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Stock Market Segmentations, Free Cash Flow and Earnings Management: The Roles of Moderating Independent Audit Committee and Audit Quality (The Case of Jordan from an Agency Theory Perspective)

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Abstract
Purpose: The current study aims at formulating the stock market segmentations as an independent variable. As well, the study develops a conceptual framework that aims to employ the agency theory in providing evidence concerning earnings management practices in particular free cash flow situation and stock market segmentations in Jordanian public firms.
Design/methodology/approach: The study uses a detailed review of current empirical studies and literature (journal papers and publications) in both developing and developed countries, to establish framework from the perspective of agency theory and to develop the propositions.
Expected findings: It's expected to document a positive relationship between free cash flow and earnings management, and this relationship is moderated by independent audit committee and audit quality. Likewise, it's expected to report a positive relationship between stock market segmentations and earnings management.
Research limitations/implications: This is a conceptual paper. Future research is needed to validate the proposed propositions empirically.
Practical implications: The results of the study will provide beneficial information to shareholders, investors, creditors, managers and members of boards of directors of public firms, internal and external auditors, tax department, regulators and policy makers.
Originality/value: This article adds value to scholarship by formulating the stock market segmentations variable for the first time in the literature. Besides, the current article is employing the agency theory framework to postulate the interactions between the variables. To date, this is the first study that attempts to explorer the moderating roles of Independent audit committee and audit quality between stock market segmentations, free cash flow and earnings management, which provides a valuable evidence for companies seeking to understand and reduce agency problems in Jordanian context.

Keywords: Earnings Management, Stock Market Segmentations, Agency Theory, Free Cash Flow, Independent Audit Committee, Audit Quality

1. Introduction

Agency theory is an archaic concept, rather an incremental progression involving a combination of relationships and ideas (Bendickson et al., 2016a). Agency theory is undeniably among the predominant theories of economic organization and management. As such, agency theorists are routinely challenged to more fully clarify the omnipresent agency problem and how to address it. The problem arises whenever one party (principal) hires another (agent) to create value. The essential features of the agency problem are the divergence of the principal and agent interests, and the imperfect knowledge of the principal about the agent's contribution (Bosse and Phillips, 2016).

Assuming the agent and principal are self-interested utility maximisers, a problem emerges for the principal when (1) the two parties have divergent interests and (2) the agent has better information than the principal. These conditions create the probability, which the agent will not act in the best interests of the principal (Bosse and Phillips, 2016). So, the domain of agency theory is relationships that mirror the basic agency structure of a principal and an agent who are engaged in cooperative behaviour, but have different goals and attitudes toward risk (Eisenhardt, 1989).

Shareholders have been losing the trust in the integrity of accounting figures, especially after several corporations financial reporting scandals around the world, and that led to a growing attention to the quality of earnings among researchers (AL-Dhamari and Ismail, 2014), the spread of these scandals in the late decades call attention to the fact that strong financial performance is not always resulting from true economic performance; rather they suggest that financial information can be manipulated by agents to appear better than the economic reality of the firm. Well-known companies such as Enron, Tyco, WorldCom, and Xerox, who commanded financial respect by appearing to provide so well financially, were uncovered to have engaged in earnings manipulation to produce their attractive financial outcomes (Litt et al., 2013). Hence, when managers engage in earnings management practices, the reported figures may not represent the real economic situation. If shareholders make non- optimum decisions as a result of these practices, then earnings management may lead to an agency cost (Davidson et al., 2004).

On one hand, public shareholding companies are usually monitored for compliance with regulations; most of these regulations are linked to financial ratios, which lead to create pressure for managers to manipulate earnings to meet regulations (Habbash and Alghamdi, 2015). However, many studies documented that these regulations create motivations to manage the financial statements (Healy and Wahlen, 1999). On the other hand, a conflict of interests has potential agency cost when management do not maximize shareholders' welfare. In a situation where a company has an excess free cash flow after all profitable projects has been financed, managers may engage in earnings management using accounting discretion to cover up negative net present value projects and to show better performance of the company (Chung et al., 2005; Nekhili et al., 2016).

