

The Role of Audit Committee Independence and Size in Constraining Earnings Management and Enhancing Financial Performance: Evidence from Iraq

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Abstract

This study examines the impact of audit committee characteristics, specifically independence and size, on the financial performance of firms, with earnings management incorporated as a mediating variable. The analysis draws on a balanced panel of 35 non-financial firms listed on the Iraq Stock Exchange from 2011 to 2023. A two-step system Generalised Method of Moments (GMM) estimator, was applied to mitigate endogeneity, heterogeneity, and simultaneity concerns. The results reveal that audit committee independence is negatively and significantly associated with both accounting-based (ROA and ROE) and market-based (Tobin's Q) performance, while committee size shows a positive effect on ROA and ROE but a negative effect on Tobin's Q. Importantly, mediation analysis confirms that earnings management plays a significant indirect role: it diminishes the positive effect of committee size on profitability and amplifies the negative impact of independence on market valuation. These findings underscore that the influence of audit committee structures on firm performance operates not only directly but also indirectly through the channel of earnings management. Overall, this study advances corporate governance research in emerging markets by demonstrating that the effectiveness of audit committee attributes in Iraq is context-specific and closely tied to the presence of earnings manipulation. The findings carry practical implications for regulators and policymakers, highlighting the importance of strengthening audit committee oversight to curb earnings management and to safeguard sustainable financial performance.

Keywords: Audit Committee Characteristics, Earnings Management, Financial Performance

Introduction

Corporate governance has emerged as a cornerstone of modern financial research, particularly in emerging markets where institutional frameworks remain underdeveloped. Among the mechanisms designed to enhance governance, the audit committee plays a pivotal role in safeguarding the credibility of financial reporting and, ultimately, in promoting firm performance. Two of its key characteristics, independence and size, have been widely recognised as determinants of the committee's effectiveness in constraining opportunistic managerial behaviour. Nevertheless, the extent to which these attributes influence firms' financial performance remains a subject of debate, especially when earnings management is taken into account as an intervening mechanism.

From the perspective of agency theory, managers may be inclined to engage in earnings management to maximise their private benefits, even at the expense of shareholders (Jensen & Meckling, 1976). Independent and adequately sized audit committees can mitigate such agency conflicts by improving monitoring quality and ensuring greater transparency. Meanwhile, Resource Dependence Theory (Pfeffer & Salancik, 1978) emphasises that the size of the committee provides firms with access to broader expertise, networks, and resources, thereby strengthening oversight capabilities (Al-Matari, 2022). Combining these two theoretical lenses enables a more nuanced understanding of how audit committees impact financial performance (Majumder et al., 2024).

Despite extensive global literature, the context of Iraq has received limited scholarly attention. The Iraqi market is characterised by transitional institutional frameworks, concentrated ownership structures, and regulatory environments that are relatively weaker than those in developed countries. These conditions create a unique setting in which the effectiveness of audit committee independence and size on curbing earnings management and, consequently, on enhancing financial performance may differ significantly from developed economies. This gap underscores the importance of conducting empirical investigations that capture the dynamics of governance and reporting quality in Iraq.

Moreover, while most prior studies have employed traditional estimation methods such as pooled OLS, fixed effects, or random effects models, these approaches are often vulnerable to problems of endogeneity, heterogeneity, and simultaneity, which may bias results. To address these challenges, the present study adopts the two-step System Generalised Method of Moments (System-GMM) estimator. This advanced econometric technique provides more robust and efficient estimates by controlling for unobserved heterogeneity, dynamic relationships, and potential reverse causality. The application of System-GMM in this study, therefore, represents a methodological advancement over much of the prior literature.

Accordingly, the present study aims to examine the impact of audit committee independence and size on constraining earnings management and enhancing the financial performance of non-financial firms listed on the Iraq Stock Exchange. Specifically, it investigates both the direct and indirect relationships between audit committee characteristics (independence and size) and earnings management as well as financial performance by testing the mediating role of earnings management in this nexus. The scope of the study is confined to non-financial companies listed on the Iraq Stock Exchange over the period 2011–2023 to gain deeper

insights into how audit committee attributes operate within Iraq's unique economic and institutional environment.

By situating the analysis within the Iraqi context, this research fills a significant gap in the corporate governance literature and provides new insights into the mechanisms through which audit committee characteristics influence firm outcomes in emerging economies. Its novelty lies in integrating the dual perspectives of agency theory and resource dependence theory within a dynamic econometric framework to explain the interplay between audit committee attributes, earnings management, and firm performance. Thus, this study contributes to the advancement of knowledge in the social sciences by providing empirical and methodological evidence that strengthens the understanding of governance effectiveness in transitional markets, such as Iraq.

