

-RESEARCH ARTICLE-

AUDIT COMMITTEE DECISION AUTHORITY, FINANCIAL RISK GOVERNANCE, AND FINANCIAL REPORTING QUALITY: A BEHAVIORAL GOVERNANCE PERSPECTIVE

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—Abstract—

Despite extensive corporate governance reforms, financial reporting quality remains a persistent concern in many emerging markets, where audit committees often exist to fulfill regulatory requirements but lack substantive influence over managerial decision-making. Prior research has predominantly focused on audit committee structural characteristics, such as independence and expertise, offering limited insight into whether audit committees possess sufficient decision authority to effectively constrain managerial opportunism. The mechanisms through which audit committee authority translates into improved financial reporting outcomes remain insufficiently understood, particularly in contexts characterized by concentrated ownership and evolving governance institutions. Addressing these gaps, this study examines the relationship between audit committee decision authority and financial reporting quality, with financial risk governance proposed as a mediating mechanism. Using an unbalanced panel dataset of non-financial firms listed on the Saudi Stock Exchange over the period 2015–2022, using firm fixed-effects regression analysis with robustness checks. Results indicate that audit committee decision authority is positively and significantly associated with financial reporting quality. Financial risk

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governance partially mediates this relationship, suggesting that audit committee authority improves reporting outcomes by strengthening risk governance mechanisms. These findings demonstrate that audit committee effectiveness depends not merely on structural presence but on the extent of substantive decision-making authority. The study contributes to corporate governance literature by shifting the focus from symbolic oversight to decision rights and by identifying financial risk governance as a key mechanism linking audit committee authority to reporting quality. The findings offer important implications for regulators and policymakers seeking to enhance governance effectiveness in emerging markets.

Keywords: Audit committee decision power, Financial risk governance, Financial reporting quality, Corporate governance.

INTRODUCTION

Corporate governance reforms in capital markets around the world have paid more attention to the role of audit committees as a key element in good financial governance and high-quality financial reporting (Alzeban, 2020). Common assumption among regulators & standard setters is that audit committees increase transparency, reduce information asymmetry and limit managerial opportunism through oversight of accounting policies, internal controls and audit processes (Alajmi & Al-Shammari, 2024). Consequently, there are governance codes enacted in many jurisdictions that mandate the establishment of audit committees and their composition and duties (Boshnak, 2021). Despite these reforms, ongoing instances of financial reporting failures and earnings manipulations suggest that having an audit committee is not necessarily having an effective oversight role and/or better quality reporting (Bhuiyan et al., 2020).

A major shortcoming of the current governance regimes is that they are very much focused on form rather than substance (Al Lawati et al., 2021). Existing empirical research has focused on audit committee effectiveness mostly in terms of structural attributes like independence, financial expertise, committee size and meeting frequency (Alhumoudi, 2024; Musallam, 2020). While these characteristics describe adherence to governance requirements, they are not necessarily indicative of the actual ability of the committee to influence the decision-making of managers or enforce corrective measures. Audit committees can check boxes but be pushovers in the financial decision-making process, particularly when power is concentrated in the hands of management or in the hands of dominant shareholders (Alsaadi et al., 2021; Haidoub et al., 2025). This emphasis on form rather than substance is hiding another question that is not addressed enough: Do audit committees have meaningful decision-making authority and does this decision-making authority result in better financial reporting results?

Recent research in governance has come to appreciate the truth that mechanisms for monitoring do not work if they are not backed by real authority and discretion (Al Lawati & Hussainey, 2021; Khan & Mahmood, 2023). From a behavioral governance perspective, effectiveness is not just about who's on the audit committee, but whether the audit committee members are empowered to challenge management, demand information and intervene in financial and risk-related decisions (Mardessi, 2022). Decision authority captures this functional dimension of governance by reflecting the extent of power or control over outcomes which audit committees are given or implicitly expected to have (Al-Dhamari et al., 2022; Azizkhani et al., 2023). However, in spite of its conceptual significance, the decision-making power of audit committees have not been studied to a sufficient extent in empirical contexts and especially in emerging markets, where governance reforms are in an ongoing transition.

Saudi Arabia provides an interesting institutional context in which to examine these issues. As part of its Vision 2030 agenda, Saudi Arabia has made major corporate governance reforms with the goal of enhancing transparency, accountability, and investor confidence (Al-Ahdal et al., 2023; Alomair & Al Naim, 2025). These reforms require listed firms to have audit committees with the audit committees having specific responsibilities. At the same time, the Saudis are also an example of a corporate environment with concentrated ownership structures, influential controlling shareholders, and developing enforcement mechanisms. In such contexts, audit committees can exist in name, but not in practice and not have the practical authority to make a difference in relation to financial reporting and risk-related decisions (Alharbi & Hashim, 2024; Dwekat et al., 2022; Salehi et al., 2023). Understanding whether or not audit committee decision authority is important in this context also gives useful insights into the effectiveness of governance reforms in practice.

Another gap in the literature which is important to our study is that of the area of audit committee authority on financial reporting quality (El-Deeb et al., 2024). Prior investigations focus mostly on direct relations between governance characteristics and reporting outcomes, financial reporting quality usually being regarded as an immediate effect of oversight structures (Alsultan, 2025; Islam et al., 2023; Kateb, 2024). This approach overlooks the internal processes through which mechanisms of governance work. One such process is financial risk governance which includes the identification, monitoring and management of financial risks associated with liquidity, leverage, earnings volatility and internal controls (Makhlouf, 2021; Umar et al., 2023). Financial risk governance has a direct bearing on managerial incentives and constraints and hence has a significant role to play in deciding the credibility and reliability of financial reporting (Hassan Bazhair, 2022).

