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The effectiveness of the oversight role of audit committees in supporting the credibility of financial information

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***Abstract*---**This research aims to focus on the vital role audit committees play in corporate governance by enhancing the credibility of financial disclosures. Such committees are regarded as key instruments in promoting an effective, transparent, and efficient operational framework. Their performance is determined by various fundamental factors, including the structure of the committee, the independence of its members, and their proficiency in financial and accounting matters. and their professional background. In addition, clearly outlining their duties and responsibilities is essential. Financial reporting serves as a crucial component in the management of economic entities, acting as a communication bridge both within the organization and with external stakeholders involved in decision-making processes. The findings of the study indicate that audit committees, through their supervisory activities, play a pivotal role in elevating the quality of financial reporting. This is achieved by assessing internal control mechanisms, This involves assessing the work conducted by external auditors, promoting effective collaboration

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between internal and external audit teams, and steering internal audit activities to ensure they support the broader objectives of the overall audit strategy.

***Keywords*---**Audit committees, financial information, internal audit, external audit.

1. Introduction

The Audit committees are of particular importance in many countries, due to their pivotal and effective role within corporate governance mechanisms, as they are an organizational and procedural means that lead and aim to enhance control over the performance of companies in terms of their management, which leads to the reduction of abuse of powers, in addition to stimulating commitment to protect the interests of shareholders and related parties, and these committees contribute to improving performance and working on its quality, as well as improving accounting practices, and this is by supporting transparency and building confidence in reports and lists. Financial, this raises the level of credibility and validity of accounting information, This is where audit committees are important as an effective tool to enhance disclosure and transparency within organizations.

Audit committees are among the essential and important means to support sound and correct practices in companies, within the framework of compliance and compliance with the approved accounting standards, in order to preserve the rights of shareholders and all stakeholders, and these committees rely on the accuracy of financial information prepared in accordance with reliable accounting standards and high quality, The principles of governance emphasized and focused on the financial statements in terms of importance, preparation as well as disclosure in accordance with recognized accounting and auditing standards, provided that the disclosure process meets the requirements of the principle of transparency and fairness, by providing users with the necessary and necessary information in a timely manner, and in an economical way that works to access data equally.

The problem of the study:

In order to obtain a clearer picture of the role of audit committees as a governance and oversight mechanism in strengthening the reliability and credibility of financial information - and to identify the various dimensions of this topic - the primary objective of the study can be formulated through the following research question:

To what extent do audit committees as a control mechanism contribute to supporting the credibility of financial information?

The main problem is divided into the following sub-questions:

- With the growing interest in audit committees, what are the reasons behind the urgency of establishing them and activating their role?
- How effective are audit committees in supporting and enhancing the credibility

and transparency of the financial information provided?

Importance of the study:

The importance of this study stems from several key aspects:
- The crucial role of the audit committee as a governance tool that enhances oversight, ensures the credibility of financial reporting, and encourages the independence of the audit function.
- The vital importance of financial information within an organization, given its impact on enhancing transparency, rebuilding trust, and ensuring the credibility of both accounting practices and the financial statements presented in reports and financial statements to various stakeholders.

To answer the previous problem, the study was divided into two main points:
- First: Audit committees as a mechanism for oversight and control.
- Second: The role of audit committees as an oversight mechanism in supporting the credibility of financial information.

2. Audit committees as a mechanism for oversight and control:

In order to prepare financial statements characterized by transparency, credibility and a good level of disclosure, institutions must activate an integrated and comprehensive control system that includes the Audit Committee, the Board of Directors, as well as internal and external auditors, in the absence of control and leaving managers without restrictions and regulatory and control controls, the possibilities of manipulation and fraud as well as fraud increase, which loses the credibility and reliability of the financial statements, and here the importance of having effective and effective control mechanisms, whether internal or external, that work to control the behavior of management, and coordination between the Board of Directors The Audit Committee as well as the auditors are a key pillar aimed at achieving comprehensive oversight that contributes to protecting the objectives and interests of the institution and all parties associated with it.