Theoretical Framework and Literature Review

Literature Review

Audit Committee Characteristics and Financial Performance

Audit committee (AC) independence is widely recognised as a key element of effective oversight, enhancing monitoring quality, strengthening internal controls, and reducing the risk of financial manipulation (Nikulin et al., 2022; Qader et al., 2023). While regulatory frameworks, such as the Iraq Code of Corporate Governance (2004), emphasise the inclusion of independent members, empirical evidence on their impact remains mixed. Some studies report that independence improves firm performance and mitigates conflicts of interest (Al-Matari, 2022; Altin, 2024; Bazhair, 2022; Hamada & Jwailes, 2021) whereas others find negative or insignificant effects (Al-Jalahma, 2022; Okeke, 2023; Pathiraja et al., 2023). These contrasting findings suggest that the influence of AC independence on performance is context-specific and continues to warrant further investigation.

Audit committee size is regarded as a critical factor influencing the effectiveness of corporate governance and financial performance. According to the Iraqi Corporate Governance Law of 2004, the committee must comprise at least three independent non-executive members, reflecting international standards such as the Sarbanes-Oxley Act of 2002. Larger committees generally provide broader expertise, resources, and perspectives, thereby improving the quality of oversight, reducing managerial opportunism, and strengthening internal controls (Altin, 2024; ElHawary, 2021; Hamada & Jwailes, 2021). Resource dependence theory also posits that an expanded audit committee enhances a firm's access to external knowledge and skills, which is particularly valuable in emerging markets like Iraq, where weak institutional frameworks heighten the need for strong internal monitoring. Empirical evidence suggests that appropriately sized committees can improve financial reporting credibility, constrain earnings management, and enhance both accounting-based (ROA, ROE) and market-based (Tobin's Q) performance indicators (Al-Okaily & Naueihed, 2020; Hezabr et al., 2023).

However, the positive effects of larger audit committees are not unconditional. Some studies caution that excessively large committees may hinder efficiency due to coordination difficulties, slower decision-making, and diluted accountability (Meah et al., 2021; Qeshta et al., 2021). In such cases, instead of enhancing oversight, committee enlargement may impair supervisory capacity and reduce governance effectiveness, with little or even negative impact on firm performance. This view aligns with the argument that governance effectiveness

depends less on size per se and more on the balance between diversity of expertise and operational efficiency (Bazhair, 2022). Therefore, while an adequately sized audit committee is expected to strengthen transparency and build investor confidence, particularly in Iraq's institutional context, the relationship between size and performance remains contingent upon achieving an optimal structure that avoids inefficiencies. Based on the previous discussions, the following hypotheses were formulated:

H1a: There is a positive relationship between AC independence and financial performance.

H1B: There is a positive relationship between AC size and financial performance.

Audit Committee Characteristics and Earnings Management

Audit committee independence is regarded as a cornerstone of corporate governance, as independent members are expected to perform their monitoring duties free from managerial influence and personal interests, thereby enhancing the credibility of financial reporting. From the perspective of agency theory, greater independence enables more rigorous scrutiny of accounting policies and financial estimates, thereby reducing the likelihood of opportunistic earnings manipulation and enhancing transparency. Prior evidence from both developed and emerging markets (e.g., Mardessi, 2021; Nikulin et al., 2022) consistently shows that higher proportions of independent directors are associated with lower levels of earnings management, thereby reinforcing the effectiveness of the audit committee in safeguarding shareholder interests. More recent studies highlight that this association is particularly relevant in emerging economies where external monitoring and legal frameworks are relatively weak, making audit committee independence an alternative governance mechanism to constrain managerial discretion (Ali & Murtaza, 2024; Bawuah, 2024).

Nevertheless, some evidence suggests that audit committee independence may not always achieve the intended effect, particularly in contexts characterised by weak regulatory enforcement or dominant managerial influence, where the impact of independence on earnings management may remain limited or even reversed (Galal et al., 2022; Tonye & Chimdikey, 2025). These mixed results underscore the complexity of the relationship between audit committee independence and earnings management and justify empirical testing in the Iraqi setting, where governance structures are still growing.

Audit committee size represents a fundamental structural attribute that shapes the effectiveness of its monitoring role. From the perspective of agency theory, larger committees are believed to enhance the board's ability to monitor management, mitigate conflicts of interest, and provide stronger collective oversight, which in turn constrains earnings management practices (Fama & Jensen, 1983). Similarly, resource dependence theory suggests that larger committees bring more diverse expertise and access to wider resources, which improves the quality of auditing and the capacity to detect manipulative financial reporting (Pfeffer & Salancik, 1978). Empirical studies provide supporting evidence. Phuong & Hong (2021) and Uddin (2022) documented that an increase in committee size is negatively associated with earnings management, while Udakumbura & Herath (2024) and Mardessi (2021) emphasised that appropriately sized committees improve reporting quality by curbing income smoothing. More recently, studies in emerging markets highlight that audit committee size strengthens monitoring effectiveness, especially when coupled with independence and accounting expertise (Ali & Murtaza, 2024; Galal et al., 2022; Qader et al., 2023).

