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Corporate Governance Dynamics in Saudi Arabia: Audit Committee Composition, Family Ownership, and Financial Performance

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Abstract

The purpose of this research is to examine how the audit committee composition, focusing on independence and the presence of external financial experts, impacts a firm's performance metrics (Tobin's-Q and Return on Equity-ROE) in the Kingdom of Saudi Arabia (KSA). Additionally, the study aims to understand how family ownership influences this relationship. The research undertook ordinary least squares (OLS) regression analysis on a dataset comprising 485 firm-year observations. The results show a positive association between having independent directors on the audit committee (AudC) and both Tobin's-Q and ROE. When the audit committee includes external financial experts, it is linked to a higher ROE but a lower Tobin's-Q. However, the presence of family ownership acts as a negative moderator in these associations, counteracting the positive effects of the audit committee's composition on firm performance. This indicates that, in certain institutional settings, investors view audit committee independence as detrimental, impacting their assessment of the firm's value. This study sheds light on the nuanced understanding of how the composition and utilization of audit committees play out in a specific institutional context, especially within public family-owned firms. It emphasizes the need for a careful consideration of audit committee composition, tailored to the unique business environment of the firm. Regulatory requirements aimed at safeguarding non-family investors may not align well with the dynamics of family businesses. This research significantly contributes to the understanding of corporate governance and its application in family-owned enterprises.

Keywords: *Audit Committee, Family Business, Saudi Arabia, Independence, Institutional Context, External Financial Experts.*

Introduction

Audit committees (hereafter, AudC) play an important role in the implementation of corporate governance principles and in increasing the quality of information (Al-okaily & Naueihed, 2019), executing the board's mandate of monitoring a firm's management, overseeing financial reporting and auditing (Kamaludin et al., 2023; Alzeban, 2020; Zalata and Roberts, 2016; Carcello et al., 2008; Chaudhry et al., 2020), and deterring fraudulent conduct by managers (Piot, 2004; Jung et al., 2012). The committee generally acts as a link between the Board of Directors (BOD) and internal and external auditors, thus mitigating any probable asymmetric information. AudC's may also provide further

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protection in countering fraud, negligence, or misconduct by monitoring and overseeing the effectiveness of internal controls, audits, and documentation. Ultimately, this enhances the quality of financial performance and reporting. An effective AudC is also expected to lessen the likelihood of default by means of enhanced risk control and by communicating the significance of such risks to all stakeholders. In fact, the Treadway Report also recommends that audit committees should be informed, vigilant, and effective overseers of the financial reporting process and the company's internal controls' (p.41).

To this end, the existence of independent AudC members and financial experts is an important determinant of quality AudC and effective overseers (Frankel et al., 2002 and Krishnamurthy et al., 2006). Independence is considered crucial for the effective monitoring of an AudC, as it authorizes a higher level of inspection and integrity (Fama, 1980; Klein, 2002a). An independent AudC is also intended to reduce information asymmetries among all stakeholders, facilitate auditor independence, and mediate any probable conflicts between the auditor and the top management. On the other hand, the presence of financial experts is fundamental, mainly to monitor accounting and financial matters, internal controls, and audit risks, and to effectively communicate with internal and external auditors (Maines et al., 2001). Krishnan and Visvanathan (2007) and Naiker and Sharma (2009) show that the existence of financial experts in an AudC positively affects financial reporting.

Though several studies have been undertaken on AudC, most studies have examined the role of AudC indirectly via accruals (e.g. Bedard, Chtourou, & Courtean, 2004; Carcello et al., 2009; Dhaliwal et al., 2010; Klein, 2002a), fraud and financial misreporting (e.g. Agrawal & Chadha, 2005; Beasley, 1996), internal control weaknesses (Zhang et al., 2007), accounting conservatism (Krishnan & Visvanathan, 2008), and the cost of debt (Anderson, Mansi, & Reeb, 2004). Furthermore, research on AudC has been undertaken in countries with relatively strong regulatory and legal environments. The influence of institutional and ownership contexts in which an audit body operates and how they may affect a firm's reported financial performance has largely been ignored (Kamaludin et al., 2020; Ter Bogt and Tillema, 2016; Darmadi, 2016). To further address this issue, the Kingdom of Saudi Arabia (hereafter, KSA) is used as the institutional context of this study. KSA is characterized by concentrated ownership, with due importance given to informal relationships in business matters (Al-Bassam et. al., 2018). Empirical studies on the influence of specific governance mechanisms (specifically, the use and characteristics of board-level audit committees) in this context are sparse. Family owners develop relatively idiosyncratic capabilities in their businesses that are said to account for their competitive and entrepreneurial advantage (Sirmon and Hitt, 2003; Short, Payne, Brigham, Lumpkin, and Broberg, 2009; Ward et al., 1987) which in turn is linked to their particularistic governance (Carney, 2005).

