Journal of Administrative and Economic Sciences • Vol 18, Issue 2 (2025) • p 715-736

Audit Committee Effectiveness and Earnings Management under IFRS Adoption: Evidence from Saudi Arabia

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Abstract:

This research work examines the impact of Audit Committee (AC) characteristics on Earnings Management (EM) in Saudi Arabia's joint-stock companies. The used sample consists of 103 non-financial joint stock companies from 2017 to 2019. This research uses the modified Jones model (1995) to measure EM. The primary outcomes of this study show that the independent and non-executive AC members have a substantial negative impact on EM. However, stock ownership by the AC, the existence of directors in the AC, and the educational level of the AC members have a considerable positive effect on EM. Other characteristics of the AC, which are the size, number of meetings, experts, educational level of the AC chairman, and the remuneration to the AC members, have no impact on EM. This paper contributes to enhancing regulators' understanding of AC effectiveness in Saudi joint-stock companies. In addition, this study enriches the academic literature by filling the gap in the literature dealing with this subject.

Keywords: Audit Committee Characteristics, Earnings Management, Saudi Joint Stock Companies.

1. Introduction

Corporate governance and earnings management (EM) have attracted significant global attention due to their critical role in ensuring transparency, accountability, and the reliability of financial reporting. Strong governance mechanisms are essential to protect investors' interests, prevent fraudulent practices, and enhance confidence in financial markets worldwide.

In recent decades, several high-profile corporate scandals, including Enron and WorldCom, revealed severe weaknesses in governance and auditing systems. These scandals underscored the importance of effective monitoring mechanisms to ensure the credibility of financial reports (Juhmani, 2017). Comparable financial collapses occurred in other regions, such as the Argentine Crisis (2001–2002), and in early 2006, the Saudi stock market also experienced a major downturn that emphasized the need for stronger oversight.

EM occurs when managers exploit the flexibility of accounting standards and rules to align reported earnings with preferred or desired outcomes (Mishra & Malhotra, 2016). This manipulation distorts the credibility and quality of financial reporting and may hinder effective decision-making by investors and other stakeholders. As a result, stakeholders have become increasingly concerned about the prevalence of EM, creating pressure on firms to provide transparent and fair financial information.

Most developed and developing nations require companies to establish an Audit Committee (AC) as part of corporate governance regulations to monitor financial reporting and the audit process. Furthermore, professional accounting and auditing bodies promote the formation of ACs to enhance public confidence in auditors' integrity and to strengthen the credibility of financial statements (Mishra & Malhotra, 2016).

In 1940, the Securities and Exchange Commission (SEC)[1] proposed forming an AC following the McKesson and Robbins[2] scandal involving financial report forgery. Later, the Sarbanes-Oxley Act[3] of 2002 expanded AC responsibilities, particularly regarding accounting oversight, financial transactions, and auditor relations. International standard 260[4] also reinforced the AC's governance role. The new Saudi corporate law[5] has similarly empowered ACs with authority comparable to international standards. Consequently, the AC's role and structure have become increasingly influential across countries. As Alshetwi (2016) confirms, the AC is a crucial component of corporate governance because it observes management's opportunistic behavior and aligns actions with shareholders' interests.

[1] It is a large independent agency of the United States federal government.

[2] It is one of the biggest financial scandals in American companies of the twentieth century.

[3] It is a law passed by the US Congress to help protect investors from fraudulent financial reports by companies.

[4] https://socpa.org.sa/SOCPA/files/b5/b5d57a03-f4b9-4b13-aec3-ffa6ba73b40d.pdf.

[5] It is a Saudi law relating to companies and the rules that establish them and regulate their responsibilities, rights, and duties. It was issued in 2015.

However, EM practices continue to exist in many markets, raising important questions about the AC's effectiveness in curbing such behavior. The relationship between AC characteristics and EM remains underexplored in emerging markets, particularly in the Gulf Cooperation Council (GCC) countries (Juhmani, 2017). In Saudi Arabia, both shareholding companies and the AC profession have undergone notable growth and institutional development.

This paper examines the effect of AC characteristics on EM in Saudi joint-stock companies over the 2017–2019 period. Since International Financial Reporting Standards (IFRS) were implemented in 2017, the analysis focuses on the post-implementation period to avoid potential bias related to IFRS adoption.

To contribute to the existing literature, this study provides two main contributions: First, it empirically demonstrates the impact of AC characteristics on EM in Saudi joint-stock companies after IFRS adoption. Second, beyond traditional AC characteristics examined in prior research, it considers the presence of board members within the AC as a potentially influential factor affecting EM.

The remainder of this study is organized as follows: Section 2 presents the literature review and hypotheses development. Section 3 details the model specifications. Section 4 describes the dataset. Section 5 defines the variables. Section 6 discusses empirical findings, and Section 7 concludes the study.

