



**Corporate Governance Effectiveness and Financial
Reporting Quality in Iraq: Enterprise Risk
Management as a Moderator**

by

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LIST OF ABBREVIATIONS

FRQ	Financial Reporting Quality
CG	Corporate Governance
BODs	Board of Directors
MO	Managerial Ownership
AC	Audit Committee
ERM	Enterprise Risk Management
ISX	Iraq Stock Exchange
PLS-SEM	Partial Least Squares-Structural Equation Model
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CAC	Chairman audit committee (CAC) Composite
CR	Reliability
AVE	Average Variance Extracted
HTMT	Heterotrait-Monotrait

Keberkesanan Tadbir Urus Korporat Dan Kualiti Pelaporan Kewangan Di Iraq: Pengurusan Risiko Perusahaan Sebagai Moderator

ABSTRAK

ketidak keberkesanan lembaga pengarah pengarah korporat dalam melaksanakan tanggungjawab mereka ditambah pula dengan peningkatan skandal kewangan di serata dunia telah meningkatkan banyak kritikan mengenai Kualiti Pelaporan Kewangan. Disebabkan ini, Suruhanjaya Sekuriti Iraq telah menekankan penghayatan budaya tadbir urus korporat antarabangsa, dengan tumpuan ke atas tanggungjawab dan keterbukaan. Kajian ini mengkaji peranan penyederhanaan pengurusan risiko perusahaan terhadap hubungan antara keberkesanan tadbir urus korporat dan kualiti pelaporan kewangan dalam firma-firma di Iraq. Data dikumpul menggunakan borang soal selidik dan diedarkan secara rawak kepada 125 responden dalam skop kajian. Bagi tujuan analisis, *Partial Least Squared Structural Equation Model (Smart PLS-3.0)* telah digunakan dan keputusan menunjukkan lembaga pengarah, kebebasan lembaga pengarah dan kepakaran lembaga pengarah adalah tidak signifikan. Sebaliknya, saiz jawatankuasa audit, kebebasan jawatankuasa audit dan kepakaran jawatankuasa audit adalah berkait secara positif dan signifikan dengan kualiti pelaporan kewangan. Sebagai tambahan, hubungan yang signifikan dan positif antara pengurusan telah tertubuh. Walau bagaimanapun, keputusan menunjukkan tiada kesan signifikan penyederhanaan oleh pengurusan risiko perusahaan terhadap ciri lembaga pengarah pengarah dan hubungan kualiti pelaporan kewangan. Selain itu, kajian menunjukkan kesan negatif dan signifikan oleh pengurusan risiko perusahaan terhadap hubungan antara ciri jawatankuasa audit dan kualiti pelaporan kewangan dalam firma di Iraq. Hasil penyelidikan ini telah menyumbang secara signifikan kepada badan literatur sedia ada, menyediakan panduan kepada pengurus dan pembuat dasar, dan mengemukakan cadangan untuk penyelidikan masa depan berdasarkan batasan kajian.

Corporate Governance Effectiveness and Financial Reporting Quality In Iraq: Enterprise Risk Management As A Moderator

ABSTRACT

The ineffectiveness of corporate board of directors in discharging their responsibilities coupled with the escalation in financial scandals throughout the world has elevated a countless criticism about the Financial Reporting Quality. Owing to this, The Iraqi Securities Commission has emphasized the internalization of corporate governance culture, with a focus on responsibility and openness. This study examines the moderating role of enterprise risk management on the relationship between corporate governance effectiveness and financial reporting quality in Iraqi firms. Data were collected using a questionnaire and personally administered at random to collect the data from 125 respondents in the study area. For analysis purpose, Partial Least Squared Structural Equation Model (Smart PLS-3.0) was used and the results show that board size, board independence and board expertize are insignificant. Contrarily, audit committee size, audit committee independence and audit committee expertize positively and significantly relates to financial reporting quality. In addition, a significant and positive relationship between managerial was established. However, the results shows that no significant moderation effect of enterprise risk management on board of director's characteristics and financial reporting quality in Iraq firms. moreover, the study shows a negative and significant impact of enterprise risk management on the relationship between audit committee characteristics and financial reporting quality. The results of this research have contributed significantly to the body of existing literature, provided a guide to managers and policies makers, and proffered suggestion for future research based on limitation of the study.

CHAPTER 1 : INTRODUCTION

1.1 Background of study

Financial Reporting Quality (FRQ) is generally significant for the progress and development of confidence of investors. Financial Reporting (FR) quality is associated with considerably improved share price performance (Penman, 2007). The FRQ is seen to be a crucial technique for decreasing information irregularity between firms and investors (Bala, Amran & Shaari, 2019; Lin, Wang, and Lin, 2018), and therefore improve the quality of FR transparency (Akhtaruddin & Haron, 2010). It is also viewed that quality reporting is also important to confirm the safety of rights of shareholders. Investors would be able to make use of the information disclosed for decision making and for other investment activities.

