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Internal mechanisms features, unfavourable behaviour and firm performance

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Abstract
In this study, we investigate the role of the Internal mechanisms features represented by board of directors in companies and the role of audit committees and executive committees in the possibility of their influence in reducing or preventing unfavourable behaviour such as income smoothing and earnings management behaviours to eventually reach a good firm performance. Such behaviours will have unfavourable effect on firm performance. in developed countries such as the USA, the reports obtained from the American stock exchanges and the Securities Commission clearly show how the members of the audit committee need to strive towards financial development, as the structure of the board of directors and the audit committee, is linked to the possibility of participation of joint stock companies in managing profits. It is worth noting that members of the Audit Committee, as well as members of the Board of Directors with institutional backgrounds, are associated with companies that have many of the smaller discretionary current receivables. The Board and Audit Committee meetings are also associated with demonstrable and low levels of discretionary accruals. These are all positive indicators that indicate that the activity of the Board of Directors, the effectiveness of the Audit Committee, and the distinction of the financial development of its members is an important factor in limiting the tendency of managers to engage in and the desire to practice in earnings management and smoothing income and then enhance firm performance.

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I. Introduction and Literature Review

Profit is one of the important tools of accounting and finance figures that express the actual performance of the firm (Alabdullah et al, 2020), (Alabdullah et al, 2019), (Alabdullah et al, 2017), and (Alabdullah et al, 2016), which is used to judge the efficiency of the management in exploiting the available resources and the decisions taken by the management to achieve the target profit (Ahmed et al., 2021), (Ahmed et al., 2020), and (Ahmed et al., 2016). Therefore, many managers tend to practice real earnings management (REM) to reflect the good performance of the company. The current research aims at reviewing the literature to clarify the concept of real profit management and the techniques used by managers to practice REM and to clarify the consequences that the company bears if the management practices earnings management.

A large amount of literature on earnings management and its relationship to company performance studies have been done (Alabduallah, 2019), (Ahmed et al., 2018), (Alfadhl&Alabdullah, 2016), (Alabdullah, 2016a), (Alabdullah, 2016b), (Ahmed et al, 2021), (Alabdullah, 2016c) , (Alabdullah, 2016d), (Alabdullah et al., 2015), (Fama, 1980), (Ahmed, 2014), and other studies' evidences have been established that financially constrained firms employ accrual earnings management (AEM) to improve their financial standing such as (Alabdullah et al., 2019), (Alabduallah et al., 2021), (Ahmed et al, 2018), (Alabduallah& Ahmed, 2021), (Abushammala et al, 2015), (Alabdullah, 2016a), (Ahmed et al., 2017), (Alabdullah, 2017), (Alabdullah, 2019), (Ahmad et al., 2014). Furthermore, see for example (Ahmad et al., 2018), (Alabduallah, 2019), (Alabdullah, 2018), (Alabdullah, 2016a), (Ahmed et al, 2021), (Alabdullah, 2016c), (Alabdullah et al., 2016), (Alabdullah, 2016d), (Alfadhl&Alabdullah, 2016), (Alfadhl&Alabdullah, 2013), (Almashhadani, 2020), (Alabdullah et al., 2021), (Almashhadani & Almashhadani, 2022), (Almashhadani & Almashhadani, 2022), (Ahmed et al., 2021). Nonetheless, a significant number of research have found a negative link between firm performance and earnings management, implying an opportunistic strategy to income management.

The fact that the research is predicated on established and rising economies must be emphasised as a source of discrepancy in the outcomes of existing studies. As a result, studies reveal that when a positive association is created with firm performance, the strategy is effective. For instance (Almashhadani & Almashhadani, 2022; Alabdullah et al., 2022), there have been instances with contradicting and equivocal

conclusions on how earnings management practices affect firm performance. Ahmed et al. (2020) mentioned that when a good connection is created with firm performance, substantial evidence but a recommendable component of the earnings management practice has been promptly recognised as an informational or efficient strategy. Alabdullah et al, (2016), discovered evidence that financially strapped firms adopt AEM to improve their financial standing. Nonetheless, a significant number of research (Alabdullah, 2016b) , (Alabduallah et al., 2015), (Alabdullah et al., 2020), (Alabdullah et al, 2019), (Yermack, 1996), (Ahmad et al, 2019), (Alabdullah et al, 2020), (Ahmed et al., 2018), (Alabdullah& Ahmed, 2018), (Essia, 2014), (Alabdullah et al, 2014a), (Alabdullah, 2014b), (Alabdullah et al., 2020), (Ahmad, 2018), (Ahmed et al., 2020), (Alabduallah, 2021a), (Alabdullah, 2021b), (Alabdullah et al, 2018), Alabdullah et al, 2018), (Alabdullah et al, 2021), (Nor et al., 2020), have found a negative link between firm performance and earnings management, suggesting an opportunistic strategy to income management.

