

Effects of Audit Quality on Financial Reporting Quality in Middle East and North Africa (Mena)

Ameer Alhzeem, PhD, Maher Azzam Ghaleb Alqadi, PhD,
Abdullahi Masud, PhD

Department of Business Administration, Ibrahim Badamasi Babangida University Lapai,
Niger State Nigeria

Email: dr-ameer@aabu.edu.jo, Maher008@yahoo.com, talk2masud2008@gmail.com

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Abstract

This paper presents an analysis between audit quality and financial reporting quality (FRQ) within Middle East and North Africa (MENA) countries. Drawing on empirical findings and theoretical frameworks, the study examines how audit characteristics including auditor consortium arrangements, auditor-partner qualifications, audit committee effectiveness, and internal audit capabilities shape the credibility, timeliness, and transparency of corporate financial disclosures. However, the impact of such measures is contingent on the specific corporate and regulatory context of each region. For regulators, the idea is to support the development of policies and guidelines aimed at promoting effective audit quality as a part of broader efforts to enhance corporate governance and transparency. Furthermore, to achieve these objectives, the study obtained data from listed firms on Amman Stock Exchange, Egypt Stock Exchange and Saudi Arabia Stock Exchange from 2020-2024 during which 128 firms were scrutinized, culminating in a total of 1280 observations. The results revealed that there is a significant positive relationship between audit effectiveness and financial reporting quality. The audit quality is also expected to enhance the audit on earnings accruals, the study presents useful insights to regulators, practitioners, and investors with new empirical evidence on audit quality from the perspective of non-financial companies. Finally, the study has implications for captains of industries to devise the most effective and efficient means of managing companies in the Middle East and North Africa (MENA). Thus, the study has implications for captains of industries to devise the most effective and efficient means of managing companies in the Middle East and North Africa (MENA). Finally, the study will add more value to the body of literature related to the variables under study.

Keywords: Audit Quality, Financial Reporting Quality MENA Countries

Introduction

The financial reporting quality has become a global concern, attracting significant scrutiny from regulators, investors, researchers, and accounting professionals, particularly in major economies such as China, the United States, and the United Kingdom. This attention highlights the critical role financial reporting plays in providing accurate financial information to external

users, forming the basis for evaluating corporate performance and financial health (Kaawaase et al., 2021). High-quality financial reporting is crucial for investor confidence, as it influences their perception of whether financial statements truthfully reflect the performance of publicly held companies, thereby shaping investment decisions (Alwardat, 2019). Similarly, in the United Kingdom, financial reporting is overseen by the Financial Reporting Council (FRC), ensuring compliance with either the UK Generally Accepted Accounting Practice (UK GAAP) or International Financial Reporting Standards (IFRS). Research by Brown and Taylor (2022) highlights the ongoing efforts to enhance financial reporting quality in the UK, focusing on the regulatory landscape and its impact on corporate reporting practices. The collective interest in the quality of financial reporting, as acknowledged by scholars such as Kaawaase et al. (2021), underscores a widespread recognition of its crucial significance. The references included in this study offer a glimpse into the contemporary research environment in China, the United States, and the United Kingdom, enriching the ongoing discourse on the quality and efficacy of financial reporting within these advanced economic systems. Financial reporting achieves high quality and utility when it is unbiased and accurately represents the entity's economic substance in terms of relevance, reliability, and comparability (Olojede, lyoha, & Egbide 2020). Thus, the objective of financial reporting quality is to enhance transparency and produce high-quality annual reports with comprehensive disclosures. The quality of financial reporting is crucial for the effective functioning of listed companies and is affect relationship between ownership and management which may affect the stakeholders. This underscores the need for a high-quality financial reporting framework to address agency conflicts and reduce information asymmetry (Adekola, 2023).

