

**The Jordanian Corporate Governance Code: a Study of Institutional Investors' Perception of
the Reliability of the Audit Report and the Audit Expectation Gap**

Submitted by

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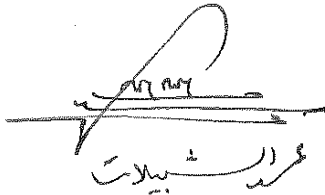
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A handwritten signature in Arabic script, reading 'محمد خليل شبيلات' (Mohammad Khaled Shbeilat), written over a horizontal line.

Mohammad Khaled Shbeilat

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Dedication

This thesis is dedicated with all my love and respect to my family. It is to my inspiring parents, supportive brothers and my compassionate sisters that I owe all my accomplishments and it is to them I dedicate this thesis.

Abstract

This thesis examines, from the perspective of Jordanian financial analysts, the impact of selected components of the Jordanian Corporate Governance Code (JCGC) on the reliability of audit reports and the extent to which the JCGC contributes in narrowing the audit expectations gap. Thus this study focuses on those elements of the JCGC that relate to auditing and seeks to fill a gap in the existing literature regarding the determinants of changes in the audit expectation gap and the perceived reliability of the audit report, in the context of Jordan.

Previous research in this area either considered a smaller range of variables or considered codes other than the JCGC. Moreover, Jordanian research has focused on studying the relative main effects of the independent variables on the dependent variables, and thus less attention has been placed on identifying interactive or configural relationships. Also the research methods used were incapable of identifying cause and effect relationships. Furthermore, given that the JCGC was only relatively recently implemented, on a “comply or explain” basis, the full impact of the code has, perhaps, not been fully reflected in prior research.

This thesis investigates, experimentally, the main and interactive effects of four independent variables on two dependent variables. The independent variables are: (1) the external auditor’s independence, (2) the internal auditor’s effectiveness, (3) disclosure and transparency, and (4) corporate accountability. The dependent variables are (1) the perceived reliability of the audit report and (2) the perceived level of the audit expectation gap. In addition, this thesis investigates the extent to which Jordanian financial analysts possess self-insight as to the weight they place on the decision cues when evaluating the reliability of audit reports and when assessing the size of the audit expectation gap. By comparing financial analyst stated beliefs about the weights they placed on various factors, on one hand, to the weights revealed by the experiment, on the other, it is possible to gauge the accuracy of self-insight of the group.

The study design is based on the agency theory and uses a mixed method approach. The study uses semi-structured interviews, concentrating on ‘how’ and ‘why’ questions, aiming to investigate how institutional investors assess the selected elements of the JCGC in terms of

their effect on the perceived reliability of the audit report and the level of the audit expectation gap. The study also uses a fully crossed 2 level factorial experiment based on the repeated measures technique, thus forming 16 possible combinations of the four independent variables (i.e. 16 scenarios). In the survey, each subject was requested to provide their assessment of the two dependent variables in each of the 16 scenarios. The interviews deliver an in-depth understanding of the investors' perceptions regarding the selected elements of the JCGC and facilitate the interpretation of the study's experimental results.

It was predicted that the sophisticated investors may make decisions regarding the assessment of audits and auditors differently from unsophisticated investors. Therefore this study focused on financial analysts as an important type of sophisticated investor from the following types of institutional investors: banks, insurance companies, brokerage houses, investment companies and funds.

An analysis of 47 completed surveys and ten interviews suggested that external auditors' independence had the greatest effect on the perceived reliability of the audit report while, contrary to the existing literature, corporate accountability had the greatest influence on the perceived level of the audit expectation gap. Several other significant interactions have been identified between the study variables. One-third of the overall effect size in relation to the perceived reliability of the audit report is attributed to interaction between the independent variables, whilst approximately one-quarter of the overall effect size in relation to the level of the audit expectation gap is attributed to interaction between the independent variables. This indicates that institutional investors configurally process decision making information when considering the influence of the selected elements of the Jordanian corporate governance code. This has policy implications for the Jordanian regulating bodies.

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Chapter 1: Thesis Introduction

1.1 Introduction

This chapter introduces the research agenda for this thesis. It provides an overview of the study, including the study's historical context, research problem and research questions, research objectives, research conclusions and contribution to the literature, research methodology and data collection methods, as well as structure of the remaining chapters of the thesis.

1.2 Background and Overview of the Thesis

The Jordanian corporate governance code draws on a number of local and international laws and codes, such as Jordan's Securities Act and Companies' Law of 1997 and the Organization for Economic Co-operation and Development's (OECD) Principles of Corporate Governance (Corporate Governance Code in Jordan, 2009). The OECD principles of corporate governance were established by OECD Ministers in 1999, then revised and replaced in 2004. The OECD code became an "international benchmark" for developing countries worldwide (OECD, 2004, p. 3). The OECD defined corporate governance as: "Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization –

such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making" (OECD Glossary, 2007, P. 151).

The Jordanian corporate governance code for shareholding companies listed on the Amman stock Exchange (ASE) was approved by the board of the commissioners of the Jordanian Securities Commission (JSC) on the 29th of July 2008 and became operational by the beginning of 2009¹ (Corporate Governance Code in Jordan, 2009). This Jordanian Corporate Governance Code (hereafter referred to as the **JCGC**), which regulates the activities of all Jordanian listed companies, is the subject of this study's investigation.

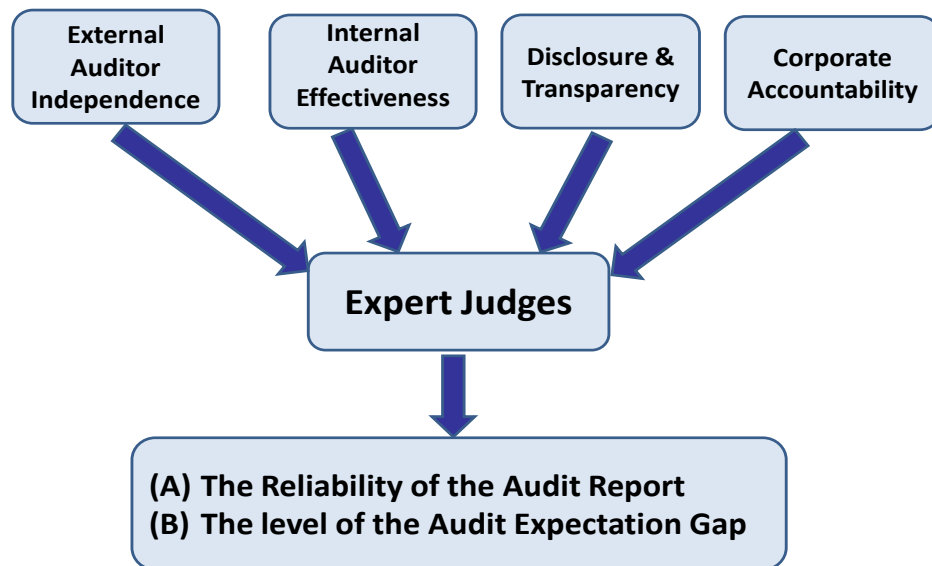
Audit committees are a cornerstone of corporate governance as they play a significant role in improving the quality and reliability of annual reporting. One way in which they accomplish this is by protecting external and internal auditors, starting from their nomination and continuously thereafter. Audit committees have the responsibility to discuss and resolve any conflict between auditors and management. The audit committee must ensure external auditor independence and internal audit effectiveness (Colbert, 2002). Colbert (2002) also stated that "under the International Standards on Auditing (ISAs) [ISA No. 260 Communications of audit matters with those charged with governance], external auditors have a responsibility to communicate certain matters, discovered during the financial statement audit, with those persons charged with governance of the entity. Similarly, the authoritative Practice Advisories (PA), issued by the Institute of Internal Auditors (IIA), require internal auditors to share observations and recommendations with those charged with oversight responsibilities" (p.147), typically the governance body of the entity.

This study investigates four primary independent variables derived from the JCGC, namely (a) external auditor independence, (b) internal auditor effectiveness, (c) disclosure and transparency levels and (d) corporate accountability (See Figure 1). These four variables are posited to influence the expert judgments of institutional investors as to (1) the perceived

¹ See also Circular Number: 12/1/4659. Dated December 15, 2010. Issued by the Jordanian Securities Commission. Available on: http://www.jsc.gov.jo/Public/english.aspx?site_id=1&Lang=3&Page_Id=2550&Menu_ID2=257

reliability of the audit report and (2) the level of the audit expectation gap. This thesis reviews and analyzes the variables of the following model, whose variables are discussed in more detail in the literature review in Chapter Three:

Figure 1: The Study Model: The key Constituents of the JCGC & the Auditing Profession



Understanding the influence of these variables could be especially valuable for Jordan. There have been criticisms that low levels of disclosure, transparency, corporate accountability, external auditor independence and internal auditor effectiveness, have undermined confidence in the Jordanian capital market, compromised the integrity of financial reporting, and contributed to a widening of the audit expectation gap (Swaiti, 2006; Malkawi, 2008; Abdullatif, 2006; Ameera, 2004; Al-Saudi, 2007).

The first independent variable (external auditor independence) is measured by assessing institutional investors' perceptions of how and why independence is crucial, and reviewing related prior studies of (1) the role of well-structured audit committees in supporting and communicating with the external auditors, based on the JCGC and the ISA No. 260, (2) the impact of the processes of nominating, dismissing and setting audit remuneration by the audit committee, (3) audit partner rotation and (4) prohibiting the supply of Non-Audit Services (NAS). These four inputs are expected to enhance external auditor independence, both in fact and appearance, leading to reliable independent audit opinions and reporting about the company's ability to continue as a going concern.

The second independent variable (internal auditor effectiveness) is measured by assessing institutional investors' perceptions of how and why some internal audit functions are more effective than others. This measurement was adopted after a review of prior related studies focusing on (1) the role of audit committees in nominating internal auditors, (2) the impact of providing internal audit reports to audit committees and executive managers, (3) the role of audit committees in reviewing internal audit reports, especially those related to violations detected by the internal auditor and (4) the role of audit committees in reviewing the external auditor's assessment of the internal audit function. These measures, exercised by a well-established audit committee, are expected to lead to enhanced internal auditor independence and effectiveness in detecting frauds and errors and preventing malpractices, thereby protecting the assets of the company. This should also lead to greater perceived reliability of the audit report and a reduction in the audit expectation gap.

The reliability and the credibility of financial reports provided by a company, whether in the annual report or at any point during the year, depend on the quality, and the level, of disclosure and transparency. In regard to the third independent variable (disclosure and transparency), the JCGC has devoted a chapter to the topic of disclosure and transparency. This thesis explores institutional investors' perceptions of how and why JCGC disclosure and transparency

requirements for listed companies improve the quality of financial reporting and reduce the audit expectation gap. Prior research is examined to help guide this investigation.

Accountability is defined as “The quality of being accountable; liability to give account of, and answer for, discharge of duties or conduct”, according to The Oxford English Dictionary. The fourth independent variable of this study involves corporate accountability. It refers to the ability of shareholders and stakeholders to hold the governing body of the company accountable to the laws, regulations and company's bylaws, based on their power and responsibilities. This factor is measured by interviewing and exploring institutional investors' perceptions, and by reviewing the related previous studies of how and why the appropriately constituted responsibilities, duties and authorities stipulated in the JCGC align the actions of governance professionals with the interests of the company and shareholders. The relevant governance professionals here are the external auditors and other governance bodies involved with auditing, such as the executive management, members of the board of directors, the audit committees and the internal auditors, all of whom are accountable for their decisions and responsibilities towards the company and the shareholders. In addition to the literature review and investor interviews, the study surveys financial analyst perceptions of how different levels of corporate accountability influence the reliability of the audit report and reduce the audit expectation gap.

Auditing has been defined as "being concerned with the verification of accounting data, with determining the accuracy and reliability accounting statements and reports" (Mautz, 1964, P.1). External auditors use their reports to communicate with the users of financial statements, such as investors, lenders and stakeholders. These parties assess investment and lending options based on the assurance provided by external auditors. Failure, by the external auditors, to give warning about the entity's viability, along with occurrences of corporate collapses and scandals, have raised the issue of the audit expectations gap; this gap partly exists because of the difference in perceptions and beliefs, between the users of the audit reports and the auditors, in regard to the auditors' duties and responsibilities (Koh and Woo, 1998).

1.3 Reviewing the Jordanian Literature and the Contribution of the Thesis

As this study is focused on corporate governance in Jordan and its impact on the audit expectation gap and reliability of audit reports, as perceived by the financial analysts, a brief overview of corporate governance in Jordan, and relevant auditing research, is necessary both as background and for the design of the study. The overview also highlights the audit problems existing prior to the establishment of the Jordanian corporate governance code, in order to assist in evaluating the perceptions of institutional investors, in the post JCGC adoption period, of the reliability of the audit report and the size of the audit expectations gap.

1.3.1 Highlighting the Problems before the Establishment of the Jordanian Corporate Governance Code.

Over the years, there have been criticisms of the level of disclosure released by listed companies in Jordan, the use of unqualified internal auditors coupled with weak internal control procedures, and the appointment of negligent and incompetent members of the board of directors. In some instances, there have been claims of malpractices conducted by the directors and the auditors (Malkawi, 2008).

While the world had its headline-grabbing corporate collapses, Jordan also experienced its share of corporate scandals, creating the need for enhanced corporate governance. Following the Petra Bank bankruptcy in 1989, one of the most notorious scandals in Jordan's history, Jordan faced a severe financial crisis, resulting in further corporate collapses and a decrease in the Jordanian Dinar (JD) exchange rate from USD 3.35 to USD 1.41 (Al-Awaqleh, 2008). Other examples of scandals in large companies include the case of the Phosphate Company and the case of the Magnesia Company, referred to the Attorney General after a loss JD130 million (Al-Awaqleh, 2008) and involving legal actions, rescheduling and a compensation plan to protect

company employees (Awartani, 2011; Alrai, 2011; Zayadeen, 2011). Poor corporate governance practices were also associated with another scandal, involving four Jordanian banks, in which facilities amounting to millions of Jordanian Dinars were extended to individuals without getting the necessary approvals (Malkawi, 2008). In another corporate scandal, one billion US Dollars in loans, provided to an IT company, went astray (The Economist, 2003).

Insufficient accountability impairs entities' compliance with laws and regulations, which consequently leads to inadequate disclosure and a lack of transparent information, and weakens Jordanian entities' compliance with the best practices of corporate governance (Malkawi, 2008). Jordanian entities' compliance with the best practices of corporate governance is questionable. In July 2009, the governor of the Jordanian Central Bank o (CBJ) dissolved the board of directors of the Jordanian Capital Bank. The CBJ's officers discovered some administrative mismanagement and irregularities contradicted corporate governance best practices (Reuters, 2009).

The auditor is considered the most capable party to assess whether the company is managed according to good corporate governance practices. A working paper, presented by Al-Basheer (2003) to the 5th Scientific Conference of the Jordanian Association of Certified Public Accountants (JACPA), about the role of the auditors in the light of the corporate governance environment in Jordan, pointed out that audit committees play a vital role in maintaining the soundness of the financial reporting system since their primary functions are examining the reports of auditors and their conformity with ISAs, and reviewing the comprehensiveness of the scope of audits. Audit committees should also ensure top management responsiveness to the observations of both external and internal auditors, facilitate the work of auditors and remove any obstacles facing auditors.

Audit committees in Jordan are mostly formed to meet the requirements and conditions of the laws rather than for their essential role in maintaining the soundness of the financial reporting system (Swaiti, 2006; Abdullatif, 2006; Al-Farah, 2001; Al-Khadash and Al-Sartawi, 2010). The literature showed that audit committees did not possess the basic requirements to carry out

their responsibilities effectively, did not have sufficient influence to reinforce the independence of external auditors, and did not effectively play their role in appointing, dismissing, and determining the fees of external auditors. These findings are supported by the results of the World Bank's assessment of the corporate governance environment in Jordan (World Bank: Corporate Governance Assessment, 2004). The literature attributed these problems to (1) insufficient legislation, (2) a lack of requirements for audit committee members to be independent, and (3) a lack of requirements specifying the minimum financial/accounting qualifications and experience that an audit committee member should hold.

Al-Basheer (2003) pointed out that greater fairness and balance in setting audit fees, taking into account the heavy responsibilities required by shareholders and legislators, will facilitate greater audit effectiveness due to motivated auditors, ensure the company's compliance with the corporate governance code, and support external auditors in expressing their independent opinions about the entity's long-term viability.

Auditing plays a key role in corporate governance. The Jordanian Association of Certified Public Accountants (JACPA) adopted the International Standards on Auditing (ISA) in 1990. Under ISA No. 570, the external auditor is responsible for evaluating whether the company is a going concern and giving early warning, to the public and users of the audit report, of any impending corporate collapse. Failure to give such early warning has raised the issue of the audit expectations gap in Jordan, where there is a discrepancy between what auditors are perceived to have done and what a group of financial statement users believes they should have done.

Al-Awaqleh (2008) investigated the evaluation of the going concern assumption by the Jordanian external auditors, revealing that Jordan also has experienced the problem of unqualified audit opinions in the auditor's annual reports followed by unexpected corporate failures and collapses. The study reached these findings by conducting a pilot study on 160 audit reports related to 32 failed shareholding entities. Examples of listed companies in Jordan which had clean audit reports in the six months prior to their receivership or liquidation include The Jordanian Candy and Chocolate Factories, in 2001; The Jordanian Clothing Industrial

Company, in 2003; The Developed Medication Industrial Company, in 2003; The Mineral Investment Company, in 2003; The Ala Aldeen Industrial Company, in 2001; The Al-Kawthar Company for Investment, in 2001.

The external auditor's reports are the medium of communication between auditors and investors. Users of financial statements, such as investors, lenders and stakeholders, look to the assurance provided by the auditors as an input to their investment decisions. Therefore, an external auditors' forthright judgment regarding client viability is valued by investors (Jones, 1996; Epstein and Geiger, 1994; O'Reilly, 2009; Citron, Taffler, & Jinn-Yang 2008).

In Jordan, investors analyze the contents of the audit report as they evaluate the alternative investment options based, in part, on the assurance provided by the external auditors. Market share prices in Jordan are also influenced by the released audited financial statements (Saaydah, 1998; Zureigat, 2006; Zureigat, 2010; Al-Awaqleh, 2008). The importance of the auditor's opinion in Jordan means that Jordanian laws and the regulatory bodies of the Jordanian capital market and the Jordanian Association of Certified Public Accountants (JACPA) should reinforce the external auditor's independence. This independence should be in both fact and appearance, in order to ensure that auditors can express, clearly and unambiguously, their independent opinion.

The failures to provide adequate warning were attributed, by Jordanian literature, to the external auditor's lack of independence, which has been compromised by (1) Inadequate audit fees, (2) Providing significant non-audit services, (3) Unlimited audit partner tenure, (4) Lack of support from audit committees to both external and internal auditors, (5) Insufficient laws and regulations, (6) Social and personal relationship between the auditors and the board of directors and the management and (7) Management pressure on the auditors and weak corporate accountability (Swaiti, 2006; Malkawi, 2008; Abdullatif, 2006; Dahmash, 1989; Matar, 1995; Matar, 2000; Momany, 1994; Al-Awaqleh, 2008; Hamdan, 1996; Abu-Tapanjeh, 2006; Al-Saudi, 2007; World Bank: Accounting and Auditing, 2004; Bani-Ahmad, 2000; Al-Basheer 2003; Malhas, 1992).

An audit committee should also ensure the soundness of the internal control procedures in detecting and preventing errors, frauds and malpractices (Cadbury Report, 1992; Braiotta, 2004). Audit committees are responsible for supporting the internal auditors and reinforcing their effectiveness (Allison, 1994). Audit committee support to the internal audit could be achieved by the nomination of the internal auditors, evaluating the requirements and the budget of the internal audit department, ensuring that the internal auditors have a direct reporting relationship and communication with the audit committee as an independent body (in addition to any reporting to company management), hold meetings with the internal auditors without the presence of the company management and by reviewing the external auditor's assessment of the internal audit function (Pickett, 2010; Goodwin, 2003; Qin, 2007; Goodwin & Yeo, 2001).

Thnaibat and Shunnaq (2010) investigated the role of the external auditors, in Jordan, in evaluating the internal audit function according to the International Standard on Auditing (ISA) No. 610. The study revealed that there were statistically significant differences between the internal and the external auditors' perceptions in regard to the implementation of the ISA No. 610. The study explained this, pointing out that internal auditors in Jordan are still doing their job in a traditional manner, focusing mainly on the accuracy of the accounts. The study also revealed that the internal auditors' independence and their organizational position were crucial factors affecting the external auditor's reliance on and evaluation of the internal audit function in Jordan. The study recommended that internal auditors should report to the audit committee to maintain their independence and effectiveness.

This variance of perceptions between external and internal auditors in the evaluation of the internal audit function in Jordan highlights the audit committee's vital role as a liaison between the external and the internal auditors, the company management, and the board of directors. This thesis, through in-depth interviews, aims to evaluate how and why the communication between the audit committees and the external and the internal auditors, as stated by the JCGC, lead to strengthening auditor independence and effectiveness.

The Jordanian Company Law (1997) specifies that shareholders appoint the external auditors. Prior to the JCGC, it was management, normally with the collaboration of the board of directors, who appointed external auditors and determined their remuneration. Malkawi (2008) criticized that situation, arguing that it undermined the independence of the external auditors.

The selection of the external auditors in Jordan prior to the release of the JCGC was influenced by the auditors' personal relationships with the board of directors, the company management and the audit committee members (Al-Saudi, 2007; Khsharmh, 2003; Ameera, 2004; Abdullatif, 2003). Malkawi (2008) suggests that comprehensive legislation to ensure audit partner rotation, disciplinary systems, an ethical code of conduct for external auditors and prohibit non-audit services for audit clients, could mitigate problems in auditor independence.

Jordanian companies are often described as family-owned businesses (MENA Corporate Governance Workshop, 2003; Zureigat, 2011b; Al-Adeli, 1993; Abed et al, 2012; Matar, 1994). Abu-Tapanjeh (2006) revealed that a number of shareholding companies in Jordan are owned by members of a family, and prefer to elect their family and relatives to be members of both of the board of directors and executives in the company. This ownership characteristic in Jordanian shareholding companies has created obstacles for implementing corporate governance best practices. With family relationships determining appointments to positions in both the board of directors and high in the executive management, decision makers often lack the flexibility and objectivity to fulfill their jobs and oversee the company's activities effectively (Sharar 2006). Moreover, family-owned businesses in Jordan sometimes do not use competence as a criterion for appointing external auditors; rather, personal relationships might be the most influential criterion (Zureigat, 2011b).

On the 29th of July 2008, the board of the commissioners of the Jordanian Securities Commission (JSC) issued and approved the Jordanian Corporate Governance Code (JCGC) for the publicly traded companies listed on the Amman Stock Exchange (ASE) which has come into effect as of the first of January 2009. The JCGC was established to develop the investment and economic climate, including the national capital market and its regulatory and organizational

framework. Corporate governance best practices became a tool to attract foreign and local investment alike. They enhance confidence in the capital market since they reflect the level of fairness, disclosure, transparency and accountability of the listed corporations and identify the measures that should be taken to limit corruption (Corporate Governance Code in Jordan, 2009).

The Jordanian corporate governance code was established to help build a clear framework to regulate the roles of the shareholders and safeguard the rights of all stakeholders. The code states that the duty of the board of directors and the company management is to establish adequate, and effective, internal control procedures to detect and prevent errors and frauds. It also specifies the role of shareholders and the audit committees in nominating the external auditors of the company and ensuring their independence. It also states the roles of the audit committee in nominating and communicating with the internal and the external auditors, evaluating their performance and removing unnecessary barriers in the way of external auditors.

According to the JCGC, Jordanian listed companies should disclose accurate, clear and timely information to shareholders and investors; this includes dealings with company insiders and their relatives as well as related party transactions. The JCGC has prohibited any person from simultaneously holding the position of chairperson of the board of directors and any executive position in the same entity, and it has also prohibited simultaneous membership by any person in more than five boards of directors of different listed companies. This measure aimed at limiting the opportunistic behavior of the managers of some closely-held corporations and ensuring accountability in corporate governance of the companies listed at Amman Stock Exchange (ASE).

The main research objective of this thesis is to investigate (1) the impact of the Jordanian corporate governance code (JCGC), in the post implementation environment, on external auditor independence and internal auditor effectiveness, and (2) the extent of the JCGC

disclosure, transparency and the accountability requirements on institutional investor perceptions regarding the reliability of the audit report and reducing the audit expectation gap.

1.3.2 Reviewing the Related Empirical Jordanian Studies.

This section presents relevant Jordanian literature about Jordanian corporate governance and the existence and effect of the audit expectation gap on the auditing profession in Jordan. It also focuses on the roles of audit committees in relation to external and internal auditors. This section aims to explore prior empirical work in relation to corporate governance environment in Jordan. The results of this exploration will be used, in the next section, to show how the current study contributes to the knowledge of Jordanian corporate governance.

A study aimed at developing a system for corporate governance in Jordanian shareholding companies and reinforcing external auditor independence was conducted by Al-Hanini and Dahmash (2008). Al-Hanini and Dahmash designed and distributed a questionnaire to 120 external auditors and conducted an unspecified number of interviews. The study pointed out that the auditors thought that both effective corporate governance systems and sub-committees (e.g. Audit committee) derived from the board of directors positively enhance external auditor independence. The study recommended that auditors should express their opinion about corporate governance through their audit report.

Swaiti (2006) argued that, according to Jordanian regulations and laws in force, all public shareholding companies are required to form audit committees. However, Swaiti argues that the audit committee functions and responsibilities stipulated in those regulations and laws were insufficient. For example, they did not require any qualifications for audit committee members, such as having financial management experience or holding a degree in accounting or any related fields.

Swaiti (2006) proposed a model for the role of audit committees in Jordan. Swaiti designed a survey questionnaire which was given to financial managers, general managers, external audit firms, and internal audit managers, and then conducted personal interviews with some of those who were involved in his study². The study concluded that audit committees at that time did not have the basic requirements to fulfil their roles effectively, and they did not have a substantial impact on external auditor independence. The study recommended that all audit committee members should be independent and suggested they have an industry expert and a legal expert among their members.

The researcher would argue that all audit committee experience and qualifications must be in the fields of auditing, accounting and finance, not just because the committee's name is 'the audit committee' and its main function is to ensure the integrity and the accuracy of the financial reporting, it is also because the audit committee has the authority to consult external legal consultants or experts for any issue related to fulfilling their roles properly. The JCGC stipulated that each company "shall put at the disposal of [its Audit] Committee all facilities that it needs to perform its duties, including the authority to seek expert assistance whenever needed" (Corporate Governance Code in Jordan, 2009, Chapter 5, section 1-3).

The effectiveness of audit committees in Jordan and the factors affecting the effectiveness of audit committees have been explored by Abdullatif (2006). In his study, a questionnaire was distributed to external auditors. The study concluded that audit committees in Jordan were somewhat effective, and they marginally fulfilled their jobs as stipulated in the related Jordanian regulations. The study revealed that those regulations were insufficient and recommended reinforcing audit committee independence from company management in order to strengthen their role in overseeing the financial reporting processes, and their role in nominating, dismissing and setting external auditor's remuneration.

Abdullatif (2007) conducted another study to investigate the relevance of audit committee responsibilities to corporate governance. The study utilized the same methodology as the previous

² The study interviewed executives, board members, auditors, and staff at Jordanian regulating bodies.

one and the same sample category. The study concluded that external auditors in Jordan perceived audit committee responsibilities as being relevant in general, and they suggested some additional responsibilities such as providing the external auditor with any necessary information and coordinating between external and internal auditors. The study also revealed that external auditors in Jordan were against giving audit committees the authority of nominating, dismissing, and setting external auditors' fees.

External auditor opinions against the role of the audit committees in nominating external auditors were also observed by Swaiti (2006). Abdullatif (2007) attributed this partially to the external auditors' criticisms of the weak composition of audit committees at that time, such as there being no requirements of being independent or having any financial experts. He also partially attributed this reluctance to the external auditors' unwillingness to undertake additional tasks or to change their personal relationship with their clients. Swaiti's study (2006) revealed that there was consensus between auditors and company executives in rejecting the role of audit committees in selecting the external auditors. Swaiti (2006), however, pointed out that the auditors' rejection was based on the audit committee members being unqualified to evaluate auditor work³. On the other hand, the study also attributed this rejection to the possibility that external auditors desire to maintain a personal relationship with their company (management) clients.

The causes and structure of the audit expectations gap have been investigated by Al-Thuneibat (2003). A quantitative method approach was adopted in the study. The questionnaire explored expectations about auditor responsibilities and duties, including whether they were reasonable or unreasonable⁴, and was distributed to the study sample which consisted of the external

³ This could be a suggestion that audit committee members are incompetent, or it could be a mistaken belief that only experts can evaluate experts when in fact their output is for non-auditors and ultimately it must be the shareholders who decide whether they have performed a useful role.

⁴ The study identified the unreasonable auditors' responsibilities, based on the previous literature especially the study of Porter (1993). The study defined the unreasonable responsibilities as those duties and responsibilities which were not stipulated in the international standards on auditing (the adopted standards in Jordan) or in the legislation that regulates the auditing profession in Jordan.

auditors, and executive and financial managers of Jordanian listed companies. Based on the analysis of the data, the study concluded that the audit expectations gap existed in Jordan, and it consisted of the following three basic components: deficient standards gap, ignorance gap and deficient performance gap.

To narrow these gaps, the study recommended that the regulatory bodies of the auditing profession in Jordan should play a more effective role in educating society as to the auditor's duties and responsibilities, developing the profession and overseeing the auditors' job, ensuring they continuously participate in seminars related to the profession, and imposing quality control on the auditors.

The performance gap could also be narrowed by strengthening the external auditor's performance. This thesis aims to investigate the role of the JCGC and support from the audit committees in reinforcing the external auditor's independence, which is expected to encourage external auditors to express an independent opinion about the company's financial position.

The gap between auditors and investors' perceptions about the qualitative characteristics of accounting information has been investigated by Obaidat (2007). These qualitative characteristics include the reliability and relevance of information in relation to helping investors in decision making (Kieso, Waygandt, & Warfield 2010). The Obaidat study adopted quantitative methods, with questionnaires distributed to a sample which consisted of 30 investors and 40 auditors. The study revealed that the major focus of the investors was on timeliness while the auditors gave neutrality the first rank in importance.

Obaidat (2007) explained the difference in priorities between investors and auditors, explaining that individual investors in Jordan are not interested in long-term investment, being more interested in gaining profits as soon as possible through speculation in the stock exchange. The auditors focused on neutrality, which means providing information that has not been prepared to favor one party of interested users over another (Kieso et al, 2010), which is the basis of the auditor's independence (Arens, Best, Shailer, Fiedler, Elder, & Beasley 2010). To ensure

neutrality, audit committees should strengthen the external auditor's independence, even in the face of management pressure. In Jordan, management pressure to issue clean opinions has been a significant problem for external auditors (Omari, 2003; Dahmash, 1989; Bani-Ahmad, 2000; Matar, 1995; Al-Adeli, 1993; Malhas, 1992). This pressure impairs the auditor's independence and highlights the necessity of adopting effective corporate governance systems.

The audit expectations gap and auditors' responsibilities, from investors' perspective, have been investigated by Hajir (2001). The researcher designed and distributed 72 questionnaires to individual investors, present at the Amman Stock Exchange at the time of data collection, and 28 questionnaires to institutional investors (the brokerage companies). The study found that perceptions of inadequate disclosure⁵, inadequate independence of auditors and inadequate performance by auditors, all contributed to a widening of the audit expectation gap.

The study also revealed that the only difference in perceptions between individual investors and institutional investors, regarding the factors affecting the existence of the expectations gap, related to the level of disclosure. The study found that the individual investors believed, at that time, that the levels of disclosure in the audit and financial reports, alongside the accompanying notes in the annual report, were adequate and provided relevant information for decision making. The institutional investors thought the level of disclosure inadequate. A possible explanation for this issue is that the institutional investors employ qualified and sophisticated financial analysts who can devote more time and skill to the analysis of the reports and notes.

The study of Omari (2003) investigated the expectation gap in relation to the credibility of the accounting figures in the financial reports, the extent of the auditor's responsibility in expressing an opinion about the entity's ability to continue as a going concern, the auditor's

⁵ The study defined the level of disclosure by stating that financial reports and the notes accompanying the financial statements should include all necessary information that reflect the real financial position of the company to make the investors informed and in helping them to make their investing decisions.

independence and the scope of the auditor's responsibility in finding the misleading financial data during the auditing process. In addition, that study set out to identify which of the investor groups (individual investors, financial brokers, employees of banks' investment units) have the greatest expectations gap. A quantitative approach was adopted in the study, with questionnaires distributed to investors and external auditors. The study concluded that the audit expectations gap in Jordan was mainly focused on the independence of the external auditors, which was affected by non-audit services, unlimited audit tenures, and perceptions of management pressure.

Al-Khadash and Al-Sartawi (2010) investigated the usefulness of legislation along the lines of the Sarbanes-Oxley Act (SOX) in enhancing the independence of external auditors in Jordan and narrowing the audit expectation gap. The study, as did most of the previous Jordanian studies, adopted a quantitative approach in which questionnaires were used to collect data from Jordanian Institutional Investors and external auditors. The study concluded that such legislation was expected to reinforce the external auditor's independence and narrow the audit expectation gap. Based on this, the study recommended that the Jordanian regulatory supervisory bodies of the auditing profession should define a list of non-audit services prohibited to their audit clients, and those prohibitions should be enforced by relevant legislation (using the SOX legislation as a guide). In addition, the legislation should reinforce the auditor's independence, limit the audit partner's tenure, and activate the role of well-structured audit committees.

1.3.3 Contribution of the Thesis and to the Jordanian Studies

The objective of this thesis is to gain insights into the perceptions of institutional investors in the period subsequent to the adoption of the JCGC, in so far as those perceptions relate to the reliability of the audit reports and the extent to which they contribute in narrowing the audit expectations gap. This thesis investigates, experimentally, the impact of the external auditor's

independence, the internal auditor's effectiveness, disclosure and transparency, and corporate accountability, on the level of the audit expectation gap and the perceived reliability of the audit report. Thus, the contribution of this thesis is to complement the existing research by investigating the relative main and interactive weights of the posited four variables on the reliability of the audit report and the reduction of the audit expectation gap, following the relatively recent introduction of the JCGC in Jordan which was intended to increase the actual and perceived independence of auditors. In addition, the thesis explores cause and effect relationships, including interactions, in the Jordanian context, in contrast to prior research focusing on associations.

The results of this thesis fill a gap in the extant body of the literature and are more comprehensive than the prior research in Jordan. For instance, the study of Al-Hanini and Dahmash (2008) focused on corporate governance's role in reinforcing the external auditor's independence. Another study, Al-Khadash and Al-Sartawi (2010), investigated the capability of legislation like the American Sarbanes-Oxley Act (SOX), rather than the JCGC, to reinforce the independence of external auditors in Jordan and narrow the audit expectation gap⁶. The current study considers a wider range of variables and focuses on investigating the relationships in the Jordanian environment.

In addition, this thesis investigates the extent to which Jordanian financial analysts possess self-insight as to the weight they place on the decision cues when evaluating the reliability of audit reports and when assessing the size of the audit expectation gap. By comparing financial analyst beliefs about the weights they placed on various factors, on one hand, to the weights revealed by an experiment, on the other, it is possible to gauge the accuracy of self-insight of the group. This comparison provides clues as to the quality of the decision making and the likelihood of consistency in judgments (Libby, 1981; Hooper & Trotman, 1996).

⁶ The study of Al-Khadash and Al-Sartawi (2010) had been conducted before the establishment of the JCGC, the study was sent for publishing in September 2008 as mentioned in the footnotes of the study.

This thesis contributes to the Jordanian literature by using experimentation. This thesis presents a new methodology to the area of understanding corporate governance in Jordan. The use of the experiment, along with in-depth interviews, aims to enhance understanding of how and why Jordanian listed companies are affected by the key components of the newly adopted Jordanian corporate governance code, from the point of view of institutional investors. The use of an experiment is intended to overcome methodological limitations inherent in prior Jordanian studies which mostly adopted quantitative approaches based on questionnaires. The use of the experiment, employing the repeated measures design, enabled cause and effect relations to be investigated and some insights to be developed, including insights into interactions between the independent variables in their impact on the dependent variables. The study results will provide valuable information to external users such as the Jordanian Securities Commission (JSC), the Certified Financial Analysts Society in Jordan (CFA-Jordan), the Jordanian Association for Certified Public Accountants (JACPA), other Jordanian regulatory bodies in addition to shareholders, as well as to the Internal users such as members of boards of directors, audit committee members, executive managers and the internal auditors.

The research's importance also stems from the lack of previous empirical Jordanian studies in this regard. Most local and international studies investigated the effect of corporate governance on market share prices, **company performance**, earnings management and financial reporting quality, and dealt primarily with exceptionally large firms in the U.S.A and Europe, countries with highly developed and active markets for corporate control in comparison to those of emerging markets like Jordan (Tomar & Bino, 2012; Ishhadat & Abed Al-Jaleel, 2012; Al-Manzou, 2009; Exi et al, 2001; Al-Najjar, 2007; Al-Khoury, 2005; Gompers, Ishii, & Metrick 2001; Al-khabash & Al-Thuneibat, 2009; Klein, 2006). Nevertheless, corporate governance best practices and the roles of the board of directors and the audit committees in communicating and supporting the internal and the external auditors may also influence the auditing profession and the demand for audit quality (Ballesta & García-Meca, 2005)

Finally, this study has the potential to contribute further to the knowledge of the impact of corporate governance on the auditing profession literature through the database that it has

developed for Jordanian listed companies. This database could be used to study other corporate governance issues.

1.4 Research Statement

This study enhances understanding of the newly adopted JCGC and audit reports in Jordan. The purpose of this thesis is to corroborate primary and interactive effects of factors and variables related to the constituents of the JCGC on the reliability of the audit report and the extent they contribute in narrowing the audit expectation gap as perceived by the institutional investors. This research employs a combination of qualitative and quantitative methods to provide a grounded investigation of the elements of the JCGC in so far they relate to the auditing profession, specifically the external auditor's independence, the internal auditor's effectiveness, disclosure, transparency and accountability. The study also includes consideration of the relative weights of effects, casual relationships, how the factors influence and interact and how they are evaluated.

1.4.1 Research Questions

The main question addressed in this thesis is:

How and why do the selected elements of the JCGC affect the institutional investor's judgment of (a) the reliability of the audit report and (b) a narrowing of the audit expectation gap?⁷

⁷ The audit expectations gap exists in Jordan (Al-Thuneibat, 2003; Obaidat, 2007; Abdullatif, 2003; Omari, 2003; Hajir, 2001) as discussed earlier. This thesis endeavors to contribute to narrowing the audit expectation gap by investigating the posited independent variables of the JCGC experimentally.

In answering this fundamental research question, this thesis both explores institutional investors' perceptions and reviews previous studies, investigating how and why corporate governance affects the auditing profession, in particular, how and why external auditor independence, internal auditor effectiveness, disclosure, transparency and corporate accountability affect institutional investors' perceptions of the reliability of the audit report and the size of the audit expectations gap. In addition, this thesis utilized the mixed method approach to answer the research questions by interviewing institutional investors to facilitate additional insight into their decision-making processes. Moreover, this thesis employs a factorial experiment, based on a questionnaire, to identify the causal relationship between the hypothesized elements of the JCGC and auditing. Also, by using the experimental technique, this study aims to identify the relative weights of the independent variables and their interactions with the dependent variables, in other words the perceived reliability of the audit report and the level of the audit expectation gap.

The first research question relates to the impact of the selected elements of JCGC, in so far as they relate to auditing, on the reliability of the audit report.

RQ.1

What are the relative main and interactive weights of:

- ❖ External auditor independence,
 - ❖ Internal auditor effectiveness,
 - ❖ Disclosure and transparency, and
 - ❖ Corporate Accountability
- on the perceived reliability of the audit report?

The second research question relates to the perceived impact of the selected elements of JCGC, in so far they relate to auditing, on the level of the audit expectation gap.

RQ.2

What are the relative main and interactive weights of:

- ❖ External auditor independence,
- ❖ Internal auditor effectiveness,
- ❖ Disclosure and transparency, and
- ❖ Corporate Accountability

on the level of the audit expectation gap?

1.4.1.1 Configurality

Slovic, Fleissner, & Bauman (1972) argued “Analysts believe that factors relevant to investment decisions should often be interpreted configurally” (p. 286). However, they defined configurality as meaning “that the analyst’s interpretation of an item of information varies depending on the nature of other available information” (Slovic et al, 1972, p. 286). Previous literature that investigated judgmental decisions for capital market investment (Wood & Ross, 2006; Hopkins, 2009; Nguyen & Ross, 2006) and judgmental decision making in auditing (Ashton, 1974; Hofstedt & Hughes, 1977; Brown & Solomon, 1990, 1991; Hooper & Trotman, 1996) have revealed that influential factors interact and intermingle in their influence in judgmental decision making. “An interaction means that the effect of one independent variable depends on the level of the other independent variable being considered” (Trotman, 1996, p. 21).

The four independent variables hypothesized to influence the dependent variables in this study might interact and result in different impacts depending on the combination of values of the other independent variables. For instance, the impact of evidence of uniformly high or low performance on all the variables might have a greater impact than would have been expected from examining the impact of each variable in the absence of the other factors. Thus, high levels of performance on all four factors may convince the investors that the company and its auditors take governance seriously because of the strong and consistent message. In such circumstances, it is possible to envisage investors having a perception of reliable reporting and robust auditing.

A further example of the interaction of the elements of corporate governance would be that high or strong levels of external auditor independence and performance, coupled with high levels of internal auditor effectiveness, might not ensure the perceived maximum influence and outcomes of corporate governance if they were associated with inadequate and untimely disclosure and transparency and a poor accountability system.

It has been evidenced that interactions between variables in experimental studies are particularly important and deliver great value to the decision makers because they lend the findings additional useful dimensions; for instance, Hopkins (2009) found statistically significant interaction between intensity of private equity involvement and duration of involvement on the attractiveness of the Initial Public Offering (IPO). Hopkins pointed out that the result was noteworthy and interesting because the intensity of private equity involvement failed to satisfy standard statistical tests of significance, but it was a relevant factor when it interacted with the duration of involvement. Teoh and Lim (1996) found two statistically significant interactions in their experiment investigating the factors affecting the level of confidence in the auditor's independence. They also found that the existence of audit committees mitigates perceptions of impairment of auditor independence when that auditor gained large audit fees (more than 15 %) from one client. Moreover, the study also found that the perceived external auditor independence was enhanced by the absence of both non-audit fees and a fee dependency situation.

Evidently, manipulation of the four independent variables may provide combined effects that are relevant information for investors in their decision making. Therefore, it is hypothesized that institutional investors will recognize the potential interactions and interrelations between the four factors and evaluate and process them configurally when considering the influence of the Jordanian corporate governance code. Given the potential significance of interactions between the four independent variables, this thesis establishes the following hypothesis:

H1:

Institutional investors process decision making information configurally when considering the influence of the selected components of the Jordanian corporate governance code.

1.4.1.2 Self Insight

The unit of analysis in this thesis consisted of institutional investors. Institutional investors are perceived as experienced and sophisticated analysts whose judgments and opinions are trusted as sources of information related to investment assessment (Bouwman, Frishkoff, & Frishkoff, 1987; Schipper, 1991; O'Brien & Bhushan, 1990). This thesis also aims to investigate the degree of self-insight demonstrated by Jordanian financial analysts. Self-insight is the extent of insight that individuals have into their judgment process (Trotman, 1996). Typically, the degree of self-insight has “been assessed as the correlation, over all cues, between a subject's cue usage and the importance rating subjectively attached to each cue” (Solomon & Shields, 1995, p. 151). This technique has been employed in studies about judgment decision making in finance, including Hopkins (2009), Wood & Ross (2006), Mear & Firth (1987) and Nguyen & Ross (2006). This thesis builds on these studies and considers the level of self-insight among Jordanian financial analysts regarding their assessments of the elements of the Jordanian corporate

governance code, in so far they relate to auditing among, by addressing the following questions:

RQ.3

What degree of self-insight do institutional investors demonstrate in their assessments of the selected key constituents of the Jordanian corporate governance code on the reliability of the audit report?

RQ.4

What degree of self-insight do institutional investors demonstrate in their assessments of the selected key constituents of the Jordanian corporate governance code on the audit expectation gap?

This thesis also aims to provide an in-depth understanding of how institutional investors assess the selected constituents of the JCGC, and to provide a justification for their conclusions. This could be achieved by conducting in-depth semi-structured interviews with a concentration on 'how' and 'why' questions (Symon & Cassel, 1998; Yin, 2009). The fifth research question of this study is:

RQ.5

How and why do institutional investors' assessments of the selected constituents of the JCGC affect their perception of:

- ❖ The reliability of the audit report, and
- ❖ The level of the audit expectation gap?

The study's research questions and hypothesis are the basis for the research objectives.

1.4.2 Objectives of the Study

The primary objective of this thesis is to improve understanding of how implementation of the Jordanian corporate governance code, in so far as it relates to auditing, has affected the perceived reliability of an independent audit opinion and the extent to which the code might help in narrowing the audit expectation gap. The experiment conducted during this study aims to test the inter-relationships between the elements of the corporate governance code (namely the external auditor's independence, the internal auditor's effectiveness, disclosure and transparency, and accountability) as regards to their influence on the auditing profession in Jordan, from the institutional investors' perspective. In particular the study sets out to:

- 1- Investigate the impact of the external auditor's independence, in the post JCGC implementation period, on the reliability of the audit report and the size of the audit expectation gap. This includes reviewing the related literature of the impact of the audit partner rotation, preventing non-audit services, external auditor's selection, remuneration, and dismissal by the audit committees, and the role of a well-established audit committee in supporting and communicating with the external auditors.
- 2- Investigate the impact of the internal auditor's effectiveness, in the post JCGC implementation period, on the reliability of the audit report and the size of the audit expectation gap. This includes reviewing the previous studies and highlighting the role of appropriately constituted audit committees in appointing the internal auditors of the company, setting their budget and communicating with the internal auditors, in addition to their role as liaisons between internal and external auditors.
- 3- Investigate the impact of the disclosure and the transparency, in the post JCGC implementation period, on the reliability of the audit report and the size of the audit expectation gap. This also includes reviewing the literature of how adequate, timely, and transparent information influence the institutional investor's perception.

- 4- Investigate the impact of accountability, in the post JCGC implementation period, on the reliability of the audit report and the size of the audit expectation gap. This includes reviewing the literature of how and why the appropriately constituted responsibilities and authorities of external auditors and governance bodies involved with auditor accountability affect institutional investor's perception of the reliability of the audit report and the size of their expectation gap.
- 5- Determine whether Jordanian institutional investors consider and evaluate the impact of the elements of the JCGC individually or in combination (configurally).

1.5 Research Methodology

Before embarking on any research project, the researcher should develop a plan, outlining a research approach and the techniques that will be used to collect the necessary data. The importance of obtaining high quality data cannot be overestimated as, according to Gill & Johnson (2010), the quality of the findings of the research project are determined by the quality of the data on which they are based. Corporate governance studies tend to use an agency theoretical frame, with research objectives expressed in testable hypotheses and using publicly available information, and in some instances a survey method is used to collect data (Saunders, Lewis, & Thornhill, 2012). The research design can be either qualitative or quantitative or a mixture of both. This research will use a strategic combination of approaches including semi-structured interviews and a factorial experimental design.

1.5.1 The mixed method approach

Although business research predominantly uses quantitative methods, the use of mixed methodology has become common in some fields of business research (Collis & Hussey, 2003). The mixed method approach uses both qualitative and quantitative methods to achieve the study objectives. Mixed methods can provide both quantitative and qualitative research strengths and offset their different weaknesses, and can also increase the generalizability of the results (Bryman, 2006; Johnson and Christensen, 2010). Conducting an experimental research design alongside a qualitative method may deliver better understanding of the research problem (Burns, 2000).

1.5.2 In-depth Interviews

Semi-structured interviews are used in this thesis because there have been few studies dealing with Jordanian corporate governance in the context of the role of audit committees as liaisons between corporate governance constituents. In Jordan, as in many developing countries, there is limited availability of financial information beyond the financial statements (Afifi, 2009). A possible explanation could be that Jordan has only recently applied a formal code of corporate governance, or it could be due to the availability of other mechanisms of acquiring information, or it could be that there is greater reliance on substantial investor-directors to look after all shareholders in a close knit commercial community, or it could be due to yet unrecognized factors.

Given the current incompleteness of knowledge, interviews offer various useful advantages, such as getting higher response rates, greater depth of information and the availability of the interviewer to clarify any misunderstood questions. The use of semi-structured interviews provides flexibility that allows new questions and topics to arise as a result of what the interviewee says (Lindlof and Taylor, 2002; Gendron and Bedard, 2006; Al-Lehaidan, 2006). In

this way, the insights gained are less constrained by the researcher's preconceptions of the likely relationships.