On the contrary, some studies argue that excessively large committees may face coordination problems, which undermine their ability to act decisively. In such cases, an increase in committee size may not improve, and might even weaken, monitoring quality, allowing earnings management practices to persist (Ali, 2022; Almarayeh et al., 2022). Likewise, Tonye & Chimdike (2025) in Nigeria found no significant relationship between committee size and earnings management, suggesting that merely increasing numbers is insufficient. This contrasting evidence reflects the complex and context-dependent role of audit committee size, where the balance between diversity and efficiency determines its impact on financial reporting.

Based on evidence from previous studies, the following hypotheses were formulated:

H2a: There is a negative relationship between AC independence and earnings management.

H2b: There is a negative relationship between AC size and earnings management.

The Mediating Effect of Earnings Management

According to agency theory (Jensen & Meckling, 1976), managers may sometimes engage in earnings management to achieve personal benefits or to send misleading signals to the market, which could reduce the quality of financial reporting and weaken long-term performance. This underscores the importance of the audit committee as a monitoring mechanism that constrains managerial opportunism.

Previous studies have confirmed that audit committee independence enhances its ability to exercise effective oversight, which reduces managerial deviations in the preparation of financial statements and thereby lowers the level of earnings management, thereby improving the real financial performance of firms. Previous studies have shown that a higher proportion of independent members significantly reduces earnings manipulation and improves firm performance (Al-Matari, 2022; Almarayeh, 2024; Nikulin et al., 2022). In contrast, weak independence may allow greater tolerance toward opportunistic accounting practices, leading to the erosion of financial reporting credibility and the deterioration of performance indicators (Galal et al., 2022).

Similarly, audit committee size is associated with the extent of expertise diversity and task distribution. Having an adequate number of members enhances internal monitoring and the ability to detect earnings manipulation attempts. Empirical evidence suggests that an appropriately sized audit committee improves financial reporting quality and reduces manipulation (Altin, 2024; Qader et al., 2023). However, an excessively large committee may weaken internal coordination and create decision-making difficulties, thereby giving management more room to engage in earnings management (Okeke, 2023).

Accordingly, earnings management plays a mediating role between audit committee characteristics and financial performance. Independent and moderately large committees contribute to reducing accounting manipulation, which enhances reporting quality and strengthens long-term performance. Conversely, if these committees fail to mitigate earnings management, the expected positive effect of their independence and size on financial performance may diminish or even turn negative, particularly in terms of market value, due to the loss of investor confidence (Al-Jalahma, 2022).

Based on the above, this study assumes that earnings management mediates the relationship between audit committee characteristics (independence and size) and financial performance, whereby both the degree of committee independence and its size reduce or increase earnings management levels, which in turn directly affect firms' financial outcomes.

H3a: Earnings management mediates the relationship between AC independence and financial performance.

H3b: Earnings management mediates the relationship between AC size and financial performance.

Figure 1 illustrates the theoretical framework of the study.

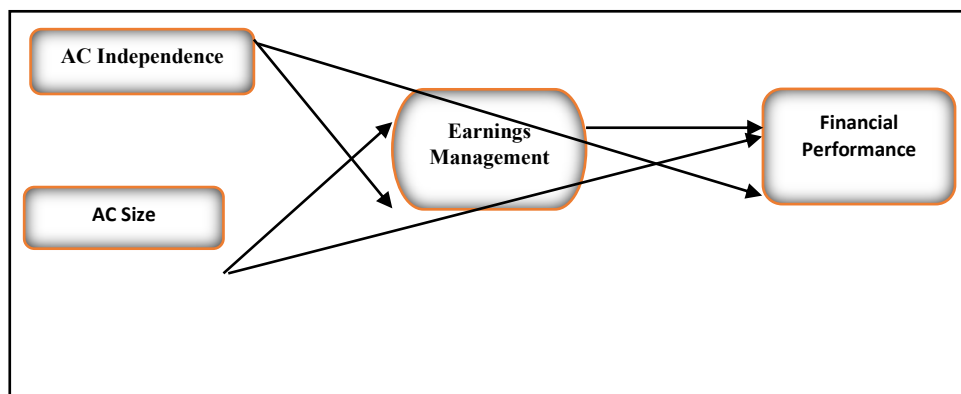


Figure 1. Theoretical Framework

Methodology

Selection of a Sample

This study employs a quantitative longitudinal design based on panel data to examine the impact of audit committee characteristics on financial performance, with earnings management as a mediating variable. The analysis covers a final sample of 35 non-financial firms listed on the Iraq Stock Exchange (ISX) over 13 years (2011–2023), which resulted in a total of 455 firm-year observations. Although the target population initially consisted of 87 non-financial companies, the number decreased due to missing governance and financial disclosures, resulting in a balanced and reliable sample. The choice of panel data enables capturing firm-specific heterogeneity, dynamic relationships over time, and addressing endogeneity concerns.