Jordan is one of the emerging countries in which users rely on accounting information before making investment decisions and Jordanian market is one of the important MENA markets, and the liberalisation and the openness of this market attract the foreign investments (Ghunmi et al., 2013). However, Jordanian firms display important resources equal to (9.6%) of net assets as cash (Al-Amarneh, 2015). So it's valuable to study agents' tendency to manage earnings in the situation of free cash flow. Moreover, On September 30, 2012 the board of directors of Amman Stock Exchange issued the decision number (33/2012), which stated that the price thresholds of the traded stocks increased to ± 7.5% instead of ±5% of the last traded price, and this advantage is applicable only for the companies listed in the first market, and price threshold for the companies that listed in the second and third market remained ±5% of the last traded price (ASE, 2012a). Based on this regulation it`s a needful to investigate the effect of the stock market segmentations on the earnings management. Accordingly, we argue that free cash flow and stock market segmentations may be inducers for the managers to engage in earnings management using accounting discretion.

However, agency theory suggested that the monitoring mechanisms might be worked to adjust managers and shareholders' interests, as well as to mitigate the conflict of interest and any opportunistic conduct emerging from (Alzoubi, 2016). Audit quality and audit committee were aforementioned in several studies are efficient in restraining managerial opportunistic behaviour (Rusmin et al., 2014; Noor et al., 2015; Nekhili et al., 2016; Astami et al., 2017). Thence, the study assumed that audit quality and independent audit committee are going to weaken the relationships between independent variables (Stock Market Segmentations & Free Cash Flow) and dependent variable (Earnings Management).

Agency theory provides theoretical justifications which can directly link the variables of the study. A conceptual framework is developed to employ the agency theory as the main theory to investigate earnings management practices in particular free cash flow situation. As well, the purpose of the current study is to formulate the stock market segmentations as an independent variable and explorer its influence on earnings management. Moreover, the study aims to investigate whether independent audit committee and audit quality are able to reduce the practice of earnings management in Jordan.

However, the significance of the current study is derived from the importance of the reliability of the financial reporting published by Amman Stock Exchange to all users of financial statements in order to make decisions. As addressed, earnings management may have a negative effect on these financial reports, which in turn may mislead shareholders. It`s vital to provide evidence on the mitigation of agency problem of surplus free cash flows and stock market segmentations in term of earnings management in such an emerging economy, and sheds light on the moderator variables.

This study contributes to the scholarship with formulating the stock market segmentations variable (for the first time in the literature), this will fill a gap in the body of literature on earnings management, and to the best of researchers` knowledge the impact of stock market segmentations on earnings management was not examined either in Jordan or elsewhere in the world. Additionally, due to the lack of studies in Jordan, it is of great importance to investigate the relationship between free cash flow and earnings management from the perspective of agency theory. Furthermore, this is the first study that tests the moderating roles of the two corporate governance mechanisms, namely independent audit committee and audit quality between free cash flow and earnings management in Jordan. This will provide original and beneficial information to shareholders, investors, creditors, regulators, tax authorities, and all other users.

2. An overview of Jordanian Stock Market

Jordan is a nation in the Middle Eastern world in the southwest of Asia. It is a small country with restricted natural resources, yet the country's legitimate and organizational structures have been reviewed, and critical moves have been made to restructure, liberalize and increment the openness of the national economy. Improvement of the Amman Financial Market is at focal point of these considerations. It intends to give a solid and secure environment for its listed securities while protecting and ensuring the rights of its investors. The financial market is focused on the standards of transparency, straightforwardness, and efficiency. Three organizations have developed out of the financial market including the Jordan Securities Commission, the Amman Stock Exchange and the Securities Depository Centre. As the legislator of the capital market, the Jordan Securities Commission proceeds with its mission in reforming and developing enactments, accentuating fairness and disclosure, revivification Jordanian investment culture, empowering and protecting investors and above all implementing the rule-of-law. The Securities Depository Centre initiated operation in May 1999 and is the only entity in Jordan that is legitimately engaged to oversee the enrolment of securities, deposit of securities, transfer of ownership, supervision of securities, clearance and settlement of securities transactions (Al-khabash and Al-Thuneibat, 2008).

