An-Najah National University

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THE EFFECT OF AUDIT QUALITY ON THE RELATIONSHIP BETWEEN EARNINGS QUALITY AND SHARE PRICE: EVIDENCE FROM PALESTINE

By

Ahmad Jehad Alardah

Supervisors

Dr. Muiz Abu Alia

Dr. Saed Alkoni

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This Thesis was Defended Successfully on 02/08/2023 and approved by

Dr. Muiz Abu Alia	
Supervisor	**Signature**
Dr. Saed Alkoni	
Co-Supervisor	**Signature**
Prof. Ibrahim Ateeq	
External Examiner	**Signature**
Dr. Sameh Atout	
Internal Examiner	**Signature**

Dedication

إلى من جنتي تحت قدميها (أمي الحنونة)،

الى من انا أحب إليه من نفسه (أبي العزيز)،

الى من خضنا بصحبتهم غمار تكوين الذات (إخواني وأخواتي الأعزاء)،

الى من ساندني دائما (جدتي الغالية)،

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الى ابي الثاني (عمي الغالي) ،

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إلى من إستقيتُ منهم الحروف، وتعلمت الكلمات،

إلى الذين مهدوا لنا طريق العلم أساتذتي الكرام كل باسمه،،،

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Declaration

I, the undersigned, declare that I submitted the thesis entitled:

THE EFFECT OF AUDIT QUALITY ON THE RELATIONSHIP BETWEEN EARNINGS QUALITY AND SHARE PRICE: EVIDENCE FROM PALESTINE

I declare that the work provided in this thesis, unless otherwise referenced, is the researcher's own work, and has not been submitted elsewhere for any other degree or qualification.

Student's Name أحمد جهاد الأطارشة

Signature أحمد الأطارشة

Date ٢٠٢٣/٨/٢

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Dr. Saed Alkoni

Abstract

This study seeks to explore the correlation between earnings quality and share prices within the Palestine Exchange (PEX). It also examines the potential mediating role of audit quality. The sample comprises 40 companies listed on (PEX) over the period spanning 2011 to 2020, totaling 400 observations. Earnings quality was assessed through an analysis that considered factors such as cash flow, net income, and total assets, while share price was determined by referencing the annual closing prices. Similarly, audit quality was quantified by considering auditor size as a crucial indicator. The findings of the investigation reveal that, when accounting for other firm-related variables within the PEX, there is no statistically significant relationship between Earnings Quality (EQ) and Share Price (SP). Additionally, the study did not identify audit quality as a mediator in the link between earnings quality and share prices. These findings will contribute to the development of more accurate and practical methods for evaluating factors that influence share values. The significance of this study lies in its examination of the degree of influence that the Palestinian market wields over earnings and audit quality, substantiated by empirical evidence. This investigation is particularly noteworthy as it represents the pioneering effort to establish a connection between earnings quality and market share prices while shedding light on the potential mediating role of audit quality, exclusively within the Palestinian market

Keywords: Audit quality, Earnings quality, Share price, Palestine, PEX

Chapter One

The general framework of the study

1.1 Introduction

The rapid developments in the current business environment are extensive and encompass a variety of sectors that contribute to the globalization trend of economies and the rapid diffusion of information. Preparation of financial reports is considered among the most important basic functions of a company management. Such reports contribute to improving investors' decisions and achieving control and supervision objectives in light of the separation between ownership and management Tyokso et al. (2016) Consequently, external audits are essential to add reliability and credibility to the information provided to investors and shareholders by certifying the accurateness_and truthfulness of the information contained in the financial reports and improving their quality. In fact, external audits provide an opinion based on reasonable assurance, as a results of the accumulated evidence, that the financial statements of the firm are fairly presented, i.e. free of material misstatements..

It is argued that audit quality has a positive association with firm value. According to Alia and Barham (2020),_high quality of auditing is assumed to minimize information asymmetry and agency costs, and raise the firm value. The market price of the share is reflects the prospective future earnings of the company. Consequently, earnings reported by management significantly influence investors. Managers may resort to manipulating profits to achieve a higher value for the company's shares. Audit procedures may curb this action and limit directors' abilities to manage the company's earnings and thus enhance the investors confidence in the financial statements Abu Afifa et al. (2020).

Additionally, audit quality may assist in increasing earnings quality (EQ), an essential financial reporting feature given which reflects the extent to which financial statements are beneficial to the users of the financial statements, in general, amd investors, in particular, in making resource allocation choices Muttakin et al. (2017). According to Martowidjojo et al. (2019) Enterprise share prices are negatively correlated with EQ, implying that a higher EQ will lead to an increase in share prices. Ma (2017) found that as a firm's systematic market risk reduces due to associated public companies and greater EQ, the share prices of rise.

Furthermore, EQ has a considerable impact on knowledge about share prices, as concluded by Martowidjojo et al. (2019). Antonio et al. (2019) identified the quality of earnings as a mediating component in the association between effective corporate governance practices and market reaction for shares. A decline in EQ creates a greater market response, which can significantly impact share prices. The quality of a company's earnings denotes the extent to which its reported earnings precisely reflect the real performance. Earnings with higher quality are generally seen as more reliable and stable, which can lead to increased investor confidence and a higher share price. Ali (2015) reported a positive association between the quality of earnings and share performance in the short term, and noted that high-quality earnings are associated with lower volatility in share prices. In contrast, Dechow and Schrand (2004) analyzed the relationship between EQ and share market value performance over a longer time period and found that firms with high-quality earnings had significantly higher stock returns over a five-year period than firms with low-quality earnings. Moreover, Leuz, Nanda and Wysocki, (2003) suggested that companies with high-quality earnings tend to receive higher price-to-earnings ratios as the market rewards them for their overall financial health and stability, making them more attractive to investors. Chan (2008) pointed out that a strong correlation exists between EQand earnings management, and that EQhas a significant impact on stock returns. Therefore, reducing earnings management practices can boost stock returns.

Numerous previous studies have addressed the association between EQ and earnings management, in addition to their impact on share prices. Dechow and Dichev (2002) found that companies with higher EQ were more likely to achieve higher valuations in the stock market, also less earnings management practices. While Graham et al. (2005) found that firms engaging in earnings management had less future returns compared with those who did not involve in such practices. According to Allahkaram et al. (2017), earnings sustainability is positivelly affected by auditor’s specialization and size. Specialized and larger auditors help to encourage investments and improve their efficiency which in turn leads to greater earnings sustainability. However, no significant effect of auditor’s tenure was identified on the earnings sustainability. Almarayeh et al.

(2020) evaluated the effect of audit quality ion earnings management and accordingly the market pricing of the share. They found that the size of the audit firm and audit fees had little impact on earnings management.

The association between EQ and share market value has become an interesting topic for investors, management, analysts, and other parties Alsufy et al. (2020). From the investors perspective, reported earnings is considered as a valuable tool for predicting future gains and stock prices. The effect of the audit quality on the stock value has been an interesting topic for research in the accounting and finance fields for several years. This research area is important because external auditing of the financial statement audits are meant to enhance the quality of the reported information by providing the investors assurance about its reliability, and high-quality audits are associated with greater investor confidence and more accurate stock valuations. Krishnan and Schauer (2000) proposed that as audit quality increases, the extent of earnings manipulation decreases, leading to more precise share prices**.** Francis and Wang (2008) investigated the combined effect of audit firm reputation and the level of investor protection on EQ in different countries. Findings indicate that high-levels of audit quality and investor protection ensure high-quality financial reporting and accurate share prices.

The Palestinian economy's political division has resulted in economic instability and environmental degradation, which has had a negative effect on company performance Alia and AbuSarees (2023). Abushammala (2011) demonstrated the inefficiency of the Palestinian stock market at the weak level through daily price analysis, with information not immediately reflected in the market but rather gradually. These findings suggest that the Palestinian market is still emerging. In their study, Dwekat et al. (2018) discovered that Palestinian companies listed on the PEX with larger boards of directors tend to appoint higher-quality auditors. As a result, they recommended adhering to the Palestinian governance guidelines that require the use of a qualified external auditor. Alia et al. (2020) noted that the influence of audit quality on earnings management in the Palestinian market is mixed and not strong enough to draw generalized conclusions.

The Palestinian market has unique characteristics that allow it to be relatively insulated from global markets. As a small market consisting of only 48 listed companies on the PEX, it has the potential to be influenced by major investors. This underscores the need for expanded research on the Palestinian economy. Furthermore, Palestine is a developing country which lacks political stability given the Israeli occupation Alia and AbuSarees (2023).

This research examines the EQ and SP relatiomship, and also examines the moderating effect of audit quality AQ on this relationship based on data from the Palestinian market between 2011 and 2021.

1.2 Study Problem & Questions

The SP is a critical metric for determining the value of a company. Investors and shareholders require accurate information, including stock prices, profits, and other relevant data depending on the nature of the investor and the investment's purpose. A company's share price is a significant indicator of its performance. A company's share price is an excellent predictor of its future earnings and dividends. Therefore, investors use this information to make informed investment decisions. Additionally, according to a study by Leuz et al. (2003), share price can serve as a signal of market expectations. A higher share price can indicate that investors expect the company to perform well in the future, while a lower share price can suggest that investors have a negative outlook. Earnings management, a practice where companies manipulate their financial statements to meet or exceed the expectations of investors and other stakeholders, can have negative consequences (Dechow & Schrand, 2010).suggested that companies that engage in earnings management may experience lower future stock returns. Likewise, Jones and Dugan (2002) found that companies that engage in earnings management experience a decline in their stock price performance in the long run implying that investors eventually recognize the manipulation and penalize the company. Managers may manipulate profits to obtain a higher quality of profits and a better share price, thereby attracting investors.

One of the fundamental roles of independent auditors is to give the financial statements credibility by independent evaluating the accurateness and correctness of the material provided in the statements. A high-quality audit is crucial to mitigate the management's manipulation of financial statements, the main source of information, and thus ensure the high reliability of their reported information and enhance investors' confidence in the information DeFond and Zhang (2014). Consequently, shares prices become associated with the audit quality as a mean to enhance the investors' confidence in the financial statements.

However, previous research has not examined whether audit quality has substantially moderate the relationship between a company's share prices and the quality of earnings or presented direct empirical evidence supporting the analyzed factors' comparative capacities to explain a company's share price, particularly in the Palestinian market. This study examines the association between EQ and SP in the Palestinian context and examines if AQ moderates this relationship.

Given what has been discussed, the following two major questions can be raised:

1. Is earnings quality related to share prices of the companies listed at the PEX?
2. Does AQ moderate the relationship between earnings quality and share prices of the companies listed at the PEX?

1.3 Research Objectives

The study has several objectives. It mainly aims to broaden the knowledge base on the relationship between EQ and (SP). In addition, it estimates the contribution of audit quality, as a moderator, to the EQ-SP relationship, in the context of the Palestinian market, as an emerging economy. Precisely, it seeks to attain the following goals:

First, the study aims to accumulate evidence from the Palestinian market to enhance our understanding of the relationship between EQ and SP. This will help expand knowledge on the factors influencing share prices in emerging economies like Palestine.

Second, the study investigates the effect of market control on audit quality and earnings quality in the Palestinian market. By exploring this relationship, the study hopes to highlight the factors that may influence the capitalization of companies in this market.

Third, it intends to expand the understanding of the significance of audit quality and accounting data quality in a biased context. This is an important issue, as many emerging economies may lack the regulatory frameworks necessary to ensure the financial data integrity.

Fourth, the study provides insights into the importance of auditing for users of all kinds. By exploring this issue, the study affords a deeper understanding of how investors can use auditing data to improve their investment decisions.

Fifth, the study aims to explore the ways in which investors rely on share prices to make investment decisions. By exploring this issue, the study shed light on the factors that influence investor behavior and their decision-making.

1.4 Research importance

The recent study findings are highly significant for a range of stakeholders, including investors, managers, decision-makers, policymakers, and other interested parties. These findings will assist them in developing predictable and realistic alternatives to identify which environmental factors positively affect share prices. The importance of the study also lies in its assessment of the degree of control that the Palestinian market has over the earnings and audits quality.

This research can help policymakers develop improved methods to achieve transparency in providing financial information that affects share prices. The study's results have the potential to benefit the supervisory authority, represented by the Palestinian Capital Market Authority, to develop monitoring methods to increase control over the manipulation of financial statements by managers and owners. Finally, this study is particularly noteworthy because it is the first of its kind to link the quality of earnings and share price and to mediate the relationship of audit quality between them at the Palestinian market level. The study's results will also have implications for both academic research and practical applications in the business world.