2.1 Origin and development of audit committees:

Comités d'Audit is one of the regulatory mechanisms that have received special attention at the international level, as many countries, including the United States, Canada, the United Kingdom, Australia and others, have relied on activating them within corporate governance frameworks, and recommended by professional bodies in specialized organizations due to their pivotal role and functions in following up the preparation of financial reports and the extent of disclosure in favor of shareholders, in addition to their role in enhancing the independence of audit and audit processes within institutions.[i]

In 1967, the American Society of Certified Public Accountants (AICPA) invited companies listed on the capital markets to establish audit committees concerned with resolving disputes that may arise between the external auditor and the company's management, especially those related to accounting aspects as well as methods of disclosing and submitting financial reports, and then, in 1972, the US Securities and Exchange Commission (SEC) issued recommendations encouraging and recommending the formation of audit committees of non-executive board members, with the necessity of announcing companies In 1999, the Blue Ribbon Committee made several recommendations aimed at raising the efficiency of audit committees in order to improve the quality of disclosed financial information, and then in 2002 the Sarbens-Oxley Act was issued to constitute a turning point, which made the establishment of audit committees a legal obligation for all companies, due to their vital and essential role in preventing crises and financial collapses[ii], In 2003, the Smith Report was released, presenting a set of recommendations concerning the responsibilities and functions of audit committees, along with guidance on how these should be communicated within an organization's annual report. The report also emphasized the importance of publishing an annual disclosure that outlines the activities and tasks performed by committee members throughout the year[iii], In 1992, the UK Committee on Financial Aspects of Corporate Governance issued a report recognizing the role of audit committees in maintaining the reliability and accuracy of financial statements. [iv]

In 1992, the Canadian Institute of Chartered Accountants (CICA) defined the audit committee as the group of board members responsible for reviewing the annual financial statements before they are formally presented to the board. The committee serves as a key link between the external auditors and the board of directors. Its responsibilities include overseeing the appointment of the external auditor, evaluating their work and results, periodically monitoring the organization's internal control system, and ensuring the accuracy and integrity of the financial information prepared for publication. [v]

Dr. Siddiqui Masoud defines the Audit Committee as "a group consisting of non-executive board members who represent mediation between the external auditor, management and the internal auditor in organizing their respective work and the relationship between them, as well as studying and proposing everything that would lead to giving an honest picture about the extent to which the information represents the actual reality of the institution.". [vi]

In light of the foregoing, several compelling factors highlight the importance of forming and effectively operationalizing the audit committee, including the following: [vii]

- Ensuring effective control over the financial reporting process, especially for large institutions, which require board members with financial and administrative experience, as well as high efficiency in accounting and finance;
- Seeking to protect rights and reduce conflicts of interest through professional and quality financial reports;
- Financial information must be regularly disclosed through periodic reports;
- Work to protect the interests of shareholders by enabling audit committees to monitor and detect violations or cases of manipulation that may infringe on their rights;
- The multiplicity of backgrounds of the members of the Board of Directors and their increase in number led to the need to prepare accurate financial reports, requiring a high level of experience and professionalism in analysis and presentation.

Based on the experiences of the countries that have adopted audit committees in addressing the expectations gap by working on managing the relationship between the auditor and the administration, Mr. Siddiqui Messaoud [viii] believes that it is necessary to establish audit committees similar to the countries that established them in order to address the Algerian reality, which will know changes in the near future and reduce the various negative effects that result from their absence:

- Establishment of audit committees, as confirmed by international experience;
- The number of its members ranges between four and five members, which is in line with the content of international experiences, and Professor Siddiqui Masoud adds that determining the number of members of these committees depends on the following elements:
  * The nature and extent of the establishment's activity;
  * Turnover achieved by the establishment;
  * Distribution and geographical distribution of the establishment.

2.2 Controls for the formation of audit committees and their tasks:

Choosing the members of audit committee is a crucial matter for the board of directors. To ensure that the committee operates with a high level of efficiency and effectiveness, the appointment process must adhere to specific criteria. Below are the key requirements that committee members should meet to carry out their responsibilities competently:[ix]

A. Possession of relevant expertise and a well-rounded skill set among the audit committee members:

Given the increasing complexity of financial operations, intricate capital structures, and the use of creative accounting techniques in the application of accounting standards by management, it is essential that audit committee members possess a high level of expertise and professional competence. Therefore, company boards must establish clear criteria regarding the qualifications required for committee members. These should include a solid background in accounting, finance, and auditing, as well as familiarity with legal matters relevant to the organization. Members should also be fully aware of the field in which the company operates as well as its work. It is important that the members of the Committee are highly experienced which is vital, as many legal and accounting issues rely heavily on the correct scientific background of its members.

B. Establishing the optimal size of the audit committee:

The size of the audit committee should be determined in relation to both the size of the board of directors and the scale of the company’s operations. It is important to establish a number that ensures a balanced mix of skills and expertise, while also aligning with the scope and complexity of the committee’s responsibilities, which may differ from one organization to another. Care must be taken to avoid having too many members, which could hinder the speed and efficiency of decision-making, as well as too few, which might limit the committee’s ability to perform its duties effectively. Generally, the model audit committee has three to five members.