An effective accounting regulatory environment plays a vital role in establishing systems and procedures for producing quality financial reports, particularly for listed entities. Regulations serve as external control mechanisms to ensure that financial information provides a fair view of the company's performance and financial position, free of unethical practices and suitable for all stakeholders' needs. This involves the formulation of rules, such as Act-based regulation, accounting standards (Principle-based regulation), and the enforcement of compliance with disclosure requirements (Market and Corporate governance-based regulations) (Adekola, 2023). Furthermore, in the contemporary business environment, the relationship between managerial ability and financial reporting quality is increasingly recognized as a critical determinant of organizational success and stakeholder trust. Financial statements serve as the cornerstone of transparency, fostering trust between companies and their stakeholders by providing accurate and reliable insights into the organization's financial health and operational performance. A key factor influencing this dynamic is the ownership structure of the board. Board ownership structure, which refers to the extent to which board members hold equity stakes in the company, can significantly impact managerial incentives and financial reporting quality. Conversely, a dispersed ownership structure with limited board equity stakes may weaken the board's incentive to monitor management rigorously. In such cases, managerial discretion over financial reporting could lead to opportunistic behaviors, such as earnings management or withholding critical information.

Literature Review

Salem et al. (2023) looked into the relationship between board characteristics and quality of voluntary disclosure. Using a three-dimensional method, we were able to record the VD_Q for 1,484 bank years' worth of data from 12 Middle East North Africa countries spanning the

years 2006 through 2019. Religion does have an impact on bank as, the study have discovered. Banks in countries with low legal protection and poor corruption control, as well as during times of crisis, have higher levels of religiosity and VD_Q, according to our research. More than quantitative factors, religion influences the dissemination and utility of knowledge. These results are not attributable to religious bias or selective sampling. This indicates that religion helps close the knowledge gap between corporate leadership and outside users. Sarhan and Ntim (2019) studied the impact of board characteristics and shareholder structures on voluntary CG disclosure in emerging MENA nations. Using multivariate regression methods such “ordinary least squares, weighted, non-linear, lagged-effects, two-stage least squares and fixed-effects regression”, the research examines data from listed enterprises in developing MENA nations. Companies in the MENA region that are publicly traded are less likely to disclose their CG practices and comply with them. Zamil et al. (2023) examined business reporting metrics were the subject of a thorough literature .135 studies were selected at random using Scopus.

In order to inform future research, the theoretical frameworks, temporal patterns, geographic spread, institutional contexts, and results of these investigations” were analysed. “Size, age, leverage, liquidity, profitability, corporate governance, ownership structure, and agency theory” were the most influential factors in voluntary reporting investigations. Abu Alia et al. (2022) showed that VD, Corporate government (CG), and leading to lower cost of equity (Ke) all go down when there's less uncertainty about the company's future. The study examined all non-financial institutions listed on the Palestine Stock Exchange between 2009 and 2018. Prevalence of voluntary disclosure (VD) was calculated using a 35-item checklist modified for use in Palestine. The CG conformity of Palestinian businesses was evaluated using a second, 19-item checklist. Five different Ke. Values were evaluated using three ex-ante proxies for returns similar to the Capital Asset Pricing Model and two proxies for realised returns. Ke was a major victim of VD. Ke is lowered by CG and VD. An increase in VD reduces Ke for businesses with higher CG by more than just that amount. Growth, scale, and leverage are all beneficial, but poor auditor quality is disastrous.

Al-Homaidi et al. (2020) investigated the profitability of Yemeni Islamic banks against voluntary disclosure. This paper uses a custom-built disclosure index of 266 elements to examine voluntary disclosure information and its correlation with profitability in 30 annual reports from 2005-2014 from Yemeni Islamic banks. “Islamic bank history, corporate governance, corporate social transparency, bank size, and bank age” all correlate negatively with return on assets. Several characteristics of Islamic financial institutions, including “return on equity, corporate governance, social transparency, zakat, and bank size”, are inversely related to ROE. Profit after tax is severely impacted by a “bank's Islamic origins, lack of corporate social transparency, and advanced age”.

Elamer et al. (2020) analysed the effect of Sharia supervisory board and governance structures on operational risk disclosures in 63 Islamic banks across 10 MENA countries during the fiscal years 2006–2013. These countries include “Bahrain, Egypt, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, and the United Arab Emirates”. Our research was influenced by discussions of “Sharia compliance, Islamic banking, and CG”. The quality of national governance is positively and statistically related to “ORDs, SSB, block ownership, board independence, and ORD density”. The consistency of our findings holds even when we

account for differences between individual banks and across countries. Our research might inform the development and implementation of SSB and governance systems in the MENA region, with the aim of enhancing operational risk reporting. The results conclude by highlighting the need of further research on SSB structures and governance in the effort to bring Islamic banks up to speed on the latest advancements in governance and accounting.