Chapter Two
Theoretical background, literature review the development of hypotheses

This chapter delves into the theoretical concepts the quality of earnings. It begins by presenting the theoretical framework for earnings quality, starting with the definition of earnings quality and its significance for users of financial statements. Additionally, the chapter explores the commonly employed criteria for evaluating the quality of earnings and examines the diverse elements that can impact them... Moreover, the chapter highlights the theoretical frameworks related to audit quality, along with presenting the theoretical background and past researches conducted on the subject matter.

2.1 Theoretical framework

2.1.1 Earnings quality

The concept of earnings refers to the revenues earned by firms after deducting costs and taxes. It is considered one of the most important goals of companies, as it enables them to sustain their operations and offer products and services to consumers Palea and Prencipe (2018). Earnings serve as a major incentive for investors, as they seek opportunities to generate higher returns on their investments. Higher earnings suggest greater management efficiency in utilizing company resources and achieving growth and expansion goals, which ultimately benefits the investor Dechow and Dichev (2002). Due to its significance to investors, earnings have been extensively studied in previous literature to identify their definition and the key factors influencing them. Mckee (2005) and Basu (1997) have provided two distinct perspectives on earnings based on the economic and accounting concepts. The economic concept defines earnings as the difference between total revenues and costs after calculating the opportunity cost, whereas the accounting concept considers earnings as total revenues minus total costs.

Due to the non-observability and quantitative nature of earnings quality, researchers have proposed several definitions from various perspectives. A definition of earnings quality was presented by Dechow and Schrand (2010) based on the perspective of financial analysts and researchers, stating that earnings are of high quality if they contain fewer unusual items. According to Penman (2003), if present earnings serve as a reliable indicator of future earnings, they can be deemed as having a high level of quality. With regard to auditors and financial standards setters, Dechow et al. (2010) argue that adherence to (GAAP) is indicative of earnings being of high quality. In their study, Entwistle and Phillips proposed that financial statements should precisely depict the genuine financial status of the company while offering valuable information to stakeholders. Salman (2012) argued that creditors perceive earnings as high quality when they can be readily transformed into cash flows, whereas shareholders perceive earnings as high quality when they genuinely reflect management performance without any manipulations. According to Richardson (2003), the quality of earnings is closely associated with their continuity, indicating that higher quality is attributed to present earnings that exhibit a greater ability to persist into the future. Additionally, Salman (2012) considered earnings as high quality when they are free from non-recurring or unusual items, ensuring their continuity and predictability without any exaggerations or manipulations by the management to affect the company's status. In turn, Karakish (2009) characterized earnings quality as the degree to which reported earnings align with the actual earnings of the company. The declared earnings must have a tangible cash presence and be free of imaginary earnings resulting from accounting manipulations and exploitation of accounting flexibility.

Similarly, Bellovary (2005), described the EQ by the degree to which earnings are correlated with cash flows. A stronger positive relationship between earnings and cash flows corresponds to a higher level of EQ. Lower receivables also indicate high-quality earnings. High-quality earnings lead to an increase in future returns per share, which reflects the real existing and potential earnings of the firm. AL-Maeeni and Nuri (2017) considered EQ as an element of financial quality that is measured by its sustainability, ability to generate cash flows, and ability to predict the operating earnings of the company. To increase its ability to predict these earnings, permanent and non-permanent returns must be separated. Schroeder et al. (2001) attempted to extract the concept of quality of earnings by measuring the convergence between accounting earnings and economic earnings using capital as an input to measure income. They focus on net assets from operating operations without distributions and additions, given that the establishments do not achieve earnings without incurring fixed operational costs.

As per the definition provided by Bashiti & Rabadi (2011), EQ refers to the company's capacity to consistently generate operating earnings through its financial activities. These profits reflect the actual performance of the company and can be achieved continuously without being subject to fluctuations from one period to another. According to Kirschenheiter & Melumad (2004), earnings can be deemed of high quality when they accurately portray the long-term value of the entity. Siam (2014) argued that the earnings quality is represented in the honest presentation of earnings figures without any manipulations that affect the choices of investors in the markets. Abu Ali, Al-Dubai, and Abu Nasar (2011) identified the earnings quality as earnings that embody the primary attributes of accounting information, namely appropriateness and reliability. These attributes align with the primary goals of financial reporting, which aim to facilitate decision-making for users of financial statements such as investors and lenders.

2.1.2 The importance of earnings quality

Investors typically rely on financial statement figures when making investing choices. As a consequence, the concept of the quality of accounting earnings has garnered significant attention from researchers due to the critical nature of the accounting earnings number reported in these statements. Ma (2011) argued that the accounting number reported in financial statements is the most crucial collection of knowledge for stakeholders, as most of the investors agreeing that the declared net accounting earnings amount is the most critical item in financial statements. This knowledge significantly influences their financial and investment choices and helps to evaluating the company's performance and value, thus reflecting its present and future performance. Understanding the concept of earnings quality helps stakeholders better understand the financial analysis process by analyzing the present and future state of the firm in a manner that reflects its value, allowing them to assess the credibility of the company and determine if its profits are of high quality. As a result, earnings quality helps investors identify companies that efficiently utilize available resources, encouraging them to seek additional funding sources to increase their investments and distribute them in financial markets, leading to a favorable influence on the country's financial situation Dechow and Schrand (2010).

Salman (2012) emphasized the importance of earnings quality by highlighting several areas where it impacts. Firstly, in contracts, where management is rewarded after announcing the final profit amount throughout the annual period. If the net profit figure is exaggerated, it leads to an unfair distribution of rewards, indicating a weakness in the quality of earnings. Higher earnings quality ensures a fair distribution of rewards to management, reflecting reality. Secondly, in economic decisions, the net profit amount is a crucial item in financial statements, relied upon by users, particularly investors, to determine the annual dividends and risks surrounding the establishment. Higher earnings quality leads to correct economic and investment decisions. Thirdly, accounting standards, as those who set accounting standards ensure their quality by indicating the results of their application and providing feedback to correct any weaknesses. The earnings number contributes indirectly to the statement of the quality of these standards after their application. Finally, higher quality earnings lead to increased investor confidence in financial reports, attracting investment and capital, and contributing to the country's economy by increasing commercial activity.

2.1.3 Measures of earnings quality

One commonly used measure is the earnings continuity index, which denotes the relationship between present as well as potential earnings, and therefore reflects the quality of earnings. This index has been used in several studies, including the study by Altamuro and Beatty (2006). The cash liquidity ratio index is another important indicator of the quality of earnings. Liquidity reflects the capacity of a firm to satisfy its present commitments using its current assets. According to Dechow and Dichev (2002), higher liquidity firms usually make greater quality earnings. Another key indicator is the absence of earnings management. Financial analysts have paid more attention to earnings quality versus only depending on the accounting earnings figure, which is prepared according to the accrual basis. The earnings number is divided into cash flows and accruals, and there is a possibility for manipulation of accruals to achieve specific goals set by management. By understanding the concept of earnings quality and using these measures, stakeholders can make informed decisions about investments; evaluate a firm's performance and value, which ultimately contribute to the overall economy growth.

The studies utilized various models to measure the accruals ratio, such as the model proposed by Jones (1991). The most important aspect presented by this model is its departure from the characteristic of the stability of optional accruals over time. Another widely recognized indicator is the operating cash flow ratio, which has been employed in numerous studies, including the one conducted by Al-Tamimi (2018). The cash flow ratio is derived from the statement of cash flows, which represents one of the most crucial statements that expresses the current situation of the company based on the operating cash flow. In contrast to other statements that are formulated using an accrual basis, the statement of cash flows depicts the actual cash flows of the company without any exaggerations or estimates by the management. In a study conducted by Obaid and Akbar (2016), several other measures were identified to assess the quality of earnings. The measures encompass various factors, such as the ratio between the absolute change in income and the absolute change in cash flows, the timing of loss recognition, exceptional accruals, the predictive capacity of current earnings for future cash flows, and the earnings' response coefficient.

2.1.4 Determinants Earnings Quality

Previous studies have several influencing elements the earnings quality earnings, and in this paper, we will focus on the most significant ones, including financial leverage, sector, dividend distributions, company financial losses, and company size. Financial leverage is regarded as one of the most significant signs that assess the adequacy of the financing policy adopted by company management, as it reflects the company's capacity to utilize its debts and obligations to purchase assets. It represented by the debt to asset proportion, where higher ratios indicate that the company incurs liabilities at a higher rate than its existing assets. In such cases, the management may resort to accounting policies that artificially inflate profits, which reduces the quality of earnings, to avoid a deficit that could prevent the company from paying its obligations or to protect the stock price of the corporation in the stock market by retaining existing investors and attracting new ones Shtewi (2009). Previous studies have taken different perspectives on the effect of leverage in finance on the earnings quality. Multiple investigations, such as Wang and Campbell (2012) demonstrated that financial leverage has a detrimental impact on earnings quality., contrast additional research, like Riahi & Ben Arab (2011), have demonstrated the opposite, revealing the positive effect of financial leverage on the earnings quality. Moreover, Shtewi (2009) confirmed the lack of a substantial link among EQ and leverage.

In terms of sector, financial markets consist of multiple sectors, with each sector having a specific nature of work and accounting procedures. Therefore, financial statements can vary across sectors, with some items appearing in one sector but not in others. For instance, in the industrial sector, inventory items are among the items that can be manipulated during inventory evaluation, which could impact the quality of earnings. Shtewi (2009) verified that the business sector has an effect on the earnings quality, whereas Hamdan (2012) have a different opinion and argue that the degree of earnings quality is unrelated to the industry. Dividends are given great importance as they reflect to the shareholders the efficiency of the management's work the firm's indicators of achievement. Upon a company's dividend announcement, the market stock price reflects the event, thereby creating a favorable perception of the company's efficacy and competence (Hanafi, 2003). Typically, dividends are linked to the net profit, which may vary from one period to another. However, sometimes companies maintain a certain level of dividends, regardless of the net profit achieved during the year, to give investors a positive view of the company's stability and success. The change in dividends from one year to the next affects the earnings quality. Put differently, if the earnings are of high quality, there is nothing preventing the company from distributing dividends, and the greater the quality of earnings, the larger the proportion of distribution that indicate the company's financial status Ahmed (2012). Shtewi (2009) had a different perspective on dividends, as his research found no correlation among the proportion of dividends and the earnings quality. Furthermore, a firm’s financial losses are considered among the elements that influence earnings quality. The impact of financial losses is usually felt in the period following their realization. According to Basu (1997), the impact of losses is faster than that of financial earnings since it results in writing off the company's assets and increasing its obligations, which affects future financial flows. When companies realize losses, they may resort to earning management, which reduces the quality of earnings Antonio (2011). However, Shtewi (2009) argued that financial losses have no impact on the earnings quality.

Firms vary in the quality of their earnings due to variations in their size. According to Hamdan's (2012) findings, there is a positive correlation between a firm's size and the quality of its earnings. While Hamdan, Moshtaha and Awwad (2012) noted an inverse relationship among the firm's size and its earnings quality. In other words, the smaller the company, the greater its earnings quality. Shtewi (2009), on the flip side, did not find any relationship or influence among the earnings quality and the size of companies. De-jun (2009) the research goes through various aspects that influence earnings quality, involves financial quality standards, the composition of shareholders, the control of shareholders, and the influence of board members on the earnings quality. Regarding financial quality standards, Hamdan et al. (2012) argued that high-quality accounting standards benefit the earnings quality since they prevent companies from manipulating or making estimates that may affect business results. In other words, less flexibility in accounting standards and the choice between alternative methods limits management's ability to practice any form of creative accounting, thereby increasing the earnings quality the declared by the firm.

As for the composition of shareholders, a higher proportion of shares held by individuals on the company's board of directors of a company positively affect earnings quality. This is because the management may resort to manipulation to inflate the net profit number to provide a better picture of the status of the business, given that the management is part of the investors. If the company is exposed to any crises later, this may affect them negatively and demonstrate this positive relationship Jenkins et al. (2006). In some countries, the state has a high control over the shares of companies, which can have an effect on shareholder control. Specifically, when the state's percentage of control is higher than 50%, it may negatively impact the quality of earnings Yan and Huacheng (2007).