The impact of family ownership on the characteristics of specific committees of the board, such as AudC, and their effect on family firms' financial performance, has not been fully investigated. The paucity of research in this area is particularly surprising given that family businesses are considered the dominant type of economic organization (Imran et al. 2021), and a key driver of economic growth and wealth creation around the world (Spanos et al., 2008), and these executive committees are attributed with performing several important governance tasks as the operating arms of the board of directors (De Kluyver, 2009). In this specific institutional context, the competency and reputation of family owners, rather than the degree of formal compliance with the corporate governance (CG) codes, may matter more in delivering financial performance. This may alter the association between AudC independence, the presence of financial experts, and firm performance. Thus, Saudi Arabia serves as a relatively novel and distinct context to study the formulation and effects of AudC among institutionally embedded family businesses and further contextualize the current works on the effectiveness of AudC composition and firm performance.

This study, in line with other studies incorporating the context of AudC composition and its effectiveness (e.g. Ter Bogt and Tillema, 2016; Chaudhry et al., 2020), as well as responding to calls to employ theoretical perspectives beyond agency theory (Carrera et al., 2017), we test the sensitivity of firm performance to AudC composition (i.e., independence and presence of external financial experts) and the moderating role of family ownership in the Saudi Arabia Stock Exchange (Tadawul). Therefore, we extend the understanding of the performance effect of AudC composition as well as governance in family businesses.

The findings of the study have several practical implications. First, the findings of this research can help guide current efforts to improve corporate governance in Saudi Arabia by shaping regulatory reforms. Emphasizing governance characteristics could improve corporate performance, as it promotes best practices, openness, and accountability. In addition, the study investigates the association between family ownership and governance, which could lead to more specific policies for family-owned enterprises. Second, the study could provide investors and shareholders valuable insights into the impact of AudC independence, the presence of financial experts, and family ownership on firm performance. The presence of AudC and external financial experts may assist individuals in making more informed investment decisions and strengthen investors' confidence in the governance structures of companies. Thirdly, the research can provide a deeper comprehension of best practices for business owners, particularly those in controlling family-owned businesses, with regard to the AudC composition of their organizations. It may demonstrate the potential benefits of incorporating independent directors and external financial experts into their governance structures, leading to enhanced corporate governance and strategic decision-making. In summary, this research has the potential to offer enhanced understanding and recommendations that can benefit a wide range of stakeholders, from academia and policymakers to investors, business owners, and society as a whole, ultimately contributing to improved corporate governance and firm performance in the Kingdom of Saudi Arabia.

The rest of the paper is organized as follows. Section 2 builds the hypotheses, and Section 3 introduces the data and variables. The results are presented in section 4, and section 5 concludes the study.

Literature Review and Hypotheses Development

Cultural, Institutional and Regulatory Background in KSA

Saudi Arabia's Corporate Governance Regulation outlines specific requirements for corporate governance practices. It mandates compliance on a 'comply or explain' basis. The composition of AudC must adhere to certain criteria, including having at least one independent director, no executive directors, a board size of not less than 3 and not more than 5 directors, and one member with financial expertise. Additionally, the chairman must be an independent director. The regulation recommends the inclusion of a finance and accounting expert, as well as someone with financial literacy, though they need not be part of the BOD. The regulation addresses external audits by providing guidelines for nominating and overseeing external auditors, ensuring their independence, and reviewing their scope of work. Regarding internal controls, it emphasizes the examination and review of internal financial control systems and risk management, analysis of internal audit reports, corrective action implementation, and monitoring of internal auditor performance. Recommendations for appointing the internal audit manager are also included.