Although audit committees are increasingly supposed to be responsible for financial risk governance, existing research has tended to either focus on the risk governance

function as a board-level responsibility, or as an isolated governance outcome (Buallay & Al-Ajmi, 2020). The subject of the authority of audit committees, and how audit committee authority affects financial risk governance and, hence, the quality of financial reporting, has not received much attention (Ragab & Saleh, 2025). This omission is a limitation in the context of understanding the manner in which audit committees translate authority to enhanced reporting outcomes and leaves the "black box" of internal governance largely unexplored.

Drawing upon the theory of agency and a behavioral governance view, this study argues that audit committee effectiveness is not only a function of audit committee monitoring activities, but of decision authority allocation and exercise (Amanamah, 2024; Maroun, 2022). Agency theory highlights the fact that the imperfect information is the source of incentives to managerial opportunism, especially for financial reporting. Audit committees are supposed to overcome these agency problems, but they can only do this if they have power to take action on risks that are discovered. Behavioral governance theory further stresses that the effects of governance are determined by power, discretion and decision rights in organizational processes. Audit committees with more decision power take a more active role in oversight of financial risk, question management actions and enforce governance standards (Omer et al., 2020; Tawfik et al., 2023).

Building on these insights, this research addresses whether audit committee decision authority enhances financial reporting quality both directly and indirectly, through financial risk governance. By modeling financial risk governance as a mediating mechanism and making it explicit, the study provides a process-oriented explanation of how audit committee authority is transformed into reporting outcomes (Alquhaif & Alobaid, 2024). Such an approach is not limited to recording associations but goes further to give more depth to the question of the effectiveness of governance from a behavioral perspective.

There are three main contributions from this research. First, it further adds to the literature of audit committee by shifting the focus from structural characteristics to decision authority as a substantive and behavioral governance mechanism. Second, it contributes to the financial risk governance research by recognizing risk governance as an important channel for audit committee authority to affect the quality of financial reporting. Third, by concentrating on Saudi listed firms, the study provides context-specific evidence from an emerging market in which governance reform is ongoing and the separation between form and substance is especially salient. Together, these contributions supplement the knowledge of how effective audit committees can be in enhancing financial risk governance and enhancing the quality of financial reporting.

The rest of the paper is organized as follows. The next section is a review of the pertinent literature and the development of the hypotheses. The research design and

methodology are described in the next section. This is followed by presentation of empirical results: regression and mediation analyses. The discussion section is used to interpret the findings, and the final section is used to conclude with implications, limitations and future research directions.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Audit Committees and Financial Reporting Quality

In governance environments where there are regulatory reforms, such as the Kingdom of Saudi Arabia, formal compliance may not be sufficient to provide effective audit committee oversight. A lot of research has been done on the role between audit committee and the quality of financial reporting due to the role of audit committees in safeguarding financial information. Good quality financial reporting helps to reduce asymmetric information, to limit opportunism of managers, and to make financial statements more credible. Audit committees contribute to these results by supervising accounting policies, monitoring internal controls and interacting with the external auditors. Empirical studies generally document that good audit committees are related to lower earnings management, less restatements, and higher quality accruals ([Alharbi & Hashim, 2024](#); [Alomair & Al Naim, 2025](#); [Kateb, 2024](#); [Kateb & Belgacem, 2024](#)).

Quality of financial reporting has been measured using a number of different proxies, including discretionary accruals, earnings persistence, restatements and measures of audit quality. Among them, discretionary accruals is one of the widely used measures, which reflects manager's discretion in financial reporting. Prior research that has used accrual-based measures shows that greater audit committee oversight is frequently linked to less earnings manipulation. However, despite numerous studies, results are not consistent from one institutional setting to another, implying that the impact of audit committees is dependent upon more than just their existence ([Al Lawati et al., 2021](#); [Hassan Bazhair, 2022](#); [Musallam, 2020](#)).

Structural Audit Committee Characteristics

Most of the past research has blamed audit committee effectiveness on structural attributes, such as independence, financial expertise, size and meeting frequency. Independence is assumed to enhance objectivity and financial expertise enhances the understanding of committee complex accounting issues. Meeting frequency is considered as proxy for diligence and engagement. These attributes are frequently codified in governance codes and regulatory requirements, being reflective of the importance of such attributes ([Alqatamin & Alqatamin, 2024](#); [Kateb, 2024](#)).

Despite their intuitive appeal, empirical findings for structural characteristics are mixed. While some research reports positive relationships between independence or expertise and reporting quality, others reveal insignificant or inconsistent findings

(Alomair & Al Naim, 2025). Similarly, frequent meetings may indicate either proactive oversight or reactive responses to extant problems. These inconsistencies imply that structural attributes may be necessary but not sufficient conditions for effective oversight. In particular, structural characteristics do not reflect the extent to which audit committees have the power to influence decisions or enforce corrective actions. As such, research has questioned to an increasing degree whether form-based governance mechanisms are adequate in explaining audit committee effectiveness variations (Alhumoudi, 2024; Umar et al., 2023).

Decision-Making Process of the Audit Committee

Audit committee decision authority is the degree to which audit committees have formal and informal decision-making authority over financial reporting and risk-related decisions. Unlike independence or expertise, which are descriptors of who is on the committee, decision authority describes what may really happen to the committee. It represents the ability of the committee to give an approval to the accounting policies, to demand information, challenge the management, and to demand remedial actions (Buallay & Al-Ajmi, 2020; Ragab & Saleh, 2025).

Decision authority is by conception more distinct from expertise and independence. A committee can be made up of independent and well-versed members in company finances, but if key decisions are centralized with management or the board chair, the committee can be meaningless. On the contrary, committees that have clear decision rights are more likely to convert their knowledge and independence into effective control. Despite its significance, decision authority has received little empirical attention, especially in emerging and reforming markets. This gap provides the motivation to look more closely at decision authority as an inherent governance mechanism that affects a committee's effectiveness as auditors (Alomair & Al Naim, 2025; Azizkhani et al., 2023).

