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THE IMPACT OF AUDIT COMMITTEE CHARACTERISTICS ON FINANCIAL REPORTING QUALITY: EVIDENCE FROM SAUDI ARABIA

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ABSTRACT

Purpose: The purpose of this study is to investigate the impact of audit committee characteristics, namely independent members in the audit committee, a financial expert in the audit committee, frequency of meetings, and audit committee size on financial reporting quality proxies by qualified audit opinion, to shed light on the role of audit committee characteristics towards the financial reporting quality with audit quality as one of the control variables, particularly the appointment of Big 4 company.

Design/Methodology/Approach: A sample of 292 observations from Saudi non-financial listed companies from 2019 -2022 were collected from annual reports across four years and analyzed using panel data. To analyze the proposed hypothesis, the study employed multiple linear regression and logistic regression.

Findings: The results indicate that the only audit committee characteristic statistically related to financial reporting quality measured by qualified audit opinion is the financial expert's number. There is also evidence that audit quality measured by audit company size (Big4) is positively related to the audit committee and financial reporting quality.

Research Limitations/Implications: The study's main limitation is that a large sum of the data collected are traced back to the lockdown period. Therefore, the examined issues could change in the future due to the shift in priorities that the COVID-19 pandemic is determining.

Practical Implications: The result will help accountancy professionals and governments as it highlights the relevance of qualified audit opinions to audit committees and enhances audit committees' characteristics and role in improving audit quality. The findings of this study contribute to the current audit quality and reporting literature.

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O IMPACTO DAS CARACTERÍSTICAS DO COMITÊ DE AUDITORIA NA QUALIDADE DOS RELATÓRIOS FINANCEIROS: EVIDÊNCIAS DA ARÁBIA SAUDITA

RESUMO
Objetivo: O objetivo deste estudo é investigar o impacto das características do comitê de auditoria, ou seja, membros independentes no comitê de auditoria, um especialista financeiro no comitê de auditoria, frequência de reuniões e tamanho do comitê de auditoria sobre a qualidade dos relatórios financeiros, representada pela opinião de auditoria qualificada, para esclarecer o papel das características do comitê de auditoria em relação à qualidade dos relatórios financeiros com a qualidade da auditoria como uma das variáveis de controle, particularmente a indicação de uma empresa Big 4.
Projeto/Metodologia/Abordagem: Uma amostra de 292 observações de empresas sauditas não financeiras listadas de 2019 a 2022 foi coletada de relatórios anuais de quatro anos e analisada usando dados de painel. Para analisar a hipótese proposta, o estudo empregou regressão linear múltipla e regressão logística.

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Resultados: Os resultados indicam que a única característica do comitê de auditoria estatisticamente relacionada à qualidade dos relatórios financeiros medida pela opinião de auditoria qualificada é o número do especialista financeiro. Também há evidências de que a qualidade da auditoria medida pelo tamanho da empresa de auditoria (Big4) está positivamente relacionada ao comitê de auditoria e à qualidade dos relatórios financeiros.
Limitações/Implicações da Pesquisa: A principal limitação do estudo é que grande parte dos dados coletados remonta ao período de lockdown. Portanto, as questões examinadas podem mudar no futuro devido à mudança de prioridades que a pandemia da COVID-19 está determinando.
Implicações Práticas: O resultado ajudará os profissionais de contabilidade e os governos, pois destaca a relevância dos pareceres qualificados de auditoria para os comitês de auditoria e aprimora as características e o papel dos comitês de auditoria na melhoria da qualidade da auditoria. Os achados deste estudo contribuem para a literatura atual sobre qualidade de auditoria e relatórios.

Palavras-chave: Comitês de Auditoria, Qualidade da Auditoria, Qualidade dos Relatórios Financeiros, Governança Corporativa, Mercado de Ações da Arábia Saudita.

EL IMPACTO DE LAS CARACTERÍSTICAS DEL COMITÉ DE AUDITORÍA EN LA CALIDAD DE LA INFORMACIÓN FINANCIERA: EVIDENCE FROM SAUDI ARABIA

RESUMEN
Propósito: El propósito de este estudio es investigar el impacto de las características del comité de auditoría, a saber, miembros independientes en el comité de auditoría, un experto financiero en el comité de auditoría, la frecuencia de las reuniones, y el tamaño del comité de auditoría en la calidad de la información financiera aproximada por la opinión de auditoría cualificada, para arrojar luz sobre el papel de las características del comité de auditoría hacia la calidad de la información financiera con la calidad de la auditoría como una de las variables de control, en particular el nombramiento de Big 4 empresa.
Diseño/Metodología/Enfoque: Se recopiló una muestra de 292 observaciones de empresas cotizadas no financieras saudíes de 2019 -2022 de informes anuales a lo largo de cuatro años y se analizaron utilizando datos de panel. Para analizar la hipótesis propuesta, el estudio empleó regresión lineal múltiple y regresión logística.
Hallazgos: Los resultados indican que la única característica del comité de auditoría estadísticamente relacionada con la calidad de la información financiera medida por la opinión de auditoría calificada es el número de expertos financieros. También hay pruebas de que la calidad de la auditoría medida por el tamaño de la empresa auditora (Big4) está relacionada positivamente con el comité de auditoría y la calidad de la información financiera.
Limitaciones/Implicaciones de la Investigación: La principal limitación del estudio es que gran parte de los datos recogidos se remontan al periodo de cierre. Por lo tanto, las cuestiones examinadas podrían cambiar en el futuro debido al cambio de prioridades que está determinando la pandemia COVID-19.
Implicaciones Prácticas: El resultado ayudará a los profesionales de la contabilidad y a los gobiernos, ya que pone de relieve la relevancia de las opiniones de auditoría con salvedades para los comités de auditoría y realza las características y el papel de los comités de auditoría en la mejora de la calidad de la auditoría. Las conclusiones de este estudio contribuyen a la literatura actual sobre la calidad de la auditoría y la información.