1.5.3 Experimental Treatments

Factorial experimentation enables researchers to evaluate interaction effects between two or more independent variables, something that cannot be obtained from single-factor experimentation (Winer et al, 1991). "Interaction effects" are effects that cannot be predicted from the sum of effects of individual variables but, rather, from the interaction of these variables together (Winer et al, 1991, p.284).

The factorial experiment method is a systematic treatment of the study variables. It allows the researcher to manipulate and control the independent variables and observe the resulting variation in the dependent variables under each scenario (Kerlinger, 1986; Collis & Hussey, 2003).

The research objectives of this study are addressed by conducting a qualitative in-depth investigation (interview) alongside the experimentation. A completely crossed ($2^4 = 16$ cases) factorial experiment is employed to investigate the influence (including relative and interactive weights) of the selected elements of the Jordanian corporate governance code on the perceptions of their impact on the value of the audit opinion as measured by the reliability of the audit report and the size of the audit expectation gap. "Another advantage to this design is that we can use each participant as his or her own control 'group,' thereby reducing the amount of variance within each treatment condition in the ANOVA" (Weathington, Cunningham & Pittenger, 2010, p. 446).

Experimental treatment provides a strong platform to ensure the evidencing of the causality of the effect of the independent variables on the dependent variables, and also helps identify any

interaction between the four independent variables in influencing the dependent variables (Keppel & Wickens, 2004; Creswell, 2009). The experiment method is recommended and well established in auditing, accounting and financial research (Libby & Lewis, 1982; Black, 1986; Chewning & Harrell, 1990; Baker and Nofsinger, 2002; Trotman, 1996; Wang & Tuttle, 2009; Krishnamoorthy, 2002; Brown, 1983; Ashton, 1974; Hofstedt & Hughes, 1977; Stocks & Harrell, 1995; Ashton & Ashton, 1995; Hooper & Trotman, 1996), and particularly in those studies that have investigated informed and knowledgeable participants such as financial analysts, professional auditors and accountants (Arnold, Bedard, Phillips, & Sutton 2011; Teoh & Lim, 1996; O'Reilly, 2009; Ganzach, 1994).

1.6 Study Population

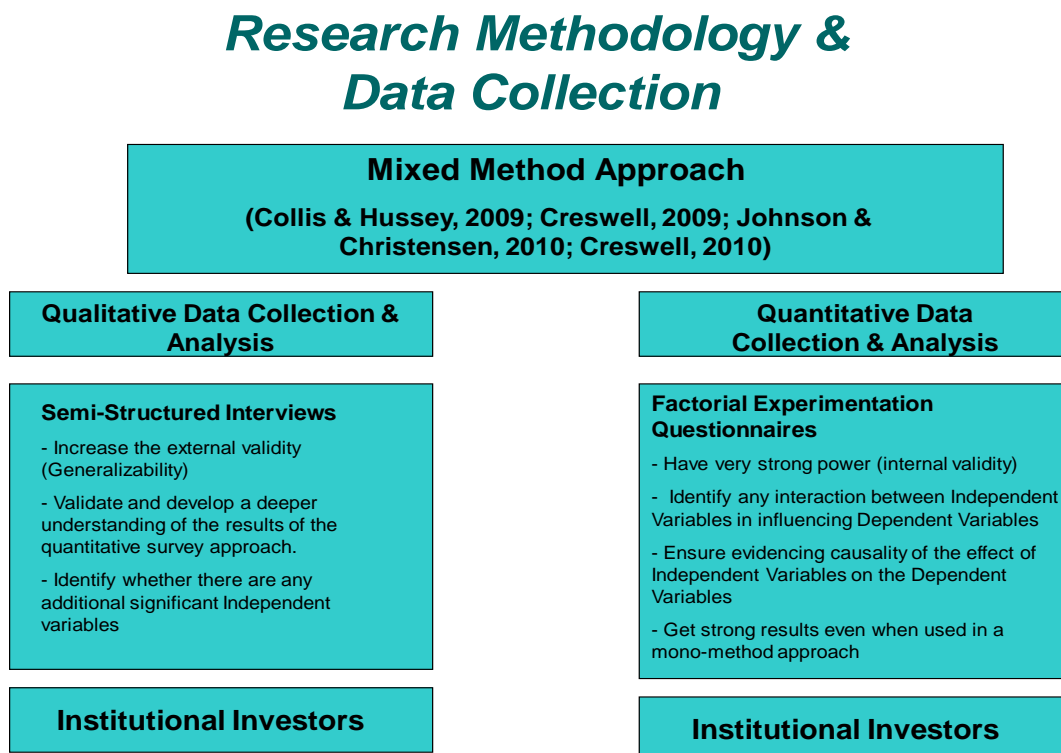
The main purpose of sampling is collecting the data needed to answer the research questions. This thesis aims at evaluating the current JCGC as regards to its impact on the reliability of the audit report and the level of the audit expectation gap in Jordan. This expectations gap arises from the differences in perceptions between the auditors and users of audit reports. The main users of audit reports are the investors; therefore, this thesis investigates the perceptions of investors in Jordan.

Investors could be either individuals or institutions. In order to provide more reliable results based on well-informed respondents' feedback, in addition to the justifications mentioned in chapter four⁸, particularly the differences in perceptions of individual and institutional investors as disclosed in previous Jordanian research, the study focuses on institutional investors. In addition, the suggestion that developing markets are more reliant on institutional investors to ensure the integrity of the market further justifies the focus on institutional investors (Afifi, 2009; Zureigat, 2010; O'Reilly, 2009). Therefore, the study sample of this thesis is derived from institutional investors in Jordan rather than individual investors; they are the financial analysts

⁸ See sections: 4.3 & 4.4

who work in institutional investment companies including insurance companies, investment and portfolio departments in banks, investment funds and companies, retirement funds, mutual funds and brokerage companies. The following figure summarizes the mixed method approach of this study.

Figure 2: The Mixed Method Approach Adopted in this Thesis



1.7 Definitions

This section provides definitions of key terms used in this thesis. An operational definition is “specification of how you will define and measure the variable in your study” (Creswell, 2008, p. 160). As the definitions presented in this section indicate the meaning of the terms used in this thesis, where applicable, this study adopts definitions from the Jordanian corporate governance code, The International Standards on Auditing (ISA) (which are the valid standards in Jordan), The Organization for Economic Cooperation and Development (OECD) and other resources that provide comprehensive definitions that help the researcher in achieving the goals of this thesis and/or in constructing the study’s own definitions.

The Jordanian Corporate Governance Code (JCGC): Refers to the JCGC approved and issued by the board of the commissioners of the Jordanian Securities Commission (JSC) on the 29th of July 2008 for the publicly traded companies listed on the Amman Stock Exchange (ASE) and which came into effect as of the first of January 2009. The JCGC contains five chapters as follows: Definitions, The Board of Directors of the Shareholding Company, General Assembly Meetings, Shareholders Rights, and Disclosure and Transparency.

Auditors' Independence: "Freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditor’s ability to make unbiased audit decisions" (ISB, 2000, para. 4).

Audit committees: Audit committees are sub-committees of the board of directors of at least 3 members established by and amongst the members of the board of directors of a company whose main responsibilities are reviewing the annual financial statements and reporting before submission to the board of directors, safeguarding the internal audit function, nominating and reviewing the findings of the external auditors, in addition to their role as liaisons between internal auditors, external auditors, executive management and the board of directors.

Internal Audit Effectiveness: Internal Audit Effectiveness refers to the extent to which the designated internal audit objectives and functions are achieved properly, are unbiased, and are free from management pressure that may compromise the internal auditor's performance. Examples of those designated internal audit functions are safeguarding assets against loss and theft, providing reasonable assurances that the financial and operating information are accurate and reliable, and ensuring the entity's compliance with laws and regulations.

Disclosure and Transparency: Refers to the quality and reliability of information, whether financial or non-financial, provided by the company to the shareholders and users of the financial reporting (International Chamber of Commerce, 2011). For the purpose of this study, it refers to the disclosure and transparency items as mentioned in chapter five of the Jordanian Corporate Governance Code.

Corporate Accountability: Refers to the ability of the shareholders and the stakeholders to hold the governing body of the company, such as the executive management, board of directors and external auditors, accountable and answerable to the laws, the regulations and the company's bylaw, based on their power and responsibilities (Porter, 2009; Gay & Simnett, 2010; Harris & Spannier, 1976).

The going concern assumption: The going concern assumption states that the financial statements of an entity should reflect that the value of its assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its debts and liabilities when they fall due in the normal course of operation for the foreseeable future, unless there is evidence to the contrary.

The audit expectation gap: The audit expectation gap refers to the different perceptions between the auditors' actual performance and to what report users believe the auditors should be performing and achieving as auditors.

Institutional Investors: An institutional investor is an individual who works in the investment section of an organization that trades securities for investment purposes on behalf of the organization's members. Common examples are an insurance company, a bank, a hedge fund, a retirement fund, a mutual fund, brokerage, or another such group that has a large amount of cash or assets to invest.

Reliability of the audit report: refers to the extent to which the audit report clearly conveys significant instances of poor internal controls, accounting errors, biases, or omissions; and concerns regarding the application of the going concern assumption. Such reports can be relied upon by institutional investors, enabling them to make informed investment decisions.

Error: "The errors refer to the unintentional misstatement in the financial report, including the omission of an amount or a disclosure" (IFAC, 2010b, p. 18).

Fraud: "Intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage" (IFAC, 2010b, p. 19).

Independent Member of the Board of directors: "A member of the board of directors who is not tied to the company or any of its upper executive management, affiliate companies, or its external auditors by any financial interests or relationships other than their shareholding in the company that may be suspected to bring that member benefit, whether financial or incorporeal, or that may affect his/ her decisions or lead to exploitation of his/ her position with the company" (Corporate Governance Code in Jordan, 2009, P. 5). Nor should the member be a recent employee of the company or its suppliers as those relationships could cause conflicts of interests.

Non-Executive Board Member: The board member who is not staff or employed by the entity, and accordingly does not get a regular salary or remuneration from the entity and is not

involved in the day to day management of the company. Such members may be remunerated for their role as a board member only.

1.8 Summary of the Study Limitations and Prospective Future Studies

As mentioned earlier, there are three sets of corporate governance codes in Jordan; one for each of the following groups: the banking sector, the insurance sector and publicly traded companies. The code for publicly traded companies is the corporate governance code investigated in this thesis.

This thesis aims to identify the impact of the elements of the Jordanian corporate governance code in so far as they relate to the perceived reliability of the audit report and the extent to which they narrow the level of the audit expectations gap, in the perception of institutional investors in Jordan. In doing so, this thesis endeavours to contribute to narrowing the expectation gap. This thesis focuses on the external auditor's independence, the internal auditor's effectiveness, disclosure and transparency, and corporate accountability. Other studies (Ojo, 2009; Siddiqui, Nasreen, & Lema 2009; Dickins & Higgs, 2009; Rehana, 2010; Sikka, Puxty, Willmott, & Cooper, 1992; Sidani & Olayan, 2007; Haniffa & Hudaib, 2007; Fadzly & Ahmad, 2004; Pierce & Kilcommins, 1997; Wolf, Tackett, & Claypool 1999) have investigated and pointed out the importance of other factors on the reliability of the audit report, such as the role of accounting professional associations, the code of professional ethical conduct in relation to auditing, the role of audit education on narrowing the audit expectations gap, and the role of the auditor's experience, integrity and the size of the non-audit services provided by the auditors. The scope of this thesis and the unit of analysis is limited to institutional investors in Jordan and excludes other users of financial statements such as the managers, members of the board of directors, creditors and the credit staff at banks, as well as the preparers of the financial statements, such as the company financial managers and accountants.

These limitations might open the door for further studies. Accordingly, there are opportunities for further research to be undertaken in Jordan in order to identify a comprehensive approach, to be adopted alongside implementation of and education about the JCGC, to minimize the audit expectation gap.

1.9 Structure and Overview of the Thesis

This thesis - including this introductory chapter - is organized into six chapters, which are briefly described below:

Chapter One provided a background for and an overview of the thesis; the justification for the study, a statement of the study research questions and objectives, and the organization of the remaining chapters of the thesis. Chapter One also looked at selected prior Jordanian research, with a view to identifying the gaps in the research which can be addressed by this thesis. Chapter Two provides a theoretical and historical perspective on corporate governance and the auditing profession in Jordan, and the definition, establishment and need for the corporate governance code. Chapter Two also discusses, in the context of authoritative guidance, the development of audit committees, internationally and locally, and communication between both external and internal auditors with the audit committees. Chapter Three reviews the literature relevant to the main themes of the thesis. Among the themes discussed in Chapter Three is the audit expectation gap phenomena and its effect on the auditing profession and investors' confidence, including the nature and the structure of the audit expectation gap in Jordan. The review presented in Chapter Three covers and critically analyzes the study of independent and dependent variables mentioned in the model of this thesis.

Chapter Four reviews the research methodology employed in the fieldwork of the thesis and based on the study model. Chapter Four provides a justification for the chosen research strategy and provides a rationale for combining the qualitative and the quantitative methods.

Sampling, data collection techniques and the limitations of this methodological approach are also presented and discussed.

Chapter Five reports an analysis and interpretation of the results of both research methods. The chapter describes and discusses the interviews and analyzes the interviewees' themes and feedback. Chapter Five also presents a description of the respondents to the survey instrument and discusses the validity of the experiment. The chapter concludes with a presentation of the integrated data from the two methods.

Finally, Chapter Six summarizes and discusses the main findings of the study, in line with the extant literature. Recommendations, potential areas for future research and recognition of study limitations on the scope and design are presented.

Chapter 2: An Overview of Corporate Governance in Jordan

2.1 Introduction

This chapter addresses the application of corporate governance and provides an overview of the auditing profession in Jordan. The chapter explores the theoretical framework of the corporate governance, and the importance of adopting the corporate governance codes to reform the capital markets and mandate that listed companies provide the shareholders and other stakeholders with adequate disclosure, and transparent information. In addition, this chapter provides a review of the definitions of corporate governance; as well it focuses on the development of the roles of the audit committees in order to enhance the independence, and the effectiveness of the external and the internal auditors. In conclusion, this chapter discusses the agency theory, and delivers an understanding of the nature of corporate governance and auditing profession in Jordan.

2.2 The Theoretical Framework

Theoretical frameworks are tools for explaining and analyzing complex concepts. Several such frameworks have been developed for corporate governance, each examining the concept from the perspective of a different discipline, profession or school of thought (Solomon, 2010). These different theoretical frameworks often varied only slightly, and some applied different terms to

describe the same concepts (Solomon, 2010). Leung, Paul & Cooper (2011) reviewed three explanatory theories that have justified the use of audits such as the information hypothesis, an insurance hypothesis, and agency theory, while Adelopo (2010), in his study about the impact of corporate governance on auditor independence, referred to the stakeholder theory, and pointed out that the essence of corporate activity is not only for the benefit of the shareholders, but also for the benefit of all relevant stakeholders.

2.2.1 Corporate Governance & Agency Theory

Theoretically, the agency theory framework has been employed in corporate governance studies (Saunders et al, 2012). Dalton, Daily, & Roengpitya (2003) argued that most research on corporate governance is based on agency theory. The critical concern of corporate governance emerges from the separation of ownership of the entities, and the control of those entities (Shleifer and Vishny, 1997b). This separation gives rise to agency problems⁹ (Jensen and Meckling, 1976).

When the era of limited liability shareholding companies first began, it heralded a dramatic expansion in investment, and ownership in companies, by the general public, but it also resulted in a fundamental change in the way that companies were controlled (Solomon, 2010). Under the new system of ownership, shareholders generally delegate the day to day control of the company to managers, essentially separating company ownership and control and resulting in the now infamous phenomenon known as the 'agency problem' (Solomon, 2010).

⁹ There is a double agency problem. Individuals invest in superannuation funds and in financial institutions. These organisations then invest in listed companies on behalf of their contributors. The executives and directors of the superannuation funds and financial institutions are often influential in appointing or removing directors of listed companies who in turn appoint senior managers and structure their reward systems. Thus primary investors are subject to two agency problems namely their initial investment being managed by others which is in turn placed with agents in the form of directors of the listed companies. The audit committees of the listed companies address the second agency problem. Also there are potential conflicts between the interests of major shareholders and minority shareholders.

Jensen and Meckling (1976) argued that conflicts of interest inevitably exist between the management and the owners of businesses in cases where owners are not managers. This is because the theory assumes a model of a man (manager) who is self-serving, individualistic and opportunistic in nature, prefers to maximize his own utility functions at the expense of the owners¹⁰. As a result, the theory is built on the assumption that there is almost always a divergence of objectives between the goals of the management, and those of the shareholders. The Effective corporate governance is seen as an active tool in reducing agency problems because it “promotes open dialogue and communication while ineffective corporate governance gives rise to conflicts and lack of transparency” (Leung, Paul, & Cooper 2011, p. 814).

The relationship amongst corporate governance constituents has been described based on the agency theory (Jensen and Meckling, 1976; Adams, 1994; Christopher, Sarens & Leung 2009) as follow: The shareholders elect a board of directors which meets a few times each year; the board of directors is responsible for appointing the company’s management, including appointing a chief executive officer to lead the managers; as the shareholders’ agents, the board of directors and the company management are charged with the responsibility of controlling the company; Independent external auditors are appointed to provide the shareholders with assurance on the quality of the financial statements prepared by company management but, in practice, the value of this assurance depends on the external auditors perceiving that their responsibility is towards the company owners rather than to the company management. In order to protect the interests of the owners, an audit committee is appointed to ensure that an appropriate relationship is maintained between external auditors and company management. An independent internal audit function that is adequately funded can further monitor internal controls and adherence to policies and risk profiles, and in that way provides further assurance to the board, via the audit committee.

¹⁰ Some theories such as stewardship theory which sees managers as stewards carrying out the wishes of the shareholders. The reality is probably a mixture of good stewards and managers who are gaming the system. Agency systems are designed to curb the latter.

As shown by this description of the relationship between the various constituents of corporate governance systems, a separation between ownership and management is a key characteristic of public shareholding companies. The problems created by this separation have been prompted significant debate among scholars, investors, finance and accounting professionals, regulators and law makers, regarding how to best ensure that management works in the best interests of company owners (Demsetz & Lehn, 1985; Allen & Gale, 2001; Adelopo, 2010). In the face of the ineffectiveness of market mechanisms alone to control management behavior, it would seem, as suggested by Solomon (2010), that there is a need to reform corporate governance.

2.2.2 Agency Theory & the Auditing Profession

The need for independent auditors, according to Imhoff (2003), was a direct result of the separation of company ownership and management that arose following the formation of capital markets that grew to feed the industrial revolution in the 18th century. The separation of ownership and management created opportunities for management to use their authority in ways that did not serve the owners' best interests, thus creating a need for an independent party to provide owners with assurance regarding management's reports (Imhoff, 2003; Leung, Paul, & Cooper 2011). In the framework of the agency theory, auditors are responsible for monitoring and controlling the quality of financial reporting and, consequently, are part of the corporate governance system (Beasley & Salterio, 2001). Auditors play a significant corporate governance role in helping shareholders monitor and control company management (Beasley & Salterio, 2001). In their role of monitoring and controlling the quality of financial reporting, auditors provide objective assurances that financial statements and reports fairly present all materially significant facts, thus lending credibility to the disclosures in management's financial reports and, consequently, increasing investor confidence in the transparency of the company (Solomon, 2010). Given the importance of the role of independent auditors, procedures for

enhancing the independence, objectivity and professionalism of auditors are included in most governance codes and guidelines (UNCTAD, 2006).

2.3 Definitions of Corporate Governance

The following three sections review the development of the term corporate governance and explore the different translations of the term in the Arab world in general, and in Jordan in particular, and the most popular and generally accepted definitions of the corporate governance are discussed in the last section.

2.3.1 Introduction

Corporate governance is a “fashionable” terminology, albeit an ambiguous concept (Farrar 2005, p. 141). In order to understand the concept of corporate governance, it is important to highlight its emergence and definition. Corporate governance has not identified with a unique accepted definition (Ching, Tan, & Ching, 2006). Abu-Tapanjeh (2009) traced the emergence of the term governance and pointed out that this term was originally derived from the Greek word "kyberman" which referred to guide, direct, and govern, then that term was transferred to the Latin and had been known as "gubernare", while the French version of the term is “governor”.

Corporate governance is not a phenomenon solely for shareholding companies, it is also applicable for all sorts of entities and its definitions could be expanded to cover all of the economic and non-economic firms and government organizations. Abdullah and Valentine (2009) pointed out that corporate governance literature contributed to ambiguity around the terms regulate, control, manage, govern and governance.

2.3.2 Translation Dilemma

The concept of corporate governance in the Arab world has not been understood properly since its first emergence and adoption, in fact, there is no definite acceptable translation of the term 'governance' in Arabic (Boutros-Ghali, 2001). This confusion of terminology has impacted the discussion seminars¹¹ and the implementation of corporate governance in Jordan. Moreover it has affected academics and researchers in designing their studies. As an example, Abdullatif (2007) avoided the use of the Arabic translation of the term corporate governance in his questionnaire in order to reduce terminological issues.

The Academy of Arabic Language has endorsed the word 'Hawkama' as an Arabic translation after discussions of the other alternatives (Saeed, 2003), while the Jordanian Academy of Arabic language adopted the word 'Hakemeyya'¹². In spite of the adoption of the word 'Hakemeyya' by the Jordanian Academy of Arabic, there is no consensus on a single term in the Jordanian literature. Most of Jordanian researches used the term 'Hakemeyya' (Al-Hanini and Dahmash 2008; Matar, & Nour, 2007; Dahmash & Abu-Zerr; Zureigat, 2011a; Al-Barghouthi, 2009; Ishhadat & Abed Al-Jaleel, 2012). Some other Jordanian literature used the term 'Hawkama' (Al-Manzou, 2009; Ahmad, 2003; Ashmawi, 2005; Shehadeh, & Barghouthy, 2009; Al-Aqdeh, Juda, & Saadah, 2011; Al-Waked, 2007). Others have used the term 'Tahakkom' as suggested by Al-Basheer (2003), the previous chairperson of the Jordanian Association of Certified Public Accountants, (Abdullatif, 2007; Bashtawi and Suleiman, 2003; Matar, 2003).

Interestingly, it is noteworthy to mention that the inconsistencies of the translation can also be seen in the Jordanian governmental regulatory bodies themselves, they have not adopted a specific term consistently; in the Jordanian corporate governance code for the publicly shareholding companies, issued by the JSC, the term 'Hawkama' was used, while the corporate

¹¹ The Policy Debate on Economic Issue has referred to the confusion of these multiple translations on its periodic. See (Jordanian Forum for Economic Development, 2004) page 5.

¹² The Decision No. 200406 issued by The Jordanian Academy of Arabic language on 8 June 2004.

governance code for the bank sector, issued by the CBJ, and the corporate governance code of the insurance sector, issued by IRC have used the term 'Hakemeyya'.

It is important to reach an acceptable Arabic version that does not compromise the theme of the term to be used consistently in the literature. This thesis is written in English, since an Arabic version of the questionnaire that should be provided to the subjects and the interviews should be conducted in Arabic, this thesis used the term "Hawkama" because this is the term that has been employed in the JCGC for the Jordanian listed companies. However, the ambiguity of the new term caused initial confusion, currently academicians and institutional investors are aware of these different translations.

2.3.3 Corporate Governance Definition

Discussions of the corporate governance issues came into the spotlight due to big corporate scandals all over the world. Issues such as the agency theory problems and how to ensure the rights of the shareholders in the entities, joint corporate-audit firm collusion, poor internal control, weak accountability system and insufficient evaluation of the risks are examples of some catalysts that have contributed to corporate collapses and raised the call to reform the capital market and to establish and adopt best practices guidelines of corporate governance. Plessis, McConvill, & Bagaric (2005) pointed out that there is no consensus on a specific definition for corporate governance although many academicians and scholars have attempted to establish a comprehensive definition.

According to Solomon (2010) and Millstein (1998) the concept of corporate governance has many definitions. Most of the definitions have a common denominator which are: the accountability, the disclosure and transparency, protecting the rights of the shareholders and the stakeholders alike, organizing the roles and the responsibilities of the board of directors and the company management, and to reinforce the effectiveness and the performance of the

external and the internal auditors in order to ensure the soundness and the accuracy of the financial reporting system (Archambeault, DeZoort, & Holt 2008; Bushman, Piotroski, & Smith 2004; Dalton et al, 2003; Monks and Minow, 2011; Farrar, 2005; Levitt, 1999; Cadbury Report, 1992; Zingales, 1994; Shleifer and Vishny, 1997a; IIA, 2011; Parkinson, 1995).

The most widely used definition of corporate governance is the definition of the Cadbury Report (Applied Corporate Governance, 2012). It defined corporate governance as "the system by which companies are directed and controlled" (The Cadbury Report, 1992, section 2.5). The codes of best practice of the Cadbury Report focused on the principles of accountability, disclosure and transparency, and probity. In addition to the equity, these four concepts have become the benchmark and the foundation for forming effective corporate governance (IIA, 2012). The four concepts are explained in figure 3.

Figure 3: Effective Elements of Corporate Governance



This figure is quoted from the Institute of Internal Auditors website (IIA, 2012)

Finally, as Jordan has mainly referred to the Organization for Economic Cooperation and Development (OECD) principles of corporate governance, this thesis adopted the definition of the OECD. The OECD defined corporate governance as "Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making" (OECD Glossary, 2007. p. 151).

2.4 Importance of Corporate Governance

Corporate collapses have negative consequences for the society because the companies are the livelihood of many communities. Corporations' governance has affected economies, and a wide range of aspect of the social environment. Corporations are banks, insurers, factories besides many other sorts working under the private sector system. Corporations generate jobs, income, incorporate capital with labor, raw materials, and management expertise to produce goods and services. Corporations also supply the state treasury with revenue and taxes (Prentice and Holland, 1993). Therefore, countries and states around the world, in relation to their public social security responsibilities, should take decisions, and implement measures to maintain the soundness of the private sector. Hence, the regulatory and the supervisory bodies of the capital market issues their own corporate governance codes of best practices and they also monitor the shareholding companies' compliance with it financially, politically, and even ethically (Cohen & Boyd, 2000).

Shareholder's confidence in the capital market and affects the market value of securities and the availability of investment funds. With the emergence of globalization, there is a threat to the ability of any government to control large multinational companies. That state of affairs places increased importance on the role of the economic regulatory bodies and also a need for establishing sufficient accountability (Crane and Matten, 2010). The corporate governance

codes specify guiding principles for all participants involved with the entities corporate affairs in regards to their rights, duties, obligations and accountability, in addition to that it identifies and evaluate any potential challenges that corporations may encounter (Healy, 2003).

Internationally, big corporate scandals in the early 21st century such as the demise of Enron-Arthur Andersen, HIH and WorldCom have undermined the stakeholder's confidence in the world's capital markets and in audit reports¹³, and also have motivated economic policy-makers, researchers and academics to develop and find solutions of the weak points of the corporate governance structure. In 2008 the world has witnessed the global financial crisis which was triggered by the collapse of Lehman Brother Bank in August 2008. This financial crisis has raised and directed critical questions to the auditing profession such as the age-old question of where were the auditors? (Tricker, 2009). Cooper & Grose (2010) reviewed audit firm scandals and raised the question of can auditors be trusted? Cheng and Abdel-Qader (2010) raised the argument of whether auditors were guilty for surprise corporate collapses.

Building and adopting a strong corporate governance structure helps achieve an entity's objectives such as implementing their strategic long-term goals by maximizing the owners' wealth, securing the rights of the employees by ensuring the company is providing them fair health coverage, training, and retirement security, it also aims to maintain good relationships with outsider parties by providing good quality services to the entity's clients and suppliers, and finally a strong corporate governance system enforces the company's compliance with the laws and the regulations (Sheridan & Kendall, 1992; Cadbury, 2002; Millstein, 1998; Gregory & Simms 1999).

A survey of the Institutional investors' perception of good corporate governance in the U.S has been conducted by McKinsey and Company in 1996. The survey findings revealed that investors believe that good corporate governance is important in their decision making to the same

¹³ The audit expectation gap is at least partly due to the failure of audit firms to stand for clear disclosure to shareholders rather than assisting management to avoid their accountability to shareholders e.g. Enron. Hence the need for an audit committee to ensure they have the right priorities in spite of the financial incentives for partners to align their interests with management.

degree of the importance as the financial performance. The study found that two-thirds of the participants revealed that they would readily pay on average over ten percentage points for well-governed¹⁴ entities. In June 2000, McKinsey and Company repeated this survey again and expanded the countries from which participants were drawn; the study surveyed Europe, Asia, and Latin America. Over 200 institutional investors in Asia, Latin America, Europe in addition to USA, representing US \$3.25 trillion in assets were surveyed and similar results were obtained (For more details about the two surveys see: McKinsey and Company, 2000; Felton, Hudnut, & Heeckren 1996; Hopkins, 2007; Block & Epstein, 1995).

2.5 OECD Principles of Corporate Governance

As mentioned earlier, the Jordanian corporate governance code for listed companies is based on the non-binding OECD principles of corporate governance which were endorsed by the OECD Ministers in 1999. These codes were revised and replaced in 2004, albeit remain non-binding, OECD principles proved its efficiency and effectiveness to the extent that even non-member countries adopted and implemented these principles (Morck, 2006; Jesover & Kirkpatrick, 2005)

The OECD principles of corporate governance aim to provide countries, both OECD and non-OECD countries, with guidelines and good practices of corporate governance provided in order to assist in achieving these goals. “The Principles are a living instrument offering non-binding standards and good practices as well as guidance on implementation, which can be adapted to the specific circumstances of individual countries and regions” (OECD, 2004, p. 4). The OECD cooperated with the International Monetary Fund (IMF) and the World Bank in promoting

¹⁴ The study defined well-governed company by referring to those companies with majority of outside directors, responsive to investors' requests for any data they ask for, and had a board of directors independent from the company management to hold the executive management accountable to shareholders.

corporate governance best practices, in fact, the IMF used the OECD corporate governance as a benchmark for observing its members (Low, 2002; OECD, 2004; Kirkpatrick, 2005).

Low (2002) argued that the main four themes of OECD corporate governance principles of 1999 lies on the basis of transparency, accountability, fairness and responsibilities, Abu-Tapanjeh (2009) argued that the revised OECD principles of 2004 were built on four core concepts that are: business ethics, decision making methods, disclosure and transparency, and the integrity of the financial reporting system.

The six OECD corporate governance principles are outlined below (OECD, 2004):

Principle One: *“Ensuring the basis for an effective corporate governance framework”*.

Principle Two: *“The rights of shareholders and key ownership functions”*.

Principle Three: *“The equitable treatment of shareholders”*.

Principle Four: *“The role of stakeholders in corporate governance”*.

Principle Five: *“Disclosure and transparency”*.

Principle Six: *“The responsibilities of the board”*.

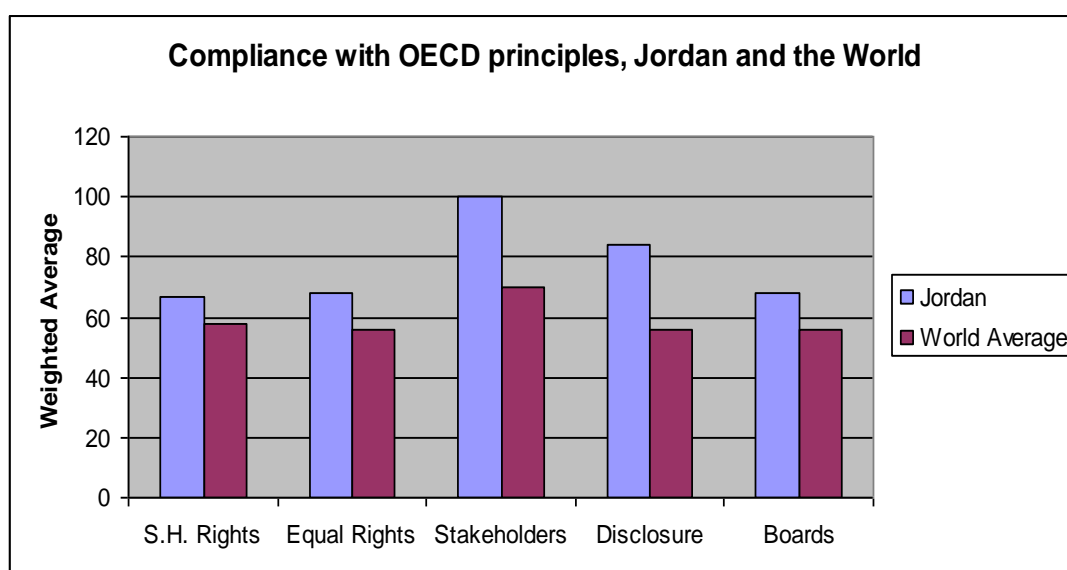
2.6 Corporate Governance Assessment in Jordan

An important assessment of corporate governance was conducted in Jordan in 2004 by the World Bank and the International Monetary Fund joint committee. This joint initiative was referred to as (Reports on the Observance of Standards and Codes "ROSC"). It benchmarked developing country's assessment of corporate governance code against those developed by

OECD (World Bank: Corporate Governance Assessment, 2004). The conducted program provides a diagnostic tool for evaluating the strengths and deficiencies of the Jordanian corporate governance framework. The ROSC evaluation of the Jordanian corporate governance was released for publication by the Jordan Securities Commission in 2005. The main ROSC results were:

- Disclosure standards (Largely observed).
- Standards of Accounting and Audit (Observed).
- Independent audit oversight body (Partially observed).
- Fair & timely dissemination (Largely observed).

Figure 4: ROSC Assessment of the Compliance to OECD Principles of Corporate Governance in Jordan



The figure quoted from (World Bank ROSC experience in MENA and the World, 2005, p. 5)

2.7 Background of the Auditing Profession in Jordan

This section discusses the historical development of the auditing profession in Jordan simultaneously along with the relevant laws and regulations especially the companies' law and the auditing profession law in Jordan.

2.7.1 The Companies' Law

The establishment of the auditing profession regulations in the Middle Eastern countries first appeared in the early twentieth century, and that exactly was in 1909 in Egypt and in 1919 in Iraq. By the passage of the time, Middle Eastern countries developed their auditing profession laws, and then established their own auditing profession associations to regulate and control the auditing profession. In Jordan, the Palestinian companies' law which was primarily based on the British Acts was applied in both countries from 1929 since they were under the British colonialism and those acts remained operational until the issuance of the provisional law in 1962 which became permanent in 1964. The companies' law of 1964 regulated the formation of the companies, liquidation, management, the financial reporting system and added some general responsibilities and rights to the external auditors (Abdullah, 1982). In 1989 another companies' law enacted and added some details to the previous one in addition to regulate the consolidations of the foreign companies working in Jordan (Abdullah, 2007).

In the middle of the last decade of the last century, Jordan was concerned of openness and being involved with the world, setting government plant reform programs, legislating and regulating the privatization to cope and deal with the globalization. In January 1994, Jordan submitted an application for the General Agreement on Tariffs and Trade (GATT) in order to gain a membership in the World Trade Organization (WTO). Jordan conducted several meetings of negotiations to answer and respond to the queries of the WTO Members on Jordan's foreign trade system and economic policies and facilities. In an endeavor to achieve this objective,

Jordan has amended, revised and enacted major legislative reforms to promote the Jordanian economic climate and to bring the Jordanian foreign trade system into conformity with WTO conditions. The majority of these amended or enacted legislations were to those related to the intellectual property rights, the free movement of capital, and taxation; examples: Trademarks law, Patents law, Copyrights laws, Trade Secrets and Unfair Competition, Customs law, General sales tax law, law on unifying fees and taxes. On the 17th of December 1999 The WTO General Council officially accepted the membership of Jordan which made Jordan the 136 WTO member (Jordan's Membership to WTO, 2011).

In 1997 Jordan issued the companies' law No. 22, this current law has been established to work in line with other commercial and capital market laws and regulations, such as the securities law of 1997¹⁵, to facilitate Jordan accession to the WTO and to accelerate the government economic reform plans. The companies' law of 1997 also added more details concerning the issuance of the shares, the face value and types of companies. The companies' law of 1997 law has been amended several times to enforce and encourage the Jordanian companies to adopt the corporate governance codes best practices. In fact, the Jordanian capital market regulatory bodies started drafting for another revised and developed companies' law (Companies Law 1997; Company Law Draft 2011; Securities law of 2002).

2.7.2 Auditing Profession Law

The first specific law dedicated to regulating the auditing profession in Jordan was established in 1961. Prior to the establishment of the Practicing of the Auditing Profession in 1961, there were no regulations or conditions to control the profession including the absence of a minimum qualification requirement that the practitioners should meet to be eligible for practicing auditing. The law of the auditing profession of 1961 set license's conditions to be met by any person willing to practice auditing and required specific academic and professional

¹⁵ Currently, The Securities law of 1997 has been replaced with the Securities law of 2002.

qualifications and experience, the law also established committees to be responsible for overseeing the profession which includes licensing and penalizing of auditors, this committee was mainly composed of governmental members (Abdullatif, 2003; Abdullah, 1982).

In 1985, the new law of the auditing profession was established to keep pace with the developments of the economic environment, the capital market, the auditing profession and to add more details to the 1961 law especially to the external auditor's rights and responsibilities and to provide a more precise framework as a guidance to the profession. In this law, the external auditors were given the right not to be rejected by the companies during the financial period of engagement. Non audit services were not prohibited in this law, the law identified and stipulated ten prohibited acts that the auditors should avoid such as the auditors must not have another job beside the auditing, unethical competition to gain audit job or unethical advertising and disclosing their client's secrets as examples. Under this law, the Auditing Profession Council was established to oversee and control the profession and its member practices. Similar to the previous committee, the majority of the council's 12 members were from the government. Based on this law, the regulation of classifying the external auditors (No. 30 for 1986) was enacted to classify the auditors on three main categories which are A, B and C where the A category represents the highest level or the highest qualified and experienced auditors.

Another important regulation enacted by the same law is the establishment of the Jordanian Association of Certified Public Accountants (JACPA) in 1987 and became legally effective in 1988. The JACPA aims at considering the members' interest; setting codes of professional ethics conducts, encouraging scientific research, protecting the rights of the auditors, conducting seminars and training workshops to follow up and explain any new additions or amendments to the International Standards on Auditing (ISAs) in order to enhance the capacity of the auditors. The membership of the JACPA is mandatory, and all of the licensed auditors represent the JACPA's general assembly and they have the right to elect the JACPA board of directors. Contrary to the companies' law of 1989 that required companies to prepare the financial statements in accordance with the generally accepted accounting and auditing standards,

taking in consideration that this expression was ambiguous since there were no specific generally accepted accounting and auditing standards in Jordan, the JACPA adopted the ISAs and International Accounting Standards (IASs)¹⁶ after about two months of the operation of the companies' law of 1989 (Khoury, 1994; Abdullah, 2007; Abdullatif, 2003).

The current auditing law that regulates the auditing profession in Jordan is Law No. 73 of regulating the Auditing Profession for the year of 2003. The article No. 3 stated that this law aims at regulating and developing the profession, ensuring the implementation of the ISAs and the International Financial Reporting Standards, develop the scientific and the professional level of JACPA members, and reinforce the certified public accountants independence and neutrality (Al-Tamimi, 2006; Al-Matarneh, 2009).

Based on Articles 29 and 45 of 2003 law, the bylaw of practicing the auditing profession No. 7 for the year of 2006 was issued to set a framework of the roles, the responsibilities, the conditions and fields for practicing the profession. The bylaw stressed the importance of following up the updates of the auditing profession and standards by the auditors. The article No. 8 identified the continuous training as following up all updates, and issues related to the profession by attending seminars and workshops or participating for training in specific institutions or by writing related articles and essays in topics related to the profession. The article No. 8 also added that the auditors should provide the JACPA with a certificate of attending at least 20 training hours or 10 hours with either participating of a research in a conference or two published articles in topics related to the auditing profession. The same article stressed that the license of practicing auditing must not be renewed unless the auditor satisfy the above requirement.

¹⁶ Replaced with the International Financial Reporting Standards (IFRS) after 2005.

Article No. 10 regulated the qualifications and the training experience ¹⁷conditions for any individual who wants to apply for a license to practice auditing as follows (Law of Regulating the auditing profession No. 73, 2003; Bylaw of Practicing the Auditing Profession, 2006):

A. Individuals who hold an accounting degree:

- 1- One year of training for those who hold a PhD degree.
- 2- Two years of training for those who hold a Master degree.
- 3- Three years training for those who hold Bachelor degree.
- 4- Five years of training for those who hold a Diploma degree¹⁸.

B. Individuals who hold the bachelor certificate majoring in fields related to the auditing profession such as finance, banking and management as an examples with at least 24 credit hours in accounting, have the right to apply for the training as follows:

- 1- Two year of training for those who hold a PhD degree.
- 2- Three years of training for those who hold MA degree.
- 3- Four years training for those who hold Bachelor degree.

¹⁷ Item (b) from article 10 stated that the training should be conducted under the supervision of licensed auditors.

¹⁸ In general, the Diploma Certificate in Jordan issued by the community colleges and it is equivalent to two years after secondary school,

2.8 The Development of Audit Committees

In response to recent concerns about the incidence of fraudulent financial reporting, expressed by various groups including accountants, users of financial reports, law makers and regulators, companies have, among other things, established audit committees (McMullen, 1996). These concerns have also brought about debates about the so called audit expectation gap. Narrowing the audit expectations gap continues to be a key issue of interest to the accounting profession (Dewing & Russell, 2002).

Many recall that the success of corporate governance in the organization depends significantly on the success of audit committees and the failure of the composition, responsibilities and the effectiveness of the audit committee can then cause a gap in the corporate governance system of the organizations (Abdel-Al, 2008).

A historical review of the development of audit committees in the US, Canada, UK, Australia, and Saudi Arabia will highlight the importance of such committees to ensure reliable, high quality financial reporting and thus by implication the need for an effective audit committee to enhance the integrity of companies' financial reports. In fact, the main theme of establishing audit committees emerged from the necessity of having another tool to protect the stakeholders, in addition to those protections provided by the external and internal auditors. The first introduction of the audit committees in the U.S. came in response to the McKesson & Robbins scandal where the management exaggerated the value of the company's assets and the auditors had relied on the management assertions of the receivables and the inventory (Teed, 2010; Mautz & Neary, 1979).

2.9 The Development of the Audit Committees in Jordan

This section reviews, and discusses the development of the audit committees in Jordan in three stages; that are the period before the establishment of Jordanian Securities Commission (JSC) in

1997, followed by the first instructions issued by the Jordanian Securities Commission in 1998 about the disclosure requirements, accounting standards, and auditing standards in which all listed companies were mandated to establish audit committees for the first time in Jordan and then followed by the revised instructions in 2004, and finally the issuance of the Jordanian corporate governance codes which became operational in 2009.

2.9.1 Audit Committees in Jordan before the establishment of the Jordanian Securities Commission (JSC) in 1997

The beginning of the appearance of the shareholding companies in Jordan started in the early thirties of the last century, that time witnessed the establishment of the Arab Bank in Amman followed by the establishment of Jordan Tobacco & Cigarette Company and the Jordanian Electricity Company. By 1978 the number of shareholding companies in Jordan reached 66 companies, and their shares used to be traded in unlicensed offices. The Amman Capital Market was established in 1978 to control and organize the issuance of the shares and to regulate the trading process. In 1997, the corporation law, and the securities law were issued and the Amman Capital Market was replaced by three financial regulating bodies; that are the Jordanian Securities Commission (JSC), Amman Stock Exchange (ASE), and Securities Depository Center (SDC). The divisions of these financial institutions came in response to the calls for separating the executives and the supervisory roles of the regulating bodies and to bridge the gap between Jordan and other developed countries (Swaiti, 2008). Following to these calls for economic reforms, in 1998 the JSC issued instructions relating to the disclosure and accounting and auditing standards in which all of the listed companies were mandated to establish audit committees.

2.9.2 The 1998 JSC Instructions of Disclosure, Accounting and Auditing Standards

Forming the audit committees in Jordan became mandatory for the listed companies in 1998. Based on the securities law of 1997 the Jordanian Securities Commission (JSC) issued the Instructions on Disclosure and Accounting Standards and Auditing Standards (1998) in which the JSC mandated all listed companies to establish audit committees (Jordan Securities Commission, 1998).

Jumaa (1999) criticized these instructions and regulations and argued that selecting audit committee members by and amongst the board of directors especially from those who lack accounting and financial experience compromises their effectiveness and leads the external auditors to waste time explaining their point of views. Jumaa also criticized lack of written charter and that there were no requirements regarding the qualifications of the audit committee members. Al-Basheer (2003) and Dahmash, Hajjier & Al-Farah (2003) pointed out that audit committees' primary functions are examining the reports of auditors, and its conformity with ISAs and the comprehensiveness of the scope of audits. They should also ensure that top management responds to the observations of both external and internal auditors, and make sure that the external auditors are doing their job without any obstacles facing them in effectively conducting their audit. The study also recommended a greater role and more supervision to be taken by the Jordanian capital market regulatory bodies over the shareholding companies and the auditing profession. Al-Wardat (2003) also criticized that selecting audit committee's members without proper accounting and financial qualification increases the bureaucracy of the job of the audit committees as a liaison between the external and the internal auditors.

2.9.3 The 2004 JSC Instructions of Disclosure, Accounting and Auditing Standards for Listed companies.

The instructions on Disclosure and Accounting Standards and Auditing Standards (1998) have been revised and replaced with the Instructions for Issuing Companies Disclosure, Accounting and Auditing Standards (2004). Abdullatif (2006) pointed out that the new revision of the Instructions in 2004 added some extended details, but did not include any new responsibilities to audit committees. The new roles and responsibilities of the audit committees have also been criticized in the Jordanian literature (Malkawi, 2008; Swaiti, 2006; Abdullatif, 2006; Abdullatif, 2007; Al-Farah, 2001; Al-Khadash and Al-Sartawi, 2010; Al-Saudi, 2007; Khsharmh, 2003; Ameerah, 2004) as follows:

In spite of fact that the instructions on disclosure and accounting standards and auditing standards (1998), the revised instructions in 2004, and the 'Directives for Listing Securities on the Amman Stock Exchange' (2004) mandated all Jordanian listed companies to form audit committees, the Jordanian listed companies' compliance with this rule was not fully implemented, although the latter one has clearly stated in article No.1 that any security can be listed in the ASE once the issuing company verifies that it has established an audit committee.

Swaiti (2006) and Abdullatif (2006) pointed out that at that time only about 75% of listed companies had audit committees. The study also revealed that both the banking and insurance sectors responded 100% to the requirement of establishing an audit committee and hence it was the other categories of the listed companies which had substantial non-compliance. The explanation for the high response by banking and insurance sector was due to the strict legislation and regulations set by other supervisory bodies that regulate the work of banks and insurance companies in Jordan, i.e. there are additional specific regulatory bodies whose main job is to follow up their activities. Banks in Jordan work under the supervision of the Central Bank of Jordan (CBJ), while the Insurance Regulatory Commission (IRC) supervises the work of insurance Companies.

The Jordanian literature - mentioned above of this section - also showed that audit committees were ineffective due to the insufficient power and functions stipulated in the laws and regulations, and they were not required to be independent or required to have a minimum experience in the accountancy and finance. Abdullatif (2006; 2007) pointed out that most of listed companies in Jordan formed audit committees in order to meet the revised Instructions issued by the Jordanian securities commission in 2004. Abdullatif (2006) and Malkawi (2008) also added that listed companies established audit committees without adequate power and even their role in relation to the auditor-related decision was undertaken by the company management. The audit committees did not get fair remunerations in line with their responsibilities. Swaity (2006) revealed that the audit committees in Jordan used to get similar remuneration to the other members of the board of directors, and attributed that to the assumption that audit committee members did not have extra burdens, tasks or fulfil a role that justified extra remuneration.

The literature has also criticized the lack of a written audit committee charters which affected the efficiency and the objectivity of their work especially in the decision of nominating the external auditor's where the personal relationships between audit committee members and the auditors affected the selection process (Al-Saudi, 2007; Khsharmh, 2003; Ameera, 2004).

2.9.4 The Jordanian Corporate Governance Code for listed Companies

On the 29th of July 2008, the board of the commissioners of the Jordanian Securities Commission (JSC) has issued, and approved the Jordanian Corporate Governance Code (JCGC) for the publicly traded companies listed on the Amman Stock Exchange (ASE) which has come into effect as of the first of January 2009. The JCGC consist of five chapters as follows: Definitions, The Board of Directors of the Shareholding Company, General Assembly Meetings, Shareholders Rights, and the Disclosure and Transparency respectively. Chapter five of the JCGC contains four sections, in addition to the disclosure and the transparency, the chapter has also

addresses audit committees, duties of the audit committee, powers of the audit committee, and the external auditor respectively.

