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A study and analysis of the level of impact of regulatory control mechanisms on the sustainability of quality in accounting profits in Saudi Banks

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Abstract

When evaluating an organization's performance and financial health, the quality of earnings is a crucial consideration. This study examines how regulatory oversight mechanisms, such as the audit committee, perceive risks in the sustainability of accounting earnings quality in Saudi banks. In order to identify and stop earnings manipulation, audit committees supervise financial statements, internal controls, and external audits. Risk committees, meanwhile, find and eliminate operational and financial hazards that might skew reported profits. The correlation coefficient was used to calculate the relationship between the independent variable and the dependent variable. The coefficient of determination was also used to calculate the effect or contribution of the independent variable to the dependent variable. The study's findings indicated a statistically significant correlation between committee independence (ACIN), size (CSIZE), and number of independent directors (ACSIZE) and earnings quality (PRQU). ACSIZE had a favorable impact, indicating that having more independent directors improves the accuracy of financial reporting. Given that the ACIN coefficient was negative, it is probable that excessive independence in the absence of sufficient control mechanisms prevents earnings quality from improving consistently. Policymakers, business executives, and investors can benefit from the study's recommendations for bolstering audit and risk committee operations to improve overall company governance and profits quality.

Keywords: Audit committee, Corporate governance, Earnings quality, Financial reporting, Internal controls, Risk committee, Stakeholder confidence.

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1. Introduction

Contemporary company stakeholders rely on financial statements to facilitate informed decision-making [1]. However, management judgment, accounting regulations, and external factors can all affect the reliability and accuracy of reported outcomes [2]. Audit and risk committees are crucial for maintaining earnings quality by ensuring transparency, compliance with accounting standards, and robust risk management practices [3]. The duties of these committees and how they affect financial integrity are examined in this essay [4]. Concerns over the veracity of reported earnings have been raised by the increasing number of business scandals and financial restatements [5]. The necessity of strict oversight to stop profits manipulation is being emphasized more and more by regulators and investors [6]. In order to guarantee that results accurately depict a company's financial performance, audit and risk committees are essential governance tools [7, 8]. This study looks at how these committees improve the quality of earnings through independent monitoring, risk assessment, and internal controls [9].

Despite comprehensive research on corporate governance and financial reporting, significant doubts persist regarding the precise influence of audit and risk committees on profit quality, and empirical data for their efficacy is lacking. Although research emphasizes the significance of these committees, there is a lack of empirical evidence about their effectiveness in curbing profit manipulation across various industries and regions [10]. The impact of committee composition, including independence, financial expertise, and industry knowledge, on earnings quality remains inadequately explored, and there is a lack of clarity regarding how differences in corporate governance regulations across countries influence these committees' functions in preserving earnings quality. While most research examines these two committees in isolation, the interplay between them and their collective impact on earnings quality remains inadequately investigated [11]. The ability of audit and risk committees to keep up with technology advancements and identify sophisticated fraud is still being studied in light of the growth of AI-based financial analysis [12]. There hasn't been enough research done on how well audit and risk committees work to preserve earnings quality during financial crises or recessions. An emerging field of study is the role audit and risk committees play in guaranteeing the integrity and correctness of ESG-related earnings data, given the increasing significance of ESG reporting in financial disclosures [13].

This study seeks to assess the efficacy of audit and risk committees by analyzing their influence on the accuracy and transparency of financial reporting [14]. It analyzes the principal determinants affecting earnings quality by examining the roles of corporate governance, regulatory compliance, and internal controls in generating high-quality earnings [15]. This study aim to assesses the role of audit committees in maintaining financial integrity by looking at how audit committee oversight can lessen financial misstatements and earnings manipulation, and it assesses the role of risk committees in maintaining earnings stability by looking at how they can detect and reduce financial risks that could skew reported earnings [16]. By analyzing how adherence to corporate governance rules impacts the efficiency of audit and risk committees, it also looks at best practices and legal standards [17, 18]. By evaluating the degree to which independent audit and risk committees support more accurate financial reporting, it also investigates the connection between committee independence and profits quality [19].