While the formal AudC requirements for Saudi Arabia do not differ from international guidelines or those in countries with well-developed capital markets (Sharma et al., 2000), KSA's Corporate Governance Regulation shows the country's peculiar cultural identity. A highly tiered social order, wherein informal relationships are usually given considerable priority over structured governance and accountability measures such as executive committees (Al-Twaijry et al., 2002; Haniffa and Hudaib, 2007; Hussainey and Al-Nodel, 2008). The Saudi corporate climate has also been differentiated by consolidated ownership structures (usually through the Saudi government and family members), restricted foreign share ownership, and low institutional ownership (AlBassam et al., 2018). Some authors have claimed that the ownership characteristics of a country account for the inadequate involvement of owners, thus hindering the execution and administration of corporate governance regulations (Al-Razeen and Karbhari, 2004; Al-Twaijry et al., 2002; Piesse et al., 2012;). The next section develops the hypotheses to be tested.

Independent Directors in AC

AudCs are generally responsible for providing oversight on a firm's internal controls, internal and external audits, integrity of financial statements, and effective communication of all financial matters with the BODs (Hela Gontara et al, 2022). AudC independence warrants impartiality in monitoring the transparency of financial reports and any possible prejudice towards the executive, concurrently mitigating the presence of agency problems and protecting minority shareholders' interests (Alleyne et al., 2006). It has also been recommended that AudCs maintain their independence and require quality audits because of the board's legal liability and the risk of reputational loss (Abbott and Parker, 2000a). Non-affiliated, independent directors are considered critical to the independence of an AudC as they may reduce information asymmetry (Woidtke and Yeh, 2013) via more active information seeking and evaluation, which may improve the monitoring of financial reporting (Choi et al., 2004).

AudC independence is a central AudC characteristic; however, extant literature has somewhat mixed outcomes. Several studies posit a direct and positive association between AudC independence and accounting performance (Abbott et al., 2004; Karamanou and Vefeas, 2005; Wan Ismail et al., 2009; Ghafran and O'Sullivan, 2013; Hamdan et al. (2013); Sarpal, 2017; and Dakhlallh et al., 2020). With reference to agency theory, Kallamu and Saat, (2015) conjectured that independent directors contribute towards minimizing opportunistic behavior by the management, via active monitoring, thus enhancing profitability. This is further supported by Chan and Li (2008), Yeh et al. (2011), and Woidtke and Yeh (2013), who report that independent AudCs underwrite valuable accounting earnings. In addition, extant literature establishes that the more independent the AudC, the lower the probability of financial restatements (Bronson et al., 2009), earnings management (Davidson et al., 2005 and Zgarni, 2016), reporting of abnormal accruals (Klien, 2002b), consecutive losses (Klein 2002a) or fraudulent reporting (Abbot and Parker, 2000). Conversely, less independent AudCs have been linked to companies that commit financial fraud (Beasley et al., 2000).

However, evidence of the positive effects of independent AudC is not unequivocal; studies have found an inverse relationship between AudC independence and firm performance (Leung et. al., 2014; Barka and Legendre, 2017; Mohammed, 2018). There are questions about whether AudCs actually perform the entire gamut of their explicit and implied duties (Beattie et al., 2012, 2014). Research indicates that stakeholders related to the organization may have greater business- or industry-specific knowledge, which may improve the success of a director (Kiel and Nicholson, 2003). Arguments have also been made that market values inside board members (Klein, 1998; Bhagat and Black, 2002) for their firm-specific knowledge and expertise. Bhagat and Black (2002) found no relationship between the ratio of outsiders to insider board members and firm performance. These findings suggest that insider AudC members who are not totally independent may have better information to execute their responsibilities more effectively on the AudC committee.

Our specific research site, the KSA, is an environment with strong hierarchical social norms that are embedded in family, tribal, and personal relationships (Al-Bassam, 2018). In this scenario, AudC independence is likely to enhance firm performance by acting as an effective monitoring tool, upholding the accuracy of financial records, and minimizing conflicts of interest between owners and managers, ultimately adding value to the company. The presence of independent directors in such an environment may enhance internal control, which is an integral component of firm performance and the active monitoring of management decisions. Monitoring reporting quality through independent AudCs also enhances firm performance (Wild, 1996). An independent AudC would be competent in the selection of external auditors and supervision of the audit process as a whole, thus contributing to high-quality financial statements and reduced earnings management. Therefore, we tested the efficacy of AudC independence in KSA using the following hypothesis:

H_1: There exists a direct association between independent directors in the AudC and financial performance.