2.9.4.1 Audit Committees Formation

The JCGC stipulated the conditions of the two committees that should be formed by the board of directors, these two committees are: the audit committee, and the nominations and compensations committee. The committees shall be composed of three or more non-executive members of the board of directors. The JCGC also stated that at least two of the members must be independent, and one of the two independent members must be the chairperson of the committee. Members of the audit committees in Jordan should have knowledge in accounting and finance, and at least one of them must have previous work experience in the accounting or financial fields, as well it must possess scientific qualifications such as a professional or an academic certificate in accounting or finance or related fields.

2.9.4.2 The Role of Audit Committees in Nomination and Communication with the External Auditors

The audit committees must oversee, and monitor the accounting and the internal control procedures and the auditing to ensure the integrity of the financial reporting system. The right of electing the external auditor is in the hands of the shareholders according to the Jordanian laws and the corporate governance code (corporate governance code in Jordan, 2009, chapter five, section, 2). The role of the audit committees in the selection process is to discuss matters associated with the external auditor to check whether they meet all the conditions stipulated in legislations in force, and also to ensure that their independence were not violated. The next step after the nomination is to submit recommendations to the board of directors in order to

recommend the election of the nominated external auditor by the shareholder at the general assembly meeting.

The role of the audit committees is not confined to the nomination of the external auditors in the JCGC, it goes further; once the auditors started fulfilling their job and setting their audit plan, the audit committees have to review their plan of work, and ensure that the entity provides them with all facilities needed to fulfill their job properly. In order to strengthen the attitude and the independence of the external auditors, the audit committee has to conduct meetings with external auditor of the company at least once a year without the presence of the company management or any of their representatives. The audit committee also has the power to request the presence of the external auditors to discuss and ask for clarifications of any issues related to their job and to seek their opinion in writing if necessary. Moreover, one of the audit committees' tasks is to discuss the external auditors' observations, reservations and suggestions, following up the extent of the company management's responsiveness to them, and submit recommendations to the board of directors in this regard.

All of the correspondences between the company management and the external auditors should be reviewed and evaluated by the audit committees and they should comment and submit recommendations to the board of directors. The audit committees also must review the periodic reports before they submit them to the board of directors.

2.9.4.3 The Role of Audit Committees in the Nomination and Communication with the Internal Auditors

The internal auditors play an important role of protecting the company's assets and the company's financial and accounting records from errors, frauds and misappropriation. The JCGC stated that the board of directors has the responsibility to take the necessary measures to ensure the integrity of the internal control procedures by establishing an internal audit unit

with functions such as: ensuring compliance with the legislations in force, the regulations of regulatory bodies, policies, procedures, and plans set by the board of directors (corporate governance code in Jordan, 2009, chapter two, section one, item 12).

The audit committees also have a role to reinforce the effectiveness of the internal auditors, and they coordinate the work of the internal and external auditors to ensure the maximum benefits of these two controlling arms. According to the JCGC, the audit committees have the power to nominate the company's internal auditors. Moreover, the audit committees have to evaluate the internal control and audit procedures, examining external auditor's assessment of the internal audit function, reviewing the internal audit reports especially those related to any breaches detected by the internal auditor, finally, the audit committee must provide the board of directors of recommendations regarding internal audit function and suggestions of any further necessary requirements for internal auditors.

2.9.4.4 Criticisms to the Current Corporate Governance Codes

Suleiman (2011) criticized the power of the audit committees section as stipulated in the JCGC and pointed out that those powers are vague, and limited, in other words they should be expanded to facilitate the audit committee members achieving their objectives. Suleiman argued that they should have the right and the power to investigate those matters that affect the performance of the external auditors and the accuracy of the financial reports issued by them and recommended that all companies must improve the skills and the experience of the audit committee members.

The JCGC stipulated that "the company shall take appropriate actions to ensure that the external auditors perform their duties impartially without interference from the board of directors or the executive management" (corporate governance code in Jordan, 2009 ch.5, Section 4, D). The JCGC did not explain how the external auditors could avoid their interference

or any possible pressure from the company management. The literature¹⁹ revealed that a strong and independent audit committee supports the external auditors and mitigates the management pressure to issue a clean or favorable audit opinion and also protecting them from dismissal after issuing qualified or a going concern modification. Therefore, the researcher would argue that one of the most important deficiencies of the current composition of the audit committees as stipulated in the JCGC is that it does not require all the audit committee members be independent.

Al-Jazy²⁰ (2005) criticized the selection process of the audit committee members in Jordan, and argued that it is not efficient and lacks of transparency. Al-Jazy explained and pointed out that the board of director's decision of selecting or changing any director does not require the general assembly approval. In this regard, the researcher would argue that the selection process of the audit committee members should be conducted directly by the shareholders at the general assembly meeting whereas only eligible candidates who satisfy the conditions and possess the appropriate qualifications can be nominated for the election.

Finally, the researcher found that the role of audit committee in the selection process of the external auditors is not identified clearly as it stated that the audit committees should discuss matters related to the nomination of the external auditors, and the role of the audit committees in dismissing, retaining and compensating the external auditors has not been clearly defined. Similarly, the JCGC has not mentioned any role for the audit committee to set the budget of the internal audit. Moreover, it has not required the audit committee to conduct meetings with internal auditors without the presence of the company management, and also it has not given the internal auditors the authority of accessing and reporting to the audit committee directly, although the JCGC stated that the audit committee should review the internal audit reports.

¹⁹ These studies have been discussed in more details in chapter three. Section 3.6

²⁰ Managing Partner for the Jordanian Centre for Dispute Resolution (JCDR)

Corporate governance code for Jordanian banks is more precise than the JCGC for all listed companies in regard to the roles of the audit committees. For instance it is clearly mentioned that the role of the audit committee to suggest to the board of directors “the appointment, the removal, the remuneration, and other contractual terms of the external auditors, in addition to assessing the objectivity of the external auditors, including the consideration of any other non-audit work performed by the external auditors” (Corporate Governance Code for Banks in Jordan, Chapter 6, Item b-vi), where the JCGC stated the right of the audit committee in discussing all matters related to the nomination of the external auditors without referencing to the external auditor’s dismissal or fees.

Additionally, corporate governance code of Jordanian banks stressed the necessity of that audit committees must work under a charter approved by the board of directors in which their powers and responsibilities are clearly documented. Furthermore, it states that “The Audit Committee has, by a specific provision in the written charter of its functions and responsibilities, the ability to obtain any piece of information from executive management, and the ability to call any executive or director to attend its meetings” (Corporate Governance Code for Banks in Jordan, Chapter 3, Item b-v)

Corporate governance code of Jordanian banks since its issuance in 2007 requested banks to state their compliance with corporate governance code every year within their annual reports, as part of its commitment to the disclosure and transparency requirements, (Corporate Governance Code for Banks in Jordan, Chapter 6, Item vi-1), while the JCGC requested the same in 2010, i.e. in the subsequent year of the issuance of the JCGC in a separate circulation²¹.

²¹ See Circular Number: 12/1/4659. dated on December 15, 2010. Issued by Jordanian Securities Commission. Available on: http://www.jsc.gov.jo/Public/english.aspx?site_id=1&Lang=3&Page_Id=2550&Menu_ID2=257

2.10 Chapter Summary

This chapter aimed to shed the light on the environment of corporate governance, and the auditing profession in Jordan along with the theoretical framework of these two topics. Starting by the agency theory, the context then extended by a detailed discussion, and analysis of its impact on corporate governance and the auditing profession. The chapter highlighted and discussed the needs, and benefits of adopting corporate governance in Jordan added to its emergence, assessment, the different Arabic translations of the term, and concluded with criticisms directed to the current Jordanian corporate governance code. The chapter also reviewed the development of the auditing profession in Jordan and the legislations that regulate the auditor's work and the conditions of licensing the Jordanian certified public accountant. Finally, the chapter reviewed the development of the audit committees in Jordan and analytically discussed their roles, responsibilities and authorities as stipulated on the JCGC in addition to their relation with both of external and internal auditors.

The next chapter (chapter 3) reviews the literature relevant to the main themes of the thesis. That chapter starts by discussing the extent of investor's reliability of the audit report followed by discussing the audit expectation gap phenomena, their effect on the auditing profession, and investors' confidence, and reviews literature of this issue in Jordan to explain the nature, and the structure of the audit expectation gap. Additionally, the extent of investor's reliability of the audit report is discussed. The presented review in this chapter has covered, and critically analyzed the study's both independent and dependent variables which were mentioned in the model of this thesis.

Chapter 3: The Literature Review

3.1 Introduction

This chapter presents the literature review of this thesis. Starting with the audit expectation gap, this chapter sheds light on the meaning, nature, and causes of the audit expectation gap in Jordan. The chapter also discusses audit opinions and the reliability of the audit report as perceived by the Jordanian financial analysts. In line with the study model presented in Chapter One, this chapter reviews the Jordanian corporate governance codes and critically analyzes the influence of the four selected factors in regards to bridging the audit expectation gap in Jordan, namely; the external auditor's independence, the effectiveness of internal auditors, disclosure & transparency, and corporate accountability. This chapter investigates the role of audit committees in supporting corporate governance mechanisms such as external and internal auditors, enabling them to produce reliable, accurate and independent financial reports.

3.2 An Overview of the Audit Expectation Gap

Over the last decade, calls for reforming corporate governance structures have become a significant global issue. The Asian financial crisis in 1997 and corporate scandals and collapses of large entities such as Barings, HIH, Parmalat, Enron (Demirag & Solomon, 2003) and Lehman Brothers have raised fears of a global economic meltdown and raised the importance of reforming corporate governance systems. The auditing profession has also come under the

spotlight, especially after the dramatic collapse of famous companies without any prior warning signals in audit reports. These events have highlighted the phenomena of the audit expectation gap (Koh & Woo, 1998).

Ojo (2009) defined the audit expectation gap as “the difference between what users of financial statements, the general public perceive an audit to be and what the audit profession claim is expected of them in conducting an audit” (p. 3). The audit expectation gap might have a substantial effect on the continuing existence of the auditing profession, especially given recent corporate collapses. These collapses have been costly to the audit profession in many ways such as compromising the profession’s reputation, incurring high costs of litigation and settling these cases in the courts, and the fear that they may increase the burdens (more responsibilities) placed on the auditors (Wolf et al, 1999). Moreover, Hassan (2004) pointed out that the audit expectation gap is considered one of the greatest dilemmas affecting the auditing profession around the world and it has affected the public’s confidence in the profession’s role in economic life. These potential negative impacts of the audit expectation gap have caused it to be of considerable interest to researchers of the auditing profession and to practitioners, especially in the last two decades of the twentieth century.

The expectations gap in auditing is an old phenomenon and goes back to the start of the compulsory audit in the late eighteenth century (Al-Duneibat, 1998). The use of the term ‘audit expectation gap’, however, likely appeared for the first time in the 1970s. Porter (1991) traced and attributed the first appearance of the term to Liggio (1974) who is considered the first academic to use the term in accounting and auditing literature. Criticisms and attacks directed at the auditing profession since the late 1960s motivated Liggio to identify the two dimensions defining the gap; the expected performance of auditors as envisioned by external auditors and as envisioned by the public who rely on the audit report’s opinion of the financial statements.

In regards to Jordan, the results of the study of Al-Thuneibat (2003), which aimed to investigate the structure of the expectations gap in Jordan, are consistent with those found by Porter (1991

and 1993) and Humphrey (1997) in regard to an ignorance gap, a deficient standards gap, and a deficient performance gap.

Porter (1991, P. 4) reviewed and analyzed the components of the audit expectation-performance gap and provided the following breakdown of key components:

- 1- “The reasonableness gap: defined as the difference between what the public expects auditors to achieve and what they can reasonably be expected to accomplish”.
- 2- “The performance gap: defined as the difference between what the public can reasonably expect auditors to accomplish and what they are perceived to achieve”.

The latter gap i.e. “performance gap” is further subdivided into:

A- “The deficient standards gap: defined as the difference between what can reasonably be expected from auditors and auditors' existing duties as defined by the law and professional promulgations”.

B- “The deficient performance gap: defined as the difference between the expected standard of performance of auditors' existing duties and auditors' perceived performance, as perceived by the public”.

An audit expectation gap can, according to Humphrey (1997), be defined narrowly as a “role-perception gap” between what could reasonably be expected from auditors and what is actually expected by the users of financial reports. This definition of the audit expectation gap suggests that some portion the gap (perhaps the entire gap) is, in fact, an “ignorance gap” and that it can thus be narrowed or closed by educating the users of financial reports. Knutson (1994), on the other hand, argued that the audit expectation gap was a difference between the expectations of users of the audit reports and the insufficient performance of external auditors, thus suggesting that the “ignorance gap” was not the problem.

As mentioned in Chapter One, in the definitions and limitations sections, this thesis deals with the auditors' performance gap. For the purposes of this thesis, the audit expectation gap refers to the difference between the auditors' actual performance and to what report users believe the auditors should be performing and achieving as auditors.

In response to Porter's analysis of the gap, Gray and Manson (2006) argued that lack of external auditor independence and competence are the main causes of deficient performance. The performance gap could also be narrowed by strengthening the external auditor's performance. This thesis aims to investigate the role of the JCGC and support from the audit committees in reinforcing perceived external auditor's independence and performance. External auditor independence is the cornerstone of the auditing profession (Leung, Paul, & Cooper 2011), and reinforcing external auditors' independence leads them to express an independent opinion about the company's financial position unaffected by any management pressure.

According to Sidani and Olayan (2007), resolving the audit expectation gap does not necessarily require an increase in the auditors' responsibilities. The gap can be bridged by adopting an effective corporate governance mechanism which ensures the sharing of the organization's responsibilities and accountability amongst corporate governance constituents, including top management, the board of directors, external auditors, internal auditors and the capital market regulatory bodies.

Corporate governance bodies with effective constituents and co-operation between the auditors and audit committees can help establish effective internal control procedures, enhancing directors' accountability and transparency, which are crucial factors in narrowing the expectations gap. Hakim (2002) pointed out that agency problems could be reduced by adopting corporate governance best practices.

3.3 The Audit Expectations Gap in Jordan

The audit expectation gap partly exists because of the difference in perceptions and beliefs between the users of the audit reports and the auditors in regard to the auditors' duties and responsibilities and the messages implied by the external auditor's reports (Koh & Woo, 1998).

The audit expectations gap has re-emerged in Jordan during the last two decades due to the modernizing of audit legislation, the privatization of some large public institutions which has led to an increase in the size, number, and power of shareholding companies in the market (Abdullatif, 2003), and due to the "increasing expectations from auditors" in Jordan (Al-Thuneibat et al, 2007, p. 85). Asfoor²² (2003), in the 5th Scientific Conference of JACPA, pointed out that the practical reality of the auditing profession in Jordan reveals a gap between auditors and non-auditors regarding external auditor's performance. In addition to that, corporate collapses and scandals in Jordanian entities, such as the failures of Petra Bank, the scandal of Magnesia Company and the scandal involving credit facilities to an IT company (Al-Awaqla, 2008; Malkawi, 2008; The Economist, 2003).

As mentioned in Chapter One, the audit expectations gap does exist in Jordan (Al-Thuneibat, 2003; Obaidat, 2007; Abdullatif, 2003; Omari, 2003; Hajir, 2001). The nature and the structure of the audit expectation gap are briefly presented below:

Al-Thuneibat's study (2003) investigated the causes and the structure of the audit expectations gap in the perception of external auditors and company managers, and concluded that the audit expectations gap did exist in Jordan, and consisted of three main components: a deficient standards gap, an ignorance gap, and a deficient performance gap.

A study by Obaidat (2007) aimed at investigating the gap between external auditors and investors in regard to the qualitative characteristics of accounting information. The study

²² Member of the founding committee of the Jordanian Association of Certified Public Accountants.

revealed that the primary focus of investors lay on timeliness while auditors primarily focused on neutrality.

The audit expectations gap and the auditors' responsibilities in investors' perceptions have been investigated by Hajir (2001). The study found that the low levels of disclosure of financial information, auditor independence and auditor performance and efficacy contributed to widening the expectation gap in Jordan. The study defined the appropriate level of disclosure, stating that financial reports and the notes accompanying financial statements should include all the information required to reflect the financial position of the company and enable investors to make informed investment decisions.

A study by Omari (2003) investigated the expectation gap in regard to auditors' responsibility to express their opinion about the entity's ability to continue as a going concern, the auditor's independence, and the scope of the auditor's responsibility in identifying misleading and incomplete financial data. The study concluded that the audit expectations gap in Jordan was mainly focused on the independence of the external auditors, which was negatively impacted by the potential loss of sales in lucrative non-audit services, unlimited audit tenures and company management pressure on the external auditors.

In summary, previous studies that investigated the audit expectation gap in Jordan revealed that the gap did exist in Jordan and that it was partially affected by external auditors' performance and independence (Al-Thuneibat, 2003; Asfoor, 2003 Omari, 2003; Al-Khadash & Al-Sartawi, 2010) and the level of disclosure & transparency (Hajir, 2001). The gap was also affected by differences between the perceptions of auditors and investors regarding the importance of different qualitative characteristics of accounting information (Obaidat, 2007). External auditors' independence, neutrality and objectivity and the level of disclosure & transparency could be improved by adopting effective corporate governance codes.

This thesis aims to investigate the role of the JCGC and audit committees in reinforcing external auditor independence. Such reinforcement is expected to lead external auditors to express

independent opinions about companies' financial positions, in the face of any management pressure, thus enhancing investor confidence in audit reports. The study also evaluates the extent of the JCGC requirements mandating Jordanian shareholding companies to provide adequate and timely disclosure and transparency and adopt sufficient accountability systems. The study also investigates the JCGC's impact on the perceived reliability of the audit report and the narrowing of the audit expectation gap. Moreover, this thesis investigates the role of the JCGC in reinforcing internal auditor's effectiveness, enabling them to detecting fraud and errors effectively, which should lead to greater reliability of audit reports and a reduction of the audit expectation gap.

Through a factorial experiment, this study investigates the degree of each variable's influence on institutional investors' perceptions of the reliability of the audit report and the level of the audit expectation gap. The factorial experimentation method identifies if there are any causal relationships rather than just correlations between variables.

3.4 Investor Reliance on the Audit Report

Financial reports published by corporations every year contain very useful information used in the decision-making processes of many parties, such as shareholders, investors, lenders and the government. The growing interest about financial reports and the extent to which they could be trusted by investors and stakeholders suggests that they should be prepared objectively and audited by an independent and neutral body, this body normally being the independent external auditors. It is a mandatory condition that public companies appoint an external auditor during the company general assembly. The Jordanian companies' law specified that listed companies, private shareholding companies, limited partnerships in shares, and limited liability companies must appoint licensed external auditors (Companies Law, 1997, Article 192).

The auditing profession is vital, playing a crucial role in reinforcing the “quality and reliability of financial statements” (Zureigat, 2011b, p. 38). The audit report adds value to the credibility of financial reports. Auditing has been defined as "being concerned with the verification of accounting data, with determining the accuracy and reliability of accounting statements and reports" (Mautz, 1964, p.1). Audited financial statements enhance investors’ judgment decision-making in the capital market (Sudsomboon & Ussahawanitchakit, 2009), and different sorts of audit reports have a significant impact on investor reactions toward the capital market (Herboh, Ragunathan & Garsden 2007).

Reliability of audit reports refers to a condition in which investors, and all those interested in a company’s business affairs, consistently find the audit reports and opinions about a company's financial statements and position to be dependable and credible. Reliable audit reports clearly identify any significant weaknesses in internal controls, as such weaknesses limit the auditor's ability to confirm that the accounting systems produce accounts which reflect all the company’s transactions in accordance with relevant accounting standards. Reliable audit reports also reveal whether accounting reports are reasonably free from error and bias and whether the accountants are justified in making a ‘going concern’ assumption. In other words, for the audit report to be reliable it must give institutional investors adequate information about the quality and comprehensiveness of the accounting reports so that they can decide to what extent they can rely on the accounting reports in making investment decisions.

The extent of the reliability and credibility of the audit report is considered the starting point for decisions by stakeholders and potential investors about the viability of an entity (Jones, 1996; Epstein & Geiger, 1994; Gul, 1990; O'Reilly, 2009; Firth, 1980; Citron et al, 2008; Saaydah, 1998; Guillamon, 2003; Zureigat, 2006; Zureigat, 2010; Al-Awaqleh, 2008). The audit report has been seen as the primary tool or medium of communication between auditors and the rest of the financial society (Hatherly & Skuse, 1991).

Auditors are assumed to belong to one of two categories: rigid external auditors who do not compromise on their probity and reliability and always report their judgments truthfully, and

other auditors who compromise their professional reporting decisions based on a cost-benefit analysis (Beyer & Sridhar, 2006; Antle, 1982). Beyer & Sridhar (2006) argued that the latter type misreport their professional assessment due to the absence of the auditing regulatory bodies while others attribute that to management pressure and auditor competition on fees (Knapp, 1985; Malhas, 1992; Omari, 2003).

This has caused Taylor, DeZoort, Munn, & Thomas (2003) to argue that the reliability of the audit report is the backbone of the auditing profession and “our view is that auditor reliability rather than auditor independence is, or should be, the profession’s cornerstone for protecting the public interest” (p. 258). They argued that the external auditor's independence was an input into stakeholders' reliance on the audit report, as were external auditor experience and integrity. Taylor et al (2003) defined the reliability of the audit report as the condition in which the users of the audit report perceive the audit report as dependable and credible.

Zureigat (2010) conducted an event study to investigate the impact of the modified auditor's opinion on the share prices of Jordanian listed companies during the period 2002 to 2007. Based on the analysis of the abnormal returns of 53 listed companies during the test period (i.e. 10 days before the assembly meeting²³ date and 10 days after), the study concluded that modified audit opinions significantly influenced the listed companies' share prices. The study attributed this to the Jordanian investor’s capability to evaluate the contents of the audit report and assess the audited financial statements.

Zureigat’s (2010) study confirmed the results (i.e. the issuance of qualified audit opinions influenced the shares prices of the Jordanian companies) of two prior studies utilizing that same methodology (Zureigat, 2006; Saaydah, 1998). Zureigat’s study (2006) covered the period 1993 to 2005, and Saaydah’s study (1998) investigated 19 listed companies that received qualified opinions during the period from 1991 to 1994.

²³ The study adopted the general assembly meeting date rather than the release of the audited annual report date, because that is the date in which the financial statements disclosed for the first time to shareholders and usually this meeting includes the ratification of the auditor's report.

The effect of the international auditing standard ISA No. 700 and its amendments²⁴ on the audit expectation gap and the level of disclosure in the audit report has been investigated by Al-Khadash, et al, (2012). The study surveyed external auditors, preparers of the financial statements, investors and academicians. The results of the study showed that ISA No. 700 and its amendments contributed in bridging the audit expectation gap and enhancing the disclosure level of the audit report. Based on the participants' opinions, the study recommended an expansion to the audit report whereby another separate paragraph would be added at the end of the audit report – after the opinion paragraph - in which the auditors should state their opinion about the effectiveness of the internal control system, the extent they relied on it, compliance with the corporate governance codes, and earnings management practices.

O'Reilly (2009) pointed out that the general assumption is that expressing an explicit statement about the likelihood of the firm being a going concern should be useful to users of the audit report. The study experimentally investigated the issuance of (uncertain) going-concern opinions, including financial analysts' expectations about how share prices in the USA will react to such opinions. The results of the experiment provided strong evidence that the going-concern opinion influenced perceptions of share values and that financial analysts perceived the auditor's opinion about the financial viability of the entities as useful information for valuing companies' shares. The results of the experiment also found that the importance of the auditor's opinion was higher when it provided information different from the market expectations.

Gómez-Guillamón (2003) investigated the extent that institutional investors rely on the audit report in investment and financing decisions in Spain. The study surveyed a sample of head officers of credit institutions who actively make investment and credit decisions and managers of investment and analysis companies. The study showed that the types of audit opinion (clean, qualified, disclaimer or adverse) provided by the external auditor affected the institutional investors in their investment and lending decisions.

²⁴ The study referred to the amendments of The ISA 700 “Forming an Opinion and Reporting on Financial Statements” that became operational in the first of January 2006.

3.5 Types of Audit Reports and Opinions

The previous section indicated that assurance provided by the external auditors is relied upon by users of financial reports such as shareholders, lenders and investors to help evaluate and make investment decisions. Moreover, the literature suggested that the external auditor's opinion about the ability of companies to continue as going concerns is appreciated by the users of the audit report, and they reconsider their investment decisions accordingly (Jones, 1996; Gul, 1990; Epstein & Geiger, 1994; Firth, 1980; O'Reilly, 2009; Guillamon, 2003; Citron et al, 2008). This section summarizes the types of audit report as categorized in International Standards.

As stated in International Standard on Auditing (ISA) No. 700, auditors are required to provide an opinion on whether, in all material respects, financial statements are prepared in accordance with all applicable financial reporting frameworks. That opinion, according to ISA No. 700, is to be reached by obtaining reasonable assurance that the financial statements are free from all material misstatement, whether from error or fraud, and thus fairly reflect the true financial condition of the organization.

Auditing standard (ISA 700) requires that the external auditors must clearly express their opinion as one of the following types:

1- An unqualified²⁵ audit report: is the most common type of audit report and is issued when the financial statements are presented fairly, in all material respects, according with applicable standards and the relevant statutory such as the corporations act (Leung, Paul, & Cooper 2011).

2- A qualified audit report: “issued when there is a disagreement with management concerning appropriate accounting policies, a conflict between applicable financial reporting frameworks, or a limitation on the scope of the audit” (Arens et al, 2010, p. 48). This opinion is issued when material misstatements exist, but their effects are not pervasive to the overall financial report.

²⁵ This type is also referred to as unmodified opinion

3- A disclaimer of opinion is issued when the auditors are unable to express an opinion about the fairness of the financial reports due to a substantial restriction or a severe limitation on the scope of the audit such as the client concealing substantial evidence.

4- An adverse opinion: issued when the external auditors believe that the overall financial reports are not presented fairly nor prepared according to the applicable accounting standards.

The executive management and the board of directors of companies always prefer the first type of the audit report in order to send a message to the shareholders that they are diligent, competent, and deserve to keep their positions and be elected for another period. Therefore, executive managements put pressure on the external auditors to ensure the issuance of the unmodified audit report. In the context of Jordan, the literature pointed out that poor corporate governance mechanisms, including the lack of well-established and independent audit committees, encourages top management to undertake the role of selecting, retaining and setting the external auditor's fees (World Bank: Corporate Governance Assessment, 2004; Swaiti, 2006; Abdullatif, 2006; Al-Farah, 2001; Al-Khadash & Al-Sartawi, 2010) which consequently compromises the objectivity of the external auditors and leads them to issue audit reports in favor of company management.

3.6 The Role and the Potential Support by an Audit Committee

The International Standards on Auditing (ISAs) also require auditors to communicate significant findings, arising from or discovered during the financial statement audit, with the appropriate persons charged with the governance of the organization, these persons usually being the audit committee (Colbert, 2002). ISA No. 260 (Communications of audit matters with those charged with governance) and ISA No. 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management) provide guidance on communicating matters of interest to the governance body of an entity (IFAC 2010b). Jubb, Rittenberg, Johnstone, &

Gramling (2012) argued that, under these standards, the external auditors have a responsibility to discuss with the audit committee all significant audit matters, deficiencies in internal control and any pressure, restriction and disagreements with company management in relation to the accounting. Jubb et al (2012) also added that the audit committee must support auditors and ensure that they are free of management pressure during the course of the audit.

Audit committees play a role in bridging the audit expectation gap. Sharaby (2010) investigated the role of audit committees in narrowing the audit expectations gap in commercial banks in Yemen. The study found that audit committees play a significant role in reinforcing external auditors' independence and performance, and the quality of financial reporting. The study also pointed out the importance of effective communications with external auditors in enhancing the quality of the audit process which would, consequently, increase the auditor's capability in reporting about the entity's ability to continue as a going concern. Another study from the region, this time conducted on Egyptian pharmaceutical companies during the period from 2005 to 2008, investigated the role of the audit committee as a key pillar of corporate governance for improving the quality of financial reports (Ahmad, 2011). The study's regression analysis of pooled data suggested that audit committee independence, the size of the audit committee in terms of number of members, and the financial experience of audit committee members are positively related to the issuance of clean opinions in the external auditor's report.

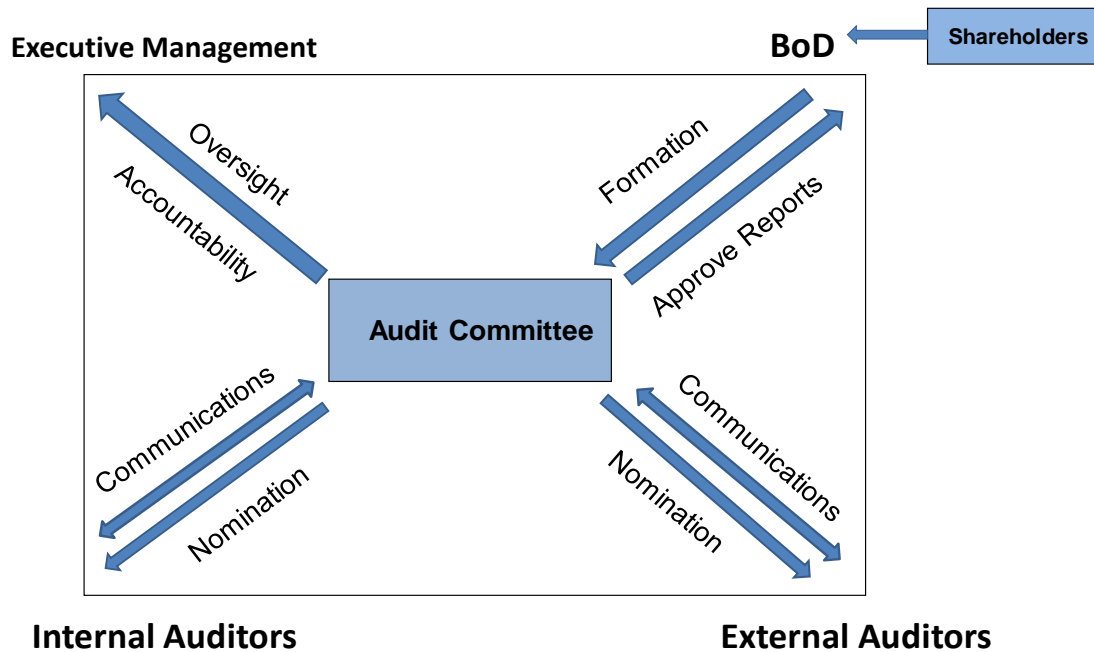
Effective audit committee is considered a cornerstone and crucial pillar of effective corporate governance (Gramling, Maleta, Schneider, & Church 2004). Independent audit committees are an essential part of the corporate governance mosaic (NYSE & NASD, 1999; The UK Corporate Governance Codes, 2010).

The audit committee has been considered a safeguard of the external auditor's independence (albeit among some other factors and bodies) due to its role in overseeing the financial reporting system and monitoring compliance with the regulatory instructions (ISB, 2000, para. 14). Furthermore, the audit committees have been seen as a safeguard for reinforcing the

internal auditor's effectiveness as well; The Malaysian Institute of Accountants (MIA) recommended that all publicly-traded company establish audit committees in order to prevent frauds and increase the integrity of the financial reports. The MIA added "audit committees provide additional safeguards against fraud and malpractice by monitoring the effectiveness of record keeping, internal controls and internal audit. They also provide an assurance to regulatory authorities, investors and depositors of the objectivity, credibility and integrity of a company" (Malaysia Institute of Accountants, 1990, p. 27, cited by Teoh & Lim, 1996). Libby, Libby & Shor (2001) went further, affirming the pivotal role of the audit committee among other safeguards. They pointed out that internal and external auditors provide a safeguard for maintaining the soundness, accuracy and reliability of financial reporting, and added that companies establish an audit committee "whose job is to review these other two safeguards" (p. 24).

The figure below shows the relationships between the major constituents of the audit-corporate governance system, emphasizing the crucial role of the audit committees in the corporate financial reporting system. The audit committee is an important body in the corporate structure because it is involved with overseeing and communicating with all other controlling and auditing bodies.

Figure 5: Relationships between the Major Constituents of Corporate Governance as they Relate to Auditing



Whittington and Pany (2012) pointed out that one of the main duties of the audit committee is to oversee and ensure accountability and responsibility over the company's financial reporting process to the external users, monitoring the company's risk and related control processes, in addition to coordinating the work of the internal and the external auditors. Rittenberg and Schweiger (2007) pointed out that proper authority and powers of audit committees enable them to oversee the flow of the financial reporting and prevent fraud by company management.

The board of directors must ensure that audit committees have the proper authority and power to do their job properly. Audit committees with inadequate authority cannot ensure corporate accountability and cannot enhance disclosure and transparency, thus negatively impacting

investor confidence and creating incorrect impressions amongst them. Audit committee effectiveness depends on the efficacy of its members. Megat (2000) pointed out that audit committees cannot help in reinforcing corporate governance unless they are composed of truly independent members, and they should have experience and analytical skills and the capability to confront management pressure. Megat (2000) also added that if audit committees do not play their vital role and are nothing more than just "window dressing", then the audit expectations gap from investors' perception will be widened.

Goodwin and Seow (2000) argued that the investors, auditors and managers all believe that a powerful and effective audit committee support external auditors to perform their job effectively and independently.

Corporate failure in Malaysia has raised questions regarding the professionalism of external auditors and affected public confidence negatively as the public blamed auditors for those scandals. Teoh and Lim (1996) conducted an empirical study of the factors affecting the perception of the external auditor's independence in Malaysia. The study employed the repeated measures experimental design. An experimental instrument consisting of 32 scenarios was distributed to a sample of 100 accountants, 50 of which worked in auditing firms and the other 50 worked in non-auditing firms. The study concluded that the establishment of audit committees has a strong positive influence in reinforcing the perceived independence of external auditors. Moreover, the study found that providing non-auditing services and the large size of audit fees gained from a single client impair the perception of auditor independence. However, the negative effect of the latter could be mitigated by the formation of audit committees. The study revealed a statistically significant interaction between the existence of an audit committee and large audit fees obtained from a single client.

Abdel-Qader (2002) highlighted the importance of establishing audit committees to bridge the audit expectations gap. The study pointed out that the AICPA, the Treadway Commission, and the SEC have affirmed that the main objective of audit committees is to foster auditors' independence. Abdel-Qader (2002) argued that an external auditor's independence is

enhanced when the auditor has direct communications with and a path to an independent party. Therefore, the existence of an independent audit committee is seen as enhancing and reinforcing the quality of the auditor's work and thus mitigating control of management over the financial reporting process. The committee should review the scope of the audit, significant accounting estimates and provisions²⁶, and policies on external audit services, thus helping the auditors reach an independent opinion in the audit report.

Prior to the JCGC, audit committees in Jordan were ineffective and had insufficient power. That lack of power could be attributed to the fact that there were no requirements regarding the qualifications that the audit committee members should hold, and no requirement for them to be independent (Swaiti, 2006; Abdullatif, 2006; Malkawi, 2008).

The JCGC has clearly defined the requirements for the independent and the non-executive (i.e. non-management) members of boards of directors, and defined the conditions that impair the independence of the board of directors. The JCGC (Chapter Five, Section One, Item 1) required that each and every member of the audit committee have knowledge and experience in the field of accounting and finance. Moreover, the JCGC requires that at least one member of the audit committee must have actually worked in accounting, finance or a related field and must also hold an academic degree or professional certificate in one of those fields.

Additionally, the JCGC (Chapter Two, Section two, Item 2) required audit committees be comprised of at least three non-executive (i.e. non-management) members selected from the board of directors, of which at least two must be independent (i.e. not be an employee of the company). One of these independent members is required to chair the audit committee.

Requiring only two independent members means that one of the audit committee members might have a beneficial interest other than ownership of shares with the company or its external auditor or the company upper executive management. Therefore, the presence of

²⁶ Provisions refer to the “liabilities for which the amount of the future sacrifice is uncertain” (Carlson, Mladenovic-McAlpine, Loftus, Palm, Kimmel, Kieso, & Weygandt 2008).

even one member who is not independent means that all discussions could leak back to the management and the non-independent member may exercise a heavy influence particularly if they are a person of high prestige. In the case of Jordan, some literature showed that upper executive management had undertaken the roles of the board and the shareholders, especially in decisions related to the selection and remuneration of external auditors (World Bank: Corporate Governance Assessment, 2004; Swaiti, 2006; Abdullatif, 2006; Al-Farah, 2001; Al-Khadash & Al-Sartawi, 2010).

Green (2004) argued that "a more independent audit committee means a more independent auditor" (p. 12). "Qualified, independent and tough minded audit committees represent the most reliable guardians of the public interest" (Levitt, 1998)²⁷. Abbott, Park, & Parker (2000) found that companies with audit committees with independent members, and which meet at least twice a year, are associated with a less likelihood of both fraud and malpractice.

In the U.S.A., the National Association of Securities Dealers Automated Quotations (NASDAQ), the New York Stock Exchange (NYSE), and the Securities and Exchange Commission (SEC) have taken many actions to enhance the quality of companies' disclosures and transparency, and have forced the corporations to alter the composition of their audit committees.

Felo and Soliere (2009) pointed out that the SOX legislation requires all audit committee members be independent of the company management. They argued that independent audit committee members are stronger, unbiased and provide better oversight over the company management because they are less likely to be influenced by management pressure. They also added that insider audit committee members are more likely to be influenced by management pressure and that CEOs could override their powers.

The SOX initiative in the U.S.A. has influenced other countries to establish reforms to strengthen the independence requirements of their capital markets. Tafara (2006) pointed out

²⁷ The former US Securities and Exchange Commission chairman

that, since the issuance of the SOX in 2002, the UK, Australia, Canada, Hong Kong and Mexico have introduced reforms.

The difficulty and the vagueness associated with reporting about the going-concern principle may put the auditor under pressure of the executive management. Independent and effective audit committee members could help mitigate such pressure by supporting the auditor in any conflicts with management (Parker, 2000). It is expected that a non-executive audit committee independent of the company management is more likely to support the external auditors when they face any management pressure to issue an unqualified opinion when the assumption of the entity's ability to continue as a going-concern is questionable (McMullen, 1996).

Carcello and Neal (2000) have examined the relation between the characteristics of the audit committee's composition and the likelihood of issuing going-concern opinions for USA corporations experiencing financial distress during 1994. The study developed a logistic regression model and found that the higher the percentage of affiliated²⁸ directors amongst the audit committee members, the lower the likelihood that the companies receive a going-concern opinion by the auditor. The study supported the call of some capital market regulators for more independent audit committee members.

Carcello and Neal (2003) investigated the relationship between audit committee characteristics and auditor dismissals following the issuance of a going concern opinion between 1988 to 1999. The study utilized the previous study's methodology to, this time, investigate the relation between the likelihood that the company dismisses its external auditor and the qualities of the audit committee of that company. The study concluded that audit committees with a higher

²⁸ Affiliated directors are directors who lack independence; which includes current or past officers, employees and the staff of the company or of a related entity, relatives of executives, professional advisors to the company such as bank officers and legal consultants, officers of significant customers and/or suppliers of the entity, and interlocking directors.

percentage of independent members, governance and financial expertise, work effectively, and support and shield the auditors from dismissal especially after expressing a going-concern opinion.

Carcello (2000) and Neal (2003) found a relationship between the variables, using the logistic regression model rather than causation relationship. This thesis includes an experiment aimed at identifying the causal relationships, rather than just correlations, between the independent variables and both the reliability of the audit report and the audit expectation gap.

3.7 External Auditors' Independence

Auditing or assurance services can be defined as an analysis of an auditee's financial statements conducted to improve the quality and reliability of the presented information for the users of the financial statements, enabling them to make informed investment decisions. This includes checking accounts to prove their truth and fairness by an independent third party and the issue of a credible and independent opinion in a special report (Gray & Manson, 2006; Arens et al, 2010; Strawser & Strawser, 2001; Whittington & Pany, 2012). The ISB considered external auditors' independence to provide significant benefits to investors and other users of financial information. The ISB stated "auditor independence helps ensure quality audits and the reliability of the financial reporting process, which also may lead to increased confidence in that reliability" (ISB, 2000, para. 28-a). Moreover, in paragraph 28-c, the ISB added that external auditors' independence is also beneficial to the company management, board of directors and to the audit committee, ensuring the credibility of the financial reporting prepared by lower-level management.

The concept of Independence is one of the most important foundations on which the auditing profession is built. Knapp (1985) defines auditor independence as the auditor's ability to resist pressure from the client (i.e. the company being audited).

Potential ethical dilemmas exist in any situation where auditors face outside pressure to compromise their professional integrity or objectivity (e.g. management pressure to decide in favor of the appropriateness of the accounting policies chosen by management) (Leung, Paul, & Cooper, 2011). Furthermore, potential problems arising from a close relationship between the auditors and company management may compromise the external auditor's independence (Cadbury Report, 1992).

Auditors' independence and the quality of the audit can be enhanced by support from effective audit committees, the maintaining of audit working papers and auditor rotation (Arens et al, 2010).

The auditing profession and the business society are interested in ensuring that the users of the audit report perceive auditors as being independent (independence in appearance) and that the auditors actually maintain an unbiased attitude throughout the audit (independence in fact) (Arens et al, 2010). According to Leung, Paul, & Cooper (2011) "independence in mind relates to the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment. It requires the professional accountant to exercise skepticism and act with integrity and objectivity. Independence in appearance means avoiding situations and facts that are so significant that a reasonable person, knowing all relevant facts and having considered the safeguards in place, would reasonably conclude that a firm's or a professional accountant's integrity and objectivity may have been impaired" (p. 85).

3.7.1 External Auditors' Selection, Retention and Remuneration

Audit committees are expected to choose the external auditors, presenting their choice of audit to the board of directors who usually have the final say (although, legally, the shareholders have the final say). The board of directors normally accepts the auditor proposed by the audit committee. It is also expected that the external auditor should report any problems to the audit

committee. As such, the audit committee is, in effect, the guarantor of the auditor's independence, an independence that is enhanced if the audit committee, not management, is truly responsible for selecting the audit. By selecting truly independent auditors and enforcing the integrity of the auditing process in the face of possible opportunistic behavior by management, audit committees serve the best interests of company shareholders (Alleyne, Howard & Greenidge, 2006).

In response to Enron's scandal in 2002, Abdel-khalik (2002) argued that the auditor's independence is critically affected by the body which has the responsibility of nominating, dismissing, and setting the external auditors' fees, and suggested establishing another board, called the Shareholders' Board of Trustees (SBT), whose sole function is to select, retain and compensate the external auditors.

Nagy (2005) pointed out that by making a voluntary auditor change, the company can:

- 1- Seek an accounting firm whose views on accounting and reporting matters are more consonant with those of the company.
- 2- Seek an accounting firm that the company views as more pliable.
- 3- Signal that the company is willing to change auditors in the future.

In the case of Jordan, personal relationships play a pivotal role in the external auditor selection process. Malkawi (2008) pointed out that, in practice, the board of directors and the company management²⁹ select the external auditors and, moreover, set the auditors' remuneration, negatively impacting the independence of the external auditors. Zureigat (2011b) found that ownership concentration in Jordan negatively impacted auditing quality in Jordan. He attributed this ownership concentration to the nature of family owned companies in Jordan. Zureigat (2011b) argued that family owned companies tend to hire external auditors based on

²⁹ Prior to the establishment of the Jordanian Corporate Governance Codes there were no requirement to separate the positions of the chairperson of the board of directors and any executive position.

personal relationships; therefore, the study recommended moving the authority of nominating the external auditors to the audit committees.

Means of reinforcing external auditor independence have been investigated in Jordan by Matar (1994). The researcher designed and distributed questionnaires to supervisory bodies of the auditing profession, the users of the financial statements, and external auditors. The study found that the role of the directors in appointing, dismissing and setting audit fees was the most influential factor affecting external auditors' independence. However, the study found significant negative impact of other factors on the external auditor's independence, such as audit tenure, non-audit services, and audit fees.

A lack of written audit committee charters in Jordan has possibly affected the auditor selection process. The lack of such systematic guidelines affects the work of audit committees and may contribute to them compromising their own objectivity and failing to operate in the company stakeholders' best interests, especially in decisions to nominate an external auditor (Al-Saudi, 2007; Khsharmh, 2003; Ameera, 2004). For instance, Al-Saudi (2007), whose study investigated audit committee members, pointed out that personal relationship between the audit committee and the auditors affected the selection process of the external auditors, in the perception of the audit committee members. He attributed this to the absence of systematic procedures regulating external auditors' nomination by those charged with governance, especially the audit committee.

External auditor's selection and retention dilemmas have been experienced in other countries. In the USA, for example, Abdel-khalik (2002) pointed out that, in practice, auditor-related decisions are taken by the company management, and even non-executive members of the board of directors are often chosen by the executives. In order to resolve this dilemma, Abdel-khalik proposed establishing another board, independent of the company board of directors and the company management, whose sole function will be to select, retain and compensate the external auditors. He called this board the Shareholders' Board of Trustees (SBT). Abdel-

khalik also suggested that the stock exchange administer the process of selecting the SBT, in exchange for a fee.

From the researcher's point of view, the potential weaknesses of the model proposed by Abdel-khalik (2002) are as follows:

- 1- The model stated "the BoD will not have any role in the choice of SBT other than acting as shareholders voting their shares" (Abdel-khalik, 2002, page 101). The researcher argues that the shareholders who elect the board of directors (BoD) are themselves the same people who elect the Shareholders' Board of Trustees (SBT). Through this lacuna, the probability of the Board of Directors having control over the Board of Trustees is high because they would elect representatives who somehow "belong" to them and work as they desire, thus compromising the independence of the SBT when selecting external auditors. This proposal might not work efficiently in Jordan due to the presence of a large portion of family businesses, thus impacting the election process. Abu-Tapanjeh (2006) pointed out that many Jordanian shareholders elect members of their families and relatives, during general assembly meetings, to become members of the board of directors and then to occupy the key executive positions.

The researcher would argue that this lacuna could be narrowed by excluding major shareholders, directors, executives, and associates (relatives and companies, trusts, etc controlled by them) from voting in the election of the Shareholders' Board of Trustees.

- 2- The cost-benefit of paying fees to the stock exchange to administer the election process of the SBT, in addition to the costs of establishing and maintaining a new board whose sole function is to select or retain an external auditor, should be taken in to consideration.

In Jordan, factors affecting decisions to select and change the external auditors have been investigated in several studies (Al-Qam, 1997; Khsharmh, 2003; Al-Saudi, 2007). These three studies were quantitative, and utilized questionnaires distributed to internal auditors, company

management, external auditors and financial managers, and audit committees. Khsharmh's study (2003) suggested that, in order to mitigate the influence of the board of directors in the external auditor's selection, the selection should be made by the ministry of trade and industry through the companies' controller. Al-Qam (1997) recommended establishing non-executive qualified audit committee to approve the appointment of an external auditor. Al-Saudi (2007) concluded that audit committees in Jordan had, at that time, no standards or systematic guidelines for the process of selecting auditors and that personal relationships between audit committee members and auditors affects the selection process. The study also revealed that both of audit fees and audit committees' powers³⁰ affect the external auditor's nomination in Jordan.

3.7.2 External auditor's Independence and the Audit Expectation Gap

Jarbou (2004) pointed out that the lack of external auditor independence is the primary factor for the audit expectation gap. He argued that the financial community and the stakeholders should be convinced that external auditors are independent because the survival of the audit profession depends on the independence of auditors. He argued that if the independence of auditors in general came to be doubted, then their reports would have limited value and, consequently, the auditing profession would become worthless. The study concluded that the perceived independence of external auditors is a crucial factor in narrowing the expectations gap, and emphasized the importance of the role of the audit committees in nominating, dismissing, and maintaining the independence, of the external auditor.

As an aside, it is worth noting that early warnings in an audit report can reduce the likelihood of unsustainable firms growing and causing losses in the wider community. Thus, while this study

³⁰ The study referred the powers of the audit committees in (1) the committee's ability in accessing and communicating with external auditors freely, and (2) the committee's ability to hold private meeting with the external auditors without the presence of the company management.

focuses on the relevance to the audit profession, it also has considerable significance for the achievement of satisfactory allocations of investments in the Jordanian economy.

Similarly, Jarbou (2007) concluded that the lack, and the suspicion of the lack, of the external auditor's independence was the principal factor widening the expectations gap. In that study, a questionnaire was developed and distributed to external auditors, bank managers, and income tax department employees in the Gaza province in Palestine. The study recommended encouraging the independence and the neutrality of the external auditor in practicing the auditing profession, and encouraging the role of the professional associations and their control over the accounting and auditing profession.

The audit expectation gap in Britain has been empirically investigated by Humphrey, Moizer & Turley (1993). The study surveyed auditors, financial analysts, directors of corporate finance, credit officers at banks, in addition to financial journalists. The study identified auditor independence as a key element of the audit expectations gap. The study confirmed that the critical components of the expectations gap included expectations regarding auditors' role in fraud detection, auditors' responsibility to third parties, auditors' valuation of companies' financial positions, and threats to auditors' independence. Humphrey et al (1993) also concluded that auditor independence was, perhaps, the core around which the debate about audit expectation gap is waged.