The members of the board of directors could also make an impact on earnings quality. When board members hold multiple positions across different companies, it can reduce their focus on one company, increasing dispersion and opportunities for earnings management. Conversely, the board of directors can great benefit to the business when composed of independent members, which decreases opportunities for earnings management and increases earnings Dechow and Schrand (2010).

Hamdan (2012) added another factor to consider when comparing privately-owned companies with publicly-owned companies. He found that private companies may resort to earnings management more often due to managerial hierarchies and management interests, while publicly-owned companies aim to reduce earnings management and any forms of manipulation to avoid litigation and accountability processes. Therefore, public ownership companies generally have a higher quality of earnings than private ownership companies.

2.1.5 Earnings Quality and Earnings Management

Previous research has looked into the notion of earnings management as a target that management seeks to achieve by using other concepts, such as income smoothing and creative accounting or misrepresentation in financial reporting. Income smoothing refers to companies manipulating their income figures to reduce fluctuations and deviations in net profit, thereby maintaining stock price stability in financial markets. Creative accounting, on the other hand, involves choosing accounting principles that do not adhere to the principle of reservation Beidleman (1973).

In his study, Al-Lawzi (2013) defined earnings management as a behavior that management may engage in to influence the amount of net profit declared in financial reports without providing any economic benefits to users, which may cause long-term damage. Earnings management is a process of adapting accounting methods and procedures to adjust accounting profit figures to suit management's desire to express an acceptable level of profits, while also concealing information to achieve specific goals and purposes.

Earnings management is a practice carried out by company management to manipulate financial reports in order to achieve their own interests, there are two ways in which this is commonly done, the first method is through the accounting approach. Management can exploit the flexibility in accounting standards and policies through the accrual accounting principle, which has become controversial due to concerns about its effectiveness in accurately determining profits. While the Financial Accounting Standards Board (FASB) considers it useful in determining accurate profits, analysts and auditors see any interference by management in accounting accrual items as weakening the benefit of authorized accounting numbers for users; this is because management may prioritize their interests over those of other users and parties. Chan (2008) confirmed this management practice of earning management.

The second method involves operational activity carried out by establishments and the nature of their work. Companies may postpone certain accounting operations such as costs and accelerate others such as revenues in order to present a desired image to management Jean and Haitao (2012). This is a result of the agency problem, where management prioritizes their interests instead of those of the owners. Establishments may link rewards and incentives directly or indirectly to the results of the establishment's work, as noted by Abdeljawad et al. (2023).

To control this phenomenon, companies may adhere to international accounting standards while selecting the most conservative alternative accounting methods. Additionally, companies may contract with independent external audit offices and major auditing firms to provide confidence to the financial statements published by the company, as suggested by Fama and Jensen (1983).

. Auditing companies place great importance on their reputation, which is why they are committed to conducting thorough audits and detecting any manipulations by management in a timely manner while adhering to accounting standards. This commitment improves the EQ, particularly if the auditing companies are from one of the well-known or specialized major firms, as noted by Balsam et al. (2003). As a result, investors can make more accurate predictions of future earnings, as highlighted by Hussainey (2009).

Dimensions of the Concept of Earning Management

Previous studies have linked earning management to more than just a concept. Some studies have suggested that it results from management choosing between accounting practices based on generally accepted principles, with the aim of maximizing their economic benefits and presenting the best possible performance picture. Other studies have linked earning management to accounting estimates and disclosure practices, with management highlighting certain items and concealing others to achieve their desired image and gain economic advantages at the end of the period Al-Maeeni and Nuri (2017). Muhammad (2016) argued that earnings management has a strong link with the quality of earnings. The more a firm engages in earning management practices, the lower the earnings quality. Despite the negative impact of earning management on earnings quality, management still resorts to this practice to maintain a steady level of earnings and avoid fluctuations that can increase risk and draw attention to the facility's performance. This helps to reduce the variation in the facility's annual business results and prevent questions about the reality of fluctuating numbers during financial periods. Given the importance of earning management and its impact on earnings quality.

previous studies have suggested various methods for revealing earning management practices.

First, accounting analysis methods involve examining the accounting policies used by management and identifying financial items that may be subject to manipulation, such as accounts receivable or debtors. By ensuring that management has chosen the most conservative accounting methods in presenting information in reports, the accuracy and integrity of financial statements can be confirmed Mohanram (2003).

Secondly, the accruals method entails computing discretionary accruals subsequent to total accruals to evaluate the extent of earnings management practices within an organization. Accruals serve as temporary modifications to accounts, shifting cash flows from one financial period to another and often relying on personal estimations and assumptions. By analyzing these accruals, the extent of earning management practices can be identified Al-Lawzi (2013).

Finally, Miller's approach entails the comparison between working capital and operating cash flows. Working capital is comprised of current assets and liabilities presented on an accrual basis in the balance sheet. Manipulation may occur by deferring expenditures and accelerating revenues or via generating false income. This manipulation can affect the revenue and expense accounts in the income statement and lead to reduced fluctuations in net accounting profits or reaching the best level of earnings over a given year. By comparing net operating cash flow and ensuring a stable and constant relationship, earning management practices can be avoided and the quality of earnings can be high Miller (2009).

Abu Almakarem (2004) presented a different viewpoint on earning management arguing that the practice of earning management is considered a legal act by the management, as long as it does not contradict existing laws or accepted principles. In other words, management is permitted to exploit the space of freedom granted to them as long as they do not violate the law. This confirms the legality of earning management practice, as it helps improve the management's strategy and future plans. Abu Almakarem relied on several justifications to support the legality of earning management. Firstly, he stated that earning management does not exceed or conflict with the existing laws that govern commercial activities in the country. Secondly, the management does not transgress the administrative authority granted to it by the Board of Directors. Thirdly, earning management does not violate generally accepted accounting standards and principles. Instead, the management chooses the best principles to reflect the best image. This opinion was supported by Mckee (2005) who considered earning management to be subject to acceptable procedures and behaviors as long as it stays within the legal aspect.

The practice of earning management is intended to reach relative stability of profits and thus, it creates a greater possibility to make future predictions. The role of state laws and governance codes is critical in organizing the technique for picking which is more suitable accounting principles which corresponded the nature of the institutions in the financial market. Although generally accepted accounting principles have been developed to be universal and acceptable in all countries, when referring to a particular society or a specific market, it is necessary to choose between several alternatives. For earning management to be at the legal disposal, it must comply with the accounting laws of the country.

2.1.6 Methods of Enhancing the Earning Quality

In light of the importance of EQ, this portion will discuss methods that can enhance the effectiveness of accounting for earnings quality in organizations. These methods can help management maximize earnings quality, attracting more investors to invest in these companies. One of these methods increasing the effectiveness of the audit committee. The size and strength of the audit committee can also increase earnings quality, with its effectiveness being enhanced by increasing the expertise and independence of its members. Additionally, increasing the number of audit committee meetings with management can increase quality of earnings within an organization (Al-Jarhawi, 2013). while another involves globalizing accounting standards and comply with the provisions of the international IFRS report, accounting standards unifies local and international accounting standards, benefiting users of financial statements by facilitating comparisons between the performance of the company and other companies engaged in similar activities. Horizontal and vertical comparisons can identify fluctuations or anomalies during a specific financial period, enhancing the accuracy of observations as well as enhancing the quality of accounting reporting. As a consequence, earnings quality improves. (Al-Jarhawi, 2013). Compliance with IFRS can be achieved by focusing on the importance of disclosing earnings per share, specifying expected return, and indicating how to calculate it. These actions are crucial in aiding users to compare company performance across different financial periods and with other companies in the same line of business (Shaheen, 2011).

2.1.7 Audit Quality (AQ)

AQ refers to the degree of confidence that can be placed on an auditor's opinion on the financial accounts of a corporation. The quality of an audit is crucial in ensuring that the firm's accounting data is reliable, transparent, and accurate. A number of variables, like the independence of the auditor, can influence AQ., competence, and ethical behavior, in addition to the complexity and risk of the audited entity. Other variables like audit fees, time pressure, and auditor tenure may also impact audit quality. To ensure high-quality audits, auditing standards and regulations have been developed by various professional organizations, such as the International Auditing and Assurance Standards Board (IAASB). These standards provide guidelines for auditors to follow and help ensure that audits are performed in a consistent, thorough, and objective manner.

According to DeAngelo's (1981) definition, audit quality pertains to the likelihood of an audit identifying and reporting significant errors or misstatements in the financial statements. In Simunic's (1984) analysis, the concept of audit quality is divided into two components, with the assertion that audit quality encompasses the combined probability that an auditor will (a) detect a violation in the accounting system and (b) disclose this violation. IAASB (2018) presented the definition of audit quality is the degree of confidence that intended consumers of accounting records have in the independent auditor's report. As per the PCAOB's (2014) definition, audit quality refers to the degree to which an audit fulfills the requirements of financial statement users, including investors, lenders, and regulators

The importance of audit quality has been highlighted by various studies, with some demonstrating that high-quality audits can improve investor confidence, improve market value and lower the cost of funding for businesses DeFond and Zhang (2014). In contrast, low-quality audits have been linked to financial scandals, which can lead to reputational damage and financial losses for companies and investors alike Krishnan and Schauer (2000).

2.1.8 Factors Affecting Audit Quality

The quality of an audit is a significant element of the auditing procedure, which can be impacted by various factors. The audit's quality is evaluated by the extent to which it achieves its objective of providing reliable and relevant information to stakeholders. Several factors have been identified as influencing audit quality, including auditor independence, auditor expertise, client pressure, and audit committee effectiveness. One of the most important factors is auditor independence; this pertains to the auditor's capacity to offer an impartial and unbiased assessment of the financial statements. Maintaining the integrity and dependability of the audit process is frequently attributed to the crucial importance of auditor independence. The influence of auditor independence with respect to audit quality was extensively studied in the literature, with many studies concluding that inadequate independence might result in worse audit quality (e.g., DeAngelo, 1981).

A study by Shah and Nadeem (2019) presented a thorough evaluation of the available research on the factors influencing audit quality, including the impact of auditor independence, auditor expertise, and audit committee effectiveness. Another important factor affecting audit quality is auditor expertise. Auditor expertise relates to the understanding, abilities, and experience of the auditor in the specific industry or business being audited. The more experienced and knowledgeable the auditor, the more likely they are to discover mistakes or irregularities in the financial reports. The importance of auditor expertise on audit quality was documented in number of research, involving a meta-analysis by Francis et al. (1999).

Another study by Al-Azzi and Al-Qudah (2016) identified auditor experience, the audit firm's size, and client pressure as key factors affecting audit quality in Jordan. The effect of auditor specialist knowledge on audit quality was investigated by Cuzdriorean

(2019), who found that industry specialization could enhance audit quality. Additionally, the impact of client characteristics, such as company size and complexity, on audit quality was explored in a study by Adams and Baskerville (2003), which found that these factors could make a big impact on audit quality.

Client pressure is a different aspect that might have an impact audit quality; clients may exert pressure on auditors to provide a favorable audit opinion, potentially compromising the auditor's independence and objectivity. Studies have shown that client pressure can lead to lower audit quality (e.g., Tyokoso, Sabari, Dogarawa, & Ibrahim, 2016). Finally, audit committee effectiveness can also impact audit quality. The oversight and effectiveness of the audit process fall under the purview of audit committees, who are accountable for ensuring its efficient execution. The effectiveness of audit committees may be impacted by many different kinds of variables, such as the composition of the committee, the degree of engagement and involvement in the audit process, and the quality of communication between the audit committee and the auditor. The impact of audit committee effectiveness on audit quality has been explored in several studies, including a review by Abdolmohammadi et al. (2015). Overall, understanding the factors that affect audit quality is critical for stakeholders to evaluate the reliability and relevance of audit information. By considering these factors, auditors might enhance their production level as well as provide stakeholders with more meaningful information.