External Financial Experts in AC

Global financial crises and corporate scandals have spearheaded the need for financial experts on AudCs (Güner et al., 2008). Studies have shown that financial expertise and experience can facilitate monitoring activities in firms (e.g., Kim et al., 2014). However, while independent directors in an AudC provide the context for greater monitoring and objectivity, their monitoring may not be as effective if they are not too knowledgeable about accounting and financial principles. In KSA, Corporate Governance Regulations mandate the appointment of a minimum of one associated with financial expertise in an AudC, but firms have leeway to choose whether this expertise is an external member or an internal, affiliated member. The extant literature on external financial experts provides evidence that the existence of external financial experts in an AudC hinders earnings management (Nelson and Devi, 2013), internal control oversight (Krishnan and Lee, 2009), improves the superiority of financial reporting, increases audit effectiveness (Abbot et al., 2003, 2004 ; Kallamu and Saat, 2015; Iyer et al, 2013), reduces the likelihood of fraudulent financial reporting (Beasley et al., 2000; Raghunandan et al., 2001), and decreases debt costs (Anderson, Mansi, & Reeb 2004), effectively contributing to firm performance. Studies by, Hamid and Aziz (2012) and Hamdan et al., (2013) and Al-Okaily & Naueihed, (2019) add further evidence on the positive impact of financial experts on AudC and firm performance. In addition to the aforementioned, these experts would also want to protect and sustain their own reputation capital and position, thereby contributing to greater monitoring and greater demand for quality audits (Karim et al., 2016), which in turn could contribute towards enhancing shareholder wealth.

In the context of KSA, as suggested by Abbot et al., (2004), the existence of an expert with an accounting and finance background is considered a complementary contributor to the improvement of financial performance. The complexity of accounting, finance, and auditing issues makes it mandatory for an AudC to have a financial expert. AudCs act as the link between internal and external auditors and the BOD, taking the lead to communicate issues related to business/audit risk and measures to prevent and detect those risks, and also to comprehend financial statements and financial reporting matters. These experts play a leading role in issues related to the BOD's decision, mainly in the event of any dispute in opinion between the external auditors and the firm (Dezoort, 1998). They also improve the level of alliances with internal auditors, thus increasing the level of conformance with the internal audit system (Zain et al., 2006), which could improve reported financial performance. Thus, ceteris paribus, external financial experts' specialized knowledge in relevant industries and administration may be valuable to the monitoring excellence of the AudC. Therefore, the following hypotheses were tested in the context of the KSA:

H_2: There exists a direct association between the external financial expert in the AudC and financial performance.

Moderating Effects of Family Ownership

In this section, we examine how family ownership, within a particular institutional framework, influences the interaction between AudC independence and firm performance. Family ownership and involvement lead to decisions that serve both family and business goals (Sahni et al., 2017; Chrisman et al., 2005; Sharma et al., 1997). The family is considered a source of idiosyncratic and particularistic resources and competencies in the family business, arising from the family's ownership, governance, and involvement in the business, which has the potential to provide the business with a competitive advantage (Mahmood et al., 2021; Irava and Moores, 2010; Frank et al., 2010; Memili et al., 2010; Webb et al., 2010; Carney, 2005). Family firms aim to achieve both economic and family non-economic goals (Saad et al., 2022; e.g., Aparicio et al., 2017; Basco, 2017; Brundin et al., 2014; Puri & Robinson, 2013), and family firm strategies take into account both the economic drivers of the business as well as the family's goals that the family aims to achieve via the family business. Because of their significant economic and emotional investment in the family firm, family leaders typically serve as active monitors of firm performance (Audretsch et al., 2013), which could substitute for monitoring via the presence of independent/external members on the board and the board's executive committees.

Consistent with the findings on majority shareholders, which suggest that majority shareholders try to control auditor selection (Watts and Zimmerman, 1986; Piot, 2004), family owners may have a significant influence on the selection of directors and financial experts in the AudC. In particular, family owners may wish to appoint those who they believe understand their family as well as their business and mode of operations. Alrubaishi et al., (2021) provide empirical evidence from the KSA that reveals the importance of family ties and culture on the entrepreneurial behavior of family firms, suggesting lower efficacy of formal monitoring structures. These conditions may improve the desirability and efficacy of the affiliate as opposed to independent directors and financial experts, who would be more flexible and pragmatic in their oversight over family firms, and take into account the family's economic and non-economic goals. These directors and experts are likely to have more information about the family and are in a better position to apply a more nuanced understanding of the context in which operations are carried out rather than rigidly applying the rules.