C. <u>Maintaining the Audit Committee's Independent Functioning:</u>

The Audit Committee is among the core committees established by the Board of Directors, usually composed of non-executive members. It reports directly to the Board of Directors and acts as a liaison between the Executive Management and the Board of Directors on matters within its area of responsibility. In order to ensure the independence of the Commission, several important considerations must be taken into account, including the following:

* The person must not hold any position in the company or any of its subsidiaries.
* The person shall not receive any remuneration or any financial compensation from the Company or any of its subsidiaries, except for the remuneration provided for employment in the Board of Directors.
* No one of the individual's relatives may be employed in any executive position within the company or its subsidiaries.
* The individual must not serve as an executive director in any company that has commercial dealings with the company or its subsidiaries.

D. The Audit Committee recognition of its role and responsibilities related to governance within the organizational structure of the organization:

Members of this Committee should have a deep understanding of their Important contribution to corporate governance by:

* Enhancing the significance of both financial and non-financial disclosures to assist stakeholders in monitoring and controlling management in an effective way.
* Supporting and reinforcing the role of auditors in raising the level of confidence in the financial data issued by institutions.
* Supporting and strengthening the effectiveness as well as the role of the internal control system to increase the accuracy and credibility of the financial statements, in addition to ensuring the management's compliance with the applicable laws and regulations.

E. Establishing a clear outline of the responsibilities and authority of the Audit Committee:

The primary mission of the audit committees is to support the Board of Directors to finish tasks accurately and efficiently, in particular in the area of accounting systems and the preparation of financial regulations, as well as strengthening internal control as well as encouraging the independence of external auditors from internal auditors, it is necessary and must be the tasks and terms of reference of the committee explained within a regulatory framework or an official guide, which determines exactly the nature of its responsibilities as well as relations with both executive management and internal auditors and also external, and this is to prevent any conflict or overlap in the tasks within The Committee must also have the necessary powers and authority to discuss topics that it may deem important, with the possibility of using external experts with competence and experience in addressing issues and problems of a financial, accounting and legal nature, which can have a direct impact on the process of preparing financial statements and the quality and integrity of the disclosure associated with them. Among the functions and responsibilities of the audit committees are the following:

* Enhancing shareholder confidence and reassuring them of the comprehensiveness and impartiality of the tasks entrusted to the Board of Directors.
* Contribute to the work to raise the efficiency and improve performance by adding value to the administrative operations they perform, which positively returns to the level of confidence among shareholders about the accuracy and validity of these operations.
* Work to settle disputes that may result from conflict of interest between the executive management and the shareholders of rights.

Audit committees are one of the essential and essential elements within the corporate governance framework, as they constitute a key effective tool to ensure compliance with the principles of governance, and have been entrusted with a set of tasks through which they are expected to contribute to raising the quality of their performance and role, as these roles are to enhance the effectiveness of internal control systems as well as support the independence and impartiality of the external auditor, in addition to increasing the reliability and credibility of published financial information, which contributes to establishing confidence among interested parties in the institution, and audit committees have a range of Duties and responsibilities include the following:

* Reviewing the accounting records and financial reports prepared by the institution before presenting them to the Board of Directors.
* Discussing with external auditors any observations or issues that may arise during the auditing tasks.
* Setting priorities for the audit process and its scope in cooperation with the auditors and reaching an agreement on it.
* Supervise the process of analyzing as well as examining the content of reports and their results, and based on them, appropriate recommendations are submitted to the administration to take appropriate and necessary measures.
* Discussing the efficiency and effectiveness of the internal control system in the institution, in addition to verifying the effectiveness of risk management, in coordination with the external auditors.
* Work on the nomination and appointment of the external auditor or the termination of his services, in addition to determining his remuneration.
* Work on the implementation of the duties related to the audit in addition to its additional tasks assigned to the Committee by the Board of Directors.

Based on the above, the tasks and competencies carried out by the audit committees seek in essence to preserve the rights of shareholders and work to maximize their returns in a fair manner, in addition to enhancing the role of the members of the Board of Directors and supporting them in performing their duties in a way that contributes to achieving an effective level of governance.

3. The role of audit committees as an oversight mechanism in supporting the credibility of financial information:

Audit committees play a pivotal role in ensuring both the accuracy and quality of financial reports, as accounting information is a real reflective mirror of the institution's performance, and this is achieved through its follow-up of internal and external audit activities, and its endeavor to reduce the impact of management interventions on the conduct of the audit process, and in order to achieve the objectives for which it was established, these committees carry out a set of tasks with a commitment to disclose them transparently.