2.2 Theories of EQ and SP

2.2.1 Agency theory

Jensen and Meckling (1976) introduced agency theory as an explanatory framework addressing the dynamics and issues arising from the relationship between corporate shareholders and their appointed agents, typically the firm's executives. The most significant reasons for the emergence of the audit profession are the existence of a separation between management and owners, hence the necessity for an external auditor to check the company’s business results and try to alleviate agency problems. On the other hand, the audit profession also supervises and provides protection to the manager Gerayli et al. (2011).The agency theory explains why independent audits are necessary in the financial sector. Independent audits help reduce the agent-principal issue by ensuring that financial reports are properly produced and free of substantial errors. They also decrease the possibility of fraudulent activity and unlawful reporting activities. When management does not conduct a company that acts in the greatest intentions for its shareholders, agency problems arise. Shareholders and other stakeholders must make financial choices based on data that may or may not represent the business's underlying economic situation when a corporation manages the impression it provides to the business by earnings management (Neu, 1991).

According to Gul et al. (2009), the application of agency theory suggests that audits of superior quality play a preventive role by curbing insider exploitation of accounting-based contractual boundaries and earnings manipulation arising from the separation of ownership and control. Assuming that managers and agents use the contract to maximize their wealth, here the issue of moral danger arises. The available information may be known to the agents more than the managers. Here comes the strike, where managers cannot determine if the agents' decisions are in the benefit of the firm or solely their individual benefit, such as speculating on the share price, for example. This is where corporate governance plays a part, including the internal control function and forcing companies to undergo external audits, especially for companies that have more widespread ownership structures Farouk & Hassan (2014). As per Watts' (1998) perspective, auditing is perceived as a bonding expense that agents incur to meet the principals' demand for accountability. Similar to other operational costs within a company, auditing is funded by principals to safeguard their economic interests

Louise (2005) indicated that audits have a critical role in building and strengthening confidence in information about finances. Studies have shown that audit quality can have a considerable influence on financial report usefulness. As a case in point, DeFond and Zhang (2014) the study revealed a positive correlation between enhanced audit quality and improved financial reporting quality, as measured by the accuracy and reliability of financial statements.

Additionally, Francis et al. (1999) found that higher audit quality is connected with greater earnings quality, as determined by the persistence and predictability of earnings. Earnings quality pertains to the extent to which declared earnings faithfully represent the fundamental performance of the economy. High quality of earnings can provide valuable information to stakeholders, while low earnings quality can be a red flag for potential financial misreporting. The quality of the audit can have implications for earning quality, as auditors can help detect and prevent financial misreporting.

Scholarly investigations have demonstrated a positive correlation between audit quality and the quality of earnings. For example, Choi, Kim and Zang (2010) discovered there is a strong connection among audit quality and the in formativeness of earnings, as indicated by the link between earnings shocks and stock returns. According to the principles of agency theory, tensions of benefit may emerge throughout the owners and their representatives. leading to agency costs. External audits can help mitigate these costs by providing assurance to stakeholders that financial statements are accurate and reliable. Audit quality is an important element which could have an impact on the usability of statements of finances, and can have implications for earning quality. Research findings indicate a positive correlation between increased audit quality, enhanced financial reporting quality, and improved quality of earnings. Overall, these findings highlight the significance of quality in audits in promoting transparency and reliability in financial reporting.

2.2.2 Signaling theory

Signaling theory can be used to describe situations where parties have different levels of information. In such cases, the individual sending the information must make choices regarding whether and in what manner to communicate it, while the receiver must make decisions on how to interpret the message. Connelly et al. (2011). The primary aim of signaling theory is to break down information asymmetry among the sender and receiver Spence (2002). In the corporate sector, management typically has more knowledge about their company's worth and performance compared to external investors, leading to information asymmetry. To bridge this gap, management can use signaling theory by asserting in their annual report that their company is a worthwhile investment, which can increase truthfulness and raise the worth of their business via hiring a more qualified auditor. Entrepreneurs possessing favorable sensitive data regarding their work are inclined to opt for auditors of qualified quality. and investors can extrapolate information about the company's owner from the auditor choice.. Enterprises with less advantageous sensitive data are unable to imitate this signal Titman & Trueman (1986).

Hay and Davis (2004) used signaling theory for non-profit organizations and discovered proof supporting the proposal that non-profit organization management may utilize the consultation of a high-quality auditor as a signal of competitive advantage to encourage conditions that contribute. This was confirmed by Kitching (2009), who suggested that charitable and non-profit institutions are using a signal of choosing and accrediting a qualified auditor to confirm the truthfulness of the financial statements. According to signaling theory, organizations with small financial resources can compete by using high-quality financial statements to attract equity investors Birjandi et al. (2015). Profitable businesses are tend to provide voluntary disclosures since it is a simple way to differentiate themselves from competitors, and voluntary disclosure is highly linked to company quality and results. Finally, Mohd-Nasir and Abdullah (2004) argued that companies with better performance provide more timely and detailed information in their financial reports, which can send a signal to investors that the firm is profitable and has a high rate of return on assets.

2.2.3 Auditors' theory (Theory of Inspired Confidence)

The theory of generated trust among auditors establishes a relationship between stakeholders' demand for trustworthy and dependable financial reporting and the abilities of procedures audit to fulfill those requirements. It observes the evolution of these demands and audit operations over time. The theory of inspired assurance, established by the Limperg Institute in the Netherlands in 1985, suggests that auditors, as sensitive information representatives, derive their broad societal role from the need for specialized expertise to detect and assess risks, as well as the need for impartial and unbiased judgment aided by rigorous entrance exams. Hence, auditors and accountants must be aware that the entire population seems to anticipate dropping percentage of audit failures, which necessitates designing and conducting audits in a way that minimizes the potential risk of undiscovered substantial errors.

The accountant has a responsibility to perform their duties with such way to uphold the trust that they have earned. At determining the audit's impact on society, Carmichael (2004) noted that the positive impact of an audit is lost when society's faith in the effectiveness of the auditor's report is misguided. Hence, auditors must ensure the maintenance of sufficient quality control particularly an audit failure can be an incident that marks the end of a person's career. Auditing helps ensure the reliability of financial information for company managers and owners, investors, and stakeholders in conjunction with financial statements, governance, and legislation, contributes to building trust within the area of finance.

The theory of inspired confidence aids in identifying how external factors affect internal auditors' procedures. Internal auditors leverage their comprehension of social dynamics and societal norms to connect their aspirations with the business's aims. This is supported by research, as external stakeholders' trust in business financial information is influenced by their perception of the company's internal audit process Holt & DeZoort (2009). Third parties expect accountability to be achieved through the periodic publication of accounting information, including the company's details. These stakeholders believe that management may produce an unfair financial report due to potential conflicts of interest, and that management teams may have non-public information that shareholders are not privy to. Furthermore, since shareholders cannot have direct control over all documents and do not have the specialized knowledge to ensure the accuracy of data pertaining to finances, it is natural and appropriate for independent auditors to confirm financial reports Owolabi & Olagunju (2020).

2.3 Literature review

2.3.1 Earnings Quality

Earnings are of significant importance for companies as they serve as a review of their performance by a diverse group of consumers (Dechow & Schrand, 2010). Ensuring the earnings quality is critical aspect of financial reporting, which means that financial statements must be relevant to shareholders and other capital providers in establishing resource allocation choices. However, appears that there is no agreement in the published material on how to define or measure the quality of earnings. Various research has concentrated at various aspects, including continuity, stability, information abundance, and predictability. Therefore, the quality of earnings can only be defined within a specific model that depends on the user's needs (Menicucci, 2020). One definition of earnings quality provided by Hodge (2003) is the extent to which declared net earnings differ from genuine earnings. Another definition, given by Mikhail, Walther and Willis (2003), represents a level that a company's previous earnings are related to future revenues. According to Schipper and Vincent (2003), investors use earnings quality like a qualifying factor untilobtain market capitalization information from earnings characteristics. As a result, earnings quality holds value for both current and prospective investors, as well as for contract procurement purposes.

Measures of earning quality

Given the absence of a generally accepted definition for earnings quality, and the presence of various definitions, the standards used to calculate the quality of earnings surpass the attention given to accounting accruals, which are considered a fundamental indicator of earnings quality. Given the diverse needs of users, there is no universally recognized method of determining quality of earnings. Different measures are employed to cover various aspects of quality of earnings. Schipper and Vincent (2003) inspected the different notions of earnings quality used in research and grouped them into 4 groups.

The first group incorporates the ideas of consistency, variability, and predictability; however, none of these categories appears particularly useful in measuring earnings quality. The second group is based on the relationship between cash, accruals, and income. The third group involves qualitative notions in the FASB's conceptual framework, measuring quality in terms of relevance, dependability, and comparability/consistency, which are interconnected and cannot be assessed independently. The fourth group focuses on execution. Chan (2008) argued the higher the quality of the accounting information, the higher the quality of financial reports, and hence, the decision-making process improves, resulting in a more efficient market. Earnings quality refers to reliable and unbiased earnings data that helps explain corporate success and benefits decision-making (Dechow et al, 2010).

In several studies, such as those conducted by Altamuro and Beatty (2006), Penman (2003), Hamdan (2012), Al-Zahra (2016), and Hamdan et al. (2012), the continuity and recurrence of the future earnings were considered an essential measure of EQ. This indicates that the more sustainable and recurring earnings are, the higher their quality. The Richardson et al. (2005) model was used in these studies to measure earnings quality. The model divided earnings into cash flows and accruals, with high-quality earnings indicating a higher continuity of cash flows than accruals. Al-Zahra (2016) supported the use of this model, as it overcame the limitations of other models by distinguishing between cash flow earnings and earnings resulting from accruals.

Additionally, the model accounts for the fact that management can manipulate accruals, while it cannot manipulate cash flows, making it a more reliable measure of earnings quality. Several researchers have found the earnings sustainability index insufficient for accurately measuring earning quality. As a result, they have added other indicators to provide a more accurate expression of earning quality. For example, Mohamed (2017) investigated the link among earning quality and share returns through employing the continuity of earning as an indicator of quality, along with other indicators such as the quality of accruals, income smoothing, and predictive ability of earning. However, His study's findings revealed no statistically correlation among the data elements. This suggests that stakeholders in the Egyptian environment focus solely on the net profit declared in companies' financial reports, without paying attention to accruals and cash flows.

Similarly, Al-Awawda and Nour (2017) used the earnings sustainability index along with other indicators such as the criterion of approaching cash and the percentage of operating cash-flows to total assets, to measure EQ. They found that the EQ is higher when earnings are more close. In addition, they used the absence of earning management as an indicator, which was measured using the Jones model Jones (1991), built around the entire accruals idea and the percentage of optional accruals. Hamdan (2012) measured earning quality based on factors affecting the continuity and recurrence of earnings in Jordan. He used the Richardson et al. (2005) model to measure earning quality and also used the absolute value to extract optional accruals to identify the earning management degree based on the Jones (1991) model.

Abu Ajila and Hamdan (2012) used the index of earnings free from earning management practices to measure earning quality based on total and optional accruals, employing the modified Jones model. Subramanyam (1996) found that the abnormal accruals of the modified Jones model are priced through the market, which gives data users confidence and discourages the manipulation of accruals, thus affecting earning quality. Skinner and Soltes (2011) studied the association between dividend policy and EQ and added another indicator, which is the distribution of earnings. This indicator depends on whether or not companies distribute dividends to investors. Companies that are committed to distributing dividends enjoy continuity of earning and thus higher earning quality than those that do not.

Financial ratios to measure earning quality

Some researchers have relied on financial ratios generated from the cash flow statement as indicators of earning quality due to the importance of financial analysis in the economy. Numbers in financial statements should not be viewed in isolation; they should be linked and interpreted to obtain useful financial information that reflects the current and future situation with the aim of meeting the needs of financial statement users,. Previous studies have focused on financial flow ratios, especially given the significance of the cash flow statement in financial analysis, as it forms the link between financial statements. The cash flow statement differs from other financial statements because it depends on the actual receipt and payment of funds and not on the accrual basis. This provides financial information that is not available in other statements, as Ayoub (2017) demonstrated when he used the cash flow statement as a tool for assessing the financial performance of an institution. He provided greater detail of financial ratios by dividing them into three parts.

First, the ratio of measuring liquidity quality includes the cash coverage index, the ratio of payments essential to pay debt interest, the ratio of cash-flows from exploitation activities to long-term debt payments, and the ratio of cash-flows from external investment to internal cash-flows from financing.

Second, the ratio of measuring profitability quality includes the operating cash ratio, the ratio of net cash-flows from operations to sales, the return on assets ratio from operating cash-flow, and the operational activity index.