Variables and Measurement

Dependent Variable

Financial Performance: In this study, the accounting measures, return on assets and return on equity (ROA, ROE), were used to evaluate corporate performance. ROA and ROE have been used in several previous studies (Ahmed & Hågen, 2023; ElHawary, 2021). The market capitalisation/total asset (TQ) measure was also used (Al-ahdal & Hashim, 2022; Kamaludin et al., 2023) to assess firm performance.

Independent Variables

The main independent variable is the audit committee, which includes AC independence and AC size.

AC Independence: Following the literature, this study measures AC independence, the percentage of independent non-executive members on the audit committee (e.g. Al-Matari, 2022; Ali, 2024; Sakhil, Bajur, et al., 2025).

AC Size: In this study, the size of the audit committee is determined by the total number of members serving on it (Almarayeh et al., 2022). Prior research indicates that a larger audit committee is positively associated with enhanced audit quality and disclosure. A greater number of members provides the committee with a broader range of perspectives in terms of independence, gender diversity, professional expertise, and experience, thereby improving its overall effectiveness in ensuring high-quality audit outcomes (Altin, 2024; Bawuah, 2024; Musa et al., 2025).

Mediating Variable

Earnings Management: To measure earnings management, this study applies the Modified Jones Model (Dechow et al., 1995), which adjusts for changes in revenues and receivables as well as property, plant, and equipment (Sakhil et al., 2024). The model is specified as follows:

$$\frac{TAt}{At - 1} = a_1 \left(\frac{1}{At - 1} \right) + a_2 \left[\frac{(\Delta REV_t - \Delta REC_t)}{At - 1} \right] + a_3 \left(\frac{PPE_t}{At - 1} \right) + \varepsilon_{it}$$

Where:

- TA_{it}: Total accruals of firm i in year t.
- A_{it-1}: Total assets of firm i in year t-1.
- ΔREV_{it}: Change in revenues.
- ΔREC_{it}: Change in receivables.
- PPE_{it}: Property, plant, and equipment.
- ε_{it}: Error term.

The residuals from this regression represent discretionary accruals (DA), which are used as a proxy for earnings management.

Control Variables

Firm size: Consistent with prior studies, firm size is operationalised as the natural logarithm of total assets (Al-Ahdal et al., 2023), as shown in Table 1. Larger firms often have more complex structures and operations, which may increase both their incentives and opportunities to engage in earnings smoothing or inflate reported earnings (Bawuah, 2024). Conversely, some research indicates that managers of smaller firms are better able to withhold information compared to those in larger firms (Nikulin et al., 2022). Since information about large firms tends to be more publicly accessible and less costly to obtain (Almarayeh et al., 2022), they are subject to greater scrutiny from investors and regulators. Nevertheless, despite this enhanced monitoring, larger firms remain more likely to engage in earnings management than their smaller counterparts.

Sales growth: According to previous studies, sales growth is measured as the difference between current and previous year sales / Current year sales (Faisal et al., 2023), as shown in Table 1.

Financial leverage: Financial leverage is commonly measured as the ratio of total liabilities to total assets (Alsayani et al., 2023; Ali et al., 2025)

Prior research suggests that firms with higher levels of leverage tend to engage more actively in accrual-based earnings management to meet targeted financial outcomes (Bawuah, 2024).

Table 1

A summarised version of the study variables measurements

Variable	Measurement	References
ACIND	The percentage of independent non-executive members on the audit committee.	(Al-Matari, 2022; Ali, 2024)
ACSIZE	It is the total number of audit committee members.	(Almarayeh et al., 2022; Zarefar & Narsa, 2023)
ROA	Net income / Total assets	(Ahmed & Hågen, 2023)
ROE	Net income / Total equity	(Ahmed & Hågen, 2023; Qeshta et al., 2021; Ali et al., 2025)
TQ	Market capitalisation / Total assets	(Al-ahdal & Hashim, 2022)
EM	Modified Jones Model (discretionary accruals)	(Ayyed, 2024; Sakhil & Ali, 2022; Dechow et al., 1995)
FSIZE	Natural logarithm of total assets	(Al-Ahdal et al., 2023)
SG	The differences between current and previous year sales / Current year sales	(Faisal et al., 2023; Nipper, 2021)
LEV	Total liabilities / Total assets	(Alsayani et al., 2023; Sakhil, Bajuri, et al., 2025)

Model Specification

The study employs a two-step system, Generalised Method of Moments (System-GMM) (Arellano & Bover, 1995; Blundell & Bond, 1998) to estimate the relationships. This method is chosen to address dynamic endogeneity, firm-level heterogeneity, and simultaneity bias. Compared to OLS and fixed effects estimators, System-GMM is more appropriate for dynamic models as it mitigates biases from unobserved heterogeneity and simultaneity. Additionally, robustness checks are conducted by estimating alternative models (Difference-GMM), testing multicollinearity using VIF, and examining residual properties.