Financial Risk Governance

Financial risk governance is the structures and processes by which firms identify, evaluate and manage financial risks such as liquidity risk, leverage risk and earnings volatility. Effective financial risk governance is important to the financial reporting outcomes because unmanaged risks may generate incentives for earnings manipulation and opportunistic financial reporting. Given their mandate over internal controls and reporting processes, audit committees are being held to focus on oversight of financial risks increasingly (El-Deeb et al., 2024).

Prior research has suggested that the stronger the risk governance, the more conservative the reporting practices and the lower the level of earnings management (Al Lawati et al., 2021). However, research tends to conceive of risk governance as a distinct area of governance, as opposed to an integral part of audit committee

oversight. In addition, few evidences exist on the factors that strengthen the financial risk governance at the committee level (Alquhaif & Alobaid, 2024). Understanding the authority of audit committee in risk governance is therefore crucial to explain the variation in reporting quality.

Decision Power and Financial Risk Management

Theoretical and empirical knowledge suggests that audit committee decision authority is likely to increase the effectiveness of financial risk governance. Committees with more authority may require management to disclose risk exposures, implement risk controls and finance policies in line with risk tolerance. Decision authority helps audit committees go beyond merely passive monitoring activities and have an active role in risk oversight processes (Al Lawati et al., 2021; Salehi et al., 2023).

In a context characterized by changing governance frameworks, as in Kingdom of Saudi Arabia, formal adherence to risk oversight requirements may not be an adequate safeguard against poor implementation. Audit committees with little authority may find it difficult to influence risk-related decisions, even in the face of obvious risks (Alquhaif & Alobaid, 2024). On the other hand, empowered committees are in a better position to ensure that financial risks are identified and managed in a well-timely manner (Makhlouf, 2021). Based on the above reasoning the following hypothesis is put forward:

H1: *Decisions authority of audit committee is associated with financial risk governance.*

Financial Risk Governance and Reporting Quality

Effective financial risk governance is expected to increase the quality of financial reporting by minimizing the incentives to engage in opportunistic behavior and improve internal controls. Firms with significant risk management frameworks are more likely to consider conservative accounting practices, anticipating adverse outcomes and transparent disclosures. By contrast, poor risk governance may promote earnings smoothing or conceal financial vulnerabilities (Amanamah, 2024). From an agency and procedural justice point of view, good financial risk governance limits managerial discretion and makes reporting processes more credible and thus improves financial reporting quality.

There is empirical evidence for a negative relationship between risk governance strength and earnings management which may imply that the oversight of financial risks tends to restrict the managerial discretion (Gull et al., 2023). Audit committees are key players in this process by making the link between risk oversight and reporting practices. Accordingly, the stricter financial risk governance should be related to the better quality of financial reporting (Salehi et al., 2023). This leads to

the second hypothesis:

H2: *There is a positive relationship between financial risk governance and financial reporting quality.*

Mediation Role of Financial Risk Governance

While the decision power of the audit committee may have a direct impact on the quality of financial reporting, it is likely to also occur through financial risk governance. Decision authority permits audit committees to influence processes of risk oversight, in turn affecting incentives for reporting, and report results. This mediation perspective is in line with calls in the literature to move beyond direct associations and to search for the inside mechanisms through which governance structures function (Al-Ahdal et al., 2023; Alsultan, 2025; Islam et al., 2023).

By conceptualising financial risk governance as a mediating variable, this study provides a process-oriented explanation of audit committee effectiveness. Rather than assume that authority directly constrains earnings management, the framework recognizes that authority first improves the quality of the risk oversight, which in effect improves the quality of reporting (Hassan Bazhair, 2022; Kateb, 2024; Musallam, 2020). This combined view provides a more sophisticated understanding of the dynamics of governance and results the final hypothesis:

H3: *Financial risk governance mediates the effect of audit committee decision authority on the quality of financial reporting.*

RESEARCH DESIGN AND METHODOLOGY

This study takes a quantitative empirical approach to examine the effect of internal governance processes on the quality of financial reporting using Saudi Arabia. A panel research design is used to reflect differences in governance arrangements and reporting outcomes by firm and over time. The use of panel data allows one to control for unobservable firm-specific characteristics, which are constant over time, as well as common temporal effects that might affect all firms simultaneously. This approach is especially appropriate to governance research, where both institutional structures and organizational practices are subject to a gradual evolution, and may have delayed impacts on reporting behavior.

The empirical framework is aimed at testing direct and indirect relationships between study variables. In addition to measuring the relationship between audit committee decision authority and financial reporting quality, the analysis looks at the extent to which financial risk governance acts as an intervening mechanism whereby the governance authority is translated into reporting outcomes. This methodological design makes it possible to better understand the effectiveness of governance, by

paying attention to the internal processes rather than simply the structural features that can be observed.

Sample Size and Data Collection

The paper examines an imbalanced sample of non-financial companies that have traded on Saudi Stock Exchange (Tadawul) between 2015 and 2022. Financial institutions were locked out because of different regulatory and reporting regimes. Annual reports and audit committee disclosures were manually used to extract data on governance, whereas published financial statements were used to take the financial variables. Upon following the standard data-screening procedures, the data was narrowed down to 185 firms, generating 1,295 observations of firms-years.