Palabras clave: Comités de Auditoría, Calidad de la Auditoría, Calidad de la Información Financiera, Gobierno Corporativo, Mercado de Valores de Arabia Saudí.

1 INTRODUCTION

The impact of the board of directors and its subcommittee on the quality of financial reporting has drawn increased attention from around the world because of multiple significant accounting scandals that have exposed management incentives to misstate earnings for their financial benefit. The role of the audit committee in the financial reporting process has received increased regulatory attention in recent years (Alhumoudi & Juayer, 2023). The Saudi

Governance Manual states that the general assembly of any corporation is the one that forms an audit committee under the Saudi Governance Regulations, and its most recent update is in 2021. The company's governance law required that each of its members be independent and that none of them be executives. Additionally, it should not have fewer members than three people, a maximum of five, with one of them being an expert in finance and accounting. The Saudi Governance Manual's article 55 states that the Audit Committee provides a technical opinion to confirm the accuracy of the financial reports.

Given the significant role that audit committee plays in corporate governance, many earlier investigations concentrated on the connection between the characteristics of the audit committee and the quality of financial statements and companies' performance (e.g., Alves, 2013; Bansal & Sharma, 2016; Hasan et al., 2020; Fariha et al., 2022). However, some concentrated on the relationship between auditing quality and the audit committee (e.g., Khudhair et al., 2019; Sana Mardessi, 2021). the subject was discussed in different countries and the results were conflicting this may relate to the special economic context in each region, or because of the differences in the proxies used to measure the audit quality or the financial statements quality. Firms can ensure high-quality financial reporting practices by involving audit committees with specific attributes, such as the number of non-executive directors, the size of the board, how often it meets, and the number of financial experts. As noted by previous studies in the Saudi context, a few of those traits significantly impact the quality of financial reporting or the prevalence of earnings management techniques (e.g., Ali Al-Matari et al., 2012; Alhumoudi, 2016; Hassan Bazhair, 2022).

Studies of DeFond et al. (2014) defined higher audit quality as greater assurance of high financial reporting quality. They summarize proxies of audit quality as Inputs and outputs, and their framework has been used in most recent audit quality studies (e.g. Xiao et al., 2020; Huang et al., 2022; Samagaio & Felício, 2022). On the other hand, the degree to which the financial statements present accurate and fair information regarding the financial position and economic performance is referred to as financial reporting quality (Defond & Zhang, 2014). Even though reports contain a more comprehensive range of information, including non-financial information, most studies use conventional financial information perspectives to test the quality of financial statements indirectly through techniques like earnings management and financial restatement (Tang et al., 2016).

Nevertheless, there are limited studies that examined the quality of financial statement reporting from an audit perspective and applied audit opinion as a proxy. (Farinha & Viana, 2009; Pucheta-Martínez & De Fuentes, 2007). When assessing an accounting system, it is essential to consider the auditor's opinion and assurance regarding the financial reports; a qualified audit opinion is indicative of poor financial reporting quality, holding audit quality constant (Tang et al., 2016.) However, the existence of qualified audit opinions, a specific aspect of financial reporting quality, has not been the subject of any research in Saudi Arabia to date. To the best of our knowledge, we are the first to examine this link using the probability that a company will obtain a qualified audit opinion as a proxy for the quality of financial reporting. While the audit opinion is observable, discretionary accruals employed in earlier research as a proxy for earnings management are not. They must be estimated using models. One of the disadvantages of earnings management measures is that they tend to have high measurement errors and even bias (Defond & Zhang, 2014). Therefore, our study utilizes a sample of 73 non-financial companies listed on the Saudi stock market between 2019 and 2022, totaling 292 observations. The Saudi Arabian Capital Market Authority (CMA) released updated corporate governance regulations in 2017 for companies listed on the Saudi Arabian Exchange. As per the regulations, companies are required to establish an audit committee, and the approval of the General Assembly is mandatory for this purpose. It is important to note that companies were given one year to implement after the publication of the regulations in 2017. The regulations concerning the formation of an audit committee were subsequently revised in 2021, as previously stated.