In the AudC context, family ownership may attenuate the positive association between independent directors and external financial experts in the AudC and financial performance for two reasons. First, because of the relative concentration of ownership in the family and, in some cases, active involvement in the management of the firm, the agency cost of family-owned businesses is expected to be relatively lower than that of firms with diversified shareholding and managed by hired professional managers (Becker, 1974; Parsons, 1986). In this context, family owners may view the cost of a high-quality audit as a redundant and non-productive expense. Independent directors may be more vigilant in their role in ensuring the integrity of financial controls and the accuracy of financial statements. External financial experts are likely to understand a firm's financial system and may ask relevant questions to ensure its integrity. These features in the firm's governance may reduce the success of any earnings management behavior by family owners. To the extent that earnings management results in higher reported earnings, the higher vigilance of independent directors and external financial experts in the AudC would curb such behavior. Nevertheless, the relative importance placed on non-economic goals by family-owned firms also suggests that independent directors and external financial experts in the AudC would be less successful in family firms. Internal directors and financial experts may bring in a more contextually nuanced perspective in performing their roles. They may use their status to guide the family firm by using as much discretion as possible, consistent with the family's overall goals, rather than being inflexible in applying the rules. Based on the above exposition, the following moderating relationships are tested:

H_{3a}: Family ownership has an adverse moderating effect on the association between independent directors in the AudC and financial performance.

H_{3b}: Family ownership has an adverse moderating effect on the association between the external financial experts in the AudC and financial performance.

Research Methods

In this research, we focus on analyzing the situation in the KSA, with the unit of analysis being companies listed on the Saudi Stock Exchange (Tadawul). The initial sample consisted of 120 companies listed in Tadawul, but the final dataset (after eliminating firms with missing values) totaled 97 companies, with 485 firm-year observations. Information pertaining to the independent variables (i.e., percentage of independent directors and the presence of external financial experts in the AudC) and the moderating variable (family business or otherwise) was manually collected from the respective firms' financial reports. AudC independence is proxied by independent directors without pecuniary relationships or executive management involvement and is operationalized as the ratio of these directors to the total AudC members. Outside financial experts in AudC signify AudC members not on the BOD but financial experts from outside the firm, operationalized as the ratio of these experts to total AudC members.

Additionally, incorporating insights from existing literature, we included firm-specific characteristics as control variables to mitigate potential endogeneity issues arising from omitted variable bias. These include factors such as AudC size, board size, the count of AudC meetings, meeting attendance, number of executive directors, firm age, firm size, auditor reputation, and industry classification. We meticulously gathered these variables from companies' financial reports. As for the dependent variables, the study utilizes both return on assets (ROA) and market performance indicators (Tobin's-Q), aligning with previous research in the field of corporate governance and performance (Zulkifli and Abdul Samad, 2007; Kim and Rasiah, 2010; Sufian and Habibullah, 2010; Al-Saidi and Al-Shammari, 2013; Ong and Gan, 2013). ROA and ROE represent operational performance, while Tobin's-Q serves as a gauge of the company's growth prospects. Tobin's-Q denotes the ratio of a company's asset market value to the replacement cost of assets, whereas ROE signifies profitability relative to shareholders' investment. Additionally, ROA measures the profit percentage concerning overall resources. These dependent variables were sourced from the Emerging Market Information System (EMIS) database. Corporate governance studies normally prefer accounting-based measures as they mirror management's capacity to augment a firm's value (Hutchinson and Gul, 2004). Higher values of ROA and ROE suggest that a firm's corporate governance mechanisms are highly effective. Simultaneously, a heightened Tobin's-Q ratio indicates a positive market perception of the firm's performance (Haniffa and Hudaib, 2006; Ntim, 2009).

The moderating variable, family ownership, is a binary variable identifying family businesses. These variables collectively form a comprehensive framework for the study, facilitating a thorough exploration of the relationships and dynamics within the research context. Using EViews software, we conducted panel data analyses using ordinary least square (OLS) regression to assess the association between the dependent, independent, moderating, and control variables for the five-year period. An endogeneity test was undertaken. Both the Durbin and Wu-Hausman tests fail to reject the null hypotheses; the test results specify the use of the random effects model in this analysis.