Generally, FRQ leads to a decline in information asymmetry between firms and outsiders' capital holders, by making firms' profitable projects more evident to those capital providers (Siregar & Nuryanah, 2018). However, companies are mandated to keep a record of their financial transactions and make FR (Bajra & Cadez, 2018), yet, the quality of their FR depends on the methods they use to report their accounting records (Jerman & Novak, 2014). FR is seen as a qualitative when they present the correct and unbiased business performance of a firm in line with generally recognized accounting standards (Martí & Kasperskaya, 2015).

FR is considered as one of the important elements of accounting system and one of its key objectives is to provide needed information for economic decisions making of

the users concerning the assessment of performance and productivity of the economic entity (Tariverdi & Keivanfar, 2017). While FRQ is not directly observable, prominent scholars assert that they are aware of it, whenever they see it and strongly emphasize its significance as a pillar of modern capital markets. (He, et. al., 2009). Unequivocally, the objective of FR is to make available dependable information about the firm's financial performance that is beneficial for several users when making economic decisions (Ujkan Bajra, & Simon Cadez, 2017).

The escalation in financial scandals throughout the world has elevated countless criticism about the FRQ (Brown, 2011; Mansur & Tangl, 2018; Sorensen & Miller, 2017; Uyar, Gungormus & Kuzey, 2017; Outa & Waweru, 2016). Numerous prominent companies were found to have involved in accounting frauds, such as Parmalat, Marconi, WorldCom, Enron etc., which has which has faded the confidence of the investors toward the management of the company and the FR (Dibra, 2016; Mansur & Tangl, 2018). The pervasive letdown in the accounting disclosure has necessitates the desire to improve the quality of financial information and to reinforce the control of managers by building up better governance structures (García - Sánchez et al., 2019; Mahboub, 2017; Pavlopoulos, Magnis & Iatridis, 2019; Petra, 2007). Certainly, the information regarding the financial position of a firm serves as a yardstick for investment decisions in the capital market. It is valuable for owners, regulators and company partners as it aids in ascertaining the previous performance of company, forecast its forthcoming gain and observe the actions of its managers (Bushman and Smith, 2003).

However, the global financial crisis, which began in mid-2008, shattered faith in the financial market, because the expected financial performance hadn't achieved, and this mean trustless of the FRQ, so this crisis introduced many views concerning the role of Corporate Governance (CG) in mitigating market uncertainties and facilitating the prediction of financial performance related to listed firms (Qian & Yeung, 2015). on the other side, CG can deal with the agency problems, by activating some rules helping in risk management and mitigating managers behavior for maximizing profits and control their decision, thus avoid the firm many risks can harm its FRQ (El-Mahdy, 2019). Therefore, because of these financial crises, many global companies, for example, have collapsed Parmalat, Marconi, WorldCom, and Enron etc. Also, Iraq was not far from these crises, and there are many companies that have been blacklisted because of mismanagement and improper financial dealings, for example (Al Majd Group Contracting Company, Al-Akhal Contracting Company, and Al Aswa Contracting Company). In addition, Al-Warka Bank Fraud: In 2014, it was reported that the Al-Warka Bank, a publicly traded Iraqi bank, had allegedly committed fraud worth more than \$300 million. (Nigrini, 2020: World Bank, 2018: Barznji, 2022).

Previous research provide evidence that the level of corporate voluntary disclosure in the annual reports of Iraqi companies still relatively low in comparison with other emerging nations such as Iran, Egypt, Jordan, Bangladesh and Malaysia (Almagtome, Almusawi & Aureaar, 2017). Although, the accounting standards and rules impose a considerable amount of mandatory disclosure through the firm's periodic financial reports, the managers tend to voluntarily release additional relevant information using a variety of indirect disclosure tools, such as press conferences,

meetings and Internet sites and other communication channels (Barac, Granic & Vuko, 2014).

Moreover, a poor business environment has emerged from a lack of effective governance, the spread of administrative and financial corruption, and electricity shortages, among other issues. Iraq's economic climate will be improved by the implementation of recent changes and a more stable security situation (World Bank, 2018). Worries with corruption, burdensome procedures for visa, undependable dispute resolution mechanisms, customs regulations and nonexistence of accessibility to finance are among common grievances from companies (World Bank, 2018). Iraq is ranked 168th out of 190 economies in the 2018 Doing Business Index, putting it far below its MENA peers (World Bank, 2018).

Also, the majority of the economic units in the country are suffering from financial and administrative corruption, and nearly no institution unaffected from this scenario, which extended to include even religious institutions (Al-taie, et al., 2017). Despite the multiplicity of supervisory bodies that fight this marvel, such as the Board of Highest Audit, the Integrity Commission and the General Inspectors in the Iraqis ministries, Iraq is in the front position of nations that undergo the blowout of this epidemic.

