam syarikat korporat telah menyebabkan timbulnya entiti di mana kepentingan pelbagai pihak yang berkaitan mungkin bertentangan. Laporan kewangan berfungsi sebagai cerminan yang menunjukkan tahap keuntungan syarikat-syarikat ini dan menjadi sumber utama maklumat yang dapat digunakan oleh pelbagai pihak berkepentingan untuk menilai prestasi mereka, meramalkan kelestarian mereka, proyeksi aliran tunai, dan lain-lain. Oleh itu, kualiti pendapatan memainkan peranan penting dalam menarik pelaburan dan mendorong pertumbuhan ekonomi dalam sesuatu negara. Oleh kerana Jordan merupakan sebuah negara membangun yang berusaha untuk menarik pelaburan dan membuka diri kepada dunia, kajian ini menyelidiki faktor-faktor yang mempengaruhi tahap kualiti pendapatan, terutamanya setelah meneliti kajian-kajian terdahulu yang menunjukkan penurunan kualiti pendapatan di Jordan. Kajian ini menggunakan model penyelidikan yang bertujuan untuk merapatkan juang dan menerangkan penemuan yang bertentangan dalam kajian-kajian terdahulu dengan mengkaji peranan lembaga pengarah dan ciri-ciri jawatankuasa audit, seperti yang digariskan dalam Kod Tataurusan Korporat Jordan. Selain itu, kajian ini menyelidiki impak komponen modal intelektual terhadap kualiti pendapatan, terutamanya mempertimbangkan bahawa perundangan Jordan tidak memerlukan sebarang bentuk pendedahan untuk modal intelektual oleh syarikat-syarikat Jordan. Selain itu, kajian ini menjelajahi peranan pengantaraan hubungan politik terhadap hubungan-hubungan dalam kajian ini. Untuk mencapai objektif kajian, sampel terdiri daripada syarikat-syarikat bukan kewangan

Jordan yang disenaraikan di Bursa Saham Amman (ASE) dari tahun 2017 hingga 2020, dan model Jones yang telah diubah suai (1995) digunakan sebagai pengganti untuk mengukur kualiti pendapatan. Selain itu, hasil kajian menunjukkan bahawa semua pembolehubah lembaga pengarah mempunyai kesan yang signifikan secara statistik terhadap kualiti pendapatan. Demikian juga, dapatan bagi jawatankuasa audit adalah signifikan bagi semua pembolehubah kecuali ahli jawatankuasa audit yang bertindih. Berkaitan dengan pembolehubah modal intelektual, hanya modal insan yang didapati signifikan manakala pembolehubah yang lain tidak signifikan. Demikian juga, berkaitan dengan kesan pengantaraan hubungan politik, hasil kajian menunjukkan bahawa hubungan politik secara signifikan mengantara hubungan antara kepakaran kewangan lembaga pengarah, kemandirian jawatankuasa audit, ahli jawatankuasa audit yang bertindih, kecekapan modal struktur, modal perhubungan, dan kualiti pendapatan. Akhirnya, kajian ini dapat menjadi panduan bagi badan-badan pengawal seperti Suruhanjaya Saham Jordan dan Bursa Saham Amman dalam merangka strategi dan dasar baru. Selain itu, kajian ini dapat meningkatkan pengetahuan penyelidik akademik dengan mengisi kekosongan dalam literatur.

**CORPORATE GOVERNANCE, INTELLECTUAL CAPITAL, AND
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ABSTRACT

The separation of ownership from management in corporations has led to the emergence of entities where the interests of multiple related parties may conflict. Financial reports serve as reflections that demonstrate the level of profitability of these companies and provide the primary source of information that can be utilized by various stakeholders in evaluating their performance, predicting their sustainability, cash flow projections, etc. Consequently, earnings quality plays a significant role in attracting investments and fostering economic growth in countries. As Jordan is a developing nation striving to attract investments and open up to the world, this study investigates the factors influencing the level of earnings quality, particularly after reviewing previous literature indicating a decline in earnings quality in Jordan. The study adopts a research model that aligns with the agency and resource independence theories aimed at bridging the gap and elucidating the contrasting findings of previous literature by examining the roles of both the board of directors and the audit committee characteristics, as outlined in the last modification of the Jordanian Corporate Governance Code in 2017. Additionally, the study investigates the impact of intellectual capital components on earnings quality, particularly considering that the Jordanian legislature does not require any form of disclosure for intellectual capital by Jordanian firms. Furthermore, the study explores the moderating role of political connections on the study's relationships. To achieve the study's objectives, the sample consists of non-financial Jordanian firms listed on the Amman Stock Exchange (ASE)

from 2017 to 2020, and the modified Jones model (1995) was used as a proxy to measure earnings quality. Moreover, the research findings indicated that all the board of directors variables have statistically significant effects on earnings quality. Similarly, the findings of the audit committee were significant for all the variables except for overlapping audit committee members. In regards to intellectual capital variables, only human capital was found to be significant while the remaining variables were not. Likewise, pertaining to the moderator effect of political connection, the results showed that political connection significantly moderates the relationship between the financial expertise of the board of directors, independence of the audit committee, overlapping audit committee members, the structure capital, relational capital, and earnings quality. Finally, the study is able to enhance the knowledge of academic researchers by filling the gap in the literature. It also provides a set of recommendations according to the results of the study for both legislators and decision makers such as the Jordan Securities Commission and Amman Stock Exchange to ensure a high level of earnings quality.