2. Literature review and hypotheses development

According to agency theory, the Audit Committee (AC) is established to protect shareholders' interests by mitigating conflicts between management and owners (Abbott et al., 2004). The AC oversees financial reporting and internal control systems, thus reducing managers' opportunistic behavior (Qamhan et al., 2018). Agency theory suggests that the presence of independent, knowledgeable, and active AC members reduces information asymmetry and limits the potential for earnings manipulation (Nguyen et al., 2022; Alqatamin et al., 2021). However, Freeman (1984) broadened this perspective through stakeholder theory, emphasizing that corporate accountability extends beyond shareholders to include creditors, employees, and the wider public (Cheung, 2019). In this view, the AC plays a governance role that balances the interests of multiple stakeholders by ensuring transparency and ethical reporting practices (Sultana et al., 2023; Baatwah, 2021). Thus, both theories jointly frame the AC as a monitoring mechanism that ensures managerial accountability and reinforces trust in financial reporting. Earnings management (EM) occurs when managers use discretion in financial reporting to achieve specific targets, often at the expense of transparency (Alshetwi, 2016). Despite regulatory reforms, EM remains a persistent concern, especially in emerging markets where governance systems are still evolving (Alqatamin et al., 2021; Suprianto et al., 2023; Zadeh et al., 2023). This raises the question of how AC characteristics influence EM within Saudi Arabia's corporate setting a context marked by rapid adoption of IFRS and recent governance reforms introduced by the Capital Market Authority (CMA) and the Saudi Vision 2030 framework. In the following subsections, we develop hypotheses on the relationship between AC characteristics and EM, drawing on both theory and recent empirical evidence.

2.1. Independent AC members

According to the corporate governance code in Saudi Arabia, the AC must include an independent member. Independent members enhance objectivity and limit management influence over financial reporting. Independent members are expected to act as effective monitors because they are less constrained by internal politics and can challenge earnings manipulation (Aifuwa et al., 2023; Baatwah, 2021; Algrady et al., 2025). It is often assumed that the independence of an AC member serves as an effective check of management's financial discretion, providing credibility to the financial statements (De Vlaminck & Sarens, 2015). Habbash et al. (2013) find no significant correlation between absolute discretionary accruals and AC independence. While (Waweru, 2018 and Nelwan & Tansuria, 2019) find a significant negative correlation between these two variables.

H_1: There is a negative association between the independent AC members and EM *in Saudi joint-stock companies.*

2.2. Size of the AC

The number of the AC is one of the unique aspects that determine its performance, according to the corporate governance code in Saudi Arabia, which states that it cannot have fewer than three members or more than five. As a result, the AC has to have a sufficient number of members, including those notable for their experience and judgment in handling complicated financial and accounting issues. According to Juhmani (2017), having an adequate number of AC members improves the effectiveness of the monitoring process. A larger committee provides diverse expertise and oversight capacity, which may improve information processing and monitoring effectiveness (Alqatamin et al., 2021). However, excessive size may reduce coordination and accountability (Alshetwi, 2016). Mishra & Malhotra (2016) and Inaam & Khamoussi (2016) prove in their studies the existence of a considerable negative link between the size of the AC and EM. However, Habbash et al. (2013) discovered no connection between the size of the AC and EM.

H_2: There is a negative association between the size of the AC and EM *in Saudi joint-stock companies.*

2.3. Number of Meetings of the AC Members

Frequent meetings indicate active oversight and signal diligence in reviewing accounting practices. In the Saudi context, where governance reforms emphasize regular monitoring, a higher frequency of meetings may reflect stronger compliance and responsiveness to financial risk (Al-Shaer & Salama, 2020). The corporate governance code in Saudi Arabia stipulates that the number of meetings of the AC not be less than (4) meetings per year. It is generally believed that the number of AC meetings is a caring agent, meaning that the inactive committee cannot effectively perform its monitoring functions. As Setiawan et al. (2020) state, many AC meetings can curb EM. Habbash et al. (2013) find an insignificant correlation between absolute discretionary accruals and AC meetings. At the same time, the results of Mishra & Malhotra (2016) and Qamhan et al. (2018) note the negative impact of the frequency of AC meetings on EM.

H_3: There is a negative association between the number of meetings of the AC members and EM *in Saudi joint-stock companies.*

2.4. Expert AC members

One member of the AC must have experience in finance and accounting, according to the corporate governance code in Saudi Arabia. As a result, the member's expertise will help detect the issues with financial reporting and in helping to understand better the program of internal and external audit and control processes to avoid and catch material misstatements. Setiawan et al. (2020) envisaged that the AC would have members with financial/accounting qualifications to oversee the financial statement process, as it's one of the critical duties of the AC. The relationship between the presence of financial experts in audit committees and EM is negative (Ioualalen et al., 2015; Inaam & Khamoussi, 2016). There is an insignificant relationship between EM and AC expertise (Sharma & Kuang, 2014; Nelwan & Tansuria, 2019). Indeed, financially skilled members can interpret IFRS requirements effectively, especially after Saudi Arabia's 2017 transition, thus reducing opportunities for EM (Suprianto et al., 2023; Jameel et al., 2024).