The Amman Stock Exchange was built up in 1999 as a non-profit, independent institution; authorized to work as a regulated market for trading securities in Jordan. On February 20, 2017, the ASE has been registered as a public shareholding company completely owned by the government under the name "The Amman Stock Exchange Company (ASE Company)". The ASE Company shall be the legal and factual successor to the ASE. The ASE is a full member of the Arab Federation of Exchanges (AFE) and of the Federation of Euro-Asian Stock Exchanges (FEAS) and is an active member of the World Federation of Exchanges (WFE) (ASE, 2017). Yassin (2017) stated that in reference to the AFE statistics, the ASE occupied the ninth place among the 17 Arab stock exchanges in terms of market capitalisation and number of shares traded, and in terms of the value shares traded occupied the eighth place, while occupied first place in terms of the number of listed companies.

3. Literature review and propositions development

3.1 Agency Theory

The corporate form of organization, packed with limited obligation, perpetual life, and dynamic markets for ownership exchanges, this form showed up for the first somewhere in the range of 400 years ago. In 1600, Elizabeth I sanctioned the East India Company, which from numerous points of view was the model of publicly traded, multinational enterprise. In parallel with the reduction of possession, influence through the redistribution of firms' equity was a transfer of direct oversight of firms' operations. Owners never again directed these organizations; instead, proficient managers held those roles increasingly. In this transition is the establishment of what progressed toward becoming "agency theory". These professional managers, who oversee the firm, may not have interests that are consonant with those of the proprietors of the firm (Dalton et al., 2007). Wherefore, economists have long been concerned with the incentive issues that emerge when managers who are not the firm's security holders make decisions (Fama, 1980). During the 1960s and early 1970s, economists investigated risk sharing among individuals or groups. This literature described the risk-sharing problem as one that emerges when collaborating parties have diverse mentalities toward risk. Agency theory expanded this risk-sharing literature to include the alleged agency that happen while cooperating parties have different objectives (Eisenhardt, 1989).

Agency costs include the costs of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests. Agency costs also include the value of output lost because the costs of full enforcement of contracts exceed the benefits (Watts and Zimmerman, 1979; Fama and Jensen, 1983). In other words, agency costs are those costs that the principals are ready to invest in, for protecting their selves from the opportunistic behaviour of the agents (Dion, 2016). Agency theory is concerned with resolving two problems that can occur in agency relationships. The first is the agency problem that arises when (a) the desires or goals of the principal and agent conflict and (b) it is difficult or expensive for the principal to verify what the agent is actually doing. The problem here is that the principal cannot verify that the agent has behaved appropriately. The second is the problem of risk sharing that arises when the principal and agent have different attitudes toward risk. The problem here is that the principal and the agent may prefer different actions because of the different risk preferences (Eisenhardt, 1989).

Agency relationship is a contract under which one or more persons (the principal) engage another person (the agent) to provide some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximisers there is a good reason to believe that the agent will not always act in the best interests of the principal (Jensen and Meckling, 1976). Since, the unit of analysis is the contract governing the relationship between the principal and the agent, the focus of the theory is on determining the most efficient contract governing the principal-agent relationship which given assumptions about people organizations, and information. These fundamental assumptions that agency theory is based on; self-interest, goal conflict, bounded rationality, information asymmetry, pre-eminence of efficiency, risk aversion, and information as a commodity (Eisenhardt, 1989).

3.2 Earnings Management

Earnings are significant since they are utilized generally by the users as a summary measure of firm performance. Earnings are created by two key accounting principles, the revenue recognition principle and the matching principle and based to these principles; the accrual process is hypothesized to alleviate timing and matching problems inborn in cash flows so that earnings mirror the actual performance of the firm (Dechow, 1994). Accrual accounting intends to record the financial impacts on an entity of transactions and other events and circumstances that have cash consequences for the entity in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the entity. (Dechow and Skinner, 2000). Nevertheless, this accounting system gives the managers right and control of selection to determine earnings in the diverse time, and they have opportunities to use their judgment (Bhundia, 2012). Hence, there is substantial evidence that managers may engage in earnings management through creative accounting by manipulation of accruals (Roychowdhury, 2006; Islam et al., 2011; Abbad et al., 2016; Astami et al., 2017).

The motivation of the managers is that they have a potential to earn some interest through direct reward such as salary and bonus or indirect reward such as future promotions, prestige, and job security. These rewards are granted to managers based on the firm`s earnings performance. If the incentives are based on the company financial performance, managers may be attracted to maximize their self-interest and to impress the shareholders of the company good performance through earnings management. The discretion of management over reported earnings and its impact on the management compensation lead to a potential agency problem (Bukit and Iskandar, 2009).