Third, the free cash-flow ratio includes the net free cash-flow index and the cash coverage ratio. Previous studies have focused on using financial ratios related to the information of the cash- flow as indicators of EQ in companies. Among these ratios are: first, the operating cash index, which reflects the company's earnings ability to generate operating cash-flows, considering interest and taxes. Second, the operational activity indicator, which measures the ability of operational activities to create operating cash-flows and represent the outcomes of operating activities on both the cash and accrual basis (Matar, 2006). Third, the cash-flows ratio from sales divided by sales, showing the percentage of cash-flows from sales (Mills & Carslaw, 1991).

Fourth, the interest rate and received distributions, which shows the relative investment-returns importance, whether in loans or financial securities (Matar, 2006).

Fifth, the ratio of cash-flows from operating activities to common shares, which reflects the ability of the institution to distribute cash earnings Gibson, (2001).

Sixth, Return on Equity (ROE) from operating cash flows, which indicates the ROE from cash flows from operating activities (Obeidat, 2006).

Seventh, Return on Assets (ROA) from operating cash-flow, which reflects the exyent to which firms assets are able to create operating cash-flows (Gibson, 2001). In a study by Wijesinghe and Kehelwalatenna(2017), financial ratios were used as indicators to measure earning quality. Among these ratios were the working capital ratio, which measures the difference between current assets and current liabilities, also the accruals ratio, which measures the difference between the net profit and the net cash-flows from operations. They also provided a way to measure earning quality through sales, by using net operating assets-sales ratio, which shows the operational capacity of the facility.

Additionally, the nature of the industry must be taken into account when using appropriate measures of earning quality, as it affects the quality of earnings and their standards. Furthermore, Al-Tamimi (2018) stated that reports must include the real position of the company and that the financial information provided to investors should be useful to decision-makers regarding the economic unit. Their study relied on several ratios based on the cash basis in evaluating earning quality: first, adequacy of operating cash flows; second, operating cash flow; and third, net operating cash flow to total assets. However, Al-Zahra (2016) had a different perspective, expressing disapproval of employing financial ratios as an indicator of earnings quality. He argued that there is a possibility of financial ratios affecting negative practices carried out by management through earnings management practices or creative accounting. Additionally, he mentioned that there are no specific standard ratios to compare these ratios, which reduces their efficiency in measuring earning quality.

The Absence of Earnings Management Practices as a Measure of EQ:

The occurrence of global financial crises has created a crisis of confidence in the accounting profession, particularly in its ability to perform its oversight role. This is due to the fact that some accountants have practiced earnings management under the pretext of maintaining the required level of profits. Considering the significance of earnings management and its influence on accounting practices,, researchers have discussed the EQ and its relationship to earnings management. For instance, Cug and Cugova (2021) found that earnings with a high level of quality have features such as greater predictability, greater promptness, less volatility, and lower levels of earnings management. Such earnings are assumed to mave high quality. If earnings management confuses the data to such a manner which becomes fewer efficient at forecasting future cash flows, it is going to cause a detrimental impact on the EQ..

Other studies, such as Muhammad (2016) and Schipper and Vincent (2003), have focused on using the Jones (1991) model for determining how far that earnings are free from earnings management practices based on the measurement of accruals. These accruals differ in their flexibility and vulnerability to manipulation. Some of them, such as depreciation, doubtful debts, and inventory, can be easily manipulated, while others related to financing, such as loans, do not enjoy this much flexibility for manipulation, but they may be subject to manipulation in timing. Studies such as Baridwan and Hariani (2010) unanimously agree that there is an impact of earnings management practices on the EQ, as it leads to its reduction. Therefore, management seeks to practice any form of earnings management with the goal of optimizing companies' market value and increase their competitive value. In order to show the profit figure as close as possible to the required number, they gain the confidence of existing investors and satisfy them, thus attracting new investors.

Kamarudin and Ismail's (2014) study showed that the quality of earnings can be determined by determining the extent of the absence of earnings management applied by management or decision-makers at the firm to manipulate and mislead investors. If earnings management is practiced, it distorts the company's accounting earning figure, making it less useful for investors in relying on it. Even if the profits resulting from earnings management continue, they will not be beneficial to the decision-makers. Due to the significance of this effect, researchers have given consideration to earnings management. Bedard et al. (2004) tried to explain the factors affecting earnings management by managers, including the existence of audit committees whose duty it is to reach out an impartial opinion on financial reports disclosed as free from fundamental errors, as well as the existence of external audit and the provision of laws that protect the investor. Saleh et al. (2020) have also studied the quality of earnings and earnings management in emerging markets and discovered a negative association between earnings management and earnings quality, where earnings management serves as a complete mediator in the relationship among financial factors and earnings quality.

Earning Quality Measures in the Palestinian Market

Audit offices are crucial in preventing earnings management and other forms of modification that could deceive investors and lower earnings quality in Palestinian banks. In an applied study conducted by Al-Sweiti and Muhammad (2015) on Palestinian companies listed on the Palestine Stock Exchange, they discussed the relationship between the quality of earnings and dividends. The most important results of their study indicated strong positive correlation among dividend status and earnings quality, suggesting that dividends can be used as a measure of earnings quality. They also noted an unfavorable connection among modest dividends and sizes and quality of earnings, as well as a substantial beneficial association exists among big dividend sizes and quality of earnings. Additionally, they revealed a strong beneficial correlation among dividend persistency and quality of earnings.

2.3.2 Audit Quality (AQ)

Economic crises like the Enron scandal and the bankruptcy of Andersen reinforced the demand to excellent audits and special pay close consideration to varied aspects that could influence quality of audit. A superior audit ensures the accuracy, completeness, and impartiality of financial information. Dang (2004) defines financially audited statements serve as a surveillance tool to give users of financial information confidence. The amount to which financial statement consumers may trust on an audit opinion is determined by the quality of the audit undertaken, which is critical to capital economic stability. The majority of the studies look at the issue, regulators, and investors. The definition, nature, and assessment of audit quality were also explored by the researchers (DeFond and Zhang, 2014). The Public Company Accounting Oversight Board (PCAOB) presently provides audit quality information through the publishing of inspection reports, and the Board aims to construct and disseminate audit quality indicators as shown in PCAOB (2014). Furthermore, the PCAOB's attempts to define and quantify audit quality may influence audit quality views among both auditors and investors.

De Angelo (1981) was the first to define AQ as the market-assessed joint chance that a specific auditor identifies and discloses a violation in the financial reporting system of the client. AQ can be expressed as a low or high, if it is low enough to be called an audit failure, which may occur in two cases. While the first exists when required accounting standards are not applied by the client (GAAP departure), the second case reflects the auditor failure to issue an audit report that is compatible with the existing conditions. In other words, the report does not reflect the company's financial situation (audit report failure) and in both cases the data in the audit report is considered misleading to users، audits can be conceptualized as either satisfying or otherwise not achieving the basic professional and legal standards as a first estimate of audit quality.

Audit failure rates are negatively correlated with AQ; the greater the failure rate, the worse the AQ (Francis, Maydew and Sparks, H. (1999)Krishnan and Schauer (2000) investigated the connection among business scale and nonprofit institutions' adherence to reporting obligations; they discovered that when firms grow, compliance rises as well. Geiger and Raghunandan (2002) determined the AQ by asking if auditors had granted a going-concern certification for US companies that have filed for bankruptcy over the previous year. They discovered that, opposite to the expressed fear that what a long auditor-client association adversely influences AQ, auditors would be less inclined to provide a going concern opinion even in early years of an agreement but not in subsequent years. Audit size might be the most often used indicator of audit quality.

Measures of Audit Quality

DeAngelo (1981) posits that the size of an audit firm can serve as an indicator of audit quality due to the abundance of resources available to larger firms. Subsequent studies, such as Krishnan and Schauer (2000), have further examined the relationship between auditor size and audit quality using objective analysis. Additionally, Ghosh and Moon (2005) suggest a potential negative correlation between auditor tenure and audit quality, as longer-tenured auditors may compromise their independence to maintain strong client relationships.

There was a different opinion of Carey and Simnett (2006) where they proved that when increasing tenure positively affects the AQ so that the auditor's judgment on the company is improved through the development of his knowledge of the client financial statements and his increasing knowledge of more details of the company, this indicates that mandating turnover will reduce audit quality by shortening tenure, not the other way around. Choi et al. (2010) studied the correlation between audit fees and AQ; their results showed that audit quality is not closely related to audit fees, whether the fees are many or few. In the scope of releasing going-concern updated reports, Geiger and Rama (2006) investigated whether the international Big-4 audit firms demonstrate greater quality by tend to have lower audit-reporting mistakes; their study found that international Big-4 audit firms are much inferior to non-Big-4 firms. Moreover, the outcomes revealed proof of a Big-4 AQ differential in reporting about the going-concern difficulties of the client.

The impact of audit environment, the caliber of audit firms, and the firm's participation in global capital markets were all examined by Maijoor and Vanstraelen (2006), they pointed out that a company's dependence on foreign markets and the caliber of the Big-4 audit firms are two variables that might lessen the impact of the local audit environment, they discovered that regardless depending on the auditor’s type a tougher audit environment lowers the size of earnings management. Components for quality auditing go much beyond auditing requirements, individual characteristics of the auditor like auditor ability and experience, ethical principles, and attitude, are a crucial factor, Auditor impression and mandatory audit bidding are other influences, to increase audit quality, businesses need to recruit top talent with the requisite technical and people capabilities (Duff, 2004).

Audit Quality and Earnings Quality

According to Sumiadji and Subiyantoro (2019), the traits of consistency and predictable help to build the quality of earnings. They used yearly data from industrial enterprises registered on the Indonesia Stock Exchange for their analysis. Their findings indicated that, while audit specialties have no effect on EQ, auditor size and tenure do. In a study covered a sample of Tunisian firms, Koubaa and Jarboui (2017) made the case that there is an obvious and mediated connection among the quality of earnings and variations in book tax and audit quality. Their study's findings that substantial book-tax discrepancies are related with greater audit quality for Tunisian enterprises suggest that these differences serve as a visible indicator for EQ that influences auditor judgments. They founded establish statistical evidence for an indirect relationship, mediated by earnings quality, between atypical book-tax discrepancies and audit quality.

In addition, they explained demonstrates how knowledge of the book-tax discrepancies might enhance audit quality. The effect of AQ as determined by financial information inspected by big-four auditing firms, on the capacity of auditors to forecast earnings potential of both profitable and non-profitable businesses was the topic of Hussainey (2009) study, which involved a sizable sample of participants from the United Kingdom. He discovered that when financial information is audited or reviewed by the international four accounting firms, users of accounting information, investors in particular, can more accurately predict future profitability. However, do not apply to unprofitable businesses. Piyawiboon (2015) showed that switching from smaller to bigger audit firms had a favorable association. According to the auditors' opinion, there was a negative association between the discretionary accrual and their comments on the going concern, which led to good earnings quality. When the auditors did not provide a judgment about the financial information and instead made a going-concern observation, the opposite outcome poor earnings quality appeared.

Audit Quality in Palestine

Qudeih & Helles (2013) conducted an applied study on Palestinian banks, the research aimed to determine the impact of the characteristics to audit committees on accounting reporting quality in banks listed on the Palestine Exchange. It found many results; most notably having a presence to inverse association among a scale or magnitude audit committee, independence members of the audit committee, as well as the quality of reporting on finances. In addition, exists a direct correlation among the percentage to bank shares owned by members of the audit committee and quality of reporting on finances. The auditing profession must be highly regulated, as it is well known that the auditing profession is regulated by The IAASB by issuing International Auditing Standards (ISAs). Auditing operations in the Palestinian market are regulated by the Palestinian Capital Market Authority in cooperation with the Palestinian Board of auditing profession and The Palestinian Governance Code also intervenes by organizing a section of business through governance guidelines. Palestinian Board of auditing profession, which plays the largest role in regulating the auditing profession in Palestine, seeks to improve the auditing profession in Palestine to attain an outstanding degree for performance as per to best international professional standards and practices. It also aims at raising the professional performance quality and also confidence in the profession and the quality and professionalism of audit reports, which reflects positively on the Palestinian national economy (PPBA, 2004).