Rezaee et al. (2021) looked at whether CG practices have an effect on the risk-EDQ link. Using a fresh dataset manually developed between 2011 and 2016, this research evaluates EDQ for a sample of 762 listed Iranian businesses. After controlling for variables like firm, industry, and year, ordinary least squares, regression analysis may be used to evaluate hypotheses. Findings are also verified by many studies. There seems to be a negative correlation between environmental disclosure quality (EDQ) and the dangers faced by a business. The risk-EDQ link is impacted more by board independence than either CEO duality or board size. Using fixed-effects panel data and Heckman two-stage regressions for sensitivity analysis and testing does not change the results.

Saha and Kabra (2020) examined the available data and provide a short theoretical framework within which to place your knowledge of VD and CG. This article systematically reviews 65 empirical research published online between 1998 and 2018. The data shows that there are other causes for the seemingly contradictory results thus far. The paper analyses the CG system and the intervening elements that explain the outcomes. Studies conducted in English have consistently linked certain characteristics of CGs to an increased risk of developing VD. Some research finds a negative correlation between “board independence and value creation “in EMS, while other research finds that BI is supported by CG features such “board size, governance depth, and AC independence, lending credence to the resource-based view”.

Underpinning Theories

Legitimacy Theory

The legitimacy theory implied that organisations must depict and sustain holistic business performance and perpetuity in the market in line with social requirements (Davis, 1973). Meanwhile, Lindblom (1993) denoted the legitimacy theory as the compatibility of organisational practices with social values and legislations. Deviations of institutional value systems from social counterparts inevitably resulted in institutional deterioration. The legitimacy theory intended to attain compatibility between (i) institutional performance and values, (ii) communal requirements and values, and (iii) organisational perpetuity and financial goal attainment. Organisations depended on voluntary disclosure to fulfil community members’ requirements and legitimise activities and businesses based on social values (Ghazali, 2007). In this vein, voluntary disclosure could be adopted by firms to explicitly impact social general policies by emphasising the legislative issues related to organisational activities. Implicit voluntary disclosure of activities was also outlined to enhance the social image (Odoemelam & Okafor, 2018). The legitimacy theory also indicated that organisations would adopt significant shifts in CG mechanisms and voluntary disclosure to deter unethical activities that deviated from communal values. For example, organisations relied on voluntary disclosure to be at par with stakeholder needs and attain community members’ satisfaction (Ahmed Haji, 2015).

Methodology

The study adopted both cross sectional and time series analysis obtained from the annual reports of the listed firms on Amman Stock Exchange, Egypt Stock Exchange and Saudi Arabia Stock Exchange of nonfinancial companies. As part of the design, the study used descriptive statistic techniques of mean variance and standard deviation to describe the effect of audit committee effectiveness on board characteristics on voluntary disclosure quality in (MENA) countries. Therefore, population structure is the total number of non-financial companies in listed on the floor of Amman Stock Exchange, Egypt Stock Exchange and Saudi Arabia Stock Exchange between 2020 to 2024. However, the population of this study is 687 and the total sample size for the three countries in the study is 128 with the annual observations of 640 for five (5) years. Therefore, the annual reports of the companies listed during the period from 2020 to 2024. The content analysis approach was used to determine the relationship between audit committee effectiveness on financial reporting quality in (MENA) countries.

Furthermore, the study used data on firms listed on Amman Stock Exchange, Egypt Stock Exchange and Saudi Arabia Stock Exchange between 2020 to 2024. The secondary data was used in this empirical analysis, the data that was collected mainly from selected published statistics on corporate information available from Bloomberg's Database. Gujerati (2003) observed that the research results are as good as the quality of the data; therefore, data for the study was obtained from the Amman Stock Exchange, Egypt Stock Exchange and Saudi Arabia Stock Exchange database. Therefore, the research excludes financial and insurance sectors due to their distinct disclosure and financial reporting norms, differing from sectors like industry and services. It utilizes non-probability sampling for data collection from the Stock Exchange, meaning the selection of industrial companies for the sample is an active choice rather than random.