This study provides multiple contributions, including the improvement of transparency, accuracy, and reliability of financial statements by elucidating the functions of audit and risk committees in maintaining the integrity of financial reporting [20];). It enhances corporate governance by demonstrating how these committees facilitate the implementation of governance principles, augment accountability, and safeguard stakeholder interests [8]; moreover, it mitigates profit manipulation by demonstrating how competent control can curtail financial crime and earnings management [21]; the research enhances risk management techniques by elucidating how risk committees recognize and alleviate operational, financial, and strategic threats that may adversely affect profits quality [3]; it further improves rules and regulations by offering recommendations to institutions, regulators, and lawmakers to strengthen the efficacy of audit and risk committees [10]; furthermore, it assists stakeholders and investors by enabling analysts to evaluate the veracity of stated results for investment decisions [22]; the research enhances professional and academic understanding by advancing continuing inquiries into the dynamics between audit committees, risk committees, and earnings quality [23]. The researchers underscore the necessity for additional significant research to furnish insights to investors and other stakeholders regarding the ongoing discourse on the influence of banking regulatory oversight mechanisms and earnings quality, which is vital for the sustainability of accounting earnings quality in Saudi banks. This region is crucial due to the pressing necessity to evaluate governance frameworks related to the dependability of financial reporting in emerging markets, maintaining transparency and protecting stakeholders' interests from accounting fraud. Therefore, the study examines the subsequent inquiry: How significantly do banking oversight systems influence the sustainability of banking earnings quality? This research arises from the growing necessity to understand the impact of regulatory monitoring systems on corporate strategy and the risks and incentives provided by governance structures within enterprises. This study examines the perceptions of regulatory oversight systems, including the audit committee, about hazards to the sustainability of accounting earnings quality in Saudi banks.

2. Literature Review

The dependability, transparency, and sustainability of reported financial earnings are referred to as earnings quality [24]. High-quality profits give stakeholders a true picture of how well a business is doing financially, whereas low-quality results are sometimes the consequence of financial misstatements or earnings management [25]. Audit committees are integral to corporate governance since they oversee internal controls, external audits, and financial reporting methods [26]. Previous studies indicate that independent audit committees with a clear framework improve the financial statements' trustworthiness such as Abbas et al. [27] and Jusoh et al. [28]. Companies with active audit committees are less likely to manipulate results, according to studies by Khudhair et al. [29]. Nonetheless, there are still gaps in our knowledge of these committees' efficacy in various regulatory contexts and businesses. The task of identifying and reducing operational and financial risks that could affect the quality of earnings falls to risk committees [16]. Due to market volatility and the growing complexity of financial instruments, their function has grown in importance [27]. Strong risk governance enhances financial stability and lowers the possibility of earnings manipulation, according to research by Ismaila et al. [31]. Nevertheless, few empirical studies have evaluated how risk committees directly affect the caliber of financial reporting. Despite having different roles, audit and risk committees work together to improve overall financial control [28]. Research shows that businesses with robust audit and risk committees are better able to prevent financial fraud and earnings deception [29]. The function of audit and risk committees in financial reporting has been reinforced during the last 20 years by changes in corporate governance [30, 31]. The necessity of independent scrutiny in preventing earnings misstatements has been reaffirmed by regulatory frameworks, including the Sarbanes-Oxley Act and IFRS rules [32, 33]. These committees support the preservation of investor confidence and earnings quality by closely examining financial reports and risk exposures [34]. This essay explores their changing function in maintaining financial openness [35].