CHAPTER 1

INTRODUCTION

1.1 Introduction

This chapter provides a background of the study, a statement of the problem, the research objectives as well as the research questions. The theoretical and practical significance of the present study, in addition to the scope and limitations of it, are discussed in detail. The chapter ends with the operational definitions of key concepts and the organisation of the study.

1.2 Background of the Study

Earnings quality has been emphasised in the existing literature as one of the most important accounting features. The significance of the earnings quality subject is related to the significance of financial data, which are provided for the users of financial statements (Gaio & Raposo, 2014). Based on Dechow and Schrand (2010), earnings quality involves relevant data, which is provided for users by the company to make decisions. The accounting data quality provided for the users of financial statements and the downturn in the equity markets worldwide were found to be associated with the shortage of transparency and quality in financial accounting information.

Financial scandals in the United States and European countries have raised concerns on the validity of financial accounting information, a situation, which has drawn the attention of investors, specifically with relevance to earnings reported (Gaio & Raposo, 2014; Himmah, 2018). These financial scandals include big corporates such as, Enron in 2001, WorldCom in 2002, Parmalat in 2003, Satyam in 2009, Tesco Plc's

in 2014, Pescanova in 2013 Toshiba in 2015, Patisserie Valerie in 2018, 1MDB in 2018 and the Germany firm Wirecard in 2020 (Huber, 2020; Jo, Hsu, Llanos-Popolizio, & Vergara-Vega, 2021; Melé, Rosanas, & Fontrodona, 2017; Tee & Rasiah, 2020; Wahab, Ariff, Marzuki, & Sanusi, 2017; Wan Mohammad, Wasiuzzaman, Morsali, & Zaini, 2018). Moreover, the financial foundation breakdown including AIG in 2005, Lehman Brothers in 2008, and Fortis in 2009 along with the economic stagnation, have all resulted in a significant decline in investor trust in corporate disclosure validity. This, in turn, has cast many doubts regarding the companies' financial reporting (Bhasin, 2016; Huber, 2020; Huynh, 2018; Marzuki, Wahab, & Aswadi, 2016; Tasios & Bekiaris, 2012). The world financial crisis has raised awareness about the significance maintaining transparency for supporting investment and fair competition, in addition to enhancing public sector trust and corporate sector accountability (Persakis, 2018).

Furthermore, the case of financial reporting efficiency is not a major problem for financial consumers only but also for the economy as it affects economic decisions (Tasios & Bekiaris, 2012). The consistency of financial statements included in every firm's annual report stock help users in decision-making on the basis of details that represent the firm's actual performance (Alzoubi, 2019b).

The quality of elevated earnings and financial reporting sheerness and audit is significant to investors and all stakeholders. The earnings management's connection which recently reported accounting scandals worldwide raised the investors' concern in asking for earnings quality for the enhancement of financial statements (Alsufy, Afifa, & Zakaria, 2020; Bedard & Johnstone, 2004; Latif, Bhatti, & Raheman, 2017). Based on the literature on accounting, earnings quality is one of the major features of accounting quality. Besides, earnings management is a crucial feature, among others,

of earnings quality. Earnings management and earnings quality are two different aspects of the same situation, meaning that, increasing earnings management can lead to decreasing earnings quality (Azzoz, Abdel, & Khamees, 2016; Ewert & Wagenhofer, 2013; Hashim, Ahmed, & Huey, 2019).

However, earnings management is not evident and its complicated because it tends to be hidden in the financial statement, this could be due to the willingness of the management to deceive investors for gaining an advantage; for instance, to decrease political expenditures and also to avert difference in the debt-to-equity ratio, which affects the financial reporting quality (Bader & Saleh, 2017; Commerford, Hatfield, & Houston, 2018). Ronen and Yaari (2008), categorised earnings management into three, namely: beneficial (white), grey and pernicious (black) earnings management. The beneficial (white) earnings management, obtains benefits from flexibility in the option of accounting treatment to provide corporate managers with unique information about the flow of cash. The grey earnings management enables the managers to increase their fortune by selecting the economically effective accounting treatment, while managers use the pernicious (black) earnings management to delude the users of financial reporting through accruals management. Fundamentally, the accruals method specified as (type three) has been massively implemented in earnings management and it signifies the variation between the earnings prior to the unusual items as well as operating cash flows (Ronen & Yaari, 2008).

Furthermore, Radzi, Islam, and Ibrahim (2011) mentioned that managers employ earnings management to change financial reports so as to obtain the required target analysis. Earnings management aims to compensate management, fulfill debt obligations, and prevent political expenditures (Alsufy et al., 2020). As such, it is not

only confined to the existing accounting term; rather, it expands to encompass balance sheets, income statements, as well as profits amassed since the corporate started operations (Commerford et al., 2018).