Earnings management has been defined as “Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers” (Healy and Wahlen, 1999). In less comprehensive definition, Schipper (1989) defined Earnings management as “the

purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain.
As stated by literature, earnings management classified into many kinds that established on different perspectives, including its legitimacy, direction, effect on cash flow, and management intent. According to its legitimacy, earnings management can be legitimate or illegitimate. Legitimate earnings management takes advantage of the discretion provided by the GAAP or the regulations to report the desired income. Illegitimate earnings management manipulates income by departure from GAAP or from the legislations to obtain the targets. Based on the direction of manipulation, earnings management can be classified to income-increasing or income-decreasing earnings management. Most importantly, earnings management can be classified into accruals-based earnings management and economic earnings management. Accruals-based earnings management takes advantage of accounting alternatives and estimations available to determine income. These accruals generally have no direct cash flows consequences. On the other hand, economic earnings management affects cash flow by engaging in real decisions such as selling some used assets to get gains. A large part of economic earnings management takes advantage of discretionary costs as advertisements and R&D costs. According to the intent of management, earnings management can be classified as informative and opportunistic. Informative earnings management aims at revealing the management's private expectations about the firm's future cash flows to shareholders, whereas the purpose of opportunistic earnings management is to ensure some private benefits for management at the interest of other parties by misleading shareholders (Al-Khabash and Al-Thuneibat, 2008).

3.3 Relationship between Earnings Management and Stock Market Segmentations

The discussions of regulatory incentives for earnings management have been stated in the literature (Healy and Wahlen, 1999). National stock exchange listing status or meeting minimum exchange listing requirements to prevent being delisted is an incentive to manage the earnings numbers (Rezaee, 2005). In developed countries, banking regulations in USA require that banks should meet certain capital adequacy criteria that are written in terms of accounting figures (Healy and Wahlen, 1999). For emerging stock markets in developing countries, the issue of earnings management is rooted in the market institutions. Modifying the thresholds in regulatory requirements for rights issuance and delisting induced more earnings management after 2000 (Li et al., 2014). For instance, China Securities Regulatory Commission (CSRC) requires listed companies to satisfy certain requirements before giving them a permission to issue additional shares to existing shareholders; one of these requirements was a minimum of 10 per cent return on equity (ROE) in each of the last three years (Chen and Yuan, 2004).
In Middle East, Egyptian Stock Exchange requires companies` securities in order to be listed; firms must achieve a minimum level of net pre-tax profits. Either firm should gain profits not be less than (5%) of capital in the year preceding the listing application or the company should attain an average net profit of at least (5%) of capital over the last three years before that period without reporting any losses. Therefore, meeting EGX's regulatory requirements is an incentive to adjust the earnings reported in the financial statements upwardly (Makhaiel and Sherer, 2017).
In the context of Jordan, Amman Stock Exchange utilizes two basic markets: the primary market, where securities are issued; and the secondary market, where securities are traded. The secondary market is divided into three sub-markets: the first, second, and third market. The listing requirements differ depending on the market segmentations where the company will be listed into

whether the first, second or third market. However, first market is part of the secondary market, through which trading takes place in shares of the listed companies according to special listing requirements as stipulated in regulations. One of these requirements in terms of earnings; the listing of the company's shares shall be transferred to the first market if the company have net profit before tax for two fiscal years at least within the last three years preceding the transfer of listing, provided the company's average net pre-tax profit for the last three years of at least 5 per cent of the company's paid-in capital. Correspondingly, listed companies in the first market have a privilege of being allowed with more fixable stock price thresholds which is ± 7.5% of last traded price, and other listed companies allowed with only ±5% of the last traded price (ASE, 2012b).
Accordingly, in accounting literature, it is widely known that whenever a contract or regulation is based on accounting numbers, managers will be motivated to manage those numbers in order to serve their own or the firm's interests (Chen and Yuan, 2004). Based on this argument, the study assumes that companies listed in Amman Stock Exchange in the first market are concerned to keep the 5% average net pre-tax profit of the paid-in capital to preserve their current ranking, while listed companies in the second and third markets are interested in reaching the same percentage in order to boost their ranking to the first market, and that may lead to incentivize Jordanian companies to engage in earnings management practices. Hence, the study develops the following first proposition:
Proposition 1**:** stock market segmentations positively related to earnings management.

