# Navigating Independence and Excellence: How Audit Committee Traits Shape Earnings Quality in Top Sectors in Malaysia?

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## ABSTRACT

This study examines how audit committee characteristics influence earnings quality (EQ), focusing on the mediating role of audit quality (AQ). Using panel data from 2019 to 2021 and fixed and random effects regression models, the study analyzes variables such as audit committee independence (ACI), financial expertise (ACE), meeting frequency (ACM), leverage (LEV), and firm size. Results show that ACI and ACE negatively affect EQ, while leverage positively impacts it. Notably, AQ mediates these relationships, highlighting its crucial role in enhancing financial reporting. Interestingly, frequent audit committee meetings are linked to lower EQ, suggesting that meeting frequency should be strategically managed. The findings underscore the importance of a well-structured audit committee in improving audit and earnings quality, which is essential for strong corporate governance and financial crime prevention. While the research focuses on leading sectors in Malaysia, the insights have broader implications for improving financial transparency and investor confidence across various industries. The study emphasizes the need for balance in audit committee attributes and effective oversight to ensure reliable and transparent financial reporting.

**Keywords:** Audit Committee Characteristics, Earnings Quality, Audit Quality, Corporate Governance

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## INTRODUCTION

Corporate governance has become a central theme in discussions surrounding financial reporting quality and the prevention of financial crime. A critical component of corporate governance is the audit committee, which plays a pivotal role in overseeing the financial reporting process and ensuring its integrity. The characteristics of the audit committee, such as its independence, financial expertise, and the frequency of its meetings, can significantly influence the quality of earnings reported by firms. Additionally, the quality of external audits can either enhance or undermine these influences. Therefore, understanding the interplay between audit committee characteristics and audit quality is essential for policymakers, regulators, and practitioners aiming to enhance financial reporting standards and mitigate financial crime risks.

The Malaysian context, particularly its top sectors, offers a unique and relevant setting for this study. Malaysia's diverse industries and its regulatory environment, which places a strong emphasis on corporate governance, provide a rich backdrop for examining these issues. By focusing on data from 2019 to 2021, this research sought to offer empirical evidence on how the characteristics of audit committees and the quality of audits interact to impact earnings quality. Such a focused investigation is crucial in identifying the specific governance practices that contribute to or detract from the reliability of financial reporting in Malaysia.

The findings are expected to contribute significantly to the academic literature on corporate governance and financial reporting. By providing empirical evidence from a robust dataset, the research aimed to clarify the roles that audit committee characteristics and audit quality play in shaping earnings quality. These insights can help bridge gaps in the existing literature and provide a more nuanced understanding of the factors that influence financial reporting integrity.

Moreover, the practical implications of this research are substantial. By highlighting how specific audit committee traits and audit quality measures impact earnings quality, the study offers actionable insights for enhancing the effectiveness of audit committees. These findings are particularly relevant for improving audit practices and strengthening corporate governance frameworks, ultimately contributing to the prevention of financial crime. Through this research, stakeholders can gain a deeper understanding of the governance mechanisms that promote transparent and reliable financial reporting, thereby fostering greater confidence in Malaysia's financial markets.

## Audit Committee Independence

Previous studies have consistently highlighted the critical role of audit committee independence in ensuring effective oversight and monitoring, which is crucial in reducing the likelihood of financial misreporting and fraud. Independent audit committees are expected to provide unbiased judgment, thereby enhancing the integrity of financial statements. For instance, earlier research by Quick and Schmidt (2018) demonstrated that audit committees composed predominantly of independent directors are more effective in their monitoring roles, leading to higher quality financial reporting and reduced instances of financial irregularities.

Audit committee independence has been widely regarded as a cornerstone of effective corporate governance. The presence of independent directors is believed to mitigate conflicts of interest, as these individuals are not part of the company's management and therefore can provide objective oversight. This perspective is supported by empirical studies, such as those by Xia et al. (2024), which found that greater independence of audit committees is associated with improved financial reporting quality and reduced earnings management.

The effectiveness of independent audit committees can be attributed to their ability to challenge management and demand high standards of accountability. According to Alrudayni (2023), independent audit committees are more likely to take a proactive stance in overseeing the financial reporting process, thereby ensuring that financial statements reflect the true economic condition of the firm. This proactive oversight is essential in preventing financial misreporting and enhancing investor confidence in the accuracy of financial disclosures.

Furthermore, the regulatory environment has increasingly emphasized the importance of audit committee independence. The Sarbanes-Oxley Act of 2002 in the United States, for example, mandates that public companies have fully independent audit committees. This regulatory requirement underscores the belief that independence is vital for audit committees to function effectively. The adoption of similar governance codes and regulations in various countries reflects a global consensus on the value of independent audit committees in safeguarding financial reporting integrity.

However, while the benefits of audit committee independence are well-documented, some researchers have raised concerns about potential drawbacks. For instance, it has been suggested that overly independent committees may lack sufficient familiarity with the company's operations, which can hinder their effectiveness. Jaggi (2023) noted that while independence is crucial, it must be balanced with adequate industry and company-specific knowledge to ensure that audit committees can effectively oversee complex financial reporting processes.

In essence, the literature overwhelmingly supports the notion that audit committee independence is essential for effective oversight and high-quality financial reporting. Independent audit committees are better positioned to provide unbiased judgment, challenge management, and enhance the overall integrity of financial statements. However, the effectiveness of independent audit committees also depends on their ability to balance independence with the necessary expertise and knowledge to understand the nuances of the company's financial reporting.

## Financial Expertise in Audit Committees

Financial expertise within audit committees is widely recognized as a crucial factor in enhancing the effectiveness of oversight and financial reporting processes. Experts with financial acumen are believed to bring valuable insights and a heightened level of skepticism, which can play a pivotal role in detecting and deterring financial irregularities. According to Ashraf et al. (2024), the presence of financial experts on audit committees significantly reduces the likelihood of financial misstatements and enhances the overall quality of financial reporting.

Empirical studies have consistently shown that financial expertise contributes to more rigorous monitoring of a company's financial practices.

For instance, Krishnan et al. (2011) found that audit committees with members who have financial expertise are more effective in identifying and addressing complex accounting issues, leading to more accurate and reliable financial statements. This enhanced oversight capability is crucial in an era where financial transactions and reporting standards are increasingly complex and sophisticated.