The significance of corporate governance (CG) and its role in improving earnings quality. It is an ideal tool used to protect and assure the stakeholder's rights and ownership (Abbadi, Hijazi, & Al-Rahahleh, 2016; Azzoz et al., 2016; Lu, 2021; Rezaee, Zhang, Dou, & Gao, 2018; Shin & Kim, 2018). The interest in CG has increased, particularly with the notorious scandals of corporates regarding earnings quality. Extant literature have depicted the efficacy of CG in improving earnings quality (Abbadi et al., 2016; Azzoz et al., 2016; Rezaee et al., 2018; Shin & Kim, 2018). Studying CG has been in the spotlight with the introduction of various amendments and standards at international and national levels, i.e., the Combined Code in the UK, the Code of the Organisation for Economic Development (OECD), the USA's Sarbanes-Oxley Act, and the Jordanian Corporate Governance Code (JCGC) (Saleem Salem Alzoubi, 2016).

This study focuses on the industrial and service companies' earnings quality with their internal mechanisms of CG that are practised in the Hashemite Kingdom of Jordan. Jordan is a strategic Middle East country and one of the emerging countries in the region which enjoys an important political and economic position. It is situated in the centre of the Middle East, in Southwest Asia, and its neighbours are Syria, Iraq, Saudi Arabia, and Palestine (Naser, 1998).

According to Fan (2004), CG involves the related mechanisms, procedures, and structure by which firms can manage their activities, aiming at maximizing the value of shareholders via managerial responsibility and consolidating company

performance. Chen, Chen, and Wei (2004) and Ayunitha, Sulastri, Fauzi, Sakti, and Nugraha (2020) argued that empirical evidence has recently supported that CG can limit agencies' costs. This emphasises that better CG leads to more efficient earnings quality in companies.

Based on the existing literature, the CG mechanisms are categorised into two main groups, which are: internal and external mechanisms (Firth, Fung, & Rui, 2006; Lei & Song, 2004; Lu, 2021; Shleifer & Vishny, 1997). For CG, the structure of the board of directors as well as the audit committee (AC) features are two important internal structures. The market management for companies is an essential external device, which represents the firms' success in marketing strategy and planning activities to advertise products and services in the market (Fawal & Mawlawi, 2018). In emerging economies, market control is weak and, hence, CG's internal structures are essential in economies (Al-Hawary, 2011; Lei & Song, 2004).

On the other hand, according to Sarea and Shaima (2016), an increasing debate in the literature exists about the connection between corporates' intellectual capital and earning quality. Relatedly, Hatane, Halim, and Tarigan (2019) mentioned that intellectual capital was viewed increasingly as a strategic wealth for companies that may be used for a variety of purposes. Similarly, intellectual capital determines the knowledge economy, which is an important issue to emphasise. Hence, it aims to look at the connection between intellectual capital and quality of earnings.

In addressing the gap, it contributes to the current body of knowledge by looking into the moderating role of political connection among the variables of the study, which are mentioned above. Previous research have shown that politically related businesses suffer from several issues, including poor quality of financial

reporting, poor earnings quality, corruption, organisational inefficiencies, and investor security vulnerabilities (Chaney, Faccio, & Parsley, 2011; Faccio, 2006, 2010; Muhammad Arsalan Hashmi, Rayenda Khresna Brahmana, & Evan Lau, 2018a; Wahab, Jamaludin, Agustia, & Harymawan, 2020).

Moreover, this study attempts to spot the light on the politically connected firms, over the course of years, a considerable number of companies on a global scale have incorporated individuals with political affiliations into their managerial or board positions, encompassing figures such as ministers, parliament members, and even government representatives. In accordance with Faccio's definition in 2006, a politically connected company is one wherein there is a significant shareholder or high-ranking executive holding a ministerial or parliamentary role, or possessing associations with a politician or a political party. It is anticipated that political connections will augment the company's access to financial resources, consequently contributing to its economic growth, as posited by Habib et al. (2018) and Karahasan and Bilgel (2018). Additional advantages may include the acquisition of government contracts and the attainment of more favorable regulatory conditions, as discussed by Goldman et al. (2009). Where the politically connected firms tend to protect related firms, secure their financial report, and influence the firm to show less financial information to achieve their goals without considering the rest of the stakeholders (Hashmi et al., 2018a). This affects the earnings quality and supports agency theory. Also, in terms of implementing CG, politically linked firms respond less to external pressures, which produces a more negligible concern about following the CG codes. (Shen, Lin, & Wang, 2015). In the same vein, using the power of political connection and negligence in improving the level of intellectual capital by not directing the interests to focus on employee training, providing new systems, technology amongst

others would affect the financial information quality used by stakeholders and could decrease earnings quality (Hou, Hu, & Yuan, 2017). This does not contradict the theory of resource dependency, whereby the level of political connections in the board of directors as an essential resource in the organisation affects the firms' decision-making, including the outcomes regarding the financial reporting and earnings quality (Mohammed, Ahmed, & Ji, 2017).