This study aims to investigate the impact of audit committee (AC) characteristics on financial reporting quality (FRQ) by utilizing a qualified opinion as a proxy for financial reporting quality. It is expected that companies with higher-quality financial reports will be less likely to receive qualified audit opinions and that audit committee characteristics will affect the likelihood of receiving a qualified audit opinion.

The study is organized into three sections. Section 2 covers the development of hypotheses and the literature review. Section 3 explains the research methodology. Finally, the last section presents the findings and discusses the results.

2 THEORETICAL FRAMEWORK

An organizations efficiency accountability and governance provides balance between economic and social goals. This can be achieved through an in-depth theoretical study. Our theoretical framework mainly aims on the quote given by (Carcello et al., 2011) “good governance" are associated with "good outcomes" that stimulates audit committee (AC) characteristics on financial reporting quality (FRQ). As also noted by (Cohen et al. 2004) that management drives governance characteristics and the accounting/auditing outcomes. In fact, the definition on corporate governance given by (OECD, 1999) shows a strong relationship between a company's board, its shareholders and other stakeholders for attaining objectives and monitoring organizational performance. Further, examination on the relation between governance and accounting/auditing as noted by (Cohen et al. 2007a; García-Meca & Sánchez-Ballesta 2009; Lin & Hwang 2010), where many governance traits are governed. Therefore, to meet modern organization complexities a combination theory is the best option for an effective and efficient governance as noted by Watts and Zimmerman (1990) and Watts, Ross and Zimmerman (1986). Let's through a bright light on various theories as discussed below.

Figure 1

Theoretical impact on audit committee characteristics and financial reporting quality (source: self-constructed)

2.1 AGENCY THEORY

Agency theory is a fundamental concept in the fields of accounting and managerial studies. It explores the dynamics between principals and agents within an organization, with a specific emphasis on scenarios where individuals (agents) are employed by and act on behalf of others (principals) to carry out tasks or make decisions. The theory examines the emergence of conflicts of interest between principals and agents because of divergent objectives and information imbalances, and it suggests strategies to align these interests and alleviate such conflicts. Agency theory, as explained by Jensen and Meckling (1976), provides a practical framework for understanding the operational relationship between a principal and their agent. However, according to Argawal and Mandelker (1987) executive ownership of business securities decreased agency issues between shareholders and management. Studies in 1998 confirmed agency theory predictions regarding task programmability, information systems, and outcome uncertainty factors. This theory examines the dynamic between principals, such as shareholders, and agents, such as managers or executives, inside an organization. The idea explores the possible conflicts of interest that occur when principals assign decision-making authority to agents to act on their behalf. Research works of many authors like Kahneman and Tversky (1979), Mac Crimmon and Wehrung (1986), and March and Shapira (1987), insists organizational researcher to measure risk demographic characteristics that reflects gain versus loss. Further, more as noted by (Madhani, 2015a) on asset-intensive businesses, managers might enhance their bargaining position by making "manager-specific investments”. The contract is specifically created to incentivize agents to work on behalf of the principal even when their interest’s conflict, as described by Scott (2015). The practical implementation of this theory highlights its significance in real-life situations, rendering it a powerful instrument for comprehending the interactions between principals and agents inside organizations.

2.2 POSITIVE ACCOUNTING THEORY

This theory has its notional basis from Agency theory. Positive accounting is more of predictive one and it aims to make managers understand what or will be in future added it assumes that managers are opportunistic and work for their self-interest (Podrug et al., 2010). However, many critics on this theory are found like Neu (1997), Sue (1997), Hall (1997), Sterling’s (1990), Deegan (1997), Milne (2002) etc, with many negative appraisals. Though there were critics the theory developed as on the concept given by Watts and Zimmerman’s (1986) on accounting literature as accounting choices and capital market-based accounting research. As accounting information on the stock market measurement is done by management in fact. Positive accounting research contributes and has helped in shaping the fair value debate as given by (Barth et al., 2001; Holthausen & Watts, 2001). Thus, in turn brings out the features and procedures of the audit committees are influenced by an organization's future goals.

2.3 STEWARDSHIP THEORY

Stewardship theory, a concept in organizational management and corporate governance, presents a contrasting viewpoint to agency theory. While Agency theory delves into the potential conflicts of interest between principals (owners or shareholders) and agents (managers or executives), Stewardship theory underscores the importance of aligning the interests of these parties. It asserts that managers are inherently motivated to act in the best interests of the organization and its stakeholders. The application of Stewardship Theory can provide valuable insights into understanding the relationship between the attributes of an audit committee and the quality of financial reporting. The theory offers a lens to examine how the characteristics of audit committees influence the quality of financial reporting. This theory suggests that managers are driven by the objectives of the principal rather than their self-interests (Davis et al., 1997). This implies that managers of the company can be trusted and relied upon (Siebels & Knyphausen-Aufseb, 2012). Researchers can explore how the unique attributes and actions of audit committees, seen as responsible guardians dedicated to the prosperity of the organization and the concerns of stakeholders, contribute to maintaining high levels of integrity and transparency in financial reporting.