2.1. A Risk Committee and Earnings Quality

The management of company risks and the efficacy of the risk committee are critical factors influencing revenue production capacities [36]. Research shows that financial success is greatly impacted by an efficient risk management committee [37]. A correlation exists between the risk management committee and the sustainability of earnings [38]. The independence of the members of the risk management committee and the frequency of their meetings have a favourable and significant impact on the quality of earnings. The quality of financial reporting in organisations will increase if risk management committees are strengthened in terms of both composition and efficacy [39]. Performance of the business is impacted by risk management, and volatility in earnings quality is negatively correlated with risk management [40]. Research shows that the quality of earnings is negatively impacted by risk management [41]. The absence of an effective risk policy, planning, and determination of a company's risk appetite and tolerance, along with inadequate regular risk assessment and monitoring, can lead to lower wages, unemployment, and diminished investment by investors in the event of a company's failure due to the board's oversight of opportunities and rewards [16]. Additional studies suggest that diversity within the risk management committee positively influences profit attainment [42]. In light of the findings from these experiments, the research posits the subsequent hypothesis:

$H_{1:}$ There is a statistically significant relationship between risk management as one of the control mechanisms of banking regulation and the sustainability of the quality of accounting profits in Saudi banks.

2.2. Audit Committees and Earnings Quality

To guarantee exceptional earnings quality, the audit committee meticulously examines all management operations and forbids any interference in earnings management. Numerous organisations frequently lack sufficient internal auditing procedures [43]. Research indicates a statistically significant negative correlation between auditor specialisation and earnings management, as enterprises audited by specialised auditors have a lower ratio of expected accruals to total assets compared to those audited by non-specialized auditors [44]. The magnitude of the audit company correlates negatively with the attainment of quality earnings [45]. Diversity within the audit committee adversely affects earnings management [46]. A robust inverse correlation exists between discretionary accruals, serving as an indicator of earnings management, and the independence of the audit committee, member expertise, frequency of audit committee meetings, and audit quality [47]. Certain research suggest that the audit committee significantly influences earnings quality [48]. The efficacy of the audit committee is positively correlated with the quality of earnings [49]. The legitimacy of the quality of earnings is increased by the Audit Committee's control over the audit [50]. Research indicates that more independent and financially savvy audit committees are positively correlated with higher-quality profits. The findings show that these factors promote higher degrees of financial reporting dependability, enhance transparency, and reduce earnings manipulation [51]. The company's size and the frequency of audit committee meetings positively influence profits quality [46]. Through an examination of pertinent research, we undertook a comprehensive analysis to ascertain the function of audit committees as a regulatory oversight mechanism in bolstering the sustainability of accounting earnings quality in Saudi banks. Consequently, this study posits the subsequent hypothesis:

H_1: There is a statistically significant relationship between audit committees as one of the oversight mechanisms of banking regulation and achieving the sustainability of quality in accounting profits.

3. Research Methodology

In order to answer the research questions and objectives, this part describes the procedures and methods the researcher used to carry out the study. Examining and assessing the role of audit and risk committees in maintaining profits quality is the study's main goal. A descriptive analytical method was utilised in accordance with the study's characteristics. A desk survey was performed to examine both theoretical and empirical literature relevant to the study subject. Regarding the analytical component, data was gathered from reports of several banks in Kas to address the research questions and assess the hypotheses. The research population comprised all banks in Saudi Arabia (10 banks) from 2018 to 2023. The researcher utilised secondary data, diligently compiled by themselves, to extract information from various bank reports. Data analysis was subsequently performed utilising SATA (17) and SPSS v26.

3.1 Measurement of the Variables

This section delineates and analyses the metrics of the dependent, independent, and control variables..

Table 1.
Summarized operationalization of the of the study variables.

Variable	Abbreviation	How to measure
Earnings Quality	Earning Quality (PRQU) ES	Earnings quality was assessed using the modified Jones model. The following is the expression for the economic model: NDA + DA = TA. The efficacy of this model as a measure of earnings management has been shown by prior research. [52].
Size of Audit committee	ACSIZE	Total membership of the audit committee [53].
Number of Independent Members	ACSIZE	Number of independent (non-executive) directors on the audit committee [54].
Committee Independence	ACIN	Proportion of independent members to total audit committee members [55].
Risk Committee Size	RMCSIZE	Total number of members on the risk management committee [56, 57].
Risk Committee Independence	IN	The ratio of independent members to all members of the risk committee [58, 59].
Total Assets	TA	Natural logarithm of total assets to normalize scale [60].
Total Liabilities	TC	Natural logarithm of total liabilities [61].
Age of the Entity	CA	Number of years since the company's establishment [62].