Much of the literature related to the audit expectations gap referred to the perceived lack of external auditors' independence as being the main factor in widening the gap. Those studies include Jordanian (Abdel-Qader, 2002; Hajir, 2001; Al-Thuneibat, 2003; Omari, 2003; Al-Khadash & Al-Sartawi, 2010), regional³¹ (Jarbou, 2004; Jarbou, 2007; Sidani & Olayan, 2007; Al-Qarni, 2004; Elmeligy, 2006; Al-Husaini, 2000) and international studies (Humphrey et al, 1993; Koh & Woo, 1998; Dewing & Russell, 2002; Salehi & Rostami, 2009; Gloeck & Jager, 1993; Gray

³¹ Regional studies referred to those studies that have been conducted in the Middle East and North Africa's area and normally it is referred to these countries as MENA.

& Manson, 2008; Lin & Chen, 2004). This lineup of studies reflects the importance of external auditors' independence and performance in bridging the expectation gap.

The issue of independence is vital because auditing, as a function, was established to provide independent and expert opinions on financial statements to assist users in making decisions regarding financial statements. These vital functions of the external auditors can be seen in the JCGC. The JCGC (Chapter Five, Section 4, Item 6- D) stated the duties of the external auditors. One of these duties is “examining the financial, administrative, and internal auditing systems of the company and submitting their opinion on their effectiveness and ensuring their suitability for the company's business and safeguarding of its assets”. Therefore, the Jordanian regulatory bodies and professional association should ensure that external auditors meet the standards of independence.

There have been many debates and criticisms surrounding the external auditor's independence in Jordan (Swaity, 2006; Malkawi, 2008; Al-Khadash & Al-Sartawi, 2010; Abdullatif, 2006; Omari 2003; Dahmash, 1989; Matar, 1995; Momany, 1994). Dahmash (1989) pointed out that 54% of auditors in Jordan feel themselves under pressure from management. Matar (1995) also pointed out that the external auditor's independence in Jordan is impaired because of management pressure on auditors. Moreover, Omari (2003) revealed that investors in Jordan believed that auditors are responding to management's desires.

In 2004, World Bank and International Monetary Fund (IMF) joint initiatives reviewed the accounting and auditing standards and practices in Jordan. They reported several drawbacks that affected the audit profession in Jordan. In regard to the external auditor's independence, the report revealed that some auditors are dependent on one key client, have close relationships with the company management and provide non-audit services such as internal audit services to audit clients (World Bank: Accounting and Auditing, 2004).

The Jordanian corporate governance codes, in Chapter Five – Section 2 and 4, focused on the importance of the external auditor's independence, and the role of the audit committees in

reviewing issues related to the selection of the external auditor, this aims to ensure that companies satisfy all the conditions as stipulated in the legislation in force. The codes also stated that the “company shall take appropriate actions to ensure that the external auditor is independent in accordance with International Standards on Auditing”. The main external auditor's duty is to fulfill their job with impartiality and independence without interference from the board of directors or the executive management. (Corporate Governance Codes in Jordan, 2009 Chapter Five: Section Two Item 1; Section Four items 3- C, D and 6- A).

3.7.3 Non-Audit Services

The provision of audit and non-audit services by one audit firm to the same client, and the resulting potential impairment of the independence of the auditor when issuing the audit report, has repeatedly been a controversial issue. Non-audit services are all services provided by the incumbent external auditor that are not considered as an audit. Such services may include bookkeeping, tax services, financial information systems design and implementation, management consultation and any service other than the audit service. In the United States, the Sarbanes Oxley Act (SOX) (2002) banned audit firms from providing most non-audit services. In Jordan, there were also many criticisms directed at the non-audit services provided by auditors to their clients prior to the JCGC's establishment.

Abdel-Qader (2002) pointed out that Jordanian commercial laws did not require public companies to disclose non-audit services. The study argued that, in order to maintain integrity, objectivity, and independence, the public accounting firm should not act as internal and external auditor for the same entity. Malkawi (2008) pointed out that the Law of the Audit Profession of 2003 in Jordan does not specify whether auditors can perform non-audit services. Omari (2003) concluded that the expectation gap is concentrated on the independence of the external auditors and that Investors believed external auditors' independence to be negatively

affected when auditors provide non-audit services to their audit clients as this would create a conflict of interest and affect their performance.

Chan, Wong, & Wong (2002) pointed out that, in the last two to three decades, audit firms have expanded their services beyond auditing companies' financial statements, and the non-audit services business had grown to the point where fees generated from non-audit services were substantial. Chan et al (2002) also found that the largest New Zealand audit companies indicated that audit firms generated as much from non-audit services as they do from their audit work. The analysis suggested that audit firms have increased their provision of non-audit services to companies over the 1996 to 2000 period. Given this rebalancing of audit and non-audit services, auditors should consider how auditor independence and, consequently, investor confidence will be impacted and take action to address related problems.

These changes in the structure of services provided by audit companies must also be addressed by regulators, perhaps placing appropriate restrictions on the type or value of services that an audit company, whether directly or through partnerships or affiliations with other service providers, can provide.

There are other ways in which these potential conflicts of interest can be addressed. The auditing profession continues to establish broad guidelines for audit independence, as it has done for quite some time, but these guidelines, perhaps, give auditors too large a margin for maneuver. Alternatively, auditors could be required to disclose the types and value of services provided the client, perhaps within the audited financial reports of the client. Such an approach would be useful in reducing some, but not all, perceived conflicts of interest. A more extreme, but perhaps more effective, measure would be to totally forbid certain services on the premise that they compromise auditor independence. In applying this approach, regulators could balance the potential impact on the auditor's independence against the potential benefit of each non-audit service to the quality of the audit.

At the same time, audit committees could help investigate the types of services that auditors perform and question whether it would be in the investors' interests to have some of those services performed by another party. An effective audit committee can moderate management attempts to pressure auditors into accepting inappropriate accounting treatments.

Non-audit services are prohibited in Jordan. The JCGC states that each company must ensure that its external audit service provider not provide them with any additional services, including administrative support or technical consultation (Corporate Governance Codes in Jordan, 2009, Chapter Five, Section Four, Item 3-b).

3.7.4 Audit Rotation

There are two types of audit rotation: rotation of the audit partner and rotation of the audit firm. The rotation stipulated in the JCGC is the audit partner rotation.

Mandatory rotation of audit partners plays a role in enhancing auditor independence and bridging the expectation gap. Nagy (2005) pointed out that enforcing mandatory rotation of auditors would break the auditor's expectation that the audit client is a perpetual source of income as well as bring a fresh and perhaps more skeptical point of view to the audit.

In a case study by Dewing and Russell (2002) describing how UK investment fund managers define the audit expectation gap and their perceptions regarding the degree to which it be closed, audit rotation was identified as a significant contributor towards narrowing the expectation gap. The same study also suggested that frequent rotation of audit management partners would help to improve auditor's independence.

Governing bodies and major professional accounting associations viewed management fraud as a major influence on the reliability of the audit report and the audit expectation gap. "A gap exists between the expectations of the users of financial statements and the performance of

the auditing profession” (Pankaj, 2003, p. 22). Pankaj investigated the relationship between corporate governance and management fraud in the USA. The study investigated instances of management fraud and reviewed the Accounting & Auditing Enforcement Releases issued by the U.S Security Commission. The results of the study suggested the importance of the role of corporate governance mechanisms in limiting management fraud, particularly in the way these mechanisms handle the selection of external auditors³². The study also added that these mechanisms lead to a decreasing of the level of the audit expectation gap as they enhance auditors’ ability to detect and prevent management fraud.

Both the revised 8th Directive of the European Countries (Council of the European Communities, 2006) and the United States’ SOX require key audit partner rotation every five years. In the context of Jordan, Omari (2003) referred to the impact of audit firm rotation on the auditors’ independence. The study indicated that the tenure of audit firms was almost unlimited, negatively impacting external auditors' independence. Al-Khadash and Al-Sartawi (2010) also recommended audit partner rotation to reinforce external auditors' independence in Jordan. Matar (1994) also found that long audit tenure was a factor, among several other factors, that had negatively impacted external auditors’ independence in Jordan. Swaiti’s (2006) proposed model for the role of audit committees in Jordan suggested mandating audit partner rotation every five years.

The newly adopted JCGC mandated audit partner rotation. It stated “the external auditor shall exercise his duties for one year renewable, provided that the renewal for the partner at the external auditor may not be for more than four consecutive years, and the re-election may not take place before a minimum of two years” (Corporate Governance Codes in Jordan, 2009, Chapter Five, Section four, Item 2).

³² In regards to the selection process, the study took into account the “identity” of the audit firm. The Identity variable indicated if the audit firm was (1) a member of the Big-Six audit firms or (2) not a member of the Big-Six.

3.8 The JCGC and the Internal Audit

Effective internal audit contributes to good corporate governance systems (Leung, Cooper & Perera, 2011). The principal duties for internal control are to prevent and detect frauds and errors. Hence, organizations should establish an adequate internal control system to protect their assets. As insider staff, and due to their subordination to company management, the internal auditors are not perceived to be as independent as the external auditors. Mandating that decisions on appointing, dismissing and compensating internal auditors is the responsibility of an independent body, such as the audit committee, may enhance the independence and the effectiveness of internal auditors.

The JCGC pointed out the importance of establishing an adequate internal control system. The JCGC (in Chapter Five, section 3, item 3) stated that nomination of a candidate to be appointed as the company's internal auditor is one of powers of the audit committee. The JCGC also pointed out the roles of the audit committee in reinforcing the effectiveness of the internal audit. In Chapter Five, Section 2, Items 6, 7, 8, 9, and 10, it stated these duties of audit committees as:

- Assessing the adopted procedures of the internal control and internal audit functions.
- Examining the external auditor's evaluation of the adopted procedures of the internal control and internal audit functions.
- Examining the internal auditor's reports, especially those related to any irregularities
- The audit committees must provide the board of directors with recommendations regarding the adopted procedures of internal control and the work of the internal auditor.

Zureigat (2011a) investigated the impact of the corporate governance codes of the banking sector, issued by Central Bank, in improving internal audit quality and effectiveness in Jordan. The researcher designed a questionnaire and surveyed the internal auditors of Jordanian banks.

The study concluded that corporate governance of the Jordanian banking sector significantly improved the quality of the internal audit. The study revealed that giving internal auditors the authority to report directly to the audit committee was the main factor enhancing the internal auditor's performance.

The current research contributes further to Zureigat's study (2011a), which focused on investigating internal audit quality and effectiveness. This thesis covers external auditors' independence, disclosure and transparency, corporate accountability, and internal auditors' effectiveness as key elements of the corporate governance codes of publicly traded companies on the Amman stock exchange.

In a study of internal auditing in Australia and New Zealand, Goodwin (2003) examined the impact of audit committee independence and financial experience on the committee's relationship with Internal Audit. While both Audit committee independence and experience were found to have an effect on the internal audit function, independence was more strongly linked to having fewer audit process-related issues. On the other hand, committee experience was more strongly linked to the degree to which Internal Audit work was reviewed by the audit committee.

Goodwin & Seow (2000) surveyed the chief internal auditors in Singapore to investigate the factors affecting internal auditor's independence. They argued that internal auditors' independence and objectivity might be compromised because of company management pressure, which could be mitigated by giving the internal auditors private and direct access to the audit committee, and by giving the audit committee the power of appointing and dismissing the internal auditors. The study concluded that the relationship between the internal auditors and an independent audit committee was the first factor affecting internal auditor's independence. This is also consistent with Braiotta (2004) and Leung, Cooper, & Perera (2011) who argued that holding several meetings with the internal auditors, without the presence of the company management, enhances their independence. Leung, Cooper & Perera (2011) also added "In order to provide relevant, timely and complete information for the board and senior

management, chief audit executives should have a clear reporting role directly to the audit committee of the board A close relationship between the chief audit executive and CEO, rather than with the audit committee, can potentially result in the risk of intimidation or management pressure on the chief audit executive” (p. 813).

Qin (2007) investigated the impact of audit committee financial expertise on earnings quality in the U.S. The author developed a regression model to test his hypothesis, concluding that members of audit committees with financial expertise strengthen the internal control system of companies, and enhance the reliability of financial reporting. The results of the study, contradicting the SEC rules, suggested that only accounting-literate professional members are associated with good quality of reported earnings.

In the period after the passing of the Sarbanes-Oxley Act (SOX) in the U.S., Krishnan & Visvanathan (2007) investigated how reporting of weakness in internal control is influenced by the audit committee and external auditors. The study found that companies that reported weaknesses were characterized by a higher frequency of audit committee meetings, lower financial experience within the audit committee and more frequent change of auditor, in comparison with companies that did not report weaknesses.

Another study, in which 114 chief internal auditors participated, also found a significant relationship between the membership structure of the audit committee and the Internal Auditing Function (Raghunandan, Rama & Read, 2001). Audit committees that consisted only of independent members, of which at least one member had experience in accounting, finance or a related field, were found to be more likely allow the chief internal auditor to address the committee in private (i.e. outside the presence of company management) and tended to have longer meetings with the chief internal auditor. Such committees were also more likely to review the work of internal auditors.

Christopher et al (2009) examined the internal auditor's independence in Australia. In the study, a questionnaire was designed and sent to Australian chief audit executives to examine

the impact of the relationships between the internal auditors, company management and the audit committee on the internal auditor's independence.

The study concluded there were three threats affecting internal auditor's independence:

- 1- The internal auditor's dependency on the management to move to other positions or seek promotion.
- 2- The setting of the internal audit budget by the company's chief executive officer or chief finance officer.
- 3- The heavy involvement of the upper management in developing the internal audit plan.

The study attributed these threats to (1) Non-compliance with the corporate governance codes of best practices that recommended that internal auditors report about technical matters to the audit committee and administratively to the company upper management; (2) Inconsistent adherence to audit committee compositions to guarantee the independence of the internal audit function, even though “the majority of audit committees have the right composition to guarantee the independence of the internal audit function”(p. 214); (3) The management’s power in selecting and dismissing the head of the internal audit. The study revealed that in one-quarter of entities, company executive management, rather than the audit committee, made the decisions to select and dismiss internal auditors.

By reviewing the plans and work of internal auditors, audit committees can ensure that internal auditors are actually able to investigate all potential risks that should be disclosed in financial reports (Mohamed & Hussain, 2005). Such a review reveals potential problems that may prevent internal auditors from adequately accomplishing their roles, and thus allows the committee to correct problems impairing internal auditors’ independence.

Reporting about internal audit effectiveness is one of several aspects that may help in bridging the audit expectation gap. Abdel-Qader (2002) pointed out the importance of external auditors’

reporting on management responsibilities and internal control, the auditor being the only independent authority who can evaluate and report on the internal control system to users of the audit report. The study concluded that the auditor should review and evaluate the internal control system in sufficient depth to form an opinion as to its effectiveness, and any weaknesses which present potential for significant injury to the client should be reported to the public.

Audit committee support also plays a significant role in increasing internal auditors' confidence in their ability to detect frauds and errors. In regard to audit effectiveness, Davies (2009) argued that audit committees must actively support the work of the internal audit function. This active role requires that audit committees evaluate the work of the internal audit function and remove any obstacles standing in the way of the accomplishing of the function's duties. The audit committee should also select the heads of the internal audit function, helping ensure that the appointees are willing and able to protect the independence of the internal audit function in the face of potential pressure from management. Internal auditors should be able to respect the audit committee's ability to evaluate and support the work of the internal audit function.

According to Vinten & Lee (1993), audit committees have significant roles to play in enhancing the work of internal auditors. As previously mentioned, Audit committees can ensure that internal auditors investigate all the company's high-risk areas of activity. This role can be enhanced through coordinating work with both internal and external auditors. Furthermore, by facilitating coordination between internal and external audit efforts, the committee can optimize the costs of both audits.

In 1994, a study conducted in Australia by the Australian Society of Certified Practicing Accountants and The Institute of Chartered Accountants recommended requiring company managements to disclose the effectiveness of their company's internal controls (Koh & Woo, 1998). These disclosures would be made in the financial reports and external auditors would provide their opinions regarding these disclosures.

Muneer (2010) focused on the importance of communication as an approach to bridge the gap. The study pointed to the role of International Standard of Auditing ISA No. 700 that stated that the auditor's report on financial statements improves awareness and understanding of the financial reporting users about the nature, duties and limitations of the auditors' function, and the level of assurance they provide. The results of the study indicate that (1) conveying vital information, observed during the audit process, to the Audit Committee and (2) evaluating and conveying the fundamental deficiencies in internal control to management and the audit committee, increases the external auditor's performance and the effectiveness of the internal audit in detecting frauds and errors, and increases the credibility of financial statements, consequently contributing to narrowing the audit expectation gap.

In summary, the literature revealed the crucial role of the audit committees in maintaining the independence and the effectiveness of internal auditors. Well-established and independent audit committees appoint the chief internal auditors, review the work of the internal audit function, report recommendations to the board of directors and work as liaisons between external and internal auditors, thus reinforcing the effectiveness of the internal auditors in safeguarding company assets and increasing the credibility of the financial reporting system. Independent audit committees can provide auditors with direct access to the committee, without the presence of the company management, thus preventing any potential management pressure and reinforcing the independence of auditors.

3.9 Disclosure & Transparency

Without transparency of corporate governance, shareholders and other stakeholders do not have adequate confidence in the information provided by company management. According to Hakim (2002) and Leung & Cooper (2005), effective corporate governance cannot exist in the absence of acceptable levels of transparency, accountability and disclosure. Hence, it can be concluded that corporate governance is a set of mechanisms that help in confirming the

fairness and justness of company dealings with all the stakeholders, and in reinforcing the level of disclosure, transparency, and accountability. Bushman et al (2004) defined governance transparency as “availability of firm-specific to those outside publicly traded firms” (p. 207).

An audit committee also has a significant role in meeting investors' expectations and ensuring that a company has complied with approved accounting standards and disclosure rules for corporate reporting. In this respect, Audit committees are expected to adopt good practices aimed at maintaining high standards of corporate disclosure and integrity of information, with prime concern for responsibility and accountability to shareholders and other stakeholders (Megat, 2000).

Disclosure aims to provide financial report users with adequate information needed for sound financial decisions. Jordanian corporate governance codes have devoted a complete chapter (Chapter Five) to the subject of Disclosure and Transparency. The chapter mainly deals with the role and duties of audit committees, external auditors and internal auditors, and communications between corporate governance constituents, in regards to ensuring and maximizing transparency, disclosure and reporting quality.

According to the JCGC and the instructions on disclosure for listed companies and accounting and auditing standards (2004, Articles 8 and 9), all listed companies on the Amman Stock Exchange (ASE) are obliged to establish their own websites, yet many companies have not generated their websites, which is a clear contradiction of the JCGC's disclosure & transparency section. As per the code, all listed companies are required to inform the public of any new material facts, as soon as possible. Within a week of this public disclosure, a copy of the public disclosure, in addition to a detailed report on the new facts, should be submitted to the Jordanian Securities Commission (JSC). Surprisingly, companies are also required to promptly and publically confirm or deny any and all news items published in the media regarding material facts about the company, and are required to provide a copy of the official statement to the JSC.

Similarly, all listed companies are required to provide the Amman Stock Exchange (ASE) with all material financial and non-financial information, without delay, and to release that information to the public through the ASE's website under the circulars and disclosure section.

The importance of having a website for each listed company is maximized when the companies provide continuously updated information to the shareholders and potential investors. "Accounting information has relevance if it is timely; it must be available to decision makers before it loses its capacity to influence decisions" (Kieso et al, 2010, p. 491). Listed companies must use their websites, in addition to the annual and interim reports, to release all necessary information to the public. This information, in the hands of current and potential shareholders, will help them take the right decision regarding keeping, selling and buying shares. Concealing information will have a negative impact on the quality of investors' decisions, creating potential future surprises for investors and, consequently, raise the dilemma of accountability regarding the audit expectations. On the other hand, there is such a thing as having too much communication, whereby the crucial information is lost within a deluge of routine disclosures.

The JCGC (Chapter 5, item 2) required companies to publically disclose all relevant information in a timely, accurate and clear manner so as to allow investors to make informed decisions. These disclosures should include periodic reports, all emerging material facts, insider dealing, related party transactions, and board of directors and executive management's remuneration and benefits.

Before the establishment of the JCGC, Malkawi (2008) pointed out that related-party transactions, such as transactions between the company and the directors and general managers, were prohibited. For example, loans to directors are prohibited. The law required companies to provide relevant disclosure for loans made to the related parties such as the company's executives, directors, its major clients and suppliers, and parent companies. However, the definition of related-party transactions was unclear.

The newly adopted JCGC has clearly defined "Related Party Transactions" in Chapter One- The Definitions. It has been defined as "Any deal or contract, the value of which exceeds JD 50,000 (fifty thousand Jordanian Dinars JD)³³ made between the company and any the related parties". The codes go on to describe and identify related parties: "families and relatives of directors, partners, and companies under the control of members of the board of directors are within the definition of related parties." The JCGC stated that the company shall provide shareholders and investors with accurate, clear and timely disclosure of information about the related party transactions. The codes also stated that the audit committees must ensure that no conflict of interest may arise from the company's transactions, contracts or projects with related parties. Audit committees also must review and approve related party transactions prior to their ratification by the company (JCGC: Chapter Five, section two, items 11 & 12).

Wright (1996) pointed out that the role of the corporate governance system is to ensure the company provides adequate disclosure and transparencies on the financial reporting to the shareholders. The study found a strong positive relationship between the soundness of the governance structure and the quality of disclosure and transparency. The study also found non-independent audit committee members are associated with negative financial reporting quality, in the perception of analysts.

Cheng and Abdel-Qader (2010) have investigated whether auditors were responsible for surprise corporate failures. The paper suggested that the lack of management disclosure of how they assess going concern assumptions, along with the lack of auditors' disclosure of how they evaluate management's going concern assumptions, in addition to the passive approach of the auditing standards, were associated with surprise corporate failures and widened the audit expectation gap between investors and auditors. In regards to narrowing the expectation gap, the article recommended improvement in disclosures by both management and auditors, with adequate disclosure of material uncertainties and an explicit qualification on the audit going concern opinion. Abdel-Qader (2002) recommended that the audit report should be expanded

³³ JD has fixed exchange rate with the USD; Approximately, 1 JD = 1.41 USD

by including a statement about the auditor's evaluation of the internal control system and the results of reviewing the entity's ability to continue in the future.

3.10 Corporate Accountability

“Accountability has definitely become a topic of concern throughout governance literature” (ERKKILÄ, 2007). The recent spate of big-name corporate collapses, such as Enron, WorldCom and Tyco in the U.S, Barings Bank in UK, Philipp Holzmann and Comroad in Germany, Yline in Austria, HIH in Australia, SAirGroup in Switzerland, Lernout & Hauspie in Belgium and Parmalat in Italy, have increased public pressure to reform corporate governance systems and demand greater accountability over the corporations. In response to corporate failures, governmental and non-governmental regulating and supervisory bodies worldwide issued strict legislation, regulations and directives in order to restore public trust in capital markets and the auditing profession (Pott, Mock & Watrin, 2009). For instance, the Sarbanes-Oxley Act of the United States and the revised 8th Directive of The European Union (Council of the European Communities, 2006), both included strict penalties to be implemented on those who violate the regulations. Mohamed and Hussain (2005) pointed out that dramatic pressure for greater accountability has placed an immense emphasis on the functions and the vital roles of the audit committees in reinforcing corporate governance. The external auditor profession also came under fire for their failure to develop a ‘whistle blower’ type mechanism.

It is perceived that increasing the awareness of accountability, in addition to having a clear delineation of powers and responsibilities, helps in limiting and /or preventing fraud and malpractice. Corporate governance can be defined, in its narrowest sense, as a system for improving accountability (Farrar, 2003; Wolfensohn, 1999; Higgs Report, 2003; Tricker, 1984; Jubb et al, 2012). Hence, corporate governance initiatives have placed a great deal of emphasis on ensuring accountability over corporate governance bodies. For instance, the British Corporate Governance Codes, issued by The Financial Reporting Council (FRC), devoted a

separate section to accountability, emphasizing the duties and responsibilities of the board of directors, the company management, the internal auditors, the audit committees and the external auditors. The section included the role of the directors in preparing the annual report, specifying their responsibility for the soundness of the financial reporting system and that the entity's ability to continue as a going concern. The codes also stipulated the role of the directors in assessing the company's risk and reviewing the internal control system, in addition to the board's responsibility to establish an independent audit committee whose main functions and responsibilities must be set in a written charter (The UK Corporate Governance Codes, 2010).

Solomon (2010) pointed out that the most common characteristic in the definitions of corporate governance is accountability because it helps protect the wealth of the shareholders and the rights of the stakeholders. Sherer & Turley (1997) pointed out that the most significant elements of corporate governance were ensuring the proper implementation of accountability and overseeing the company executive management. Millstein (1998) pointed out that the corporate governance simply aims to ensure that the managers are accountable to the board of directors and directors are accountable to the shareholders. He also argued that having the managers and the directors accountable for corporate assets leads to improved corporate performance.

Accountability, in the context of financial reporting, is defined as "the responsibility to provide information to enable users to make informed judgments about the performance, financial position, financing and investing, and compliance of the reporting entity" (Statement of Accounting Concepts, SAC 2.5, 2012). Gay & Simnett (2010) pointed out that accountability refers to the responsibilities of the governing body of the company to be held accountable for reporting, and is subject to an examination according to an accountability system that involves both internal and external parties.

Wild (1994) argued that the audit committees are the most effective pillar of corporate governance, overseeing accountability and reducing fraud, error and the risk surrounding the

financial reporting. Wild (1994) examined and reviewed data from 260 companies in the U.S.A., both before and after the establishment of an audit committee. That data covered the period from 1966 to 1980, and was analyzed to establish empirical evidence about the relationship between accounting earnings and audit committees. The results showed that the formation of audit committees has significantly made the earnings more informative to users of financial statements and reports. The study attributed that to the vital role of the audit committee in overseeing the quality of the management accountability to the shareholders.

Porter (2009) reviewed the corporate governance accountability literature, pointing out that accountability was demanded, due to giant corporate collapses, to counter any possible abuse of executives' powers and to produce reliable and informative financial statements that were free of error and fraud. Porter stressed on the importance of the tripartite or "trinity" audit function (external auditors, internal auditors and audit committees) in maintaining the integrity of corporate accountability, and argued that the audit trinity members have interlocking and mutually supportive functions. Porter also added that, in addition to the vital roles of the audit trinity in securing the integrity of the financial reporting, audit committees should have the power and responsibility to ask probing questions of executives and employees, and should possess a high degree of skepticism in order not to be easily satisfied with any reply.

Corporate governance systems characterized as having a poor accountability system impair internal and external auditors' ability to do their jobs effectively and with due professional care which, in turn, affects the integrity of the financial reporting system. In Jordan, Qadamani (2007) criticized the accountability of corporate governance systems, and pointed out that some of the large controlling investors, especially those who hold both positions on the board of directors and are executive managers, believe that they own the assets of the entity regardless of the interest of the minority shareholders, and feel that they are not accountable. The former controller of the Companies Control Directorate in Jordan, Khaza'alah (2001), pointed out that, due to the lack of accountability, external auditors did not accomplish their tasks as agents of shareholders, and were mainly tasked with preparing the financial statements from the ending balances as per the trial balance while external auditors were

supposed to assess their client's risk, the efficiency of their internal control, and perform preliminary analytical procedures. Khaza'alah also attributed this situation to the unbalanced (low) audit fees compared to the external auditors' legal responsibilities. Furthermore, weak accountability in Jordan brought about demands for implementing strict punishments against external auditors who violate the code of the auditing profession (Matar, 1994).

Abdullatif (2003) has interviewed Jordanian lawyers and revealed that the weak accountability system, insufficient legal responsibilities and the low probability of punishment falling on corporate governance constituents in Jordan, have led some external auditors to cooperate with dishonest managers at client companies to keep their jobs as auditors. He also added that in the case of Jordan, where the owner/manager was a dominant characteristic among companies (i.e there was no separation between the positions of owners and management), the likelihood of malpractice and theft of company assets was high. This duality of positions (owner/manager) in Jordan was also criticized by Al-Hasani (1999), Saadah (1993), and Al-Jazy (2005), all of whom criticized relevant laws and demanded reform of corporate accountability to separate management of listed companies from their owners. They also argued that the separation enhances the external auditor's independence and performance when the appointers of the auditor are different from the company executive management.

Abed et al (2012) investigated, over the period 2006-2009, the impact of Jordanian corporate governance characteristics on management's ability to manipulate financial reporting and income. The study revealed that Jordanian listed companies' compliance with the corporate governance code was poor due to insufficient accountability and penalties. The authors also related this to the fact that the JCGC became operational in 2009 on a comply or explain basis. The study recommended Jordanian policy makers encourage compliance with the codes in order to control the opportunistic behavior of boards of directors and management regarding manipulation of financial statements, such compliance thereby enhancing the reliability of the financial reporting system.

Compliance with the JCGC might be enhanced by mandating the external auditors to report, within the audit report, the entity's compliance with the JCGC, as suggested by Al-Hanini & Dahmash (2008) and Al-Khadash, et al, (2012). In the UK, Porter (2009) pointed out that, under the United Kingdom Listing requirements, the external auditors report about the publicly traded companies' compliance with the accountability provisions of the UK corporate governance codes.

The JCGC (Chapter 2, Item 5) has prohibited duality of the roles CEO and chairman. This segregation of duties aims clarify the responsibility and accountability of the company board and management. The JCGC stipulated the role of the audit committee in making recommendations on the selection of the internal and external auditor and securing the independence of the latter. The audit committees also have the responsibility to evaluate the internal control and auditing procedures. The JCGC stated that the external auditors have the responsibility to audit the company's accounts according to the ISAs and to answer any queries and questions raised by the shareholder during the assembly meetings. In addition, the auditor has the responsibility to inform the authorities concerning any violation of the legislation in force and regulations, or any administrative or financial matters that affect the company's financial position negatively (Corporate Governance Codes in Jordan, 2009, Chapter Five, Section 4).

In regard to corporate governance bodies' legal liabilities toward the laws, the JCGC (Chapter 2, Item 12) stated that members of the boards, the company executive management and the external auditors are legally accountable to notify the supervisory authorities if:

- The board of directors or the general manager exploits their powers for their personal benefit.
- The board of directors or the general manager performs any act that implies fraud, embezzlement, bribery or betrayal of confidence that influences the shareholders and the stakeholder's rights.

- If the entity suffers severe financial or administrative deficiencies, or if the company suffers massive losses that might impact shareholders' and/or stakeholders rights.

The JCGC (Chapter 2, Section 1, Items: 13, 14, 17) also stipulated the responsibility of the board of directors to oversee and evaluate the performance of company management, and to annually review their implementation of the codes of corporate governance. The board also has the responsibility to establish a mechanism to receive complaints and recommendations from the shareholders.

In regard to the shareholders' rights, the JCGC has devoted a chapter to the discussion of their rights. In an effort to give shareholders the power to hold company management and the board of directors accountable for their actions and decisions, the JCGC (Chapter 4, Section 1, Items 8 & 9) stated that the shareholders have the right to file a lawsuit against the company management and directors. The JCGC added that shareholders can further claim for compensation for damages or losses incurred as a result of revealing the company's secrets, confidentiality, and breaches of the legislation in force or of the company's bylaw, or any fraud or negligence in managing the company.

Interestingly, the JCGC has not identified the legal responsibilities of the external auditors, although they were stipulated in the Company's Law of 1997 (Articles 201, 202 and 203). The law stated that the auditors are legally accountable toward the company, the shareholders and the stakeholders for any violation of the legislation in force, the company bylaws and the internationally accepted (adopted) accounting and auditing standards. The auditors are also liable to compensate any realized loss incurred as a result of negligence and errors committed by the auditors, or as a result of their failure to fulfill their duties, or as a result of expressing opinions about the financial statements that significantly do not confirm with real facts, or for approving disordered financial statements. Furthermore, the law also stipulated penalties if the auditors disclose client company secrets or speculate in the company's shares.

In summary, this section, reviewed the literature of corporate accountability and their impact on the reliability of the audit report and the level of the audit expectation gap as perceived by financial analysts. The section reviewed corporate failure and the need to adopt effective corporate governance systems in order to protect the capital market. Corporate accountability was considered one of the major constituents of corporate governance, as can be seen in many cited definitions of corporate governance. This study discussed how and why the institutional investors consider, or might be affected by, the extent of corporate accountability and the responsibility of the board of directors, the company management, the external auditors, the internal auditors and the audit committees in formulating their judgment decisions.

3.11 Chapter Summary

Narrowing the audit expectations gap continues to be a key issue of interest to the accounting profession (Dewing & Russell, 2002). The expectation gap is considered one of the major issues confronting the accountancy profession. The expectation gap cannot be ignored as it is a key strategic risk for the audit firms, and claims that the expectations of the community are not objective, or that criticisms directed to the auditing profession are not fair, do not reduce the risk entailed (Jarbou, 2007).

Based on reviewing and analyzing the literature, uncertainty about the external auditor's independence is considered the main reason for the expectations gap in Jordan. The literature showed that an independent and well-established audit committee enhances external auditor's independence and mitigates management pressure to issue a clean opinion, and shield the auditors from being dismissed after issuing a qualified or a going concern opinion.

Insufficient internal control procedures, coupled with weak and unqualified internal auditors, compromise internal controls' effectiveness in detecting fraud and errors and in preventing malpractice. The literature highlighted the importance of the audit committees in nominating

the internal auditors and reinforcing their effectiveness. The effectiveness of internal auditors could be enhanced by giving them direct access to the audit committees. The literature also showed that the audit committee should evaluate the work of auditors, the internal audit budget, and the observations of the internal auditors, and should work as a liaison between the external and internal auditors and between the auditors and the company management and board of directors.

Adequate and timely disclosure of transparent information, in addition to sufficient corporate accountability systems, help direct the work of executive management, board of directors and company employees towards achieving the interests of the company's stakeholders, resulting in enhanced investor confidence in financial reports and, consequently, contributes to narrowing the audit expectation gap.

The next chapter reviews the research methodology employed in the fieldwork for the thesis and outlined in the study model. The chapter also provides a justification for the chosen research strategy and provides a rationale for combining the qualitative and the quantitative methods. The chapter also identifies the population of the study and the utilized data collection techniques and justifies the chosen sample. The chapter also presents the limitations of the study's methodological approach.

Chapter 4: Research Methodology

4.1 Introduction and Chapter Overview

This chapter discusses the study hypothesis and the research questions that are utilized to address the gap in knowledge regarding how the selected elements of the Jordanian corporate governance code affect the auditing profession in Jordan in terms of the reliability of the audit report and the level audit expectation gap as perceived by institutional investors. These elements of the JCGC selected for this study are external auditors' independence, internal auditors' effectiveness, disclosure & transparency, and corporate accountability.

The rationale for the adopted method (the mixed method approach) and the research design are addressed in this chapter. The research design includes a combination of two methodologies that integrate and complement each other to provide a thorough analysis of the research topic. In addition to the design of the methodology, this chapter also describes the unit of analysis, the data collection techniques and the research implementation.

The postpositive approach is adopted in this study. According to Creswell (2003, p. 7) "Postpositivism reflects a deterministic philosophy in which causes probably determine effects and outcomes. Thus, the problems studied by postpositivists reflect a need to examine causes that influence outcomes such as issues examined in experiments".

4.2 Research Method

This section discusses the prevailing methods used in prior studies of corporate governance and the auditing profession in Jordan, in relation to the external auditor's report and the level of the audit expectation gap. This section also justifies the rationale for the mixed method approach and discusses the strengths of the combination of the experimental and interview methods.

4.2.1 The Related Research Methods Previously Adopted

Cooper & Schindler (2010) point out that good research should establish dependable data, based on professional and systematic processes, and provide reliable information for decision making. According to Veal (2005), there are many points to be taken into consideration while the researcher chooses an appropriate research methodology, such as the research questions or the study hypothesis, previous research and data availability. Veal (2005) point out that the research questions guide the researchers to the data sources, and previous research might provide the researcher with methods to be adopted, improved or replicated to achieve comparability between the new and prior research.

This thesis adopted the mixed method approach to achieve the study objectives. This approach involves integration of qualitative and quantitative data collection and analysis. The quantitative element was designed to investigate, through experiment, the relative and interactive weights of the influence of selected elements of the Jordanian corporate governance on (1) the perceived reliability of the audit report and (2) the level of the audit expectation gap as perceived by financial analysts. This thesis is the first study to adopt an experimental approach (i.e. the repeated measures design) in the field of corporate governance and auditing in Jordan. The design of the questionnaire for the factorial experiment of this thesis was prepared based on many previous research studies that adopted the same method (e.g. Hopkins, 2009; Wood & Ross, 2002).

Quantitative approaches, utilizing financial data or perceptual data, are in common use in Jordan, with quantitative research utilizing perceptual data being dominant, especially in studies related to corporate governance and the auditing profession. In fact, most non-Jordanian studies that have investigated the audit expectation gap utilized questionnaires as an instrument for achieving their study objectives (McEnroe & Martens, 2001; Porter, 1993; García Benau, Humphrey Moizer, & Turley 1993; Gloeck & Jager, 1993; Humphrey et al, 1993; Al Husaini, 2000).

The mixed method approach is rarely used in Jordan. This approach is more frequently adopted in academic PhD theses rather than other types of applied research³⁴. The researcher noted that none of the previous Jordanian studies discussed earlier (in Chapter One and Three) adopted the experimental approach, although the use of experimental studies delivers great value by identifying causal correlations among the variables, according to Black (1986) who also added “experimental studies in economics and finance have value” (p. 537). Hence, the use of the experiment approach is common and is recommended for use in developed countries (Black, 1986; Baker & Nofsinger, 2002; Trotman, 1996). Table 1 shows a list of some of the key related Jordanian studies in the fields of corporate governance and the auditing profession³⁵, with a brief description of the methodology adopted in each case.

Table 1: Jordanian Corporate Governance and Auditing Profession Studies, Highlighting the Methodology Adopted.

	Research Title/ Author(s) & Year of Publication³⁶	Brief description of the method
1	Developing a System for Corporate Governance in Jordanian Stock Corporations to Reinforce the Independence of the Auditor/ Al-Hanini & Dahmash (2008)	Mixed method: Questionnaires administered to external auditors, and interviews conducted with external auditors
2	A Proposed Model for the Role of Audit Committees in the Jordanian Public Shareholding Companies, and their Influence on the	Mixed method: Questionnaires and interviews conducted with Financial managers, external auditors, internal

³⁴ The first two studies in table 1 are Ph.D. theses.

³⁵ All of these studies have been reviewed in chapters One and Three.

³⁶ Full citation is presented in the References Section

	Effectiveness and Independence of External Audit/ Swaiti (2006)	auditors, chairpersons of the board of directors and audit committees.
3	The Effect of ISA 700 (Revised) "The Independent Auditor's Report on Narrowing the Audit Expectations Gap./ (Al-Khadash, et al, 2012).	Quantitative: Questionnaires distributed to auditors, preparers of financial statements, investors and academicians.
4	The Effectiveness of Audit Committees in Jordanian Public Shareholding Companies and Potential Characteristics Affecting It: Perceptions from Auditors in Jordan/ Abdullatif (2006)	Quantitative: Questionnaires distributed to the external auditors
5	Structure and Causes of the Audit Expectations Gap: Evidence From Jordan/ Al- Thuneibat (2003)	Quantitative: Questionnaires distributed to external auditors and executive and financial managers of Jordanian listed companies
6	Expectations gap and the responsibilities of auditors: Jordanian Investors' perspective/ Hajir (2001)	Quantitative: Questionnaires distributed to individual and institutional investors.
7	The Effect of Modified Auditors Opinions on Shares Prices: Evidence from Amman Stock Exchange/ Zureigat (2010)	Event Study: based on the data available for the Jordanian listed companies at ASE during the period from 2002 to 2007
8	Accounting Information Qualitative Characteristics Gap: Evidence from Jordan/ Obaidat (2007)	Quantitative: Questionnaires administered to a sample of external auditors and investors.
9	Audit Committees' Responsibilities and Their Relevance to the Corporate Governance Process/ Abdullatif (2007)	Quantitative: Questionnaires administered to a sample of external auditors
10	Assessment of Corporate Governance in Jordan: An Empirical Study/ Shanikat & Abbadi (2011)	<i>Qualitative</i> : 20 Interviews carried out with key employees of 10 listed companies
11	The expectation gap between investors and auditors in Jordan/ Omari (2003)	Quantitative: Questionnaires distributed to investors (individual investors, financial brokers, employees of banks' investment units) and external auditors
12	The Capability of Sarbanes-Oxley Act in Enhancing the Independence of the Jordanian Certified Public Accountant and its Impact on Reducing the Audit Expectation Gap "An Empirical Investigation from the Perspectives of Auditors and Institutional Investors/ Al-Khadash & Al-Sartawi (2010)	Quantitative: Questionnaires were used to collect data from Jordanian Institutional Investors and external auditors
13	Factors that Affect Decisions on Selecting and Changing Public Accountants in the Jordanian Public Companies from the Perspective of the Audit Committees/ Al-Saudi (2007)	Quantitative : Questionnaires administered to chairpersons and members of audit committees in Jordan

14	External Auditors' Assessment of the Internal Audit Function in the Light of Implementation of the International Standard on Auditing No. (610): Analytical Study from the Point of View of the External and Internal Auditors in Jordan/ Thnaibat & Shunnaq (2010)	Quantitative: Questionnaires distributed to samples of external and internal auditors
15	The Effect of Corporate Governance Guide Issued by the Central Bank of Jordan in Improving Internal Audit Quality in Jordanian Banks/ Zureigat (2011)	Quantitative: Questionnaires distributed to internal audit staff in Jordanian banks.

One of the major advantages of qualitative studies is that they provide a high level of understanding, but, at the same time, they lack empirical robustness, which consequently affects their generalizability and makes them questionable (Bryman, 1988). Quantitative methods offer stronger statistical evidence than qualitative methods do. However, quantitative studies that aim to capture attitudes (usually via survey instruments such as self-administered questionnaires) are subject to criticism regarding their objectivity, as they tend to be self-completed, and usually suffer from low return rates (Buglear, 2012; Cohen & Manion, 2007; Mitchell & Jolley, 2012). On the other hand, quantitative research that depend on publicly available data (such as corporate annual reports and data available on stock exchange sites) enjoy an advantage in objectivity.

The studies mentioned in Table 1 provided evidence about the existence and the nature of the audit expectation gap in Jordan, including suggestions on how to narrow the gap; they also explained the situation of corporate governance in the Jordanian environment. However, there are several points, inherent in their structure, that possibly limited their added value, such as they were mostly quantitative and questionnaire-driven studies with much focus on external auditors' independence and performance. This might lead researchers to miss or ignore some other factors given their focus on testing their study hypothesis rather than producing new theories (Johnson & Christensen, 2010). Whilst such studies can identify assumed relationships, they cannot show the direction of the relationship nor their relative Importance to the variables being studied.

As mentioned earlier, the JCGC has been implemented relatively recently in Jordan, becoming operational at the beginning of 2009. However, the Jordanian Securities Commission has mandated all listed companies to report, in a separate chapter of their 2010 Annual Reports, the extent of their compliance with the code³⁷. Due to the recentness of the implementation of the JCGC, publicly available data about the corporate governance of listed companies is still rare. Therefore, in order to answer the research questions of the study, which aimed to provide empirical evidence of the impact of the selected factors of JCGC and their potential interactive weights on both the perceived reliability of the audit report and the level of the audit expectation gap in Jordan, this thesis adopted the mixed method.

4.2.2 The Rationale for the Mixed Methods Approach

The research questions and objectives, set out in sections 1.4.1 and 1.4.2 respectively, are best addressed by adopting a mixed-method approach. This approach proffers a mix of contextual interpretive relevance and generalizability, in addition to providing deeper perceptions, closer insights and greater diversity of viewpoints than any single method alone (Borkan, 2004). Johnson & Onwuegbuzie (2004) defined mixed methods research as "the class of research where the researcher mixes or combines quantitative and qualitative research techniques, methods, approaches, concepts or language into a single study" (p. 17). The Authors also added "A key feature of mixed methods research is its methodological pluralism or eclecticism, which frequently results in superior research" (p. 14). Therefore, the adoption of the mixed method has become common in business research (Collis & Hussey, 2003).

³⁷ See Circular Number: 12/1/4659. Dated December 15, 2010. Issued by Jordanian Securities Commission. Available on: http://www.jsc.gov.jo/Public/english.aspx?site_id=1&Lang=3&Page_Id=2550&Menu_ID2=257

To conduct a mixed method study, several combinations of quantitative and qualitative techniques might be used. Smith (2003) suggested four general types of quantitative approaches for use in mixed methods: Experimental Method, Quasi-Experimental Method, Survey Method and Archival Method. Mason (1996) pointed out that qualitative studies are of three main types: Case Studies, Ethnographic Studies and Phenomenological Studies. The mixed method produces better, higher quality findings if it is conducted appropriately; this means selecting the best combination of qualitative and quantitative techniques and choosing the appropriate sequence that best achieves study objectives (Hurmerinta-Peltomäki & Nummela, 2006; Bryman, 1992; Bryman, 2006; Bryman & Bell, 2007; Creswell, 2009; Onwuegbuzie & Leech, 2005; Collins, Onwuegbuzie, & Sutton 2006). Combining experimental research design with a qualitative method delivers better understanding of the research problem (Burns, 2000).

There have been, during the 1970s and 1980s, arguments about the usefulness of using a mix of quantitative and qualitative techniques in a single study. However, the adoption of mixed methods is now commonplace and widely accepted by academicians and professionals alike (Torrance, 2012; Creswell, 2010; Tashakkori & Teddlie, 2003; Johnson et al, 2007; Clark & Creswell, 2007; Teddlie & Tashakkori, 2009; Bryman, 2006; Sale, Lohfeld, & Brazil 2002; Johnson & Onwuegbuzie, 2004). In the health care and clinical fields, it is common to conduct research that combines both qualitative and quantitative approaches to improve generalizability, reliability, validity and accuracy (Morgan, 2007; Borkan, 2004; Johnstone, 2004; Andrew & Halcomb, 2009). It is noteworthy to mention that some scholars classified the mixed method as a third paradigm in research (Cameron, 2011; Creswell, 2009; Howe, 1988; Datta, 1994; Johnson & Onwuegbuzie, 2004). Scholars also pointed out that the adoption of the mixed method approach delivers potential complementarities for qualitative and quantitative research (Luyt, 2012; Yauch & Steudel, 2003; Bryman, 2006; Bryman, 2008; Sale et al, 2002).

Reichardt & Cook (1979, p. 225) remarked that there existed no convincing reasons not to use the mixed method, after appropriately considering how to best use it to achieve the research objectives. Moreover, they suggested that there was no essential conflict in world view or

outcomes generated from the various components of the mixed method (Datta, 1994; Johnson & Onwuegbuzie, 2004).

The quantitative part of this thesis delivers objective evidence and verification of the magnitude of influences and the relative weights of selected JCGC variables on the perceived reliability of the audit report and the level of the audit expectation gap. The qualitative part of this study lends additional depth of understanding of the judgment process. In this regard, this thesis adopts the recommendations of Reichardt & Cook (1979): “comprehensive evaluations should be process-oriented as well as outcome oriented, exploratory as well as confirmatory and valid as well as reliable” (p. 225). The use of the mixed method enhances the construct validity of the study findings since it enables discovery of (1) the level of confidence in the operational definitions of variables, (2) whether the relationships between the study variables logically reflect the true theoretical meaning of a phenomenon under investigation and (3) the extent to which the variables were actually measured (Zachary, McKenny, Short, & Payne 2011; Shadish et al, 2002; Keats, 1988; Wenger, 1999; Ariño, 2002).

The adoption of the mixed method delivers many advantages, such as triangulation, complementarity, and expansion, as outlined by Greene, Caracelli, & Graham (1989). Triangulation refers to combining qualitative and quantitative research to get mutually corroborated conclusions and to demonstrate convergence (Bryman, 2006; Bryman, 2008; Greene et al, 1989; Yin, 2009). Complementarity research utilizes quantitative and qualitative methods to deliver, and support, robustness, clarification, enhancement, and interpretation of the findings of the adopted methods (DeCuir–Gunby, 2008; Brannen, 1992; Wenger, 1999; Yin, 2009). Expansion is to use various approaches in order to “extend the breadth and range of the study” (Greene et al, 1989, p. 259).

4.2.3 Judgment and Decision Making

External auditors play a significant role, via their audit reports, in lending independent integrity to published financial statements, which are essential inputs in investment decisions made by financial analysts, shareholders, creditors and other stakeholders. However, investment decision-making is in the hands of individual human beings, which make them subject to their biases, partiality and prejudices (Statman, 2005). This thesis investigates the perceptions of financial analysts regarding the impact of the JCGC on the value of audit opinion, as measured by the reliability of the audit report and the size of the audit expectation gap; those financial analysts are also subject to normal biases and idiosyncratic errors in their judgments (Hunter & Coggin, 1988).