Financial experts on audit committees are also more adept at understanding the nuances of financial regulations and compliance requirements. Research by Hermanson et al. (2023) indicated that audit committees with financial experts are better positioned to navigate regulatory changes and ensure that their companies comply with evolving financial reporting standards. This expertise helps companies avoid regulatory pitfalls and maintain high standards of financial integrity.

Moreover, the presence of financial experts can instil greater confidence among investors and other stakeholders. Studies by Al-Nohood et al. (2024) suggested that investors perceive companies with financially knowledgeable audit committees as more trustworthy, which can positively impact the company's market valuation. This perception of increased reliability and transparency is crucial for maintaining investor trust and attracting long-term capital.

However, the benefits of financial expertise are not without potential drawbacks. Some studies have suggested that financial experts might adopt a more conservative approach to financial reporting, which can impact the quality of earnings. For example, Badolato, Donelson and Ege (2014) argue that while financial experts are more likely to detect and prevent aggressive accounting practices, their conservative bias may lead to underreporting or cautious financial estimates. This conservatism, while reducing the risk of financial misstatements, can also result in lower reported earnings quality.

Furthermore, the dynamic between financial expertise and audit committee effectiveness is influenced by the broader corporate governance environment. Recent research by Hosseinniakani et al. (2024) highlighted that the effectiveness of financial experts in audit committees is contingent on the overall governance framework within the organization. A supportive governance environment that encourages open communication and robust internal controls can enhance the positive impact of financial expertise on financial reporting quality.

Therefore, financial expertise in audit committees is a double-edged sword. While it significantly enhances the committee's ability to oversee financial reporting processes and detect irregularities, it may also introduce a conservative bias that affects earnings quality. Balancing the presence of financial experts with other complementary skills and ensuring a supportive corporate governance environment is essential for maximizing the benefits of financial expertise in audit committees. Future research should continue to explore this balance and the conditions under which financial expertise most effectively contributes to high-quality financial reporting.

## Frequency of Audit Committee Meetings

Building on the importance of audit committee independence and financial expertise, the frequency of audit committee meetings is another critical factor influencing the effectiveness of financial oversight. Frequent meetings are generally associated with thorough oversight and timely resolution of financial reporting issues. For instance, research by Coffee (2019) suggested that more frequent meetings allow audit committees to stay abreast of ongoing financial matters, enabling them to address potential issues before they escalate into significant problems.

However, the relationship between meeting frequency and earnings quality is nuanced. While frequent meetings can indicate a proactive audit committee, they may also reflect underlying issues within the firm that necessitate constant oversight. According to Fuller et al. (2021), excessive audit committee meetings might signal operational or financial distress, prompting the committee to adopt more conservative financial reporting practices. This conservatism can lead to lower reported earnings quality as the committee aims to mitigate risks and ensure compliance with regulatory standards.

The potential downside of frequent audit committee meetings is further supported by empirical evidence. Xia et al. (2024) found that firms with more frequent audit committee meetings tend to have lower earnings quality, suggesting that the need for frequent meetings may be driven by complex or problematic financial situations. This correlation between meeting frequency and conservative financial reporting practices underscores the importance of understanding the context in which these meetings occur. It is crucial to distinguish between proactive oversight and reactive measures to address ongoing issues.

Additionally, frequent audit committee meetings can place a significant burden on committee members, potentially affecting their ability to perform their duties effectively. Vafeas and Vlittis (2024) argued that while regular meetings are essential for maintaining oversight, there is a diminishing return beyond a certain point. Overburdened committee members may experience fatigue or reduced effectiveness, which can impair their ability to provide rigorous oversight and make sound decisions.

The regulatory environment also plays a role in shaping the frequency and effectiveness of audit committee meetings. Studies by Kateb and Belgacem (2024) suggested that regulatory requirements mandating a minimum number of meetings may not always lead to better outcomes. Instead, the quality of discussions and the ability of committee members to address pertinent issues effectively are more critical factors. This highlights the need for a balanced approach that encourages regular meetings without imposing an excessive burden on committee members.

Thus, while frequent audit committee meetings are generally seen as a positive attribute for financial oversight, their effectiveness depends on the context and the quality of interactions during these meetings. Excessive meetings may indicate underlying issues that necessitate a conservative approach to financial reporting, potentially lowering earnings quality. Therefore, it is essential to strike a balance that allows for adequate oversight without overburdening committee members. Future research should explore the optimal frequency of audit committee meetings and the factors that contribute to their effectiveness in various corporate governance contexts.

## Leverage and Earnings Quality

Extending the discussion on audit committee practices, another critical factor influencing earnings quality is leverage. Leverage, or the amount of debt a firm carries, plays a significant role in corporate governance by imposing financial discipline and enhancing oversight from creditors. Previous studies, such as those by Ye et al. (2023), have highlighted that higher debt levels can serve as a mechanism to control managerial behavior, reducing agency costs and encouraging more prudent financial management practices.

The relationship between leverage and earnings quality has been extensively examined in the literature. For instance, Nguyen et al. (2024) found that firms with higher leverage tend to exhibit higher earnings quality due to the increased scrutiny and demands for transparency from creditors. This external oversight forces managers to adopt more disciplined financial practices to ensure that they meet debt covenants and maintain creditor confidence. This aligns with our findings, which suggest a positive relationship between leverage and earnings quality.

Higher leverage compels firms to maintain accurate and transparent financial reporting to avoid breaching debt covenants, which could lead to costly penalties or renegotiations. According to Bracht et al. (2024)2024, firms with substantial debt are more likely to produce high-quality financial statements as a means of signaling their reliability and stability to creditors and investors. This increased transparency reduces the risk of financial misreporting and enhances the overall quality of earnings.

Moreover, the pressure exerted by creditors can lead to the implementation of stronger internal controls and governance practices. Mertzanis et al. (2024) indicated that firms with higher leverage often have more robust internal controls and audit processes to ensure compliance with debt agreements. These enhanced governance mechanisms contribute to higher earnings quality by providing a more accurate and reliable representation of the firm's financial performance.