2.4 RESOURCE DEPENDENCE THEORY

Resource Dependence Theory (RDT) is a theoretical framework in organizational studies that analyses how organizations collect and control essential resources to accomplish their objectives, specifically in the context of inter-organizational interactions and dependencies. Resource Dependence Theory offers a significant paradigm for comprehending the dynamics of resource acquisition, allocation, and management in intricate organizational systems. According to the idea of resource dependence, directors play a crucial role in establishing a significant link between a company and valuable external resources that are necessary for the firm's growth (Pearce & Zahra, 1992). Resource Dependence Theory (RDT) can provide valuable insights into the correlation between the characteristics of audit committees and the quality of financial reporting. Similarly, management disclosures of internal control and audit opinions effectiveness found in SOX section 302 discussed by (Hoitash et al., 2009; Krishnan & Visvanathan 2007; Zhang et al., 2007). This can be achieved by analyzing how organizations, specifically corporations and their audit committees, handle their reliance on crucial resources to ensure efficient supervision and reporting procedures. Resource Dependence Theory provides a detailed viewpoint on how the features and procedures of audit committees are influenced by an organization's reliance on essential resources that are connected to financial reporting.

3 LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Our quest from different theories brought out four important characteristics like: Member independence in the audit committee, Audit committee size, Audit Committee financial experience and Frequency of audit committee meetings for the receipt of a qualified audit report through a strong literature review.

3.1 CORPORATE GOVERNANCE AND AUDIT COMMITTEE

Audit committees oversee the quality of auditing, which is a crucial part of corporate governance procedures. Consequently, strong audit committees with the necessary knowledge should enhance audit quality and raise the standard of financial reports (Defond & Zhang, 2014).

According to agency theory, stakeholders need protection; thus, forming audit committees (AC) is usually an attempt to reduce agency costs. (Turley & Zaman, 2014), To address this agency issue, the board takes on an oversight function that usually entails approving the company's plan, keeping an eye on the control system, monitoring the CEO and other top executives, and increasing the effectiveness of AC from the standpoint of agency theory. (Dezoort et al., 2002) Suggests that an effective AC can protect stakeholders' interests by ensuring reliable financial reporting, efficient internal control, and superior risk management. These are the output measures that indicate how effective an AC is.(Turley & Zaman, 2004) synthesize the studies on the influence of AC outputs on corporate governance, in contrast to DeZoort et al. (2002), who concentrate on the elements contributing to AC effectiveness, they develop a framework to organize the AC empirical research, categorizing the effects of ACs in terms of (a) the expectations that led to their creation and (b) the corporate governance effects, represented by the audit function, financial reporting quality (FRQ), and firm performance, Drawing on this framework, Ghafran and O'Sulliva (2013) reviewed the role of the AC and divided the audit committee's effectiveness into three main categories: The quality of financial reporting, the internal audit, and the external audit.

According to the regulations, the audit committee is responsible for supervising the company's financial reporting process on behalf of the board of directors. This committee meets separately with senior financial management and the external auditor and selects the external auditor. In addition, the committee evaluates whether management, internal auditors, and external auditors are working in the best interests of the company. The relationship between corporate governance characteristics and firm value has also been studied in developed and developing markets. For example, using U.S. data, (Bedard et al., 2010) discovered that there is an association, but not a causal link, between audit committee characteristics and the level of earnings management. found that the features of audit committees have an impact on UK firm performance; additionally, some of the audit committee characteristics and company value have been discovered to be favorably correlated in both developed and developing countries, U.S. (Sun et al., 2014); Greece (Mouratidou, 2019); Oman (Mohammed Al-Matari et al., 2014)). On the other hand, some studies found a negative relationship between the audit committee and firm performance. For example, in India (Bansal & Sharma, 2016) and in Malaysia (Hasan et al., 2020), study results show that the corporate governance mechanism (audit committee independence, audit committee financial expertise, audit committee size) was not significant in financial reporting quality.

The conflicts in the results of the research motivate us to discover the effects of audit committee characteristics in the Saudi Arabian market. Although few studies examined the AC characteristics and firm performance (Ali Al-Matari et al., 2012), their sample was in 2010 and found an insignificant relation with firm performance; (Boshnak, 2021) examined a sample from 2010 to 2019 he found that audit committee size and meetings negatively influence firms' performance, While audit committee independence and financial expertise indicate a strong and positive relationship with financial performance; (Boshnak, 2023) examined corporate governance mechanisms and firm Performance before and after COVID-19, their results show that during the COVID-19, firm market performance has decreased with larger board size, and more board meetings, while it has increased with board experience, board education, and board gender (number of women on the board). In 2021, Boshnak (2023) examined the impact of AC characteristics on audit quality from 2017 to 2019, using audit firm type as a proxy for audit quality. He found that firms with an AC accounting education background are more likely to assign big four audit firms, which increases audit quality. At the same time, the number of meetings and AC independence does not have a significant effect on audit quality.