The data at the firm level were obtained through publicly available corporate reports, such as annual reports and corporate governance reports. These manuals give detailed information about the duties of the audit committees, their mandate and risk-oversight practices and general governance commitments. Accounting-based metrics and firm characteristics were constructed using the data of the financial statements. The final dataset retained only firm-years with all the information on the important variables. The data collection process includes several screening processes to ensure data reliability. Observations with missing or inconsistent disclosures are excluded and firms with insufficient longitudinal data are deleted to support panel estimation techniques. The end dataset is an imbalanced panel, which reflects natural movements in firm participation over time. This structure retains useful information while still having enough variation to be able to test it empirically (Al Sultan, 2025).

Variable Measurement

The empirical analysis includes one dependent variable, one primary independent variable, a mediating variable and a series of control variables. All constructs are operationalized by approaches well known in literature on accounting and corporate governance with special focus on the capture of governance processes rather than on just formal compliance.

Financial Reporting Quality

Financial reporting quality is proxied by measures that are based on accrual accounting and reflect the degree to which the reported earnings represent the underlying economic performance. Accruals-based indicators are extensively used in accounting research because they reflect managerial discretion that is embedded in estimates and judgments used in accounting. Better quality of reporting tends to be related to less discretionary accounting adjustments (Musallam, 2020).

To operationalize this construct, total accruals are broken down into discretionary and non-discretionary components based on an existing accrual estimation framework.

The absolute value of the discretionary accruals is used as the main proxy since it is the size of the reporting discretion no matter in which direction. This approach enables the analysis to concentrate on the quality of financial reporting rather than on earnings management approaches. Lower discretionary accruals are respectively seen as an indication of better reporting quality and better oversight.

Audit Committee Decision Making Power

Decision authority of the audit committee is an indication of how the audit committee is procedurally and formally enabled to impact audit related and financial reporting decisions. Contrary to structural composition characteristics like independence, financial expertise, which are traditional audit committee qualities, decision authority is the functional aspect of the audit committee to act, intercede management and take corrective measures whenever a reporting issue is created. This construct is especially applicable in the context of governance whereby formal adherence may lack substantive regulation (Alomair & Al Naim, 2025).

The operationalization of audit committee decision authority is based on a disclosure-based governance index developed based on annual report and corporate governance disclosure of firms. The index measures the existence of explicit decision rights in which the audit committee has been given authority over which auditor to appoint and remunerate, decision on accounting disagreements and leadership in the audit committee structure. All the components are referred in terms of observable disclosure indicators and combined in a composite score with higher scores denoting more authority to make decisions. Though disclosure-based measures might not be suitable to fully represent informal power relations, they give visible and similar evidence of formal authority and are congruent with previous studies of governance. This measurement method is in line with a process viewpoint as it focuses on the rights to decisions and functional influence instead of structural qualities.

Financial Risk Governance

Financial risk governance is a set of processes and mechanisms that help firms to identify, track, and address financial risks that can undermine financial reporting integrity. These risks are the liquidity, leverage, earnings volatility and internal control weakness exposures. In line with previous governance studies, this construct is defined through a disclosure based index which reflects the amount and degree of the audit committee involvement in financial risk management (Alomair & Al Naim, 2025).

It is built by a systematic content analysis of annual reports and corporate governance disclosures of firms. It contains observable practices regarding audit committee supervision of internal controls, evaluation of financial risk exposures, as well as tracking of risk mitigation and compliance procedures. All the components have the

same weight in the composite index it is believed that successful financial risk governance needs a balanced consideration over various levels of risk management and not one singular mechanism. The values of the index are higher, which means that the financial risk governance is stronger and more active.

Disclosure based measures might not be comprehensive in the measure of informal risk management practices but offer consistent, verifiable and comparable information of formal risk oversight. This method lays stress on the procedural aspect of financial risk governance, and it is consistent with a process-based concept of corporate governance that stresses on how oversight is performed in practice and not just on the formal structural provisions.

Control Variables

Several control variables are included to account for firm characteristics that may influence the quality of financial reporting. Firm size is measured (Table 1) by the natural logarithm of total assets to capture the size of operations and complexity of reporting. Financial leverage is included to control for the monitoring pressures related to debt, and profitability is assessed with return on assets to capture the effects of performance. Firm age is included to account for differences in organisational maturity (Al Lawati et al., 2021; Alzeban, 2020; Bhuiyan et al., 2020). In addition, conventional audit committee characteristics, such as independence and number of meetings per year, are also controlled to isolate the influence of decision authority from other governance attributes (Tawfik et al., 2023).

Table 1: Measurement of Variables

Variable Type	Variable Name	Symbol	Measurement Description
<i>Dependent Variable</i>			
	Financial Reporting Quality	FRQ	Measured using the absolute value of discretionary accruals estimated from an accrual-based model. Lower values indicate higher financial reporting quality and reduced managerial discretion in financial reporting.
<i>Independent Variables</i>			
	Audit Committee Decision Authority	ACDA	Composite index reflecting the extent of formal and procedural decision-making power of the audit committee. The index captures disclosed authority related to audit oversight responsibilities, decision rights in audit-related matters, and leadership responsibility within the committee. Higher values indicate stronger decision authority.
Mediating	Financial Risk Governance	FRG	Index measuring the intensity of financial risk oversight practices. Constructed from disclosures related to audit committee involvement in financial risk assessment, internal control monitoring, and oversight of financial reporting risks. Higher values represent stronger financial risk governance.
Control	Firm Size	SIZE	Natural logarithm of total assets, used to control for differences in firm scale, operational complexity, and reporting incentives.

Table 1: Measurement of Variables (cont...)

Variable Type	Variable Name	Symbol	Measurement Description
	Leverage	LEV	Ratio of total debt to total assets, capturing financial risk and debt-related monitoring pressure.
	Profitability	ROA	Return on assets, measured as net income divided by total assets, reflecting firm performance.
	Firm Age	AGE	Number of years since firm incorporation or listing, representing organizational maturity.
	Audit Committee Independence	ACIND	Proportion of independent directors serving on the audit committee.
	Audit Committee Expertise	ACEXP	Indicator variable equal to one if at least one audit committee member possesses accounting or financial expertise, and zero otherwise.
	Audit Committee Meetings	ACMEET	Total number of audit committee meetings held during the financial year, capturing monitoring intensity.