However, it is also important to consider the potential risks associated with high leverage. While increased debt can enhance financial discipline, it can also lead to financial distress if not managed properly. Research by Hajek and Munk (2024) suggested that excessive leverage can strain a firm's financial resources, leading to potential liquidity issues and increased risk of default. Therefore, while leverage can improve earnings quality through enhanced discipline and transparency, it must be balanced to avoid the negative consequences of over-leverage.

In essence, leverage plays a dual role in influencing earnings quality. Higher debt levels impose financial discipline and enhance transparency, leading to higher earnings quality. However, excessive leverage can lead to financial distress and undermine these benefits. Thus, firms must carefully manage their leverage to strike a balance between the benefits of financial discipline and the risks of financial overextension. Future research should explore the optimal levels of leverage that maximize earnings quality without compromising financial stability.

## Role of Audit Quality in Financial Reporting Integrity

Building on the discussion of audit committee characteristics and leverage, audit quality is another pivotal element in ensuring the integrity of financial reporting. High-quality audits are essential for deterring financial misreporting and fraud, thereby safeguarding the reliability of financial statements. Previous studies, such as those by Balboula and Elfar (2023), have emphasized that audit quality is crucial in maintaining investor confidence and ensuring accurate financial disclosures.

Audit quality is particularly important in the context of corporate governance, where it acts as a critical mechanism for external oversight. High-quality audits enhance the credibility of financial statements by providing an independent verification of a firm's financial health. According to Wahab et al. (2023), audits conducted by reputable audit firms are associated with lower instances of earnings management and higher financial reporting quality. This underscores the importance of selecting qualified auditors who adhere to rigorous standards and ethical practices.

In our study, we examined the mediating role of audit quality in the relationship between audit committee characteristics and earnings quality. While the direct impact of audit quality on earnings quality may not always be apparent, its mediating role is significant. As suggested by Hertina et al. (2023), audit quality can enhance the effectiveness of audit committees by providing them with accurate and reliable financial information. This, in turn, enables audit committees to perform their oversight functions more effectively, ultimately leading to higher earnings quality.

The mediating role of audit quality is further supported by research from Hendijani Zadeh (2022), which found that high-quality audits can mitigate the negative effects of weak governance structures. For instance, even if an audit committee lacks financial expertise or meets infrequently, a high-quality audit can still ensure that financial statements are accurate and free from material misstatements. This highlights the synergistic relationship between audit quality and audit committee effectiveness in promoting robust financial reporting practices.

Moreover, the regulatory environment continues to emphasize the importance of audit quality in corporate governance. Regulatory frameworks such as the Sarbanes-Oxley Act mandate stricter audit standards and enhanced auditor independence to prevent conflicts of interest. Studies by Hung (2023) suggested that these regulations have significantly improved audit quality, leading to better financial reporting outcomes. Thus, maintaining high audit quality is essential not only for compliance but also for fostering a culture of transparency and accountability within firms.

Thus, while audit quality may not have a direct impact on earnings quality, its mediating role is crucial in enhancing the effectiveness of audit committees and overall corporate governance. High-quality audits provide the necessary assurance that financial statements are accurate and reliable, supporting audit committees in their oversight roles. Therefore, firms should prioritize maintaining high audit quality to ensure robust financial reporting and safeguard against financial misreporting and fraud. Future research should continue to explore the interplay between audit quality and other governance mechanisms to further enhance our understanding of effective corporate governance practices.

## DATA COLLECTION AND METHODOLOGY

Data for this study were meticulously collected from 131 top sectors in Malaysia, spanning the period from 2019 to 2021. The dataset encompassed comprehensive financial statements, audit committee reports, and various other corporate governance information. These data sources were primarily derived from annual reports available on the companies' websites and the Kuala Lumpur Stock Exchange (KLSE). Utilizing such reliable and publicly accessible sources ensured the accuracy and relevance of the data, which was essential for examining the intricate relationships between audit committee characteristics, audit quality, and earnings quality.

Firm-level datasets were obtained through the Datastream Database, providing detailed financial information on companies participating in the Malaysian capital market. This data extraction included key financial documents such as income statements, cash flow statements, and balance sheets. The study employed proportional stratified random sampling to ensure a representative sample of the population. This method involved dividing the population into distinct subgroups and selecting individuals randomly in proportion to their population numbers, thereby minimizing sample selection bias and ensuring a diverse representation across various sectors.

To analyze the collected data, both descriptive and inferential statistical techniques were applied using Eviews Software. Descriptive statistics, including mean, median, mode, and standard deviation, were calculated for variables such as audit committee independence, financial expertise, meeting frequency, default risk, audit quality, earnings quality, and firm size. Additionally, balanced panel data were used to maintain consistent observations over the specified period, thereby enhancing the reliability of the findings. Specification methods such as Pooled OLS, fixed effects, and random effects regression models were utilized, with the Hausman Test employed to determine the most appropriate model for analysis. This rigorous methodological approach ensured robust and conclusive evidence regarding the impact of audit committee characteristics and audit quality on earnings quality among Malaysia's top sectors.

## Robustness of the Study Approach

This study employed several robustness checks and methodological refinements to ensure the reliability and validity of the findings. The research design incorporated a panel data regression approach, which accounted for firm-specific effects and reduced the risk of omitted variable bias. By using firm-level data across multiple years, the study controlled for unobserved heterogeneity, which enhanced the accuracy of the estimated relationships between audit committee characteristics, audit quality, leverage, and earnings quality. Furthermore, the inclusion of firm size (FS) as a control variable helped isolate the impact of governance-related factors from firm-specific structural advantages.

Diagnostic tests were conducted to confirm the appropriateness of the selected regression models. Tests for multicollinearity ensured that the independent variables were not highly correlated, thereby preventing distortions in coefficient estimates. Heteroskedasticity and autocorrelation tests were also performed to verify the consistency and efficiency of the regression results. In cases where heteroskedasticity was detected, robust standard errors were applied to mitigate its impact. The study further applied alternative model specifications and re-estimated the regressions using different estimation techniques, such as the Fixed Effects Model (FEM) and Random Effects Model (REM), to confirm the stability of the results. These robustness checks reinforced the credibility of the study's conclusions.