Moreover, As posited by Faccio (2006), the advantages derived from political connections within companies are more prone to materialize in nations characterized by less stringent regulations pertaining to conflicts of interest in political realms. This propensity is particularly evident in less-developed countries. Consequently, this research endeavors to investigate the moderating influence of political connections within the developing country context of Jordan, considering the distinctive features inherent in its business environment. Notably, Jordanian public listed companies are mandated to adhere to International Financial Reporting Standards (IFRS). However, the corporate landscape in Jordan is characterized by closely held firms with limited segregation of ownership and managerial roles (Haddad et al., 2015; Abdullatif, 2016), coupled with restricted rights for minority shareholders (Shanikat and Abbadi, 2011). Given these circumstances and the prevailing tribal and collectivist system in Jordan, affiliations between local companies and political figures are likely to be prevalent to some degree. Consequently, this study is motivated by the pursuit of insights into how such connections may serve as a moderator in influencing the relationships under examination, particularly with regard to earnings quality, within a context where the demand for such quality is constrained (Abdullatif, 2016), and regulatory frameworks governing the roles of political figures in managing and impacting the operational processes of Jordanian companies are insufficient.

Thus, the political connection would be examined as a moderating variable (MV) regarding the link between CG, intellectual capital, and earnings quality in this research. The independent variables, comprise the board of directors's independence and the board meetings, in addition to the board's financial expertise, the AC features (i.e., AC financial expertise, AC independence, and overlapping AC members), and intellectual capital (i.e., human capital, relational capital, and structural capital). The political connection would be employed as the moderating variable (MV).

Therefore, it is expected that the findings will answer the unresolved problem in the literature by investigating the political connection influence as a MV on the ties between CG, intellectual capital, and earnings quality. Based on the knowledge available to the researcher, this is the first study to look into the moderating effect of political connection on the relationship between CG, intellectual capital, and earnings quality. Moreover, this study combines, in one model, both CG mechanisms and intellectual capital, as well as, investigates their effect on the quality of earnings. In the same vein, it investigate the influence of overlapping AC members on earnings quality in the Jordanian market after applying the new CG code.

1.3 Problem Statement

It is generally believed that with the globalization of trade and financial markets worldwide, there have been intense demands for earnings quality from corporates across many countries. This indicates that investors conduct a comparative risk evaluation and return of corporates in various countries (Jaggi & Leung, 2007; Latif et al., 2017).

The importance of the high earnings quality of firms has long been recognised. However, many firms are involved in showing high earnings through wrong

accounting numbers. For instance, Satyam in India, Tesco Plc in the United Kingdom, Toshiba in Japan, Enron, Global Crossing, Tyco, and Worldcom, Wirecard in Germany, have shaken the investor's confidence in the corporate's earnings quality, thereby making it hard for companies to raise equity from the stock market (Agrawal & Chadha, 2005; Bhasin, 2016; Huynh, 2018; Jo et al., 2021; Marzuki et al., 2016; Melé et al., 2017; Tasios & Bekiaris, 2012; Wan Mohammad et al., 2018). Further, Huang, Chung, Chiu, and Chen (2018) added that the above-mentioned cases were just the beginning of a series of incidents of fraud and that the reasons for the fiasco of these corporations are hidden earnings manipulations, leading to operations spiral out of dominance.

In addition, decreasing the level of earnings quality lead to increasing earnings management, which is more common in emerging market enterprises than in developed market ones (Zweig, 2019). In light of Jordan being one of the developing countries in the Middle East, a significant challenge arises for investors in the process of making investment decisions in Jordanian companies. This concern is rooted in the fear of earnings management or a lack of transparency in the published financial reports (Ghaleb, Qaderi, Almashaqbeh, & Qasem, 2021). Similarly, the Jordanian economy as a whole suffers from this issue, as a decline in the quality of earnings within Jordanian companies leads to hesitation among investors in making investment decisions, particularly considering the substantial presence of foreign investment in the Amman financial market (Al-Haddad & Whittington, 2019). According to Jordanian empirical studies, listed companies on the Amman Stock Exchange (ASE) actively engage in earnings management operations (Al-Haddad & Whittington, 2019; Alhadab & Nguyen, 2018; Almashaqbeh, Shaari, & Abdul-Jabbar, 2019; Ghaleb et al., 2021). Moreover, Jordan is an active country in terms of earnings management which

produces lowing in earnings quality (Enomoto, Kimura, and Yamaguchi (2015); Ghaleb et al. (2021). In the same vein, the results of Al Awawdeh, Al-Sakini, and Nour (2020) study showed that the Jordanian industrial companies listed on the ASE provided poor information to investors which indicated a lower output in the level of earnings quality. Furthermore, Iskandrani, Hamad, Yaseen, AlZoubi, and Almaharmeh (2020) indicated that there is a poor and decrease in the level of earnings quality in Jordanian firms within the years 2010-2016. Additionally, Saleh, Abu Afifa, and Alsufy (2020) added more evidence about the low level of earnings quality in the Jordanian firms during the period 2010-2018 and recommended that future researchers investigate the impact of internal monitoring factors on earnings quality among the Jordanian firms. The above mentioned are fully consistent with the world bank report, which indicated the low level of disclosure and information transparency among companies listed on the ASE, which leads to a lack of protection for investors (World, 2020).