H_4: There is a negative association between expert AC members and EM *in Saudi joint-stock companies.*

2.5. Stock Ownership to the AC Members

According to the agency theory, directors who own stock in the company have interests aligned with stakeholders and are, therefore, more motivated to oversee the financial reporting process. Due to the impact of stock ownership on aligning interests between directors and stockholders, the quality of results may increase if the AC members own shares in the company (De Vlaminck & Sarens, 2015). (Habbash et al., 2013) finds an insignificant correlation between absolute discretionary accruals and AC members' ownership because the committee ownership is considered very low in the study sample. While Sharma & Kuang (2014) and Alshetwi (2016) find a negative correlation between the stock ownership of AC and EM. Excessive ownership may impair independence and increase tolerance for EM (Baatwah, 2021).

H_5: There is a negative association between the stock ownership of the AC members and EM *in Saudi joint-stock companies.*

2.6. Existence members of the Board of Directors in the AC

To the best of our knowledge, this variable is brand new, and no study has been done to evaluate its influence on EM. According to the corporate governance code in Saudi Arabia, the AC must be established by an act of the ordinary general assembly, which may consist of shareholders or other individuals, but not of the executive board of directors' members. The proportion of board of directors' members in the AC will be measured, as will its impact on EM because the AC in a company is made up of both boards of directors' members and those who are not board members. According to earlier studies that examined this variable indirectly, the board's characteristics significantly limit EM (Kankanamage, 2016). According to Sharma & Kuang (2014), independent directors participating on other boards negatively correlate with EM.

According to De Vlaminck & Sarens (2015), the quality of financial statements and the percentage of AC members who simultaneously hold more than three directorships have a significant positive link. Such overlap may improve coordination but could compromise independence, particularly in concentrated ownership structures common in Saudi firms (Alqatamin et al., 2021).

H_6: There is a positive association between existing members of the board of directors in the AC and EM *in Saudi joint-stock companies.*

2.7. Non-executive AC members

Non-executive members are those who do not run the company full-time or who do not receive a monthly or annual salary from it. According to (De Vlaminck & Sarens, 2015), non-executive directors are not employed by the business but have some connection to it or its management. Analyzing prior research reveals that the AC's non-executive directors do not lessen the likelihood of aggressive EM, contrary to what was found by Sharma & Kuang (2014). According to another study, the presence of non-executive members on the audit committees reduces EM (Khalil & Ozkan, 2016). This indicates that they are less inclined to raise their earnings. So, their outsider status may be particularly valuable in Saudi Arabia, where family ownership and concentrated control can undermine independence (Al-Shaer & Salama, 2020).

H_7: There is a negative association between the non-executive AC members and EM *in Saudi joint-stock companies.*

2.8. Educational Level of the AC Members

An AC's performance will be more effective if it has a higher educational level since it will be better able to read and comprehend financial statements. Higher-educated AC members can learn specific tactics for handling EM (Qi &Tian, 2012). Higher-educated AC members can make better decisions due to their cognitive ability to process and analyze information, and they are anticipated to be more competent in their jobs (Wardhani & Joseph, 2010). The AC chairman's educational level significantly enhances EM (Susanto, 2016). The AC chairman's academic rank does not influence EM (Wardhani & Joseph, 2010). The AC members' academic level has an insignificant effect on EM (Qi & Tian, 2012). Therefore, Advanced education, particularly in accounting and finance, is expected to increase vigilance and decision quality (Wardhani & Joseph, 2010; Alqatamin et al., 2021).

H_8: There is a negative association between the educational level of the AC members and EM *in Saudi joint-stock companies.*

2.9. Remuneration to the AC Members

The AC's members become more dedicated and effective due to the remuneration, which improves the performance of the AC. The AC members may be more successful at upholding objectivity in financial reporting oversight activities when payment plans are primarily made of cash (Rickling & Sharma, 2017). There is an insignificant relationship between the remuneration of the AC members and absolute discretionary accruals (Habbash et al., 2013). The expertise of AC members is enhanced by higher compensation (Engel et al., 2010). Outside member fees and discretionary accruals

have a negative relationship (Habbash et al., 2010). Alkebsee et al. (2021) found that high AC remuneration correlates positively with EM. In Saudi Arabia, higher remuneration may attract qualified members but could also risk compromising independence if tied too closely to management performance (Alkebsee et al., 2021; Baatwah, 2021).

H_9: There is a negative association between the remuneration to the AC and EM *in Saudi joint-stock companies.*

3. Model Specification

This study aims to look at the impact of nine independent variables and five control variables on EM in Saudi joint-stock enterprises. To examine the relationship between the dependent variable and the independent variables, the following Ordinary Least Squares (OLS) regression is employed in this study:

$$\begin{aligned} DACC = {} & \beta_0 + \beta_1(ACIND) + \beta_2(ACSIZE) + \beta_3(ACMEET) + \beta_4(ACEXP) \\ & + \beta_5(ACOWN) + \beta_6(ACEXIST) + \beta_7(ACNE) + \beta_8(ACEDU.CH) \\ & + \beta_9(ACEDU.ME) + \beta_{10}(ACFEES) + \beta_{11}(SIZE) + \beta_{12}(LEV) \\ & + \beta_{13}(ROA) + \beta_{14}(BIG4) + \beta_{15}(BLOCK5) \\ & + \varepsilon_{it} \end{aligned} \quad (1)$$

Where ACIND is an independent member of the AC; ACSIZE is the AC's size; ACMEET is the number of the AC meetings; ACEXP is an expert member of the AC; ACOWN denotes stock ownership by AC members; ACEXIST denotes the presence of AC members on the board of directors; ACNE denotes AC non-executive members; ACEDU.CH is the educational level of the AC chairman; ACEDU.ME is the educational level of the AC members; ACFEES is remuneration for AC members; SIZE refers to business size; LEV is the company leverage; ROA is the company performance; BIG4 is a BIG4 audit office; BLOCK5 is a block holders; β0 refers to intercept; β1 to β15 refers to the coefficient of slope parameters; ε is an error term, and it denotes a company i for the year t.