3.2 AUDIT QUALITY AND AUDIT COMMITTEE

Audit committees have been seen as a crucial tool for improving the quality of financial reporting and improving the governance of businesses (Sarbanes Oxley, 2002). (Ghafran & O’Sullivan, 2017) investigated the impact of audit committee expertise on audit quality and found that audit committees possessing greater levels of financial expertise are associated with higher audit quality (measured by audit fees. Khudhair et al., (2019) discovered a positive correlation between audit quality and the proportion of non-executive directors serving on the audit committee.

Different proxies are applied in the studies to measure audit quality, such as audit firm size, audit fees, and audit opinion. In this study, the audit firm size (Big 4) will employed as a control variable to measure the audit quality and the qualified audit opinion to measure the quality of financial reporting, as mentioned earlier. In Spain, Pucheta-Martínez and García-Meca (2014) found that better corporate governance structures lead to higher quality financial information from listed companies and lower likelihood of receiving a qualified audit report. Thus, audit quality and financial reporting quality may have a role if audit committees are sizable, comprise both independent and financially experienced members, and meet frequently throughout the year. The study will concentrate on a few of the audit committee's characteristics as follows:

3.2.1 Member independence in the audit committee

The importance of member independence in the audit committee has garnered much attention. According to Kallamu and Saat (2015), the audit committee's structure will allow for a separate perspective on financial reporting and prevent any one person from dominating, resulting in improved audit quality. Furthermore, according to (Pucheta-Martínez & De Fuentes, 2007), when the Audit Committee (AC) consists of more independent members, there is a positive correlation between better financial reporting and a lower incidence of false information being reported. Chan Guoping Liu Jerry Sun (2014) documents that both board independence and board size are positively associated with audit quality. The committee is more effective in promoting transparency when it monitors the company's operations objectively. Consequently, it is arguable that the AC's independence plays a crucial role in strengthening its capacity to stop financial statement fraud.

Previous studies have proven that management may try to pressure auditors into not issuing a qualified and going-concern report. However, increasing the independence of audit committees can increase the likelihood of companies receiving going-concern opinions (Carcello et al., 2000). This is because an independent audit committee can support the auditor in any disputes that may arise with management.

Thus, the following hypothesis will be investigated:

H1: Member independence in the audit committee is positively associated with financial reporting quality, reducing the receipt of qualified audit reports.

3.2.2 Audit committee size

One key element that assists the Committee in accomplishing its objectives is the number of members that make up the audit committee. Corporate governance regulations and guidelines in Saudi Arabia specify the audit committee's minimum size of three and a maximum of five members. There are conflicting findings regarding how the audit committee's size affects both the quality of the audit and the financial reports. A few studies back up the audit committee's modest size because it offers dedication and consistency and improves its capacity for observation, follow-up, dialogue, inquiry, and communication with every stakeholder, including the Board of Directors, external auditor, and management. The increase in the number of audit committee members could result in more conflicts between members and more prolonged procedures to reach a decision. (Fariha et al., 2022) investigated the effect of board characteristics and audit committee attributes on the firm performance of publicly listed commercial banks of Bangladesh. They found that Audit Committee Size has a negative and significant relationship with firm performance.

On the other hand, some research suggests that a larger audit committee is more productive since it makes it possible to assess the external auditor's role and supports the independent Board of Directors in its efforts to enhance audit quality by offering recommendations, for example (Bagais & Aljaaidi 2020). According to regulations, as mentioned earlier, the maximum number of audit committee members is five. So, the following formulation of the second study hypothesis is possible:

H2: Audit committee size positively affects financial reporting quality, reducing the receipt of qualified audit reports.

3.2.3 Audit committee financial background

According to Carrera et al. (2017), the relationship between AC and FRQ in the US, FRQ declines as the percentage of AC members with experience in financial accounting rises. Additionally, (Mustafa & Ben Youssef, 2010) found that an independent AC member is only effective in reducing the occurrence of misappropriation of assets in publicly held companies if he/she is also a financial expert. (Bilal et al., 2018) indicate that audit committee financial expertise has a positive association with earnings quality. Thus, the presence of a financial specialist in the AC demonstrates that the internal audit program and financial information might be monitored with good intentions. It is required for monitors to have sophistication in financial matters to detect financial problems.

Thus, the following hypothesis is developed:

H3: Audit Committee financial experience positively affects financial reporting quality, reducing the receipt of qualified audit reports.

3.2.4 Frequency of audit committee meetings

Research has found that holding more frequent board meetings can lead to more active supervision of the firm's management and provide an opportunity to examine more external information. It is also shown that increasing committee activities, such as meetings, has a positive correlation with firm performance. (Brick & Chidambaran, 2010). Regular meetings are preferred for AC members who are aware of the company's conditions (Ali Al-Matari et al., 2012). These meetings offer enhanced supervision and a financial monitoring system that involves preparing and disclosing financial information about the company. In Addition, (Ghafran & O’Sullivan, 2013) found that internal auditors view certain audit committee characteristics, specifically independence, expertise, and frequency of meetings, as leading to more effective audit committee performance. Thus, the following hypothesis is proposed:

H4: The frequency of meetings in the audit committee is positively associated with financial reporting quality, reducing the receipt of qualified audit reports.