4. Study Findings

4.1. Descriptive Analysis

Table 2 displays the results, encompassing the computed mean values alongside their maximum and average figures as illustrated. The descriptive analysis was limited, as it did not account for the interrelations of the independent variable. The next stage entails computing the variance inflation factor (VIF), with the results again presented in Table 2. VIF values exceeding 10 indicate a multicollinearity issue [63]. The VIF scores varied from 0.014 to 0.769, signifying the absence of any such issue.

Table 2.
Statistical descriptiveness and the Variance Inflation Factor

Variable	Mean	Std. dev.	Min.	Max.	VIF	1/VIF
PROFIT	0.375	0.4892	0.0	1.0		
CSIZE	4.48	1.072	3	8	71.68	0.0139
ACSIZE	3.40	0.917	2	7	64.19	0.016
ACIN	0.78073	0.189126	0.400	1.000	60.27	0.016
RMCSIZE	3.90	0.951	3	6	2.19	0.457
IN	1.48	1.130	0	5	1.30	0.769
	267480367.35	206809570.80	63207676.00	945496166.00	154.63	0.006
TC	228646333.91	178707055.47	55618883.00	778718535.00	153.15	0.006
CA	46.375	24.9038	12.0	92.0	1.90	0.526
Mean VIF					63.66	

A severe collinearity issue is indicated by a correlation matrix with coefficients of 0.9 or higher, according Hair Jr, et al. [63]However, as Table 3 demonstrates, the model does not exhibit multicollinearity because none of the variable correlations were greater than 0.9, with the majority falling below this cutoff, so demonstrating the lack of multicollinearity problems.

Table 3.
Pearson Correlation for Continues Variable (Model 1).

Variables	PRQU	CSIZE	ACSIZE	ACIN	RMCSIZE	IN	TA	TC	CA
PRQU	1.000								
CSIZE	-0.107	1.000							
ACSIZE	-0.101	0.561	1.000						
ACIN	-0.028	-0.510	0.417	1.000					
RMCSIZE	-0.051	0.259	0.366	0.092	1.000				
IN	-0.178	-0.106	0.203	0.304	0.186	1.000			
TA	0.006	0.278	-0.116	-0.435	-0.472	-0.306	1.000		
TC	-0.007	0.283	-0.120	-0.443	-0.466	-0.299	0.996	1.000	
CA	-0.003	0.012	0.075	0.089	-0.520	-0.279	0.342	0.319	1.000

4.2. Regression Results

The relationship between an independent variable and a dependent variable is assessed using the correlation coefficient. Analysing the aforementioned table, we discovered that the R value is 0.418, indicating a modest correlation between Earning Quality (PRQU) and the independent variables, particularly the audit committee and risk committee dimensions. The independent variable's impact or contribution to the dependent variable is evaluated with the use of the coefficient of determination. According to our data, the audit committee aspects account for 18% of the variation in Earning Quality (PRQU), with an R2 value of 0.175. The model appears to have no autocorrelation issues, as indicated by the Durbin-Watson statistic result of 2.35, which is close to 2. The T-test results showed that three variables (CSIZE, ACSIZE, and ACIN) had P values less than α=0.05, indicating a significant association with Earning Quality (PRQU), when hypotheses pertaining to the independent variables, audit committee, and risk committee dimensions were tested. Nevertheless, the control variables (TA), (TC), and (CA) and two risk committee dimensions variables (RMCSIZE) (IN) were not significant. This suggests that: earning Quality (PRQU) and the audit committee dimensions (CSIZE, ACSIZE, and ACIN) have a statistically significant association. The risk committee dimensions variables (RMCSIZE) (IN), control variables (TA), (TC), (CA), and earning quality (PRQU) do not statistically significantly relate to one another.