In addition, noting that DACC stands for discretionary accruals, which are used as a proxy for EM will be measured using the modified Jones Model (1995) based on prior studies such as (De Vlaminck & Sarens, 2015; Alshetwi, 2016; Qamhan et al., 2018; Mohammad et al., 2016; Bartov et al., 2000; El Diri, 2017). Discretionary accruals are more likely to be manipulated by managers; therefore, they're a valid measure of EM.

To estimate DACC that follows 4 steps:

1/ Determine total accruals using the cash flow approach or the balance sheet approach, depending on earlier research such as (Alshetwi, 2016; Qamhan et al., 2018) this study uses a cash flow approach. This is because total accruals represent the discrepancy between operating income and operating cash flows for the business (Mishra & Malhotra, 2016). The cash flow approach to computing total accruals is expressed in the following formula:

$$\begin{aligned} & TACC_{it} \\ & = OI_{it} - CFO_{it} \end{aligned} \quad (2)$$

Where, $TACC_{it}$ represents the total accruals of the company i in the year t; OI_{it} is the operating income of the company i in the year t; CFO_{it} is the operating cash flow of the company i in the year t.

2/ Estimate the parameters for the model: These parameters will be used to calculate non-discretionary accruals through the following regression equation for all companies in each industry for each year separately, according to the next form:

$$\frac{TACC_{it}}{A_{it-1}} = \alpha_1\left(\frac{1}{A_{it-1}}\right) + \alpha_2\left(\frac{\Delta REV_{it}}{A_{it-1}}\right) + \alpha_3\left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon_{it} \quad (3)$$

$TACC_{it}$ is the total accruals for the company i in the year t; A_{it-1} is the total assets for the company i at the end of the year t−1; ΔREV_{it} is the change in revenue for a company i in year t; PPE_{it} is the Property plant and equipment for the company i in year t; ε_{it} is the Random Error.

3/ Calculation of non-discretionary accruals: These accruals are calculated for each company in every year of the study period, using the estimated annual model parameters in the previous stage through the following equation:

$$NDACC_{it} = \alpha_1(1/A_{it-1}) + \alpha_2[(\Delta REV_{it} - \Delta REC_{it})/A_{it-1}] + \alpha_3(PPE_{it}/A_{it-1}) \quad (4)$$

Where ΔREC_{it} represents the change in account receivables for the company i in year t.

4/ Calculate discretionary accruals: These accruals are assessed for each company through the difference between total accruals and non-discretionary accruals as follows:

$$DACC_{it} = \frac{TACC_{it}}{A_{it-1}} - NDACC_{it} \quad (5)$$

Then the absolute value of DACC will be used in this study.

4. Dataset

The initial sample comprises all companies listed on the Saudi stock market except for financial institutions, insurance, and banks due to differences in incentives and opportunities for practicing EM. Moreover, the discretionary accruals model does not apply to these companies. This study excludes companies with incomplete financial data, which consists of eight companies. Then, until this study obtains reliable coefficient estimates for the variables that demonstrate EM, industries with fewer than six companies are excluded (Alshetwi, 2016; Qamhan et al., 2018), which brings us to 41 companies. The study years will only be from 2017 to 2019 and will not be taken before 2017 because the IFRS was implemented in 2017. As a result, the study results will be unaffected and compatible. Then the final sample of this study will be (103) out of (152) companies. The data has been collected from the annual reports of Saudi joint-stock companies on the TADAWUL website. In addition, Bloomberg Terminal is used to extract financial data.

5. Variables Definition

5.1. The Dependent Variable

In this study, we use the modified Jones Model (1995) to estimate discretionary accruals as a measure of EM because this variable is more likely to be manipulated by managers (De Vlaminck & Sarens, 2015; Alshetwi, 2016; Qamhan et al., 2018; Mohammad et al., 2016; Bartov et al., 2000; El Diri, 2017).

