



# THE RELATIONSHIP BETWEEN AUDIT COMMITTEE AND FINANCIAL REPORTING QUALITY: APPLIED TO COMMERCIAL COMPANIES IN IRAQ

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Article history:	Abstract:
<p><b>Received:</b> 6<sup>th</sup> May 2023 <b>Accepted:</b> 6<sup>th</sup> June 2023 <b>Published:</b> 7<sup>th</sup> July 2023</p>	<p>This study investigates the strength of the relationship between the audit committee and the quality of financial reports for Iraqi commercial companies. For this purpose, purposive sampling was used to collect data from 50 Iraqi commercial companies. The results demonstrate that all dimensions of the audit committee affect the dimensions of quality of the financial reports, which are timeliness, relevance, faithful representation, comparability and understandability.</p>

**Keywords:** The audit committee (AC) - Financial reporting quality (FRQ).

## INTRODUCTION:

In recent years, issues related to the characteristics of audit committees (ACC) have attracted the attention of many researchers and practitioners for its role in alleviating the conflict between managers and external auditors, and achieving a balance between their points of view about accounting standards. Ultimately, the characteristics of audit committees have become one of the most important elements of corporate governance (Gerayli, 2021).

The quality of financial reports also attracted the attention of many researchers, especially after the collapse of major companies that exaggerated the falsification of their financial reports (Mardessi, 2022). In this context, some previous studies such as Alzeban (2020), Gerayli (2021) and Mardessi (2022) highlighted the role of the audit committees in ensuring accurate and objective financial reports, as the audit committee mainly focuses on monitoring the financial reporting procedures to ensure the integrity and credibility of these reports.

Accordingly, this study seeks to investigate the relationship between the audit committee and financial reporting quality, applied to commercial companies in Iraq.

## THE RESEARCH PROBLEM:

The problems resulting from the conflict of interests between the managers of companies and users of the information may highlight their motive towards concealing information or providing misleading information to the information's users, which leads to a lack of confidence in the quality of the information in the reports, and there is no doubt that the presence of an audit committee in the company may add confidence in this information. From this point, the main question of this research is proposed as follows; How the audit committee (AC) could ensure the quality of financial reporting (FRQ)?

This question involves 5 sub-questions as shown below;

- 1- Do the dimensions of AC affect the relevance of the information presented in financial reports?
- 2- Do the dimensions of AC affect the faithful representation of the information presented in financial reports?
- 3- Do the dimensions of AC affect the comparability of financial reporting information?
- 4- Do the dimensions of AC affect the timeliness of the information presented in financial reports?



5- Do the dimensions of AC affect the understandability of the information presented in financial reports?

**RESEARCH OBJECTIVES:**

- 1- Assess the strength of the correlation between the dimensions of the audit committee and Financial Reporting Quality.
- 2- Detect the effect of audit committee dimensions on the relevance of the information presented in the financial reports.
- 3- Investigate the effect of audit committee dimensions on the faithful representation of the information presented in financial reports.
- 4- Determine the effect of audit committee dimensions on the comparability of financial reporting information.
- 5- Measure the effect of audit committee dimensions on the timeliness of the information presented in financial reports.
- 6- Reveal the effect of audit committee dimensions on the understandability of the information presented in the financial reports.

**RESEARCH HYPOTHESES:**

- 1- There is a significant association between audit committee dimensions and financial reporting quality.
- 2- Audit committee dimensions affect the relevance of the information presented in financial reports.
- 3- Audit committee dimensions affect the faithful representation of the information presented in financial reports.
- 4- Audit committee dimensions affect the comparability of financial reporting information.
- 5- Audit committee dimensions affect the timeliness of the information presented in financial reports.
- 6- Audit committee dimensions affect the understandability of the information presented in financial reports.

This study contains one independent variable represented in the audit committee which includes 4 dimensions, and one dependent variable represented in financial reporting quality which includes 5 dimensions as shown in Figure 1.