4 DATA DESCRIPTION AND METHODOLOGY

4.1 SELECTION OF SAMPLES

The non-financial companies registered on the Saudi stock exchanges from five sectors for which complete data sets are available are the subject of the current study. The Saudi Stock Exchange (Tadawul) disclosed the top 10 companies on the MSCI Tadawul 30 Index (MT30) by the end of Oct 2023. The financial sector was the heaviest on MT30 with a 44.45% weight, followed by materials (20.42%), Telecommunication (10.71%), Energy (9.44%), Utilities (4.12%), and Consumer staples (2.95%). The information was gathered from companies' financial reports from TADAWUL. To be included in the study's final sample, a company needed to fulfill three primary requirements: non-monetary listed companies, availability of a company's whole four-year annual reports between 2019 and 2022, as well as having access to a company's comparable financial records for that time.

4.2 THE RESEARCH MODELS

The standards were chosen for several reasons. Initially, banks and insurance companies were omitted because of their unique set of guidelines. The sample consisted of 73 firms and 292 observations. To test empirically the relation between AC characteristics and FRQ via qualified audit opinion, the logistic regression method were utilized to examine the moderating effect of audit quality, and we introduce an interaction term between FRQ and AC characteristics, the four dependent variables namely, the audit committee size (ACSIZE), the audit committee independence (ACIND) measured by the portion of independent members (classified as independent in board's reports) as disclosed in the annual reports, the audit committee meetings (ACMEETIN), and the portion of financial experts in the audit committee (ACFIN). For the dependent variable, the audit report (AR) received by the firms were used, and measured as a dummy variable that takes a value of 1 if the audit report contains qualifications and 0, otherwise, and five control variables: Big4 if the company was audited by one of the Big 4, ROA calculated by Earnings before tax divided by total assets of the company, firm size (FIRMSIZE) the natural log of total assets, most previous studies in AC characteristics used the firm size as a control variable (Carcello et al.,2000; Pucheta-Martínez & De Fuentes, 2007) Loss (LOSS) if the company reports a negative net income in the previous year, Otherwise 0, and leverage (LEVERG) calculated as total debt over total assets. The ROA is also used in studies as a measure of financial reporting quality (Al-Matari et al., 2012) and as a control variable in others (e.g. Boshnak, 2023; Engel et al., 2010), and it is expected that there will be a negative relation between ROA and qualified opinion (AR). The study also applied the control variable Big 4 because most studies in audit quality convey the client's requirement for high audit quality through the selection of auditor qualities such as Big N or Industry specialization. Although the evidence is limited, most of the research in this field supports the idea that agency costs explain audit quality selection. (Defond and Zhang,2014), Moreover, it is expected to find a negative and significant relationship between Big 4 and AR. Table 1 offers a variables measurement summary.

Table 1

Definitions and measurement of variables (source: self-constructed)

Acronym	Definition	Type	Measurement scale	Source of data
AR	Audit report	Dependent	dummy variable that takes a value of 1 if the audit report contains qualifications and 0, otherwise	Audit Report
ACIND	Independent members	Independent	The proportion of independent audit committee members	Annual reports
ACFIN	Financial Expertise	Independent	The potion of financial experts in the audit committee	Annual reports
ACMEETIN	AC meetings	Independent	The number of audit committee meetings held in 1 year	Annual reports
ACSIZE	AC size	Independent	The number of audit committee independent members	Annual reports
Audit Quality (BIG4	Big 4	Moderator	1 if the firm is audited by a Big 4 company and 0 otherwise	Annual reports
LEVERG	Leverage	Control var.	Total debt over total assets	Calculated measure
FIRMSIZE	Firm Size	Control var.	The natural log of total assets	Calculated measure
ROA	Returns on assets	Control var.	Earnings before tax divided by total assets of the company	Calculated measure
LOSS	LOSS in the previous year	Control var.	Dummy value (1 if the firm reported a loss in either or both two previous years	Annual report

4.3 DATA ANALYSIS AND RESULTS

4.3.1 Descriptive statistic

Table 2 presents descriptive statistics and t-values of our dependent and independent variables. The descriptive statistics, including mean, standard deviation, minimum, and maximum, were computed using SPSS version 29. The reported t-statistics show that ACSIZE and ACIND mean values are 3.75, and 53.13, respectively. These results show that AC independence has a mean of 53%. It seems that many companies comply with the best practice of the Saudi Corporate Governance Code, which requires that AC members be independent. The minimum number of financial experts is 1, and the maximum is 5. From the descriptive statistics, on average, there are 2 members of the AC with a financial expert, which indicates that all selected companies meet the Saudi Code of Corporate Governance requirement regarding the minimum number of financial expert members to serve on the AC. Moreover, on average, the number of meetings conducted by AC is around 6. As per legal regulations, a minimum of 4 meetings per year is mandatory. Although some ACs conduct meetings only once a year, others conduct them monthly or even more frequently. The ACs must have a minimum of 2 members and a maximum of 8 members. Furthermore, 47% of the sample was audited by a Big 4.