5.2. The Independent Variables:

The independent variables in this study are the company's AC characteristics. Based on previous literature, we use the following variables: the size of the AC, number of meetings of the AC members, expert AC members, stock ownership of the AC members, existing members of the board of directors in the AC, non-executive AC members, educational level of the AC members, remuneration to the AC members. The definition of the variables mentioned above are as follows:

Table 1: The independent variables

	Variables	acronyms	Measurements	References
1	The independent AC members	ACIND	The proportion of independent members to total AC members	Mohammad et al., 2016; De Vlaminck & Sarens, 2015
2	The AC size	ACSIZE	The number of AC members	Mishra&malhotra,2016; Ben Amar, 2014
3	The number of meetings of the AC	ACMEET	The number of AC meetings held during the year	Mishra&malhotra,2016; Juhmani, 2017
4	The expert AC members	ACEXP	The number of AC members who have a background in finance and/or accounting to the total number of AC members	Nelwan&Tansuria,2019
5	The stock ownership of the AC members	ACOWN	Percentage of the company's common stock shares held by AC members [(Shares owned by AC members on total shares) *100]	Habbash et al., 2013
6	The existing members of the board of directors in the AC	ACEXIST	The number of board of directors' members in the AC to the total number of AC members	New variable

7	The non-executive AC members	ACNE	The number of non-executive members to the total number of AC members	Sharma& Kuang,2014
8	The educational level of the AC members	ACEDU.CH	A dummy variable = 1 for the chairman of the AC with post-graduate (Master's and Ph.D. degrees) and 0 otherwise	Susanto,2016
		ACEDU.ME	The AC members with post-graduate (Master's and Ph.D. degrees) to the total number of AC members.	Qi & Tian, 2012
9	The remuneration of the AC members	ACFEES	Average AC member fees in natural logarithm (total fees of AC members/number of AC members)	Habbash et al., 2013

5.3. The Control Variables:

Previous studies that measured EM indicate that EM can be affected by factors other than the characteristics of the AC, such as (Mishra & Malhotra, 2016; Alshetwi, 2016; Habbash et al., 2013). To control the effect of these confounding factors and improve test durability, this study includes five control variables: company size, company leverage, company performance, BIG4 audit office, and block holders.

5.3.1. The company size (SIZE)

Big corporations are typically more cautious in managing their earnings since they are subject to a higher level of analyst scrutiny (Habbash et al., 2013). Furthermore, according to Alshetwi (2016), EM is less as a firm's size grows. The authors found that business size and EM had a favorable connection (Alves, 2013). While Juhmani (2017) showed no correlation between business size and EM, Qamhan et al. (2018) discovered a negative relationship between firm size and EM. This variable is assessed by the total assets' natural logarithm (De Vlaminck & Sarens,2015; Nelwan&Tansuria,2019).

5.3.2. The company leverage (LEV)

A company close to breaching its debt covenants can be compelled into earnings manipulation so that a high leverage ratio can increase the risk of bankruptcy and associated litigation (Mishra & Malhotra, 2016). Companies with debt covenants tend to practice EM to avoid a violation of the agreement (Siagian & Siregar, 2018). There is a positive relationship between leverage and EM (Alves, 2013; Al-Absy et al., 2019). Leverage has an insignificant relationship with EM (De Vlaminck & Sarens, 2015).

This variable is assessed by the ratio of total liabilities to total assets (De Vlaminck & Sarens,2015; Nelwan&Tansuria,2019).

5.3.3. The company performance (ROA)

Mohammad & Wasiuzzaman (2019) state that high-performance companies are associated with a grander scale of EM. Besides, De Vlaminck & Sarens (2015) believe that managers have incentives to manage profits if there are potential benefits in reducing company profits. (Mohammad & Wasiuzzaman, 2019 and Al-Absy et al., 2019) find ROA significantly impacts EM. At the same time, De Vlaminck & Sarens (2015) discover that ROA has a negligible relationship with EM. This variable is assessed by the ratio of net income to total assets (Al-Absy et al., 2019; Qamhan et al., 2018).

5.3.4. The BIG4 audit office (BIG4)

BIG4 may impact financial reporting quality (Sharma & Kuang, 2014). High-quality auditing improves the quality and transparency of financial reporting (Siagian & Siregar, 2018). There is a negative association between Big4 and EM (Mohammad& Wasiuzzaman, 2019; Mishra & Malhotra, 2016; Qamhan et al., 2018). In contrast, Sharma& Kuang (2014) find an insignificant relationship with EM. This is a dummy variable with a value of 1 if the company is audited by a Big-4 auditor and 0 otherwise (Juhmani,2017; Sharma& Kuang, 2014).

5.3.5. The block holders (BLOCK5)

Block ownership could affect the quality of financial reporting (Sharma& Kuang, 2014). Block holders create conditions for major shareholders to acquire business operations and adjust the business's earnings (Nguyen et al.,2021). There is an insignificant relationship between block holders and EM (Al-Absy et al., 2019; Sharma& Kuang, 2014). In contrast, Nguyen et al. (2021) find the Block holders' significant positive impact on EM. This variable is assessed by the cumulative percentage of common shares held by stockholders who own at least 5% of the company's ordinary stock (Sharma& Kuang, 2014). The descriptive statistics for the study's variables are provided in the Table 2.