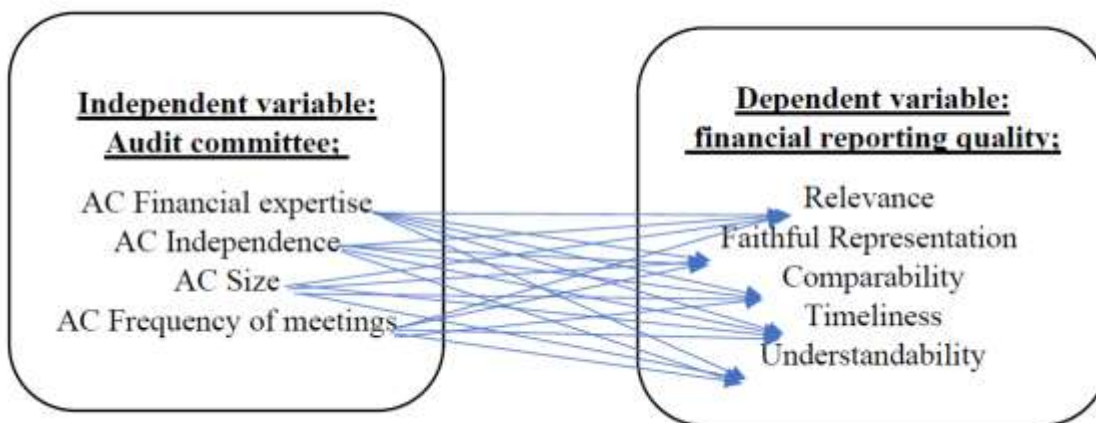


Figure 1: The study model  
 Source: Prepared by the researcher depended on previous study

**RESEARCH IMPORTANCE:**  
**The theoretical importance:**

Due to the mixed results in the literature review regarding the relationship between both independent and dependent variables and their dimensions, it appears that the path of research in this relationship is

still interesting to future studies to provide theoretical reasoning for the nature of these relationships. Therefore, this study is considered to be a complementary attempt to previous studies in this field, as it seeks to clarify the concept of audit committees and their characteristics with a scientific



methodology that highlights the role, they play in ensuring the quality of financial reports.

#### **The practical importance:**

This study sheds light on the role played by the audit committee in ensuring the reality and credibility of financial reports, as it fully monitors the results of accounting procedures. On the other hand, financial reports are considered one of the most important factors influencing investors' decisions. Accordingly, the results of the study could motivate the companies to pay enough attention to the characteristics of the audit committee that affect the quality of their financial reports.

#### **Theoretical Framework:**

##### **1- The Audit committee (AC):**

AC is an operational committee of the board of directors responsible for overseeing the financial reporting and disclosure procedures within the company.

It is responsible for monitoring the company's business and checking the integrity of internal control systems, reports, and financial statements (Tumwebaze et al., 2022).

##### **Audit committee characteristics:**

The most frequent and common dimensions of the audit committee in previous studies are AC independence, AC financial experts, AC size and AC meetings, and they will be briefly covered as follows:

##### **1/1- AC independence:**

An independent member is a member who is not associated with any financial or non-financial relationship that conflicts with the nature of his work (Al-Jalahma, 2022; Ha, 2022; Lutfi et al., 2022; Pozzoli et al., 2022).

##### **1/2- AC financial experts:**

Audit committee members must have sufficient experience in preparing, analyzing, evaluating and reviewing financial statements, as it's required to ensure the effectiveness of their duties (Ha, 2022; Lutfi et al., 2022; Pozzoli et al., 2022).

##### **1/3- AC meetings:**

The number of audit committee meetings is an indicator of its fulfillment of its responsibilities, which in turn increases the level of quality of disclosed information. In this context, most of the previous studies indicated that the periodic meetings of the audit committee should not be less than three times a year (Al-Jalahma, 2022; Ha, 2022).

##### **1/4- AC size:**

It is necessary that the number of audit committee members not be less than three. The more members of the audit committee, the greater the diversity of

skills, knowledge and experience on it (Al-Jalahma, 2022; Ha, 2022).

##### **2- Financial reporting quality (FRQ):**

The FRQ depends on its utility and adequacy to their users. Consequently, financial statements should provide explicit, transparent, appropriate, adequate, timely and trustworthy information (Kabwe, 2023).

##### **2/1- Relevance:**

It indicates that the information contained in financial reports should contribute to the decision making through its predictive value, so it can be said that it is suitable for all of its users (Abed et al., 2022; Kabwe, 2023).

##### **2/2- Faithful Representation:**

It means that financial reports should contain comprehensive information, and this information should be represented without bias.

Financial reports should also be free of omissions in order to be reliable, so it could be said that these reports are faithful in representation (Kabwe, 2023).

##### **2/3- Comparability:**

It means that the information presented in the financial report during a specified period of time should be able to compare with the same information that was represented in an earlier period or with the same information of another company. This requires applying the same accounting rules (Abed et al., 2022; Kabwe, 2023).

##### **2/4- Timeliness:**

It means displaying information to decision makers at the appropriate time, as the information becomes useless when it is delayed (Kabwe, 2023).