To test the main effects, the following models were run:

$$Tobin's\text{-}Q_{it} = \beta_0 + \beta_1 IDAudC_{it} + \beta_2 EFE_{it} + \beta_3 FA_{it} + \beta_4 FS_{it} + \beta_5 BS_{it} + \beta_6 ED_{it} + B_7 AudCM_{it} + \beta_8 AudCMA_{it} + \beta_9 AudCS_{it} + \beta_{10} Ind_{it} + \beta_{11} AudR_{it} + \varepsilon \quad (1)$$

$$ROE_{it} = \beta_0 + \beta_1 IDAudC_{it} + \beta_2 IFE_{it} + \beta_3 FA_{it} + \beta_4 FS_{it} + \beta 5BS_{it} + \beta_6 ED_{it} + B_7 AudCM_{it} + \beta_8 AudMA_{it} + \beta_9 AudCS_{it} + \beta_{10} Ind_{it} + \beta_{11} AudR_{it} + \varepsilon \quad (2)$$

$$ROA_{it} = \beta_0 + \beta_1 IDAudC_{it} + \beta_2 EFE_{it} + \beta_3 FA_{it} + \beta_4 FS_{it} + \beta BS_{it} + \beta_6 ED_{it} + B_7 AudCM_{it} + \beta_8 AudCMA_{it} + \beta_9 AudCS_{it} + \beta_{10} Ind_{it} + \beta_{11} AudR_{it} + \varepsilon \quad (3)$$

To test for moderating effects, the following models were run:

$$Tobin's\text{-}Q_{it} = \beta_0 + \beta_1 IDAudC_{it} + \beta_2 EFE_{it} + \beta_3 FamB + \beta_4 (IDAudC_{it} \times FamB) + B_5 (EFE_{it} \times FamB) + \beta_6 FA_{it} + \beta_7 FS_{it} + \beta_8 BS_{it} + \beta_9 ED_{it} + B_{10} AudCM_{it} + \beta_{11} AudCMA_{it} + \beta_{12} AudCS_{it} + \beta_{13} Ind_{it} + \beta_{14} AudR_{it} + \varepsilon \quad (4)$$

$$ROE_{it} = \beta_0 + \beta_1 IDAudC_{it} + \beta_2 EFE_{it} + \beta_3 FamB + \beta_4 (IDAudC_{it} \times FamB) + B_5 (EFE_{it} \times FamB) + \beta_6 FA_{it} + \beta_7 FS_{it} + \beta_8 BS_{it} + \beta_9 ED_{it} + B_{10} AudCM_{it} + \beta_{11} AudCMA_{it} + \beta_{12} AudCS_{it} + \beta_{13} Ind_{it} + \beta_{14} AudR_{it} + \varepsilon \quad (5)$$

Where,

IDAudC - independent directors in AudC, subscript i denotes the firm and subscript t denotes the year.

EFE - outside financial experts in the AudC

FA – Firm age

FS – Firm size

AudCS – Audit Committee size

ED – Executive directors on board

AudCM – number of AudC meetings

AudCMA - % of meeting attendance

Ind – Industry

ID AudC $_t$ x FamB – interaction between independent directors in AudC and family ownership

EFE_{it} x FamB- interaction between external financial experts in AudC and family ownership

FamB – Family ownership

Results

Descriptive statistics for all variables are provided in Table 1. The descriptive results offer valuable insights into the key variables under consideration. The AudC composition analysis reveals that, on average, 63% of directors in the AudC are independent, showcasing a substantial presence of independent oversight. Additionally, around 14% of AudC members are external financial experts, indicating a moderate utilization of specialized financial knowledge within AudC. In terms of performance metrics, the average Tobin's Q is 1.16, suggesting that, on average, the market values a company's assets at approximately 1.16 times their replacement cost, whilst ROE and ROA averages at 14.48% and 12.44% respectively, showcasing a diverse range of profitability levels among the firms studied. The dataset consists of firms with an average age of 31.45 years, indicating established companies. The average auditor's reputation is high at 0.862, signifying a prevalent presence of reputable auditors. Lastly, companies hold an average of 8 AudC meetings. These descriptive findings lay the foundation for a deeper understanding and subsequent analysis of the dataset.