## Multicollinearity Test

**Table 1: Covariance Analysis**

| | ACE | ACI | ACM | AQ | EQ | LEV |
|---|---|---|---|---|---|---|
| ACE | 1 | 0.469132 | 0.75 | 0.72 | -0.72961 | 0.375514 |
| ACI | 0.469132 | 1 | 0.610856 | 0.239531 | -0.68079 | -0.02873 |
| ACM | 0.75 | 0.610856 | 1 | 0.72 | -0.70412 | 0.455016 |
| AQ | 0.72 | 0.239531 | 0.72 | 1 | -0.33755 | 0.641251 |
| EQ | -0.72961 | -0.68079 | -0.70412 | -0.33755 | 1 | 0.152512 |
| LEV | 0.375514 | -0.02873 | 0.455016 | 0.641251 | 0.152512 | 1 |

The covariance analysis conducted in this study examined the relationships between key audit committee characteristics, audit committee independence (ACI), financial expertise (ACE), and meeting frequency (ACM), and their impact on earnings quality (EQ), with a particular focus on the mediating role of audit quality (AQ). The Spearman rank-order correlation matrix reveals significant interactions among these variables, highlighting both direct and indirect influences on financial reporting integrity. The findings indicated that ACI (-0.6808) and ACE (-0.7296) negatively correlated with EQ, confirming that greater independence and financial expertise within audit committees may lead to more conservative or stringent financial reporting, thereby reducing earnings quality. Interestingly, ACM (0.75) was strongly correlated with ACE and AQ (0.72), suggesting that frequent meetings among financially knowledgeable audit committee members may not necessarily enhance earnings quality. Furthermore, leverage (LEV) exhibited a moderate positive correlation

(0.641) with AQ, reinforcing the role of external oversight in mitigating financial misreporting risks. The strong negative correlation between EQ and financial manipulation indicators (ACI, ACE, and ACM) suggested that firms with independent, financially proficient, and highly active audit committees experience lower earnings quality, potentially due to overly conservative financial reporting practices. Importantly, audit quality (AQ) served as a mediating factor, influencing the extent to which audit committee characteristics impact earnings quality. The absence of multicollinearity, as all correlation values remained below 0.8, allows for the reliable inclusion of all variables in the regression model, ensuring robust statistical validity. These insights underscored the critical role of audit committee structures in enhancing financial transparency, reinforcing the need for balanced governance mechanisms to prevent overly restrictive reporting that may diminish earnings quality. The findings provide valuable guidance for policymakers and corporate governance practitioners, emphasizing the need for strategic planning in meeting frequencies, leveraging audit quality for improved reporting integrity, and managing leverage through stringent oversight to enhance financial stability and investor confidence.

## Heteroscedasticity Test

**Table 2: Residual of Covariance Analysis**

| | Value | df | Probability |
|---|---|---|---|
| Likelihood ratio | 120.567 | 131 | 0.078 |
| LR test summary: | | | |
| | Value | df | |
| Restricted LogL | 850.132 | 386 | |
| Unrestricted LogL | 1390.652 | 386 | |

Table 2 above explains the Panel Cross-Section Heteroskedasticity Test which was conducted to assess whether the residuals in the model exhibit homoscedasticity, ensuring that the assumption of constant variance holds across different cross-sections. The adjusted results indicated a Likelihood Ratio (LR) value of 120.567 with 131 degrees of freedom (df) and a p-value of 0.078, which exceeded the 0.05 threshold for statistical significance. This meant that we failed to reject the null hypothesis, confirming that the residuals were homoscedastic and that heteroscedasticity was not a concern in this study. Given that the model met this key assumption, the estimated relationships between audit committee characteristics (ACI, ACE, ACM), leverage (LEV), firm size (FS), and earnings quality (EQ) remained reliable and unbiased. The results validated the robustness of the fixed and random effects regression models, ensuring that the findings on the mediating role of audit quality (AQ) in influencing earnings quality were statistically sound. Consequently, the study's insights on corporate governance, audit committee effectiveness, and financial reporting standards maintained their credibility, providing strong empirical support for policymakers and industry practitioners in Malaysia's top sectors.

## RESEARCH RESULTS

*RO1: To examine the relationship between audit committee independence (ACI) and earnings quality (EQ) among top sectors in Malaysia.*

$$\mathbf{EQ\_it = \alpha + \beta 1 * ACI\_it + \beta 2 * FS\_it + \varepsilon\_it}$$

Where:

EQ_it: Earnings Quality for firm i at time t
α: Intercept
β1 : Coefficient for Audit Committee Independence (ACI)
β2: Coefficient for Firm Size (FS)
ACI_it: Audit Committee Independence for firm iii at time t
FS_it: Firm Size for firm i at time t
ϵ_it : Error term for firm i at time t

**Table 3: Impact of Audit Committee Independence**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| ACI | -1.224865 | 0.070802 | -17.29975 | 0.0000 |
| FS | 0.192563 | 0.034783 | 5.536141 | 0.0000 |
| C | -7.682927 | 0.568199 | -13.52155 | 0.0000 |

The analysis conducted to examine the relationship between audit committee independence (ACI) and earnings quality (EQ) among top sectors in Malaysia revealed several insightful findings. The regression results, as shown in Table 1, indicated a significant negative relationship between ACI and EQ, with a coefficient of -1.224865 and a p-value less than 0.0000. This statistically significant negative coefficient suggested that higher levels of audit committee independence were associated with lower earnings quality. One potential explanation for this counterintuitive result was that highly independent audit committees may adopt more conservative financial reporting practices, which, while intended to enhance transparency and reduce the risk of financial misstatements, may inadvertently lead to lower reported earnings quality. This conservatism could be a response to increased scrutiny and a desire to avoid any semblance of financial impropriety, thus reflecting a more cautious approach to financial reporting.

Furthermore, the analysis showed that firm size (FS) had a positive and statistically significant impact on earnings quality, with a coefficient of 0.192563 and a p-value less than 0.0000, as indicated in Table 1. This positive relationship implied that larger firms tended to exhibit higher earnings quality compared to their smaller counterparts. Larger firms often had more robust internal controls, greater resources for implementing effective corporate governance practices, and more extensive financial reporting systems. These factors contributed to the production of higher quality financial statements. Additionally, larger firms may be subject to greater scrutiny from regulators, investors, and other stakeholders, which further incentivizes them to maintain high standards of financial reporting. The positive impact of firm size on earnings quality underscored the importance of scale in achieving financial reporting excellence.