##### **2/5- Understandability:**

It means that the information presented in financial reports should be straightforward, unpretentious and easy to understand. It also requires that information users know some of the terms used in financial reports (Abed et al., 2022; Kabwe, 2023).

##### **Previous Studies:**

Alzeban study (2020) was conducted to determine the impact of AC, CEO and the external auditor quality on FRQ. The results showed that all these variables have a positive and significant influence on the FRQ. The results also showed that the audit committee has the greatest influence.

Gerayli's study (2021) was conducted to determine the relationship between the FRQ and the characteristics of the audit committee (AC) represented in independence and financial expertise. The result demonstrated that financial expertise influences the FRQ significantly and positively, meanwhile the independence of the audit committee doesn't influence financial reporting quality significantly.



Mardessi (2022) study was conducted to determine the role of audit quality as a moderator variable in the relationship between the audit committee (AC) and financial reporting quality (FRQ). The results partially confirmed these relationships, as it illustrated that all AC characteristics; AC independence, AC financial experts and AC size have a positive and significant association with the FRQ. However, audit committee meetings and FRQ were not significantly associated.

**RESULTS:**

**Reliability Analysis Results:**

To determine the validity of the questionnaire for the following stages of analysis, Cronbach's alpha coefficient was used, and the results were as shown below:

**Table (1)**  
**Reliability Coefficients**

Variable	Dimensions	Cronbach's Alpha
audit committee	AC Financial expertise	0.916
	Ac Independence	0.943
	AC Size	0.944
	AC Frequency of meetings	0.777
Financial Reporting Quality	Relevance	0.941
	Faithful Representation	0.825
	Comparability	0.992
	Understandability	0.886
	Timeliness	0.989

Source: Cronbach's Alpha Analysis.

Based on table 1, all Cronbach's Alpha coefficients values exceeded the prescribed threshold of 0.7. The reliability of Comparability has the highest value ( $\alpha=0.992$ ) followed by Timeliness ( $\alpha=0.989$ ), Relevance ( $\alpha=0.941$ ), Understandability ( $\alpha=0.886$ ), and Faithful Representation ( $\alpha=0.825$ ), which means that all FRQ dimensions have high reliability, high internal consistency. The reliability of AC size has the highest value in AC dimensions ( $\alpha=0.944$ ) followed by Ac Independence ( $\alpha=0.943$ ), AC Financial expertise ( $\alpha=0.916$ ), and finally AC Frequency of meetings ( $\alpha=0.777$ ) which represented the minimum value. This shows that the data collected is valid for the following analysis stages.

**The research Method:**  
**The questionnaire:**

This research used the questionnaire as a comprehensive instrument consisting of two parts, the first part contained the four dimensions of the independent variable "AC" as it is a multidimensional construct that includes; Financial expertise, Independence, Size and Frequency of meetings. It also addressed the FRQ as multidimensional construct as the second part which includes; Relevance, Faithful

Representation, Comparability, Understandability and Timeliness. Finally; a semantic differential instrument was used on a five-point rating scale called the Likert scale.

**The sample and data collection method:**

- The study used a questionnaire consisting of 6 items to measure AC expertise, 6 items to measure AC independence, 6 items to measure AC size, 5 items to measure relevance, 5 items to measure faithful representation, 4 items to measure understandability, 4 items to measure comparability and all of them retrieved from the study of Qader et al. (2023). Finally, for timeliness the study adopted the measures used in Kabwe's study (2023).
- Purposive sampling technique was used to obtain a representative sample from 50 of commercial companies listed in Iraq stock exchange.

**Testing the Hypotheses:**

**H1: There is a significant association between AC dimensions and FRQ.**

Pearson's correlation coefficient was used to test this hypothesis, and the results are as shown below;



**Table (2)**  
**Correlations**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<b>(1) Financial Expertise</b>	1								
<b>(2) Independence</b>	0.526* *	1							
<b>(3) Size</b>	0.483* *	0.600* *	1						
<b>(4) The Frequency of meetings</b>	0.518* *	0.656* *	0.613* *	1					
<b>(5) Relevance</b>	0.622* *	0.732* *	0.668* *	0.747* *	1				
<b>(6) Faithful Representation</b>	0.549* *	0.668* *	0.609* *	0.839* *	0.728* *	1			
<b>(7) Comparability</b>	0.567* *	0.686* *	0.631* *	0.675* *	0.935* *	0.662* *	1		
<b>(8) Understandability</b>	0.563* *	0.710* *	0.655* *	0.909* *	0.809* *	0.889* *	0.725* *	1	
<b>(9) Timeliness</b>	0.549* *	0.672* *	0.616* *	0.654* *	0.914* *	0.637* *	0.975* *	0.704* *	1

\*\* . Correlation is significant at the 1% level (2-tailed).  
 Source: Pearson correlation analysis in SPSS.