Several authors have studied the importance of human information processing research in relation to the field of accounting and auditing (Libby & Lewis, 1982; Trotman, 1996; Maletta & Kida, Cohen & Paquette 1990; Hooper & Trotman, 1996; Solomon & Trotman, 2003) and the field of behavioral finance, which adopted techniques from the psychology literature (Snowball, 1986; Kahneman, 2011; Andersen, 2008; Fama, 1998). In the context of financial decisions, human information processing and judgments are categorized as a field of study under behavioral finance as described by Pike & Neale (2006): "the study of how psychological and sociological factors influence financial decision making and financial markets" (p. 665). Al-Khafaji, Aly, Gheyara, & Metawae (1993) provided a broader definition, arguing that, under conditions of uncertainty, decision makers need to use the ability to interpret information to reveal more information. When decision makers do not have direct access to information about a given event, they may need to interpret indirect signals or cues. These information cues could arrive simultaneously or over time and may, therefore, be missed since the decision maker may not be expecting them or may be unable to separate them from other cues.

Payne (1982) argued that decision making is connected to information processing. He also pointed that individuals consider common characteristics when considering similarities, and distinguishing characteristics when considering different options of choices (See also Slovic &

MacPhillamy, 1974; Einhorn & Hogarth, 1981). Libby (1981) stated that causal data is thought to be more sufficient and has more influence on decision makers than diagnostic data does.

Financial analysts appreciate the added value that external auditors integrate into financial statements; that added value depends on the corporate governance system and is believed to be influenced by many factors, such as external auditors' independence, internal auditors' effectiveness, disclosure & transparency, and corporate accountability, as outlined in the previous chapter. Financial analysts consider these factors in formulating their judgments, based upon multiple cues. They might assess that these cues interact in their influence (configurally) or impact independently (main effects). Information Processing & Judgment Decisions are discussed in the following section, followed by a review of the literature relevant to main effects and configularity, self-insight and decision confidence.

4.2.3.1 Information Processing & Judgment Decisions

When Individuals consider their judgment decisions, as human beings, they are subject to several factors that may lend potential bias into their decisions (For examples of potential influential factors see Hilbert, 2012; Merkle, 2009; Pronin, 2007; Tversky & Koehler, 1994; Kahneman & Tversky, 1972). During the 1970s, Kahneman & Tversky affirmed the importance of the following influential factors: the representativeness heuristic, the availability heuristic, and the anchoring and adjustment heuristic.

Kahneman & Tversky (1972) pointed out that the representativeness heuristic emerges when factor (A), for example, resembles another factor, (B), and so may lead to systematic biases. Kahneman (2011) added "when 'A' is highly representative of 'B', the probability that 'A' originates from 'B' is judged to be high. On the other hand, if 'A' is not similar to 'B', the probability that 'A' originates from 'B' is judged to be low" (p. 420). In other words, the

representativeness heuristic is likely to occur when incidents are described by their general characteristics.

The availability heuristic refers to the assessment, by individuals, of the probability of an event by the ease with which relevant, frequent or recent events come to their mind. Steginga, Occhipinti, Gardiner, Yaxley, & Heathcote (2002) added "when a judgment or a decision is mediated through an instance that comes easily to mind, [it] may refer to an event with a positive or a negative outcome" (p. 6). According to Kahneman (2011), "availability is affected by factors other than frequency and probability. Consequently, the reliance on availability leads to predictable biases" (p. 425).

The anchoring and adjustment heuristic emerges, for instance, when individuals underweight new information when adjusting past overweighting of another event or initial value (Libby, 1981). According to Kahneman (2011), "the initial value, or starting point may, be suggested by the formulation of the problem, or it may be the result of a partial computation . . . different starting points yield different estimates, which are biased toward the initial values" (p. 427).

In the accounting and auditing arena, judgment decision making has been employed in experiments (Solomon & Trotman, 2003; Schultz, Bierstaker, & O'Donnell 2010; Martinov-Bennie, Cohen & Simnett 2011; Ng & Tan, 2003; Trotman, 1996), and it has been influenced by psychological research as noted by Gibbins & Swieringa (1995). The experimental design is primarily based on statistical methods to measure treatment usage, and the ANOVA technique is the most widely used statistical analysis employed in judgment decision making (Solomon & Shields, 1995).

The experimental research undertaken in this thesis involved presenting participants with a series of different treatments of independent variables (the four selected elements of the JCGC). In each treatment, participants' judgment decisions regarding the value of the dependent variables (the perceived reliability of the audit report and the level of the audit expectation gap) are analyzed in order to establish relationships with combinations of cues or

even with a particular cue. Cues must be balanced in their quality and quantity; because a mix of less and more functional cues limits their performance (Libby, 1981).

Human information processing is influenced by individual experience, age and time pressure. Individuals with less experience usually evaluate information based on how they were presented to them (the organization of the information), whereas more experienced people usually look for additional, and specific details within the, information (Bouwman et al, 1987). Taylor (1975) related age with longer decision making processes, seeking more information combined with an ability to evaluate this information. Time pressures mitigates efficiency in human information processing as individuals are more risk averse when they feel that they are under time pressure (Wright, 1974; Ben Zur & Breznitz, 1981). Finally, personality characteristics have not been seen to have a significant impact on human information processing (McGhee, Shields, & Birnberg 1978).

4.2.3.2 Main Effects, Linearity and Configurality

Brown & Solomon (1989) defined configural information processing as "cognition in which the pattern of stimuli is important to the subsequent judgment/decision" (p. 2). Judgment decision studies aim to investigate the impact of key cues and treatments on judgment decision making and whether they contribute to the findings of the study independently (main effects) or in combination with other effects (configurality). Ganzach (1997) pointed out that in configural relationships, "the impact (weight) of a given attribute depends on the level of other attributes" (p. 954).

In a linear model of judgment decision making, the relationship between cues and the dependent variables is consistent (monotonic relationship) regardless of the level of other cues; hence, the linear model delivers a good fit for some purposes of decision making (Einhorn, 1970; Libby, 1981). Libby (1981) has also pointed out that a positive relationship occurs when

the increase in one variable leads to an increase in the size effect of another variable and vice versa.

Configural cue processing is influenced by a number of factors, as evidenced by Ganzach (1997), Libby, Artman, & Willingham (1985), Payne (1982), Maletta & Kida (1993) and McGhee et al (1978). Firstly, experienced individuals are more configural in their judgments than less experienced individuals are. Secondly, judgment tasks are associated with less dimensional processing than choice tasks. Thirdly, individuals tend to shift from sophisticated tasks to simplified heuristic methods. Fourthly, environmental risk leads to the use of systematic and sophisticated configural decision processing.

4.2.3.3 Self-Insight & Decision Confidence

Self-insight refers to “an individual’s ability to express the relative emphasis he or she places on information cues when generating judgments” (Mear & Firth, 1987, p. 176). Self-insight is also defined as the extent of insight that individuals have in their judgment process (Trotman, 1996). Typically, the degree of self-insight has “been assessed as the correlation, over all cues, between a subject's cue usage and the importance rating subjectively attached to each cue (e.g. by allocating 100 points among the cues)” (Solomon & Shields, 1995, p. 151). In this study, self-insight is investigated by correlating and matching the objective outcomes obtained from cue usage (the 16 scenarios of the factorial experimental questionnaire) against the subjective weightings which have also been gathered from the participants via the same instrument. It is important to perceive the level of self-insight because that helps improve understanding of the learning process (Libby, 1981) and improve the accuracy of judgment as noted by Hooper & Trotman (1996).

Ganzach (1997) pointed out that experienced individuals do not, necessarily, demonstrate more accurate decisions than inexperienced individuals, although they are expected to demonstrate

a higher degree of self-insight (Feldman & Arnold, 1978). Large amounts of information do not guarantee greater accuracy (Slovic, 1972; Goldberg, 1968). The greatest increase in accuracy comes from obtaining data from two additional judges; any further increases in the number of judges contribute relatively little to accuracy (Libby & Blashfield, 1978). Hooper & Trotman (1996) showed that consensus between auditors who processed information configurally was higher than among auditors who did not process configurally. Consensus is often accepted as a reasonable and equitable replacement for accuracy (Libby, 1981; Ashton, 1985) which leads to establish an association between configural processing and improved performance since configural processing of cues decreases inconsistencies in decision making (Hooper & Trotman, 1996).

4.2.4 Experimental Method and Analysis

This study adopted the mixed method approach whereby an experimental design was employed in the quantitative part of this research. Kerlinger (1986) defined the experiment in research as: “a scientific investigation in which an investigator manipulates and controls one or more independent variables and observes the dependent variable or variables for variation concomitant to the manipulation of the independent variables” (p. 293). Systematic experimental design was employed in this thesis in order to present judgment tasks and to infer cause-effect relationships (Libby, 1981; Keppel & Wickens, 2004). “Experimental studies allow causal relationships to be identified. The aim is to manipulate the independent variable (e.g. a reduction in price) in order to observe the effect on the dependent variable (e.g. sales levels of Sunday newspaper)” (Wilson, 2010, p. 110). Analysis of variance (ANOVA) is utilized in the current study. Slovic (1969) pointed out that ANOVA delivers improved quantitative understanding of configural effects (of interactively combined factors) and non-configural effects (independent main effects of the factors) in the use of information in judgments.

A brief historical review of the use of ANOVA techniques shows that it has been applied since the 1960s, initially in the medical arena (Hoffman, Slovic, & Rorer 1968). Its application in finance was introduced by Slovic (1969) who pointed out "The ANOVA technique has considerable promise as a device for describing and furthering the understanding of complex judgment processes. It is likely that this technique can provide even the expert with new insight into his inferential processes" (p. 262). Slovic (1969) concluded his study saying "It is now clear that substantial configural processing of information does occur and can readily be detected by the ANOVA technique" (p. 263). Since then, ANOVA became common in the field of investigating auditors' judgment decisions (e.g. Schneider, 2011; Teoh & Lim, 1996; Hooper & Trotman, 1996; Daniels & Booker, 2011; Trotman, 2005). Trotman (2005) argued that ANOVA has become the most commonly adopted technique in most prestigious research journals.

In this thesis, analysis of variance was used to measure the impact of the selected JCGC factors on the reliability of the audit report and the level of the audit expectation gap. ANOVA is an appropriate statistical technique for experimental studies that aim to investigate both main effects and interactions between the study factors. "ANOVA tests are based on the partitioning of the variability in the dependent variable. Components of variability associated with the main effects of the factors and the joint effects of combinations of factors are obtained and compared with the component that reflects error variability" (Myers & Well, 1995, p. 6). The use of ANOVA has some advantages such as the elimination of multicollinearity which makes the interpretation of the main and interactive effect clear without ambiguity, furthermore, the demonstration of the relative weights of the significance of the cues is also considered one of the important advantages of ANOVA (Libby, 1981; Trotman, 1996).

Slovic et al (1972) stated "the ANOVA technique is important because, by isolating the effects of interactions from those of main effects, it makes the empirical description of configural judgments feasible" (p. 290). They also added that two conditions have to be satisfied to conduct ANOVA analysis: (1) The levels of the variables should be categorical, i.e. not continuous; this condition can be met by designing a suitable survey instrument; (2) The

variables must be orthogonal; this can be satisfied by using a complete factorial design in which all possible combinations of the cues and variable levels are presented (Trotman, 1996).

In this study, the reliability of the audit report and the level of the audit expectation gap were investigated as dependent variables, and an initial Multivariate analysis of variance (MANOVA) test was used to test the significance of the study independent variables as a set. Using MANOVA helps reduce type one statistical errors when individual tests of ANOVA are measured with the same significance level (Coolican, 2009). Coolican (2009) also added "If MANOVA is significant it is legitimate to investigate further and take as significant any of the individual (univariate) ANOVA results which the MANOVA procedure has shown to be significant" (p. 494).

Within-subject design, also called "repeated measures design" (Myers & Well, 2002, p. 210; Mitchell & Jolley, 2012, p. 560; Coolican, 2009, p. 69) is the technique employed for the experiment of this study. Coolican (2009) also pointed out that the technique investigates the differences within each subject or participant. Within-subject designs have been described as a "true experiment" (Heppner, Wampold, & Kivlighan 2008, p. 172). "The true experiment is the only research method that allows the researcher to confidently conclude that A caused B" (Trotman, 1996, p. 7) due to the random allocation of treatments combined with the manipulation of the study independent variables. This technique is widely employed for judgment decision-making studies and in analyzing problems associated with the use of cues (Libby et al, 1985; Trotman, 1996).

Repeated measures design does not just make comparisons between the subjects; it compares each subject's score and assessment using a specific condition with the same subject's assessment using another (different) condition. The advantage of the repeated measures design is that the subjects involved in the study are used as their own controls (Gay & Diehl, 1992; Cox & Reid, 2000; Ryan, 2011; Weathington et al, 2010) which helps in controlling confounding factors (Coolican, 2009; Trotman, 1996) and, consequently, detecting any systematic differences between the treatment conditions, if they appear, therefore increasing the power of the design (Keppel & Wickens, 2004; Heppner et al, 2008). However, allocating

the treatments randomly also allows for the control of systematic differences between subjects.

Like all research designs, the within-subject design has some disadvantages to go with its advantages. The major drawbacks related to the application of repeated measures design are the treatment carryover effects and practice effects (Keppel & Wickens, 2004; Mitchell & Jolly, 1992; Trotman, 1996). Treatment carryover effects have been described as "the effects or side effects of an earlier treatment on responses in later trials" (Mitchell & Jolly, 1992, p. 301). The practice effects refer to the subjects' capability to adjust their perceptions of specific scenarios when they feel that they are being presented, and restricted to, a series of similar scenarios. However, both of these disadvantages are addressed in this study by utilizing a fully crossed, 2 level, factorial experimental design, based on the repeated measures technique, to test the impact of the selected four factors of the JCGC. One of four different patterns of the factorial questionnaire was presented to each subject, these patterns differing only in the order of cases, the order being selected randomly.

"Experimental design is an area of enquiry wholly devoted to the removal of the irrelevant sources of variability for the increase of precision and, therefore, for the increase of the statistical power of tests of null hypotheses" (Cohen, 1988, p. 8). In repeated measures design, all possible levels of treatments are presented to each participant, thus leading Boniface (1995) to say it was "in general a more powerful design than the independent group design" (P. 9).

Keppel (1982, p. 58) stated "A quantitative index of the sensitivity of an experiment is its power". Coolican (2009, p. 342) said "The power of any particular statistical test is the probability of detecting the effect, if it is there, and of not making type II error. It is, therefore, the value $1 - \beta$ ". Coolican (2009, p. 340) explained "Type II error occurs when the alternative hypothesis is true but we actually get a result that would be quite likely under the null hypothesis".

Levels of power are acceptable if they are higher than 0.8, according to Cohen (1988) and Coolican (2009). They have also classified a level of power higher than 0.8 as a gold standard for power.

"Sample size is indeed important-virtually any desired level of power can be attained in any design simply by making the samples large enough. . . For the range in which most treatment effect sizes fall, the sample size needed to attain high power of level is often much larger than what is customary, or perhaps even possible, under most circumstances of research" (Lipsey, 1989, p. 137). Sample size might be increased to reach a desired high level of power, but doing so is "generally costly and time-consuming to the researcher" (Leong & Austin, 2005, p. 307). Coolican (2009) pointed out that in experimental studies, a sample size of 25 - 30 participants is a "good idea" (p. 393). Burns (2000), Weathington et al (2010) and Trotman (1996) considered the requirement of fewer subjects in within-subjects experimental studies as one of its practical advantages³⁸.

Within subject designs rely on the assumption of sphericity. Sphericity refers to the "condition where there is homogeneity of variance among treatment variables and the variances of their differences are also similar" (Coolican, 2009, p. 539). Violating the sphericity assumption raises the likelihood of making type II error and "missing real effects" (Coolican, 2009, p. 523).

Statistically, power is measured by the effect of size. Leong & Austin (2005) described the effect of size as "a standardized indication of the impact of the treatment effects" (p. 307). Size effects could be estimated by the use of partial eta squared (η^2) as suggested by Coolican (2009, p. 530) and one of the most common method for estimating effect size, where:

³⁸ Referring to 2 experimental studies that have utilized the repeated measures techniques revealed that: out of 72 mailed questionnaires, 42 were returned and analysed (Wood, 2006), and out of 54 mailed questionnaires, 25 were returned and analysed. In this thesis, out of 60 mailed questionnaires, 47 were returned and analysed.

$$\eta^2 = \frac{\text{Sum of Squares effect}}{\text{Sum of Squares effect} + \text{Sum of Squares error}}$$

Coolican (2009) categorized size effects with values between 0.01 and less than 0.06 as “small”, size effects between 0.06 and less than 0.14 as “medium”, and size effects of 0.14 or higher as “large”; this study uses these category definitions to categorize effect sizes.

This thesis also investigated the degree of self-insight among the subjects by "allocating 100 points among the cues" (Solomon & Shields, 1995, p. 151). The scale of 100 points is considered the most common technique to gather subjective data (Cook & Stewart, 1975) due to its simplicity and understandability by the subjects (Wright, 1977), and it has been employed in studies about judgment decision making in finance (Hopkins, 2009; Wood & Ross, 2006; Mear & Firth, 1987). This method generates subjective measures by requesting the participants to allocate 100 points onto the four variables based on their relative importance on their decision-making process. These subjective judgments are matched with the objective judgments obtained from the factorial experimental analysis in order to assess the level of self-insight among the subjects.

In conclusion, the use of experimental design delivered evidence for the study hypothesis H1, and evidence on the impact of relative weights of the selected variables of the JCGC (external auditors' independence, internal auditors' effectiveness, disclosure & transparency, and corporate accountability), as well as the variables' interactions, on the auditing profession in Jordan in respect to the reliability of the audit report and the level of the audit expectation gap

(which addresses research questions 1 & 2) and on the financial analysts' self-insight (addresses research questions 3 & 4).

4.2.5 Use of the Factorial Experiment

“A factorial design is a strong experimental design in which two or more independent variables, at least one of which is manipulated, are simultaneously studied to determine their independent and interactive effects on the dependent variable” (Johnson & Christensen, 2010, p. 306). As stated in Chapter One, the factorial experimentation technique was utilized as the most appropriate approach to answer research questions 1 & 2; these research questions aimed to test the relative importance of the study's independent variables on both the perceived reliability of the audit report and the level of the audit expectation gap in Jordan. This technique also allows the researcher to determine both the interactive and independent effects of the study variables. In the fully-crossed factorial experiment, where the researcher manipulates the factors, all possible combinations of the study variables are tested.

Potential interactive effects are considered significant in this thesis. Interactive effects may suggest that the selected factors of the JCGC may work more effectively and appropriately in certain combination rather than independently.

4.2.6 Interview Method and Analysis

Qualitative methods can generate a great depth of knowledge and cover a wide range of perspectives in judgment decision making (Creswell, 2009; Nykiel, 2007). The qualitative method was described by Bryman (1988) as “an approach to the study of the social world which seeks to describe and analyze the culture and behavior of humans and their groups from the point of view of those being studied” (p. 46). One of the main methods of getting qualitative

data is qualitative interviews, also called in-depth interviews (Johnson & Christensen, 2010). Easterby-Smith, Thorpe, Jackson, & Lowe (2008) pointed out that valuable information could be achieved by conducting in-depth interviews since "this approach aims to discover the views, perceptions and opinions" (p. 142) of participants. Johnson & Christensen (2010) also added that this approach aims to "obtain in-depth information about participants' thoughts, belief, knowledge, reasoning, motivations, and feelings about a topic" (p. 202).

In this study, semi-structured interviews have been conducted to gain a depth of understanding of motives and reasoning from the financial analysts' own perspective, and to help disclose potential data that might not be gained by structured interviews. This approach also allows the participants to elaborate and emphasize specific issues and raise particular themes, and gives the researcher greater flexibility to ask follow-up questions if any interesting points arose from participants' answers (Johnson & Christensen, 2010; Bryman, 1988 & 2006; Fontana & Frey, 2003; Wilson, 2010; Collis & Hussey, 2003 & 2009; Burns, 2000).

The qualitative interviews of this thesis were conducted to obtain a depth of understanding of how financial analysts perceive and assess the influence of elements of the JCGC on the reliability of the audit report and the level of the audit expectation gap. Furthermore, interviewees were requested to provide justification and reasons for their conclusions³⁹.

Typical interviews "last anywhere from 30 minutes to more than one hour" (Johnson & Christensen, 2010, p. 202). Effective in-depth interviews require up to ten participants (Creswell, 1998). In this study, 10 interviews were conducted, their durations ranging from 45 minutes to 67 minutes.

Creswell (1998) pointed out "Undoubtedly, no consensus exists for the analysis of the forms of qualitative data" (p. 140) while Wilson (2010) argued "there is no definitive series of steps applicable to qualitative data analysis" (p. 254). However, Wilson (2010) suggested four steps to overcome any confusion that may arise when dealing with qualitative data analysis; these steps

³⁹ See Appendix 3: The Interview Protocol

start by transcribing the data, followed by a comprehensive reading to code the data and generate themes, followed by interpretation of the outcomes and, finally, writing the report.

This study's interviews were conducted in Jordan. They were audio recorded and transcribed in Arabic. However, key terms were described in both languages (Arabic and its corresponding English term). Prior to carrying out the qualitative analysis, these transcripts were fully read to get a general view of the respondents' opinions and perspectives (Warren & Karner, 2009), then the transcripts were carefully studied, focusing on themes derived from the respondents' views and feedback. These themes were categorized in order to facilitate associating them with the main variables of the study. Additionally, cross-case synthesis was employed, developing "word tables" to display the data gathered from the participants, with focus on each study variable (Yin, 2009, p. 156). Finally, the tables were analyzed to draw conclusions on the differences and similarities in the cross-case patterns in order to probe the extent of variables' effects on the financial analysts' decision making (Yin, 2009 & 2011).

4.2.7 Integrating Experimental and Qualitative Interview Methods

The rationale for the mixed method has been discussed in section 4.2.2. The current section extends this discussion by presenting the benefits of integrating the experimental results with qualitative interviews.

"Experimental studies allow causal relationship to be identified" (Wilson, 2010, p. 303). However, Shadish, Cook & Campbell (2002) go a step further by stating that "Causal inference, even in experiments, is fundamentally qualitative" (p. 6). Hence, integrating experimental technique with qualitative approach enhances the validity of the study.

This thesis investigates a contemporary phenomenon that has financial and economic dimensions. This thesis analyzed the institutional investors' perceptions of the JCGC's impact on

the perceived reliability of the audit report and the level of the audit expectation gap. The JCGC became operational at the beginning of 2009 and, therefore, is still a relatively new factor in the Jordanian environment. The qualitative interview approach adopted in this study focuses on 'how' and 'why' questions to deliver rich insights into the dimensions of this phenomenon and to obtain richer conclusions and enhance the understanding of the experimental study (Yin, 2009). Yin (2009) explained why 'how' and 'why' questions added value, saying "This is because such questions deal with operational links needing to be traced over time rather than mere frequencies or incidence" (p. 9). Furthermore, combining the experiment with the qualitative interview in a single study facilitates the analysis and the interpretation process of the experimental findings since the results of each component complements the other, and the qualitative interview results suggest potential explanations and reasons behind financial analysts' objective judgments (Yin, 2009).

Integrating experimental and qualitative studies increases both internal and external validity. Internal validity concerns satisfying the question: "Do the experimental treatments, in fact, make a difference in the specific experiments under scrutiny or can the differences be ascribed to other factors?" (Burns, 2000, p. 357). In other words, it refers to the validity of whether the influence observed on the study dependent variable(s) was the result of the manipulation and the variation of the study independent variable(s) rather than being caused by other factors (Shadish et al, 2002; Trotman, 1996). Repeated measure designs are associated with strong internal validity (Mitchell & Jolley, 2012; Collis & Hussey, 2003 & 2009; Coolican, 2009).

External validity, generally referred to as generalizability, is concerned with satisfying the question "Given these demonstrable effects, to what populations or settings can they be generalized?" (Burns, 2000, p. 357). Although within-subject designs are described as the most powerful experimental design (Mitchell & Jolley, 2012), experimental studies usually suffer from poor external validity due to the restrictive conditions and controls placed to confirm causal relationships (Shadish et al, 2002). However, integrating the qualitative approach with the experiment approach contributes to enhancing external validity by delivering comprehensive interpretation of the identified relationships (Yin, 2009). Consequently, this

combination improves external validity by lending statistical generalizability, through the experiment, and analytical generalizability, through the qualitative interview (Yin, 2009; Shadish et al, 2002). Moreover, Yin (2009) pointed out that triangulation improves the construct validity of the study. He defined it as “establishing correct operational measures for the concept being studied” (p. 34).

Finally, conducting an interview alone might open a door for criticisms of possible bias given that there are sometimes discrepancies between what people do and what they say, whether the differences are deliberate or unintentional. (Milne & Chan, 1999; Bouwman et al, 1987). That potential criticism could be addressed by reinforcing the qualitative findings with the objective and subjective findings of a well-designed factorial experiment. The experimental survey of this thesis consists of three main parts: Part (A) provides the objective analysis of weightings from the factorial experiment, Part (B) provides a subjective self-insight analysis⁴⁰, and Part (C) is designed to gain some demographic information.

4.3 The Unit of Analysis – Institutional Investors

Investors are one of the main annual report user groups. Investors are considered one of the main parties involved in the audit expectation gap. Most studies conducted regarding the ‘messages’ carried in audit reports and the audit expectation gap have taken into consideration investors’ perceptions and opinions. The in-depth understandings generated by these studies help address the question of how to enhance the message conveyed by the audit report and how to bridge the audit expectation gap (Porter, 1993; Kelly & Mohrweis, 1989; O'Reilly, 2009; Humphrey et al, 1992; Citron et al, 2008;; Al-Khadash & Al-Sartawi, 2010; Zureigat, 2010; Hajir, 2001; Al-Khadash et al, 2012; Omari, 2003)⁴¹

⁴⁰ See Appendix 4: The Factorial Experiment Questionnaire

⁴¹ The latter five studies have been conducted in Jordan

The unit of analysis of this study is the financial analysts whose main job involves reviewing financial statements and accounting reports as part of making investment decisions and recommendations. The study sample was derived from financial analysts who work in investment companies in Jordan. This study surveyed financial analysts from the following types of institutional investors: banks (the investment portfolio department), insurance companies, brokerage houses, investment companies and funds.

4.4 Institutional and individual investors in the context of Jordan.

Two main reasons are behind the choice to use institutional investors, rather than individual investors, as the unit of analysis for this study. The first reason is based on the review of related literature on Jordan, and the second reason is to satisfy the experimental method adopted in this study.

The Jordanian literature reveals the necessity of surveying institutional investors rather than individual investors. Furthermore, Al-Khadash & Al-Sartawi (2010) surveyed institutional investors because of the difficulties of accessing individual investors in Jordan and because institutional investors are qualified, sophisticated and knowledgeable in comparison to individual investors. They argued, furthermore, that institutional investors are highly dependent on financial reports in making investment decisions. Their study revealed that the managers of investing and portfolio departments perceive the important role of the external auditors and rely on auditors' independent opinions. Consistent with that opinion, Abu-Nassar & Al-Thnaibat (2005) surveyed institutional investors because they were seen to be more dependent than the individual investors on the audited financial statements and, due to their financial knowledge and experience, more capable of answering the survey questions. These viewpoints are also consistent with viewpoints of other Jordanian studies (Omari, 2003; Obaidat, 2007).

Another reason for choosing institutional investors, rather than individual investors or any other group, is that not only can they be considered expert judges, but they also influence or control a substantial share of investment decisions and are, therefore, highly influential in Jordanian financial markets (Al-Khadash & Al-Sartawi, 2010). Institutional investors have, for several decades, been playing a significant role in fostering corporate governance best practices as a means of enhancing management performance, long-term value for stakeholders and better return on their investments (Abu-Tapanjeh, 2006). In studying the relationship between ownership structure and audit quality in Jordan, Zureigat (2011b) found that institutional investors in Jordan tend to nominate “high quality auditors” (p. 38). However, the study identified high quality auditors on the basis of the size of the audit firm. That study explained the tendency of institutional investors to hire high quality auditors, typically one of the ‘Big 4’ audit firms, saying that it was in order to increase the credibility of the audited financial statements for the purpose of decision making.

Regarding the second reason for utilizing institutional investors in this study, respondents who understand what is being asked of them in the experiment can give informed responses. Professional groups and practitioners, such as professional accountants, auditors and financial analysts, have been recommended for the conduct of experimental studies (see, for instance, Teoh & Lim, 1996; O'Reilly, 2009). Teoh & Lim (1996) chose professional accountants in their study because they “represent a group of professionally qualified and trained individuals, capable of making informed judgments” about the effect of the independent variables on the external auditors’ independence (p. 239). O'Reilly (2009) argued that expert subjects demonstrate a better understanding of experimental surveys. Financial analysts who work in institutional investment companies were chosen for that study’s experiment due to the sophisticated knowledge and experience they demonstrate as prudent investors, which allows them to answer and analyze the treatments and the different scenarios provided in the factorial experimentation questionnaire quickly and more accurately (O'Reilly, 2009). Therefore, surveying institutional investors obtains informed judgment decisions regarding the impact of the adoption of the Jordanian corporate governance code on their perceptions of the reliability of the audit report and size of the expectations gap.

4.5 Research Implementation Strategy

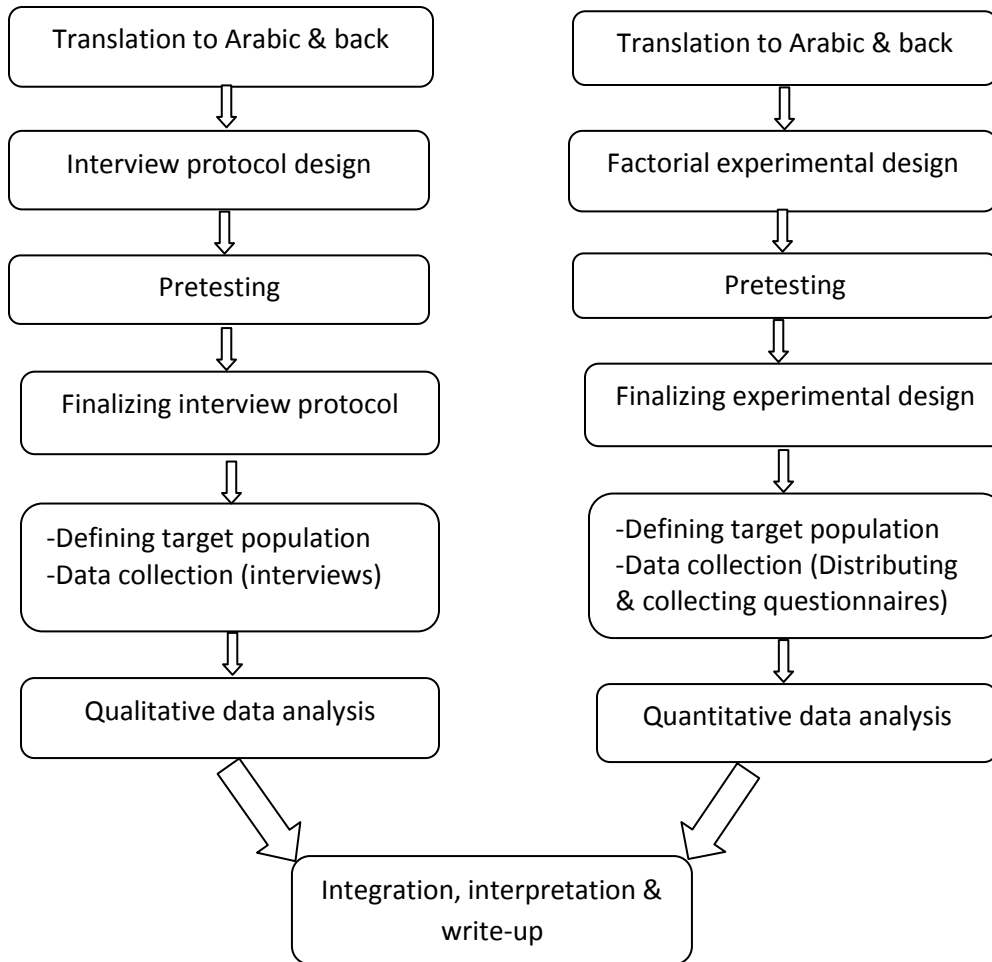
The decision of adopting a relevant methodology for any study depends on the study objective and the research questions (Denzin & Lincoln, 2000; Miller & Crabtree, 1999). The mixed method approach is employed in this study to achieve the study goals. Creswell (2008) pointed out that the researchers “could collect quantitative and qualitative data separately in two phases so that data from one source could enhance or complement data from the other source” (p. 554). There are many types of mixed method research design; based on time orientation, they could be classified as concurrent or sequential (Johnson et al, 2007). The simultaneous mixed method technique was adopted in this thesis. This type of simultaneous triangulation method is described as “concurrent or parallel” (Creswell, 2008, p. 557). This implies that the data collection and analysis for both the qualitative and experimental quantitative methods were fulfilled in parallel, and the findings of the two methods integrated at the interpretation stage.

The experimental instrument, interview protocol, information letter to participants and the consent forms were all translated to Arabic and then translated back (to English). These documents have been reviewed by academicians familiar with the area of study.

Prior to conducting the fieldwork for this study, the researcher obtained the ethical approval letter from the Human Ethics Committee at The Australian Catholic University⁴². The data collection process was implemented based on the guidelines of the ethical approval, with formal prior consent from the subjects. Purposes, aims, and procedures of the field work have been outlined in the Information Letter to the Participant and were circulated by the Certified Financial Analysts Society in Jordan (CFA-Jordan). The figure below explains the implementation strategy.

⁴² See Appendix 5: Ethical Approval Letter from the Australian Catholic University

Figure 6: Research Implementation Strategy



4.5.1 Experimental Treatments

For the factorial experimental treatments, data was collected by distributing a self-administered survey instrument. This was conducted via postal mail. The postal questionnaire survey method is a popular method for data collection, and it has many advantages relevant to this study, such as respondents arguably provide a “more honest reply” (Wilson, 2010, p. 157) to the scenarios and questions provided due to the absence of the interviewer. Another advantage of self-administered mailed questionnaires, according to Burns (2000), is that “The

respondents are free to answer in their own time and their own pace” (p. 581) Burns (2000) also added that this survey technique guarantees confidentiality. This characteristic satisfies part of the human ethics standards’ requirements as the respondents feel free to either disclose or conceal their identities.

A well-established questionnaire is capable of producing accurate and reliable data, especially if the instrument is presented in a logical and clear manner (Wilson, 2010). The Arabic version of the questionnaire was distributed. The design of the front cover of the distributed questionnaire satisfied the five elements suggested by Creswell (2008) which are (1) the importance of the respondents to the study; explaining why this particular category of participants has been chosen, stating that this category is the most relevant and capable to provide effective and accurate data, or by emphasizing the perceived added value of the respondents’ contribution so as to encourage them to fill in the questionnaire, (2) the purpose of the study, (3) the confidentiality, (4) the status of the sponsorship, such as the institution that supervises the research and using the university insignia and (5) the expected time needed to complete the questionnaire. In addition to the above five points, the cover letter included the instructions for the questionnaire. The 16 experimental scenarios of the study are presented in the internal pages of the questionnaire while the last two pages were designed to gather the subjective weights of the four dimensions and to gain some demographic information, with space left for any additional comments by the respondents.

The questionnaires were designed in four different variants, each differing in only one way: the random order of scenarios, the purpose of the randomization being to mitigate the carryover effects and practice effects (Keppel & Wickens, 2004; Mitchell & Jolly, 1992; Trotman, 1996). The survey instrument contained 16 different scenarios testing the influence of the selected elements of the JCGC on both the reliability of the audit report and the level of the audit expectation gap. Each scenario is made up of four dichotomous factors. The sixteen scenarios represent the fully crossed composition of the four independent variables at two levels, namely, higher and lower. A full factorial design for the four dichotomous factors requires a

total of sixteen scenarios, which is $2 \times 2 \times 2 \times 2$. The scenarios were presented in terms of (numbered cases) case one to case 16.

The respondents were requested to consider each scenario, each being a different combination of the study's independent variables, independently of other scenarios, and requested to provide their assessment of the influence of each scenario to the perceived level of the reliability of the audit report and the level of the audit expectation gap. Participants were requested to indicate the perceived level of influence on a scale with seven levels, ranging from 'Substantially Worse' to 'Substantially Better'. The questionnaire included a filled in (completed) example scenario to illustrate the appropriate use of the instrument as shown in Figure 7.

Figure 7: Example of the Explanatory Scenario

Example - The response for your typical case would appear like this:

Typical	External Auditor's Independence	Typical	Disclosure and Transparency
Typical	Internal Auditor Effectiveness	Typical	Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse				Substantially Better		
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

4.5.1.1 Independent Variable Definitions

Undoubtedly, the design of any survey instruments should maintain simplicity (Easterby-Smith et al, 2008; Burns, 2000; Cooper & Schindler, 2010). Slovic et al (1972, p. 286) pointed out that “the levels of the factors must be categorical” when designing an experimental survey. Only two levels for the independent variables are used in this study, the reason being to have a manageable number of treatments.

Kida, Cohen & Paquette (1990) investigated whether categorical descriptions attached to cues affect decision making and found that cue importance was significantly influenced by the selection of categories. They also pointed out that categorical descriptions assigned to cues affect the importance of those cues and make it more motivating and stimulating than static descriptions. The design of cues should also maintain consistency and unambiguity whether individually and in combinations (Slovic, 1966).

Each of the four corporate governance dimensions (the four independent variables) is assigned either a ‘higher’ or ‘lower’ rating. Higher refers to the level achieved by the top 1/3 of companies on that factor and Lower refers to a level of performance achieved by the 1/3 least successful companies on that factor. The definitions of the independent variables were provided in the front cover of the instrument and were as follows:

- ❖ **External Auditors' Independence:** “Freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditor’s ability to make unbiased audit decisions” (ISB, 2000, para. 4).
- ❖ **Internal Audit Effectiveness** refers to the extent to which the designated internal audit objectives and functions are achieved properly, are unbiased, and are free from management pressure that may compromise the internal auditor's performance. Examples of those designated internal audit functions are safeguarding assets against loss and theft, providing reasonable assurances that the financial and operating information are accurate and reliable, and ensuring the entity's compliance with laws and regulations.

- ❖ **Disclosure and Transparency:** refers to the quality and reliability of information, whether financial or non-financial, provided by the company to the shareholders and the users of the financial reporting.
- ❖ **Corporate Accountability:** refers to the ability of the shareholders and the stakeholders to hold the governing body of the company such as the executive management, the board of directors and the external auditors accountable and answerable to the laws, the regulations and the company's bylaws based on their power and responsibilities.

4.5.1.2 Dependent Variable Definitions

The two dependent variables of the study have been assessed separately based on different scenarios of the manipulated independent variables. The respondents were requested to consider each scenario in isolation. Figure 8 shows an example of one treatment taken from one of the survey's four variants whilst figure 9 shows an example of one treatment taken from one of the Arabic versions of the factorial questionnaire.

Figure 8: Example of Treatment- English Version

Case 1

<p>Lower External Auditor's Independence</p> <p>Lower Internal Auditor Effectiveness</p>	<p>Higher Disclosure and Transparency</p> <p>Lower Corporate Accountability</p>
--	---

Your Assessment on the Following (circle)

	Substantially Worse				Substantially Better			
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3	
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3	

Figure 9: Example of Treatment- Arabic Version

الحالة الأولى							مستوى أقل من استقلالية مدقق الحسابات الخارجي
							مستوى أقل من فعالية التدقيق الداخلي
							مستوى أعلى من الإفصاح والشفافية
							مستوى أقل من المساءلة في الشركات
يرجى وضع دائرة حول تقييمك النموذجي للمستويات أعلاه على ما يلي:							
أفضل بشكل جوهري				أسوأ بشكل جوهري			
3	2	1	محايد	-1	-2	-3	الاعتماد على تقرير مدقق الحسابات
3	2	1	محايد	-1	-2	-3	فجوة التوقعات في التدقيق

16 cases of different combinations of independent variables were presented in Part A of the questionnaire, and the respondents were asked to provide their assessment, in each scenario, on (1) the reliability of an audit report (in comparison with the reliability of a “typical” audit report, in the participant’s experience in Jordan) on a discrete scale with common intervals and (2) the size of the audit gap (in comparison with the “typical” gap, in the participant’s experience in Jordan) on a discrete scale with common intervals.

The scale on which respondents have to indicate their assessments consisted of seven points, ranging from ‘-3’ through ‘same’ to ‘+3’, where ‘-3’ refers to substantially worse, ‘+3’ refers to substantially better and ‘same’ was positioned in the middle to allow respondents to demonstrate neutral assessment. The design of the treatments was simple, as suggested by Dillman (2006). For statistical analysis, using SPSS software version 19, these 7 levels were coded from 1 (Substantially Worse) to 7 (Substantially Better).

Part B of the questionnaire requested the respondents to provide their subjective assessment of the weighted influence of the four independent variables on (1) the reliability of the audit report and (2) the size of the audit gap, allowing comparison with the findings of their objective judgments.

The definitions of the dependent variables were provided in the front cover of the instrument and were as follows:

- ❖ **The audit expectation gap:** The audit expectation gap refers to the different perceptions between the auditors' actual performance and to what report users believe the auditors should be performing and achieving as auditors.
- ❖ **Reliability of the audit report:** refers to the extent to which the institutional investor can rely on the audit report to clearly convey significant instances of poor internal controls; accounting errors, biases, or omissions; and concerns regarding the application of the going concern assumption.

4.5.2 In-depth Interviews

It has been argued that quantitative studies do not answer 'how' and 'why' questions regarding the phenomenon under study while qualitative studies do (Silverman, 2009; Symon & Cassel, 1998; Denzin & Lincoln, 2000). 'How' and 'why' questions deliver in-depth understanding of the topic and provide exploratory tools that help to gain a clear and rich picture of the process (Symon & Cassel, 1998). "What' questions, 'who' and 'where' questions . . . are likely to favor survey methods In contrast 'how' and 'why' questions are more explanatory and likely to lead to the use of case studies, histories and experiments as a preferred research method" (Yin, 2009, p. 9).

The qualitative interview of this study was conducted according to the interview protocol⁴³ attached in Appendix 7. The design of the interview protocol has been developed based on the related literature review and the main theory employed in this study which is the agency theory. The interview protocol concentrated on 'how' and 'why' questions aiming at investigating how institutional investors' assessment of the selected elements of the JCGC affects their perception of the reliability of the audit report and the level of the audit expectation gap. Subjects were requested to justify their conclusions by 'why' questions.

4.5.3 Pretesting: Survey Instrument & Interview Protocol

The design of any survey instrument needs to be pretested in order to ensure that ambiguities, vagueness, and grammatical errors have been avoided, and ensure that the language is understood and the layout of the experiment presented smoothly to the potential participants (Dillman, 2006). Collis & Hussey (2003) also say that pretesting experimental instruments is important.

The experimental instrument of this study was pretested with the help of six financial analyst practitioners. Pretesting resulted in two amendments to the survey instrument. The first amendment was to split the last requirement of part C (which requests subjects to list any other related factors, other than the Jordanian Corporate Governance Codes, that they think would be relevant to their assessment) into two sections, one for each of the dependent variables, i.e. to state if there were any factors that would affect their perception of the reliability of the audit report and then any other JCGC factors that would affect their perception of the level of the expectation gap. The second amendment was the addition of a brief definition of the Jordanian corporate governance code.

⁴³ Appendix 7 shows the interview protocol of this study. The protocol starts by briefing the contribution of the study. However, beside the request of unprompted impression of what does corporate governance means to the participants and the main 8 questions, there were some questions (follow up & prompt) raised during the interviews. Chapter 5 shows some of them.

Similarly, three preliminary interviews were conducted with financial analyst practitioners. The results of these preliminary meetings contributed to enhancing the definitions of one of the independent variables (internal auditor independence)⁴⁴. Moreover, the participants suggested defining the key terms of the study in English as well as Arabic, a suggestion later implemented in the study.

4.5.4 Data Collection process

Prior to conducting the field work for this study, an Information letter to Participants⁴⁵ was prepared and distributed to the potential participants, as per the Human Ethics Committee's regulations at the Australian Catholic University (ACU). The information letter to Participants has a particular format designed by ACU, and it aims to communicate to the potential participants some basic information about the study, the research's confidentiality and participants' rights.

The Information letters to Participants were advertised and circulated to the members of the Professional Association of Financial Analysts in Jordan (CFA-Jordan). The interviews were arranged with nine persons who telephoned to volunteer, and a tenth person was suggested by one of the interviewees. Interview times and locations were discussed during those Initial phone calls. All interviews were face-to-face and have been conducted in Amman (the capital city of Jordan). In Jordan, most large companies have their headquarters in Amman. Interviews were audio recorded and conducted at the participants' offices, as per their requests.

⁴⁴ Interestingly, one participant (in pretesting period) pointed out that the term 'management pressure' may confuse participants: it could mean pressure being put on the internal auditors to make them work harder and to their maximum capacity, or it could mean pressure that aims to jeopardize internal auditors' effectiveness by affecting their reports. This led the researcher to reword the definition of internal auditors effectiveness to make it clear and consistent with the objectives of the study.

⁴⁵ The form of the Information letters to participants has been downloaded from the Website of the Australian Catholic University. See appendix 1

Addresses and Information about Institutional Investors, as for all types of companies in Jordan, are available for access through the website of the Companies Control Department (CCD) and the Amman Stock Exchange (ASE). The CCD website provides data bases and statistical information about all the Jordanian companies, and the website allows individuals to make queries and search for any type of company using various search criteria such as company name, purposes, capital, etc, (CCD: Companies Inquiry, 2012; ASE: Broker Members, 2012).

As mentioned earlier, experimental studies that use repeated measure techniques require few participants and deliver robust results (Coolican, 1994; Burns, 2000; Weathington et al, 2010; Trotman, 1996). Institutional investors in Jordan have been identified with the help of the CFA-Jordan, CCD and ASE. 60 institutional investing companies were randomly drawn from the list of commercial banks⁴⁶, insurance companies, brokerage houses, and investment funds and companies. Data collection packages containing the survey instrument, the information letter to participants, and a reply envelope with a stamp attached. The packages were distributed to the target sample. 47 usable survey instruments were received and included in the analysis. The response rate was thus 78%.

4.6 Methodological Limitations

There are inherent limitations accompanying the methodology adopted in this study due to the fact that the survey instrument were self-administered and were filled out in an uncontrolled environment. This means that instruments might not have been completed by the potential subjects, might not been completed by the subjects independently, or, in the absence of the researcher and his unavailability to answer questions, may not have been completely understood by the participants (Trotman, 1996). In regards to the latter problem (absence of the researcher), this study's research implementation strategy included pretesting of the survey

⁴⁶ Non-commercial banks were excluded from the study population and left as suggestions for future studies such as (Cities and Villages Development Bank, Industrial Development Bank, Islamic Banks.)

instrument, an approach that helped mitigate the potential for confusion, although the researcher's and the supervisors' contacts (including e-mails and telephone) were presented in the last part of the survey instrument for any clarification that subjects may need. While the first issue (surveys completed by someone other than the selected participant) is unlikely to happen, it is, like in all studies that use self-administered surveys, a possible threat to the validity of this study. Finally,

Another methodological issue is the time and cost restrictions. According to Johnson & Onwuegbuzie (2004) conducting a mixed method research is costly and requires more time than what a single method needs. This is true especially when taking into consideration that the fieldwork study of this thesis was conducted in Jordan (which is another country where the researcher studies in Australia). However, the employment of the concurrent (simultaneous) mixed method strategy mitigated these difficulties.

4.7 Chapter Summary

The choice of the appropriate methodology that best addresses the study objective and the research questions is a very crucial decision when researchers plan their studies. This chapter provided an overview of methodology adopted in this thesis, which is the mixed method approach, and also provided the rationale and a justification for the selected method. The experimental survey design and the qualitative interview protocol were discussed in this chapter. The next two chapters discuss and analyze the data collected from both the experiment and the interview in order to develop the study's conclusions and recommendations.

Chapter 5: Results & Analysis

5.1 Introduction

This chapter describes the respondents, and presents separately the findings and analysis of the data obtained after conducting the fieldwork for both the experimental survey and the personal interviews. The quantitative and qualitative data are then integrated in section 5.4.

5.2 Experiment Results

This section presents the findings of the quantitative stage of the study. The results of the experimental survey were analyzed using the SPSS package version 19. The quantitative findings relate to the three main parts of the factorial questionnaire which are considered part A (the objective judgments of the participants), part B (the subjective judgments and the check on the importance of the experimental variables) and part C (particulars on the relevant backgrounds of participants).