Data Presentation and Analysis

Table 4.1

Descriptive table, Combined Countries

Audit effectiveness score	Audit firm size	Audit fee	Audit tenure	Earnings Accruals	Value Earnings	Relevance
Audit committee effectiveness score	1.0000					
Audit firm size	0.2415	1.0000				
Audit fee	-0.1121	0.0608	1.0000			
Audit tenure	-0.0499	-0.0061	0.1742	1.0000		
Earnings Accruals	0.0728	0.1967	-0.0000	0.0545	1.0000	
Value Earnings	0.0493	0.0583	-0.0168	0.0436	0.1869	1.0000

Source: Author's Computation (2025)

Table 4.1 presents a correlation matrix which is part of an econometric model investigating the impact of Audit Effectiveness on financial reporting quality Quality. The table

encapsulates seven variables, with correlation coefficients that offer insights into the interrelations among these variables. The correlation coefficient between Audit Effectiveness is 0.0658, indicating a positive but weak relationship. This suggests that higher effectiveness in audit committees might be associated with better disclosure quality, albeit the association is not strongly pronounced. The relationship between Audit Firm Size and Audit Committee Effectiveness shows a more substantial positive correlation (0.2415), implying that larger audit firms might be associated with more effective audit committees. However, the correlation between Audit Firm Size and Earnings Accruals is relatively weaker (0.0192), suggesting that the size of the audit firm has a minimal direct impact on value relevance earnings. An intriguing aspect is the negative correlation between Audit Fee and Audit Committee Effectiveness (-0.1121). This could suggest that higher audit fees do not necessarily correlate with higher effectiveness of audit committees, challenging conventional expectations. Audit Tenure shows a weak positive correlation with earnings accruals (0.0627) and a slight negative correlation with Audit Effectiveness (-0.0499). This indicates that longer audit tenures might slightly improve disclosure quality but don't necessarily enhance the effectiveness of audit committees. Firm Size shows a positive correlation with Audit Effectiveness (0.0728) and a very weak positive correlation with Value relevance earnings (0.0245). This suggests that larger firms may have slightly more effective auditing and marginally better quality of audit.

Table 4.2

Regression table, Combined Countries

Audit quality	Coefficient	P>z
Lag_y_b	-.2323447	0.000
Audit effectiveness score_b	.0009562	0.013
Audit size_b	.0003929	0.806
Audit fee_b	.0001206	0.085
Audit Tenure_b	-.0017447	0.407
Earnings Accruals_b	.0341755	0.000
Value relevance Earnings	.4122539	0.000
cons_d	-.2481396	0.000
r	12	0.000

Source: Author's Analysis (2025)

Given direct model of the impact of the Audit effectiveness on the earnings accruals. As for the impact of the disclosure quality lag, the coefficient for Lag_y_b is -0.2323447 with a p-value of 0.000, indicating a statistically significant negative relationship. This negative coefficient implies that in region 'b', higher levels of disclosure quality in the past are associated with lower levels in the present. This could reflect a pattern where firms that previously had high levels of disclosure might reduce their transparency in subsequent periods, possibly due to changing strategic priorities, market conditions, or regulatory environments. This finding resonates with the idea of dynamic disclosure practices, where firms adjust their disclosure levels based on past experiences and future expectations (Fields et al., 2001). The significant negative impact of the lagged variable suggests that maintaining consistent disclosure standards is challenging. Regulatory bodies and firms should focus on understanding the reasons behind this variability and strive to promote consistent and high-quality disclosure practices over time. The coefficient for Lag_y_d is 0.4122539 with a p-value

of 0.000, indicating a significant positive relationship. Contrary to region 'b', in region 'd', higher past value relevance earnings positively influence quality audit. Therefore, this pattern suggests a reinforcing cycle where good auditing practices are sustained over time. Firms with a history of high-quality disclosures may continue to prioritize transparency, possibly due to established corporate governance norms, positive stakeholder feedback, or regulatory incentives (Lang and Lundholm, 1996). The positive relationship in region 'd' highlights the importance of establishing a culture of transparency within firms. It suggests that once firms achieve a high standard of auditing effectiveness, they are likely to maintain it. Efforts to improve disclosure quality should, therefore, focus on long-term strategies to embed good practices in corporate culture. The divergent impacts of the lagged variable of voluntary disclosure quality in different regions highlight the complex nature of disclosure practices and their dependence on past performance. In region 'b', previous high disclosure quality leads to a reduction in current disclosure levels, while in region 'd', there is a positive reinforcement effect.