Although audit committee decision authority is conceptualized as a behavioral governance mechanism, its empirical measurement captures observable manifestations of authority reflected in firms' governance disclosures.

Empirical Models

This study uses panel data regression techniques to study the relationship between audit committee decision authority, financial risk governance and financial reporting quality. Panel estimation is suitable because it can control for unobservable firm-specific characteristics which are not changing over time, as well as common causes over time that may affect all firms at the same time. All models have firm fixed effects and year fixed effects to control for omitted variable bias related to unobserved heterogeneity and macroeconomic shocks. The study uses firm fixed effects panel regressions with year fixed effects using STATA to control for unobserved firm specific heterogeneity. Standard errors are clustered at the firm level to account for heteroskedasticity and serial correlation, as is typical in recent research on corporate governance and accounting.

Baseline Model

The baseline specification examines the effect of audit committee decision authority on financial risk governance. The following model is estimated:

$$FRG_{it} = \alpha + \beta_1 ACDA_{it-1} + \sum_{it} \gamma Controls_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

where FRG_{it} is financial risk governance of firm i in year t , $ACDA_{it-1}$ is the lagged financial risk governance item of the audit committee decision authority, $Controls$ is a

vector for firm level and governance control variables.

Mediation Model

To analyze whether financial risk governance mediates the relationship between audit committee decision authority and financial reporting quality, the following model is estimated:

$$FRQ_{it} = \alpha + \beta_1 ACDA_{it-1} + \beta_2 FRG_{it-1} + \sum \gamma Controls_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

where FRQ_{it} denotes financial reporting quality, measured using discretionary accruals, for firm i in year t . $ACDA_{i,t-1}$ represents lagged audit committee decision authority, and $FRG_{i,t-1}$ denotes lagged financial risk governance. The terms μ_i , λ_t capture firm and year fixed effects, respectively, while ε_{it} is the idiosyncratic error term. The mediation evidence is fulfilled in case three conditions are met: (i) the decision authority of an audit committee has significant impact on the governance of financial risks; (ii) the quality of financial reporting is affected significantly by financial risk governance; and (ii) the coefficient of the magnitude of the impact of the decision authority of an audit committee is decreased after introducing the mediator. This method is in line with conventional mediation testing methods that are often used in governance and accounting studies based on panel data.

All the meaningful explanatory and mediating variables are lagged one period to alleviate the issues of reverse causality and simultaneity, which assumes that the governance structures can affect the reporting outcomes with a time lag. There are firm fixed effects to control the unobserved and time-invariant firm features and there are the year fixed effects to control common macroeconomic and regulatory shocks.

To be robust, all continuous variables are winsorized at the 1st and 99th percentiles to keep the impact of extreme values under control and alternative model specifications give qualitatively similar results. Measurement of multicollinearity is done through the variance inflation factors, which are much lower as compared to the traditional levels meaning that the calculated coefficient is consistent and valid.

EMPIRICAL RESULTS

Descriptive Statistics

Table 2 presents descriptive statistics for 1,295 firm-year observations. Financial reporting quality (FRQ), as measured by the absolute value of discretionary accruals has mean value of 0.091 (std. dev. 0.047) ranging from 0.014 to 0.236, which implies meaningful variation in reporting outcomes across firms. The audit committee decision authority index (ACDA) has a mean of 2.210 and standard deviation of 0.930

and ranges over the full range of 0-4, indicating that there is substantial heterogeneity in the level of empowerment of audit committees. Financial risk governance (FRG) Mean = 0.550, (Std. dev. 0.160) Range = 0.120 to 0.890 Corresponding to differences in the level of oversight of risk. Audit committees seem on average quite independent (ACIND mean 0.790). Committees meet approximately 5.2 times per year (but the variation in meeting frequency is great). Firm characteristics are also diverse with average leverage being 0.460 and profitability (ROA) having both losses and gains.

Table 2: Descriptive Statistics

Variable	Mean	Std. dev.	Min	Max
FRQ	0.091	0.047	0.014	0.236
ACDA	2.210	0.930	0.000	4.000
FRG	0.550	0.160	0.120	0.890
ACIND	0.790	0.180	0.330	1.000
ACMEET	5.200	2.100	2.000	12.00
SIZE	15.18	1.360	12.05	18.90
LEV	0.460	0.220	0.050	0.910
ROA	0.061	0.084	-0.410	0.390
ACEXP	0.613	0.487	0.000	1.000
AGE	18.70	9.400	3.000	52.00

Source(s): Authors' creation

Bivariate analysis

Table 3 presents the Pearson correlation coefficients between the study variables and corresponding variance inflation factors that provide some preliminary information on the direction of associations before conducting multivariate analysis. The negative correlations between financial reporting quality and both audit committee decision authority and financial risk governance are in line with the study's expectations, implying that risks in firms with more empowered audit committees and stronger risk governance tend to have lower discretionary accruals. However, the moderate extent of these correlations suggests that although governance attributes are linked to reporting quality, they do not dominate reporting outcomes, highlighting the need to use multivariate analysis to separate out the impact of these attributes on reporting quality.

The positive relationship between audit committee decision authority and financial risk governance gives some preliminary support to the proposed mediation structure by suggesting that empowered audit committees are more actively involved in financial risk oversight. Nonetheless, correlation analysis does not prove causality, and it cannot differentiate between whether stronger authority results in better risk governance or if stronger authority is granted by firms with better governance environments to audit committees. This limitation supports the need for lagged fixed effects regressions which are used in later analysis.