The models are specified as follows:

1. Direct effect of audit committee characteristics on financial performance:

$$FP_it = \beta_0 + \beta_1 ACIND_it + \beta_2 ACSIZE_it + \beta_3 FSIZE_it + \beta_4 SG_it + \beta_5 LEV_it + \epsilon_it$$

2. Direct effect of audit committee characteristics on earnings management:

$$EM_it = \beta_0 + \beta_1 ACIND_it + \beta_2 ACSIZE_it + \beta_3 FSIZE_it + \beta_4 SG_it + \beta_5 LEV_it + \epsilon_it$$

3. Mediating role of earnings management:

$$FP_it = \beta_0 + \beta_1 ACIND_it + \beta_2 ACSIZE_it + \beta_3 EM_it + \beta_4 FSIZE_it + \beta_5 SG_it + \beta_6 LEV_it + \epsilon_it$$

Estimation Diagnostics

Sargan/Hansen Test: To verify the validity of the instruments. Arellano–Bond AR (2) Test: To confirm the absence of second-order serial correlation. Additional diagnostic checks, such as the variance inflation factor (VIF), are applied to ensure the absence of multicollinearity. The combination of these procedures ensures the robustness and reliability of the System-GMM estimation results.

Data Analysis and Results

Descriptive Statistics

The descriptive statistics in Table 4.1 reveal notable variation across the study variables. Firm performance indicators suggest weak profitability overall, as the mean ROA (−0.030) and ROE (0.050) indicate that several firms incurred losses, while Tobin's Q (mean = 3.514) reflects considerable disparities in market valuation among firms. Regarding audit committee characteristics, independence is relatively high (mean = 0.903), implying that most Iraqi listed companies maintain committees dominated by independent directors, consistent with international governance principles. By contrast, audit committee size is modest and homogeneous (mean = 1.899), suggesting that committees are relatively small and may face constraints in fulfilling their monitoring role effectively. Earnings management shows a moderate presence (mean = 0.119), with some firms displaying substantial manipulation of reported earnings. Control variables also exhibit heterogeneity: firm size is stable (mean = 22.348), sales growth varies widely (−1.000 to 60.971), and leverage (mean = 0.543) ranges from firms with negligible debt to those with heavy reliance on external financing. Collectively, these findings highlight that while audit committees in Iraq are generally independent, their limited size may constrain oversight capacity, underscoring the importance of examining how these governance mechanisms influence earnings management and financial performance.

Table 4.1

Descriptive Statistics

Variable	Mean	Std. Dev	Minimum	Maximum
ROA	-0.03	0.335	-4.339	0.338
ROE	0.05	0.598	-4.091	2.786
TQ	3.514	5.403	0.0	33.658
ACIND	0.903	0.104	0.571	1.0
ACSIZE	1.899	0.157	1.609	2.485
EM	0.119	0.155	0.0	1.428
FSIZE	22.348	1.373	18.996	27.049
SG	1.137	7.132	-1.0	60.971
LEV	0.543	1.125	0.004	8.697

Correlation Analysis

The simplified correlation matrix in Table 4.2 presents relationships among firm performance (ROA, ROE, Tobin's Q), earnings management (EM), audit committee characteristics (ACIND and ACSIZE), and control variables (FSIZE, SG, LEV). Audit committee independence (ACIND) is positively and significantly associated with Tobin's Q ($r = 0.191$, $p < 0.05$), suggesting that independence enhances market valuation by increasing monitoring credibility. ACIND also shows a negative, though insignificant, correlation with earnings management ($r = -0.159$), consistent with its expected monitoring role. Audit committee size (ACSIZE) demonstrates significant positive correlations with both ACIND ($r = 0.501$, $p < 0.05$) and firm size ($r = 0.422$, $p < 0.05$), indicating that larger firms are more likely to maintain bigger and more independent committees. However, ACSIZE itself does not display meaningful correlations with profitability or earnings management, implying that size alone may not ensure effective oversight. Overall, these results highlight independence as a more critical determinant of governance quality than size.

Table 4.2

Pairwise Correlation (Focused on ACIND & ACSIZE)

	ROA	ROE	TQ	ACIND	ACS	EM	SIZE	SG	LEV
ROA	1								
ROE	0.196*	1							
TQ	-0.162*	0.113	1						
ACIND	-0.032	0.064	0.191*	1					
ACSIZE	-0.039	0.007	0.104	0.501*	1				
EM	-0.068	0.010	0.053	-0.159	-0.137	1			
FSIZE	0.152	0.028	-0.231	0.404*	0.422*	-0.040	1		
SG	0.009	-0.007	0.005	-0.013	-0.086	0.018	-0.024	1	
LEV	-0.55*	0.061	0.155	0.097	0.114	0.072	-0.117	-0.05	1

* Correlation is significant at the 0.05 level.