Table 2: Descriptive statistics

Variable	Mean	Median	Std. Dev.	Minimum	Maximum
DACC	5.52E-02	3.92E-02	5.24E-02	1.50E-05	2.78E-01
ACIND	4.45E-01	3.33E-01	2.04E-01	2.00E-01	1.00E+00
ACSIZE	3.42E+00	3.00E+00	6.57E-01	2.00E+00	5.00E+00
ACMEET	5.79E+00	5.00E+00	2.37E+00	1.00E+00	2.20E+01
ACEXP	5.21E-01	5.21E-01	2.21E-01	2.00E-01	1.00E+00
ACOWN	8.90E-01	1.54E-02	3.26E+00	7.00E-06	4.02E+01
ACEXIST	5.26E-01	4.13E-01	2.29E-01	2.00E-01	1.00E+00

ACNE	4.11E-01	4.13E-01	1.21E-01	2.00E-01	1.00E+00
ACEDU.CH	9.85E-01	1.00E+00	8.78E-02	3.33E-01	1.00E+00
ACEDU.ME	5.34E-01	5.00E-01	2.25E-01	2.00E-01	1.00E+00
ACFEES	1.07E+01	1.07E+01	1.03E+00	6.91E+00	1.27E+01
ROA	1.60E+00	2.11E+00	1.23E+01	-1.64E+02	3.15E+01
LEV	3.79E+01	3.60E+01	2.21E+01	1.20E+00	9.36E+01
SIZE	7.59E+00	7.52E+00	1.51E+00	2.95E+00	1.27E+01
BIG4	9.62E-01	1.00E+00	1.41E-01	3.33E-01	1.00E+00
BLOCK5	3.96E+01	3.94E+01	1.61E+01	5.00E+00	8.25E+01

6. Results and Discussion

6.1. Preliminary Analysis

The correlation analysis for the study's variables is provided in Table 3. According to Gujarati & Porter (2009), there is no multi-collinearity problem if the correlation value is less than 0.8. As shown in this table, the highest correlation is 0.475 between the remuneration of the AC members and company size. The next highest correlation is 0.372 between independent

Table 3: The Correlation Matrix

BLOCK 5	BIG4	SIZE	LEV	ROA	ACFEES	ACEDU. ME	ACED U.CH	ACNE	ACEXIST	ACOWN	ACE XP	ACMEET	ACSIZE	ACIND	DACC	Var.
															1	DACC
														1	-0.107	ACIND
													1	-.275**	-0.083	ACSIZE
												1	0.091	-0.058	0.002	ACMEET
											1	-0.043	-.180**	0.012	-0.001	ACEXP
										1	-0.11	0.056	-0.017	-0.084	.228**	ACOWN
									1	0.089	-0.073	0.11	-0.026	.372**	.173**	ACEXIST
								1	.247**	0.077	-0.084	0.042	-0.083	-0.072	0.014	ACNE
							1	0.053	0.052	-0.009	0.022	-0.088	0.035	-0.03	0.059	ACEDU.CH
						1	-0.021	-.123*	-0.067	0.032	-0.061	0.086	0.035	0.015	0.087	ACEDU.ME
					1	0.082	0.021	-0.106	-.258**	-0.082	-0.037	.275**	.140*	-.226**	-.132*	ACFEES
				1	.161**	-0.088	-0.031	-0.005	-.184**	0.08	-0.079	0.009	0.042	-.170**	-0.079	ROA
			1	-.146*	.180**	-0.046	.133*	-0.01	-0.009	-0.014	0.003	0.028	0.028	-0.044	0.048	LEV
		1	.248**	.274**	.475**	.196**	0.022	-.206**	-.214**	-0.041	-0.063	.168**	.343**	-.196**	-.238**	SIZE
	1	0.055	.129*	-0.003	-0.028	.121*	.187**	0.106	.172**	-0.066	-0.078	0.077	.160**	-0.085	0.042	BIG4
1	.266**	.170**	0.004	0.058	0.054	0.067	0.052	-0.005	.121*	0.024	-0.011	0.041	.126*	-0.04	0.094	BLOCK5

Notes: DACC = Discretionary Accruals (proxy for Earnings Management); ACIND = Independent Audit Committee Members; ACSIZE = Audit Committee Size; ACMEET = Audit Committee Meeting Frequency; ACEXP = Audit Committee Financial Expertise; ACOWN = Audit Committee Members' Stock Ownership; ACEXIST = Presence of Board of Directors Members in the AC; ACNE = Non-Executive AC Members; ACEDU.CH = Educational Level of AC Chairman (Postgraduate Degree); ACEDU.ME = Average Educational Level of AC Members (Postgraduate Degrees); ACFEES = Audit Committee Remuneration; ROA = Return on Assets; LEV = Leverage; SIZE = Firm Size; BIG4 = Engagement of a Big-4 Audit Firm; BLOCK5 = Block Ownership (≥ 5%).

Correlation is significant at the 0.01 level (**), and at the 0.05 level (*).

AC members and members of the board of directors in the AC, which remains below 0.8. Furthermore, the table shows that DACC has a significant positive relationship with ACOWN and ACEXIST, while it has a significant negative relationship with ACFEES and SIZE. The other variables show no significant relationship with DACC. Therefore, there is no multi-collinearity problem among the variables, as all correlations are under 0.8.

Additionally, the Variance Inflation Factor (VIF) for each variable, as shown in Table 4, confirms that all values are less than 2.5 (Senaviratna & Cooray, 2019), indicating no multi-collinearity issues in the model. The OLS regression results, presented in Table 4, reveal that the regression model is statistically significant ($F = 5.353$, $p < 0.001$) and explains 21.5% of the variance in earnings management (EM), as indicated by the coefficient of determination (R^2).