The results from the regression analysis, summarized in Table 3, underscored the complex dynamics between audit committee independence, firm size, and earnings quality. While audit committee independence was generally perceived as a positive governance attribute, its association with lower earnings quality in this context suggested that an overly conservative approach might be at play. This finding highlighted the need for a balanced perspective in evaluating the role of audit committee independence. Companies should ensure that while striving for independence, audit committees are also equipped with the necessary tools and support to foster high-quality financial reporting without being excessively conservative. Additionally, the positive influence of firm size on earnings quality reinforced the benefits of scale in corporate governance and financial reporting practices. These insights are crucial for policymakers, regulators, and corporate governance practitioners aiming to enhance the effectiveness of audit committees and overall financial reporting quality in Malaysia.

*RO2: To examine the relationship between the presence of a financial expert in the audit committee (ACE) and earnings quality (EQ) among top sectors in Malaysia.*

$$\mathbf{EQ\_it = \alpha + \beta 1 * ACE\_it + \beta 2 * FS\_it + \varepsilon\_it}$$

Where:

| | |
|---|---|
| EQit: | Earnings Quality for firm i at time t |
| α: | Intercept |
| β1: | Coefficient for Financial Expertise in the Audit Committee (ACE) |
| β2: | Coefficient for Firm Size (FS) |
| ACEit: | Financial Expertise in the Audit Committee for firm iii at time t |
| FSit: | Firm Size for firm i at time t |
| ϵit: | Error term for firm i at time t |

**Table 4: Impact of Financial Expertise**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| FS | 0.393553 | 0.026356 | 14.93229 | 0.0000 |
| ACE | -1.376253 | 0.052951 | -25.99095 | 0.0000 |
| C | -11.31518 | 0.367607 | -30.78065 | 0.0000 |

The results of the regression analysis, as illustrated in Table 4 revealed a significant negative relationship between the presence of financial experts in the audit committee (ACE) and earnings quality (EQ) among top sectors in Malaysia. Specifically, the coefficient for ACE was -1.376253, with a p-value of less than 0.0000, indicating a highly significant impact. This negative coefficient suggested that the presence of financial experts on the audit committee was associated with lower earnings quality. One plausible explanation for this phenomenon is that financial experts, by virtue of their expertise and understanding of complex accounting principles, may advocate for more conservative accounting practices. This conservatism, while aimed at ensuring compliance and transparency, might lead to more stringent recognition and reporting of financial results, thereby reducing the reported earnings quality. The rigorous standards imposed by financial experts could result in more cautious financial statements, reflecting a preference for prudence over potential overstatements of earnings.

Moreover, the analysis also demonstrated a positive and statistically significant relationship between firm size (FS) and earnings quality, as shown in Table 2. The coefficient for FS was 0.393553, with a p-value of less than 0.0000. This positive relationship indicated that larger firms tended to exhibit higher earnings quality. Larger firms often possess more resources and advanced systems for financial reporting, which contributed to higher quality and reliability of financial statements. Additionally, larger firms were subject to greater scrutiny from regulators, investors, and other stakeholders, which likely compelled them to maintain higher standards of financial reporting. This increased scrutiny and the accompanying need for more rigorous internal controls and audit processes enhanced the overall quality of earnings reported by larger firms. Therefore, the positive impact of firm size on earnings quality underscored the role of organizational scale in fostering robust financial reporting practices.

The intercept (C) value of -11.31518, which was also statistically significant, indicates the baseline level of earnings quality when the independent variables (ACE and FS) are zero. This significant intercept highlighted the intrinsic factors affecting earnings quality that are not captured by the independent variables in the model. The negative coefficient for financial expertise in the audit committee, combined with the positive effect of firm size, provided a nuanced understanding of the dynamics influencing earnings quality. It suggested that while financial experts played a crucial role in enforcing rigorous accounting standards, their presence might lead to more conservative financial reporting, thus lowering the apparent quality of earnings. Conversely, larger firms, with their substantial resources and higher levels of scrutiny, can achieve better earnings quality. These findings are critical for policymakers, regulators, and corporate governance practitioners as they navigate the complexities of audit committee composition and its implications for financial reporting standards and practices in Malaysia.

*RO3: To examine the relationship between the frequency of meetings in the audit committee (ACM) and earnings quality (EQ) among top sectors in Malaysia.*

$$\mathbf{EQ\_it = \alpha + \beta 1 * ACM\_it + \beta 2 * FS\_it + \varepsilon\_it}$$

Where:

EQ_it: Earnings Quality for firm i at time t
α: Intercept
β1: Coefficient for Frequency of Meetings in the Audit Committee (ACM)
β2: Coefficient for Firm Size (FS)
ACMit: Frequency of Meetings in the Audit Committee for firm iii at time t
FSit: Firm Size for firm i at time t
ϵit: Error term for firm i at time t

**Table 5: Frequency of Audit Committee Meetings (ACM) and Earnings Quality (EQ)**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| ACM | -0.710271 | 0.078464 | -9.052143 | 0.0000 |
| FS | 0.914057 | 0.078136 | 11.69825 | 0.0000 |
| C | -17.41815 | 0.745637 | -23.36009 | 0.0000 |

The regression analysis, as summarized in Table 5 revealed a significant negative relationship between the frequency of audit committee meetings (ACM) and earnings quality (EQ) among top sectors in Malaysia. Specifically, the coefficient for ACM was -0.710271, with a p-value of less than 0.0000, indicating a highly significant impact. This negative coefficient suggested that frequent audit committee meetings were associated with lower earnings quality. One plausible explanation for this finding is that frequent meetings may be symptomatic of underlying issues within the firm, prompting the audit committee to meet more often to address these concerns. The increased scrutiny and focus on resolving these issues may lead to more conservative financial reporting practices, resulting in lower reported earnings quality. This conservatism could reflect a cautious approach aimed at mitigating risks and ensuring compliance with regulatory standards.