Likewise, earnings quality is a significant construct in Jordan's current market scenario, especially with the tendency to open up to global markets and attract foreign investments (Al-Othman & Al-Zoubi, 2019; Azzoz et al., 2016). A high level of earnings quality is therefore, necessary to guarantee the provision of financial information and thereby, reflect the authenticity of the situation of companies to help stakeholders make decisions (Alhadab, Abdullatif, & Mansour, 2020). The government of Jordan strives to privatise its owned enterprises (Aridah & Ahmed, 2020). Many corporates aim to attract new investors, whereby current corporates exert pressure to achieve sales, goals and managerial expectations. Many companies have suffered as one primary form of accruals, which influenced corporates' earnings quality in the Jordanian context (AL-Shar & Dongfang, 2017).



Figure 1.1 Earnings quality index score of Jordanian companies

In the Jordanian context, Figure 1.1. displays the results of a study by AL-Shar and Dongfang (2017), which evaluated the earnings quality in Jordan with a sample of 73 companies using five proxies as indicators of earnings quality from (2012 to 2015). In 2012, the highest earnings quality index score company was 10.99 based on the research formula, whereas the lowest score was -2.91. However, In 2013 the highest score was 40.09 and the lowest score was -12.07. In 2014, the highest score was 9.01, while the lowest score was -8.46. Finally, in 2015, the highest score was 48.04, whereas the lowest score was -3.00. The significant variation in the level of earnings quality among Jordanian companies underscores the necessity to study the factors influencing earnings quality in the Jordanian stock firms listed, where this is crucial to ensure the attainment of the highest level of earnings quality. Also, the study of AL-Shar and Dongfang (2017) was limited to evaluating the level of earnings quality in Jordan without investigating the relationships, which influenced earnings quality in

Jordanian firms, example of this showcases in the CG mechanism or Intellectual capital (IC) componants.

Several studies recommended investigating the importance of CG and its substantial role in improving earnings quality as it represents an ideal tool to protect and warranty stakeholders' rights and ownership (Abbadi et al., 2016; Al-Othman & Al-Zoubi, 2019; Azzoz et al., 2016; Rezaee et al., 2018; Shin & Kim, 2018). In the current study, the Jordanian context is deemed significant from various perspectives, as it represents one of the developing nations situated in the heart of the Middle East. It shares cultural, ethnic, and linguistic ties with the surrounding countries, making it an integral part of the regional dynamics. The main objective of the study involves examining the relationship and the moderating role of political connection between the mechanisms of CG, intellectual capital as well as earnings quality. Besides, earnings quality in conformity with the board's role in monitoring the management supports other vital mechanisms. Upon defining CG, it has become obvious that the board of directors is an essential agent that controls, directs corporates, and delivers reliable information to shareholders. AC's role is important in managing financial reporting and producing earnings quality. Furthermore, it has been contended that an operative board of directors and effective AC can result to the reduction of earnings management, thereby increasing the quality of earnings (Ali & Kamardin, 2018; Chen & Komal, 2018; Egbunike & Odum, 2018; Kusnadi, Leong, Suwardy, & Wang, 2016; Oehmichen, 2018). On the other hand, Jordan has established a long-term plan or vision, i.e., the 'Jordan 2025' vision to support and modernize the Jordanian economy (MPIC, 2016). The primary purpose of 'Jordan 2025' involves primarily performing appropriate policies and regulations to enhance the private sector that can be internationally competitive (Jordantimes, 2015). Also, Jordan economic monitors

indicated that the effective implementation of ‘Jordan 2025’ needs a high level of commitment in CG, which is closely related to capital markets, and the capacity to attract foreign investments (worldbank, 2016). Likewise, Malkawi (2018) indicated that enhancing CG is significant in facilitating Jordan’s enhancement plans. This is to achieve a modern economy that is capable of being a competitor in a hugely globalised market. This is because poorer levels of CG would scare foreign investors, which would affect the economy. Therefore, CG in Jordan should be modernised.

In Jordan, Alhadab et al. (2020) confirmed that Jordanian corporates do not completely follow CG principles and regulations. The firms are following a very initial phase of the Jordanian CG code (Qadorah & Fadzil, 2018). Also, the Chairman of the Securities Commission, in an interview with the Jordanian newspaper (Alghad, 2017), mentioned that the number of Jordanian companies faltering is around 30 companies with a total capital of up to one billion US dollars. Two reasons were responsible for this. These are the weak application of the assigned rules and regulations of CG and the necessity to enhance the existing code as the Jordanian CG Code has been amended. Besides, the European Bank for Reconstruction and Development stated in its report that there exist weaknesses in applying the rules and regulations of CG regarding the board of directors and AC’s characteristics (Cigna & Sigheartau, 2017). Thus, it can be concluded that there is a serious issue, which necessitates further investigation of the influence of such weaknesses on earnings quality.