2.3.3 EQ and the SP

Investors view reported earnings as a valuable tool for forecasting future gains and stock price. In contrast,analysts are concerned with methods for conducting analysis the earnings quality to optimize investors' portfolios. As a result, analysts, managers, and investors face challenges in their ability to dismiss the importance quality of earnings in resource distribution (Chan, 2008). Knowing the link among earnings quality and share price is critical because strong earnings quality instills a positive image within the perceptions of both existing and prospective investors, alongside other relevant stakeholders (Ekoja, 2004). In an empirical study conducted by Larson and Resutek (2011), they made a discovery the earnings quality positively raises the market return and is reflected in the share price.

Leuz et al. (2003) they presented findings derived from their study, applied to thirty-one countries, that the quality of earnings increases the share price. However, there may be differences in the association among share price and earnings quality internationally in various nations due to legal and institutional factors. According to Alsufy et al. (2020), high-quality earnings have a favorable impact on investor protection, raising stock prices. On the flip side, Wijesinghea and Kehelwalatennab's research (2017) demonstrated the presence of earnings quality little bearing on manufacturing businesses' stock returns, undermining the value of their stock. Abu Afifa et al. (2020) studied the association among audit quality and earnings quality on the share price of Jordanian manufacturing companies, using EQ as a mediating variable. The results showed that AQ and EQ raise the stock prices, but it is not necessary that an increase in audit quality will improve earnings quality.

Oroud, Islam, Ahmad, and Ghazalat (2019) discussed the impact of accounting information represented by cash-flows and accruals on the share markey value, with audit quality added as an intermediate variable. The results of their study, conducted on Jordanian companies, showed that cash flow and accruals can be relied upon by the investor to predict share price, with different dependencies according to different sectors. Additionally, the AQ has a considerable influence to a stock price through the investor's decision, which may sometimes depend on buying shares according to the quality of the audit in a particular company. Saleh (2022) used the assumption that the share price was a dependent variable, while audit quality and earning quality were two independent factors in a study on the Egyptian market. The study's results enhanced our comprehension of the manner in which fundamental studies demonstrate a favorable and considerable influence of EQ on stock prices.

The AQ had a negligible effect on stock prices, while the amount of financial leverage expressed as a control variable had a positive impact on the relevance of the accounting numbers. Al-Saidi (2011) considered earning quality as one of the factors influencing the return on the share of companies, using Healy (1985) model to measure earning quality. The study demonstrated a significant and direct correlation between earnings quality and the market rate of return on the share. Ali et al. (2000) argued no correlation was found among earning quality and share returns, as investors focus on the amount of net profit without looking at the actual profit components of dues and financial flows. Richardson et al. (2005) revealed a beneficial connection among earning quality and stock returns. The more the quality of accruals is lower, the lower the continuity of earning, which affects securities in financial markets, affecting the returns of shares by declining. This positive relationship was corroborated by Chan (2008), as they found that most investors in the US market possess adequate investment knowledge to comprehend the implications and interpretations of accounting numbers. Furthermore, the US stock market demonstrates efficient and effective responses to changes in accounting policies.

Share Price and Size, Leverage and Return on Asset

In recent decades, share prices have garnered increasing attention from researchers due to their association with various variables(e. g. firm size, firm profitability, and financial leverage). For instance, Bani Khaled (2018) studied the share prices of industrial-grade Jordanian companies and linked them with the size of the company and other variables. The study's most significant finding was a beneficial connection among the size of the company and the share price. On the flip side, Arnaout (2021) argued differently in a study conducted on the Damascus Stock Exchange, stating that the size of the company does not directly affect the ratio of the market value of the share to the book value of the share or its profitability. However, it was proven that the company's directly impacts the degree size of financial leverage. Iqbal (2016) conducted a study on the industrial companies, particularly the cement sector of the Pakistan Stock Exchange, and found that the ratio of debt and leverage negatively affects the share price when considering the share price as a dependent variable. Furthermore, the findings of the study revealed a positive impact of company's size on the share price.

Zhang and Zhou (2020) conducted a study on the Chinese market, dividing the financial leverage into two types: operating leverage and financing leverage. The results showed that both operating and financing leverage had an adverse impact on the synchronization of share prices. Furthermore, the study found that companies owned by more than fifty percent of the government sector have a greater impact on operating and financing leverage.

Different studies used various measures to assess profitability, including ROA, ROE, and gross profit margin ratio. Murniati (2016) used ROA, ROE and net profit margin (NPM) to evaluate profitability, and found that the ROA has a positive influence on stock prices, whilst the ROE has an adverse influence indicating that the lower the ROE, the lower the share prices. The NPM was found to have no effect on stock prices. In another study, Alami (2018), conducted on the Palestinian market, he linked profitability ratios, represented by operating income margin ratio, net profit margin, ROA, and share price, and found a beneficial connection among profitability ratios and share price. The direct connection among profitability ratios and share price could have been stated via a function of profits in increasing the book value of shares, thus increasing stock returns. Profitability also serves as evidence of a company's success in investments and management, increasing investors' appetite for acquiring shares of those companies, thereby increasing demand and leading to a rise in share prices.

2.4 Hypotheses Development

Many researchers, such as Balsam et al. (2003), numerous efforts have been made to examine the connection among audit quality and stock price, and they also link this relationship with earnings quality in various countries. However, it is evident from the studies of these researchers that their results differ and are not consistent. For instance, Zakaria and Daud (2013) found that having an audit from one of the Big 4 auditors can make a big impact on earnings and its quality. Deakin and Konzelmann (2004) devoted attention to market-based and accounting-based qualities, respectively, which is deemed inadequate because neglecting any category of characteristics in a share price study will fail to capture the true influence of various property measurements. Kim (2015) studied the oversight functions of larger auditors, characterized as office-level business experts, and found that switching the auditor to an industry expert can significantly improve the market value of cash. Jiang et al. (2008) concentrated on either accounting-based or market-based features, which is viewed as insufficient because a share price study that ignores either category of attributes would be unable to identify the true impact of various quality measurements. After scrutinizing prior research and literature, it emerged evident that there exists a limited body of work addressing the auditing quality, earning equality, and their interplay withshare price, both in a general context and within the specific domain of the Palestinian market, Based on the preceding discussion, two hypotheses have been formulated:

H1: Higher EQ leads to an increase in the share price of companies listed on the PEX.

H2: The relationship between EQ and the share price of companies listed on the PEX is moderated by audit quality.

Chapter Three

Research Methodology

3.1 The Sample of the Study and Data Collection

The study uses data obtained from the annual reports of 48 companies listed on the Palestine Exchange (PEX) across various sectors, including Service, Insurance, Industry, Banks, and Investment, over the period ranging from 2011 to 2020. Eight companies are neglected from the study due to the unavailability of data. Subsequently, the final sample size is 40 companies with 400 observations. As the PEX accept more than one currency, data in other currencies was converted to Jordanian dinars (JOD) based on the closing price of each year. Table (1) shows a summary of the final sample size used in the study.

Table (1)

study sample

Sector	Companies included in the sample	The total number of companies	Sample proportion of the population
Service	8	9	88%
Insurance	7	8	87%
Banks	6	8	75%
Industry	11	12	91%
Investment	8	11	72%
Total	40	48	83%

3.2 Research variables and measurement

This section of the research defines the variables of the study (dependent and independent), in addition to the moderator variable and controlling variables. It also identifies the appropriate methods for measuring each one of them. While the dependent variable is defined as the variable that is being studied or predicted, the independent is the variable that is being manipulated or controlled to see how it affects the dependent variable. On the other hand, the moderator variable is a variable that has an effect on the strength or direction of the association between the independent and dependent variables. Finally, the controlling variables are the variables that need to be accounted for or controlled to confirm the accuracy and reliability of the study's results. The research identifies the appropriate methods for measuring each of them to ensure the results' accuracy and reliability.

The Independent Variable

Earnings quality (EQ) is the independent variable. Previous studies have used various measures to evaluate EQ, including the renowned Accruals measure that assesses the extent to which earnings depend on non-cash items, such as depreciation, accounts receivable, and accounts payable. High-quality earnings are less prone to errors or manipulation in accruals, and the Jones model measures this by breaking down total accruals into anticipated and discretionary accruals based on changes in sales and current assets/liabilities, **respectively (Dechow & Dichev, 2002). The Jones model's formula is:**

$$\text{Accruals} = \Delta CA - \Delta CL - (0.5 * \Delta Sales) \ldots\ldots\ldots\ldots\ldots\ldots\ldots(1)$$

Here, ΔCA represents the change in current assets, ΔCL denotes the change in current liabilities, and $\Delta Sales$ indicates the change in sales.

Other measurement methods were also used, such as Cash Flow Quality, which assesses the degree to which earnings rely on operating cash flow rather than accruals. High-quality earnings result from sustainable cash flows from operations, measured by the Cash Flow Coverage Ratio, which compares cash-flow from operations to total debt (Bartov, 2000). The formula for the Cash Flow Coverage Ratio is:

$$\text{Cash Flow Coverage Ratio} = \text{Cash Flow from Operations / Total Debt} \ldots\ldots\ldots(2)$$

For this study, a ratio method was chosen as it's more suitable for the model used. The EQi.t ratio is calculated by dividing the operating cash-flow to total assets ratio (OCFTAi.t) for the company (i) in period (t) by the net income to total assets ratio (NITAi.t) for the same company (i) in period (t). The equation is as follows (Alsufy et al, 2020):

$$\mathrm{EQi.t} = (\mathrm{OCFTA\ i.t})/(\mathrm{NITA\ i.}t) \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots(3)$$

The Dependent Variable

There are various methods used in previous studies to measure the share price (SP), the dependent variable. Some commonly used methods include: Firstly, the closing price is the final market price at which a share is exchanged on a specific trading day. Many studies use the price at the year-end to evaluate the performance of a stock. For instance, Guo (2020) examined the performance of Chinese mutual funds by using the closing price at the year-end. Secondly, the average price is calculated by taking the average of a share's daily closing prices during a period of time. This method smooth out the volatility in the stock price and provides a more representative measure of its performance. For example, Lin et al (2016) used the average monthly stock price to assess the impact of insider trading on stock returns. Thirdly, market capitalization is the overall value of all outstanding shares of a firm. It is calculated through multiplying the outstanding stocks number by the current market value per stock. Many studies use market capitalization to represent the size and performance of a firm. Cai (2017) examined the association between the level of corporate social responsibility (CSR) and the performance of the company employing market capitalization. Fourthly, total returns are calculated as the sum of a share's capital appreciation and dividend payments over a period of time. This measure takes into account both price changes and the payments of dividends and is often used to evaluate the performance of stocks. Peterson (2016) used total return to examine the performance of mutual funds in terms of social responsibility.

In this study, the share price was delineated as the closing value of a publicly traded company's stock at the conclusion of each fiscal year spanning 2011 through 2021. This approach was selected for its alignment with the research model and the abundance of accessible data, as it has been widely employed in previous scholarly inquiries.

The Moderating Variable

Audit quality (AQ) is employed as a moderator. AQ is usually measured in the extant literature by audit-firm size, auditor specialization, and auditor tenure Sumiadji & Subiyantoro (2019); Balsam et al, 2003). These measurments are considered as dichotomous variables, assuming that the Big Four international accounting firms are of higher quality than non-Big four audit firms. As the Palestinian market has a limited number of specialized audit firms and most companies do not change their audit firms, this study focuses on auditor size as the sole measure of AQ. Therefore, the study uses company disclosures to measure AQ components, with auditor size represented as a dummy variable taking 1 if the company uses one of the Big Four audit firms and 0 if not Sumiadji & Subiyantoro (2019).

The Control Variables

To ensure the accurateness and reliability of the study results, the several control variables are considered in the study to account for any potential confounding factors. These variables include size of the company, leverage, and profitability. Company size is measured based on the total assets classified into four sizes, where a value of [1] represented a small-sized company the amount of the total assets is bellow JD 20 million, [2] represented a medium-sized company with total assets between JD 20 million and JD 40 million, [3] represented a large-sized company with total assets between JD 40 million and 60 million, and [4] represented a very large-sized company with total assets greater than JD 60 million. On the other hand, leverage is estimated as the total liabilities divided by the total assets for year t. This measure allows the researchers to evaluate the level of debt a company has taken on relative to its total assets. Finally, profitability is measured using the ROA ratio, which identifies a firm's ability to generate profits compared to its total assets. A higher ROA indicates high efficiency of the firm in employing its assets and accordingly generating profits.