Empirical Results

The results in Table 4.3 indicate that Audit Committee Independence (ACIND) has a significant negative effect on ROA ($\beta = -1.130$, $p < 0.01$), suggesting that firms with more independent committees may report lower returns on assets, possibly due to stricter oversight limiting short-term earnings. Conversely, Audit Committee Size (ACSIZE) has a positive and significant impact ($\beta = 0.247$, $p < 0.05$), indicating that larger committees strengthen monitoring capacity and improve ROA. Among control variables, firm size shows a positive relationship with ROA, while leverage is strongly negative, highlighting the detrimental effect of debt. Model diagnostics (Sargan, AR (2)) are satisfactory, supporting the robustness of the results.

Table 4.3

(GMM Model for ROA) Based on Hypotheses H1a-H1b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1.ROA	0.005	0.005	1.150	0.250
ACIND	-1.130	0.191	-5.920	0.000
ACSIZE	0.247	0.123	2.010	0.044
FSIZE	0.154	0.028	5.410	0.000
SG	0.001	0.001	1.240	0.215
LEV	-0.230	0.009	-25.760	0.000
_cons	-2.723	0.756	-3.600	0.000
Sargan test	0.5058	AR (2)	0.159	
Wald Chi2	14773.05	Prob	0.000	

The results in Table 4.4 indicate that Audit Committee Independence (ACIND) has a strong negative and significant influence on ROE ($\beta = -1.862$, $p < 0.01$), reinforcing the notion that stricter monitoring reduces reported equity returns. Audit Committee Size (ACSIZE), however, is positive and significant ($\beta = 0.382$, $p < 0.01$), suggesting that larger committees enhance ROE by improving the quality of financial reporting. Sales growth (SG) negatively affects ROE, while leverage has a positive impact, and firm size remains a key determinant of higher returns. Model fit is strong, as reflected by the Wald Chi-square and diagnostic tests.

Table 4.4

(GMM Model for ROE) Based on Hypotheses H1a-H1b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1.ROE	-0.223	0.006	-38.280	0.000
ACIND	-1.862	0.252	-7.370	0.000
ACSIZE	0.382	0.148	2.590	0.010
FSIZE	0.243	0.032	7.620	0.000
SG	-0.001	0.000	-3.020	0.003
LEV	0.133	0.013	10.280	0.000
_cons	-3.789	0.725	-5.220	0.000
Sargan test	0.308	AR (2)	0.302	
Wald Chi2	144912.34	Prob	0.000	

The results in Table 4.5 indicate that, unlike accounting-based measures, Audit Committee Independence (ACIND) is not statistically significant for Tobin's Q ($\beta = -3.170$, $p > 0.05$), implying that independence is not directly valued by the market in the Iraqi context. Audit Committee Size (ACSIZE), however, exhibits a negative and significant effect ($\beta = -5.290$, $p < 0.01$), indicating that larger committees may be perceived as inefficient by the market, thus lowering firm valuation. Firm size and sales growth are also negatively related to market value, while leverage shows a positive and significant association. These results reflect the unique dynamics of the Iraqi market, where debt financing may be viewed more favourably by investors.

Table 4.5

GMM Model for Tobin's Q (TQ) Based on Hypotheses H1a-H1b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1. TQ	0.458	0.047	9.700	0.000
ACIND	-3.170	2.253	-1.410	0.159
ACSIZE	-5.290	1.487	-3.560	0.000
SIZE	-4.753	0.327	-14.520	0.000
SG	-0.037	0.005	-7.510	0.000
LEV	0.809	0.110	7.380	0.000
_cons	121.152	8.866	13.660	0.000
Sargan test	0.4974	AR (2)	0.8283	
Wald Chi2	8.91e+06	Prob	0.000	

Table 4.6 presents the GMM estimation results for the effect of audit committee independence (ACIND) and audit committee size (ACSIZE) on earnings management (EM). The lagged dependent variable (L1.EM = 0.146, $p < 0.01$) is positive and significant, confirming the persistence of earnings management practices over time in Iraqi listed firms.

With respect to the audit committee characteristics, both independence and size show statistically insignificant effects on EM. Specifically, ACIND displays a positive but non-significant coefficient ($\beta = 0.036$, $p > 0.05$), suggesting that although independent members are present in most audit committees, their monitoring role does not translate into a meaningful reduction in earnings manipulation within the Iraqi institutional setting. Similarly,

ACSIZE is negative but insignificant ($\beta = -0.037$, $p > 0.05$), implying that merely enlarging the number of committee members does not improve its effectiveness in constraining opportunistic financial reporting. These findings indicate that the quality of oversight mechanisms may be more crucial than the numerical size or formal independence in this emerging market context.

Among the control variables, firm size (FSIZE) shows a significant negative association with EM ($\beta = -0.039$, $p < 0.01$), consistent with the notion that larger firms are subject to stronger external scrutiny and adopt stricter governance practices. Sales growth (SG) also exerts a significant negative effect ($\beta = -0.001$, $p < 0.01$), while leverage (LEV) reduces EM ($\beta = -0.013$, $p < 0.01$), suggesting creditor monitoring plays a disciplining role.