3.4 Relationship between Earnings Management and Free Cash Flow

The considerable growth in corporate cash holdings around the world has prompted scholarly interest. Accordingly, cash holdings and their consequences on firm values have been studying by an enormous academic literature. Companies worldwide have considerably increased their cash holdings over the past two decades. A recent report by Deloitte stated that "The top 1000 non-financial companies globally are holding $2.8 trillion in cash; these numbers indicate that cash holdings are important to firms and worthy to be examined (Amess et al., 2015).
Free cash flow was adopted in the late 1980s as a financial tool to assess the firm and the investment in the individual projects. The finance-based statement of Free Cash Flow provides a basic tool for the evaluation of a firm. Based on traditional financial statements, the free cash flow should report the periodic cash flow components generated by the operations of the firm (Yaari et al., 2016).
Jensen and Meckling (1976) proposed influential work in introducing a theory of the firm based upon conflicts of interest between shareholders and corporate managers. Subsequently, Jensen (1986) developed the agency cost of free cash flow and he defined it as a cash flow in excess of that required funding all projects that have positive net present values when discounted at the relevant cost of capital. Conflicts of interest between shareholders and managers over pay-out policies are especially severe when the organization generates substantial free cash flow. The problem is how to motivate managers to exploit the cash rather than investing it at below the cost of capital or wasting it on organization inefficiencies.
When Firms hold surplus of cash without appropriate investment opportunities they may have a possibility to face potential agency problems from free cash flow (Chen et al., 2011). Free cash flow problem allied to low-growth opportunities (Lehn and Poulsens, 1989; Chung et al., 2005), then an overinvestment problem is likely to arise (Nekhili et al., 2016), since Firms with low-growth opportunities are more likely to invest free cash flow in negative net present value projects

(Jensen, 1986). Therefore, the manager may be engaged in earnings management to show better performance of the company (Bukit and Iskandar, 2009; Bhundia, 2012), using the accounting discretion and employ accounting procedures to increase reported earnings that will camouflage the effects of the non-wealth-maximizing investments (Chung et al., 2005; Yaari et al., 2016), and hide the real picture of company poor performance (Bukit and Nasution, 2015). That, leading to the second proposition as below:
Proposition 2**:** free cash flow positively related to earnings management.

3.5 Moderating role of Independent Audit Committee
At the present time, the case of governance mechanism attracts the scholars` attention. This interest is derived from the corporate financial scandals in several companies (such as Enron, WorldCom, etc.) that have triggered a crisis of confidence about the reliability of financial information and had a terrible effect on shareholders' behaviour. Indeed, these failures were usually caused by the conflict of interests inherent to the agency relationship between the agent and the principal. In this conflict, it was necessary to establish formulas for government to regulate the actions of all parties involved in companies. Moreover, to improve the quality and the transparency of the financial information through mechanisms that control the companies, different laws were issued worldwide. The recent regulatory reforms have focused on improving corporate governance; these regulations have had significant suggestions for the role and responsibilities of all parties in the corporate governance process, specifically, the audit committee (Zgarni et al., 2016; Abbad et al., 2016).
During the past decade there have been considerable reforms to improve the effectiveness of audit committees. Two key reforms to improve audit committee quality concentrate on the independence of audit committee members. Responses to recent large accounting scandals and corporate frauds, regulators have been increasingly concerned with the effectiveness of audit committees in monitoring the financial reports (Lisic et al., 2016). Since, good internal control quality is an important factor in achieving good financial reporting policy because an internal control system represents an important tool for investors to assess the adequacy of corporate reporting practices (Khlif and Samaha, 2016).
Many large companies have used the audit committee to protect themselves from fraud, mismanagement and financial liability. Audit committee that generally comprised of outside directors serves as an intermediary between the external and internal auditors and the board of directors in their monitoring role of the financial reporting process (Reinstein and Weirich, 1996), because the audit committee is a board sub-committee of non-executive directors concerned with audit, internal control and financial reporting matters (Spira, 1998).
The audit committee should be independent from management to be able to perform the oversight effectively (Zgarni et al., 2016). Thus, previous empirical results suggested that the existence and independence of audit committee members may assist them to balance divergent views of management and external auditors to produce higher quality financial information. Furthermore, there are some countries such as the US and the UK require all audit committee members to be independent, while many other countries such as Australia, China and Singapore have been only requiring the majority of audit committee members to be independent (Kusnadi et al., 2016). Audit committees are instituted by the boards of directors to oversee the financial activities of the management and to act as a liaison between the external auditors and management when there is a dispute between them (Vanasco, 1994; Bukit and Nasution, 2015). It considered as a central body