5.2.1 Description of Response Rates and Respondents

As mentioned in the previous chapter, 47 survey instruments were received and they all were usable giving a 78% response rate. In reviewing recent Jordanian studies that investigated or

surveyed institutional investors such as Al-Khadash and Al-Sartawi (2010); Al-Khadash et al, 2012; Ishhadat, & Abed Al-Jaleel (2012) the response rates of these studies were 63%, 68%, 94% respectively, which suggest that response rate of this study is reasonable in relation to this sector.

The following tables (2, 3 and 4) provide descriptive statistics about the institutional investors responding to the survey regarding their sectors, positions and experiences. The tables reveal that the four major types of institutional investors were adequately covered, and the positions of the financial analysts vary from the manager to the head of the section to the financial analyst. Two respondents chose the other category and indicated that they were an investment consultant and a credit officer respectively. The latter has been accepted for the study analysis since the main job of credit officers in Jordan is to evaluate the financial position and the audit reports of their clients when considering credit facility decisions (Al-Zebdieh & Al-Thuneibat, 2012; Lutfi, 2001; Maswada, 1992). Finally, with 12 years of experience on an average and 11 years being the median, and no one having less than 5 year experience, the subjects of this study could be considered as experienced.

Table 2: Respondents' Distribution by Sectors

Sector	Frequency
Bank	7
Insurance Company	8
Brokerage House	9
Investment fund/Company	23
Total	47

Table 3: Respondents' Distribution by Positions

Position	Frequency
Manager - of the investment portfolio department	16
Head of the investment portfolio section	12
Financial analyst/officer	16
Credit Officer *	1
Investment Consultant *	2
Total	47

* This position was not listed in the survey instrument and has been indicated by the subject as they were allowed to specify another job position if not mentioned.

Table 4: Respondents' Distribution by Experience

Respondents' Experience	Years
Mean	12
Median	11
Std. deviation	5.4
Minimum	5
Maximum	27

5.2.2 The Validity of the Survey Experiment

Part B of the survey instrument aimed to test the validity of using the chosen JCGC factors as well to investigate whether they are considered as the major effective significant factors institutional investors' perceptions of the reliability of the audit report , and the size of the audit expectation gap separately, or if there are some other factors that need to be included in the survey. Participants were requested to indicate on a 1 to 7 Liker scale their level of confidence that the four factors examined in this thesis capture the major determinants of the reliability of the audit report and the size of the audit expectation gap. Figure 10 below shows the questions asked, while the results of their answers are shown in Table 5. A subsequent question requested the respondents to list any other possible related variables from the JCGC they consider relevant to their assessment of the dependent variables separately.

Figure 10: Level of Confidence that the Selected Variables of the JCGC Represent the Major Variables in terms of their Impact on the Dependent Variables

Please indicate by circling a number on the scale below how confident you feel that the four factors together represent the major determinant of your assessment of the:										
(1) Reliability of the audit report	Lower Confidence	1	2	3	4	5	6	7	Higher confidence	
(2) Audit expectation gap	Lower Confidence	1	2	3	4	5	6	7	Higher confidence	

Table 5: Confidence Level of the Factors

Dependent variable	Mean	Median	Mode
Reliability of the audit report	5.4	6	6
Audit expectation gap	5.6	6	5

The mean of the confidence level indicated by the 47 subjects' assessments of the reliability of the audit report was 5.4, and 5.6 for the audit expectation gap, where the median for both of the dependent variables was 6. This level of confidence as indicated by the respondents suggests that the model of the study is reasonably strong in capturing the influence of the selected factors of the Jordanian corporate governance code on both the reliability of the audit report and the level of the audit expectation gap.

Table 6 shows the additional variables from the JCGC suggested by the participants and the frequency for each dependent variable.

Table 6: Frequency of Mention of other Factors Seen as Having an Important Impact on the Dependent Variables

Factors	Reliability of the audit report	Audit expectation gap
The role of the Jordanian Association of Certified Public Accountants	2	3
Educating the users of the audit report	-----	3
Audit fees	4	1
International standard on auditing (ISA)	1	-----
Audit rotation	3	1

The above table reveals that the factor that generated the highest number of mentions is the audit fees affecting the reliability of the audit report. It is acknowledged that the factors generating multiple citations for a dependent variable generally do contribute to narrowing the audit expectation gap and in increasing the reliability of the audit report as revealed in the prior literature (Ojo, 2009; Siddiqui et al, 2009; Dickins and Higgs, 2009; Rehana, 2010; Sikka et al, 1992; Sidani and Olayan, 2007; Haniffa & Hudaib, 2007; Fadzly & Ahmad, 2004; Pierce & Kilcommins, 1997; Wolf et al, 1999). Therefore, since they are not derived from the JCGC, they were mentioned in the limitations of the study as other factors that may affect institutional investors' perception of the reliability of the audit report as well as the level of the audit expectation gap.

With regards to the other mentioned factors above, it is worth mentioning that they have been reviewed in Chapter 3 as constituents of external auditor's independence; the audit partner rotation issue was discussed in Section 3.7.4, while audit, fees and remuneration were discussed in Section 3.7.1⁴⁷.

Finally, the assumption of sphericity was checked using the 'Muachy's test'. Field (2009) pointed out that the Muachly's test, "tests the hypothesis that the variances of the differences between conditions are equal" (p. 460), while Coolican (2009) pointed out that the lack of sphericity results in increasing the likelihood of making a type II error. Muachly's test statistic was not significant suggesting the condition of the sphericity was met (Field, 2009).

⁴⁷ A possible explanation of mentioning audit fees by the subjects could be attributed to the fact that the JCGC did not discuss clearly the role of the audit committee in setting external audit fees, it has generally stated the role of the audit committee of discussing matters related to the nomination of the external auditors. In regard to the audit rotation, it noteworthy to mention that audit rotation in Jordan is a Guideline Code (not imperative) according to the JCGC; listed companies must comply or provide explanations in case of inability to comply.

5.2.3 Factor Weightings

An initial MANOVA test was conducted, and proved significant, thus the two dependent variables of the study were analyzed by using individual ANOVA tests (Meyers, Gamst, & Guarino, 2005; Coolican, 2009; Field, 2009).

5.2.3.1 Factor Weightings on the Reliability of the Audit Report

The analysis of the gathered data from the experiment provided evidence in addressing Research Question 1.

RQ. 1

What are the relative main and interactive weights of:

- ❖ External auditor independence;
 - ❖ Internal auditor effectiveness;
 - ❖ Disclosure and transparency, and
 - ❖ Corporate Accountability
- in the perceived reliability of the audit report.

In answering this question, subjective and objective measures used to obtain evidence are:

1- Self-reported weights, (the subjective measure) where each financial analyst was requested to allocate 100 points among the selected key dimensions of the JCGC.

2- The effect size (the objective measure) was measured by calculating each of the selected key dimensions of the JCGC measure's main effect and those interactions were found to be

significant. Effect of size is measured through using partial eta-squared which in its turn shows that the proportion of variance explained by each of the four independent variables.

The relative weights of the Jordanian corporate governance code's related factors in contributing to the reliability of the audit report are presented in Table 7.

Table 7: Factor Weightings for the Reliability of the Audit Report

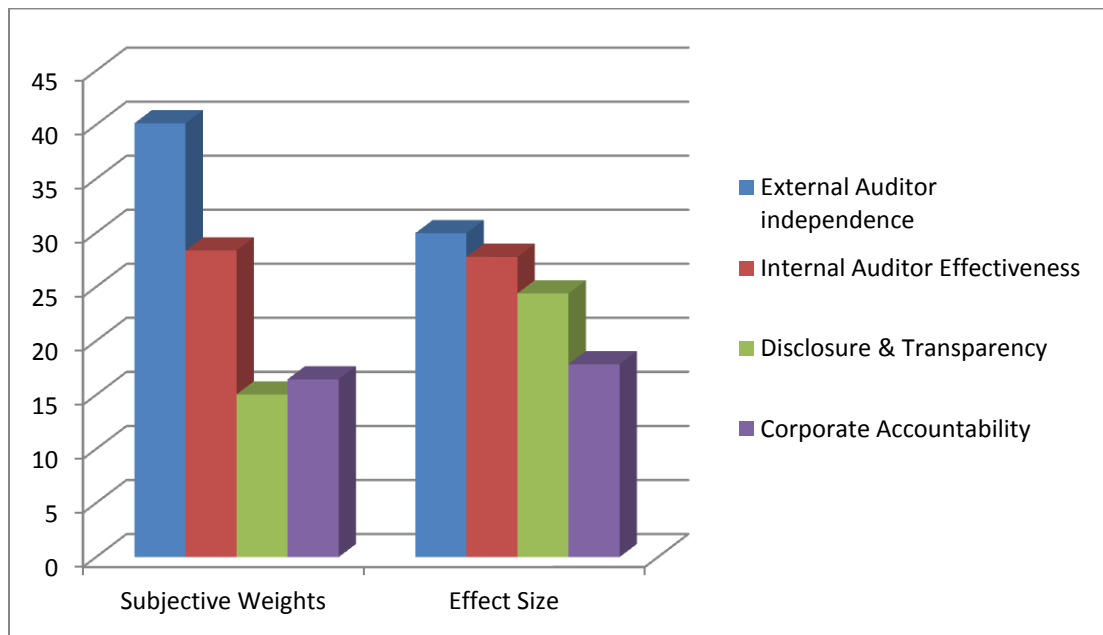
	External Auditor's Independence	Internal Auditor Effectiveness	Disclosure & Transparency	Corporate Accountability	
Self-Reported Weights (%)					
Mean	40.14%	28.36%	15.05%	16.45%	100%
SD	8.619	9.185	7.159	7.435	
Range	20%-60%	10%-45%	5%-30%	5%-30%	
n=47					
Rank	1	2	4	3	
Effect Size ‡					
Main Effects	22.71%	18.59%	15.70%	9.66%	66.66%
Interactions ‡‡	7.26%	9.19%	8.70%	8.19%	33.34%
Combined Effects	29.97%	27.78%	24.40%	17.85%	100.00 %
n=47					
Rank	1	2	3	4	

‡ Effect of size is measured by using partial eta-squared

‡‡ Interaction effects are allocated to each factor involved in the interaction equally.

The figure below shows the Comparisons of the subjective and objective (experimental scenarios) weights in relation to the reliability of the audit report.

Figure 11: Weights of Factors' Influence on the Reliability of the Audit Report



The self-reported weights show a wider distribution between the four independent variables on their effects on the reliability of the audit report; the external auditor's independence factor showed the highest effect followed by the internal auditor's effectiveness, then the corporate accountability which slightly exceeded the disclosure and transparency factor.

The objective measure (the effect size) has a tighter range with regard to the ranked order of importance of factors. The Effect Size suggests that the external auditor's independence gained the highest rank among the other selected factors from the JCGC on the effects on the perceived reliability of the audit report followed by internal auditor's effectiveness, while the corporate accountability had the least contribution. The results obtained from the two measures show that the major influential factors on the perceived reliability of the audit report i.e. external auditor's independence and internal auditor's effectiveness gained the same

ranking order suggesting that Jordanian financial analysts demonstrated a relatively high degree of self-insight.

The detailed Effect Size analysis (Table 8) shows large and statistically significant (at the 1% level) main effects for each of the four variables selected from the JCGC on their individual effect on the reliability of the audit report. The external auditor's independence is the highest followed by the internal auditor's effectiveness, disclosure and transparency, and corporate accountability respectively. The statistical power for all of the four variables is very high and classified as 'gold' standard for power, suggesting there is little likelihood of Type II errors (Cohen, 1988; Coolican, 2009).

With regard to the interactions between the posited factors, the interactions between (External auditors independence * Internal auditors effectiveness) and (External auditors independence * Internal auditors effectiveness * Disclosure & Transparency) and between (Internal auditors effectiveness * Disclosure & Transparency * Corporate accountability) reveal large and statistically significant (at the 1% level) main effects and high statistical power. However, the interactions of (External auditors independence * Corporate accountability) and (External auditors independence * Disclosure & Transparency) and (Disclosure & Transparency * Corporate accountability) and (External auditors independence * Internal auditors effectiveness * Corporate accountability) and between (External auditors independence * Internal auditors effectiveness * Disclosure & Transparency * Corporate accountability) show significance at the 5% level and have a strong power level, but failed to attain a magnitude sufficient to be satisfactorily classified as large, therefore classified as moderate according to Coolican (2009).

The finding of the large, statistically significant main effect sizes for all of the four variables plus the findings of moderate and large, statistically significant interactions between the variables-mentioned above - under these controlled conditions supports and further confirms the validity of the study model and the presence of a causality relationship between the posited elements of the JCGC variables and the reliability of the audit report.

Table 8: Effect Sizes for the Reliability of the Audit Report

Factor	Effect Size ‡	P Value	Power
Main Effects			
External Auditor independence (Ext)	0.933**	0.00*	1.00***
Internal Auditor Effectiveness (Int)	0.764**	0.00*	1.00***
Disclosure & Transparency (D & T)	0.645**	0.00*	1.00***
Corporate Accountability (Acc)	0.397**	0.00*	1.00***
Total Main Effects	2.739		
Interactions			
Ext * Int	0.178**	0.003*	0.87***
Ext * D & T	0.075	0.060	0.47
Ext * Acc	0.106	0.024~	0.62
Int * D & T	0.031	0.235	0.22
Int * Acc	0.011	0.481	0.11
D & T * Acc	0.129	0.012~	0.73
Ext * Int * D & T	0.170**	0.004*	0.85***
Ext * Int * Acc	0.091	0.038~	0.55
Ext * D & T * Acc	0.008	0.549	0.09
Int * D & T * Acc	0.457**	0.00*	1.00***
Ext * Int * D & T * Acc	0.113	0.020~	0.66
Total Significant Interactions at alpha 0.05	1.319		
Total Interactions	1.369		
Sum of the Effect Sizes	4.108		

* Significant at alpha = 0.01

~ Significant at alpha = 0.05

** An effect size equals or exceeds 0.14 can be considered large according to (Coolican, 2009)

‡ Effect size is measured by partial eta squared

*** exceeds the 0.8 considered the 'gold' standard for power (Coolican, 2009; Cohen, 1988)

The analysis of table 8 also shows that one-third of the overall effect size in relation to the perceived reliability of the audit report are attributed to interaction terms between the variables, this result also further confirms and supports Hypothesis 1.

Hypothesis 1 is further supported by the existence of the statistically large and significant interaction effect between (External auditors independence * Internal auditors effectiveness) and (External auditors independence * Internal auditors effectiveness * Disclosure & Transparency) and between (Internal auditors effectiveness * Disclosure & Transparency * Corporate accountability).

In addition to evidencing configurable cue processing, these findings are particularly important because they indicated that the external auditor's independence, when considered interactively with internal auditor's effectiveness is a relevant factor in affecting the reliability of the audit report. The findings also revealed that external auditor's independence when considered interactive with disclosure and transparency as well as corporate accountability, are also considered relevant factors in influencing the reliability of the audit report.

Interestingly, the largest interaction showed that even internal auditor's effectiveness when considered interactively with both disclosure and transparency and corporate accountability are also relevant factors in influencing the reliability of the audit report. This finding is particularly noteworthy due to the fact that in this interaction, in which corporate accountability was involved, accounted for 0.457 of the effect size on the reliability of the audit reports is higher than corporate accountability in isolation (as noted at 0.394). However, this interaction implies that the Jordanian financial analysts perceive that internal auditor's effectiveness, the level of the disclosure, and transparency and the nature corporate accountability system that applied on all governing bodies (including external auditors) establish a combined cue that might be termed as 'internal procedures within companies' since

this combination contributes significantly to the reliability of the audit reports. This could be further explained and possibly attributed, based on the interviews and the literature, to the reliance of the external auditors on the work performance and objectivity of internal auditors who were considered the main defense line against fraud, errors and malpractices. Moreover, the subjects pointed out that giving internal auditors direct access to report to an independent and well-established audit committee⁴⁸ reinforces their effectiveness and, accordingly, increases the accuracy and the reliability of the financial reporting system (Pickett, 2010; Goodwin, 2003; Qin, 2007; Goodwin & Yeo, 2001; Thnaibat and Shunnaq, 2010). Furthermore, the subjects, based on the interviews, added that a strong corporate accountability system makes all governing bodies (including external and internal auditors) work in the best interest of the company and produce reliable reports that enjoy high levels of disclosure and transparency. Another possible interpretation is that the consistent adoption of positive attributes of governance conveys genuine interest in good corporate governance.

As a summary, the interactive effects may possibly indicate that the financial analysts look for clear messages namely unambiguous signs. The largest main effect they are looking for is to place more confidence in the audit report is a strong independent auditor. The effectiveness of that external audit can primarily be supported by a quality internal audit section (hence the Ext * Int interaction being the second largest significant term), where both external, and internal audit may indicate that the high assurance of reliable, and adequate disclosure are provided to the outside investors (hence the Ext * Int * D & T being the second largest significant term). The other issue they might be considering would be the importance of the management places on governance internally. This would be more likely if the quality of the internal audit, disclosure level, and corporate accountability appear to be uniformly strong and that would be picked up by the three way interaction of Int * D & T * Acc. This of course was the highest significant interaction term.

⁴⁸ Strong audit committee is designed to achieve the appointment of an independent auditor and to increase the likelihood of the internal audit being effective. The current study restricted itself to external audit independence and internal audit effectiveness to achieve clarity of relationships. However given the success of the current experiment the relationship between audit committee independence and external and internal audit quality and performance could be a follow up study.

5.2.3.2 Factor Weightings on the Level of the Audit Expectation Gap

The analysis of the gathered data from the experiment also provided evidence in addressing Research Question 2.

RQ. 2

What are the relative main and interactive weights of:

- ❖ External auditor independence;
 - ❖ Internal auditor effectiveness;
 - ❖ Disclosure and transparency, and
 - ❖ Corporate Accountability
- on the level of the audit expectation gap.

Likewise, the impact on the reliability of the audit report, as shown in the previous section, both subjective (Self-reported weights) and objective (effect size) measures were used to address research question 2.

The relative weights of the Jordanian corporate governance code's related factors in contributing to narrowing the audit expectation gap are presented in Table 9.

Table 9: Factor Weightings for the Audit Expectation Gap

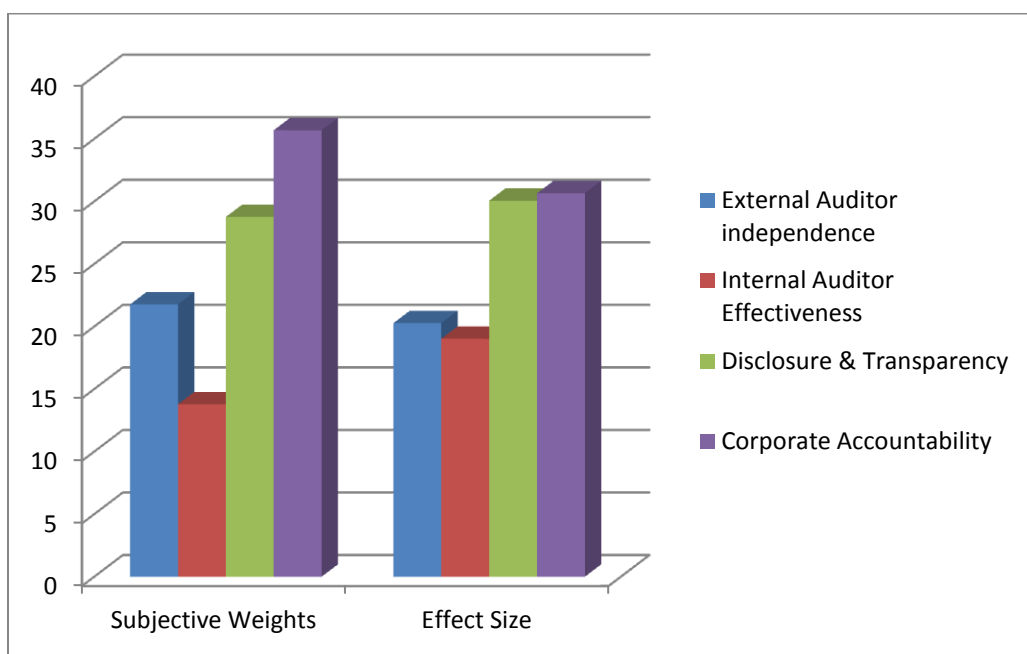
	External Auditor's Independence	Internal Auditor Effectiveness	Disclosure & Transparency	Corporate Accountability	
Self-Reported Weights (%)					
Mean	21.77%	13.78%	28.76%	35.69%	100%
SD	8.089	6.763	8.491	8.067	
Range	5%-40%	3%-30%	15%-53%	20%-55%	
n=47					
Rank	3	4	2	1	
Effect Size ‡					
Main Effects	16.03%	14.32%	22.94%	23.61%	76.90%
Interactions ‡‡	4.24%	4.70%	7.12%	7.04%	23.10%
Combined Effects	20.27%	19.02%	30.06%	30.65%	100.00%
n=47					
Rank	3	4	2	1	

‡ Effect of size is measured by using partial eta-squared

‡‡ Interaction effects are allocated to each factor involved in the interaction equally.

The figure below shows the Comparisons of the subjective and objective (experimental scenarios) weights in relation to the audit expectation gap.

Figure 12: Weights of Factors' Influence on the Level of the Audit Expectation Gap



The self-reported weights show a wider distribution between the four independent variables on their effect on the level of the audit expectation gap as perceived by financial analysts. Both the corporate accountability and the disclosure, and transparency factors gained the highest influence on reducing the audit expectation gap followed by external auditor's independence and the internal auditor's effectiveness respectively. On the other hand, the objective measure (the effect size) showed a tighter distribution of the effects of the selected JCGC factors on reducing the audit expectation gap. The Effect Size suggests that the corporate accountability gained the highest rank among the other factors which slightly exceeded the disclosure and transparency factor which are then followed by external auditor's independence and the internal auditor's effectiveness respectively. The two sets of the measures are consistent in their ranked order of importance of selected key JCGC factors on the level of the audit expectation gap suggesting that Jordanian financial analysts demonstrated a high degree of self-insight.

The detailed Effect Size analysis (Table 10) shows large and statistically significant (at the 1% level) main effects for all of the four variables selected from the JCGC individually on their effect on the size of the audit expectation gap, where corporate accountability is the top followed by disclosure and transparency, external auditor's independence and the internal auditor's effectiveness respectively. The statistical power for all of the four variables is very high and classified as 'gold' standard of power, suggesting there is little likelihood of Type II errors (Cohen, 1988; Coolican, 2009).

In regard to the interactions between the posited factors, interactions between (Corporate accountability * Disclosure & Transparency) and (External auditors independence * Internal auditors effectiveness) and between (External auditors independence * Disclosure & Transparency * Corporate accountability) reveal large and statistically significant (at the 1% level) main effects and high statistical power. However, the interactions of (Internal auditors effectiveness * Corporate accountability) and between (Internal auditors effectiveness * Disclosure & Transparency * Corporate accountability) show significance at the 5% level and have a strong power level but failed to attain a magnitude sufficient to be satisfactorily classified as large and therefore classified as moderate according to Coolican (2009).

The finding of large, statistically significant main effect sizes for all of the four variables plus the findings of moderate and large statistically significant interactions as indicated between the variables, under these controlled conditions supports and further confirms the validity of the study model and the presence of a causality relationship between the posited JCGC variables and the level of the audit expectation gap.

The analysis of Table 10 shows that approximately one-quarter of the overall effect size in relation to the level of the audit expectation gap are attributed to interaction terms between the variables, this result also further confirms and supports Hypothesis 1.

Table 10: Effect Sizes for the Audit Expectation Gap

Factor	Effect Size ‡	P Value	Power
Main Effects			
External Auditor independence (Ext)	0.608**	0.00*	1.00***
Internal Auditor Effectiveness (Int)	0.543**	0.00*	1.00***
Disclosure & Transparency (D & T)	0.870**	0.00*	1.00***
Corporate Accountability (Acc)	0.895**	0.00*	1.00***
Total Main Effects	2.916		
Interactions			
Ext * Int	0.143**	0.008*	0.77
Ext * D & T	0.074	0.061	0.47
Ext * Acc	0.001	0.839	0.06
Int * D & T	0.040	0.173	0.27
Int * Acc	0.105	0.025~	0.62
D & T * Acc	0.262**	0.000*	0.97***
Ext * Int * D & T	0.000	0.958	0.05
Ext * Int * Acc	0.000	0.972	0.05
Ext * D & T * Acc	0.143**	0.008*	0.77
Int * D & T * Acc	0.091	0.037~	0.56
Ext * Int * D & T * Acc	0.016	0.395	0.13
Total Significant Interactions at alpha 0.05	0.744		
Total Interactions	0.875		
Sum of the Effect Sizes	3.791		

* Significant at alpha = 0.01

~ Significant at alpha = 0.05

** An effect size equals or exceeds 0.14 can be considered large according to (Coolican, 2009)

‡ Effect size is measured by partial eta squared

*** exceeds the 0.8 considered the 'gold' standard for power (Coolican, 2009; Cohen, 1988)

Hypothesis 1 of the study is further supported by the existence of the statistically large and significant interaction effect between (Corporate accountability * Disclosure & Transparency) and (External auditors independence * Internal auditors effectiveness) and between (External auditors independence * Disclosure & Transparency * Corporate accountability). In addition to evidencing configurable cue processing, these findings are particularly important because they indicate that external auditor's independence, when considered interactively with internal auditor's effectiveness, is a relevant factor in affecting the level of the audit expectation gap accounted for 0.143. Similarly and at an effect size of 0.143, the Jordanian financial analysts are combining external auditor's independence, disclosure and transparency and corporate accountability to form a combined cue that is relevant to their perception on the effect on the level of the audit expectation gap.

The largest interaction as measured by effect size was noted between corporate accountability and the level of disclosure and transparency, accounting for 0.262 of effect size on the audit expectation gap. The Jordanian financial analysts perceived that these two factors form a combined cue which might be termed 'accountability for disclosing adequate information'. The analysis of the interviews suggests the importance of this decision cue. According to the interviews, lack of accountability encourages top executive management to act in their own personal interest, at the expense of the company's overall interest. It may also lead corrupt staff to steal company assets and, consequently, may lead to company insolvency and collapse. The interviews revealed that the level of disclosure and transparency has an inverse relationship with the size of the audit expectation gap. Interviews suggested that more control procedures should be applied by the Jordanian securities commission to ensure that Jordanian listed companies implement the disclosure instructions in the best way possible.

In summary, if both corporate accountability and the level of disclosure and transparency are high then as a result it gives a greater confidence that the company management and the board of director accept their responsibilities to outside investors by disclosing transparent and adequate financial data which accordingly reduces the audit expectation gap. Additionally, in the absence of the management commitment to corporate governance there is a reliance on a strongly independent auditor to lower the audit expectation gap hence the common factor in the second and third statistically large and significant term was external auditor's independence whether with the need for the external auditor to be supported by an effective internal audit or by ensuring the provision of adequate disclosure and transparency and the implementation of strong corporate accountability system.

5.3 Interview Data

This section presents the qualitative interview data obtained from the subjects. The section starts with describing the ten participants' background and their unprompted impression of how they perceive corporate governance, and then that is followed by a cross case comparison section in which the main themes of the outcomes of the interview discussion are presented. Additionally, direct quotations⁴⁹ by subjects are also presented to highlight the importance of some issues that were relevant.

⁴⁹ According to Harvard APA bibliographic guide "When quoting (or paraphrasing) from a publication written in a language other than English, the quotation should be faithfully translated into the English language" See (ENQUIRE GUIDE TO HARVARD APA STYLE BIBLIOGRAPHIC REFERENCING. P. 5) accessed on October, 2012 from: http://www.nottingham.ac.uk/shared/shared_enquire/PDFs/ENQUIREreferencingguide.pdf. To ensure that these quotations are presented faithfully, the quotations were translated to Arabic and then a back translation step (to English) also had been implemented by academics familiar with the area of the study.

5.3.1 Interview Summaries

Interviews were conducted with the respondents based on the interview protocol. Prior to conducting the interviews, subjects were requested to indicate their experience, job title or position and the type of company in which they work in, similar to the demographic information of the survey instrument. This section provides a brief description of the respondents' financial industry experience and presents their perceptions of what corporate governance means to them.

Subject A

Subject A was a financial analyst at an investment fund specializing in the Jordanian capital market and had been in this industry for around 18 years. Subject A started the discussion by referring to the emergence of corporate governance in the nineties of the last century and the several translations of this term to Arabic⁵⁰. Corporate governance as a phenomenon became the focus of attention by financial markets worldwide due to the dramatic collapses and scandals that occurred in the world since the Asian financial crisis in the middle of the nineties of last century and the scandals of the big European, and American corporations. Most of these scandals occurred due to manipulation of the accounts, corruptions committed by insiders and due to the lack of adequate and fair disclosure and transparency. Therefore, there was a need for a tool that works to reduce those financial problems and guarantees that all parties involved in corporate governance work in the best interest of the company. Subject A affirmed that the most important benefits that effective corporate governance should deliver are adequate disclosure and transparency along with ensuring the applicability of corporate accountability. Subject A added that these two elements are essential to ensure equitable treatments amongst shareholders.

⁵⁰ All of the different translations of corporate governance to Arabic that were mentioned by Subject A were discussed in chapter 2 except for the translation to "Rational management". However, when asked about the better or preferable translation that best describe the term, Subject A replied "Hakemeya or Tahakkom".

Corporate governance should distinguish the tasks, responsibilities and duties of the company management and the board of directors, and this identification and separation of roles is what needs to be activated in Jordan. *“The role of the executive management is to administer the company while the role of the board of directors is to control and to ensure that executives are held accountable”*. Accountability was described by Subject A as the shareholders and the stakeholders’ right of holding the company management accountable for their actions and decisions through the board of directors.

Subject B

Subject B’s position was a manager of an investment portfolio department. Almost 25 years of experience were in the investment field in different sectors where the last seven years were in an insurance company. Subject B pointed out that corporate governance gained growing interest recently in developed and developing countries alike. The presence of corporate governance best practices becomes an essential for any company to get facilities and to compete in the contemporary free market.

Subject B believes that, *“theoretically”* the Jordanian corporate governance code is advanced and close to those codes adopted in developed countries, but the most crucial drawback of these codes is on its weak implementation by the shareholding companies. Subject B provided two examples of the weaknesses of the compliance with the JCGC, the first one is the multi-membership by some of the listed companies’ board of directors, which should not exceed five memberships in different listed companies for each person. Moreover, there is weak compliance to one of the JCGC policies of the disclosure and transparency, that each listed company has to use its website to provide relevant, on-time and adequate disclosures.

Subject C

Subject C was head of a portfolio section in a Jordanian Bank, and worked in this area for 18 years. Subject C perceived that corporate governance aims to ensure companies are directed in

the interest of its owners. *“There are many studies associated with corporate governance best practices adopted in certain companies with the quality of the financial reporting for those companies since it becomes the main guidance for decision making”.*

Subject C pointed out that financial statements are prepared by the company management according to the International Financial Reporting Standards, although these standards aim to secure the financial reporting, ensure that the financial statements are free of errors and biases and that they faithfully presented, *“these standards give the management some flexibility to choose between some alternative accounting methods”* which might be used by executives to achieve personal interests at the expense of the shareholder and stakeholders interests, which contributes to further corporate collapses, and that’s why the adoption of effective corporate governance is always important for any company. Subject C also affirmed the vital role that audit committees play to enhance the soundness of the company’s financial reporting, and asked to *“strengthen corporate governance by reinforcing and empowering audit committees’ effectiveness”* and to focus on its role as a supervisory committee. Moreover, Subject C added that independent and experienced audit committees are more capable of protecting companies’ financial accounts and to detect errors, frauds, and distorted reports.

Subject D

Subject D was also head of a portfolio section in a Jordanian company specializing in securities investment, and worked in that position for 14 years. Subject D added that the main company activity is to invest in securities in Jordan and real estates in Jordan, also the company’s investment in securities outside Jordan are mainly in the Arabian Gulf area market. Subject D highlighted the importance of corporate governance in enhancing disclosure and transparency and accountability in shareholding companies, since corporate governance aims to lend integrity and fairness into the financial reporting system and to maintain transparent policies and to establish bases to protect investors and stakeholders.

Subject D affirmed that lack of effective corporate governance code may lead to corporate failure, as the absence of these effective codes means weak disclosure, transparency policies, internal control systems and weak accountability which may encourage corruption and lead to corporate collapses such as the failures of WorldCom, Enron and Tyco in the U.S.A. Then, and in response to these corporate collapses many legislations and acts have been endorsed globally to limit and mitigate the effects of these corporate scandals.

Subject E

Subject E was a senior financial analyst in one of the Jordanian investment funds, he worked in this position for nine years and before that time he was a financial analyst in an insurance company for eight years. Subject E described corporate governance from a financial perspective as *“the mechanism that provides shareholders (owners and funders) guarantees that they will receive returns on their investment”*. Subject E also added that corporate governance provides an ideal approach that allows stakeholders to control and supervise their interests in the company, and this could be achieved by establishing an effective bylaw that encourages releasing transparent information to be disclosed to the shareholders equally and to ensure that the executive directors are controlled, and worked under a strong and effective accountability system, subsequently this leads to protection of the company assets.

Subject E considered the definition of the OECD⁵¹ as the most comprehensive definition of corporate governance because it highlighted the supervisory and controlling task for the organizations on the one hand, and the definition identified, and distributed the tasks, roles and responsibilities of all parties and bodies involved with the organization, such as the board of directors, the company management, shareholders and stakeholders.

Subject E pointed out that corporate governance best practices help organizing and coordinating activities between the company management, the board of directors and the audit committees, and it facilitates external auditors' procedures; this leads to a decrease in the

⁵¹ The OECD definition was discussed in chapter one.

level of the potential risks of the company which contribute, accordingly, to increase the value of company shares in the capital market and to decrease financing costs (borrowing costs).

Subject F

Subject F was a manager and partner in a Jordanian brokerage company, and deals with evaluating and assessing securities, and also works as a financial consultant to the company's clients. 20 years of experience in many Jordanian banks where the last five years were in the brokerage company.

Subject F affirmed that the global attention to establish and adopt best practices of corporate governance emerged along with the financial crisis over the world such as the Asian crisis in 1997 and international corporations especially the big American companies that manipulated their accounts to hide and to cover the losses and to embezzle owners' equities whether those of shareholders or those of creditors. Corporate governance needs tools and mechanisms to ensure the best implementation, which includes the collaboration of the board of directors, the executive managers, audit committees, internal auditors and external auditors with the company's bylaw and regulations as explained by Subject F.

"The most important element of corporate governance is the audit committee and is considered an essential part to lend confidence to the financial reports". Subject F described the audit committee as a sub-committee from the board of directors with its main functions to supervise the whole financial reporting system of the company, to follow up and to evaluate the effectiveness of the internal control system and to follow up with the external auditors of the company. Therefore, *"audit committee members should be independent, and possess relevant and adequate experience that enables them to do their duties effectively"*, subject F also pointed out that many studies revealed that the existence of these characteristics with audit committee members enhances the soundness of the financial reporting system. Subject F pointed out that the Jordanian disclosure regulations required all listed companies to form

audit committees, but complained that not all of them required them to be independent members.

Subject F also affirmed that the second important element of corporate governance is the board of directors, since the audit committees are formed by and authorized from the board of directors. Subject F criticized the current corporate law and the related regulations that there is no requirement to separate the positions of the CEO and chairperson of the board of directors, and while the JCGC stated that requirement, it was ineffective because the JCGC provisions are implemented on the basis of comply or explain. Subject F also added that the JCGC prohibited the external auditor from performing any additional services (non-audit services) which is inconsistent with many opinions, and comments of Jordanian professionals.

Subject G

Subject G was a manager of one of the Jordanian investment funds and has 27 years of experience in the finance and stock market arenas. Before being the manager of an investment fund subject G was working as a financial analyst then senior financial analyst in the same investment fund for about 8 years. Subject G holds a bachelor degree in accounting and a master's degree in accounting and finance.

Subject G provided two main reasons for the increased demand for adopting corporate governance; starting with the agency theory and the subsequent possibility of generating a conflict of interests between the company management from one side and the company shareholders and stakeholders from the other side, which increased the necessity of establishing effective guides and rules to organize the relations between all parties involved in corporate governance. The other main reason is the increasing occurrence of corporate scandals, insolvency and failures globally, the financial crisis that left some crucial effects on the capital markets led governments, institutions and experts to analyze the reasons behind managerial, and financial corruption.

Subject G perceived corporate governance as a set of legislative, administrative ,and economical requirements that govern organizations in a systematic way and would also interact with the internal control team, external auditors, the board of directors, the company executive management, the audit committees, professional associations and the governmental regulatory bodies to produce outputs that contribute to achieving the company goals which include maintaining the rights of the shareholders and the stakeholders alike, adequate and fair disclosure and transparency and produce reliable financial reports.

Subject G pointed out that it was originally believed that there are deficiencies surrounding the International Financial Reporting Standards (IFRS) which contributed to most of corporate scandals and companies' failures, but later it was discovered that the deficiency was not with the IFRS, it was related to who implement the IFRS and their behaviors. Subject G explained the issue of Enron, and their auditors (Arthur Anderson) who had not followed the standards as an example. Therefore, there must be a mechanism to ensure the compliance with law and the corporate governance code. Subject G affirmed that the board of directors has the responsibility to ensure the implementation of effective corporate governance, and to make the company's bylaw compatible with the corporate governance code.

Subject H

Subject H worked as a manager of one the Jordanian investing companies with the major investments in securities, and real-estate spread over the Jordanian market, the Arabian gulf area, and internationally with concentrations in the U.S.A and U.K. Subject H has a total working experience of 22 years most of them in the investment and stock market area, where the first five years were in a Jordanian auditing firm.

Subject H perceives corporate governance as the method that aims to achieve the maximum usage of the company resources and to protect shareholders and stakeholders rights due to the separation of the jobs between the company's owners and the company management. Subject H added that it has gained a great deal of publicity after the unprecedented corporate failures,

and that has also led international organizations to help countries in establishing and implementing corporate governance best practices, and even academicians wrote and presented many articles about how to improve corporate governance.

Subject H pointed out that corporate governance aims at increasing a company's performance in a directed manner at enhancing the soundness, and the reliability of the financial reporting system. With regard to the definition of corporate governance, subject H pointed that there are many definitions of corporate governance because they involve many parties whether internally or externally such as the government, securities commission, professional associations, external auditors and even the society. However, most of the definitions concentrating on protecting shareholder's rights by enhancing disclosure, and transparency, accountability and ensuring the reliability of the released financial reports and statements. Finally Subject H pointed out that corporate governance provides a mechanism against corruption, and malpractices especially the implementation of corporate governance supervised by the top management and the board of directors.

Subject I

Subject I was manager of a Jordanian investment company, and has a total of around 20 years of experience in the same field, he also held different positions in several investment companies. Subject I pointed out that corporate governance gained great interest recently as a result of a number of administrative malpractices and financial failures that occurred with many big companies all over the world. *"An investigation of reasons that lead to administrative and financial failure revealed that the absence of effective corporate governance enabled those charged with the company's governance to work for their own interests at the expense of shareholders and creditors interests"*.

Subject I pointed out that nowadays with the globalization and the free movements of the capital across the world have opened the doors toward investors and businessmen, and they seek to invest their wealth in institutions that adopted good corporate governance structure

that allows them to control and supervise their investment fairly and equally with other investors, and provide them with fair disclosure of information and the procedures of those institutions should enjoy high standards of transparency without misleading financial accounts and reports.

“Corporate governance is a term based on a respect basis”; that is respecting the rights of the owners, creditors, employees, government and any related body. Corporate governance contribute in reducing agency theory problems as explained by Subject I, that is by mitigating the conflict of interests and reducing the risks associated with the separation between company’s ownership and the company’s management. Subject H added that good corporate governance practices attract investors and help in curbing financial corruption and increasing institution’s competitiveness.

Subject I pointed out that corporate governance facilitates the job of the external auditors and helps external auditors in communicating with management and the internal auditors of the company. Furthermore, Subject I raised the point and the argument in the United States about the effectiveness of external auditors and the reliability of their reports especially after the subsequent corporate collapses in the beginning of the 21st century. On that, Subject I pointed that all blame was placed on the external auditors, beside the company directors, which jeopardize the public confidence in the auditing profession, and in the wake of these scandals, the U.S legislators passed new laws and regulations to retrieve the public confidence in the capital market and to the auditing profession by tightening controls on the executive financial management and the external auditors.

Subject J

Subject J was a senior financial analyst at one of the Jordanian investment funds, 15 years of experience in different investment companies, and funds, and also possess CMA and CFM professional certifications. Subject J pointed out that undoubtedly the recent highlight of the importance of corporate governance concept has shaped the foundation of corporate

management system in the world. Subject J pointed out that the recent corporate scandals, especially in the American market resulted in questioning of the roles of the board of directors, the roles of top management, external auditors' performance and internal auditors' functions. Subject J added that in order to meet these criticisms, strict laws and systems were legislated in the U.S followed by similar actions in many countries including Jordan where corporate governance codes were established by the Central Bank of Jordan, the Insurance commission and the Jordanian Securities Commission.

"Corporate governance simply refers to institutionalization governance i.e. organization are not to be governed or administered by one person or one party allied with each other and works for their interests as their main priority". Subject J also pointed that in order to achieve this goal organizations must be managed under a certain framework based on considering both the company's interest and the various parties' interests. In the same context, Subject J added that effective corporate governance requires increasing the concept of independent members, whether the composition of the board of directors or the audit committees, furthermore, good corporate governance does not have any added value without full implementation by listed companies, therefore, organizations should establish strict bylaws to ensure the applicability of corporate governance and follow up its implementation and to ensure that non-compliance by individuals makes them liable before the law.

5.3.2 Cross Case Comparison

This section views the respondents' viewpoints of how they assess the JCGC elements, and the manner and the reason why their assessments had affected their perceptions of the auditing profession in Jordan that is with regard to their perceptions of the reliability of the audit report and the level of the audit expectation gap. This section also shows the main core themes derived from the ten interviews.

Since four dimensions of the JCGC were investigated in this study, namely, external auditor's independence, internal auditor's effectiveness, disclosure and transparency, and corporate accountability, this section presents core themes derived from institutional investors' perception on the effects of each of these dimensions on: firstly the reliability of the audit report, and secondly the level of the audit expectation gap separately. Further discussions of the respondents' comments are reserved for Chapter 6.

5.3.2.1 The Reliability of the Audit Report

--- External auditor's independence

The main themes and key remarks that have been derived from the financial analysts of the influence of how and why the external auditor's independence affected their perceptions of the reliability of the audit report are that there is a consensus among respondents that external auditor's independence was perceived as the cornerstone of the auditing profession and that it enhances the integrity and the reliability of the audit report and consequently the audited financial reports and statements. The participants also viewed that the objectivity and neutrality lead external auditors to produce unbiased and reliable reports. Another issue raised by the subjects was the negative impact of management pressure placed on external auditor. Moreover, the subjects stressed the vital role of an independent audit committee in nominating, communicating and overseeing the external auditor's work.

"It is considered the cornerstone of the audited financial reports"

Subject A

"Undoubtedly, external auditor's independence plays a vital role in increasing the reliability of the audit report"

Subject B

“External auditor’s independence is the backbone of the auditing profession, without this independence, there will be neither value nor meanings of the professional auditor’s report “

Subject C

“Users of the of the financial statements seek the feeling of confidence in the soundness of the financial reports and they seek the reliability and confidence by appointing independent external auditors”

Subject G

“Independence is the ability to work objectively without bias and is an indispensable necessity that would increase the credibility of the of the audited financial information”

Subject E

“The emergence of the need for an independent external auditor stems mainly from the existence of a conflict of interest and a gap between shareholders and the company management”

Subject H

External auditor’s independence is the cornerstone of the auditing profession and furthermore, it has established a suitable climate to create the profession”

Subject I

“Undoubtedly, external auditor’s independence leads to the objectivity and reliability of the audit report”

Respondents also provided several viewpoints of their assessment of the external auditor's independence; independence in appearance, independence in fact, the roles of the audit committees, the roles of the professional associations and ethics code of conduct, auditors' rotation, non-audit services, and management pressure were raised and discussed by subjects.

Subject A pointed out that the reliability of the audit report is enhanced when external auditors enjoy high standards of independence requirements whether those of the JACPA, or those required by the ISA.

Subject A

"External auditor cannot express an independent opinion unless being neutral and objective . . . and must be strong enough to avoid any possible management pressure"

Interviewer: "could you please explain why independence is important and how to achieve that?"

Subject: "Again I want to repeat that the priority of corporate governance is to generate confidence amongst investors and users of the audit report". Subject A explained that in regard to "'why', that is because the absence of objectivity and neutrality increases the likelihood of investor's doubt in the validity of the financial statements"; in regard to 'how' subject A answered that "by adopting effective corporate governance that describes and distributes responsibilities, tasks and the rights of each party including external auditors. Additionally, compliance with the ethics code of conduct reinforcing objectivity and independence".

Subject B referred to the importance of satisfying independence conditions of the international standards, however, the subject affirmed the role of the professional association in maintaining auditor's performance.

Subject B

"The output of auditing profession which is the independent audit report depends on the external auditor's independence and performance. Independence also reinforces their attitudes against executive management pressure."

Interviewer: "How could the independence of the external auditors be protected beside the compliance with ISAs?"

Subject: "It is the role of the auditors' professional associations to promote the profession and it should solve the audit fees dilemma, to help auditors not to compromise their duties as to what happened with the case of Enron and Arthur Anderson. Another important point is the nomination process of the external auditors must be carried out with full transparency and clarity, and it should be in the hand of the audit committee".

Subject C also commented on the necessity of enjoying the highest levels of independence and its role of detecting frauds and errors. Subject C explained these levels of independency by referring to the international standards by the IFA and local regulations whether these are set by the JACPA or by companies' law, in addition to independence in fact and independence in appearance, and finally the subject added *"auditors are human beings, where some of them have a strong personality and others have a weak personality while for some others the religious morals play a significant role in their character"*.

"External auditor's Independence and neutrality criteria raised many arguments between auditors and interested parties because it is associated with the attitude and mind of auditors" and that is why it is difficult to find an accurate definition of the independence as explained by subject E. However when asked how to reinforce external auditors independence, the subject replied, the auditors should be neutral, honest, and fair with all parties and provide opinions that are not biased or in favor of any specific body. Subject E argued that the most important

issue or concern that might impair an auditor's independence is management pressure. Subject E explained in more details how that pressure could be practiced on auditors:

Subject E

"The company management represents the greatest source of pressure on the auditor which is at the same time a source of non-confidence of users of financial statements"

Interviewer: "What do you mean by management pressure on auditors and how do they practice it?"

Subject: "management pressure and intervention might start with the beginning of auditor's job in the company even by setting their fees and by making them concentrate on particular accounts, hindering and delaying in providing them with requested audit evidence and hinder the auditors from disclosing frauds and errors and even of some financial facts that are of interest to other parties. The management may also intervene in setting audit fees which negatively affect their independence. Finally, in order to ensure auditors' independence they should not intervene in day-to-day operational and administrative procedures which are the duties of the executives".

Subject I is also consistent with Subject E in regard to management intervention and pressure by stating that *"the company management has many reasons and motives to put pressure on auditors in order to appear to the public as one of best director teams, even if that leads the management to distribute unrealized profits"*. Subject I added that the company management might intervene in selecting particular auditors who are willing to achieve their goals.

"The more the independence of the external auditor, the more the confidence of the shareholders and other users of the financial statements and in the work of the external auditors and their audited financial statements"

Subject H

While subject J affirmed that in order to maintain the vital role of the auditing profession, the complete independence concept must be realized in its two sides; those are independence in mind and independence in appearance and they must not be separated but be in parallel with each other as the absence of one of them may weaken or eliminate the effect of the other one. Subject J added that – which is consistent with the point of views of I & E – bring independent in preparing an audit report and in gathering audit information and evidence, contribute greatly in lending much confidence to the audit report and consequently increasing the reliability of the audited financial statements.

The subjects have also discussed many factors affecting external auditor's independence and those factors which lead to increases in the credibility of the audit reports such as the roles of audit committees, audit fees and remuneration, auditor's selection, auditor's rotation, and the provision of non-audit services.

There was consensus on the role of the audit committee in nominating external auditors, except one subject who preferred to reserve this role to shareholders in the general assembly, justifying that by:

“The issue of selecting and dismissing external auditors should not be left in the hands of the body that manages and prepares the financial accounts, rather, it should be in the hands of the owners of the company”

Subject J

However, this point of view does not represent a matter of discrepancy, since the selection of the auditors is still in the hands of the shareholders at the general assembly meeting, but the JCGC stated the role of the audit committees in nominating the external auditors.

Subject I pointed out that the issue of audit fees might be used by the company management to affect the work of the auditors. However, despite the fact that the JCGC stated that one of the audit committee's duties is to discuss all matters related to the selection of the external

auditors and to follow up their compliance with independence criteria as stipulated in legislations in force, Subject C noted that it is common in some of Jordanian listed companies that executive managers dominate and control the board of directors and *“it seems to you that they are like one team”* regardless of the supervisory duty of the board of directors.