Table 2

Descriptive statistics (source: self-constructed)

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
AR	292	0	1	.10	.304
ACSIZE	291	2	8	3.75	.977
ACIND	291	0.00000000%	100.000000%	53.1309115%	19.2545554%
ACMEETIN	291	0	18	5.51	2.311
ACFIN	291	0	5	1.77	.927
FIRMSIZE	292	16.457913784	28.544477435	21.324391853	2.1117744318
LOSS	291	0	1	.30	.459
LEVERAGE	292	.00010667137	417.80648675	1.9474647022	24.436272879
ROA	292	-.4455235219	64.463707485	.29058114001	3.7968184599
Big 4	292	0	1	.47	.500
Valid N (listwise)	289				

4.3.2 Correlation matrix

Tables 3 summarize the result of the correlation of the study variable. The Spearman correlation test was used to investigate the link between the variables studied. Correlation analysis is a helpful tool in identifying any issues with multicollinearity that may exist among the variables being analyzed. Gujarati and Porter (2009) recommend 0.8 at the start of the regression analysis to account for multicollinearity problems. The statistics VIF, which is not more than 2 for all independent variables, demonstrates that there is no multicollinearity. Looking into the correlation between the independent variables, it was found that there is a positive and significant relations between (ACSIZE) and (ACMEETIN) at 0.05 and significant negative relations between (ACFIN) and (ACSIZE) at 0.001.

Table 3

Nonparametric correlations Spearman's rho (source: self-constructed)

		AR	ACSIZE	ACIND	ACMEETIN	ACFIN	FIRMSIZE	LOSS	LEVERAGE	ROA
AR	Correlation Coefficient	1.000								
	Sig. (2-tailed)									
ACSIZE	Correlation Coefficient	-0.024	1.000							
	Sig. (2-tailed)	0.686								
ACIND	Correlation Coefficient	-0.072	0.050	1.000						
	Sig. (2-tailed)	0.224	0.396							
ACMEETIN	Correlation Coefficient	0.034	.120*	0.105	1.000					
	Sig. (2-tailed)	0.563	0.040	0.074						
ACFIN	Correlation Coefficient	-0.004	.446**	0.072	.150*	1.000				
	Sig. (2-tailed)	0.946	0.000	0.220	0.010					
FIRMSIZE	Correlation Coefficient	-.281**	.329**	0.060	.155**	0.101	1.000			
	Sig. (2-tailed)	0.000	0.000	0.309	0.008	0.086				
LOSS	Correlation Coefficient	.174**	-0.054	-.141*	-.168**	-0.016	-.207**	1.000		
	Sig. (2-tailed)	0.003	0.363	0.016	0.004	0.792	0.000			
LEVERAGE	Correlation Coefficient	.139*	0.065	-0.031	-0.102	0.069	-0.094	.229**	1.000	
	Sig. (2-tailed)	0.017	0.272	0.602	0.083	0.238	0.108	0.000		
ROA	Correlation Coefficient	-.306**	0.090	.138*	.132*	0.012	.258**	-.552**	-.320**	1.000
	Sig. (2-tailed)	0.000	0.127	0.019	0.024	0.838	0.000	0.000	0.000	
Big 4	Correlation Coefficient	-.253**	.297**	0.074	0.045	0.048	.418**	-.240**	.128*	.310**
	Sig. (2-tailed)	0.000	0.000	0.206	0.444	0.410	0.000	0.000	0.029	0.000
	N	292	292	292	292	292	292	292	292	292

**Correlation is significant at the 0.01 level (2- 2-tailed); *Correlation is significant at the 0.05 level (2-tail)

The significant positive relation between (ACSIZE) and (FIRMSIZ) indicates that larger firms have larger AC sizes. For the control variables, it noticed that there is a significant positive relation between (ACIND) and (ROA), a highly significant positive relation between (BIG4) with (and ROA, FIRMSIZ) and Leverage), and a strong significant negative relation between (BIG$) and (AR, LOSS).

4.3.3 Multiple liner regression analysis

Table 4 presents the results of the regressions where the dependent variable is when the company receives a qualified opinion, The F -value in the model is significant at the 0.001

level. So, the overall model is highly significant ($p < 0.0001$), and the model's pseudo-R2 is 49 percent. In terms of audit committee independence (ACIND), the results were found to be positively but insignificantly related to the audit report with a qualified opinion (AR). Thus, the results do not support H1: Member independence in the audit committee is positively associated with financial reporting quality, reducing the receipt of qualified audit reports, the result consists with (Pucheta-Martínez et al., 2016). However, it is not consistent with most of the previous studies, which used other financial quality indicators such as (ROA, REM, and Abnormal accruals). However, the control variable ROA has a significant positive relation, and the results show that the probability of receiving a qualified opinion is very low. However, these results could be explained by the findings of (Carcello et al., 2000), that increasing the independence of audit committees can increase the likelihood of companies receiving going-concern opinions. Thus, the hypothesis 1 is not supported.