6.2. Independent AC members and EM

There is a significant negative impact of the independent AC members on EM. Hence, H1 is supported. This result indicates that this characteristic determines the effectiveness of the AC's monitoring role in Saudi companies and is consistent with previous studies (Waweru, 2018; Nelwan & Tansuria, 2019; Juhmani, 2017). Independent members can exercise judgment autonomously and without management pressure, thus enhancing credibility in financial statements and reducing EM.

In the Saudi context, this finding highlights the growing influence of the 2017 Corporate Governance Regulations issued by the Capital Market Authority (CMA), which emphasize the inclusion of independent directors. These independent members—often external professionals—help reduce the effect of family ownership and managerial dominance, both long-standing features of Saudi corporate structures. Their presence provides greater transparency and reinforces investor confidence in financial reporting, which is essential for the country's Vision 2030 objective of strengthening corporate accountability.

6.3. Size of the AC and EM

The AC meeting frequency shows a slight positive and insignificant relationship with EM; thus, H3 is not supported. This finding suggests that the number of meetings is not a key determinant in reducing EM levels in Saudi enterprises and aligns with previous studies (Habbash et al., 2013; Alshetwi, 2016).

A possible explanation is that frequent meetings may not necessarily lead to effective monitoring but rather become routine. As Habash et al. (2013) observed, members who meet too frequently may become uncritical. In the Saudi context, this could be attributed to a symbolic adherence to governance norms—where meetings are held to satisfy regulatory expectations rather than to critically evaluate financial reporting. Moreover, cultural norms that emphasize harmony and respect for authority may discourage open confrontation or criticism of management during such meetings.

6.4. Number of AC Meetings and EM

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6.5. Expertise of the AC Members and EM

There is an insignificant positive impact of AC members' financial expertise on EM; hence, H4 is not supported. This finding is consistent with previous studies (Sharma & Kuang, 2014; Nelwan & Tansuria, 2019).

In Saudi Arabia, this may be due to the limited development of the accounting and auditing profession. Although the CMA requires at least one financial expert in the AC, many "experts" come from management or banking backgrounds rather than professional accounting. Some AC members with financial expertise also serve as CEOs or CFOs in other firms, creating conflicts of interest and reciprocal dependence. As Habbash et al. (2013) explain, such dual roles may prevent these individuals from questioning management actions. Consequently, expertise without independence does not enhance monitoring effectiveness in Saudi firms.

6.6. Stock Ownership of AC Members and EM

The AC's ownership has a considerable positive impact on EM; therefore, H5 is rejected. This result suggests that AC members who hold shares in the firm are less independent and may even facilitate EM practices, consistent with Yang and Krishnan (2005).

This finding reflects a broader feature of the Saudi corporate landscape, where ownership structures are highly concentrated and dominated by families or major shareholders. In such settings, shareholding directors may align more closely with controlling owners than with minority investors, thus weakening the AC's monitoring function. Ownership stakes may create incentives to manipulate earnings upward to protect stock value or reputation. Consequently, equity-based incentives, often used in Western contexts to align interests, can have the opposite effect under Saudi governance dynamics.

6.7. Existence of Board Members in the AC and EM

The presence of board directors on the AC has a significant positive effect on EM; thus, H6 is supported. This finding is novel, as few studies have directly examined this variable. It indicates that when board members simultaneously serve on the AC, EM increases due to conflicts of interest.

According to agency theory, such dual roles blur the separation between oversight and management. In the Saudi context, this situation often arises because the same small

pool of elite individuals serves on multiple boards and committees. These overlapping memberships reduce independence and oversight rigor. Moreover, family-controlled firms tend to appoint trusted board members to ACs, reinforcing internal cohesion but weakening external accountability. This result highlights the need for the CMA to revisit its regulations, ensuring that ACs include truly independent members not involved in executive or board management.

6.8. Non-Executive AC members and EM

The AC's non-executive members have a significant negative impact on EM; thus, H7 is supported. This finding aligns with previous research (Khalil & Ozkan, 2016; Drogalas et al., 2020) and confirms that non-executive participation enhances AC effectiveness.

In Saudi Arabia, non-executive directors play a crucial role in balancing managerial dominance, particularly in firms with concentrated ownership. Their lack of direct involvement in daily operations allows them to act more objectively, safeguarding shareholders' interests. This finding supports the CMA's emphasis on non-executive representation as a core principle of corporate governance reform and indicates progress toward better transparency and accountability under the Vision 2030 agenda.

6.9. Educational Level of the AC Members and EM

The educational degree of the AC chairman has a negligible positive impact on EM, while the AC members' educational level has a significant positive influence. Therefore, H8 is not supported. These findings are consistent with Wardhani & Joseph (2010) and Susanto (2016).

In the Saudi setting, this suggests that higher education alone does not necessarily translate into effective monitoring. Highly educated members may possess theoretical knowledge but lack practical experience in auditing or accounting. Furthermore, the hierarchical nature of Saudi corporate culture may prevent them from questioning top management's decisions. In some cases, overeducated members may dominate discussions, discouraging others' contributions, while in others, education leads to overconfidence and passive reliance on management-provided information. These factors together reduce the potential benefits of educational attainment for improving governance outcomes.