The correlations involving the control variables are consistent with the previous literature with audit committee independence and frequency of meeting negatively associated with discretionary accruals - reflecting better monitoring. The positive correlation between leverage and financial risk governance is suggestive that highly levered firms are under more pressure to formalize risk oversight mechanisms. Importantly, the low correlation coefficients, and variance inflation factors well below conventional thresholds, indicates that the possibility of multicollinearity biasing the regression estimates is low. Overall, Table 3 does provide supportive but non-conclusive evidence that serves as the motivation for the multivariate and mediation analyses that follow.

Table 3: Pearson correlation matrix and VIF

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	VIF
FRQ	1.000										
ACDA	-0.178**	1.000									1.002
FRG	-0.264**	0.180**	1.000								1.002
ACIND	-0.155**	0.220**	0.107***	1.000							1.008
ACEXP	-0.057**	0.071**	0.063***	0.051**	1.000						1.005
ACMEET	- 0.064***	0.208**	0.030	0.065***	0.027	1.000					1.002
SIZE	- 0.163***	0.075***	0.088***	0.040*	0.010	0.027	1.000				1.002
LEV	0.032	0.035	0.288***	0.012	0.030	-0.024	0.000	1.000			1.003
ROA	- 0.105***	-0.044**	- 0.111***	0.003	-0.007	- 0.040*	0.297***	- 0.124***	1.000		1.004
AGE	-0.028	0.049**	0.056**	0.049**	0.044**	0.017	-0.032	0.026	- 0.010	1.000	1.005

Notes: Pearson correlations are reported in the lower triangle; diagonal elements equal 1.000. *, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. VIF values are computed for the explanatory variables.

Source(s): Authors' creation

Regression Results

Table 4 shows firm fixed effects regression results on the relationships between audit committee decision authority, financial risk governance and financial reporting quality. Model (1) indicates a positive and statistically significant association between lagged audit committee decision authority and financial risk governance, which means audit committees with more decision authority in auditing are more actively involved in monitoring financial risks. This result supports a behavioral governance argument in the study which appears to suggest that authority allows audit committees to translate monitoring responsibilities into effective risk oversight and not remain as symbolic governance structures.

Models (2) and (3) extend the analysis to quality of financial reporting. In Model (2), audit committee decision authority is associated with a negative and significant association with discretionary accruals indicating that empowered audit committees are effective in their ability to limit managerial discretion and improve quality of reporting. This finding is consistent with agency theory, which highlights the role played by authority in reducing information asymmetry and opportunistic reporting behavior. When the risk governance over finance is introduced in Model (3), it exhibits a high negative relationship with discretionary accruals, confirming the hypothesis that increased risk oversight contributes directly to increased quality in financial reporting. Importantly, the coefficient on audit committee decision authority decreases in magnitude, but is statistically significant, suggesting partial mediation.

Table 4: Regression Results using Fixed Effects Model

Variables	(1) FRG	(2) FRQ	(3) FRQ
L1. ACDA	0.085*** (0.002)	-0.006*** (0.001)	-0.008*** (0.000)
L1. FRG	—	—	-0.188*** (0.004)
ACIND	0.101*** (0.012)	-0.031*** (0.004)	-0.014*** (0.002)
ACEXP	-0.000 (0.002)	0.002** (0.001)	0.001** (0.000)
ACMEET	0.001* (0.001)	-0.001*** (0.000)	-0.000 (0.000)
SIZE	0.000 (0.001)	-0.002*** (0.000)	-0.000 (0.000)
LEV	-0.005 (0.008)	-0.005* (0.003)	-0.004*** (0.001)
ROA	-0.004 (0.024)	0.009 (0.007)	0.013*** (0.004)
AGE	0.000 (0.001)	0.000 (0.000)	-0.000 (0.000)
Firm fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Adjusted R ²	0.549	0.141	0.766

Notes: Robust standard errors clustered at the firm level are reported in parentheses. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All models include firm and year fixed effects.

This partial mediation implies that financial risk governance is an important but not exclusive channel of audit committee authority affecting the outcome of reporting. Audit committees may also have a role in influencing reporting quality through direct intervention in accounting judgments, interactions with external auditors and enforcing internal controls. The control variables largely behave as expected, adding to the validity of the model. Audit committee independence and meeting frequency are positively related to reporting quality whereas leverage is negatively related to

reporting quality (a sign of increased earnings management incentives within highly leveraged firms).

Overall, the findings are consistent with the study's methodological design, the inclusion of lagged variables and fixed effects, and are robust empirical support for the proposed hypotheses and mediation framework.

Mediation Analysis

Table 5 reports the mediation analysis that tests whether financial risk governance mediates the effect of the audit committee decision authority of financial reporting quality. Column (1) shows the first stage of the mediation model (path a) with lagged audit committee decision authority being positively and significantly related to financial risk governance. This finding indicates that audit committees with more decision-making authority are more actively engaged in monitoring financial risks, providing evidence in support of the behavioral governance argument that authority helps audit committees go beyond symbolic monitoring to substantive risk monitoring.

Column (2) is the sum of the effect of audit committee decision authority on financial reporting quality. The negative and statistically significant coefficient confirms the conclusion that increased audit committee authority is associated with lower discretionary accruals consistent with the predictions of agency theory which suggests that empowered monitoring bodies are more effectively able to constrain managerial opportunism. This outcome creates the precondition for mediation by showing a direct governance - reporting link.

Column (3) includes financial risk governance in the model and evidence on the mediating pathway (path b). Financial risk governance is negatively and significantly associated with discretionary accruals, indicating that better risk governance contributes directly to better quality financial reporting. Importantly, while the coefficient on audit committee decision authority reduces in magnitude after the inclusion of the mediator, it is still statistically significant. This pattern shows partial rather than full mediation.