These findings indicate that auditing practices are not static and are influenced by a variety of factors including past disclosure decisions, market dynamics, and regulatory environments. Policymakers and corporate governance bodies should consider these dynamics when developing guidelines and regulations aimed at enhancing and sustaining high-quality of auditing practices.

As for the Audit Effectiveness, the coefficient for the Audit Effectiveness Score in region 'b' is 0.0009562 with a p-value of 0.013. This indicates a statistically significant positive relationship. The positive coefficient suggests that in region 'b', more effective audit committees are associated with higher earnings accruals. This relationship underscores the role of audit committees in enhancing transparency and accountability in financial reporting. Effective audit committees, as suggested by Vafeas (2005), often result in more rigorous oversight of the financial reporting process, leading to higher-quality of auditing. This finding aligns with the view that strong internal governance mechanisms are crucial for ensuring accurate and comprehensive disclosures (Krishnan and Visvanathan, 2008). The significant positive impact implies that firms in region 'b' should focus on strengthening their audit committees to enhance audit quality. This could involve ensuring that audit committees have the necessary expertise, independence, and resources. For regulators, this finding supports policies and guidelines that promote the effectiveness of audit committees as a means to improve overall corporate governance and transparency. In region 'd', the coefficient is 0.0007728, but it is not statistically significant with a p-value of 0.204.

The positive yet non-significant coefficient in region 'd' suggests a potential positive relationship between audit effectiveness and value relevance earnings, though this relationship is not strong or consistent enough to be deemed significant. This variability could be attributed to differing corporate governance structures, regulatory environments, or the nature of industries predominant in this region (Carcello et al., 2011). For region 'd', while the importance of audit effectiveness cannot be discounted, it should not be the sole focus. Companies and regulators should also consider other factors that might influence audit quality, such as the overall corporate governance framework, company culture, and external regulatory pressures.

The analysis reveals that the impact of audit effectiveness on earnings accruals varies across regions. In region 'b', there is a clear positive and significant relationship, highlighting the importance of effective audit committees in enhancing audit quality. In contrast, region 'd' shows a positive but non-significant relationship, suggesting that while audit effectiveness is important, it might be influenced by other regional factors. These findings imply that enhancing audit effectiveness can be a valuable strategy for improving audit quality, but its impact is contingent upon the specific corporate and regulatory environment. In terms of the influence of audit Size, the coefficient for audit Size in region 'b' is 0.0003929, with a p-value of 0.806. This suggests a very weak and statistically insignificant relationship between audit size and earning accruals. The insignificance of the coefficient implies that in region 'b', audit size does not play a substantial role in influencing quality of auditing. This might indicate that factors other than size, such as corporate governance mechanisms, industry-specific factors, or regulatory environment, are more determinant in shaping disclosure practices in this region. This observation aligns with the findings of prior research which suggest that the relationship between audit size and audit quality is not always straightforward (Hossain et al., 1994; Watts and Zimmerman, 1986).

Given the non-significant relationship in region 'b', it would be prudent for policymakers and corporate managers not to prioritize audit size as a key factor in shaping disclosure practices. Instead, focus should be on other aspects such as enhancing the quality of corporate governance and adapting to industry-specific disclosure norms. In region 'd', the coefficient for audit Size is -0.0075359, with a significant p-value of 0.000, indicating a substantial and statistically significant negative relationship. The negative coefficient in this region suggests that larger firms tend to have lower audit quality compared to smaller firms. This could be attributed to larger firms possibly having more complex operations and structures, which can lead to difficulties in maintaining high-quality of auditing, or a tendency to withhold information to maintain competitive advantage.

This finding is in line with some previous studies that highlight the challenges larger firms face in maintaining transparency (Lang and Lundholm, 1993). The significant negative impact in region 'd' suggests a need for enhanced scrutiny and regulatory frameworks targeting larger firms' disclosure practices. It may be beneficial for regulators to develop more stringent disclosure requirements for larger companies and for these firms to focus on improving their internal processes to enhance transparency. The analysis reveals a nuanced relationship between audit size and value relevance earnings, which varies significantly across different regions. In region 'b', audit size does not significantly influence audit quality, while in region 'd', larger audit size is associated with lower audit quality. These findings suggest that the impact of audit size on disclosure practices is contingent on various regional factors, including regulatory environment and industry characteristics. Policymakers and corporate governance experts should consider these regional differences when developing disclosure-related guidelines and regulations. This observation is consistent with broader corporate finance theories that suggest liquidity is just one aspect of a firm's financial health and operational stability impacting its disclosure practices (Healy and Palepu, 2001). For region 'd', firms should consider that while maintaining a healthy liquidity position is important, it does not necessarily translate into improved audit quality. Focus should also be given to other aspects of corporate governance and financial management that can more directly influence auditing practices.