**H2: Audit committee dimensions affect the relevance of the information presented in financial reports.**

According to the results shown in Table 2, it is clear that the multiple regression analysis used to test all dimensions of AC and the FRQ at the 1% level of significance. The hypothesis between AC financial expertise; Faithful Representation and Timeliness represented the minimum value (r=0.549), while the relationship between the frequency of AC meetings and the understandability as one of financial reporting quality dimensions represented the maximum value (r=0.909).

**Table (3)**  
**The effect of AC dimensions on relevance**

Independent Variables	Dependent dimension	$\beta$	T	(Sig.)
AC Financial expertise	Relevance	0.204	6.036	0.000
AC Independence		0.292	7.398	0.000
AC Size		0.189	5.094	0.000
AC Frequency of meetings		0.334	8.419	0.000
<b>R= (0.847)    R<sup>2</sup>= (0.717)    Adjusted R<sup>2</sup>= (0.714)    F (Sig.) =239.612 (0.000)</b>				

Source: Linear regression analysis.

The results shown in Table 3 can be interpreted as follows;

- 1- The model fit is good as (F (Sig.) = 0.000).
- 2- All AC dimensions have a positive and significant effect on the relevance of the information presented in financial reports as all standardized coefficients "Beta" are positive and significant. The frequency of meetings has the strength impact on relevance ( $\beta = 0.334$ ),

- 3- followed by the independence of AC ( $\beta = 0.292$ ), then financial expertise ( $\beta = 0.204$ ), and finally AC size ( $\beta = 0.189$ ). Ultimately, H2 was accepted.
- 3- (R)= (0.847), which means that all audit committee dimensions and the relevance of the information presented in financial reports are significantly and positively related.



4- The determination coefficient value ( $R^2$ ) = (0.717), which means that 71.7% of the changes in the relevance of information presented in the financial reports of commercial companies in Iraq are due to the

dimensions of the audit committee with a confidence level of 95%.

**H3: Audit committee dimensions affect the faithful representation of the information presented in financial reports.**

**Table (4)**  
**The effect of AC dimensions on faithful representation**

Independent Variables	Dependent dimension	$\beta$	T	(Sig.)
AC Financial expertise	Faithful representation	0.102	6.036	0.002
AC Independence		0.146	7.398	0.000
AC Size		0.079	5.094	0.028
AC Frequency of meetings		0.643	8.419	0.000
<b>R= (0.861) R<sup>2</sup>= (0.741) Adjusted R<sup>2</sup>= (0.738)</b>		<b>F (Sig.) =270.513 (0.000)</b>		

The results shown in Table 4 can be interpreted as follows;

- 1- The model fit is good as "F (Sig.) = 0.000".
- 2- all audit committee dimensions have a positive and significant effect on faithful representation presented in financial reports, as all "standardized coefficients (Beta ( $\beta$ ))" are positive and significant. The frequency of meetings has the strength impact on faithful representation ( $\beta$ = 0.643), followed by the AC independence ( $\beta$ =0.146), then financial expertise ( $\beta$ =0.102), and finally AC size ( $\beta$ = 0.079). Ultimately, H3 was accepted.

- 3- All audit committee dimensions and the faithful representation of the information presented in financial reports are significantly and positively related as "(R) = (0.861)".

- 4- The determination coefficient value ( $R^2$ ) = (0.741), which means that 74.1% of changes in the faithful representation of the information presented in financial reports of commercial companies in Iraq could be accounted for audit committee dimensions at a 95% confidence interval.

**H4: Audit committee dimensions affect the comparability of financial reporting information.**

**Table (5)**  
**The effect of AC dimensions on comparability**

Independent Variables	Dependent dimension	$\beta$	T	(Sig.)
AC Financial expertise	comparability	0.175	4.404	0.000
AC Independence		0.298	6.447	0.000
AC Size		0.207	4.747	0.000
AC Frequency of meetings		0.262	5.632	0.000
<b>R= (0.781) R<sup>2</sup>= (0.611) Adjusted R<sup>2</sup>= (0.607)</b>		<b>F (Sig.) =148.587 (0.000)</b>		

The results shown in Table 5 can be interpreted as follows;

- 1- The model fit is good, as "F (Sig.) = 0.000".
- 2- All AC dimensions have a positive and significant effects on the comparability of financial reporting information, as "all standardized coefficients (Beta ( $\beta$ ))" are positive and significant. The independence of the audit committee has the strength impact

on the comparability ( $\beta$ = 0.298), then the frequency of meetings ( $\beta$ =0.262), followed by the size of the audit committee ( $\beta$ =0.207), and finally the financial expertise ( $\beta$ = 0.175). Ultimately, H3 was accepted.