Previous researchers have emphasised the importance of intellectual capital in business and finance. In agreement with the definition of Edvinsson and Sullivan (1996), this involves knowledge, which is translated to wealth. Previous studies have shown that little research has been conducted to examine how intellectual capital is associated with earnings quality (Darabi, Rad, & Ghadiri, 2012; Hatane et al., 2019;

Sarea & Shaima, 2016). Moreover, it has been highlighted by Sarea and Shaima (2016) that intellectual capital affects the earnings quality through accounting performance improvement, and firms that have poor accounting performance showed poor earning quality. Although intellectual capital is significant for companies and nations, it must be closely checked (Alshhadat, 2018). Therefore, mechanisms of transparent control are required, which will guarantee that the executive management does not misuse wealth sources. It is also established that CG is the system which identifies the rules, regulations, and guidelines to manage the firm (Hagiu & Barbulescu, 2016). It is a group of policies, mechanisms, and procedures, which govern business (Alshhadat, 2018). This study aims to combine CG and intellectual capital in a single research framework to examine its impact on earnings quality.

Over the last ten years, one example of how vital intellectual capital is for firms involves investing in intangible assets in the UK according to Intellectual Capital Office (ICO) at £133 bn, £121bn, correspondingly (IPO, 2016). In intellectual capital, these investments allocations involved organisational capital of £22bn, training accounts of £26bn, and the design of £14bn, branding of £15bn, software of £28bn, in addition to scientific research and development £19bn.

Despite the interest of developed countries in intellectual capital in the United Kingdom as an example, the Jordanian government did not publish any official reports or official documents, which outlined the investment level in intellectual capital. This shows that Jordanian authorities did not consider the intellectual capital's role in improving the level of earnings quality and the country's economy (Alshhadat & Stenka, 2017). Jordan has strived to improve the application of intellectual capital in the country. Among these endeavours is King Abdullah II Centre for Governmental Performance Excellence and Transparency (KACE, 2019). The Royal Scientific

Association is another channel of improvement. It is the major foundation that empowers intellectual capital and provides technical support for other investors, corporates, and scholars in development areas (RSS, 2019). This study aims to direct the Jordanian authorities' attention toward the intellectual capital significance and its role in enhancing earnings quality.

Prior studies emphasised that politician-related businesses mostly breach the rights of minority shareholders and suffer from serious agency issues (Chaney et al., 2011; Faccio, 2010; Hashmi et al., 2018a). Moreover, Chaney et al. (2011) revealed that political relations affect the profit output of corporations. Because businesses can obtain funding through their political connections, it is less need to respond to external market conditions, resulting in lower quality accounting information being reported. The level of earnings quality is consequently reduced. In some under developed countries, particularly those with higher levels of corruption, the effect of political ties on earnings output has been the strongest impact (Boubakri, Cosset, & Saffar, 2012; Chen, Ding, & Kim, 2010; Faccio, 2010; Iman Harymawan & John Nowland, 2016; Hashmi et al., 2018a; Wahab et al., 2020).

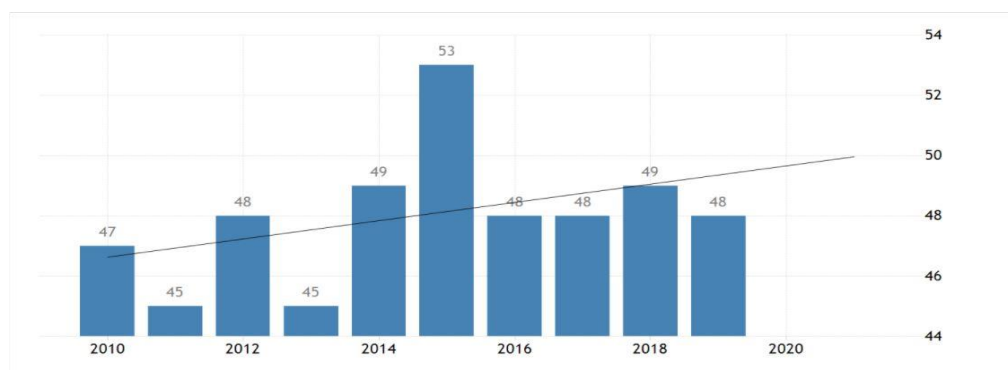


Figure 1.2 Corruption percentage index in Jordan (2010-2019)

As shown in Figure 1.2, the corruption perceptions index report stated that, in 2019, Jordan has a high level of corruption, scoring 48 points from 100 on the corruption scale; zero signifies “extremely corrupt” and 100 signifies “very clean” (tradingeconomics, 2019). Such results showed the existence of an appropriate environment for the emergence of political connections among the members in the board of directors in the Jordanian firms. Moreover, this is consistent with the results of Abdullatif, Alhadab, and Mansour (2019) which showed that there is a high percentage of political connection of the boards of directors members in Jordanian companies. Also, the study of Al-Sraheen and Alkhatib (2016) investigated the Jordanian firms and documented that political connections contributed to decreasing financial reporting quality and influenced the level of earnings quality. Besides, companies that are subject to great political connections have engaged in poorer CG practices, thereby suffering from huge agency problems.