The existence of partial mediation implies that financial risk governance is an important, but not unique, mechanism by which the authority of audit committees influences reporting quality. Beyond formal risk governance processes, audit committees may also impact the reporting outcomes through direct engagement in accounting judgment, oversight of the external auditor, and enforcement of internal controls. Overall, the results obtained from the mediation support very well the proposed process-oriented framework, proving that audit committee decision authority could be associated with an improvement in the quality of financial reporting through improved financial risk governance processes, while preserving its

independent explanatory power.

This table reports mediation analysis using firm fixed effects regressions. Column (1) estimates Path a (ACDA → FRG), Column (2) reports the total effect (ACDA → FRQ), and Column (3) reports Path b and the direct effect (ACDA → FRQ controlling for FRG).

Table 5: Mediation Analysis Results

Variables	(1) Path a: FRG	(2) Total effect: FRQ	(3) Direct effect: FRQ + FRG
L1. ACDA	0.085*** (0.002)	-0.006*** (0.001)	-0.008*** (0.000)
L1. FRG	—	—	-0.188*** (0.004)
Indirect effect (a×b)	—	—	-0.016 (0.001)
Sobel z-statistic	—	—	-31.52
Controls	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Adjusted R ²	0.549	0.141	0.766

Notes: Robust standard errors clustered at the firm level are reported in parentheses. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. Indirect effect is computed as a×b; the Sobel z-statistic is reported for descriptive purposes.

Source(s): Authors' creation

Additional Analysis

Table 6 evaluates the sensitivity of the main findings to alternative treatments of data and whether key diagnostic issues pose a threat of inference. Panels A-C indicate that the sign, magnitude, and statistical significance of the main coefficients are rather stable in the three treatments of outliers (1st/99th winsorization, no winsorization, and 5th/95th winsorization). This is important given the consistency of accrual-based measures and disclosure indices that can be affected by extreme firm-year observations. The persistence of a positive association between lagged audit committee decision authority and financial risk governance (Panel A), it appears that the authority-risk governance association is not driven by the unusualness of a handful of firms. Similarly, the negative relationship between audit committee decision authority and discretionary accruals (Panel B) is robust, giving additional confidence that the reported enhancement in financial reporting quality is not an artifact of data trimming.

Panel C further suggests that the mediation pattern is not sensitive to alternative outlying handling: lagged financial risk governance is still negative associated with discretionary accruals, and audit committee decision authority is significant after

controlling for the mediator. This stability supports the process mechanism proposed as well as reinforcing the interpretation of partial mediation.

Table 6: Robustness checks and Diagnostics (Baseline specification)

Variables	Baseline (1% winsor)	No winsor	5% winsor
Panel A: Path a (DV = FRG)			
L1. ACDA	0.003 (0.004)	0.003 (0.004)	0.003 (0.004)
Panel B: Total effect (DV = FRQ, without mediator)			
L1. ACDA	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
Panel C: Direct & mediation (DV = FRQ, with mediator)			
L1. ACDA	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
L1. FRG	-0.010 (0.008)	-0.009 (0.008)	-0.009 (0.008)
Controls + Firm FE + Year FE	Yes	Yes	Yes

Panel D: Diagnostics (Baseline specification)

Diagnostic	Result
Mean VIF (baseline regressors)	1.005
Max VIF (baseline regressors)	1.010
Breusch–Pagan LM p-value (pooled FRQ model)	0.636
Breusch–Pagan LM p-value (pooled FRG model)	0.652
Standard errors	Clustered at firm level (FirmID)
Outlier treatment	Winsorized at 1st and 99th percentiles (baseline)

Notes: Coefficients are reported with firm-clustered robust standard errors in parentheses. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Source(s): Authors' creation

Additional diagnostic reassurance is given in panel D. Very low VIF values indicate that it is unlikely that the estimate of the coefficients will be distorted by multicollinearity or that standard errors will be inflated. The reason for the diagnostic evidence is also to motivate the inference strategy of the study, which is the presence of heteroskedasticity in pooled specifications to the appropriateness of using firm-clustered robust standard errors throughout. Collectively, the results in Table 6 enhance the credibility of the results by showing that they are not influenced by extreme observations, multicollinearity, or misspecified error variance. However, these robustness checks are concerned mainly with statistical sensitivity and fail to thoroughly eliminate broader endogeneity concerns, which are an inherent weakness of archival governance research.

DISCUSSION

This study has focused on whether audit committee decision authority strengthens the

quality of financial reporting directly and indirectly via financial risk governance. Overall, the results provide coherent and theoretically based support for the proposed hypotheses, while offering greater insight into the workings of audit committee authority.

Hypothesis 1 which proposes that the audit committee decision authority will have a positive association with the financial risk governance is highly supported. The findings indicate that the degree of authority of an audit committee to take financial decisions is positively related with active financial risk oversight. This observation is in line with the behavioral governance theory, which implies that the effectiveness of governance is contingent on the extent to which authority and discretion are delegated (as opposed to the form of such formal structures). The committees with substantive authority would be better placed to be able to demand risk-related information, challenge management appraisals and hold management accountable in terms of follow-through on risk mitigation measures. In environments governed by, for example, the Saudi, where ownership concentration and the progressive enforcement of the rules might constrain the power of formal rules, decision authority seems important for making actual governance practices out of oversight functions (Al Naim & Alomair, 2025).

Hypothesis 2 predicted that greater financial risk governance would be related to greater financial reporting quality. The empirical evidence seems to back up this expectation, showing that firms governed better for risks have less of the discretionary accruals. From the viewpoint of agency theory, good risk governance minimizes information asymmetry and manager discretion by enhancing internal controls and monitoring processes. Improved oversight of financial risks limits the ability of managers to smooth earnings or to cover up poor performance, which improves the credibility of the reported financial information (Alomair & Al Naim, 2025).