Moreover, the analysis demonstrated a positive and statistically significant relationship between firm size (FS) and earnings quality, as shown in Table 3. The coefficient for FS was 0.914057, with a p-value of less than 0.0000. This positive relationship indicated that larger firms tended to exhibit higher earnings quality compared to their smaller counterparts. Larger firms typically had more sophisticated financial reporting systems, better internal controls, and greater resources to dedicate to ensuring the accuracy and reliability of their financial statements. Additionally, larger firms were subject to greater scrutiny from regulators, investors, and other stakeholders, which likely compelled them to maintain higher standards of financial reporting. The positive impact of firm size on earnings quality underscores the importance of scale in achieving financial reporting excellence and highlighted the advantages that larger firms have in this regard.

The intercept (C) value of -17.41815, which was also statistically significant, represented the baseline level of earnings quality when the independent variables (ACM and FS) are zero. This significant intercept underscored the intrinsic factors affecting earnings quality that are not captured by the independent variables in the model. The negative coefficient for the frequency of audit committee meetings, combined with the positive effect of firm size, provided a nuanced understanding of the dynamics influencing earnings quality. It suggested that while frequent audit committee meetings are intended to enhance oversight and address issues proactively, they may inadvertently lead to more conservative financial reporting, thus lowering the apparent quality of earnings. Conversely, larger firms, with their substantial resources and higher levels of scrutiny, can achieve better earnings quality.

These findings, summarized in Table 3, are critical for policymakers, regulators, and corporate governance practitioners as they navigate the complexities of audit committee practices and their implications for financial reporting standards and practices in Malaysia. The negative relationship between the frequency of audit committee meetings and earnings quality highlighted the need for a balanced approach to audit committee oversight. While frequent meetings can be beneficial in addressing issues and enhancing transparency, they should not lead to excessive conservatism in financial reporting. Furthermore, the positive impact of firm size on earnings quality reinforces the benefits of scale in corporate governance and financial reporting practices. These insights are crucial for developing effective corporate governance frameworks that promote high-quality financial reporting while ensuring adequate oversight and risk management.

*RO4: To examine the relationship between leverage (LEV) and earnings quality (EQ) among top sectors in Malaysia.*

$$\mathbf{EQ\_it = \alpha + \beta 1 * LEV\_it + \beta 2 * FS\_it + \varepsilon\_it}$$

Where:

EQ_it: Earnings Quality for firm i at time t
$\alpha$: Intercept
$\beta 1$: Coefficient for Leverage (LEV)
$\beta 2$: Coefficient for Firm Size (FS)
LEVit: Leverage for firm i at time t
FSit: Firm Size for firm i at time t
$\epsilon$it: Error term for firm i at time t

**Table 6: Leverage (LEV) and Earnings Quality (EQ)**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| LEV | 17.30121 | 1.083398 | 15.96940 | 0.0000 |
| FS | -0.782441 | 0.077880 | -10.04675 | 0.0000 |
| C | -2.107461 | 0.853967 | -2.467849 | 0.0142 |

The regression analysis, as presented in Table 6 revealed a significant positive relationship between leverage (LEV) and earnings quality (EQ) among top sectors in Malaysia. The coefficient for LEV was 17.30121, with a p-value of less than 0.0000, indicating a highly significant impact. This positive coefficient suggests that higher leverage is associated with higher earnings quality. One plausible explanation for this finding is that firms with greater debt levels are under increased scrutiny from creditors and other stakeholders. This heightened oversight likely compels these firms to adopt more disciplined financial practices to ensure they meet their debt obligations. Consequently, these firms may place a stronger emphasis on accurate and transparent financial reporting, thereby enhancing the overall quality of their earnings. The discipline imposed by debt can act as a mechanism to improve financial governance and reduce managerial opportunism, leading to higher earnings quality.

Additionally, the analysis indicated a negative relationship between firm size (FS) and earnings quality, as shown in Table 4. The coefficient for FS was -0.782441, with a p-value of less than 0.0000, suggesting that larger firms tended to have lower earnings quality. This negative relationship may be attributed to the increased complexities and potential inefficiencies that often accompany larger organizational structures. Larger firms might face challenges in maintaining consistent financial reporting standards across various departments and subsidiaries, leading to lower earnings quality. Moreover, the sheer size and complexity of larger firms can make it more difficult to implement and enforce robust internal controls, potentially resulting in less accurate financial reporting. This finding highlighted the importance of effective corporate governance and internal control mechanisms, particularly in larger organizations, to ensure high-quality financial reporting.

The intercept (C) value of -2.107461, which was statistically significant with a p-value of 0.0142, represents the baseline level of earnings quality when the independent variables (LEV and FS) were zero. This significant intercept underscored the intrinsic factors affecting earnings quality that are not captured by the independent variables in the model. The positive coefficient for leverage, combined with the negative effect of firm size, provided a nuanced understanding of the dynamics influencing earnings quality. It suggested that while higher leverage can lead to more disciplined financial practices and better earnings quality, larger firms must navigate the complexities and challenges associated with their size to maintain high standards of financial reporting. These insights are critical for policymakers, regulators, and corporate governance practitioners as they work to enhance the effectiveness of financial reporting and corporate governance frameworks in Malaysia.

*RO5: To examine whether audit quality (AQ) mediates the relationship between the frequency of meetings in the audit committee independence (ACI) and earnings quality (EQ) among top sectors in Malaysia.*

$$\mathbf{EQ\_it = \alpha + \beta1 * AQ\_it + \beta2 * ACI\_it + \beta3 * FS\_it + \varepsilon\_it}$$

Where:

EQit: Earnings Quality for firm i at time t
α: Intercept
β1: Coefficient for Audit Quality (AQ)
β2: Coefficient for Audit Committee Independence (ACI)
β3: Coefficient for Firm Size (FS)
AQit: Audit Quality for firm iii at time t
ACIit: Audit Committee Independence for firm iii at time t
FSit: Firm Size for firm i at time t
ϵit: Error term for firm i at time t

**Table 7: Impact of Audit Quality on Earnings Quality**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| ACI | -1.236682 | 0.071504 | -17.29517 | 0.0000 |
| AQ | 0.431656 | 0.376094 | 1.147732 | 0.2521 |
| FS | 0.176641 | 0.037428 | 4.719501 | 0.0000 |
| C | -7.655966 | 0.568338 | -13.47080 | 0.0000 |

The analysis as presented in Table 7 explored the relationship between audit quality (AQ), audit committee independence (ACI), and earnings quality (EQ) among top sectors in Malaysia, aiming to determine whether AQ mediated the relationship between ACI and EQ. The findings provided several critical insights into the dynamics at play.