- 3- All AC dimensions and the comparability of financial reporting information are related significantly and positively as "(R) = (0.781)".



4- "The determination coefficient value ( $R^2$ )" = (0.611), which means that 61.1% of the changes in the comparability of financial reporting information for commercial

companies in Iraq are due to audit committee dimensions with a confidence level of 95%.

**H5:** Audit committee dimensions affect the timeliness of the information presented in financial reports.

**Table (6)**  
**The effect of AC dimensions on timeliness**

Independent Variables	Dependent dimension	$\beta$	T	(Sig.)
AC Financial expertise	timeliness	0.069	2.888	0.004
AC Independence		0.144	5.163	0.000
AC Size		0.093	3.518	0.000
AC Frequency of meetings		0.722	25.742	0.000
<b>R= (0.926) R<sup>2</sup>= (0.858) Adjusted R<sup>2</sup>= (0.857) F (Sig.) =573.797 (0.000)</b>				

The results shown in Table 6 can be interpreted as follows;

- 1- The model fit is good as "F (Sig.) = 0.000".
- 2- All AC dimensions have a positive and significant effects on the timeliness of financial reporting information, as "all standardized coefficients (Beta ( $\beta$ ))" are positive and significant. The frequency of meetings has the strength impact on timeliness ( $\beta$ = 0.722), followed by AC independence ( $\beta$ =0.144), then AC size ( $\beta$ =0.093), and finally the financial expertise ( $\beta$ = 0.069). Ultimately, H3 was accepted.

3- "(R) = (0.926)", which means that all AC dimensions and the timeliness of financial reporting information are related significantly and positively.

4- The determination coefficient value ( $R^2$ ) = (0.857), which means that 85.7% of changes in the timeliness of the financial reporting information of commercial companies in Iraq could be accounted for audit committee dimensions at a 95% confidence interval.

**H6: Audit committee dimensions affect the understandability of the information presented in financial reports.**

**Table 7:**  
**The AC dimensions effect on understandability**

Independent Variables	Dependent Variable	Beta	T	(Sig.)
AC Financial expertise	understandability	0.164	3.970	0.000
AC Independence		0.301	6.275	0.000
AC Size		0.205	4.514	0.000
AC Frequency of meetings		0.247	5.105	0.000
<b>R= (0.761) R<sup>2</sup>= (0.580) Adjusted R<sup>2</sup>= (0.575) F (Sig.) =130.611 (0.000)</b>				

The results shown in Table 7 can be interpreted as follows;

- 1- The model fit is good, as "F (Sig.) = 0.000".
- 2- All AC dimensions have a positive and significant effects on the understandability of financial reporting information, as "all Standardized Coefficients (Beta ( $\beta$ ))" are positive and significant. The AC independence has the strength impact on understandability ( $\beta$ = 0.301), followed by the frequency of meetings ( $\beta$ =0.247), then AC size ( $\beta$ =0.205), and finally the financial expertise ( $\beta$ = 0.164). Ultimately, H6 was accepted.

3- "(R) = (0.761)", which means that all AC dimensions and the understandability of financial reporting information are related significantly and positively.

4- The determination coefficient value ( $R^2$ ) = (0.580), which means that 58% of the changes in the understandability of financial reporting information for commercial companies in Iraq are due to audit committee dimensions with a confidence level of 95%.

**THE CONCLUSION:**

Consistent with agency theory, the results of this study confirmed the positive relationship between AC & FRQ.



Accordingly, AC's financial expertise and independence will result in high-quality financial reporting. The size of the AC and the frequency of its meetings will also contribute to the quality of financial reporting by ensuring that AC has various expertise in the financial & economic aspects, and they have adequate time to perform their role in an effective manner.

Finally, this study recommends that investors should only trust financial reports approved by companies that have all of the aforementioned AC characteristics, as these characteristics lead to high-quality financial reports that they could rely on to make their decisions. Therefore, the board of directors must ensure that the audit committee has all of these characteristics.

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