4.3.4 Logistic regression

Table 4

Logistic Linear regression (source: self-constructed)

		B (Coefficient)	S.E.	Wald (Chi-square)	df	Sig. (P-value)	Exp(B)	95% C.I.for EXP(B)	
								Lower	Upper
Step 1[a]	ACSIZE	0.400	0.281	2.034	1	0.154	1.492	0.861	2.587
	ACIND	0.004	0.013	0.115	1	0.734	1.004	0.979	1.030
	ACMEETIN	0.433	0.107	16.421	1	0.000	1.542	1.251	1.901
	ACFIN	-0.021	0.293	0.005	1	0.944	0.980	0.552	1.738
	FIRMSIZE	-0.576	0.207	7.745	1	0.005	0.562	0.375	0.843
	LOSS	-0.126	0.606	0.043	1	0.835	0.882	0.269	2.889
	LEVERAGE	0.285	0.077	13.579	1	0.000	1.330	1.143	1.548
	ROA	-15.525	4.094	14.376	1	0.000	0.000	0.000	0.001
	Big 4	-2.065	0.786	6.913	1	0.009	0.127	0.027	0.591

a. Variable(s) entered on step 1: ACSIZE, ACIND, ACMEETIN, ACFIN, FIRMSIZE, LOSS, LEVERAGE, ROA, Big 4.

The Audit Committee size (ACSIZE) was found not to be significant, and the probability of receiving qualified opinions could increase with the increase in the committee size, therefore H2 also rejected. The number of audit committee meetings (ACMEETIN) is positive and significant with (AR), which means that increasing the meetings increases the possibility of getting a qualified opinion. (ACFIN) negatively associated with receiving qualified opinions, but not significant, hence H3 is accepted; Audit Committee financial experience positively affects financial reporting quality, reducing the receipt of qualified audit reports. These results consist of the results of (Boshnak, 2021). For (ACMEETIN) there is a significant and positive relation with the dependent variable (AR); the increase in audit committee meetings will increase the probability of receiving qualified audit opinions, therefore H4 is rejected.

5 PRACTICAL AND SOCIAL IMPLICATIONS

The features of a strong audit committee, such as independence, expertise, and diligence, can contribute to improved financial reporting quality. This, in turn, enhances transparency in financial disclosures, fostering greater trust among stakeholders, including investors, regulators, and the public. For instance, influential audit committees that ensure high-quality financial reporting may attract more local and international investors by providing them with a sense of security and confidence in the company's financial health. Findings from studies on audit committee characteristics can inform regulatory reforms aimed at strengthening corporate governance standards in Saudi Arabia. Insights into the impact of audit committee characteristics can drive educational initiatives and professional development programs for auditors, board members, and financial professionals in Saudi Arabia. Improved financial reporting quality can facilitate better stakeholder engagement, as it provides stakeholders with accurate and timely information about a company's performance and risks. Influential audit committees are better positioned to oversee risk management processes and detect financial irregularities or fraud.

Understanding the impact of audit committee characteristics on financial reporting quality can benefit smaller companies and startups in Saudi Arabia by guiding them on best practices for establishing governance structures that support reliable financial reporting from the outset. Research on this topic can stimulate further academic inquiry into corporate governance practices and financial reporting quality within the Saudi context. Overall, the implications of studying the impact of audit committee characteristics on financial reporting quality in Saudi Arabia extend beyond regulatory compliance to broader economic, social, and educational realms, ultimately contributing to a more robust and trustworthy financial ecosystem.

6 CONCLUSION

This study analyzes how the characteristics of an Audit Committee (AC) affect the quality of financial reporting (FRQ) in non-financial companies listed on the Saudi stock market between 2019 and 2022. The study investigates the impact of AC independence, size, meetings, and the percentage of financial experts on the board. The findings indicate that only the percentage of financial experts on the board was positively related to reducing the likelihood of a company receiving a qualified opinion. The frequency of meetings and the independence in AC are significantly and positively associated with the probability that companies may receive qualified opinions; the first conclusion to note is that the independency of an AC does not reduce the occurrence of error and non-compliance qualifications, which usually include in the qualified opinion, this consists with (Carcello et al., 2000), that the more percentage of affiliated directors in the committee is less likely the auditor is to issue a going-concern audit report. Thus, an independent audit committee can support the auditor in his arguments with the management and support the transparency and the quality of financial reporting. However, the audit committee meetings are positively related to the firm size, and audit committee size has a significant positive relation with the financial expert percentage in the audit committee.

The results of the study could help regulators improve the effectiveness of the AC, overall corporate governance practices, and owner confidence in the company. Therefore, the findings have implications for regulators, policymakers, and standard setters seeking to improve the credibility of financial reporting, as there is an interesting correlation between some of the independent and control variables. The research has some limitations. First, the period is mainly during COVID-19, which may affect the results. Second, the qualified opinion was included without classifying the type of qualification. It would be interesting for future research to explore the different types of qualified opinions or going-concern opinions. Additionally, it would be beneficial to examine the classification and details of independence among audit committee members. It is worth noting that some companies use three categories to refer to the degree of dependency: non-executive, independent, and outside the board. However, it was not found any paragraph in articles 90 and 93 in the regulations that explain the (outside the board). In this study, only the independent category was applied.

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