Table 4.
Multi regression- result.

PRQU	Coefficient	Std. Err.	t	P>t	[95% conf. interval]	
CSIZE	-1.254	0.562	-2.231	0.032	-2.391	-0.117
ACSIZE	1.342	0.622	2.157	0.037	0.084	2.600
ACIN	-6.326	2.921	-2.166	0.036	-12.234	-0.419
RMCSIZE	-0.021	0.111	-0.189	0.851	-0.245	0.203
IN	-0.111	0.072	-1.550	0.129	-0.256	0.034
TA	0.0001	0.000	0.842	0.405	-0.000	0.000
TC	-0.0001	0.000	-0.897	0.375	-0.000	0.000
CA	-0.001	0.004	-0.192	0.849	-0.009	0.007
cons	6.703	2.722	2.463	0.018	1.198	12.208
F(8, 39)	1.04					
R	0.4184					

5. Conclusion

This study seeks to examine the viewpoints of regulatory oversight entities, including audit committees, regarding hazards related to the sustainability of accounting earnings quality in Saudi banks. The findings suggest that although the characteristics of risk committees do not demonstrate a statistically significant correlation, many elements of the audit committee significantly influence profit quality. The principal findings reveal a statistically significant link between earnings quality (PRQU) and variables such as committee size (CSIZE), the number of independent members (ACSIZE), and committee independence (ACIN). ACSIZE positively influences the dependability of financial reporting, indicating that an increased number of independent members improves it.

Nevertheless, due to ACIN's negative coefficient, increased autonomy without adequate control mechanisms may not consistently enhance earnings quality. The analysis also revealed no statistically significant correlation between earnings quality and committee independence (IN) or risk committee size (RMCSIZE). This indicates that risk committees may not directly affect reported financial performance, maybe owing to differences in governance practices or industry-specific variables. Total assets (TA), total liabilities (TC), and company age (CA) did not significantly influence earnings quality, suggesting that firm size and age alone do not considerably alter the transparency of financial reporting.

The model's R-squared coefficient was 0.175, indicating that the independent variables explain merely 18% of the variance in earnings quality. The Durbin-Watson statistic (2.35) verified the lack of autocorrelation. The study advises organisations to enhance their risk governance methods to improve financial transparency, notwithstanding the lack of significant influence of risk committees on earnings quality. Legislators ought to focus on enhancing audit committee regulations while preserving their autonomy and sufficient budget.

6. Implication, Limitation of study and future suggestion and recommendations

Companies should maintain a balance between the importance of an independent and suitably sized audit committee in corporate governance and the necessity for sufficient independent oversight. Although risk governance methods can be refined to enhance financial transparency, risk committees have not demonstrated a substantial effect on profits quality. Legislators must to concentrate on enhancing audit committee legislation, guaranteeing their autonomy, and allocating sufficient resources.

Future study should investigate the influence of risk committees on financial stability across various industries and economic environments. While audit committees are essential for preserving earnings quality, risk committees may necessitate further structural enhancements to strengthen their impact on the precision of financial reporting.

The study omits consideration of technical developments, legal changes, or macroeconomic issues that could affect the sustainability of earnings quality, hence excluding external effects. The impact of data analytics and artificial intelligence on the efficacy of audit and risk committees remains inadequately examined in the scant study concerning technology and AI. To comprehend disparities in the efficacy of audit and risk committees in preserving profits quality, we advocate for broadening the sector scope in further research.

We recommend undertaking longitudinal studies to observe trends and the enduring impacts of audit and risk committee oversight across multiple years. Additionally, we advocate for cross-national comparative study to examine the impact of diverse corporate governance legislation on the efficacy of audit and risk committees across various financial systems. We advocate incorporating artificial intelligence and big data analytics to investigate how AI-driven financial research might assist audit and risk committees in identifying profits manipulation.

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