A– Promote and support the professional independence of external auditors: [x]

- Contribute to the selection and selection of external auditors: In order to protect the interests of shareholders, the external auditor should be selected, who is responsible for examining, auditing and approving the financial statements, as the selection process depends on several factors, most notably:

* The competence, professional experience and academic background of the external auditor and his staff, as well as the expected fees for service;
* The prestige and reputation of the audit office, and the extent to which it relies on sophisticated examination techniques and methods;
* The existence of a quality control system within the office and its compatibility with recognized performance standards.

- Approval of consulting services: When management requires advisory services provided by external audit firms, the Audit Committee reviews these services, determines the associated fees, and ensures that these services align with its objectives without compromising the independence of the external auditor.
- Reviewing discrepancies between the external auditor and management: The audit committee seeks to reconcile differing perspectives and assesses the extent of the disagreement, ensuring the external auditor's independence is maintained. It provides an unbiased technical opinion on the matter in dispute and works to resolve any conflicts that may arise between the auditor and the company's management, particularly in cases where the application of accounting policies differs from those used in previous financial periods.

B- The connection between the Audit Committee and the Internal Auditors:

A strong connection exists between internal auditors and the audit committee, and through this relationship, the governance of organizations is enhanced. The audit committee's effectiveness is heightened when it has the capability to allocate internal audit resources to gather crucial information about the organization[xi],Gaining access to trustworthy and accurate accounting and financial information relies on[xii] The effectiveness of both external and internal audits, along with their alignment with the audit committee, plays a crucial role. The audit committee’s focus on internal audits serves as a vital control mechanism over the institution’s operations, offering an accurate reflection of the organization’s actual situation. To achieve this, the audit committee should:

* Review and authorize the internal audit program;
* Align the internal audit plan with the institution’s broader audit objectives;
* enhance the organization of effective relationship between internal and external auditors;
* reinforce the internal auditor’s independence;
* Provide the necessary financial as well as human resources for the professional development of the internal audit function.

C- checking of the internal control system:

Internal control is a very essential and important component of the organization, established and maintained under its own responsibility. It comprises a range of tools, practices, and procedures tailored to the institution’s unique characteristics, aiding in the supervision of operations, enhancing efficiency, and optimizing resource utilization. Internal control also plays a crucial role in identifying and managing risks, ensuring compliance with applicable laws, safeguarding assets, supporting operational integrity, and ensuring the reliability of financial data[xiii], The accuracy and usefulness of financial information rely on how well it reflects the actual components of the financial statements and, ultimately, the true state of the institution. Therefore, emphasis must be placed on strengthening and refining the internal control system. This can be achieved through regular assessments conducted by auditors to identify its strengths and pinpoint areas of weakness. Addressing these weaknesses helps uncover irregularities, whether due to systemic flaws or user errors. The audit committee plays a key role in evaluating the robustness of the internal control system in place, with the goal of correcting deficiencies and reinforcing the system—ultimately ensuring that the financial information presents a fair and truthful picture of the institution's performance[xiv].

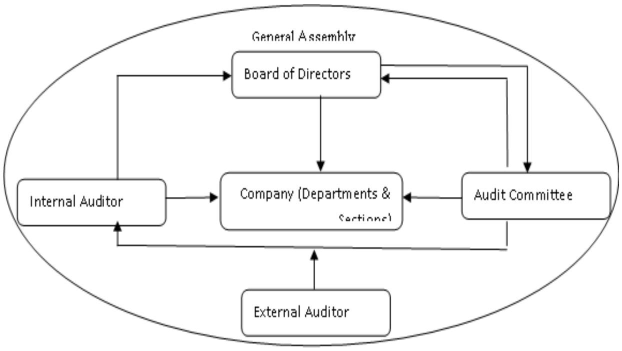
D- checking and analysis of financial statements and reports: [xv]

The Audit Committee oversees the examination of the annual financial statements in addition to the periodic financial statements, which must cover all of the following aspects:

* Review the accounting methods and procedures to ensure their consistency with current professional standards and developments;
* Assess the accounting estimates included in the financial statements, such as provisions made for potential losses arising from legal claims against the organization;
* Verify the organization's ability to maintain ongoing operations;
* Review all major adjustments suggested by the external auditor, analyzing their rationale and assessing their impacts on the financial statements;
* Examine and check the content of the annual reports prepared by the management and its board to ensure their compatibility with the statements presented in the financial statements;
* Ensure and check the adequacy and appropriateness of the disclosures contained in the financial statements.