Subject I stated that *“the company management may put direct and indirect pressure by using their influence of the nomination, re-nomination, dismissing and setting their fees this caused developed countries to place this decision in the hand of an independent and experienced body which is the audit committee”*

Subject F also stated that *“external auditor’s independence is affected by audit fees, nomination and dismissing”*, this comment is also consistent with the viewpoints of Subject G and subject E who added that *“to overcome this problem, the authority of appointing, remunerating and dismissing the auditors must be authorized by the audit committees”* to avoid any possible factor that could be used by the company management.

Subject D affirmed the vital roles of audit committees in reinforcing external auditor’s independence especially if it is composed of independent members: *“in my opinion, the most important body that can ensure the neutrality and the independence of the external auditors is the audit committee therefore the Jordanian Securities Commission should oversee the nomination process of the audit committee members to sum up summary, truly independent audit committee may result in selecting effective auditors that the users of the their reports can depend on for decision making”*.

Auditor rotation was perceived to enhance external auditor’s independence as the Jordanian literature revealed⁵². However this factor received little comments by the participants⁵³.

⁵² See section 3.7.4

⁵³ The researcher has not mentioned or reminded the subjects of these factors, because doing so might lead the subjects.

Subject C pointed out that there have been many debates about the impact of providing non-audit services to author's client where subject C stands for prohibiting these services. Subject C added that *"the JACPA should play crucial roles in overseeing non-audit services"*. While Subject G commented that *"in some developed countries, non-audit services were prohibited to reinforce external auditor's independence"*. Subject E pointed out that *"providing consultation and managerial services to the same company client considered one of the important factors that affect the independence standard and surrounds the audited financial statements with suspicion regarding its credibility"*.

Subject E concluded that *"despite the different opinions of the impact of providing non-audit services I would prefer prohibiting it, however I appreciate that the JCGC limited the provision of non-audit services"*.

Audit partner's rotation was described by Subject G as one of the factors that aims to reinforce external auditor's independence *"it decreases the financial interests that may arise between the external auditors and their clients and consequently increasing auditor's independence"*.

--- Internal Auditor Effectiveness

The participants appreciated the vital role of the internal auditors for the credibility of the audit report due to two main themes derived from their remarks. The first theme is that the integration between external and internal auditors and that they complement each other as both of them aims to ensure the soundness of the financial reporting. The second theme highlighted the importance of the role of the audit committee in reinforcing the internal auditor's effectiveness, not just in facilitating communications with external auditors, but also in setting their budget and giving them authority to report to the audit committee.

Subject J affirmed the crucial role that audit committees should play to ensure effectiveness of internal auditors: *"the audit committee facilitates the communications between external and internal auditors"* which reflected positively on the extent of the reliability of the audit report

and the audited financial statements since internal auditor's performance increase when they report to the independent audit committee. *"The search for an integrated framework to inspire confidence in the financial information provided to users depending on the degree of integration between the internal and external audit and the degree of harmony with the Audit Committee"*

Subject J

"Internal audit is to be seen as one of the constituent and important mechanism of corporate governance Both external and internal audit complements each other. Internal auditor's independence, albeit hard to be perceived, but it is possible to be achieved taking into consideration that the JCGC authorized the audit committee to nominate and oversee the internal audit function, however, giving internal auditors the authority to report any discovered frauds and errors to the audit committee increases the credibility of the financial reporting system of that company".

Subject D

"Definitely internal audit effectiveness affects the reliability of the audit report" as stated by subject B, who added that "As we know, external auditors in the early stages evaluate the effectiveness and the soundness of the internal audit function in order to determine the scope of the audit therefore, based on their efficiency of detecting errors and frauds, external auditors design their audit plan"

Subject I referred to generally accepted standards that *"internal auditors should be independent of the company activity"* and that independence could be achieved by providing the internal audit a special position in the organizational structure that allows and facilitates internal auditors to fulfill their job effectively, and by giving internal auditors sufficient power to investigate the whole financial accounts.

“The internal audit function must be under the subordination of the board of directors or audit committee as well as the communication should be at this level”

Subject I

“The importance of the impact of effective internal audit on the reliability of the auditor's report derives from the close cooperation between the two functions” according to Subject C. However, subject C explained many ways that internal and external auditor may cooperate in, such as following up external auditors' notes of their evaluation of the weaknesses of the internal control procedures, and correcting any deficiencies discovered by the external auditors.

Subject C added that *“in order to get financial statements with a high level of disclosure and transparency and credibility, the internal audit function should be activated properly and this could be achieved by the existence of an effective and professional organization that ensures the best cooperation between the board of directors, internal auditors, and external auditors”*.

Subject E pointed out that *“Effective internal control procedures are the biggest support for auditing; hence, external auditors evaluate the efficiency of the internal audit effectiveness to determine the audit scope and the extent of audit evidences”*. However, Subject E's viewpoint of assessing internal audit effectiveness was based on many criteria such as being independent of the company management, and to be associated with the audit committee that is composed of the board of directors, being competent and experienced which enables internal audit staff to investigate and analyze evidence and work objectively. *“Therefore, obviously the internal audit function provides the external auditor great and valuable services which helps to increase the credibility of the report of the external auditor”*.

“The relationship between internal and external audit is not a new phenomenon, but it got a great deal of interest with the increasing instances of corporate failures and the calls for adopting corporate governance best practices worldwide”.

Subject G

Subject G also added that internal audit effectiveness affect the scope, time, procedures and efforts of external auditors when assessing the risk of the company and when seeking audit evidence and when conducting their tests *“that is external auditors pay much attention to understand internal control procedures of their clients”*.

“Indeed, there is a significant effect of the internal audit effectiveness and external auditors on the extent of the reliability of the audit report” as stated by subject A. However consistent with subject G who explained external auditor’s purposes of evaluating the effectiveness of internal audit function, Subject A added that *“but the key point is that internal auditors are subject to the subordination of the top management and that they depend economically on the (salaries) provided by the company, furthermore, there is a possibility that the top management hire relatives or friends for the internal audit department”*.

“Adopting effective internal audit becomes a focal mechanism of strengthening corporate governance, therefore, reinforcing internal auditor’s effectiveness and strengthening the relationships between corporate governance elements is essential to ensure corporate viability and their ability to achieve their goals”.

Subject F

Subject F added that the integration between internal and external auditors conveys benefits to both of them; it increases the experience and performance of the internal auditor as a result of the continuous contact with external bodies, especially when investigating new items and accounts that needs special techniques. On the other side it increases the confidence and the credibility of the audit report and the audited financial statements as that integration guarantees comprehensive auditing processes by external and internal auditors. Subject F also

referred to the vital role of *the audit committees in following up the efficiency of the internal audit system by stating that “audit committees consult with external and internal auditors about the efficiency of internal audit and then it follows up their notes with the company management”*

Subject H highlighted the importance of effective and independent internal auditors. Subject C defined the independence of internal audit as *“It does not mean that it is independent from the company, it means the ability of internal auditors to express an objective and neutral opinion of internal control systems, management risks, and corporate governance without bias or any influence from anybody in the company, this independence will not be realized if there are limitations on the work of internal auditors”*.

Subject H also referred to the importance of internal audit standards issued by the IIA, especially linking internal audit activity with the audit committee of the company. Subject H criticized the reality of the situation and level of the cooperation between audit committees and internal audit and requested the board of directors to pay more attention to reinforce internal auditor’s independence and performance. Subject H concluded that the harmonization between internal auditors, audit committees, and the executive management contribute to reinforcing corporate governance pillars and consequently increasing the quality of the financial reporting system.

--- Disclosure and transparency

Subjects perceived corporate governance as a tool to ensure that fair disclosure of transparent information has been released to the users of the audit report and audited financial statements. However, subjects were aware of the different types of disclosures such as full, adequate and fair disclosure and they also raised the importance of on-time disclosure that

investors rely on for making decisions. Additional issue raised by the subjects is disclosing the effectiveness of the internal audit function in the external auditor's report.

"The level of effective disclosure of financial reports depends on defining the target users of these reports" and then the next step is to identify the nature of the required quantity and quality of disclosure as explained by Subject F.

"Accounting disclosure create a climate of confidence amongst the users of the financial statements on the credibility of these statements"

Subject H

"Adequate disclosure of the financial statement is the role of the company management, where the role of the external auditors is to express their opinion indicating the extent that adequate disclosure assumption was followed and to tell the users of the audit reports that there is no significant information that has been hidden".

Subject J

Subject G stated that *"disclosure, and transparency generally mean 'expose information', while in accounting field it means that all of the financial statements should appear with full disclosure of all necessary information that helps the users in their decision making"*. Subject I concentrated on explaining the characteristics of sufficient disclosure as that they should be on-time, transparent, understandable and unbiased.

In response to explaining the levels of disclosures and transparency, subject B stated that *"weak level of disclosure and transparency means that there is some information that was hidden and not disclosed to the users of the financial statements, and vice versa"*. Subject B added that companies that enjoy high levels of disclosure and transparency increase the credibility of the financial reports and helps its investors in taking right decisions.

“Disclosure and transparency are considered one of the most important principles of corporate governance”

Subject A

“Accounting reports must disclose all the information necessary in order to be described as non-misleading”

Subject E

Subject C pointed that corporate disclosure is a result of the separation of corporate ownership, and corporate management because this separation created a gap between shareholders (company owners) and the financial reporting that are prepared and released by the company management, therefore it was necessary to report the real financial position of the company for these shareholders by the independent external auditors. Subject C also added that a special report about the extent of the internal auditor’s effectiveness should be prepared and disclosed by the external auditors because having that report affects shareholders and investors’ perceptions in relation to the reliability of the audit report. This viewpoint is also in line with comments by subjects J, H and G.

Subject D pointed out that because of the growing importance of accounting disclosure, international professional associations were careful about issuing special standards of disclosure principles. Subject D referred to the International Accounting Standards Committee (IASC) rules and guidance on information that must be disclosed in the financial statements. Subject D considered the external auditor as *“the guarantor person of the integrity of the financial statements since financial statements are prepared according to the IFRS where full disclosure is one of its components”*.

--- Corporate Accountability

Corporate accountability was perceived by the subjects as the mechanism that holds all governing parties accountable for their decisions and makes them work under their roles, duties and responsibilities. There was a consensus that effective corporate accountability ensures the soundness of the financial reporting system. However, they raised the issue of ensuring the best implementation of the rules, regulations and legislations in force referring to the potential role that the JSC should play in this regard.

“Corporate accountability is a vital element of corporate governance therefore every company should establish a strong corporate accountability system. Unfortunately, an accountability system could be weakened by the existence of corrupted staff and directors, and it also can be weakened when there is no specific identification of the roles, duties, powers and authorities for all parties working inside the company again, the accountability affects the reliability of the audit report since the auditors when they feel that they work in a company under appropriately-organized systems and structures that ensures there are no interactions of powers and duties, and when they feel they are liable to answerability and accountability, then the auditors will practice professional due care and work under the auditing standard and local laws without deviations”.

Subject D

Subject C pointed out that the concept of accountability is a major dimension of corporate governance where companies should establish a strong organizational structure that includes defining and documenting the roles, duties and responsibilities of all staff regardless of their level in the organization. The subject added that the existence of such systems in the company makes it easier for the auditor tracking weaknesses and shortcomings and gaps that corrupted staff and directors might go through, thus, adopting an effective corporate accountability system contribute to an increase in the reliability of the auditor's report and provide more assurance that the presented financial statements are not prepared in favour of the company management and are not misleading. Interestingly, the subject called for more governmental

control and roles in fighting corporate corruption, and attributed the increasing number of the companies that have been sent to the court to the Arab uprising where 'anti-corruption' becomes a common slogan in most of the demonstrations.

Subject C:

"Governmental regulatory bodies in the capital market should not be lenient or tolerant with corrupted directors in Jordanian companies"

Interviewer: "do you call for more governmental control of the market?"

Subject: "In fact, in the past Jordanian governmental bodies were lenient in dealing with corrupted companies, but for about approximately one year we used to hear that many of the Jordanian corporations were sent to the court after discovering malpractices by the company management and staff. If you go back one year and view the newspaper you will realize the dramatically increasing number of companies that have been sent to the court due to committing corruption"

Interviewer: "What is the reason for that from your point of view?"

Subject: "I think the reason behind that could be attributed to the Arab Spring uprising, where anti-corruption, implementing accountability and ensuring transparent procedures become the slogan of many people in the demonstrations, and the reforms are required in the financial sectors and it is not just a political issue".

Similar to Subject C, Subjects B, H, and I also called on the government for more control over listed companies by the JSC, ASE, and CCD.

Subject A pointed out that a clear definition of the functions, powers, and responsibilities of the company management, audit committees, internal auditors and external auditors helps in tracing those responsible for the errors and frauds and send them to the court. This opinion is close to that of subject G who added that *"it increases the credibility of their reports especially when these parties feel that they are liable to an effective accountability system"*.

“The robustness of accountability regulations depend on firstly, the support it got from top management to ensure that its implementation to all ranks and staff categories. Secondly, the existence of clear organizational structure in which there are no overlapping in duties and powers between company staff. These points – from my viewpoint - identify the levels of accountability whether strong, moderate or weak. Therefore external auditors who work in a company that has a clear organizational structure and all staff comply with its regulations will increase the reliability of their reports”.

“It is the professional association’s responsibility to set strict guidelines to hold all auditors accountable in order to produce reasonable assurance that the audited financial statements are free of error and fraud”

Subject A

“Accountability establishes for retribution, so auditors would fulfill their tasks honestly as they would not forget that they are liable for accountability. This explains why some auditors choose words carefully in their reports because they fear responsibility and consequences”.

Subject F

Subject I explained the three types of auditor’s responsibilities that govern auditors scope which include civil, criminal and disciplinary responsibility, the latter one belongs to the professional association. Subject I added that it is a crucial point to ensure accountability over the company management and the board of directors. *“External auditors should not be left working alone as the only guarantor of the accuracy of financial accounts”*, the securities commission should play its role on overseeing strict accountability over the companies’ management.

Therefore, when management and internal auditors work altogether with external auditors under a clear division between the managerial roles and the control roles, that in turn, should help external auditors working effectively.

Reinforcing corporate accountability could be enhanced by an extra assurance provided by the external auditors about the entity's compliance with the corporate governance code, albeit it increases an auditor's tasks which may consequently imply a parallel demand for more audit fees. Subject I affirmed that the benefits of that assurance exceeds its costs, and interestingly, the subject pointed out that many of the audit tasks and duties already existed in the JCGC.

Subject I

"Undoubtedly corporate accountability supports corporate governance and both top management and the board of directors should not just ensure the existence of the accountability system, they should also ensure the practical and actual implementation of the corporate accountability and corporate governance code".

Interviewer: "How do you increase corporate compliance with the corporate governance code"?

Subject: "I believe that external auditors should check and follow up listed companies' compliance with the corporate governance code i.e. it should be added to the auditors' duties and included in their reports".

Interviewer: "What about the potential burdens whether costs or extra tasks that might occur, as you know auditors in Jordan consider low audit fees compromise their performance?"

Subject: "There will be consequential costs, but we also should look at the potential benefits. Reporting about the entity's compliance with corporate governance increases external auditors' responsibilities and awareness of issuing a factual audit report. In regard to the potential additional cost, I would like to mention here that it is the management's duty to report about the company's compliance with the corporate governance code which means the auditors' role will be checking and auditing this report rather than preparing it. However, if we review corporate governance code we will find that many of its items are already essential parts of auditors' responsibilities whether those stated in the companies' law or the regulations of JACPA or even the circulations and the regulations of the Jordanian Securities Commission".

5.3.2.2 The Audit Expectation Gap

--- External auditor's independence

The external auditors were perceived as one side of the audit expectation gap phenomenon, and the other side consists of the users of the financial reporting system whether as preparers of the financial statements, investors, lenders, and the respondents also pointed out that it could be expanded to the whole of society. The key themes derived from the participants' viewpoints is the corporate collapses and scandals are the major contributors to the widening of the audit expectation gap, and they also affirmed the crucial role of the signals that the audit report should convey with regard to the entity's ability to continue as a going concern.

Subject B

"External auditors are main part of the phenomena of the expectation gap, which reflects the differences in perceptions between the users of the audit report and the auditors themselves . . . I believe that external auditor's job should not be just to express their opinions on the financial statements, it should exceed that to provide evidence of the viability of companies by evaluating their ability to continue as a going concern, since the phenomenon of expectation gap emerges with the beginning of corporate collapses"

Interviewer: "How can the auditors ensure the best evaluation of viability of companies 'going concern assumption'?"

Subject: "this might not be achieved by only detecting frauds and errors, the auditors should work in the interest of the owners of the company who appointed them for this purpose. Auditors should report to the anti-corruption department, the Jordanian Securities Commission and the company control department when they discover serious violations and breaches committed by the company management before the effects of these breaches increase and subsequently leads to corporate failure and a widening of the audit expectation gap"

"The audit expectation gap occurs when the users of the audit report feel that their expectation of the message of the audit report was not realized and usually this phenomenon appears

along with the occurrence of corporate collapses especially after the issuance of an unqualified audit opinion. Therefore external auditors must be independent the existence of qualified auditors does not mean anything unless they are being independent”

Subject J

“If we seek to reduce the audit expectation gap, we should consider external auditor’s independence, otherwise, external auditors may work for their personal interest rather than shareholders, and they might cover errors and fraudulent which if discovered later, it will widen the audit expectation gap from the shareholders’ perception who believed that auditors were working for their benefit”.

Subject E

Subject A pointed out that the users of the audit report may not be aware of the nature of the audit process and called for educating them:

Subject A

“The gap results because of the difference of external auditor’s performance and the expectations of the users of the audit report. Auditors may not audit all transactions and may just audit samples of transactions, external auditors who fulfil their job independently and without management intervention helps in narrowing the gap because this enables the auditors to convey a more factual audit report that reflects the real financial position of the company”.

Interviewer: “Why do you think users of audit report are not aware of the audit job, such as ‘sampling in auditing’ – as you mentioned-, and how to make them more awareness of auditor’s duties and tasks?”

Subject: “Most of investors and users of the audit report are not aware of the practical job of the external auditors. Therefore they should be educated by conducting seminars and workshops about external auditor’s functions and issuing booklets that explains external auditor’s fieldwork procedures and mechanisms, this helps in bridging those different views”.

Subject G pointed out that external auditor's independence affects the level of the gap whether increasing or decreasing it, as the users of the audit report expect and consider external auditors to be neutral and honest. The subject added that if auditors are not independent they might be involved with management in committing frauds and the problem is that this collusion is hard to discover in the early stages, but when discovered later it creates the gap.

Subject D highlighted the importance of the audit committees in reinforcing external auditor's independence:

Subject D

"External auditor's independence is an important pillar in the auditing profession, and the Jordanian legislator should limit any thing that compromises their independence, because non-independent auditors result in widening the audit expectation gap"

Interviewer: "Could you please explain how does external auditor's independence affect or contribute in widening the audit expectation gap?"

Subject: "Because the audit expectation gap emerges with the occurrence of corporate scandals and collapses, and as we know external auditors are considered as the agent to protect the wealth of the shareholders who appointed them because they expect they have appointed independent and strong auditors who are able to send them a message about the viability of the company, while weak and non-independent auditors may succumb to the demands of the management of not disclosing frauds and errors if detected."

Interviewer: "How can you reinforce external auditor's capability to confront management pressure?"

Subject: "In my opinion the body that should help external auditors in confronting management pressure is the audit committee. An independent and strong audit committee is an essential element of reinforcing external auditor's independence and performance against management pressure"

Subject H stated that *“In my opinion the relationship between external auditor’s independence and the audit expectation gap depends on the auditor’s efficiency of reporting about the entity’s ability to continue as a going concern when auditors express a qualified opinion, investors will re-consider their assessment of that company, and if that company collapsed, auditors would not be blamed and even would not be responsible for widening the audit expectation gap.”*. In line with Subject’s H opinion, Subjects G and J have similar viewpoints.

Subject F was not optimistic of the capability of the external auditor alone in bridging the gap, although he agreed with the importance of their independence in reducing the gap. *“External auditors may not be able alone to audit and ensure financial control over company’s accounts, so, efforts of internal auditors and audit committees are needed to work with each other and with external auditors, because for a long time the professional associations of auditors have always tried to reduce the audit expectation gap, but the gap emerges from time to time, therefore I believe that leaving the matter of reducing the audit expectation gap in the hands of auditors alone is a prejudice against the auditors and everybody who deals with the capital market”*

“External auditor’s independence whether in fact or in appearance are fundamental for their performance and increases investor’s confidence of the real financial position of the company in order to make rightful decisions which accordingly helps in reducing the audit expectation gap the reason behind selecting external auditors is that shareholders need an independent and neutral body that could not be influenced by the company management”.

Subject I

--- Internal Auditor Effectiveness

The subjects viewed internal auditors as a primary protector of the company assets. The key theme is that the internal audit function is fundamentally established in order to detect frauds, errors and malpractices which ensure the final reports, are transparent and unbiased leading to an increased likelihood of a company's viability being discernible and thus reducing the audit expectations gap. Moreover, the subjects pointed out the important role of the audit committees in reinforcing internal auditor's performance and working as a liaison between internal and external auditors.

"The most important quality that characterized the job of the internal auditors is their involvement in day-to-day operations, which enables them to control the company activity Internal auditors dedicate the majority of their time to check the accuracy of the accounts of the company, more than the time spent by the external auditors in regard to the expectation gap, although this term is associated with the external auditors, we should not forget the correlation and the cooperation between them as they integrate, and complement each other. Hence, internal auditor's effectiveness helps and facilitates external auditors in detecting and preventing frauds, errors and breaches and it helps them to the best evaluation of the company's ability to continue as a going concern."

Subject I

Subject F stressed the importance of the role of an independent audit committee in nominating internal auditors:

Subject F

“The aim of an internal audit function is to ensure the accuracy of the accounts and that they are free of errors and frauds, therefore, companies must pay attention to who they recruit in the internal audit department, they should be competent and possess a high level of related experience. . . . Nowadays it is common to outsource internal auditors, notwithstanding, and from my experience, that staffs still work according to what the company management tells them to do, because they worry about their salary and about re-appointment. However, the JCGC gave the audit committees the right to nominate the internal auditor, and my opinion if this condition is implemented properly it will increase internal audit effectiveness in detecting frauds”

Interviewer: “From your opinion how could we reach the best implementation of internal auditors’ appointment?”

Subject: “The essential requirement is the audit committee members must be fully independent and have sufficient experience in accounting and auditing”

Subject J pointed out that the success of internal audit depends on the support they get from the board of directors and from the audit committee in particular, as they are responsible for providing them with adequate powers, independence from the company management, and with any necessary requirements and provisions. Subject J suggested that internal auditors should be under the supervision of the audit committee as recommended by most of the initiatives in developed countries, *“internal auditors draw their strength and power from the audit committee because the audit committee makes them more independent as a result of distancing them from the company management authority”*. Subject J stressed that audit committee members should be non-executives and independent members in order to overcome executive management’s pressure on auditors. The audit committee should also providing direct lines of communication between internal auditors on the one hand and with

external auditors and the board of directors on the other hand. Subject J concluded that audit committees oversee the company management and, therefore *“this integration helps internal and external auditors in hindering frauds, errors and corporate failures and consequently reducing the audit expectation gap”*.

Similar to this viewpoint, Subject B and D have the same opinion as to the vital role of the audit committees:

“It is very important to maintain the effective internal audit function; the company should appoint qualified internal auditors and this appointment must be in the hand of the audit committees as well as the appointment of external auditors and working as a liaison between them”

Subject B

Subject D criticized the independence condition requirements of the JCGC.

Subject D

“An internal audit function aims to detect frauds, errors and malpractices, therefore, they should be qualified to fulfil their duties and must be appointed by the independent audit committee as stipulated in the Jordanian corporate governance”

Interviewer: “To what extent do you believe that the independence of the audit committee is important, taking into consideration that the JCGC stipulated that the independent audit committee members should not be less than two?”

Subject: “In my opinion all of them must be independent; although there are many committees that could be formed by the board of directors, I believe that the audit committee is different and I consider the audit committee as a vital artery to ensure the soundness of the financial reporting system they also should be qualified with experience in accounting and auditing”

Subjects G, H and A have the same viewpoints in regard to the internal auditor's role of detecting frauds and errors and maintaining the viability of corporations and also to the importance of the integration with the external auditor. Subject G described that integration as *"these two functions are considered as the faithful custodian of the company's accounts"*. However, Subjects H, C and I perceived that the audit expectation gap as a phenomenon primarily relates to the external audit profession; for instance Subject C pointed out that *"in my opinion, it is the external auditor's responsibility to reduce the audit expectation gap since this gap represents the gap between the auditors and the users of the audit report. Internal audit, albeit its significant roles, can be seen by external auditors as an assistant function . . . and an effective external auditors may cover the deficiencies of internal auditors"*

--- Disclosure and transparency

The participants stressed the importance of fair and on-time disclosure in reducing the audit expectation gap, they have also mentioned several sorts of financial facts the company management sometimes prefer to hide. The key theme is that the participants perceive the fair and on-time disclosure as the medium that tells the investors, shareholders, and stakeholders about the true position of the company and pointed out that providing these parties with transparent information makes them informed about the real financial position of the company, accordingly, making correct decisions.

Subject B argued that *"disclosure and transparency levels are much associated with the audit expectation gap whether weak, medium or strong. Disclosure and transparency have an inversely relationship with the audit expectation gap, that is the more the level of disclosure and transparency, the lower the level of the audit expectation gap, because based on that level of disclosure and transparency the users of the audited financial statements will be aware of what is going on inside the company"*. Subject B added that, regardless of the nature of the disclosure and transparency whether they are in favor of the company management or not (such as bad

news about unexpected losses and so on), the disclosure of these information will contribute in bridging the audit expectation gap, because informing investors and the users of the audit report about the facts surrounding the company will make them unsurprised when financial problem faces the company and even if these financial problems may cause the company to be insolvent or leads to corporate failure.

Subject B provided an example of the importance of the disclosure and transparency in Jordan which is how the Jordanian Central Bank (JCB) dealt with the problem of 'one Jordanian bank' about 3 years ago [in the middle of 2008]: *"The governor of the JCB himself immediately appeared in the media and TVs to justified the reasons behind dissolving the board of directors of that bank and explained that clearly and in transparent detail, from the dissolving step, appointing another board of directors instead of the previous one until the election of a new board. The bank now is working like any other bank. Just imagine if the procedures of the JCB were vague without transparency, how would the situation of that bank be and imagine how that widens the audit expectation gap."*

"There are many ways of providing adequate disclosure to the investors which enables them to make their informed decisions and accordingly helps in reducing the audit expectation such as: disclosure within the context of the financial statements, using clear and understandable terms, explanations that might appear between brackets, footnotes and the accompanying appendices of notes, attaching explanatory tables and reports, the board of director's report, and finally the external auditor's report as well."

Subject G

"Fair disclosure is the guarantor of reducing the audit expectation gap. Fair disclosure is considered the most influential element on the audit expectation gap because it aims to provide information about the company activities and put them at the disposal of shareholders; thus this reduces the audit expectation gap"

Subject H

Subject J pointed out that the accounting and auditing profession play a significant role in affecting decision making and that depends on the level of disclosure and transparency released to the public because of the fundamental goal of the disclosure and transparency concept is to tell the investors and shareholder the truth about the financial position of the companies.

Subject J stressed that the provided information must be adequate, objective, on time, and away from speculations and rumors. Subject J explained how the company executives and directors manipulate the disclosed information. The subject stated that companies may not comply with disclosure requirements whether intentionally, unintentionally or even due to the insufficient knowledge about the disclosure requirements set by the Jordanian Securities Commission, this may include hiding information about transactions with the related parties and insiders, inadequate disclosure in the annual reports and the board of director's report, and it could be by manipulating the business results in newspapers before the official publication of the financial statements.

Subjects E, F and A have similar viewpoints in regard to the association of corporate disclosure and transparency on the level of the audit expectation gap and the importance of making investors and shareholders informed of the real financial position of the company. However, Subjects I, D, and C criticized the role of JSC in maintaining and overseeing Jordanian listed companies' compliance with the disclosure requirements:

"When a company's shares increase dramatically, the JSC uses its power by asking the company to justify that sudden increase of its shares, especially when there are no published reasons or causes for that increase such as published statements of a meeting with strategic partners. However the normal answers from those companies were: we do not have specific justification for that increase and it may relate to the market mechanism and the rules of supply and demand. However, we always hear that routine answer but we, as financial analysts, have

doubts that the insiders⁵⁴ at the company know the real reasons behind that increase such as this example about poor level of disclosure and transparency leads to widen the audit expectation gap”

Subject C

Subject I pointed out that strong disclosure and transparency measured by its capability of providing shareholders clear clues about the entity’s ability to continue as a going concern. The subject added that investors suppose that auditors and the JSC are doing their job sufficiently, otherwise, the JSC and ASE participate in widening the expectation gap. Interestingly, Subject I added other bodies that may participate in widening the audit expectation gap. Subject I also explained how the Jordanian ASE and JSC can play their roles in reducing the audit expectation gap by stating that: *“[their role] is not just by demanding listed companies to comply with disclosure requirements, they also need to follow up the compliance with the disclosure instructions and ensure that the companies do not disclose vague information and to ensure that they are provided on the right time, furthermore, the JSC must give shareholders the right to obtain information from listed companies in a transparent manner, if they want to satisfy the corporate governance code of ensuring equitable treatments of shareholders”*.

--- Corporate Accountability

The participants perceived that the existence of an effective corporate accountability system increases the performance of the external auditors and reinforces the effectiveness of internal auditors in protecting the assets of the company and increases the likelihood of its ability to continue as a going concern. They also pointed out that increasing the awareness of the

⁵⁴ The JCGC defined insider at the company as “A person who has access to internal information by virtue of his position or function within the company, including the chairman and members of the board of directors and the company's general manager, financial manager and internal auditor, the representative of the legal person, and relatives” (Corporate Governance Codes in Jordan 2009, Chapter One, Definition section, p. 6)

directors that they work under a strict accountability system and are liable to be accountable reduces instances of management fraud. Another noteworthy issue raised by the participants is the large interest of accountability and anti-corruption in both private and public sectors as a result of the Arab Spring.

“The matter of effective corporate accountability is a vital element and indicator of companies’ strength. Therefore, all staff and employees working in the company should recognize that they are liable to be held accountable and that the company is not as we say in slang language ‘free money that anyone can steal’. However, I believe that the key thing is to ensure the implementation of the regulations that were essentially founded to maintain the company assets out of theft and loss”.

Subject E

Subject C stressed the importance of corporate accountability and pointed out that it plays the significant role of limiting the audit expectation gap, because *“the company that enjoys strict and high level of accountability applicable on all levels of staff from the small position to the top management and the board of directors are directed properly according to regulations, bylaws and legislations in force”*. Subject C also explained ‘why’ he reached that conclusion by pointing out that both external and internal auditors will report any serious breaches and malpractices committed by the executive management to the securities commission and even to the company shareholders to clear their responsibilities. However, Subject C affirmed again the importance of implementing strong corporate accountability over Jordanian listed companies and their directors, the subject added that now, there are many calls for anti-corruption in companies demanded by the public as we can see in the newspapers. Subject C highlighted the importance of the accountability and repeated again the unprecedented number of the Jordanian listed companies which have been sent to the court and attributed that to the unprecedented number of demonstrations demanding economic reforms beside the political reforms.

Similar to the opinions subjects E and C, subject F added that “*effective corporate accountability must be documented*”, while Subject B argued that the absence of effective corporate accountability system makes all staff who works with the company believe that the company is ‘like what we say in slang language a house with low fences’ which leads to an increase in malpractices instances and therefore to corporate failure and accordingly, increases the audit expectation gap. Subject A pointed out that a strong accountability system makes staff hesitant and reluctant to commit frauds, accordingly, makes the users of the audit reports more convinced about the soundness of the outcomes of the financial reporting, and on the assessment of the ability of the entity to continue as a going concern. Subject D’s opinion is consistent with Subject F and stated that “*Corporate accountability stands like a bulwark to preserve corporate governance*” and called for more governmental intervention in the capital market.

Subject J pointed out that the term audit expectation gap appears whenever corporate collapse occurs and due to the insufficient assurance provided by the company and by the auditors about the ability of the companies to continue as a going concern therefore, all those responsible for manipulating company’s accounts must be held accountable and sent to the court. Subject J argued that many of the causes of audit expectation gap relate to ‘business failure’ rather ‘auditing failure’ and added that the gap also emerges because the users of the audit report perceive the auditors as the guarantor of the integrity and the accuracy of the financial reporting system.

Subject I stressed that there is misconception that when auditors express a clean opinion it means the financial statements and the financial position of the company are 100% free of errors and frauds, while the generally accepted auditing standards required auditors to practice the maximum levels of “*due professional care*”. The subject added that another aspect of widening the audit expectation gap is the auditor’s responsibility of reporting about the company’s ability to continue as a going concern and also pointed out that there are many cases in which the external auditors were sued because of negligence in fulfilling their job from a shareholder's perception. However, in their opinion the company management should be

accountable and liable for strict accountability regulations if they are corrupted or even if they do not cooperate with the external auditors. The subject also pointed out that audit committees help in narrowing the audit expectation gap since they are independent and non-executive committees and because they aim to settle disputes and to reinforce external and internal audit performance. However, the subject concluded that the audit committees are the strongest party that is capable to ensure the right implementation of *“the financial accountability”* over the company.

In regard to suing and sending corrupt staff, auditors, directors and managers to the court, Subject H affirmed the vital role that government bodies should play: *“the Jordanian Securities Commission should help auditors to ensure the highest level of corporate accountability over the companies by adding more strict items to the current JCGC, and it should send all directors involved in corruption to the court”*. While subject G pointed out that strict corporate accountability limits committing corruption, and added that *“these days we are used to hearing about companies being sent to court and to the anti-corruption department which is a good indicator of implementing a high level of accountability, the accountability becomes a public demand these days as we can see the demonstrations”*. Consistent with that, subject J added *“large instances of sending corrupted directors to the court these days as we see from time to time in the media is an example of good implementation of the accountability”*.

5.4 Integration of the Mixed Methods Data

The mixed method approach helps the researcher to gather quantitative and qualitative data from different sources. This allows the researcher to analyze these data and then integrate them to deliver a comprehensive understanding of the phenomenon, as noted earlier in the previous chapter; adopting quantitative and qualitative methods complement each other and facilitate interpreting the results obtained from the other. This section shows the findings of the study to provide a comprehensive analysis of the impact of the JCGC on the value of the audit

opinions as basically measured by the reliability of the audit report and the level of the audit expectation gap.

5.4.1 Context

It is clear that institutional investors in Jordan do perceive the importance of the constituents of the Jordanian corporate governance code and its impact on the reliability of the audit report and the level of the audit expectation gap even if that evidence was often identified with the impact of failures to conform. The effect of the four variables whether individually or in combination (configurally) was obtained from both data sets, those were, the results of the experimental survey and the additional comments to the survey instrument, and the direct comments by interviewees. The findings of the survey method suggest the integrity of the study model and provided a degree of quantification and robustness. The qualitative interviews also supported the study model and provided in-depth understanding of how and why the model factors affect the value of the audit opinions as basically measured by the reliability of the audit report and the level of the audit expectation gap from the institutional investors' perceptions.

5.4.2 Self insight

Both data sets suggest a relatively strong self-insight on the part of institutional investor's assessment of the evaluation of the constituents of the JCGC on both the perceived reliability of the audit report and the level of the audit expectation gap. The experimental survey instrument revealed relatively consistent rankings between the objective (effect size) and subjective data for the factor's influence on both the reliability of the audit report and the level of the audit expectation gap. On the other hand, the interview findings also showed relatively strong self-insight of institutional investor's assessment of the evaluation of the constituents of the JCGC on both the reliability of the audit report and in reducing the audit expectation gap. However,

one subject referred to the role of the board of directors and the shareholders in nominating external auditors and one subject referred to the role of the company management to appoint internal auditors 'ignoring the role of the audit committee as stipulated in the JCGC'.

These dispositions of some subjects' comments, however, they could be attributed to the recent implementation of the JCGC, and that the premises of the role of the board of directors and the shareholders in nominating external auditors still in their mind, as well as the role of the company management to appoint the internal auditors. Additionally, their comments possibly could also reflect a political reality that management or the dominant shareholder/directors still dominate. It is perhaps a reflection that cultures in the Jordanian companies are resistant to change.

5.4.3 External Auditor's Independence

External auditor's independence was shown to be a significant, positive factor in influencing the auditing profession in regard to increasing the perceived reliability of the audit report and in reducing the audit expectation gap as well as being the highest subjectively weighted factor in considering the reliability of the audit report. The experiment suggested that external auditor's independence gained the highest rank of importance of its effect on the reliability of the audit report. This could be explained, based on the interviewees' opinions, as there were consensuses in perceiving external auditor's independence as the cornerstone of the profession and it leads to objectivity, credibility and then to the reliability of the audit report. However, external auditor's independence gained the third rank of the influence in the bridging the audit expectation gap.

5.4.4 Internal Auditor's Effectiveness

Internal auditor's effectiveness was shown to be a significant, positive factor in influencing the auditing profession in regard to increasing the perceived reliability of the audit report and in reducing the audit expectation gap as the factor satisfied the standard statistical tests for that suggestion. The experiment suggested that internal auditor's effectiveness gained the second rank of importance of its effect on the reliability of the audit report. This could be attributed, based on the interviewees' opinions, to the crucial role of effective internal auditors in detecting and preventing frauds, errors, and malpractices because of the internal auditor's wide knowledge of the detailed activities of the company, moreover, that also might be attributed to the subjects' perceptions of the efficient integration of both internal and external functions in maintaining the soundness of the financial reporting system. However, Internal auditor's effectiveness gained the last rank of the influence in the bridging the audit expectation gap. This perhaps could be explained by the fact that in viewing the expectation gap the institutional investors were judging on the integrity of management and the quality of the audit to determine whether the required standard has been reached. Failure to convince management to be honest and forthright could raise issues as to the effectiveness of the internal audit. In addition to that, two subjects have primarily associated the concept of the audit expectation gap with the external auditors⁵⁵.

5.4.5 Disclosure and Transparency

Disclosure and transparency were shown to be significant, positive factors in influencing the auditing profession in regard to increasing the perceived reliability of the audit report and in reducing the audit expectation gap as the factor satisfied the standard statistical tests for that suggestion. The experiment suggested that disclosure and transparency was a major factor in

⁵⁵ Traditionally the audit expectation gap has been attributed to the external auditors failing to show sufficient independence from management as indicated in the common reference of the auditors to management as their clients rather than seeing the shareholders and creditors as the clients.

regard to the effect on the level of the audit expectation gap since the results showed that the disclosure and transparency gained the second rank of effect, slightly less than the corporate accountability factor, as the influential factor on the level of the audit expectation gap. This could be explained, based on the interviewees' opinions, as that the more the level of disclosure and transparency, the lower the level of the audit expectation gap, because based on that level of disclosure and transparency the users of the audited financial statements will be aware of what is going inside the company. However, disclosure and transparency gained the third rank of the influence on the reliability of the audit report.

5.4.6 Corporate Accountability

Corporate accountability was shown to be a significant, positive factor in influencing the auditing profession with regard to increasing the perceived reliability of the audit report, and in reducing the audit expectation gap as the factor satisfied the standard statistical tests for that suggestion. The results of the experiment suggested that corporate accountability gained the first rank of (effect size) of importance on the level of the audit expectation gap. This could be explained, based on the interviewees' opinions, as that when all parties involved in corporate governance such as the board of directors, the executive management, external auditors and internal auditors work with a company that has an effective accountability system and good organizational structures in which all responsibilities, powers, duties and roles are stipulated clearly, such points make those parties liable to the strict accountability system and make them work in the best interests of company rather than their personal interests, therefore, increasing the capability of the company continuing as a going concern.

5.4.7 Significant Interactions

The objective measure revealed three large and statistically significant (at the 0.01% level) interactions and four moderate interactions related to influence of the perceived reliability of the audit report (the first dependent variable), the sum of these interactions accounted for approximately one-third of the total effect size. On the other hand, the objective measure has also revealed three large, and statistically significant (at the 0.01% level) interactions and two moderate interactions related to influence of the level of the audit expectation gap (the second dependent variable), and the total of the effect of these interactions accounted for approximately one quarter of the total effect size. These interactions have been discussed in the early section of this chapter. However, the analysis of data derived from the qualitative interviews sheds considerable light, and provided depth understanding on this phenomenon. The existence of these significant interactions supported hypothesis 1 which states [Institutional investors process decision making information configurally when considering the influence of the selected components of the Jordanian corporate governance code]. These indicated interaction terms along with the statistically significance (at the 0.01% level) main effects for all of the four variables individually, supported the model of this study, and the causality relationship between the four posited independent variables, and the dependent variables. Where these interactions have been discussed in the early sections of this chapter, the implications of these interactions are discussed in section 6.6.2.

Chapter 6: Discussion and Conclusions

6.1 Introduction

This chapter consists of eight main sections, not including this brief introduction. Section 6.2 reviews the independent variables of this study. Sections 6.3 and 6.4 bring together the results of the quantitative and qualitative elements of this study and relate them back to the relevant literature. Theoretical and practical implications of the study are summarized in sections 6.5 and 6.7, respectively. Section 6.6 presents the findings of the study in relation the original research questions. This chapter ends with a discussion of the limitations of the study (section 6.8) and suggests a number of areas for further research (section 6.9).

6.2 Discussion of the Independent Variables

The audit expectation gap has plagued the auditing profession almost from inception. The profession struggles to mitigate this phenomenon (Epstein & Geiger, 1994) while confidence in audit reports and audited financial statements are undermined by dramatic instances of corporate failure arising without warning from external auditors. Examples of such failures include Enron, WorldCom and the recent global financial crisis.

The literature reveals that the audit expectation gap exists in Jordan, and is partially affected by (1) the external auditor's performance and independence, according to some authorities (Al-

Thuneibat, 2003; Asfoor, 2003 Omari, 2003; Al-Khadash & Al-Sartawi, 2010) and (2) the level of disclosure and transparency (Hajir, 2001). The literature also shows that inadequate evaluation of the going concern assumption (Al-Awaqleh, 2008) and management pressure on auditors (Omari, 2003; Bani-Ahmad, 2000; Matar, 1995; Al-Adeli, 1993; Malhas, 1992) reduces the reliance placed on the audit report.

This section discusses the results of the study in respect of each of the four independent variables.

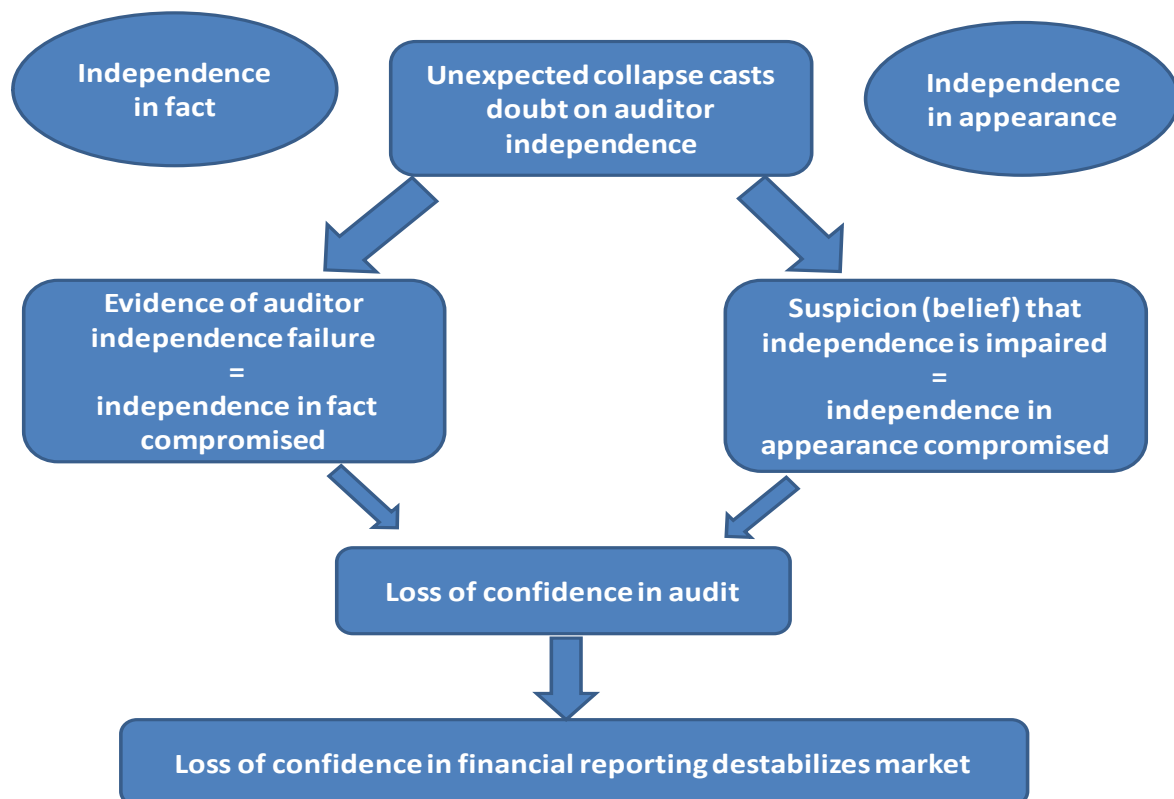
6.2.1 External Auditors' Independence

The value of the assurance provided by the external auditors to shareholders and stakeholders relies on the auditor's perceived ability to detect breaches, irregularities and errors in the financial reporting system, in addition to the auditor's perceived ability to resist management pressure to hide some or all of those breaches (Pott et al, 2009). Based on the interviews conducted in this study, external auditors' independence is seen as the cornerstone of the auditing profession and should lead to reliable and credible financial statements. The intent behind independent auditor opinion is to provide confidence, supposedly being a genuine and expert opinion about the likelihood of absence of material errors and fraud.

This study adopted the definition of external auditor independence provided by the Independence Standard Board (ISB) as noted in Chapter One, section 1.7. The definition focuses on the strength of auditors' attitudes and their performance in the face of any possible pressure that may compromise their effectiveness. The ISB also states "Quality audits improve the reliability and enhance the credibility of the financial reporting process, thereby contributing to its usefulness and to the efficient functioning of the capital markets, which serves the public interest" (ISB, 2000, para. 3). Both this statement and the previously mentioned definition emphasize the key role of external auditors' independence in the

perceived reliability of the audit report and the level of the audit expectation gap. The figure below shows two aspects of auditor's independence, i.e. independence in fact and appearance, as well as the extent to which they are essential parts of maintaining the objectivity of an auditor's performance (Strohmer, 2006). This finding is in conformity with Fearnley & Beattie (2004) and Pott et al (2009) who argued that failure of the external auditor's independence is enough to undermine the audit process and leads to a loss of trust in the financial reports, thus destabilizing the capital market. Such failures in independence also raise questions about the role and objectivity of external auditors and contribute to a widening of the audit expectation gap.

Figure 13: External auditor Independence and Reliability of the Audit Report



This figure is quoted from Strohm (2006, p. 19)

According to Duska, Duska, & Ragatz (2011), there is no “absolute [degree of] independence” or “total independence” (p. 127). They argued there will always be some interest and bias among auditors. While Mcgrath, Siegel, Dunfee, Glazer and Jaenicke (2001) argued that the ISB concept of auditor’s independence does not require external auditors to be totally free of all influences on their ability to express an unbiased audit report; it requires them to be free from influences significant enough to compromise that ability. The ISB provides guidance that enables external auditors to identify whether undue bias exists in specific circumstances and also suggests several safeguards for external auditor independence.

The results of the objective measures (as captured by the experimental instrument) and the subjective measures (based on self-reporting by participant) revealed that external auditor independence is the most influential factor in the perceived reliability of the audit report, according to Jordanian financial analysts. This result is consistent with results in the existing literature highlighting the association between external auditor independence and the perceived reliability of audited financial statements (Gupta, 2004; Teoh, 1992). This perceived influence could be explained by the interviewees’ consensus that external auditors’ independence is the cornerstone of the profession and that it leads to objectivity, credibility and thus to the perceived reliability of the audit report.

In regard to the audit expectation gap, the results of this study are not consistent with prior Jordanian literature, those earlier studies having revealed external auditors’ independence and performance to be major factors affecting the gap (Al-Thuneibat, 2003; Asfoor, 2003; Omari, 2003; Al-Khadash & Al-Sartawi, 2010). The experiment and the subjective weights in this study indicated independence to be an important factor but not as significant as disclosure and transparency, and accountability. Based on the interviews of financial analysts in this study, this could possibly be attributed to the increasing Jordanian interest in accountability over the past two years⁵⁶. Furthermore, the objective measure showed that the most significant interaction affecting the size of the audit expectation gap was the interaction between ‘corporate accountability’ and ‘disclosure and transparency’, implying that the institutional investors

⁵⁶ For more details, see section 6.2.4

consider the ability of shareholders and stakeholders to hold corporate governance bodies accountable for their level of disclosure to be a key factor affecting the level of the audit expectation gap in Jordan.