meant to maintain shareholders` confidence and interests by providing a number of functions, such as; reviewing the adequacy of internal controls; monitoring the financial reporting process; reviewing external audit functions and selecting and monitoring external auditors. Recent studies show the significant influence of the committee's independence on discretionary accruals (Nekhili et al., 2016).

In Jordan, audit committees are still a recent form of corporate governance to be conducted. In 1998, the Jordanian government mandated the establishment of audit committees in Jordanian public shareholding companies that filing with the Jordan Securities Commission in 1998, in an attempt to improve corporate governance. This was partly due to some local corporate failures and partly due to Jordan's willingness to increase its involvement in international trade and attract foreign capital. In 2009 the code of corporate governance for the listed companies provided more detail to the nature of the audit committees duties, and stated that the committee is to be answerable to the board of directors and is comprised of three non-executive members of the board of directors, and they must have knowledge and experience in finance and accounting, and at least one of them must have worked previously in accounting or finance fields, or that person must have an academic or professional certificate in accounting, finance or related fields. The code also required audit committees to meet at least four times in a year, and to meet with the external auditor independently from the company's management at least once in a year, and they have an authority to seek information and advice from any internal or external source. According to these regulations, the audit committee is responsible for studying and discussing company's annual and interim financial statements, the work of the internal and external auditors (Abdullatif, 2006; Abdullatif et al., 2015). This role reflects the principle of agency theory and the need to reduce the managers` ability in acquiring private gains from the firm (Badolato et al., 2014) Therefore, independent audit committee is expected to conscientiously monitor and control the management from an opportunistic behaviour relating to accounting choices, and it is expected to weaken the positive association between high free cash flow and earnings management (Bukit and Iskandar, 2009; Bukit and Nasution, 2015; Nekhili et al., 2016). Thus, it is proposed in the following manner:

Proposition 3a**:** independent audit committee weakens the positive relationship of stock market segmentations and earnings management.

Proposition 3b**:** independent audit committee weakens the positive relationship of free cash flow and earnings management.

3.6 Moderating role of Audit quality

Management is responsible for reporting the results of the firm's operations and financial position to shareholders by issuing the financial statements. The potential conflict of interest between management and the users of financial statements exists. This conflict, in addition to the asymmetry of the information provided, creates together the needing for auditing the financial statements by a third competent and independent party (Al-Thuneibat et al., 2011).

External auditor is accountable for substantiating that financial statements are impartially specified according to GAAP and those statements revealed a firm accurate financial situation and operational outcomes. Consequently, the confirmation of external auditor enhances reliability of firm's financial statements; audit quality was anticipated to limit opportunistic earnings management and highlights the hazard that financial statements encompass misstatements material or exclusions (Alzoubi, 2016).