1.4 Research Objectives

This study aims to address four objectives as follows:

1. To examine the relationship between the characteristics of the board of directors (independence, meeting, and financial expertise) and earnings quality.
2. To examine the relationship between AC characteristics (independence, financial expertise, and overlapping AC members) and earnings quality.
3. To examine the relationship between intellectual capital (human capital, structure capital, relational capital) and earnings quality.

4. To examine the role of political connection as a moderator in the relationship between the characteristics of AC, the board of directors, intellectual capital, and earnings quality.

1.5 Research Questions

In conformity with the statement of the problem, four research questions are as follows:

1. Does the characteristics of the board of directors (independence, meeting frequency, and financial expertise) affect earnings quality?
2. Does the characteristics of AC (AC independence, AC financial expertise, and overlapping AC members) affect earnings quality?
3. Does intellectual capital (human capital, structure capital, relational capital) affect earnings quality?
4. Does political connection moderate the relationship between the characteristics of the board of directors, AC, intellectual capital, and earnings quality?

1.6 Theoretical and Practical Significance of the Study

The present study will be of significant benefit to several parties. Firstly, it will contribute to the body of knowledge regarding non-financial sector researchers because it will provide empirical evidence of the relationship between CG, intellectual capital, and earnings quality as well as the moderating role of political connections. Based on the knowledge available to the researcher, this is the first study to examine the moderating effect of political connection on the relationship between CG, intellectual capital, and earnings quality which provides novel insights into this

unexplored aspect. Moreover, this study is significant because it will of benefit to Jordanian government as non-financial sectors are the largest portion of the total companies in the entire country. The government and stakeholders need to know the level of earnings quality in non-financial sectors. In addition, the present study will highlight the function of CG in the earnings quality of Jordanian companies. The obtained results will, therefore, help regulatory organizations such as the Amman Stock Exchange (ASE), and Jordan Securities Commission (JSC) assess the effectiveness of the new code of CG in Jordan. Furthermore, it aims to create more awareness among the relevant organizations and authorities about the importance of investing in intellectual capital in Jordanian firms to produce a high level of quality of earnings.

Likewise, the study also contributes to all the accounting information users in Jordan as the obtained results will reflect the level of earnings quality in the non-financial firms listed in the Amman stock exchange based on the findings. Also, the study serves as a valuable resource for investors and financial analysts operating in the Jordan Securities Commission. By understanding the level of earnings quality in non-financial firms, these stakeholders can refine their investment strategies, allocate resources judiciously, and better assess the long-term sustainability and performance of companies listed on the Amman Stock Exchange.

This study seeks to enhance the understanding of the application of the two theories of agency as well as resource dependency to elaborate the relationships between the variables. According to agency theory, the mechanisms of monitoring are supposed to match the interests of shareholders and managers, reduce opportunistic behaviour, and conflict of interests. Therefore, from the perspective of agency theory, this study considers CG mechanisms as monitoring tools, which provide a high level

of earnings quality in Jordanian firms. In the same vein, resource dependency In the same vein, resource dependency theory contends that organizations depend on their external environments, and, that, organizational effectiveness is therefore not only contingent on how well a firm can manage its resources. Rather, it lies in its capacity to acquire them from the environment around the organization. From the resource dependency theory's perspective, this study will contribute to enhancing the application of the role of political connection in providing helpful resources in identifying the level of intellectual capital and earnings quality in the Jordanian environment. The findings of this study will contribute to fill in a gap in the body of knowledge about the connection between CG, intellectual capital, as well as earnings quality. This study tries to offer empirical proof on one of the emerging economies in Jordan.

1.7 Scope of the Study

Regarding the study's scope, several aspects should be considered. According to Amman Stock Exchange (ASE), the three sectors of the Jordanian listed firms include the financial sector, the industrial sector, as well as the services sector. Two sectors will be selected in this study that is: the industrial sector and the services sector due to the contribution of the Jordanian industrial sector to the country's GDP at basic prices. The growth of the manufacturing sector increased from 18.4 to 21.3% during 2003-2006 compared with other sectors (Barakat & Saif, 2010). Also, from 21.3 to 31% throughout 2006-2018. It is shown that this sector plays an essential role in upgrading the economic growth in Jordan (Central bank of jordan, 2018). The services sector also plays a significant role in the country's GDP, which is equivalent to 61%

compared to industrial sector's low percentage in 2018, i.e., 31% as shown in Table 1.1 (Central bank of Jordan, 2018).

Table 1.1 The contribution of sectors to Jordanian GDP

Sector	GDP (%)
Services sector	61
Industrial sector	31
Other sectors	8

The financial sector is excluded in the current study as it focuses on practices and regulations, which are made by the collaboration between the Central Bank of Jordan and the Insurance Commission. These regulations are different from the remaining sectors. This study aims to investigate the moderating role of political connection between CG, intellectual capital and earnings quality in Jordanian non-financial companies that are listed on the ASE. For the study results to be generalizable, all Jordanian companies that are listed on the main market must be taken into account.