The model diagnostics confirm robustness: the Sargan test ($p = 0.506$) validates instrument exogeneity, the AR (2) statistic ($p = 0.471$) confirms the absence of second-order autocorrelation, and the Wald Chi² test (1725.94, $p < 0.01$) indicates joint significance of the model.

Ob – 2 - Table 4.6

GMM Model for EM Based on Hypotheses H2a-H2b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1.EM	0.146	0.031	4.670	0.000
ACIND	0.036	0.051	0.700	0.484
ACSIZE	-0.037	0.071	-0.530	0.599
FSIZE	-0.039	0.010	-3.890	0.000
SG	-0.001	0.000	-3.250	0.001
LEV	-0.013	0.005	-2.610	0.009
_cons	1.155	0.272	4.250	0.000
Sargan test	0.5055	AR (2)	0.471	
Wald Chi2	1725.94	Prob	0.000	

The results in Table 4.7 show that audit committee independence (ACIND) has a strong and significant negative effect on return on assets (ROA) ($\beta = -1.438$, $p < 0.01$). This suggests that, in the Iraqi context, higher levels of independence in audit committees may not directly enhance accounting-based performance, possibly due to formal independence without substantive oversight. Audit committee size (ACSIZE) has a positive but insignificant effect on ROA ($\beta = 0.201$, $p > 0.05$). Earnings management (EM) demonstrates a negative and significant impact on ROA ($\beta = -0.209$, $p < 0.01$), confirming its role as a mediator that reduces financial performance. Control variables such as firm size positively affect ROA, while leverage exerts a strong negative impact, consistent with theoretical expectations. Model diagnostics (Sargan test $p = 0.432$; AR (2) $p = 0.136$) confirm instrument validity and absence of second-order autocorrelation, while the Wald test indicates strong joint significance of the model.

Ob – 3 - Table 4.7

(GMM Model for ROA) Based on Hypotheses H3a-H3b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1.ROA	0.003	0.005	0.490	0.626
ACIND	-1.438	0.118	-12.150	0.000
ACSIZE	0.201	0.157	1.280	0.202
EM	-0.209	0.031	-6.760	0.000
FSIZE	0.155	0.029	5.370	0.000
SG	0.001	0.001	0.970	0.332
LEV	-0.225	0.010	-22.490	0.000
_cons	-2.338	0.736	-3.180	0.001
Sargan test	0.432	AR (2)	0.136	
Wald Chi2	15288.23	Prob	0.000	

Table 4.8 reports the effect of audit committee independence and size on return on equity (ROE). The coefficient of ACIND is negative and significant ($\beta = -2.052$, $p < 0.01$), indicating that greater independence reduces ROE, which may reflect overly stringent monitoring that constrains managerial flexibility. By contrast, ACSIZE shows a positive and significant effect on ROE ($\beta = 0.323$, $p < 0.05$), suggesting that larger audit committees contribute to improved accounting-based profitability. Shows earnings management (EM) is not significant ($\beta = -0.036$, $p > 0.05$), implying that its mediating role is weaker for ROE. Firm size remains a strong positive determinant of ROE, while sales growth and leverage demonstrate significant effects in the expected directions. Model diagnostics confirm the validity and robustness of the estimates (Sargon test $p = 0.207$; AR (2) $p = 0.299$).

Table 4.8

(GMM Model for ROE) Based on Hypotheses H3a-H3b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1.ROE	-0.222	0.011	-19.390	0.000
ACIND	-2.052	0.332	-6.180	0.000
ACSIZE	0.323	0.141	2.290	0.022
EM	-0.036	0.044	-0.810	0.420
FSIZE	0.246	0.036	6.910	0.000
SG	-0.001	0.000	-4.980	0.000
LEV	0.134	0.017	8.110	0.000
_cons	-3.481	0.704	-4.950	0.000
Sargon test	0.207	AR (2)	0.299	
Wald Chi2	2.96e+06	Prob	0.000	

Table 4.9 presents the results for market-based performance (Tobin's Q). The findings show that ACIND has a negative and significant effect on TQ ($\beta = -2.811$, $p < 0.05$), while ACSIZE exerts a strong negative impact ($\beta = -7.804$, $p < 0.01$). This indicates that both independence and larger audit committees are associated with lower market valuation in Iraq, which contrasts with theoretical expectations but may reflect inefficiencies in governance practices in emerging markets. Earnings management (EM) also shows a negative and significant effect on TQ ($\beta = -1.130$, $p < 0.01$), highlighting the detrimental role of earnings manipulation in

market valuation. Firm size and sales growth negatively affect TQ, whereas leverage has a significant positive effect. Diagnostic tests confirm the reliability of the model (Sargon test $p = 0.325$; AR (2) $p = 0.789$; Wald χ^2 significant).