6.10. Remuneration of the AC Members and EM

The remuneration of AC members has a negligible negative impact on EM; hence, H9 is not supported. This result aligns with Habbash et al. (2013).

A possible explanation lies in the low and uniform compensation structures prevalent in Saudi firms. AC members are often compensated with fixed allowances rather than performance-based pay. Compared with other markets, such as China (Alkebsee et al., 2021), Saudi AC members are less financially incentivized to engage in extensive oversight. The limited reward may discourage diligent monitoring and reduce motivation to challenge management, explaining why remuneration fails to meaningfully influence EM in Saudi corporations.

6.11. Control Variables

Among the control variables, ROA shows a negligible positive impact on EM, indicating that profitability does not drive EM behavior in Saudi firms (De Vlaminck & Sarens, 2015). Leverage significantly increases EM, confirming that highly indebted companies use EM to avoid breaches of debt covenants and manage bankruptcy risk (Alves, 2013; Al-Absy et al., 2019; Mishra & Malhotra, 2016). Company size has a significant negative effect, implying that larger firms—being more scrutinized by analysts, regulators, and the public—are less likely to engage in EM (Qamhan et al., 2018; Habash et al., 2013). BIG4 audit office affiliation has a negligible negative influence, suggesting that external audit reputation alone does not constrain EM in Saudi firms. Finally, block ownership significantly increases EM, consistent with Nguyen et al. (2021), indicating that dominant shareholders in Saudi firms use earnings manipulation to maintain control and protect private benefits.

Table 4: OLS Regression Results

Variables	Coefficient	t-Statistic	p-Value	Sig.
(Constant)		2.586	0.010	**
ACIND	-0.255	-4.148	0.000	***
ACSIZE	-0.062	-1.054	0.293	
ACMEET	0.011	0.198	0.843	
ACEXP	0.003	0.053	0.957	
ACOWN	0.171	3.166	0.002	**
ACEXIST	0.213	3.351	0.000	***
ACNE	-0.120	-2.142	0.033	**
ACEDU.CH	0.046	0.864	0.388	
ACEDU.ME	0.157	2.829	0.005	***
ACFEES	-0.027	-0.423	0.673	
ROA	0.025	0.425	0.671	
LEV	0.134	2.344	0.020	**
SIZE	-0.316	-4.543	0.000	***
BIG4	-0.040	-0.692	0.489	
BLOCK5	0.112	2.034	0.043	**
Model summary: $F = 5.353$, $p = 0.000$, $R^2 = 0.215$. Significance levels: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Notes: Abbreviations as defined in Table 3.				

7. Conclusions

This study examined the impact of audit committee (AC) characteristics on earnings management (EM) in Saudi joint-stock companies between 2017 and 2019, using a sample of 103 non-financial firms. By focusing on an emerging market context following the implementation of International Financial Reporting Standards (IFRS) and the Saudi Capital Market Authority (CMA) governance reforms, the research contributes to the limited empirical literature on corporate governance effectiveness in Gulf countries.

The findings reveal that independent and non-executive AC members significantly reduce EM, confirming the importance of independence and external oversight in improving reporting quality. Conversely, stock ownership, the presence of board members within the AC, and the educational level of AC members were found to increase EM, suggesting that these characteristics may compromise independence or encourage alignment with management interests. Other AC attributes—such as size, number of meetings, expertise, remuneration, and the educational level of the chairman—did not show significant effects. Regarding control variables, leverage and block ownership were positively associated with EM, while firm size exhibited a negative association, consistent with the view that larger firms face stronger monitoring and market scrutiny.

From a theoretical perspective, the study extends agency and stakeholder theories to the Saudi context, illustrating how governance mechanisms operate within an environment characterized by concentrated ownership, family-controlled firms, and evolving regulatory oversight. The results demonstrate that certain governance mechanisms effective in developed economies may not automatically yield the same outcomes in emerging markets, where cultural norms and institutional settings differ. This highlights the need to contextualize governance models rather than applying them uniformly across jurisdictions.

From a policy and practical standpoint, the findings provide evidence that can inform the CMA and policymakers in their ongoing evaluation of governance reforms. Specifically, the results underscore the importance of strengthening the independence of AC members, limiting dual board memberships, and re-evaluating the role of equity-based incentives. Such measures can enhance the monitoring capacity of ACs and improve investor confidence in financial reporting.

This study is subject to certain limitations. It focuses only on non-financial Saudi joint-stock companies between 2017 and 2019, excluding firms with missing data and industries with fewer than six observations. Future research could extend the analysis to financial institutions or other GCC countries, incorporate longitudinal data to capture regulatory evolution over time, or employ advanced econometric or machine-learning techniques to assess causal dynamics. Additionally, future work could explore newly emerging AC characteristics—such as gender diversity, tenure, or cross-board memberships—and how these interact with EM practices under varying governance regimes.

Overall, this research enhances the understanding of AC effectiveness in an emerging-market setting and contributes to ongoing academic and policy discussions on how institutional reforms can improve transparency and corporate accountability in Saudi Arabia and comparable economies.

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