Moreover, the website of ASE will be utilised in the current study to download the annual report of the selected company from 2017 to 2020 because the code of governance guide (2017) will be employed, which has changed several codes. Therefore, the new code will be used in this study as a reference for the CG variables. Hence, the year 2017 onwards will be selected since it is the first year, in which, CG became compulsory for the entire Jordanian companies listed on ASE. This study is limited to an extended period of four years only as it is more viable, whereby discretionary accruals (DACC) are used to gauge earnings quality. Data from 2017 to

2020 will be used in this study as the financial reports of the Jordanian companies have not been published yet after 2020.

1.8 Definitions of Key Terms

This section provides the definitions of the terms used in this study to provide further insights into the topic. These key terms will be used throughout the study.

1.8.1 Earnings Quality:

The definition of earnings quality in this study draws from Menicucci (2019) where he defined earnings quality as “the ability of reported earnings to reflect the company's true earnings to predict future earnings”. The calculation of earnings quality in this study will be based on the Modified Jones model.

1.8.2 Corporate Governance:

Corporate governance (CG) is defined as “a combination of rules, regulations, laws, and examples of good practice that enable companies to attract financial and human capital to perform jobs efficiently” (Berber, Slavić, & Aleksić, 2019). Therefore, The allocation of duties and rights among the firm's participants, such as managers, the board of directors, stakeholders, as well as other shareholders, will therefore be determined by the CG structure (JSC, 2019).

1.8.3 Board of Directors Independence:

The concept of "independent board members" addresses a person in a board of directors, affiliates, executive management, or external auditors who is not a shareholder in the company and who has no financial ties that could benefit him

(financially or corporately), which could influence his decisions or allow him to take advantage of his position (SDC, 2017).

1.8.4 Board of Directors Expertise:

It is the percentage of directors who have experience in accounting or finance, or comparable experience or an accounting professional certification (Chen, Elder, & Hsieh, 2007).

1.8.5 Board of Directors Meeting Frequency

The term is defined as a formal assembly of the board of directors taking place on predetermined dates throughout the year to discuss ongoing policy concerns and issues. The meeting is chaired by the board chairman or a nominee, and it must adhere to the rules for meetings, with the discussions being documented in minutes. The board meeting sessions that are called annually are counted (Makhlouf, Laili, Ramli, Al-Sufy, & Basah, 2018; Xie, Davidson III, & DaDalt, 2003).

1.8.6 Audit Committee Characteristics

It is a committee that the board of directors established. Its responsibilities include examining the financial statements and management commentary, assisting with improved financial accountability and financial supervision, and ensuring that management is properly prepared and follows internal controls and accounting principles. One of the committee's responsibilities, according to ASE (2017), is to regularly review the conclusions of the Internal Audit Department, ensure that management diligently implements the recommendations of the Internal Audit

Department, guarantee adherence to applicable laws, and suggest the appointment of an outside auditor (ASE, 2017).

1.8.7 Audit Committee Independence

An independent audit committee (AC) member is the one without financial or personal relationships either with the company or with its executive. AC must have at least one independent member (Persons, 2005; SDC, 2017).

1.8.8 Audit Committee Financial Expertise

A person that gained training and experience as a public accountant such as (CFA, CPA) or as an auditor or chief financial officer, auditor or principal accounting officer of a corporation (Chen & Komal, 2018; SEC, 2019).

1.8.9 Overlapping Audit Committee Members:

Overlapping audit committee members refers to the situation where a member of an audit committee (AC) also serves on the compensation (remuneration) committee of the same organization (Chandar, Chang, & Zheng, 2012; Habib & Bhuiyan, 2016).

1.8.10 Intellectual Capital

Intellectual capital involves a combination of organisations' processes, patents, technologies, employees' skills, and information about customers and suppliers (Lerro, Linzalone, & Schiuma, 2014; Stewart, 1997).

1.8.11 Human Capital

It can be defined as the mutual capacity of the firm to extract the best solution from the awareness of its members (Bontis, 1998).

1.8.12 Structural Capital

Structural capital is described as a company-owned stock of knowledge, including corporate culture, IT, and explicit knowledge (Inkinen, 2015; Jardon & Susana Martos, 2012).

1.8.13 Relational Capital

Relational capital is defined as the product of the value created by businesses, including suppliers, customers, rivals, shareholders, stakeholders and society in their relationship with the world (González-Loureiro & Dorrego, 2012; Inkinen, 2015).

1.8.14 Political Connection

It is the number of board of directors members with political connections. A politically connected director could be a state assemblyman, a minister, a member of parliament, or the head of state (Chaney et al., 2011). Alternatively, an individual who is or was a government bureaucrat (Mohammed et al., 2017).

1.9 Organisation of the Study

This study comprises five chapters in which chapter one provides the background of the study and the statement of the problems, the research objectives and the questions of the study. It also provides the theoretical and practical significance of