The measurement methods used for each variable were based on previous studies. For example, the measurement of firm size using a dummy variable was used by Abu Afifa et al. (2020), while the calculation of leverage using the total liabilities to total assets ratio was based on the method used in the study by Al-Najjar and Abed (2015). The use of ROA as a measure of profitability was based on the method used in the study by Alia and Awwad (2020). By including these control variables and using established measurement methods, the researcher aimed to produce more accurate and reliable results in their study.

Table 2 summarizes the study variables and the corresponding measurement methods utilized for each variable. By clearly outlining the measurement methods and their sources, readers can better evaluate the validity of the study's findings and compare them with other similar studies. Therefore, Table 2 serves as an essential resource for researchers, academics, and other parties to assess the quality of the study's data and conclusions.

Table (2)

Summary of the variables

Variable	Name	Measurement	Ref
Audit quality (Moderating)	AQ	By the size of the audit firm: A dummy variable, with the value of (1) if the company uses one of the big 4 audit firms and (0) otherwise	Sumiadji and Subiyantoro (2019)
Earnings quality (Independent)	EQ	EQ i.t = (OCFTA i.t)/(NITA i.t)	Alsufy et al (2020); Alia and Barham (2020)
Share price (Dependent)	SP	Price of a company stock (i) at the end of each fiscal period (t)	Alia and Barham (2020)
Firm Size (Control v.)	SIZE	Quadruple classification: [1] (small-sized) when the total assets of the company are less than JD 20 million, [2] (medium-sized) companies of total assets between JD 20 million and JD 40 million, [3] (large-sized) includes companies with total assets between JD 40million and JD 60 million, and [4] (very large-sized) if amount of the total assets of the company is greater than JD 60 million.	Abu Afifa et al. (2020)
Leverage (Control v.)	LEV	Total liabilities / Total assets.	Al-Najjar and Abed (2015); Alia and Awwad (2020)
Profitability (Control v.)	ROA	Return / Total assets	Alia and Awwad (2020)

3.3 Research Models

This study has developed models to identify the impact of earnings quality on share price, and whether the relationship is moderated by audit quality. The models are based on a framework proposed by Alsufy et al. (2020), which has been adapted to suit the specific research objectives of the study. When developing the models, the study aims at providing a comprehensive understanding of the effect of EQ on share price and how audit quality may moderate this relationship. The models have been carefully designed to incorporate relevant variables and measurement methods that are essential for accurately assessing the impact of EQ on share price. The models will enable researcher to identify the underlying factors that contribute to changes in share price, and how these factors may be influenced by the quality of accounting and audit procedures. Overall, the models developed in this study are a valuable tool for researchers and analysts who are interested in understanding the association between EQ and the share market price. They provide a robust framework for analyzing financial data and assessing the influence of various factors on share price, which can be used to inform investment decisions and financial reporting practices. The following models will be used:

1. $SP\ it = \alpha + \beta 1\ EQ\ it + \beta 2\ size\ it + \beta 3\ ROA\ it + \beta 4\ LEV\ it + (\varepsilon i + vit)$

2. $SP\ it = \alpha + \beta 1\ EQit + \beta 2\ AQ\ it + \beta 3\ size\ it + \beta 4\ ROA\ it + \beta 5\ LEV\ it + (\varepsilon i + vit)$

Where:

SP it = price of a public company stock (i) at the end of each fiscal year (t).

EQ it = the earning quality of company (i) and year (t) measured by (OCFTA i.t)/ (NITA i.t).

AQ it = auditor size of company (i) and year (t) measured as a dummy variable takes (1) if the company uses one of the big four auditors and (0) if not.

size it = the size of company (i) and year (t) measured as a dummy variable where: [1] (small-sized) when the company's total assets are less than JD 20 million, [2] (medium-sized) if total assets are between JD 20 million and JD 40 million, [3] (large-sized) when the total assets are between JD 40 million and 60 million, and [4] (very large-sized) if total assets are greater than JD 60 million.

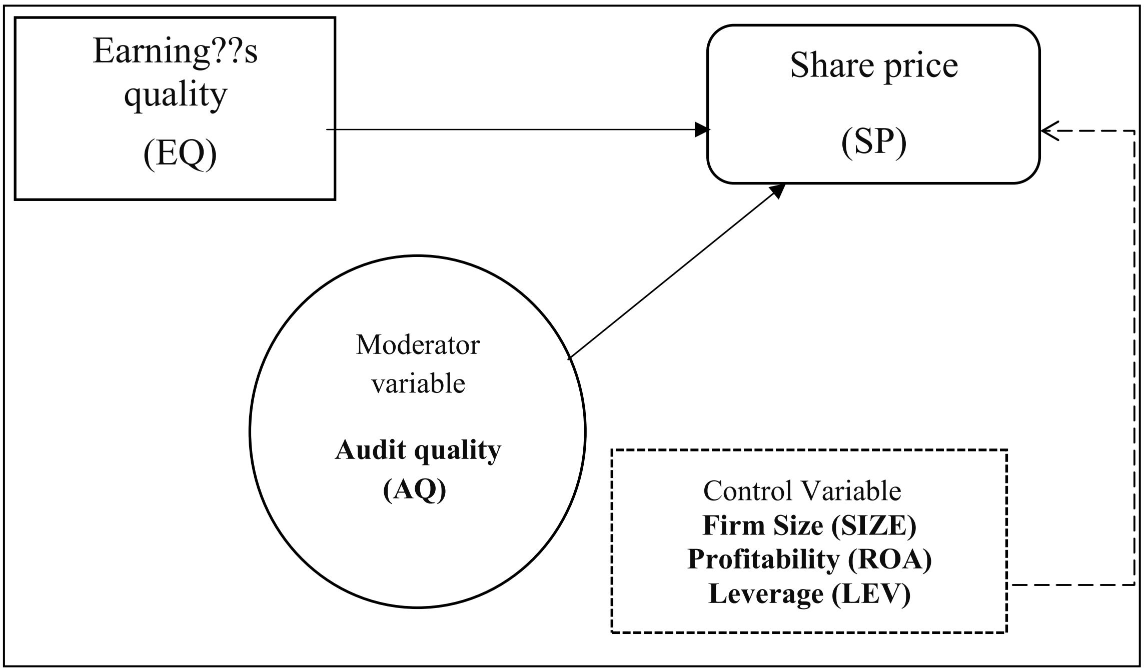
ROA it = Return / Total assets of firm (i) and year (t).

LEV it = Total liabilities / Total assets of firm (i) and year (t).

Figure 1 shows the study model and the relationship that will be tested based on the correlation of the variables.

Figure (1)

Independent Variable Dependent Variable



3.4 Data Analysis

3.4.1 Descriptive Statistics

To increase accuracy and validity of the data for analysis, the study first removed unusual numbers from the dataset. Table 3 displays the companies' distribution according to their size classified into four categories. The table shows that the total assets of 54.5% of the companies is less than JD 40 million, while the rest (45.5%) had total assets of JD 40 million or more. It is evident from the table that most Palestinian companies listed on the Palestinian market fall into two categories: small-sized companies, accounting for 34.8% of the total, and very large-sized companies, accounting for 32.5% of the total. In other words, medium-sized and large-sized companies do not make up a significant percentage of the listed companies' size.

Table (3)

Firm Size (SIZE)

	Number of companies	**Percent %**
Less than twenty million JD	139	34.8
≥ twenty million JD to less than forty million JD	79	19.8
≥ forty million JD to less than sixty million JD	52	13.0
sixty million JD and more	130	32.5
Total	400	100.0

400 Observations

Table (4)

Descriptive results

	N	**Minimum**	**Maximum**	**Mean**	**Standard Deviation**
Share Price (SP)	400	0.0994	14.1000	1.618196	1.7580590
Earnings Quality (EQ)	400	-144.756311826	430.36852320	2.5213874414	30.318615688373
Audit quality (AQ)	400	0	1	0.71	0.453
Firm Size (SIZE)	400	1	4	2.43	1.263
Profitability (ROA)	400	-0.621924612	0.317145266	0.02375427170	0.070671223003
Leverage (LEV)	400	0.297409589	82.266145813	6.00275295876	11.243399465833
Valid N (listwise)	400				

The descriptive data are shown in Table 4. The Share Price variable ranges from 0.0994 to 14.1000, with a mean of 1.618196 and a std deviation of 1.76. Earnings Quality ranges from -144.77 to 430.37, with a mean of 2.52 and a std deviation of 30.32. Audit Quality takes a value of either 0 or 1, with a mean of 0.71 indicates that 71% of the sample companies were evaluated by Big 4 auditors during the period covered by the study (2011 to 2020), compared to 29% of the companies reviewed by local auditors, and a std. deviation of 0.453. The Firm Size takes a value from 1 to 4, representing the company's size, with a mean of 2.43 and a std. deviation of 1.263. Profitability ranges from 0.62 to 0.317145266, with a mean of 0.02 and a std. deviation of 0.07. Finally, Leverage variable varies from 0.29 to 82.27, with a mean of 6.00 and a std. deviation of 11.24. All 400 observations are complete for all variables.

In addition to the previous analyses, this study also conducted a Multicollinearity test to check for any potential econometric issues in the data. Multicollinearity arises if a high correlation exists between two or more independent variables, which can lead to unreliable regression results. To detect this issue, the Variance Inflation Factor (VIF) and its inverse, the tolerance (TOL, 1/VIF), were calculated for each independent variable. The VIF shows the extent to which the variance of an estimated regression coefficient increases as a result of multicollinearity, while the tolerance measures the proportion of a variable variance that is not explained by the rest of the independent variables in a model. Generally, a VIF value above 5 or a tolerance value below 0.2 indicates significant multicollinearity, which can lead to biased regression coefficients and standard errors. Therefore, this test ensures the reliability and validity of the regression results by identifying any potential issues with the independent variables

Table (5)

Multicollinearity test

Variables	**Collinearity Statistics**	
	Tol (1/VIF)	**VIF**
Earnings Quality (EQ)	1.000	1.000
Audit quality (AQ)	0.829	1.207
Firm Size (SIZE)	0.761	1.313
Profitability (ROA)	0.982	1.018
Leverage (LEV)	0.879	1.137

a. Dependent Variable: Share Price (SP)

Table 5 illustrates the Multicollinearity test results, conducted on the independent, mediator, and control variables of the model of the study. The test used the Variance Inflation Factor (VIF) and tolerance (TOL) to check for any issues of multicollinearity among the variables. The results show the absence of significant problem of multicollinearity in the research model, as all TOL values are above 0.1 and all VIF values are less than 10 for all variables. This means that each variable in the model explains a unique part of the variance exists in the dependent variable. Furthermore, there is no strong correlation among any of the independent variables that could cause biased regression coefficients or standard errors. As a result, the regression results can be considered reliable and valid, and thus the model is a good fit for the data. These results are in consistence with the prior studies that have used the same methods to test for multicollinearity (Gujarati, 2003).

3.4.2 Hypothesis Testing

The study utilized the linear multiple regression test to test the model, employing the Driscoll-Kraay standard errors method to correct for any potential issues. The outcomes of the multiple regression tests for each hypothesis are elaborated in the subsequent paragraphs.

First hypothesis: Higher EQ leads to an increase in the share price of companies listed on the PEX.

Table (6)

Regression results of the first hypothesis

SP it= α + β1 EQ it + β2 size it + β3 ROA it + β4 LEV it + (εi + vit)			
Variables	**Coefficients**	**T**	**Sig.**
(Constant)	0.179	7.753	<0.001
EQ	0.001	-1.488	0.138
SIZE	0.049	-0.133	0.895
ROA	3.364	3.864	<0.001
LEV	0.004	-2.951	0.003

Dependent Variable: Share Price (SP)
Adjusted R Square 0.266
(F-value) 37.104

Table (6) presents results of the linear multiple regression tests, which aimed to examine (the first hypothesis) that "Higher EQ leads to an increase in the share price of companies listed on the PEX." The study used the Driscoll-Kraay standard errors method to correct for any potential issues. Statistically, the regression model is significant ($F = 37.104$, $p < .001$), implying that the model as a whole provides a better fit than a model with no predictors.