6.2.2 Internal Auditors' Effectiveness

The results of this study showed that the internal auditor's effectiveness was a significant positive factor in both the perceived reliability of the audit report and changes in the level of the audit expectation gap. The internal auditor's effectiveness was the second most significant influence on the reliability of the audit report and accounted for 18.59% of the total effect sizes, and had the least, but nevertheless significant, influence on lowering the audit expectation gap as it accounted for 14.32% of the total effect sizes. These two different rankings of significance could also be clearly seen in the financial analysts' subjective weighting of the independent variables. They weighted internal auditor's effectiveness as the least significant factor affecting the size of the audit expectation gap and the second factor affecting the reliability of the audit report. This difference in ranking could be partially attributed, based on the interviews of Subjects H, C and I, to the perception that the audit expectation gap phenomena primarily relates to the external audit profession rather than the internal audit function, although the subjects were aware of the importance of the integration between external and internal audits. The difference in ranking may also be partially attributed to financial analysts' perception of increasing interest in the effect of corporate accountability on the reduction of the audit expectation gap along with the importance of disclosure and transparency⁵⁷.

Based on the interviews, the audit committee was seen as a great supporter of the internal auditor's effectiveness. The interviewees pointed out that an effective audit committee reinforces internal auditors' effectiveness in detecting frauds and errors. They also added that

⁵⁷ See the next two sections: 6.2.3 & 6.2.4

the internal auditors should have the authority to report directly to the audit committee in order to enhance their independence and performance. This is, in turn, increases the accuracy of the financial reporting system. Accordingly, due to the reliance of the external auditors on the work performance and objectivity of internal auditors, and due to the vital role of the audit committee in facilitating the communications between both external and internal auditors, this should increase the reliability of the audit report. These viewpoints of the subject are also consistent with the literature that affirmed the substantial roles of the audit committees in maintaining the effectiveness of the internal auditors (Zureigat, 2011a; Goodwin & Seow, 2000; Goodwin, 2003; Braiotta, 2004; Qin, 2007; Krishnan & Visvanathan, 2007; Christopher et al, 2009).

6.2.3 Disclosure & Transparency

The results of the study showed that 'disclosure and transparency' was a significant positive influence on both the perceived reliability of the audit report and the level of the audit expectation gap. The results showed that the main effect of disclosure and transparency on the change in the size of the audit expectation gap was higher than its effect on the reliability of the audit report (23% and 16% respectively).

A possible explanation, derived from the interviews, is that disclosure and transparency are seen as having an inverse relationship with the level of the audit expectation gap; that is, the higher the level of disclosure and transparency, the lower the level of the audit expectation gap. This is because when information is disclosed appropriately, the users of the audited financial statements become aware of what is going on inside the company. Another possible explanation, again derived from the interviews, might be that there is considerable skepticism relating to the actions of management, particularly the obstruction of auditors' (internal and external) efforts to increase transparency and accountability. With such obstruction, auditors may be perceived by investors as having insufficient access to information.

It could be argued that the results of this study, in regard to the impact of disclosure and transparency on the level of the audit expectation gap, are consistent with Hajir (2001). Hajir found that the level of the disclosure and transparency was one the main factors of influence on the size of the audit expectation gap between external auditors and institutional investors in Jordan. Similarly, the results of the experiment in this study showed that the level of disclosure and transparency was the second most significant factor reducing the level of the audit expectation gap, only slightly less significant than the first-ranked factor. Hajir (2001) explained this by stating “investors perceive that the level of disclosure is not adequate and that they then look for higher levels of disclosure from the auditors” (p. 51). Hajir also recommended that the Jordanian regulatory bodies and the JACPA provide audit firms with a mandate, going beyond the expression of opinions about going concern assumptions, to disclose significant facts and financial information, and all uncertainties surrounding the company as such actions would help reduce the audit expectation gap.

6.2.4 Corporate Accountability

The results of the study showed that corporate accountability is a significant positive influence on both the perceived reliability of the audit report and changes in the level of the audit expectation gap. However, the experiment findings showed that corporate accountability was the main influence on the changes in the size of the audit expectation gap, but the least significant factor influencing the perceived reliability of the audit report.

It is noteworthy to recall that most related literature found the external auditor’s independence to be the most significant factor influencing the level of the audit expectation gap⁵⁸. However, interestingly, this thesis evidenced that corporate accountability was the most influential factor on changes in the level of the audit expectation gap between the external auditors and financial analysts. The interviews suggest that this noteworthy result could be attributed to the

⁵⁸ For more details, refer to section 3.5.4 of Chapter 3

increasing interest in the role of accountability in fighting corruption in Jordan. Such interest arises from the implication that weak corporate accountability suggests that the top management are not accountable and, if they are also major shareholders, they may consider it appropriate to view the company as theirs to do whatever they wished with. This implication has negatively affected trading in the shares of some companies. Similarly, poor corporate accountability has led to a perception by analysts that external auditors in Jordan are failing to accomplish their role as agents of shareholders⁵⁹.

In the past two years, the issue of corporate accountability has received more attention than normal in Jordan, in the light of a series of corporate scandals. "Corruption exceeded expectations, especially in public shareholding companies," said Samih Bino, the president of the Jordanian Anti-Corruption Commission (JACC) (Bino, 2013)⁶⁰. The interviewees in the current study pointed out that subsequent to the Arab Spring, Jordan witnessed the largest number of demonstrations demanding both economic reforms and political reforms. Tunisia, the Arab country that arguably triggered the Arab Spring, established an accountability act, seeking to reinforce anti-corruption efforts and establish a national accountability board (Seghaier, 2013).

In an effort to reinforce the principles of transparency and accountability, the Jordanian Transparency Center (JTC) was established in March 2011. The JTC aims to increase public awareness of the importance of accountability and is also trying to increase public awareness of the efforts being made to stamp out corruption in both the private and public sectors. In the same context, Jordanian Partners Center launched a series of educational films aiming at spreading awareness within Jordanian society of their roles of advocating accountability and transparency practices (Ammon news, 2013). Calls for accountability and anti-corruption became a slogan raised in most of demonstrations in Jordan. According to some interviewees, Jordan witnessed numerous cases of companies and well-known directors and executives who

⁵⁹ For more details, see also Qadamani (2007) and Khaza'alah (2001).

⁶⁰ From a speech during a meeting with the Financial and Economic Committee of the Jordanian House of Representatives

have been sent to the Jordanian Anti-Corruption Commission and to the courts in the past two years. The interviewees pointed out that a review of Jordanian media in the past two years would reveal a dramatic number of companies being sent to the court. A review of the media at that time confirms the interviewees' comments. For instance, in one headline, "48 listed companies were sent to the court", according to information revealed by the general observer of the Jordanian Companies Control Department (CCD) (Al-Talhouni, 2012). "The Arab Spring should be a winter for corruption", said the news reporter Akl (2013). Akl pointed out that public frustration with the dramatic instances of corruption was one of the major catalysts behind the Arab uprisings in the Middle East.

6.3 Discussion of Analysts' Decision-Making

This study provided evidence on the decision-making processes of Jordanian financial analysts and the degree of their understanding of these processes. The two sections below discuss the configularity and the level of self-insight of Jordanian financial analysts in comparison with previous research.

6.3.1 Configularity

The research revealed that Jordanian financial analysts process cues configurally (in combination) when assessing the elements of the JCGC, namely external auditor's independence, internal auditor's effectiveness, disclosure & transparency, and corporate accountability. This finding is consistent with some studies that supported configural cue processing among financial analysts in other countries (e.g. Hopkins, 2009; Ebert & Kruse, 1978; Mear & Firth, 1987; Nguyen & Ross, 2006; Slovic, 1972; Wood, 2002; Teoh, 1996).

6.3.2 Self Insight

This study is the first to establish the degree of self-insight among Jordanian financial analysts and it revealed relatively high degrees of self-insight into their decision-making processes. This conclusion is based on both quantitative and qualitative data.

This degree of self-insight demonstrated by Jordanian financial analysts is not consistent with other prior studies of financial analyst decision-making, such as a study in which financial analysts in Australia demonstrated limited and poor self-insight. Those studies revealed that financial analysts tend to overestimate the importance of minor cues and underestimate the importance of major cues (Hopkins, 2009; Mear & Firth, 1987; Libby, 1981). On the other hand, studies using external auditors, accountants (Solomon & Shields, 1995; Savich, 1977) and professional managers (Wood, 2002; Gibbins & Swieringa, 1995) as subjects have shown relatively high degrees of self-insight. The high degree of self-insight among auditors was attributed to the implementation of professional standards on auditing and to regular training performed by the professional associations (Libby, 1981; Pike, Sharp & Kantor 1988). In contrast, the high degree of self-insight among professional managers was attributed to their professionalism and their high level of experience.

It has been evidenced that the financial analysts with more work experience demonstrate moderate degrees of self-insight in the U.S and New Zealand (Feldman & Arnold, 1978; Mear & Firth, 1987; Slovic et al, 1972). In this thesis, the experience of the survey respondents who completed the experiment ranged between 5 to 27 years, with a mean of 12 years⁶¹. Those who were interviewed for the qualitative study had experiences which ranged between 14 and 27 years. This high level of subjects' experience, along with their professionalism, might be a possible explanation for that relatively high degree of self-insight among the Jordanian financial analysts.

⁶¹ See Table 4: Respondents' distribution by experience.

6.4 Perceptions of the Elements of the Corporate Governance Code in Jordan

This section discusses the interviewee's viewpoints in regard to the Jordanian corporate governance code. Prior to being presented with the eight core questions, as specified in the attached interview protocol⁶², the participants were requested to give unprompted impressions of what corporate governance means to them, thus revealing the extent of their understanding of the elements of the Jordanian corporate governance code.

The financial analysts demonstrated a high level of awareness of the elements of the Jordanian corporate governance code and their importance. The prominent consensus among the participants was that they attributed the emergence, development and adoption of codes of best practice to the increasing number of large-scale financial scandals that have taken place worldwide. Most of the participants commenced their meeting by referring to these scandals, particularly the Asian financial crisis and the collapse of some large European and American corporations such as Enron and WorldCom as common examples. The participants pointed out that these recent corporate collapses resulted in a questioning of the roles of the board of directors and the external auditors alike. They added that, in response to these financial scandals, investors, stakeholders and all those interested in dealing with the capital markets demanded the adoption of corporate governance best practices in order to ensure better protection of their interests.

Jordanian financial analysts perceived corporate governance, in general, as being important and pointed out that such systems ensure that corporations work in the best interests of their shareholders, employees, and society in general. They added that these corporate governance systems aim to reduce agency theory problems by limiting any potential conflict of interest between the company management, shareholders and other stakeholders. Poor accountability encourages directors to achieve personal interests at the expense of the owners' interests. Such corruption can lead to corporate collapses. The participants added that well-governed

⁶² See Appendix 7: Data Collection – Interview

companies are those companies that have strong corporate accountability systems in which all governing bodies and staff comply with the company's bylaws and regulations, and ensures that equitable rights of the shareholders, especially their rights to timely and adequate disclosure and transparent financial information, are provided for.

The major concern of the Jordanian financial analysts was whether listed companies embraced the JCGC. Some analysts pointed out that the JCGC is similar to those codes adopted in developed countries, but the problem lies in compliance with the code and not with the code itself. The analysts called for a more effective role for government enforcement to achieve compliance.

6.5 Theoretical Implications

As mentioned earlier, several theoretical frameworks emerged to explain corporate governance. These theories differed slightly since they viewed corporate governance from different angles (Solomon, 2010). In regard to auditing, the information hypothesis, insurance hypothesis, and agency theory evolved to justify the use of auditing (Leung, Paul, & Cooper 2011).

Agency theory is commonly employed in corporate governance (Saunders et al, 2012; Dalton et al, 2003). The research model for the current study is primarily grounded in the agency theory. The associated conflict of interests between corporate governance mosaics (in particular, the board of directors, the executive managements, the external auditors and the owners of the company) that arose because of the separation of the entities and control of those entities could be mitigated by adopting effective corporate governance mechanisms. Since poor corporate governance contributes to financial crisis and corporate collapses, it is associated with a widening of the audit expectation gap. This gap partially exists due to the lack of perceived external auditor independence, weak internal auditor effectiveness, insufficient

disclosure and transparency, and poor corporate accountability systems, according to both the interviews and the literature review in chapter 3.

Separation of ownership and control of entities means that outside (i.e. non-manager) owners need an independent body to provide assurance. The auditing profession was created in an effort to help resolve the agency theory problem, and is being further developed to ensure that shareholders and investors can rely, with confidence, on audit reports and audited financial statements. However, perceived reliance and confidence was compromised due to the instances of corporate failures that occurred without any warning signals in audit reports.

In the Jordanian context, lack of perceived reliance on the audit report and the expansion of the audit expectation gap were partially attributed to the problems associated with the agency theory and conflict of interests that may arise because of the separation between different owners, executive directors and the appointed external auditors. One aspect of agency problems (i.e. compromised auditor independence) was attributed to management pressure on the auditors, weak corporate accountability, inadequate audit fees determined by company management rather than by an independent body (e.g. the audit committee), social and personal relationships between the auditors and the board of directors and the management, which has affected the integrity of external auditor selection. Moreover, the soundness of financial reporting has been negatively impacted by the lack of well-established audit committees, with insufficient roles and authorities, as well as a lack of communication with both external and internal auditors (Swaiti, 2006; Malkawi, 2008; Abdullatif, 2006; Abu-Tapanjeh, 2006; Dahmash, 1989; Al-Basheer, 2003; Matar, 1995; Al-Saudi, 2007; Matar, 2000; Momany, 1994; Al-Awaqleh, 2008).

The interviews also revealed that the conflict of interest can be seen when the external auditors appointed by the company owners (shareholders) depend on the company management for their fees. It is common in Jordan for executive management to, effectively, appoint the external auditors and, at the same time, set their fees. Those perceptions, however, are consistent with the Jordanian literature (Malkai, 2008; Matar, 1994). The subjects considered

company management intervention on the audit fees as a tool of management pressure on auditors. The subjects also stressed the necessity of handing the duties of selecting, dismissing and remunerating the external auditors to a body independent from the company management, which should be the audit committee.

In summary, the research model appears theoretically robust. The four posited independent variables that are derived from the JCGC contributed to an increase in the perceived reliability of the audit report and in bridging the audit expectation gap. The posited four independent variables were found to be statistically significant in their influence. In addition to that, several statistically significant interactions were identified between the posited four independent variables in their influence on both the reliability of the audit report and on the reduction of the audit expectation gap.

6.6 Conclusions from the Analysis and Discussion of Findings

This study program allowed for in-depth understanding of the key selected elements of the JCGC, in so far they relate to auditing, and their relative main and interactive influence on the perceived reliability of the audit report and the level of the audit expectation gap, in the Jordanian context. The study program and the adopted mixed method technique addressed the research questions of the study. Next, the findings of the study will be summarized.

6.6.1 The relative main and interactive weights of the JCGC Selected Dimensions

6.6.1.1 The reliability of the audit report

The research technique adopted in this study succeeded in identifying and assessing the relative main and interactive weights of the selected elements of the JCGC and their influence

on the auditing profession, as measured by the perceived reliability of the audit report and changes in the level of the audit expectation gap. The relative main and interactive weights of the four hypothesized independent factors on the perceived reliability of the audit report (the first research question) were measured using objective and subjective techniques. For the objective technique, the 'Effect Size' (Coolican, 2009), was utilized.

The results of the objective measure revealed that perceived external auditor's independence had the greatest effect on the perceived reliability of the audit report among the selected factors of the JCGC. It accounted for 30% of effect size, when interaction terms are allocated back to their parent factors. The second-most influential factor was the internal auditor's effectiveness, which accounted for 27.80% of influence on the perceived reliability of the audit report. Disclosure & transparency was another statistically significant influence, measured at an effect size of 24.40%. Of the JCGC elements selected for investigation in this study, corporate accountability had the least influence on the perceived reliability of the audit report, with an effect size of 17.9%. Table 11 shows the percentage of influence for statistically significant Effect Sizes of the four selected dimensions of the Jordanian corporate governance code in relation to the reliability of the audit report:

Table 11: Effect Sizes as a Percentage of Total Effect Sizes- Reliability of the Audit Report

<u>Main Effects</u>	Percentage⁶³
External Auditor Independence (Ext)	22.71%
Internal Auditor Effectiveness (Int)	18.59%
Disclosure & Transparency (D & T)	15.70%
Corporate Accountability (Acc)	9.66%
 <u>Interactions</u>	
Significant (large*) effects and interactions at alpha 0.01	19.6%
Other significant interactions at alpha 0.05	10.70%
Sum of non–significant effects and interactions	<u>3.04%</u>
Sum of effects of interaction	<u>33.34%</u>
	100%

* According to Coolican (2009), an effect size equal to or greater than 0.14 is large.

Table 11 shows that external auditor independence is notably the main effective factor on perceived reliability of the audit report, in the perception of institutional investors.

This result is consistent with several studies (Strohm, 2006; Fearnley & Beattie, 2004; Pott, Mock, & Watrin, 2009) that pointed out that compromising the external auditor’s independence results in a loss of confidence in financial reporting and destabilizes the capital market. “Quality audits improve the reliability and enhance the credibility of the financial

⁶³ The percentage of the total variability explained by both main and interactive effects.

reporting process, thereby contributing to its usefulness and to the efficient functioning of the capital markets, which serves the public interest” (ISB, 2000, para. 3). This result was supported by the comments of interview subjects in the current study as there was a consensus that the concept of external auditor’s independence is the cornerstone of auditing and the main guarantor of the auditor expressing an independent audit report.

6.6.1.2 The audit expectation gap

The model of this study was also successful in identifying and assessing the relative main and interactive weights of the selected elements of the JCGC and their influence on the size of the audit expectation gap whether reducing or widening the gap (the second research question). The relative main and interactive weights of the four hypothesized independent factors, as regards reducing the audit expectation gap, were measured using objective and subjective techniques.

The results of the objective measure revealed that corporate accountability had the greatest effect on reducing the size of the audit expectation gap among the selected factors of the JCGC. Corporate accountability accounted for 30.65% of the effect size, when the interaction terms are allocated back to their parent factors. The second-most influential factor was disclosure & transparency, coming slightly behind corporate accountability in terms of overall influence. External auditor’s independence factor was another statistically significant underlying dimension, measured at 20.27 under the objective measure. The least influential factor affecting the level of the audit expectation gap was the internal auditor’s effectiveness, which accounted for 19.20% of effect size. Table 12 shows the percentage of influence for statistically significant Effect Sizes of the four selected dimensions of the Jordanian corporate governance code in relation to the change in the size of the audit expectation gap:

Table 12: Effect Sizes as a Percentage of Total Effect Sizes- Audit Expectation Gap

<u>Main Effects</u>	Percentage⁶⁴
External Auditor Independence (Ext)	16.03%
Internal Auditor Effectiveness (Int)	14.32%
Disclosure & Transparency (D & T)	22.94%
Corporate Accountability (Acc)	23.61%
 <u>Interactions</u>	
Significant (large*) effects and interactions at alpha 0.01	14.46%
Other significant interactions at alpha 0.05	5.20%
Sum of non–significant effects and interactions	<u>3.44%</u>
Sum of effects of interaction	<u>23.10%</u>
	100%

* According to Coolican (2009), an effect size equal to or greater than 0.14 is large.

Interestingly, the results of the study suggested that corporate accountability was the most influential factor on the size of the audit expectation gap. Much of the literature related to the audit expectations gap (Abdel-Qader, 2002; Hajir, 2001; Al-Thuneibat, 2003; Omari, 2003; Al-Khadash & Al-Sartawi, 2010; Jarbou, 2004; Jarbou, 2007; Sidani & Olayan, 2007; Al-Qarni, 2004; Elmeligy, 2006; Al-Husaini, 2000; Humphrey et al, 1993; Koh & Woo, 1998; Dewing & Russell, 2002; Salehi & Rostami, 2009; Gloeck & Jager, 1993; Gray & Manson, 2008; Lin & Chen, 2004)

⁶⁴ The percentage of the total variability explained by both main and interactive effects

have referred to the external auditor's perceived lack of independence as the main factor in widening the audit expectation gap.

The interviews suggest that the perceived importance of cooperate accountability is related to the increasing public interest within Jordan regarding accountability and corruption. Accountability, political and economic reforms and anti-corruption actions in all Jordanian sectors have attracted a great deal of publicity in the past two years. The call for reform in Jordan was not an accident nor divorced from what was happening in neighboring countries. Indeed, the Arab uprising affected the situation in Jordan and accelerated the pace of reform. Some of the interviewees affirmed that these demonstrations succeeded in bringing about action against corruption in Jordan, as demonstrated by the dramatic number of directors and companies that have been sent to the Jordanian Anti-Corruption Commission and to the courts in the past two years.

6.6.2 The Constituents of the JCGC and Cue Processing

The hypothesis of the study suggests that the Jordanian financial analysts process information configurally when considering the selected dimensions of the Jordanian corporate governance code. Several significant interactions between the study variables have been identified on both the perceived reliability of the audit report and the level of the audit expectations gap. These interactions accounted for approximately one-third of the effect on the reliability of the audit report and approximately one-quarter of the effect on the level of the audit expectations gap. Furthermore, the existence of 'large' statistically significant interactions between the study variables further confirms and supports the hypothesis of the study.

The existence of these significant interactions in the impact of the selected elements of the JCGC, based on the perceptions of Jordanian financial analysts, sends a clear message to the policy makers and Jordanian regulatory bodies, especially the JSC which is responsible for

issuing, revising and monitoring listed companies' compliance with the JCGC. The message is that Jordanian financial analysts, during their judgment decisions, take into consideration the joint effects of these key factors, not just their individual effects. Therefore, the JSC must not just focus on the most decisive factor in their enforcement program, but must realize that the complete environment, in the form of the complementary factors, influence analyst decisions. The JSC must consider how these factors interact.

6.6.3 A Note on Self-Insight

Research questions three and four were aimed at investigating the degree of self-insight that institutional investors in Jordan demonstrate in their assessment of the impact of the selected elements of the Jordanian corporate governance code on both the perceived reliability of the audit report and changes in the size of the audit expectation gap. After completing the 16 hypothetical scenarios (the objective measure), the financial analysts were asked to complete a self-reported weighting (the subjective measure) in which they allocate 100 points among the four selected elements of the JCGC. In conclusion, the comparison of these two measures plus the analysis of the qualitative in-depth interviews delivered further evidence of relatively high degrees of self-insight among Jordanian financial analysts into their decision making processes.

6.6.4 In-depth interviews

This section addresses this study's fifth research question "How and why do institutional investors' assessments of the elements of the JCGC affect their perception of the reliability of the audit report and changes in the level of the audit expectation gap?" Jordanian institutional investors were asked to explain why the selected elements of the JCGC influence their assessments. The analysis of the participants' viewpoints regarding each of the independent variables, focusing on identifying recurring themes among the various viewpoints, contributed

to an in-depth understanding of the participants' perceptions of the influence of the JCGC, facilitated the interpretation of relative main and interactive weights of the study factors, and contributed to ascertaining the degree of self-insight among the Jordanian financial analysts.

The financial analysts demonstrated high levels of awareness of the importance of and the nature of the elements of the JCGC. The participants pointed out that recent corporate collapses resulted in a questioning of the roles of the directors, and the external and internal auditors, and enhanced the importance placed by financial analysts on good corporate governance, with particular focus on ensuring adequate disclosure and transparency and effective corporate accountability.

6.7 Practical Implications

The insights gained could be used as follows:

- a) Better targeting of enforcement actions by regulators of companies and auditors so as to have a positive impact on the stock market.
- b) The evidence would provide an important message for communicating to directors the impact that their governance decisions will have on institutional investors' willingness to invest in their shares.
- c) To reorient academic research in this area to include interactional dimensions.
- d) To encourage a reorientation of governance research in other developing countries to include cause and effect relationships.

6.8 The limitations of the Study

As with all research, there are actual and potential limitations to the current study. This study's limitations can be categorized into three types: limitations of design, limitations of scope, and limitations of application.

6.8.1 Limitations of Design

“Limitations of design are principally related to the limited contact between the researcher and respondents, which does not really allow the researcher to gain clarification of responses or additional information on points of interest” (Wood, 2002, p. 257).

This thesis aims to identify the impact of the selected elements of the Jordanian corporate governance code in so far as they relate to the impact on the perceived reliability of the audit report and changes in the size of the audit expectations gap, according to institutional investors in Jordan. This thesis focuses on the external auditor's independence, the internal auditor's effectiveness, disclosure & transparency, and corporate accountability. Through this investigation, this thesis endeavors to contribute to narrowing the expectation gap. Other studies (Ojo, 2009; Siddiqui et al, 2009; Dickins & Higgs, 2009; Rehana, 2010; Sikka et al, 1992; Sidani & Olayan, 2007; Haniffa & Hudaib, 2007; Fadzly & Ahmad, 2004; Pierce & Kilcommins, 1997; Wolf et al, 1999) have investigated and pointed out the importance of other factors such as the role of accounting professional associations, the code of professional ethical conduct in relation to auditing, and the role of audit education in narrowing the audit expectations gap. Some studies also highlighted the importance of auditors' experience and integrity, alongside auditors' independence, in regards to maximizing auditors' objectivity and ultimately increasing the reliability of the audit report (Taylor et al, 2003). Other studies (Teoh et al, 1996; Gul, 1991) posited the impact of disclosing the extent of non-audit services, and/or restrictions on the provision of non-audit services to audit customers, on the perceived reliability of the audit

report. The repeated measures design, applied to four independent factors, yielded 16 scenarios. Adding more variables, such as some of those outlined in other studies, would have increased the number of the scenarios to such an extent that they might have rendered the questionnaire impractical (i.e. participants could find it harder to complete), which consequently, could jeopardize the response rate.

The questionnaire contained 16 hypothetical scenarios, any of which could have been difficult to conceptualize for some respondents. This potential difficulty contributed to the decision to confine the unit of analysis to institutional investors only. Individual investors were excluded in order to enhance the experimental design adopted in this study. Professional financial analysts are the better choice when conducting experimental studies because they demonstrate a better understanding of experimental surveys and have more skills with which to analyze the treatments provided in the questionnaire. Furthermore, they are more capable of making informed judgments about the causal relationship of the factors in the study (O'Reilly, 2009; Teoh & Lim, 1996).

Another inherent limitation of the factorial experiment design employed in this study is the decision to limit scenario variations to two levels: lower and higher. Including additional levels would result in a dramatic increase in the number of scenarios and would have rendered the questionnaire unfeasible (for instance, the use of three levels instead of two, under the four posited independent variables, results in increasing the number of scenarios from 16 to 81). The use of two levels is common in research and has enabled various studies to achieve their objectives (Hopkins, 2009; Wood & Ross, 2006; Teoh & Lim, 1996; Nguyen & Ross, 2006).

6.8.2 Limitations of Scope

There are three sets of corporate governance codes in Jordan; one for the banking sector, another for the insurance sector and a third one for publicly traded companies at the Amman Stock Exchange, the latter one being the code under investigation in this thesis.

The audit expectation gap phenomenon emerges because of the difference in perceptions between auditors and non-auditors regarding the responsibilities of the auditors. Many parties rely on the message conveyed by the auditor's report including the company managers, members of the board of directors, creditors and the credit staff at banks, and the preparers of the financial statements such as the company financial managers and accountants. These parties, in addition to the investors, are the principal parties impacted by the quality of the audit report, and they constitute the other side of the audit expectation gap (see for instance, Abdullatif, 2003; Al-Khadash et al, 2012; Jarbou, 2007; Al-Khadash & Al-Sartawi, 2010; Hajir, 2001; Omari, 2003). However, the scope of this thesis is confined to a unit of analysis made up of institutional investors in Jordan, enabling this study to achieve precise and focused results. In regards to suggestions for future studies, research covering those groups of financial statement users excluded from this study may generate further insights and contribute to a more comprehensive understanding of how corporate governance codes impact the independence of auditors and the audit expectations gap.

This study's field work in Jordan was conducted during the 'Arab Spring'. Based on the interviews, the participants highlighted the importance of accountability in both private and public sectors and asked for more governmental intervention in controlling and regulating the capital market. Slogans demanding strict implementation of accountability and the fighting of corruption became common in Jordanian demonstrations. This situation probably influenced the viewpoints of the interviewees, therefore, the findings of the study must be considered in this context, and caution should be exercised in applying the findings outside this context.

6.8.3 Limitations in Applications

This thesis was limited to testing the corporate governance code in so far as it relates to the auditing profession in Jordan. The general concepts and elements of corporate governance are likely to be comparable in developing and developed countries. However, some differences are likely because of specific legal and social contexts. Examples of such differences include the composition and the authority of the audit committees, and the regulations regarding auditors providing non-audit services. Furthermore, business culture may vary from country to country, with, for example, varying degrees of dominant shareholdings, crony capitalism, and the influence of religious values, which may limit the ability to generalize the study's findings. Therefore, cautions must be taken in generalizing the findings of the study to other countries.

6.9 Suggestions for Future Research

The findings of this thesis provide useful insights into how the external auditor's independence, the internal auditor's effectiveness, disclosure & transparency, and corporate accountability affect institutional investors' perception of the reliability of the audit report and the level of the audit expectation gap. The results also established a starting point for future research.

While effective corporate governance was found to have a positive influence on the Jordanian auditing profession in regard to increasing the perceived reliability of the audit report and on narrowing the audit expectation gap, more empirical evidence is needed since the JCGC was implemented in 2009 and is thus relatively recent. Further research is suggested to investigate the potential roles of the JCGC on other issues such as the practice of earnings management and the characteristics of effective audit committee as a key pillar of corporate governance. Such studies might add a valuable contribution to understanding the importance of maintaining effective corporate governance systems. Moreover, the other (excluded) users of the financial statements, mentioned in the limitation of scope section, and the other factors mentioned in

the limitation of design section, including those elements of the JCGC not selected for this study, present opportunities for further studies to be undertaken in Jordan in order to identify a comprehensive approach to be adopted to minimize the audit expectation gap.

Financial analysts, as expert judges, are expected to possess high degrees of self-insight since that reflects the extent of the accuracy, consistency and confidence in their judgement decision-making process (Libby, 1981; Hooper & Trotman, 1996). Libby (1981) and Hooper & Trotman, (1996) also pointed out that understanding the contributors to self-insight is an crucial issue in the learning process, in training and education, and for maintaining consistency and accuracy in judgment decision making. Therefore, since both qualitative and quantitative methods suggested that Jordanian financial analysts possess a relatively high degree of self-insight, more research is needed to investigate the causes and contributors to that degree of self-insight, and to develop tools to maximize and maintain a high degree of self-insight.

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Appendices

Appendix 1: Ethics Approval

Human Research Ethics Committee

Committee Approval Form

Principal Investigator: Waleed Abdel-Qader

Student Researcher: Mohammad Shbeilat

Ethics approval has been granted for the following project:

The Jordanian Corporate Governance Code: A study of Institutional Investors Perception of the Reliability on the Audit Report and the Audit Expectation

for the period: 02/07/2012 – 30/06/2013

Human Research Ethics Committee (HREC) Register Number: 2012 116N

Special Condition/s of Approval

Prior to commencement of your research, the following permissions are required to be submitted to the ACU HREC:

N/A

The following standard conditions as stipulated in the *National Statement on Ethical Conduct in Research Involving Humans* (2007) apply:

- (i) that Principal Investigators / Supervisors provide, on the form supplied by the Human Research Ethics Committee, annual reports on matters such as:
 - security of records
 - compliance with approved consent procedures and documentation
 - compliance with special conditions, and

- (ii) that researchers report to the HREC immediately any matter that might affect the ethical acceptability of the protocol, such as:
- proposed changes to the protocol
 - unforeseen circumstances or events
 - adverse effects on participants

The HREC will conduct an audit each year of all projects deemed to be of more than low risk. There will also be random audits of a sample of projects considered to be of negligible risk and low risk on all campuses each year.

Within one month of the conclusion of the project, researchers are required to complete a *Final Report Form* and submit it to the local Research Services Officer.

If the project continues for more than one year, researchers are required to complete an *Annual Progress Report Form* and submit it to the local Research Services Officer within one month of the anniversary date of the ethics approval.

Signed:  Date: 06/12/2012

(Research Services Officer, Melbourne Campus)



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INFORMATION LETTER TO PARTICIPANTS

TITLE OF PROJECT: Corporate Governance and the Auditing Profession

PRINCIPAL SUPERVISOR: Dr Waleed Abdel-Qader

STUDENT RESEARCHER: Mohammad Shbeilat

PROGRAMME ENROLLED: Doctor of Philosophy

Dear Participant

You are invited to participate in a study about The Jordanian Corporate Governance Code. This survey is part of a PhD study being undertaken by Mohammad Shbeilat of the faculty of business at the Australian Catholic University. You are invited due to your experience as a financial analyst. The primary objective of this thesis is to improve understanding of how the implementation of the newly adopted Jordanian corporate governance code has affected the perceived reliability of an independent audit opinion and the extent to which the code might help in narrowing the audit expectation gap. The audit expectation gap refers to the different perceptions between the auditors' actual performance and to what report users believe the auditors should be performing and achieving as auditors. If you participate in this study, you will

be invited to take part in a one-on-one interview with the researcher, in addition to the survey questionnaire.

As professional investors, the participants will share equally with other Jordanian investors the social benefits of improved knowledge of the influence of the Jordanian corporate governance code. We do not foresee any significant risk in participating in this study. The interview will not ask after details of your personal life, other private matters, or any organizational specific questions, but it will take on the form of a conversation about your experience of the Jordanian corporate governance and the auditing profession.

The duration of the interview will be between 45-60 minutes, where the time needed to fill in the questionnaire is approximately 20 minutes. No preparation on your part is necessary. The interview will be held at your office, alternatively, you can request for the interview to be held in a different location and whether to be conducted during work hours or during the break. The interviews will be recorded using a mobile recording device.

The purpose of this study is to fill the gap in knowledge surrounding institutional investors' perception in evaluating the impact of the newly adopted Jordanian Corporate Governance Code on the auditing profession and to Increase knowledge of how the elements of the Jordanian corporate governance codes affects the reliability of the audit report. It is expected that the results and the potential recommendations will also be of the benefit of the Jordanian capital market regulatory bodies.

Participation is voluntary and you are free to refuse consent or withdraw from project at any time without any penalty and without giving a reason.

This study will ensure the confidentiality of your Participation. No identifying factors such as name or contact details will be disclosed to anyone but the researcher. When the study is published, your name and the name of your workplace (or any other identifying information) will be replaced with pseudonyms, and may appear like this:

Katrina (pseudonym) worked at Organization A (pseudonym) , , ,

Interview transcripts and recordings will be stored in the student laptop which has a security password while conducting the study in Jordan, and then in secure facilities at ACU, with no identifying information attached.

Please return the completed questionnaire in the envelope provided to: P.O.Box 410969 Jabal Al-Taj 11141 Amman – Jordan. Please indicate if you would like to receive a copy of a summary conclusions report on the published results at the end of the meeting or by answering question 4 of Part C of the questionnaire. If you would like further information about this study, please contact the student researcher or the Principal Supervisor at any time.

Principal Supervisor

Dr Waleed Abdel-Qader

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Tenison House Level 10, 8-20 Napier Street, North Sydney NSW 2060

Student Researcher

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Level 10, 8-20 Tenison House. North Sydney NSW 2060

Please be advised that this study has been approved by the Human Research Ethics Committee at Australian Catholic University. In the event you have any complaint or concern or if you have any query that the supervisor and Student Researcher have not been able to satisfy, you may write to the Chair of the Human Research Ethics Committee on the following address:

NSW and ACT: Chair, HREC

C/- Research Services

Australian Catholic University

North Sydney Campus

PO Box 968

NORTH SYDNEY NSW 2059

Tel: 02 9739 2105

Fax: 02 9739 2870

res.ethics@acu.edu.au

Any complaint or concern will be treated in confidence and fully investigated. The participant will be informed of the outcome.

If you agree to participate in this project, you should sign both copies of the Consent Form, retain one copy for your records and return the other copy to the Principal Supervisor or Student Researcher.

Dr Waleed Abdel-Qader

Principal Investigator

Mohammad Shbeilat

Student Researcher

Appendix 3: Letter to the Professional Association of Financial Analysts



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Letter to the Professional Association of Financial Analysts

TITLE OF PROJECT: Corporate Governance and the Auditing Profession

PRINCIPAL SUPERVISOR): Dr Waleed Abdel-Qader

STUDENT RESEARCHER: Mohammad Shbeilat

PROGRAMME ENROLLED: Doctor of Philosophy

Dear Professional Association of the Financial Analysts in Jordan

Mohammad Shbeilat is a student researcher at the faculty of business at the Australian Catholic University and conducting a study about The Jordanian Corporate Governance Code and its impact on the auditing profession in Jordan. Mohammad is seeking permission to advertise the attached file (Information Letter to Participants) amongst the members of Professional Association of Financial Analysts in Jordan. Please refer to the attached Information Letter to Participants for more details about the study aims, location, and duration.

Dr Waleed Abdel-Qader

Mohammad Shbeilat

Principal Investigator

Student Researcher

Appendix 4: Reply From CFA-Jordan

Dear Mohammad,

“After consulting with our board we can help in disseminating the information letter to participants and the questionnaire to the contact list that we have, with any replies going back directly to you.

You would then have to manage any further correspondence on your own (interviews etc) directly based on the replies you get”.

All the best,

President of CFA Society Jordan

Appendix 5: Consent Form



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CONSENT FORM

TITLE OF PROJECT: The Jordanian Corporate Governance Code: A study of Institutional Investors' Perception of the Reliability on the Audit Report and the Audit Expectation Gap

PRINCIPAL SUPERVISOR: Waleed Abdel-Qader

STUDENT RESEARCHER: Mohammad Shbeilat

I have read and understood the information provided in the Letter to Participants. Any questions I have asked have been answered to my satisfaction. I agree to participate in this approximately one hour audiotaped interview or in the questionnaire that takes about 20 minutes to complete, realising that I can withdraw my consent at any time without adverse consequences. I agree that research data collected for the study may be published or may be provided to other researchers in a form that does not identify me in any way.

NAME OF PARTICIPANT:

SIGNATURE.....

DATE:

SIGNATURE OF PRINCIPAL SUPERVISOR: Waleed Abdel-Qader

DATE:

SIGNATURE OF STUDENT RESEARCHER: Mohammad Shbeilat

DATE:

Appendix 6: Data Collection - Experimental Survey



The Jordanian Corporate Governance Codes

&

The Auditing Profession Study

This questionnaire is part of a PhD study being undertaken by Mohammad Shbeilat of the faculty of business at the Australian Catholic University into the institutional investors' perceptions of the reliability of the audit report and the audit expectations gap

Your views will contribute greatly to the level and quality of information being gathered. Please complete all 3 parts of the questionnaire yourself and without discussion with colleagues.

Your responses and comments are strictly confidential. This questionnaire is anonymous unless you opt to provide contact details to receive a copy of the research report. No responses or comments will be individually attributed in any published report and any comments used will be de-identified. Participation in the study is entirely voluntary. The questionnaire should take less than 20 minutes to complete.

Please return the completed questionnaire in the envelope provided to:

P.O.Box 410969 Jabal Al-Taj 11141 Amman – Jordan

OR You can send a soft copy to mohammad.shbeilat@acu.edu.au

COMPLETION INSTRUCTIONS – PART A

Please read the following definitions in order to best visualize the scenarios presented.

The Jordanian Corporate Governance Codes (JCGC):

Refers to the JCGC that has been approved and issued by board of the commissioners of the Jordanian Securities Commission on the 29th of July 2008 for the publicly traded companies listed on the Amman Stock Exchange and which has come into effect as of the first of January 2009. The JCGC contains five chapters as follows: Definitions, The Board of Directors of the Shareholding Company, General Assembly Meetings, Shareholders Rights, and the Disclosure and Transparency respectively. The latter chapter has also discussed the roles and duties of the audit committees, external auditors and the internal auditors.

External Auditors' Independence: Freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditor's ability to make unbiased audit decisions (ISB, 2000).

Internal Audit Effectiveness refers to the extent to which the designated internal audit objectives and functions are achieved properly, are unbiased, and are free from management pressure that may compromise the internal auditor's performance. Examples of those designated internal audit functions are safeguarding assets against loss and theft, providing reasonable assurances that the financial and operating information are accurate and reliable, and ensuring the entity's compliance with laws and regulations.

Disclosure and Transparency: Refers to the quality and reliability of information, whether financial or non-financial, provided by the company to the shareholders and the users of the financial reporting.

Corporate Accountability: Refers to the ability of the shareholders and the stakeholders to hold the governing body of the company such as the executive management, the board of directors and the external auditors accountable and answerable to the laws, the regulations and the company's bylaw based on their power and responsibilities.

The audit expectation gap: The audit expectation gap refers to the different perceptions between the auditors' actual performance and to what report users believe the auditors should be performing and achieving as auditors.

Reliability of the audit report: refers to the extent to which the institutional investor can rely on the audit report to clearly convey significant instances of poor internal controls; accounting errors, biases, or omissions; and concerns regarding the application of the going concern assumption.

PART A - The Exercise

You are presented with 16 hypothetical investment scenarios. Each scenario is slightly different. Each investment scenario requires 2 responses. Please consider each in isolation relative to your Typical Assessment of each scenario on the reliability of an audit report and the typical size of the audit expectation gap and then score all the cases relative to those two typical scenarios. Each of the four corporate governance dimensions is assigned either a high or low rating. High refers to the a level achieved by the top 1/3 of companies on that factor and Low refers to a level of performance achieved by the 1/3 least successful companies on that factor.

Example - The response for your typical case would appear like this:

Typical External Auditor's Independence

Typical Disclosure and Transparency

Typical Internal Auditor Effectiveness

Typical Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse				Substantially Better		
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 1

Lower External Auditor's Independence

Higher Disclosure and Transparency

Higher Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse				Substantially Better		
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 2

Lower External Auditor's Independence

Lower Disclosure and Transparency

Higher Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 3

Higher External Auditor's Independence

Higher Disclosure and Transparency

Higher Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 4

Higher External Auditor's Independence

Lower Disclosure and Transparency

Higher Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 5

Higher External Auditor's Independence

Lower Disclosure and Transparency

Lower Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 6

Lower External Auditor's Independence

Higher Disclosure and Transparency

Lower Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 7

Higher External Auditor's Independence

Higher Disclosure and Transparency

Higher Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 8

Lower External Auditor's Independence

Higher Disclosure and Transparency

Lower Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 9

Higher External Auditor's Independence

Lower Disclosure and Transparency

Higher Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 10

Lower External Auditor's Independence

Lower Disclosure and Transparency

Lower Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 11

Higher External Auditor's Independence

Higher Disclosure and Transparency

Lower Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 12

Lower External Auditor's Independence

Lower Disclosure and Transparency

Lower Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 13

Higher External Auditor's Independence

Lower Disclosure and Transparency

Lower Internal Auditor Effectiveness

Lower Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 14

Higher External Auditor's Independence

Higher Disclosure and Transparency

Lower Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 15

Lower External Auditor's Independence

Lower Disclosure and Transparency

Higher Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

Case 16

Lower External Auditor's Independence

Higher Disclosure and Transparency

Higher Internal Auditor Effectiveness

Higher Corporate Accountability

Your Assessment on the Following (circle)

	Substantially Worse					Substantially Better	
Reliability of the Audit Report	-3	-2	-1	Same	+1	+2	+3
Audit Expectation Gap	-3	-2	-1	Same	+1	+2	+3

PART B

Please indicate the relative importance each of the four variables had on your judgments by allocating 100 points between them for each of the outcome measures (i.e. each column should total 100):

	Reliability of the Audit Report	Audit Expectation Gap
External Auditor's Independence	-----	-----
Internal Auditor Effectiveness	-----	-----
Disclosure and Transparency	-----	-----
Corporate Accountability	-----	-----

Please indicate by circling a number on the scale below how confident you feel that the four factors together represent the major determinant of your assessment of the:

(1) Reliability of the audit report	Lower Confidence	1	2	3	4	5	6	7	Higher confidence
(2) Audit expectation gap	Lower Confidence	1	2	3	4	5	6	7	Higher confidence

Please list other related factors from the Jordanian Corporate Governance Codes that you think would be relevant to your assessment of your perceptions of:

A greater reliability of the audit report

A narrowing of the expectation gap

PART C

1- Please indicate the type of the company you are currently work in:

a- Bank b- Insurance Company c- Brokerage company d- Investment fund

e- Other, please specify

2- How many years have you worked as a financial analyst, Investment analyst/officer or investment manager? _____ years

3- Please indicate your position:

a. Manager (of the investment department) b. Head of the investment section

c. Investment analyst/officer d. If others, please specify.....

4- Please indicate if you would like to receive a copy of a summary conclusions report. Yes / No

If you have answered Yes to the above, please provide your contact details:

Name _____ Position _____

Company _____

Telephone _____ email _____

If you have any questions regarding this questionnaire please contact:

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Appendix 7: Data Collection – Interview

Interview Protocol

- ❖ Thank
- ❖ Explain the terms used in the study and deliver a brief introduction to study contribution
- ❖ Hardcopy of the corporate governance code was available during the meetings
- ❖ Request unprompted impressions of what does the corporate governance means to them.

1- How does your assessment of the external auditor's independence affect your perception of the reliability of the audit report?

Can you please tell me why?

2- How does your assessment of the internal auditor's effectiveness affect your perception of the reliability of the audit report?

- Can you please tell me why?

3- How does your assessment of the level (poor, medium, strong) of the disclosure and transparency affect your perception of the reliability of the audit report?

- Can you please tell me why?

4- How does your assessment of the level (poor, medium, strong) of corporate accountability affect your perception of the reliability of the audit report?

- Can you please tell me why?

5- How does your assessment of the external auditor's independence affect your perception on the level of the audit expectation gap?

- Can you please tell me why?

6- How does your assessment of the internal auditor's effectiveness affect your perception on the level of the audit expectation gap?

- Can you please tell me why?

7- How does your assessment of the level (poor, medium, strong) of the disclosure and transparency affect your perception on the level of the audit expectation gap?

- Can you please tell me why?

8- How does your assessment of the level (poor, medium, strong) of corporate accountability affect your perception on the level of the audit expectation gap?

- Can you please tell me why?

Thanks Interviewee

Appendix 8: List of Abbreviations

ACU	Australian Catholic University
AICPA	American Institute of Certified Public Accountants
ASCA	Arab Society of Certified Accountants
ASE	Amman Stock Exchange
ASXCGC BP	THE Australian Stock Exchange Corporate Governance Council Best Practices
BoD	Board of Directors
CBJ	Central Bank of Jordan
CCD	Companies Control Department in Jordan
CEO	Chief Executive Officer
CFA - Jordan	Professional Association of Financial Analysts in Jordan
CIPE	Centre for International Private Enterprise
CFM	Certified Financial Management
CMA	Certified Managerial Accounting
CPA	Certified Public Accountant
FRC	The Financial Reporting Council in the UK
FASB	Financial Accounting Standard Board
GAAS	Generally accepted auditing standard
GATT	General Agreement on Tariffs and Trade
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
IRC	Insurance Commission: in Jordan
ISA	International Standards on auditing
JACC	Jordanian Anti-Corruption Commission
JACG	The Jordanian Association of Corporate Governance
JACPA	Jordanian Association for Certified Public Accountants
JCGC	Jordanian Corporate Governance Code for the publicly-traded companies which have been approved by the JSC board of the commissioners on the 29th of July 2008 and came into effect as of the first of January 2009
JSC	The Jordanian Securities Commission
JTC	Jordanian Transparency Center
MENA	Middle East and North Africa
NYSE	New York Stock Exchange
NASDAQ	National Association of Securities Dealers Automated Quotations
NAS	Non-audit services
OECD	The Organization for Economic Co-operation and Development
ROSC	Report on the Observance of Standards and Codes
SDC	Securities Depository Center – for Jordan

SEC	Securities and Exchange Commission in American
SOX	Sarbanes-Oxley Act of 2002
SPSS	Statistical Package for Social Sciences
WTO	World Trade Organization

Appendix 9: Proofreading Certificate



To Whom It May Concern:

Thesis Title: The Jordanian Corporate Governance Code: a Study of Institutional Investors' Perception of the Reliability of the Audit Report and the Audit Expectation Gap

University: Australian Catholic University

Student Name: Mohammad K. Shbeilat

This is to certify that Clarity Editors have edited the above titled Ph.D. thesis by Mohammad Shbeilat, providing feedback on the language, completeness and consistency of the document. The services rendered were limited to copyediting and proofreading, as covered in Standards D and E of the Australian Standards for Editing Practice. Clarity Editors did not modify or provide feedback on the substance and structure of the thesis beyond drawing the author's attention to potential problems.

Sincerely,

A handwritten signature in black ink, appearing to read "Hisham Alhubaishi".

21 May 2013

Hisham Alhubaishi

Chief Editor

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