Table 4.9

(GMM Model for TQ) Based on Hypotheses H3a-H3b

Variable	Coefficient	Std. Error	z. Statistic	Prob
L1. TQ	0.471	0.038	12.420	0.000
ACIND	-2.811	1.143	-2.460	0.014
ACSIZE	-7.804	1.998	-3.910	0.000
EM	-1.130	0.348	-3.250	0.001
FSIZE	-4.768	0.308	-15.480	0.000
SG	-0.035	0.008	-4.480	0.000
LEV	0.788	0.107	7.330	0.000
_cons	126.783	6.609	19.180	0.000
Sargan test	0.3253	AR (2)	0.789	
Wald χ^2	350352.75	Prob	0.000	

Discussion of Results

This study aimed to examine three main objectives: first, to verify the relationship between AC characteristics (ACIND, ACSIZE) and firm performance (ROA, ROE, and TQ); second, to verify the relationship between AC characteristics (ACIND, ACSIZE) and earnings management; and third, to determine the mediating effect of earnings management in the relationship between AC characteristics and firm performance (ROA, ROE, and TQ). The results provide a comprehensive understanding of how audit committee characteristics shape firm performance within the Iraqi context.

Hypotheses H1a–H1b (direct effect on financial performance). For H1a, we hypothesised a positive effect of audit committee independence (ACIND) on financial performance. However, the findings reveal a significant negative effect on ROA, ROE, and Tobin's Q. Thus, H1a is not supported. This implies that in Iraq, formal independence does not necessarily enhance performance and may even be perceived by investors as ineffective when not accompanied by an audit committee that includes diversity in terms of experience, skill, and gender (Okeke, 2023; Pathiraja et al., 2023) for H1b, we hypothesised a positive effect of audit committee size (ACSIZE). The results partially support this hypothesis: ACSIZE has a positive and significant effect on ROA and ROE, confirming H1b is acceptable in terms of accounting-based measures, which is consistent with (Altin, 2024; ElHawary, 2021). However, ACSIZE shows a negative and significant effect on Tobin's Q, contradicting the expected positive association. Hence, H1b is partially supported.

Hypotheses H2a–H2b (direct effect on earnings management). For both independence and size, we hypothesised a negative effect on earnings management (EM), expecting that greater independence and larger committees would constrain manipulation. However, the results show that neither ACIND nor ACSIZE has a statistically significant effect on EM. Thus, H2a and H2b are not supported. This suggests that in the Iraqi setting, these attributes alone do not meaningfully curb opportunistic reporting, consistent with evidence from emerging markets (Galal et al., 2022; Tonye & Chimdike, 2025).

Hypotheses H3a–H3b (mediating effect of earnings management). When incorporating EM as a mediator, the results reveal important indirect pathways. For H3a, we hypothesised that the negative influence of independence on EM would transmit to performance. The results show that EM indeed mediates this relationship, leading to further negative effects on ROA and Tobin's Q. This confirms the mediating role, but in the opposite direction of our expected positive effect. Hence, H3a is partially supported. For H3b, we hypothesised that committee size would reduce EM and thereby improve performance. The results show that once EM is included, the previously positive effect of ACSIZE on ROA disappears, while the negative effect on Tobin's Q becomes stronger. This indicates that EM partially mediates the ACSIZE performance relationship.

Conclusion

The findings reveal that while audit committee size appears to enhance accounting-based financial performance, this positive effect diminishes once earnings management is taken into account, suggesting that opportunistic practices offset the potential benefits of larger committees. In contrast, audit committee independence consistently exerts a negative influence on performance, both directly and indirectly through earnings management. These results indicate that, within the Iraqi context, audit committee characteristics do not function as predicted by established governance theories. Instead, their effectiveness is constrained by weak institutional enforcement mechanisms, which undermine the anticipated role of audit committees in improving governance outcomes.

Limitations and Recommendations

While this study contributes meaningful evidence on the role of audit committee characteristics in shaping earnings management and financial performance within Iraqi firms, it is not without certain limitations. First, the analysis was confined to 35 non-financial firms listed on the Iraq Stock Exchange between 2011 and 2023, which restricts the applicability of the findings to other sectors, particularly financial institutions or privately held companies. Second, performance was measured solely through conventional financial indicators (ROA, ROE, and Tobin's Q), leaving out broader non-financial dimensions such as sustainability practices, stakeholder engagement, or corporate social responsibility initiatives. Third, the scope of governance variables was limited to two specific audit committee attributes, independence and size, while other potentially influential factors, including meeting frequency, member busyness, age, education, or professional background, were not examined. In addition, the institutional setting of Iraq, characterised by underdeveloped market structures and relatively weak enforcement mechanisms, makes the evidence more context-specific and less transferable to other emerging economies.

Future research could address these limitations by broadening the sample to include different industries and firm types, incorporating both financial and non-financial metrics for a more holistic assessment of performance, and extending the set of audit committee characteristics under investigation. Cross-country comparative studies among emerging markets are also recommended to identify common patterns and unique country-specific governance dynamics. Moreover, complementing quantitative analysis with qualitative approaches, such as interviews, surveys, or field-based case studies, may enrich understanding of how audit committees function in practice and uncover contextual factors that shape their effectiveness.

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