Audit quality is one of the most major issues in the auditing profession (Vanstraelen, 2000) and it defined as “the market-assessed joint probability that a given auditor will both (a) discover a breach in the client’s accounting system, and (b) report the breach” The probability that a given auditor will discover a breach depends on the auditor's technological capabilities, the audit procedures employed on a given audit, the extent of sampling, etc. The conditional probability of reporting a discovered breach is a measure of an auditor's independence from a given client (DeAngelo, 1981). Agency theory proposed that the monitoring mechanisms are assumed to align managers and shareholders’ interests (Alzoubi, 2016), there is an emphasis that firms should have governance mechanisms and control systems (Dion, 2016), one of these mechanisms is audit quality. Agency problem over contracting that might be affected by accounting figures is expected to be alleviated through higher audit quality that makes the contracting process quality more reliable (Astami et al., 2017). Audit quality may enhance the value relevance of earnings and improve the usefulness of accounting figures in the investment decision making process (Alfraih, 2016).
The audit system is designed to detect whether the figures reported in financial statements present the firm’s operating results and faithful financial position. Therefore, improving the audit quality would provide reasonable assurance about the accuracy of reported accruals, and as a result, attest the quality for earnings (Al-Thuneibat et al., 2011). Moreover, Audit quality is considered as a mechanism that highlights the risk that financial statements comprise misstatements material and preventing overstated opportunistic behavior of the corporate management. Thereafter, limiting earnings management practices (Dechow et al., 1996; Alzoubi, 2016; Astami et al., 2017). In conclusion, high audit quality moderates the relationship between free cash flow and earnings management (Rusmin et al., 2014; Inaam and Khamoussi, 2016). Based on this argument, this study promotes the following propositions:
Proposition 4a: audit quality weakens the positive relationship of stock market segmentations and earnings management.
Proposition 4b: audit quality weakens the positive relationship of free cash flow and earnings management.

4. Proposed Conceptual Framework

Based on the aforementioned theoretical and empirical literature, a proposed conceptual framework has been developed for the current study as illustrated in figure 1. The model comprises five variables; stock market segmentations, free cash flow and earnings management, independent audit committee and audit quality. It`s proposed that stock market segmentations and free cash flow have a positive relationship with earnings management. Literature review indicates that governance mechanisms may reduce earnings management practices, therefore the model also proposed that independent audit committee and audit quality will moderate the positive relationships between stock market segmentations, free cash flow and earnings management.