The Audit Committee's responsibilities, as outlined above, involve ensuring the production of accurate, trustworthy, and reliable financial statements while preventing fraudulent activities. This helps to present a genuine and an actual image of the institution. The following chart illustrates the link between the Audit Committee of the Foundation and other relevant regulatory bodies.

Form (01): The link between the Audit Committee and the regulatory agencies of the institution



Source: Awad bin Salama Al-Rahili, Audit Committees as one of the pillars of corporate governance - the case of Saudi Arabia - King Abdulaziz University Journal: Economics and Management, Volume 22, Issue 01, 2008, p. 197.

As discussed above, the oversight and supervisory functions of audit committees play a crucial role in enhancing the quality of financial reports, boosting the credibility of financial data, and ensuring the integrity of the financial reporting process. The reliability of accounting profits increases when the management's opportunistic or self-serving behaviors are mitigated. Moreover, audit committees support investors by aligning the interests of management with those of other stakeholders in the organization. This highlights the significance of audit committees as key components of corporate governance, particularly in their role of overseeing management, monitoring both internal and external audits, and assessing the adequacy and effectiveness of the internal control system. Additionally, audit committees offer recommendations to the Board of Directors to strengthen and improve the system, ensuring the achievement of corporate goals while safeguarding the interests of shareholders and investors. An efficient audit committee ultimately contributes to enhanced accountability and greater trust in the financial statements.

Audit committees are regarded as crucial due to their role in overseeing and regulating the preparation of financial statements, assessing the internal control framework, and reinforcing the independence of both internal and external auditors. These functions contribute to improving the quality and reliability of financial reports, which in turn positively impacts the effectiveness of the Board of Directors in strengthening the institution's standing by fostering greater confidence among financial statement users.

Audit committees have a close relationship with the Board of Directors and report regularly to them. The Board of Directors shall form the Audit Committee, and specific rules must be followed as a minimum standard for its operations. Many studies focusing on corporate governance have highlighted the importance of audit committees in organizations aiming to implement governance practices. These studies emphasize that the existence of such committees is a key factor in evaluating the effectiveness of governance within institutions. Accordingly, there are several convincing reasons that support and reinforce the activation of the Audit Committee, involving:

* In big institutions, audit committees supervise the reporting process, which demands board members who possess a thorough understanding of both administrative and financial matters, along with significant expertise and competence in finance, accounting, and management;
* Audit committees aim to remove personal biases, safeguard rights, and ensure the production and publication of periodic financial reports that are both effective and of high quality;
* Safeguarding shareholders' interests by identifying any mistakes or fraudulent activities that could negatively impact them.

The Committee is authorized to access all information and issues it considers essential, without any limitations. The Board of Directors is responsible for taking all necessary steps to support the Committee in fulfilling its duties and achieving its objectives by:
* Reviewing the financial statements prior to their approval and release, ensuring that no significant data, information, or amounts have been omitted, as such omissions would render the financial statements misleading.
* Examining the accounting policies implemented by the organization before they are finalized, as well as any changes to these policies, while considering their alignment with the nature of the institution's operations and their effect on its financial position and performance.
* Assessing whether the design of control activities is sufficient and evaluating the effectiveness of their execution.
* Monitoring the investigations into any instances of fraud or errors that arise within the institution.
* The Committee reviews the reports and comments submitted by the Certified Accountant serving as an intermediary between the external auditor and the Board of Directors. This function ensures that the external auditor carries out his duties without any interference or pressure from the board or management. This is accompanied by the Committee's recommendation to appoint a Certified Accountant for the upcoming fiscal year, emphasizing that the professional services provided by the accountant align with specific regulatory requirements, and proposing the removal of the accountant with justifications provided for this.
* emphasis the independence of internal auditors, reviewing their audit plans, the scope of their evaluations, and the reports they present. The committee also produces recommendations and instructions to enhance the independence of internal auditors and acts as a link between the board of directors and the internal audit group.
* When the committee has to, it can hire independent consultants to conduct specialized studies that assist in fulfilling its responsibilities, and it will determine their compensation.

4. Conclusion

In the end, and more broadly, audit committees play a vital role in upholding the credibility of financial information by reinforcing principles of good governance, transparency, and adherence to accounting standards, thereby fostering trust among stakeholders and strengthening the overall financial reporting and statement preperation process as well as local accounting systems.

Thus, these committees contribute to ensuring the improvement of the quality of financial reporting by carrying out and supervising internal as well as external audits, in addition to the objectivity and accuracy of financial information provided to stakeholders, and their role in assessing risks and ensuring compliance enhances the confidence of investors, shareholders and all parties in the published financial statements and information. Audit committees thus remain a key element in achieving fiscal discipline and enhancing institutional stability.

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