Furthermore, In order for a country to attract foreign direct investment, financial data must be of high quality and able to meet the demands of a broader variety of users than it was earlier, when a larger number of enterprises were state-owned or controlled. As a result, Iraq is likely to adopt the institutions of its major trading partners in order to

resolve these issues (Hassan et al., 2014). Moreover, other countries with less established governance systems, such as Iraq, are likely to mimic the schemes in their key trade partners to the extent that they are under similar pressures to implement methods to promote economic development. Because of the lack of market control in emerging economies like Iraq, internal CG mechanisms play a crucial role in the CG of such countries (Alabdullah & Ahmed, 2018; Khanna & Palepu, 2000). So, using these internal mechanisms of CG will reflect on the resultant decision made by the management and thus on FRQ (Alabdullah, 2018; Ali, Salleh & Hassan, 2008; Lemmon & Lins, 2003).

Also, researchers devoted more attention to FRQ and its association with CG, ever since the collapse of some high-profile companies owing to the financial wrongdoings of their managers (Osemeké & Adegbite, 2016). Therefore, regulators and investors have often interrogated the character of both audit committee members and external auditors since the audited FR have been established to be misleading in numerous recent financial scandals (Alves, 2013).

In addition, prior studies examined the influence of BODs characteristics (e.g. D'onza & Lamboglia 2014; Akeju & Babatunde, 2017; Ibrahim & Jehu 2016; Ilaboya & Lodikero, 2017), AC characteristics (e.g. Mishra & Malhotra, 2016; Majiyebo, et al., 2018; Haji-Abdullah & Wan-Hussin, 2015), managerial ownership (e.g. Khafid & Brief, 2017; Oluku, 2017; Alzoubi, 2016; Ramadan, 2016) on FRQ. However, based on Iraq scenario studies on BODs, ACs and managerial ownership in one study is important because one of a major concern of CG in Iraq is corporate transparency and disclosure practices for bringing quality in FR.

As stated by the utmost accountability of the BODs coordinate the internal corporate governance of a company which includes improving the FRQ of an organization. They should also be responsible for managing the firm's interior control systems and operations of the company. However, there is still inconclusive result with regards to the prior studies conducted on the association between board of director's characteristics and financial reporting quality.

In ACs, previous studies on developing markets are scant, with most research in developing countries like Iraq, having concentrated on the value of corporate authority reforms on market value (Black et al., 2006). AC is seen as one of the most important inner authority supervisory mechanisms in the company (Ali & Kamardin, 2018) It plays an indispensable position in monitoring monetary coverage to guarantee FRQ and Company's accountability (Zhang, Zhou, & Zhou, 2007). But, the value of AC depends on the efficiency of members.

Moreover, managerial ownership will make the managers feel they also have the company, thus reducing the conflict of interest between the owners and the agents. Saftiana et al. (2017) have reported that ownership of managers has no significant effect on FRQ. on the other hand, Agency theory anticipated that when managers are not the owners of a company, or they own a minor portion of stock in that company, their conduct is influenced by self-interest which is not in line with the aim of improving firm value and as a result from shareholders' interest, all of which eases FR activities (Jensen & Meckling, 1976).

Hence, there is a need to apply a more innovative method to study the direct and indirect influence of (board characteristics, audit committee characteristics & managerial ownership) in relation to FRQ (Bala, Amran & Shaari, 2019). This is as a result of the fact that it has been resisted that the complementary functions of board of directors (BODs) and Audit Committees (ACs) concerning FRQ are intricate. It goes beyond a direct relationship and warrants the need for further investigation to fully explore the influence of both on FRQ.

On this track, a group of Iraqi researchers conducted their studies in the field of internal auditing and corporate governance and their impact on the quality of financial reports in conventional institutions (Khudhair et al., 2019; Sabbar & Abdalamer, 2018; Talab et al., 2018; Farhan & Nayan, 2018; Wahhab et al., 2021; Salehi et al., 2021).

In this study, the fundamental argument is that CG mechanisms usage is more probable to positively bring more improvement and advanced FRQ in circumstance of the existence of risk management practices. It is also believed that good CG may provide better mechanisms based on the certain internal mechanisms signified by CG characteristic including BODs and managerial ownership and audit committee. Prior studies on enterprise risk management (ERM) - FRQ relationship focused on direct effects between ERM-FRQ. However, a study that considers ERM as a moderating role between BODs, ACs, MO and FRQ is still lacking. The focus on internal audit function and internal audit quality is where this study differs from earlier studies in this area. Absence of research on the effects of the audit committee and board characteristics on FRQ. Moreover, no research has been done on ERM as a moderator in an Iraqi business. Due to the paucity of research on ERM.