The fact that existing research is cantered on established and rising economies must be emphasised as a source of discrepancy in their findings. As a result, the results of research in industrialised economies differ from those in other contexts as mentioned by (Ahmed, 2014), (Alabduallah et al., 2021), (Ahmed, 2017), (Alabduallah et al., 2014), (Alabdallah et al., 2020), (Alabduallah & Ahmad, 2019), (Ahmad et al., 2019), (Ahmed et al., 2018). Even though earnings management is still used in advanced countries, there were claims that it is more prevalent in emerging economies. The economic impact of the behaviour is intuitively low. Nevertheless, because of the inconsistent character of prior studies indicating that earnings management strategy could have a good or negative effect on a firm's performance, empirical issues have been made.

Earnings management has previously been divided into two categories, namely AEM and REM. Note that AEM was commonly employed until the passage of the Sarbanes-Oxley (SOX) Act in 2002, which led to a major reduction in its use. Firms, on the other hand, began to recognise and pay attention to REM. Both approaches, nevertheless, are still in use today, especially in emerging economies.

The Asian Stock Exchange (GSE) has announced the suspension as well as the delisting of firms from the Asian market. According to reports, the scenario is due to a variety of management concerns, for instance, poor performance. In recent years, the market has seen a wide range of low and high-performance variations.

Numerous technical problems could contribute to the delisting and suspension of firms on the GSE in this respect. Researchers looked into working capital, liquidity, corporate social responsibilities, as well as capital structure to see how these affected firms' performance on the GSE. In light of the foregoing, Alabdulah, et al, (2019), in their research they assessed the non-financial earnings management enterprises on the GSE to determine if there are any factors that could affect financial health. The empirical data on the scope of such engagements have raised questions about whether income manipulation is advantageous or damaging to GSE enterprises' performance. The study is unquestionably centred on awareness creation, information generation, and control in the Asian context. Many practical, academicals, and theoretical studies and works had been undertaken to introduce insights into the development, practice and theory of corporate governance mechanisms and their impact on firm performance, however the contribution from a Middle East in general and Asia in particular is few and peripheral in light of the existence and impact of pandemic of COVID-19, taking into account several important mechanisms such as CEO duality, board size, managerial ownership, risk management, audit committee role, foreign ownership, financial leverage and market share and their impact on firm performance.

II. Signalling Theory

Ross (1977) links signal theory to the asymmetric information problem between investors and management, arguing that the incentive signal of the firm's management determines the structure of the firm's capital. Personal information is signalled through debt-rate alternatives by management with an information advantage.

Since every business activity taken by the company has meaning for outsiders, this study employs signal theory. A signal is the interpretation supplied by the data, which can be either negative or positive, and is preceded via a market reaction. Assuming the signal is favourable, the stock price rises, affecting the company's performance even more. Moreover, growth in stock value represents improved corporate performance, as evidenced by return on equity, increased stock returns, and earnings per share. The quality of information offered by the company is a variable that affects the signal (Manurung, 2012).

III. Agency Theory

The agency theory was introduced by Jansen, M.C and Meckling W.H (1976). The separation of firm ownership and control is the central theme of this approach. According to the agency theory, management acts as an agent for the company's owner, who acts as the company's principal. The working relationship between the party that gives the authority (principal), which is the shareholder, and the party that receives the authority (agent), which is management, in the manner of a cooperation contract known as "Nexus of Contract."

This study employs agency theory, taking into account that (1) the company's external funding originates from debt and stock, and (2) there are three closely related parties in the company, namely the investor as a lender, agent as manager, and the owner as a fund-raiser or capital, according to organisational theory. The difficulty with the agent is that there is a conflict between the investor and the agent, as well as the agent and the owner. Therefore, in this situation, the management that acts as an agent for the company is considered in developing the company's performance.

IV. Information Asymmetry Theory

"The market for lemons," was the first to present the information asymmetry theory. Using the example of used vehicle markets, Akerlof relates quality with uncertainty and produces information asymmetry ideas or theories. The purpose of this study is to apply the information asymmetry theory to (1) stock prices that happen in markets affected by information factors and (2) the presence of government policies that influence the business environment.

As a result, with the human as well as stakeholders' capitals' environment, there should be effective corporate governance, which is recognised as the pillars of corporate governance. Corporate governance is regarded as one of the corporate governance pillars because of its ability to provide organisations having self-regulation, appropriate advice, and open access to capital through its operations. Corporate governance is defined by the Forum Corporate Governance in Indonesia (FCGI) as "a set of rules that establishes a connection between managers, shareholders, government, creditors, employees, other external and internal interest holders in relation to their obligations and rights," or "another system that oversees and operates the company."