Table 1. Descriptive statistics

	Mean	Min	Max
Independent directors in AudC	63%	18%	100%
Outside financial experts in AudC	14%	0%	54%
Tobin's-Q	1.16	0.46	1.64
ROE	14.48	-49.54	56.59
ROA	12.44	-24.68	64.66
FA	31.45	8.000	90.00
Ln FS	8.509	6.409	12.33
AuDR	0.862	0.000	1.00
Number of AudC meetings	8	4	10
AudC Meeting Attendance	68%	41%	100%

AudC =Audit Committee; ROE=Return on Equity; ROA=Return on Assets; FA=Firm Age; FS= Firm Size; AuDR=Auditors' Reputation

To analyze the effects of AudC independence and the presence of external financial experts on firm performance, the control variables and all test variables are regressed against Tobin's-Q, ROE, and ROA. The empirical evidence in Table 2 indicates a significant relationship between the test variables. Model 1 shows the relationship between the test variables and its impact on Tobin's-Q, whereas Models 2 and 3 show the impact on ROE and ROA, respectively. A significantly positive relationship is detected between AudC independence and Tobin's-Q and ROE, but not for ROA, thus partially supporting H1. The presence of external financial experts in the AudC is positively associated with the ROE. Contrary to expectations, the results indicate that the presence of external financial experts as members of the AudC is negatively associated with Tobin's-Q. Thus, these results partially supported H2.

Table 2. Regression Results between AC independence and firm performance

	Model 1		Model 2		Model 3	
	Tobin's-Q		ROE		ROA	
Independent directors in AudC	0.570***	8.246	0.083*	1.944	6.188	0.440

Outside financial experts in AudC	-0.153**	-2.889	0.570***	8.246	-0.940	-0.573
FamB	-0.185***	-2.705	-0.624***	-5.345	-8.914**	-2.050
AudC size	-16.891***	-7.910	-1.396**	-2.070	0.028	1.071
Board Size	-0.120***	-4.773	-0.005***	-4.088	-0.656	-0.703
Number of AudC Meeting	0.092	0.131	0.047*	1.622	-0.137	-0.591
AudC meeting attendance	0.575**	2.396	0.003**	2.359	0.023	0.151
ED on BOD	-16.891***	-7.910	-1.396**	-2.070	0.028	1.071
Firm Age	11.96***	4.016	0.006***	5.490	0.006***	5.490
Log Firm Size	0.001**	2.175	2.014***	2.585	0.445***	6.901
AuDR	-3.452	-0.764	-16.936	-1.770	1.900	1.071
Industry	0.185	2.705	0.133	0.569	0.017	0.361
Number of observation	485		485		485	
Adjusted R^2	0.63		0.47		0.18	

*,**,*** indicates significance at the 10%, 5%, and 1% levels, respectively; AudC, audit committee; ID, independent directors in AudC; FamB, family ownership; ED, executive directors; BOD, board of directors; AuDR, auditors' reputation.

Table 3 shows the results of the moderation effects of a family business on the relationship between the test variables and firm performance. The presence of family ownership negatively moderates the relationship between AudC independence and Tobin'sQ and ROE. The findings also demonstrate that family ownership has an adverse moderating effect on the correlation between the existence of external financial experts on the AudC, Tobin's-Q, and ROE. Thus, both H3a and H3b are supported. Since the main effect of AudC independence and the presence of external financial experts on ROA was not significant, we did not run a moderation model for this relationship.

Table 3. The moderating effect of family ownership

	Model 4		Model 5	
	Tobin's-Q		ROE	
% of ID in AudC	0.397***	8.251	0.445***	6.901

% of outside financial experts in AudC	0.061***	2.462	0.168***	4.882
FamB	-1.550***	-5.952	-0.061***	-2.872
% of ID in AudC x FamB	-0.624***	-5.634	-0.099*	-1.751
% of outside financial experts in AudC x FamB	-0.010***	-4.202	-0.153***	-2.889
Board Size	0.422***	3.766	6.714***	3.263
Number of AudC Meeting	0.829	0.214	5.354	0.730
AudC meeting attendance	2.309	0.382	0.552	0.701
% of ID on BOD	0.409***	2.673	0.845	0.358
Firm Age	0.006*	1.975	7.629	0.773
Log Firm Size	0.397***	8.251	0.061**	2.462
AudC Size	5.830***	3.353	0.526***	3.801
AuDR	0.095	0.818	0.002	0.543
Industry	-0.587	-0.160	-0.120	-1.536
Number of observation	485		485	
Adjusted ^{2}	54.%		48.1%	