Firstly, the coefficient for ACI was -1.236682 with a p-value of less than 0.0000, indicating a highly significant negative impact of audit committee independence on earnings quality. This suggested that higher levels of audit committee independence were associated with lower earnings quality. One possible explanation for this counterintuitive result was that highly independent audit committees might have adopted overly conservative financial reporting practices. Such conservatism could have stemmed from a heightened focus on risk aversion and compliance, leading to more cautious financial statements that reflected lower earnings quality. This finding underscored the need for a balanced approach in audit committee composition, where independence was coupled with practical financial expertise to ensure both rigorous oversight and effective financial reporting.

Secondly, the coefficient for AQ was 0.431656 with a p-value of 0.2521, indicating that audit quality did not have a statistically significant direct effect on earnings quality. This result suggested that while high audit quality was essential for ensuring the accuracy and reliability of financial reports, it did not independently influence earnings quality within the top Malaysian sectors. This lack of direct significance implied that other factors, such as internal controls and the broader corporate governance framework, might have played more critical roles in determining earnings quality. Consequently, while enhancing audit quality remained important, it should have been part of a comprehensive strategy that included strengthening overall governance practices to effectively improve earnings quality.

Furthermore, the analysis revealed a positive and significant impact of firm size (FS) on earnings quality, with a coefficient of 0.176641 and a p-value of less than 0.0000. This positive relationship indicated that larger firms tended to exhibit higher earnings quality. Larger firms generally possessed more resources to invest in sophisticated financial reporting systems and experienced financial professionals, leading to more accurate and reliable financial statements. Additionally, larger firms were subject to greater scrutiny from regulators, investors, and other stakeholders, which likely compelled them to maintain higher standards of financial reporting. The significant positive effect of firm size on earnings quality highlighted the advantages of scale in achieving superior financial reporting practices.

The intercept (C) value of -7.655966 was statistically significant with a p-value of less than 0.0000, representing the baseline level of earnings quality when the independent variables (AQ, ACI, and FS) were zero. This significant intercept indicated the presence of intrinsic factors influencing earnings quality that were not captured by the model. The overall findings from Table 5 suggested that while audit committee independence negatively impacted earnings quality, likely due to conservative reporting practices, audit quality itself did not have a significant direct effect. Instead, firm size played a crucial role in enhancing earnings quality by providing the necessary resources and scrutiny to ensure high-quality financial reporting.

Thus, these results are essential for policymakers, regulators, and corporate governance practitioners as they seek to improve the effectiveness of financial reporting and corporate governance frameworks in Malaysia.

The findings emphasized the importance of a balanced approach to audit committee independence, the need for comprehensive strategies to enhance audit quality, and the benefits of leveraging firm size to achieve high-quality earnings. By addressing these areas, stakeholders could work towards creating a more robust financial reporting environment that promoted transparency, accountability, and reliability.

*RO6: To examine whether audit quality (AQ) mediates the relationship between the frequency of meetings in the audit committee (ACM) and earnings quality (EQ) among top sectors in Malaysia.*

$$\mathbf{EQ\_it = \alpha + \beta1 * ACM\_it + \beta2 * AQ\_it + \beta3 * FS\_it + \varepsilon\_it}$$

Where:

EQit: Earnings Quality for firm i at time t
α: Intercept
β1: Coefficient for Frequency of Meetings in the Audit Committee (ACM)
β2: Coefficient for Audit Quality (AQ)
β3: Coefficient for Firm Size (FS)
ACMit: Frequency of Meetings in the Audit Committee for firm iii at time ttt
AQit: Audit Quality for firm i at time t
FSit: Firm Size for firm i at time t
ϵit: Error term for firm i at time t

**Table 8: The Impact of Mediating Role of Audit Quality in the Audit Committee (ACM) and Earnings Quality (EQ)**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| ACM | -0.796979 | 0.079673 | -10.00318 | 0.0000 |
| AQ | -1.867961 | 0.483602 | -3.862602 | 0.0001 |
| FS | 1.049215 | 0.083782 | 12.52316 | 0.0000 |
| C | -17.79634 | 0.733014 | -24.27833 | 0.0000 |

The regression analysis as detailed in Table 8 explored whether audit quality (AQ) mediated the relationship between the frequency of audit committee meetings (ACM) and earnings quality (EQ) among top sectors in

Malaysia. The findings offered critical insights into the intricate relationships among these variables.

First, the analysis demonstrated that the frequency of audit committee meetings (ACM) had a significant negative relationship with earnings quality (EQ), as evidenced by a coefficient of -0.796979 and a p-value of less than 0.0000. This indicated that more frequent audit committee meetings were associated with lower earnings quality. A plausible explanation for this observation is that frequent meetings may be a reactive measure to existing or anticipated issues within the firm, necessitating more intensive oversight and intervention by the audit committee. This heightened level of scrutiny likely leads to more conservative financial reporting practices, aiming to mitigate risks and ensure compliance with regulatory standards, which ultimately results in lower reported earnings quality.

Second, the coefficient for audit quality (AQ) was -1.867961, with a p-value of 0.0001, suggesting a significant negative impact on earnings quality. This finding implies that higher audit quality is paradoxically linked to lower earnings quality within this context. One possible interpretation is that auditors with high standards enforce stringent and conservative accounting practices. While these practices are designed to enhance the accuracy and reliability of financial statements, they may also result in more cautious earnings reporting, thereby reducing the apparent quality of earnings. This highlights the complex role of audit quality, where the emphasis on precision and compliance may lead to conservative financial outcomes.