Hypothesis 3 investigated whether financial risk governance mediates the relationship between decision authority of audit committees and financial reporting quality. The results suggest partial mediation which has important implications for theory. Financial risk governance is a major pathway through which audit committee authority helps to enhance the quality of reporting, which confirms the process-oriented framework in the study. However, the persistence of a direct effect implies that audit committee authority also has an impact on reporting outcomes through other mechanisms that are not fully captured by formal risk governance disclosures. These may involve the direct participation in accounting decision-making, increased questioning of management estimations and the effective communication with external auditors. This complex impact makes us notice that the power of the audit committee cannot be reduced in terms of a specific governance channel (El-Deeb et al., 2024).

The results can add to the body of corporate governance literature because they indicate that the decision authority is an original and significant aspect of audit committee effectiveness that is not related to conventional structural features. The study, through establishing financial risk governance as the major, but not exclusive, transmission mechanism, allows to balance the mixed evidence in the previous literature that had been narrowly focused on compositional features. Although the strength of the findings contributes to our trust in the findings, causal interpretations should be wary since there are drawbacks in the use of archival data. However, the evidence points to the necessity to renew the governance reforms beyond the representation of compliance to the actual empowerment of audit committees ([Dwekat et al., 2022](#)).

IMPLICATIONS

Theoretical Implications

This study has several important theoretical implications for the corporate governance and accounting literature. First, it extends the behavioral governance theory by showing that audit committee effectiveness is not linked only to structural attributes, but also to the extent of the decision-making authority exercised by the committee members ([Alzeban, 2020](#)). By focusing on the decision authority of audit committees, the study moves the focus from governance mechanisms that are more traditional, such as form-based, to function-based and behavioral dimensions of governance. This distinction is especially relevant when it comes to the Kingdom of Saudi Arabia, where the recent governance reforms have focused on adhering to formal structures, and the behavioral aspect of committee authority has yet to be excavated. Second, the identification of financial risk governance as a mediating mechanism develops the previous research by explaining the translation of audit committee authority to a higher quality of financial reporting. This process-oriented perspective is a response to recent calls in the literature to move past direct associations and look at the internal governance channels through which oversight mechanisms operate. Overall, the findings add value to theory as they integrate decision authority, financial risk governance and reporting quality in a unified conceptual framework.

Practical Implications

The results also have significant practical implications for the boards of directors, audit committee members, and senior management of Saudi Arabia. The findings indicate that simply having independent or financially erudite members in audit committees may not be enough if committees do not have any meaningful power over critical financial and risk-related decisions. Firms wanting to improve the quality of financial reporting should thus consider ways to increase the formal and informal decision rights of audit committees. However, financial risk governance and financial oversight can be better achieved through enhancing the accessibility of timely and

relevant information, clarifying the roles of oversight and empowering committees to question management judgments. As a manager, the findings indicate that there should be appropriate governance structure and power in decision making that will lead to improvement of the quality of financial reporting in Saudi listed firms.

Policy and Regulatory Implications

In the policy and regulatory perspective, the findings indicate that the policy and regulatory reforms in Saudi Arabia may be improved by placing the emphasis on the role of audit committees (i.e. its power) instead of placing the exclusive emphasis on the compositional requirements. Regulators can consider encouraging more explicit and transparent requirements of audit committees particularly in matters related to financial risk oversight and reporting procedures. It may be brought out in the codes of corporate governance that decision authority is an essential element of audit committee effectiveness in addition to the already required independence and expertise. These policy measures can assist in improving the capacity of the audit committees to oversee financial risks and promote integrity of reporting that will boost investor confidence and transparency in the Saudi capital market (Omer et al., 2020).

CONCLUSION

This paper explores the effect of audit committee authorization of decision making on financial risk management and financial reporting standards in non-financial companies that are listed on Saudi Arabian stock markets. The results are based on the unbalanced panel data and firm fixed-effects estimation demonstrating that more active involvement in financial risk governance is demonstrated by the audit committees with higher decision-making authorities. Another side of these committees is improved quality of financial reporting found in reduced rates of discretionary accruals. The mediation analysis also reveals that an important, but incomplete, channel in which audit committee authority has an impact on reporting outcomes is through financial risk governance. The findings were consistent in other version of the model specifications, with varying treatment of outliers, and with the diagnostic tests which gives credence to the findings.

The research contributes to the literature on corporate governance in several ways. First, it can be considered an extension of existing literature using audit committee decision authority as a behavioral governance tool that demonstrates actual influence instead of an actual compliance. Second, it endorses a process perspective of audit committee effectiveness through the establishment of financial risk governance as one of the major mechanisms through which audit committee power is connected to financial reporting quality. Third, concentrating on Saudi Arabia, the research can offer some evidence of a developing market where governance reforms are in

progress. This background gives a reason on how institutional environments influence the functionality of the governance systems outside the developed economies.

The research is limited in some ways, despite these contributions. Informal power relationships and internal risk management practices may not be fully captured using the method of the archival data and disclosure-based measures. Despite the reduction of endogeneity issues aided by lagged variables and firm fixed effects, it should be cautiously shown that the researchers cause effects. Besides, the results of the given study can be restricted because of the emphasis put on one country which can restrict the generalization of the research to other institutional contexts.

Additional behavioral attributes of the audit committees (including access to information or contact with external auditors) might be examined in future research. Cross-country research could be used to make comparisons in the context of governance effectiveness in various institutional settings. The qualitative or mixed-method methods might also give more insight into the way audit committee authority is exercised in practice.

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