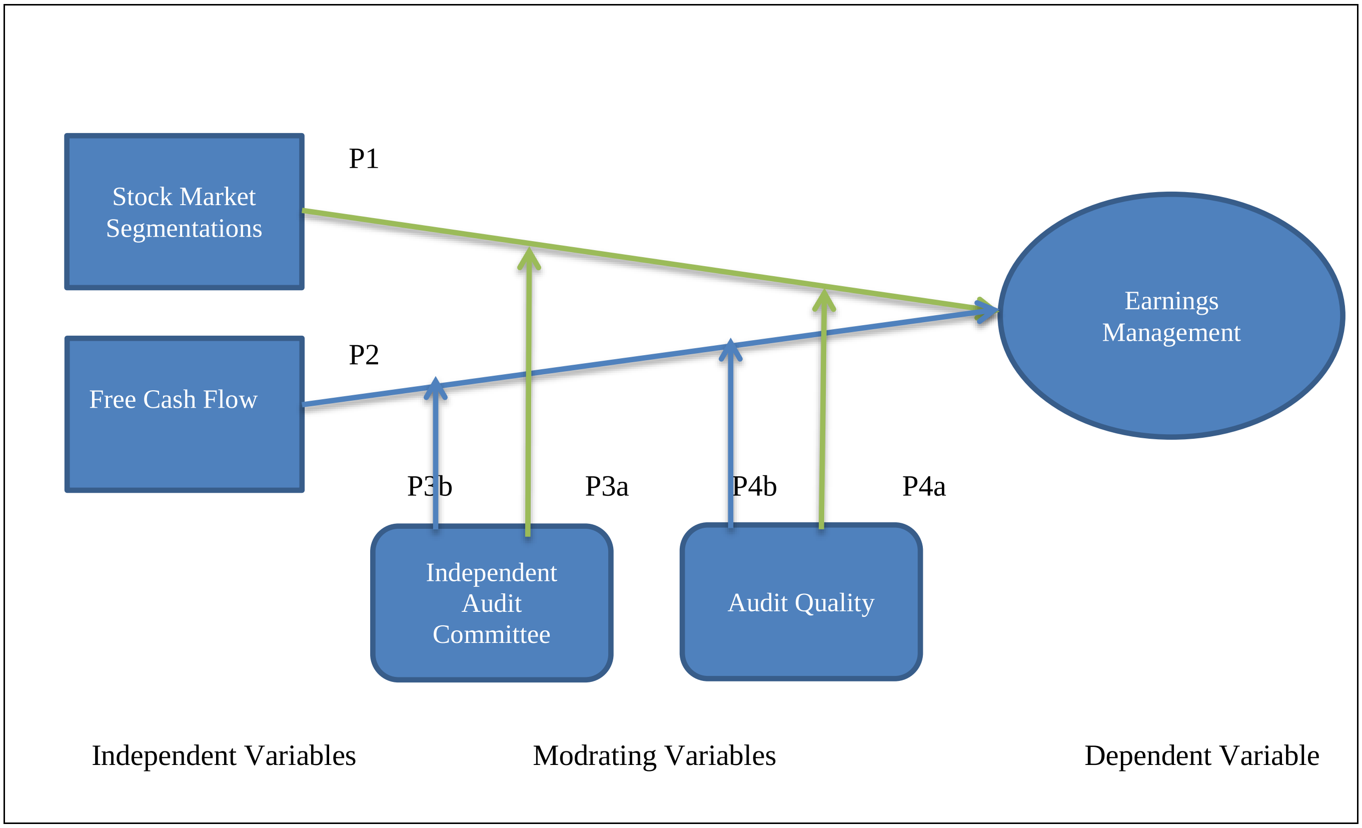

Figure 1: Proposed Conceptual Framework
(Green lines indicates to the originality of our proposed framework)

5. Conclusion

Unprecedentedly, the proposed framework is introducing the stock market segmentation as a regulatory incentive for earnings management. However, proposed framework contributes to society by presenting helpful information for companies and shareholders seeking to realize and diminish agency problems.

Palliam and Shalhoub (2003) concluded that agents are able to select and accept the reporting of economic events by various accounting systems boosted by alternative accounting methods and estimates, make the presentation of the financial statements an approximation of economic reality. The propensity to delay accounting recognition of some transactions proposes that financial statements lag beyond reality. The difference between reality and imaginary is often referred to as the agency problem.

Agency theory presupposes that their self-interest cannot be the same. There will inevitably be a conflict between shareholders’ self-interest (shareholders’ opportunism) and executives’ self-interest (managerial opportunism). Executives could try to get their annual bonus at any cost, including opportunistic decisions: for instance, executives could favour business contracts that have advantageous consequences in the short-term (particularly on corporate image), without having any positive effect on corporate profitability (Dion, 2016). Misalignment of managers' and shareholders' incentives could induce managers to use the flexibility provided by the Accounting

Standards to manage income opportunistically, thereby creating distortions in the reported earnings. Accordingly, if earnings management is utilized primarily opportunistically by managers, firms where agency costs are more severe should exhibit a higher degree of earnings management. In other words, the extent of earnings management is positively related to the gravity of agency conflicts (Jiraporn et al., 2008).

Agency theory may be a suitable framework to explain the divergent interests of principals and agents who are involved in cooperative conduct. One of these conflicts when managers exploit the free cash flow of the firm by make an investments in negative NPV projects for their own benefit, condoning the best interest of shareholders. This behaviour encouraged managers to manage income opportunistically so they can hide the real picture of the distorted earnings (Jones and Sharma, 2001; Bhundia, 2012; Cardoso et al., 2014; Bukit and Nasution, 2015; Yaari et al., 2016; Astami et al., 2017). On the other side, listed companies may be attracted to the flexibility of the first market to enjoy with an advantageous stock price thresholds that stated in the ASE regulations. Further, manager may be engaged in earnings management to satisfy the earnings condition to maintain or to boost their ranking in/to the first market.

Agency theory is one of the dominant theories in strategy, particularly in corporate governance (Bendickson et al., 2016b), and it suggested that the corporate governance mechanisms would reduce the agency problem and increase the efficiency of contract between shareholders and managers. The function of the corporate governance mechanism in financial reporting is to guarantee compliance with IFRS and to preserve the reliability and truthfulness of financial statements. Therefore, good corporate governance provides efficacious mechanisms of control to reduce the opportunistic behaviours of management (Inaam and Khamoussi, 2016). Substantial amount of research has been directed toward investigating the influence of corporate governance mechanisms on earnings management, and they found that independent audit committee is negatively associated with earnings management (Klein, 2002; Bukit and Iskandar, 2009; Nekhili et al., 2016). Likewise, many other studies in the literature documented significant negative relationship between audit quality and earnings management (Chung et al., 2005; Noor et al., 2015; Alzoubi, 2016; Astami et al., 2017).

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