This finding contributes to the ongoing debate in financial literature about the impact of financial reporting quality on auditing practices, with some studies suggesting that more profitable firms might be less motivated to disclose information comprehensively (Watson et al., 2002). Given the non-significant relationship, it's recommended that policymakers and companies in region 'b' should not rely solely on EA as a predictor of FRQ. Instead, a broader range of factors should be considered in efforts to enhance transparency and audit practices. In region 'd', the coefficient is -0.0082083, with a p-value of 0.050, indicating a negative relationship at the borderline of conventional significance levels.

Conclusion

The research is set against the backdrop of three pivotal Middle Eastern economies: Jordan, Saudi Arabia, and Egypt. The time frame for the study spans from 2013 to 2022, a period marked by significant economic and regulatory changes in these countries, making it an ideal setting for this investigation. The choice of these specific nations provides a rich, diverse, and yet comparably relevant context to explore the nuances of audit committee operations and their influence on disclosure practices in emerging markets. In the pursuit of robust and insightful findings, the study employs a dynamic panel threshold model. This advanced econometric technique is particularly suited to capture the complexities and dynamics of the relationship between audit committee effectiveness and voluntary disclosure quality.

However, to utilizing this model, the research aims to unearth the thresholds or critical points at which the effectiveness of audit committees begins to significantly influence the quality of voluntary disclosures. The summary of findings presented in this section not only reveals the intricate dynamics between the studied variables but also provides valuable insights into the broader implications of effective audit committees in enhancing transparency and trust in financial reporting. Finally, this study contributes significantly to the understanding of corporate governance and auditing practices in emerging markets, particularly in the Middle Eastern context. It highlights the complex, multifaceted relationships between various governance mechanisms and voluntary disclosure quality, emphasizing the importance of regional nuances and the need for context-specific approaches in corporate governance and auditing practices.

Theoretical and Contextual Contribution

The theoretical and Contextual Contribution of this study described, Legitimacy theory to include monitoring, bonding, and residual costs. In order to lower the corporate governance system must untangle the origins of these conflicts, thus the necessity to comprehend "agency theory. Legitimacy theory may be used to construct incentives by considering the agent's interests. Incentives for bad conduct must be eradicated, and moral hazard regulations must be implemented. Businesses may design better corporate policy by understanding issue processes. Therefore, if agency costs are correctly handled, it may assist boost share value and the firm's financial performance. The legitimacy theory discusses the independent variables corporate governance and audit committee effectiveness and seeks to create and monitor the relationship between shareholders and managers so as to achieve firm's objectives which is maximization of shareholders' wealth. Again, the theory is significant because it explains how conflicts of interest arise among various stakeholders, especially shareholders and managers. This theory elaborates on how this trade-off between agency costs contributes to the establishment of an optimal structure that balances the

interests of all stakeholders. This research uses legitimacy theory (LT) framework to examine the impact of audit effectiveness, representing the interest of corporate owners as a counter to the potential self-interest of management. According to agency theory, separation between the owner and manager, which results in the separation between ownership and control, subsequently leads to agency costs. In order to mitigate risk contracts written between the parties that Payne & Petrenko (2019).

Contributions of the Study

The results of objective under study makes key contributions to the literature on audit quality in Middle East North Africa, as it highlights the importance of evaluating a large number of firms. Most of the studies conducted in MENA have focused mostly on trading and services and manufacturing companies. Most of the previous studies did not take care of multicollinearity and serial and auto correlation effects on their variables under study. Such neglect cast doubt on the reliability of their findings. Arising from the above, the present study is the first study that examines the issue on a large scale which includes 128 firms and for a longer period of five years, resulting into 1280 firm-year observations. The data for this study were tested and appropriately corrected against errors that might lead to misspecification and misleading results, unlike the previous studies. It also highlights the role that specific variables play in promoting good auditing practices that will lead to higher performance. Thus, this study contributes to the existing literature by addressing the need to undertake a robust study worthy of being generalized.

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