*,**,*** indicates significance at the 10%, 5%, and 1% levels, respectively AudC = Audit Committee; ID=Independent Directors in A AudC; FamB= Family and non family business; ED=Executive Directors; BOD=Board of Directors; AuDR=Auditors' Reputation

Discussion and Conclusion

This study examines whether AudC independence and the presence of external financial experts affect firms' financial performance in a traditional Saudi Arabian context. Furthermore, the research examined how family ownership moderates this relationship. The results validate a favorable correlation between independent directors within the AudC and both Tobin's-Q and ROE, enhancing the applicability of these findings across various settings and aligning with previous findings from a distinct context (Chan & Li, 2008). As for the presence of external financial experts as members of the AudC, while the results confirm a positive relationship for ROE, a negative relationship was found for Tobin'sQ. These results suggest that external financial experts, as members of the AudC, are associated with higher returns to equity holders. Interpreting our results with respect to Tobin's-Q, this measure is partially determined by market participants–that is, shareholders and investors–as opposed to ROE, which is an accounting measure of performance. Results with respect to Tobin's-Q could suggest that the market perceives the presence of external financial experts in the AudC as a hindrance to potentially profitable business transactions, which lowers the market's expectations about firm value in the future.

In terms of the moderation effects, family ownership negatively moderates the relationship between independent directors and external financial experts in the AudC for Tobin's-Q and ROE. These results suggest that family ownership acts as a superior substitute for the effect of external monitoring via independent and external expert representation on a firm's financial performance, supporting the findings of the substitution effects of ownership concentration and audit (AlQadasi and Abidin, 2018). This implies that market values provide more leeway for family business owners to mine the entrepreneurial opportunities that they see via their knowledge and expertise in the local context.

Overall, our study provides a more nuanced view of the composition and use of AudC in the context of specific institutional characteristics and in public family firms. Our results have useful implications for firm owners, investors, board members, external experts involved in advising firms, stock market regulators, and framing public policy. The main implication of our findings is that AudC composition must be sensitive to the overall context in which the firm conducts business (Agnew, Ford, & Hayes, 1994). This context includes the type of owners that the firm has, the informal norms that govern the conduct of business, and the efficacy of formal institutions that facilitate business transactions. Collectively, these determine the entrepreneurial opportunities that are created by the firm's owners. As investors assess the value of the firm, they may also factor in the context of the firm and AudC. If investors ignore ownership and look for AudCs that are more appropriate for non-family owners as signals of firm value, they may undervalue family businesses.

Future research could take several different directions to extend the findings of our study further. Studies that explore how family firms tailor specific governance features (e.g., the adoption and composition of specific committees) as well as their functioning to preserve their discretion in specific institutional contexts would certainly be merited. The issue of the public benefit of AudC independence and the presence of external financial experts (i.e., encouraging entrepreneurship over reducing earnings management) can be studied by adding more contingencies (Samkin & Schneider, 2010). Additionally, the overall results can be tested for sensitivity to different measures of committee independence. In addition to replicative studies from contexts with similar institutional characteristics as KSA, studies with contrasting samples of widely different institutional characteristics could shed more light on the strength of the "independence" effect. For instance, it is likely that the degree to which the institutional context is unique for a specific country versus the degree to which the country shares key characteristics of its institutional context with others could determine the degree to which local family-owned firms would benefit from tailoring their governance configurations to local conditions. These differences can also predict the speed of internationalization for these firms because they determine the ease with which their capabilities can be deployed in other countries. In addition to differences in institutional contexts, studies of AudC independence and contrasting differences in ownership patterns within each institutional context may also refine our knowledge of improving AudC effectiveness and outcomes. Such differences may emerge, even within a single ownership pattern. For instance, heterogeneity exists within family-owned firms, with some exhibiting agency behavior and others exhibiting stewardship behavior based on the family's founding values and history (Le Breton-Miller et al, 2011). This may affect their relationship with other minority investors, leading to differing returns on the AudC composition.

To surmise, this study makes a significant contribution by exploring the complexity of AudC composition. It goes beyond the conventional understanding by evaluating the effectiveness of AudC composition in a conventional Eastern economic setting. This investigation may lead to the creation of improved structural systems regulating internal controls and audit standards, encompassing both internal organizational processes and external regulatory compliance, ultimately enhancing operational efficiency and financial transparency within the organization. The envisaged enhancements have the potential to positively influence the financial performance of companies while preserving the distinctive competencies inherent to family businesses within their respective contexts.

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