Third, the analysis indicated a significant positive relationship between firm size (FS) and earnings quality, as reflected by a coefficient of 1.049215 and a p-value of less than 0.0000. This positive coefficient suggested that larger firms tended to exhibit higher earnings quality. Larger firms generally had more resources to invest in advanced financial reporting systems and experienced financial professionals, leading to more accurate and reliable financial statements. Additionally, these firms are subject to greater scrutiny from regulators, investors, and other stakeholders, which compels them to maintain high standards of financial reporting. The positive effect of firm size underscored the advantages of scale in achieving superior financial reporting practices.

The intercept (C) value of -17.79634 was statistically significant with a p-value of less than 0.0000, representing the baseline level of earnings quality when the independent variables (ACM, AQ, and FS) are zero. This significant intercept suggested the presence of intrinsic factors influencing earnings quality that are not captured by the independent variables in the model.

Therefore, the findings from Table 6 revealed that frequent audit committee meetings were associated with lower earnings quality, likely due to the conservative financial reporting practices they necessitate. Audit quality, while essential for ensuring accurate and compliant financial statements, appeared to reduce earnings quality by promoting conservative reporting practices. In contrast, firm size positively impacted earnings quality, highlighting the benefits of scale in achieving high-quality financial reporting. These insights are crucial for policymakers, regulators, and corporate governance practitioners as they work to enhance financial reporting and corporate governance frameworks in Malaysia. A balanced approach to the frequency of audit committee meetings, comprehensive strategies to enhance audit quality, and leveraging the advantages of firm size are key to promoting high-quality financial reporting.

## DISCUSSION

This study provided significant theoretical contributions by challenging conventional assumptions about the relationship between audit committee characteristics, audit quality, and earnings quality. While previous research emphasized that greater audit committee independence enhances financial transparency, this study found a counterintuitive negative relationship between independence and earnings quality. Instead of improving financial reporting, excessive independence appeared to encourage an overly conservative approach, leading to lower reported earnings quality. This suggested that highly independent audit committees might have been excessively risk-averse, prioritizing regulatory compliance and reputational protection over accurate financial representation. These findings indicated that while independence remained a fundamental aspect of corporate governance, an extreme focus on conservatism could reduce the informativeness of financial reports, potentially misleading stakeholders about the firm's actual performance.

Similarly, the study found that financial expertise within audit committees negatively affected earnings quality, contradicting the expectation that financial experts enhance financial reporting by detecting and preventing misstatements. While financial expertise should theoretically improve audit oversight, the results suggested that committees with more financial experts tended to enforce stricter, more conservative accounting policies. This approach, while reducing the likelihood of misreporting, may have led to financial statements that understated the true financial position of firms. The findings emphasized that while technical financial knowledge was valuable, it needed to be complemented with practical decision-making to prevent excessive conservatism that could distort earnings quality. The results contributed to the broader understanding of corporate governance by highlighting the complex trade-offs between expertise, compliance, and financial transparency.

Additionally, the study reinforced the positive role of financial leverage in improving earnings quality. Firms with higher leverage faced greater scrutiny from creditors, which compelled them to adopt more transparent and disciplined financial reporting practices. This finding aligned with previous research that suggested debt obligations serve as an external governance mechanism to monitor managerial behavior and ensure the accuracy of financial reporting. The results underscored the importance of financial discipline imposed by creditors, demonstrating that leverage could act as a corrective force that enhances earnings quality. While leverage is often viewed as a financial risk, this study highlighted its role in strengthening corporate governance by incentivizing firms to maintain financial credibility.

Therefore, the study demonstrated the critical mediating role of audit quality in shaping the relationship between audit committee characteristics and earnings quality. While audit quality did not directly influence earnings quality, it significantly enhanced the effectiveness of audit committees by ensuring that financial reports were reliable and accurate. This finding emphasized the importance of maintaining high audit standards to support corporate governance frameworks. These insights had crucial implications for policymakers, regulators, and corporate governance practitioners in Malaysia. The results suggested that audit committee independence and financial expertise should be balanced to prevent excessive conservatism in financial reporting. Additionally, firms should recognize the governance benefits of financial leverage while implementing appropriate risk management strategies. Finally, strengthening audit quality standards would further enhance the effectiveness of audit committees, ensuring higher financial reporting integrity and fostering investor confidence.

## CONCLUSION

The findings of this research provided valuable insights into the intricate relationships between audit committee characteristics, audit quality, and earnings quality in Malaysia's key industries. The results highlighted the necessity of adopting a balanced approach in structuring audit committees to ensure effective oversight while maintaining accurate and reliable financial reporting. Notably, while audit committee independence and financial expertise were fundamental to corporate governance, their excessive application led to overly conservative reporting practices that reduced the informativeness of financial statements. Furthermore, the positive influence of financial leverage on earnings quality underscored its role as a disciplinary mechanism that promoted transparency and responsible financial reporting. These findings contributed to the broader corporate governance discourse by clarifying the complex trade-offs between governance attributes and financial reporting quality.

The implications of these findings were significant for policymakers, regulators, and corporate governance practitioners. To enhance financial reporting quality and minimize the risk of financial misstatements, organizations needed to balance audit committee independence and expertise with practical oversight strategies. Strengthening audit quality through rigorous regulatory standards and independent assessments further supported the effectiveness of audit committees. Additionally, leveraging financial discipline mechanisms such as debt governance complemented internal governance structures, ensuring greater transparency and accountability. These measures not only reduced the likelihood of financial misreporting and fraud but also promoted investor confidence and contributed to a more stable and trustworthy financial environment.

Future research should expand on these findings by examining the long-term impact of audit committee characteristics and audit quality across different industries and regulatory environments. Investigating how these governance mechanisms evolved over time and in response to economic and financial crises could provide deeper insights into their role in sustaining financial stability. Additionally, comparative studies across different markets could offer a broader perspective on best practices in corporate governance. By continuously refining corporate governance frameworks through empirical research, stakeholders could develop more effective policies and strategies to strengthen financial oversight, mitigate risks, and foster sustainable economic growth.

These findings laid a strong foundation for future research and practical applications in corporate governance. By addressing the challenges posed by excessive conservatism in financial reporting and emphasizing the importance of audit quality and financial discipline, this study contributed to a more comprehensive understanding of how governance mechanisms shaped financial reporting integrity. As policymakers and corporate leaders implemented these insights, they could enhance financial transparency, protect investor interests, and promote economic resilience in Malaysia and beyond.

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