Companies use earnings management to attain a specific aim. This objective can be achieved by a preference for more consistent earnings; in this situation, management is said to be income smoothing. Note that smoothing income could signify decreased risk and raise the value of a company's stock if done correctly. Other motivations, including surpassing analyst expectations by lobbying for a levelled accounting ratio to avoid debt concerns and the need to continue earnings growth, may also inspire earnings management. The existence of AEM and its various associations with corporate performance has been reported in numerous research. The size of earnings management practices has been argued to have an impact on corporate performance. Furthermore, studies have indicated that performance might affect the shift in earning management level, as lower or higher earnings may inspire companies to manage their earnings. The political system in any country has legislative and governmental powers that have the power to redistribute wealth among the various groups of society, the corporate sector is also the most vulnerable to redistribution. This creates an incentive for the management of companies to face such government interventions by choosing accounting policies that lead to the reduction of declared profits and the announcement of social responsibility campaigns in order to divert the attention of government agencies from the company.

Political costs refer to the costs incurred by the company as a result of the sovereign decisions, regulatory actions, or statutory legislation that would adversely affect the value of the company, these may be political interventions, such as new tax laws, burdensome social burdens, the introduction of new taxes, and the prevention of monopoly policies. These may be political interventions, such as new tax laws, burdensome social burdens, the introduction of new taxes, and the prevention of monopoly policies. Political costs also include the political risk to companies dealing with strategic industries such as pharmaceuticals or oil and gas and to make huge profits represented by the possibility of companies subject to severe restrictions and pressures.

The process of modifying a company's operating activities to boost current-period profitability is known as real earnings management (REM). Real activity management can take a variety of shapes in business operations, for instance, increasing production/overproduction to lower sales costs or to cut specific desirable costs, such as R&D, to boost present profits. REM, , occurs when a company's administrators alter the acquisitions, arrangement or timing of activities or financial transfers in order to control the financial statements' published results.

According to agency theory, the relationship between firm performance and earnings management is influenced by managers' opportunistic viewpoint. Investors are also left with less knowledge than they need to make good decisions due to information asymmetry. As a result, managers take advantage of earnings to signal positive future performance. In earnings management practice, the company's management has two goals. The first goal of earnings management is to make the earnings stream appear more stable and predictable. Once the news is made, the share price of a firm normally rises or falls, depending on whether the company meets or misses earnings estimates. Management attempts to sway accounting processes in order to satisfy earnings forecasts as well as keep the stock prices high.

Through the foregoing, it becomes obvious how significant REM is and how well the department can manipulate the firm's profits or not show the firm's actual performance, REM is a set of actions taken by managers m to influence the declared profits through structuring transactions and manipulating timing or financial transactions to reach the optimum level. Therefore, the management has a lot of motivations that

encourage it to practice earnings management. Thus, management seeks through the practice of earnings management to maintain contracts with other parties and seeks to raise the market value of the company, as we have shown in this paper the techniques that the administration uses in the practice of earnings management. Although management believes that earnings management helps the company achieve gains, these gains are short-term and not long-term. The earnings management practice would have an impact on the company's overall performance and the financial statement users' confidence in the management as well as the company.

V. Conclusion and Recommendation

Corporate governance is a procedure of social impact in which one company can enlist the aid via CG mechanisms and principles its events and also to support of others in the accomplishment of a common task. Corporate governance has control firm performance and the policy agenda in developed and developing market countries for more than three decades including Asia and African that they gradually adopting it on their plan, strategy and policy agenda on enhancing firm performance and firm sustainability of their corporations. The current study pursue to establish the contribution of one of the most valuable control system; Corporate Governance system on firm performance of studies done Developed and developing countries. The current study revealed that good corporate governance system is a key ingredient to enhancing form performance and then enhancing its value. Thus, there should be deliberate and concentrate efforts by companies' management to create valuable corporate governance system that ensure there is effective mechanisms belong corporate governance flowing its principles. The study recommends that board of directors should actively promote and support the existence of a long term performance, take into account the control of the company business and significantly enhance growth in companies' financial performance, market perfectibility , shareholder wealth and return, share value and customer deep satisfaction. The current study extremely encourages firms leaders and managers to draw strong and well planned strategies to counter any unexpected political interferences, ethnicity and nepotism that are the core cancerous impact to leadership and management styles and firms structures, leadership and top management composition, leadership and manger independency, external parties ownership and managerial ownership concentration that are represent as significant factors to firm financial performance. Therefore, the recommendations for the future studies in regard with corporate governance should take into account the current economic, social , and health crisis represented by COVID-19 to include in their studies several important mechanisms of corporate governance to be investigated especially the studies in the developing countries including Asia in particular for the reason of the lack of studies such as CEO duality, board size, managerial ownership, risk management, audit committee role, foreign ownership, financial leverage and market share and their impact on firm performance.

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