The coefficients column shows the effect size of the independent variables, separately, on the dependent variable (SP) while holding other variables constant. The t-value indicates the statistical significance of each coefficient, with $p < .05$ indicating statistical significance. The "Constant" variable has a coefficient of 0.179, indicating that when all other variables are held constant, the predicted value of the dependent variable (Share Price) would be 0.179. As the t-value is 7.753 and the p-value is less than 0.001, the constant is statistically significant. Moreover, the coefficient of the "EQ" is 0.001, demonstrating a positive relationship between EQ and prices. Since the t-value is -1.488 and the p-value is 0.138, this relationship (EQ-SP) is not statistically significant. Consequently the relationship between earnings quality and share price is absent. The coefficient for the "SIZE" variable is 0.049, indicating that firm size is positively related with share price, but the t-value of -0.133 and the p-value of 0.895 suggesting that this relationship is not statistically significant. Therefore, we cannot reject the null hypothesis stating that no relationship between firm size and share price exists. On the other side, the coefficient for the "ROA" is 3.364, indicating that profitability and share price are positively associated, and the t-value of 3.864. Furthermore, the p-value is less than 0.001 implying that the relationship is statistically significant, and meaning that higher-profitability firms tend to have higher share market prices. Similarly, the coefficient for the "LEV" variable is 0.004, indicating a negative association between leverage and share price. Considering that the t-value is -2.951 and the p-value is 0.003, leverage-share price relationship is statistically significant. Precisely, companies with higher leverage have lower share prices. The adjusted R-squared value of 0.266 shows that the independent variables in the model explain 26.6% of the variation of the dependent variable. Finally, the F-value of 37.104 and the associated p-value is less than 0.001 indicate that the overall regression is statistically significant, which means that the independent variables together significantly impact the dependent variable.

Second hypothesis: The relationship between EQ and the share price of companies listed on the PEX is moderated by AQ.

Table (7)

Regression results of the second hypothesis

SP it = α + β1 EQit + β2 AQ it + β3 size it + β4 ROA it + β5 LEV it + (εi + vit)			
Variables	**Coefficients**	**T**	**Sig.**
(Constant)	0.183	7.344	<0.001
EQ	0.001	-1.443	0.150
AQ	0.166	0.679	0.497
SIZE	0.054	-0.406	0.685
ROA	3.358	3.879	<0.001
LEV	0.004	-2.790	0.006

Dependent Variable: Share Price (SP)
Adjusted R Square 0.265
(F-value) 29.712

Table 7 indicates the results that the constant term (intercept) is statistically significant (t = 7.344, p <.001), suggesting that the existence of a significant factor, other than the independent variables, that is affecting the share price. The coefficient for EQ is not statistically significant (t = -1.443, p =.150), indicating that an absent of significant association between EQ and SP when controlling for other variables. The coefficient for AQ is also not statistically significant (t =.679, p =.497), suggesting that the association between EQ and SP is not mediated by AQ. The coefficient for SIZE is not statistically significant (t = -.406, p =.685), suggesting that firm size does not significantly affect the share price. The coefficient for ROA is statistically significant (t = 3.879, p <.001), suggesting that firms that achieve higher ROA, their share prices are higher. The coefficient for LEV is also statistically significant (t = -2.790, p =.006), indicating that firms with lower leverage have higher share prices. The adjusted R-squared value of 0.265 suggests that the independent variables of the model explain 26.5% of the variance in share price. Overall, the F-value of 29.712 suggesting a statistical significant of the model. In summary, the results suggest that the share price of the firms listed at the PEX is significantly affected by ROA and LEV, but not by EQ, AQ, or SIZE. The findings also indicate that AQ doesn't moderate the relationship between EQ and SP.(rejecting the 2nd hypothesis) However, the model succeeds in explaining a small portion of the variance in share price, indicating that further factors, not included in the model, may provide relevant explanation for the share price behavior.

Chapter Four
Results and Discussion

4.1 Results Summary and Conclusions

The findings of the present investigation indicate no significant relationship between earnings quality (EQ) and share price (SP) when controlling for other variables of firms listed at the Palestine Exchange (PEX), during (2011-2020) period. The coefficient for the EQ variable is positive, telling a positive association between EQ and SP, but it is not statistically significant. Therefore, we cannot discard the null hypothesis stating no association between EQ and SP exists. In other words, there is not sufficient evidence to suggest that EQ significantly effects the share market prices. The adjusted R-squared value of 0.266 indicates that only 26.6% of the variation in share prices may be explained by the independent variables contained in the model. Such findings are similar to what was obtained by the previous studies, Wijesinghea and Kehelwalatennab (2017) for example, which have also found that EQ has no significant impact on share prices. Likewise, Li et al. (2021) investigated the effect of EQ on share prices for Chinese firms. They found that while earnings quality was positively related to share prices, the effect was not statistically significant. However, this conflicts with several other studies, such as those conducted by Leuz et al. (2003). Overall, the outcomes of this investigation agree with previous studies that have found similar results, indicating that EQ may not have a significant influence on stock prices. However, further research is required to fully understand the association between EQ and SP and to identify any potential moderating factors that may impact this relationship.

Absent of a significant association between EQ and SP found in this study may be explained by several theoretical frameworks. Firstly, agency theory suggests that shareholders use management to run the firm on their behalf, and that managers may act in their own interests rather than those of shareholders. Therefore, investors may be more interested in other factors, such as dividend payments, rather than EQ when evaluating a company's share price. Signaling theory, on the other side, suggests that firms with higher EQ may signal their financial health and potential to investors, leading to an increase in share price. However, if other factors, such as leverage and ROA, have a stronger effect on the market share price, the effect of EQ may be diluted.The auditors' theory also plays a an important role in understanding the relationship between EQ and SP. Auditors play an essential role in evaluating and warranting the accuracy of a firm's financial statements. If a firm has high EQ, this may lead to higher audit quality, which could positively impact share prices. However, if investors do not perceive a strong association between EQ and AQ, the effect on share prices may be limited. In the Palestinian context, the results of the study may have practical implications related to investors and managers. Firstly, managers may need to consider other factors, such as leverage and return on assets, when making decisions that affect share price. Secondly, investors may need to evaluate companies based on a wider range of indicators, rather than solely focusing on EQ. Moreover, the results of the study may have implications for the regulatory environment in Palestine. For instance, policymakers may need to consider whether the current regulatory framework is sufficient in ensuring that firms are disclosing accurate and transparent financial information to the market. In conclusion, while the study shows no significant association between EQ and SP in the Palestinian context, further studies are needed to fully understand the complex influences that affect share prices.

The study findings indicate the AQ does not moderate the relationship between EQ and share price. Additionally, the results suggest that firm size doesn't significantly affect share price. The study also suggests that companies with higher return on assets (ROA) tend to have higher share prices, while those with lower leverage tend to have higher share prices. The adjusted R-squared value of 0.265 indicates that the independent variables considered by the model may explain 26.5% of the variance in share price. The F-value of 29.712 suggests that the model is statistically significant overall. The results of the study align with prior research that has obtained similar outcomes. For example, Jones and Kennedy (2015) found that earnings quality and audit quality did not significantly impact share price. Additionally, Chen (2018) suggested that firm size had no significant influence on share price. However, their findings also highlighted that other factors, such as market sentiment and economic conditions, may also influence share price. The study results suggest that the share price of the firms listed at the PEX is significantly influenced by ROA and leverage, but not by earnings quality, audit quality, or size. Furthermore, the study results suggest that audit quality does not mediate the association between EQ and share price. However, it is essential to note that the model explains only a slight part of the variance in share price, indicating that further factors, neglected by the model, may also play a role in explaining the determinants of the share price. The study findings have significant implications for theories that explain the relationship between EQ, SP and AQ, such as agency, signaling, and auditors' theories. The agency theory suggests that higher-quality financial reporting can increase investor confidence and reduce information asymmetry, leading to raise the share prices. However, the current study results indicate that earnings quality and audit quality do not significantly affect share prices, which challenges the assumptions of agency theory. Signaling theory proposes that managers can use financial reporting quality as a signal to convey credible information related to the firm's prospects to investors, thus influencing stock prices. However, the study results indicate that neither earnings quality nor audit quality act as significant signals for investors to affect share prices. Auditors' theory suggests that external auditors can enhance the reliability of the financial information through providing independent and objective assurance services. However, the study results indicate that audit quality doesn’t moderate the relationship between earnings quality and share prices, challenging the assumptions of auditors' theory. The study results are consistent with prior studies conducted by Jones and Kennedy (2015) and Chen (2018), as examples, which found that earnings quality, audit quality, and firm size do not significantly impact share prices. However, these studies also highlighted the potential influence of other factors, such as market sentiment and economic conditions, on stock prices. In the Palestinian environment, the results of the study can provide insights into the factors that influence share prices for firms listed at the Palestine Exchange (PEX). The findings suggest that investors should focus on a company's ROA and leverage when making investment decisions, rather than relying solely on financial reporting quality or firm size. The results also highlight the importance of considering other external factors that may impact share prices in the Palestinian market, such as political instability and regional conflicts. In conclusion, the study findings provide valuable insights into the relationship between the quality of the financial reporting and stock prices and have significant implications for theories that explain this relationship. The study's results suggest that ROA and leverage are the primary drivers of stock prices, and investors should consider these factors when making investment decisions. However, it may be essential to recognize that other external factors may also have a role in determining share prices in the Palestinian market.

4.2 Study Recommendations and Future Researches

Relying on the findings of the study, it is recommended that businesses, especially those in Palestine, should be encouraged to remove any barriers that limit the impact of AQ and EQ on the accuracy of the information of the financial statements. This can help in reducing information asymmetry and increasing the investor's confidence, leading to an increase in share prices. The researcher also suggests that investors and managers should take into account other factors, such as a company's ROA and leverage, in addition to financial reporting quality or firm size when making investment and decision-making. Furthermore, investors should evaluate companies based on a wider range of indicators, rather than solely focusing on earnings quality. Policymakers should evaluate the current regulatory framework to ensure that firms are providing transparent and accurate financial information to the market. In terms of future research, it is recommended to identify specific characteristics that influence share prices, especially in emerging economies. This research can also expand upon the measurement of audit quality by considering the auditor's size and specialization and linking it to earning management. However, it is essential to recognize that external factors such as political instability and regional conflicts may also impact share prices in the Palestinian market. Therefore, more research is necessary to understand the complex factors that affect share prices in this context.

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كليَّة الدّراسات العليا

أثر جودة التدقيق على العلاقه بين جودة الارباح وسعر السهم: دليل من فلسطين

إعداد
أحمد جهاد العارضة

إشراف
د. معز ابو عليا
د. سائد الكوني

قدمت هذه الرسالة استكمالاً لمتطلبات الحصول على درجة الماجستير في المحاسبة، بكلية الدراسات العليا في جامعة النجاح الوطنية في نابلس، فلسطين.

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الملخص

تسعى هذه الدراسة الى فحص العلاقة بين سعر السهم وجودة الأرباح في سوق فلسطين. تبحث الدراسة أيضًا في جودة التدقيق كمتغير وسيط. تتكون العينة من 40 شركة من الشركات المدرجة في بورصة فلسطين (PEX) من 2011 إلى 2020، بإجمالي 400 مشاهدة. تم تقييم جودة الأرباح بناءً على تحليل يتضمن التدفق النقدي وصافي الدخل وإجمالي الأصول ، بينما تم تقييم متغير سعر السهم بالاعتماد على سعر الإغلاق السنوي، كما تم تحديد مقياس جودة المراجعة من خلال حجم المدقق كمعيار حاسم.

أظهرت الدراسة عدم وجود علاقة ذات دلالة إحصائية بين جودة الأرباح (EQ) وسعر السهم (SP) عند التحكم في المتغيرات الأخرى للشركات المدرجة في بورصة فلسطين. علاوة على ذلك ، فإن جودة المراجعة لا تعدل العلاقة بين جودة الأرباح وسعر السهم. ستساعد نتائج الدراسة في تطوير بدائل واقعية يمكن التنبؤ بها لتحديد العوامل البيئية التي تزيد من سعر السهم. تكمن أهمية هذه الدراسة أيضًا في تقييم مستوى سيطرة السوق الفلسطيني على جودة الأرباح وعمليات التدقيق مع الأدلة. اضافة الى ذلك، تولي الدراسة اهتمامًا استثنائيًا لربط جودة الأرباح وسعر السهم ، مع توضيح الدور الوسيط لجودة التدقيق في هذه العلاقة حصريًا في السوق الفلسطيني.

الكلمات المفتاحية: جودة المراجعة ، جودة الأرباح ، سعر السهم ، فلسطين ، بورصة فلسطين.